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Supreme Court Deals Another Blow to Availability of Class Arbitration

On April 24, 2019, the Supreme Court issued a decision in *Lamps Plus, Inc.* v. *Varela*, holding that under the Federal Arbitration Act ("FAA") class arbitration may not be compelled based on ambiguous contract language.[1] This decision closes yet another door to class arbitration and split the Court 5-4 along ideological lines, with Chief Justice Roberts writing the majority opinion, Justice Thomas writing a concurring opinion, and Justices Ginsburg, Breyer, Sotomayor and Kagan penning dissenting opinions.

Relevant Background and Procedural History

In 2016, a Lamps Plus employee was persuaded to release the confidential tax information of approximately 1,300 other company employees to a hacker. A fraudulent tax return was subsequently filed on behalf of one of those employees, Frank Varela. Varela filed a putative class action against Lamps Plus in Federal District Court in California on behalf of all Lamps Plus employees whose information had been compromised by the security breach, asserting federal and state claims. Lamps Plus, pointing to an arbitration agreement in Varela's employment contract (drafted by Lamps Plus), argued that Varela's claim must be resolved through individual arbitration, rather than a class lawsuit. The District Court dismissed the claims in the lawsuit and granted the company's motion to compel arbitration, but authorized class – rather than individual – arbitration. Lamps Plus appealed to the Ninth Circuit, seeking to avoid class arbitration and instead resolve its dispute with Varela in individual arbitration.

The Ninth Circuit affirmed the decision below, finding that previous Supreme Court precedent in *Stolt-Nielsen S.A.* v. *AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010) – which held that a court cannot compel classwide arbitration if an agreement is silent as to such arbitration – was not controlling because the agreement here was ambiguous, rather than silent. Relying on the state law doctrine of *contra proferentem* that contractual ambiguities should be construed against the drafter, the Ninth Circuit adopted Varela's interpretation and authorized class arbitration. Lamps Plus then sought *certiorari* to have the issue decided by the Supreme Court, arguing that the Ninth Circuit's decision had created a conflict among the Courts of Appeals and that it contravened Supreme Court precedent in *Stolt-Nielsen*. Varela opposed.

[1] *Lamps Plus, Inc.* v. *Varela*, No. 17-988 (U.S. Apr. 24, 2019).

The Ruling

The majority opinion relied, in large part, on the Court's 2010 ruling in *Stolt-Nielsen*, which held that classwide arbitration cannot be imposed on parties where the applicable arbitration agreement is silent on that point.[2] The majority deferred to the Ninth Circuit's finding that the underlying employment contract was not silent, but rather was ambiguous as to whether classwide arbitration was permissible.[3] The majority then held that, under the reasoning in *Stolt-Nielsen,* an ambiguous contract is insufficient to demonstrate the requisite consent of the parties to class arbitration.

Chief Justice Roberts emphasized that it is a "rule of fundamental importance" that "arbitration is a matter of consent not coercion."[4] While premised on the concept of consent, the underpinnings of the majority opinion were policy based. Specifically, the majority explained that the concept of consent is so critical in enforcing arbitration agreements because, in part, parties make a reasoned decision to trade off the procedural rigor of court proceedings in order to take advantage of the benefits of private arbitration (such as lower cost, greater efficiency and access to subject matter experts to resolve specialized disputes). The majority stated that class arbitration "sacrifices the principal advantage of arbitration–its informality."[5] As a result, the majority held that "[n]either silence nor ambiguity provides a sufficient basis for concluding that parties to an arbitration agreement agreed to undermine the central benefits of arbitration itself."[6]

The Court further held that the doctrine of *contra proferentem*, on which the Ninth Circuit relied to interpret the contract, could not be used to "reshape traditional individualized arbitration by mandating classwide arbitration procedures without the parties' consent."[7] Chief Justice Roberts stated that, while ordinarily courts look to state law contract principles to interpret arbitration agreements, "state law is preempted to the extent it stands as an obstacle to the accomplishment and execution of the full purposes

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2 Opinion at 1.

3 Interestingly, Justice Thomas wrote a concurring opinion finding that the agreement was in fact silent as to class arbitration, rather than ambiguous. Justice Sotomayor points out that such a conclusion "would avoid the need to displace state law at all" and criticizes the majority for "hast[ily]" concluding that such incursion was necessary. *See* Sotomayor, J., dissent at 2–3. Contrary to both the majority and Justice Thomas, Justice Kagan opined that the arbitration agreement was properly viewed as neither silent nor ambiguous but as authorizing class arbitration. Kagan, J., dissent at 1–4. Indeed, as Justice Kagan pointed out, while the decision came out in favor of Lamps Plus at 5-4, only four justices endorsed the view of the majority opinion that the arbitration agreement was properly viewed as ambiguous on the issue of class arbitration. Kagan, J., dissent at n. 3.

4 Opinion at 6–7 (internal quotations and alterations omitted).

5 Opinion at 8 (citing *AT&T Mobility LLC* v. *Concepcion*, 563 U.S. 333, 348 (2011)).

6 Opinion at 9.

7 Opinion at 10–11 (internal quotations omitted).

and objectives of the FAA."[8] Framing the issue as a conflict between the "rule of fundamental importance" that "arbitration is a matter of consent, not coercion"[9] and the state law contract principle of *contra proferentem*, the majority found the application of the *contra proferentem* doctrine to permit class arbitration to be "flatly inconsistent" with the foundational principle of the FAA that arbitration is strictly a matter of consent.[10]

The Dissents

Four justices dissented from the majority opinion, with Justices Ginsburg, Breyer and Kagan writing dissents. Justice Breyer joined in the dissents of Justice Ginsburg and Justice Kagan, and wrote his own dissenting opinion focusing solely on the issue of jurisdiction.

Justice Ginsburg's dissent hearkened back to the original intent of the FAA, which was to enable parties of roughly equal bargaining power to enter into binding arbitration agreements regarding commercial disputes. The parity assumed by this historical context, she argued, is a far cry from the negotiation of an employment agreement between a corporation and an individual employee who characteristically has little bargaining power. "Shut from the Court's sight is the Hobson's choice employees face: accept arbitration on their employer's terms or give up their jobs."[11] Justice Ginsburg argued that the Court's recent decisions limiting the ability of employees to pursue class arbitration, including *Lamps Plus*, have "hobbled the capacity of employees and consumers to band together in a judicial or arbitral forum."[12] Indeed, she argued, employees who are forced to engage in individual arbitration face "severe impediments to the vindication of their rights."[13] She indicated that the cost-benefit analysis of taking on an individual arbitration could prevent potential plaintiffs from proceeding, or from obtaining counsel if they do so. She described the majority's reasoning as "paradoxical[]" in emphasizing the importance of consent, but nevertheless facilitating "companies' efforts to deny employees and consumers the important right to sue in court, and to do so collectively, by inserting solo-arbitration-only clauses that parties lacking bargaining clout cannot remove."[14]

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8 Opinion at 6 (quotations omitted) (citing *Concepcion*, 563 U.S., at 352).

9 Opinion at 6–7 (internal quotations omitted) (citing *Stolt-Nielsen*, 559 U.S., at 681).

10 Opinion at 11.

11 Ginsburg, J., dissent at 4 (internal quotations omitted) (citing *Epic Systems Corp.* v. *Lewis*, 138 S. Ct. 1612, 1636, n.2 (2018) (Ginsburg, J., dissenting)).

12 Ginsburg, J., dissent at 3 (citing *Epic Systems*, 138 S. Ct. at 1644, n.12 (Ginsburg, J., dissenting)).

13 Ginsburg, J., dissent at 3 (internal quotations omitted) (citing *Stolt-Nielsen*, 559 U.S., at 699 (Ginsburg, J., dissenting)).

14 Ginsburg, J., dissent at 5 (citing *Compu-Credit Corp.* v. *Greenwood*, 565 U.S. 95, 115 (2012) (Ginsburg, J., dissenting)).

Justice Kagan, on the other hand, argued for the application of the doctrine of *contra proferentem* on the grounds that it is a nondiscriminatory, neutral rule of contract interpretation: "Under the FAA, state law governs the interpretation of arbitration agreements, so long as that law treats other types of contracts in the same way."[15] She reasoned that the FAA's exception to the rule that state contract law should govern the interpretation of arbitration agreements, embodied in Section 2, which makes arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract,"[16] is limited to instances in which state law discriminates against arbitration agreements.[17] Referring to the doctrine of *contra proferentem* as a "plain-vanilla rule of contract interpretation"[18] that is as "even-handed as contract rules come,"[19] Justice Kagan argued that the application of *contra proferentem* in this case mandates in favor of class arbitration. Justice Kagan disagreed with the majority's reasoning that the doctrine undermined a fundamental attribute of arbitration—namely, consent—by imposing class arbitration. She pointed out that the doctrine, in fact, favored no outcome over another—noting that if Varela had drafted the agreement then the doctrine would have been applied to disallow class arbitration.[20] Justice Kagan argued that the majority decision "disrespects the preeminent role of the States in designing and enforcing contract rules" and disregards universally accepted principles of contract interpretation.[21]

Implications and Key Takeaways

In last year's *Epic Systems* decision, the Supreme Court held that employment arbitration agreements with class action waivers requiring individual arbitration are enforceable under the FAA.[22] With this holding, it is now clear that classwide arbitration will be largely unavailable to employees seeking to enforce their rights against their employers unless the parties have expressly and clearly consented to class arbitration in their employment agreement. That said, in a footnote noting that whether the availability of class arbitration is a "question of arbitrability" that an arbitrator must decide is still an open legal question, the *Lamps Plus* decision leaves open the possibility that some courts will defer to arbitrators the decision as to

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15 Kagan, J., dissent at 1.

16 9 U.S.C. § 2.

17 Kagan, J., dissent at 6.

18 Kagan, J., dissent at 1.

19 Kagan, J., dissent at 7.

20 Kagan, J., dissent at 8.

21 Kagan, J., dissent at 12.

22 *Epic Systems*, 138 S. Ct. 1612. *See also* Paul, Weiss Client Alert, "The U.S. Supreme Court Issues Important Decision Finding Class Action Waivers in Employment Arbitration Agreements Enforceable," May 24, 2018 (*available at* https://www.paulweiss.com/practices/litigation/employment/publications/the-us-supreme-court-issues-important-decision-finding-class-action-waivers-in-employment-arbitration-agreements-enforceable?id=26468).

whether parties have consented to class arbitration. It remains to be seen how the *Lamps Plus* decision will be applied to arbitration agreements in non-employment contexts, such as consumer contracts.[23]

In the aftermath of the *Stolt-Nielsen* and *Lamps Plus* decisions requiring express consent to class arbitration in the parties' agreement, employers may wish to review their employment agreements to ensure that they clearly express the parties' intent with respect to class arbitration. Employers should consider the pros and cons of individualized and class arbitration, after considering such factors as the burden, expense, privacy and finality attendant to each option. Employers who wish to prohibit class arbitration may wish to include clear waivers of class arbitration in their employment agreements. Employers who would like to permit class arbitration, on the other hand, may wish to ensure that their agreements contain language clearly demonstrating the parties' consent to such proceedings.

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[23] In its 2011 decision in *AT&T Mobility LLC* v. *Concepcion*, the Supreme Court held that the FAA preempts state laws that invalidate class action arbitration waivers in the consumer context. 563 U.S., at 341.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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