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The Roberts Court VS. the Regulators: Surveying Arbitration's Next Battleground

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Over the past three decades, the Supreme Court has taken a series of steps having the design or effect of restricting access to judicial process. This "disadjudication" project has proceeded along three tracks: 1) with respect to its own docket, the Court has dramatically reduced the number of cases it decides each year; 2) in the criminal area, the Court has cut way back on access to the federal courts through *habeas corpus*; and 3) in the civil area, the Court has simultaneously erected barriers to litigation by heightening pleading standards and expanded the scope of arbitration to suck more and more claims out of courts at both the federal and state levels.

For the Rehnquist Court, the disadjudication project at times seemed motivated primarily by a desire to clear judicial dockets. The Roberts Court appears to have a more ambitious agenda, particularly when it comes to arbitration. It has almost always sided with the Chamber of Commerce in business cases, and the Chamber wants its members to have control over the processes used to ensure that they comply with the law. The Court has enthusiastically complied. Through a string of decisions, most recently *CompuCredit Corp. v. Greenwood,* 131 S. Ct. 2874 (2011)(upholding arbitration of claims under Credit Repair Organizations Act) and *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011)(upholding class waiver in arbitration agreement), the Court has encouraged companies to push their consumers and employees into arbitration, placing the enforcement of both federal and state laws in private hands and allowing companies to opt out of class actions entirely in many contexts.

With the states and the lower federal courts unable to limit the scope of pre-dispute arbitration agreements or preserve class actions, the next arbitration battleground will pit the Supreme Court's conservative majority against federal agencies staffed by Democratic appointees seeking to use regulation to slow the arbitration juggernaut. Two recent agency decisions and a new court ruling upholding a third have placed the agencies squarely in opposition to the Court on the permissible scope of arbitration agreements and the effect of class waivers. These agencies are, in effect, telling the courts to reopen the doors and start hearing cases. The result is a

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through-the-looking-glass moment in which agencies defend rights to court adjudication against incursions by the Supreme Court.

The NLRB and Collective Action under the Labor Laws

In *D.R. Horton, Inc. and Michael Cuda*, the National Labor Relations Board ruled that an employer may not compel its employees—whether unionized or not—to waive their rights to enforce the labor laws through collective legal action. D.R. Horton had included an arbitration agreement with a class waiver in its employment contracts, ostensibly precluding employees from maintaining either class actions or class arbitrations in the pursuit of employment-related claims. Cuda tried to initiate a class arbitration claiming violations of the wage and hour provisions of the Fair Labor Standards Act, and lodged an unfair labor practice charge when D.R. Horton refused to arbitrate.

The NLRB based its decision on its construction of NLRA Section 7, which guarantees employees the right to engage in collective action to enforce labor laws such as the Fair Labor Standards Act. The NLRB equated class action litigation and class action arbitration to other forms of concerted labor activity, such as the pursuit of collective grievances within a collective bargaining relationship and strikes. It further interpreted the Norris-LaGuardia Act to "protect[] concerted employment-related litigation by employees against federal judicial restraint based upon agreements between employees and their employer." It then concluded that "an arbitration agreement imposed upon individual employees as a condition of employment cannot be held to prohibit employees from pursuing an employment-related class, collective, or joint action in a Federal or State court."

Significantly, the NLRB did not reproach D.R. Horton for pushing its employees into arbitration—it focused only on the provision in the employment agreement prohibiting collective action, whether through arbitration or litigation. It invalidated the provision to the extent it prohibited class action litigation without allowing class arbitration in its place, on the grounds that the labor laws guarantee collective action of some kind in their enforcement.

FINRA and Class Action Waivers under the Securities Laws

The Financial Industry Regulatory Authority, FINRA, is a private self-regulatory organization that regulates the securities industry under delegation from Congress through the Securities Exchange Commission. *See* 15 U.S.C. § 78s. FINRA's Rules are approved by the SEC pursuant to the Securities Exchange Act of 1934 and have the force and effect of federal

regulation. Since the Supreme Court blessed arbitration of disputes under the1934 Act in *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987), virtually all securities disputes involving broker-dealers and their customers have been arbitrated; FINRA oversees those arbitrations.

FINRA Rule 2268(d)(3) prohibits member firms from including "any condition" in their arbitration agreements that "limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under any agreement." FINRA and its predecessors have long interpreted this provision in Code of Arbitration Procedure Rule 12204 to prohibit broker-dealers from enforcing arbitration agreements with respect to claims that are the subject of a certified or putative class action. Both of these rules have been approved by the SEC. Thus, under rules promulgated by FINRA and approved by the SEC, customers must be permitted to bring class actions in court and must not be forced to arbitrate claims that are the subject of class litigation.

Following *Concepcion*, Charles Schwab began inserting a class action waiver into its arbitration agreements with customers. FINRA commenced an internal disciplinary action against Schwab for violating FINRA rules. In turn, Schwab filed a declaratory judgment action in the Northern District of California arguing that FINRA's interpretation of Rule 2268(d)(3) to bar class action waivers is impermissible in light of *Concepcion* and *CompuCredit*. Schwab argues that *Concepcion* "establishes that the federal policy favoring the enforcement of arbitration agreements also favors the enforcement of class action waivers in arbitration agreements" and that *CompuCredit* "establishes that the FAA's policy directive controls over other federal laws absent a clear contrary Congressional command." See Schwab Complaint ¶ 39.

Arbitration Policy Meets Agency Action: **Chevron** ***Deference***

These cases present a stark choice: the agencies' determinations that the labor laws and securities laws guarantee rights to collective action on the one hand, and Supreme Court precedents validating adhesion contracts that strip the right to collective action by way of arbitration on the other. As challenges to these agency actions wend their way through the courts, they will likely pit the "federal policy favoring arbitration" that the Supreme Court has divined from the Federal Arbitration Act against the principle of deference to agency decision-making enshrined in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

Chevron requires courts to engage in a two-step analysis of agency decisionmaking. In the first step, the court asks whether Congress has

"directly spoken to the precise question at issue." If the court finds that the statute is "silent or ambiguous with respect to the specific issue," the court must ask whether the agency's interpretation "is based on a permissible construction of the statute." In practice, the *Chevron* analysis has been understood to require judicial deference to any reasonable construction of statutory language by an agency delegated rulemaking authority.

There is little doubt that the NLRB has been delegated rulemaking authority under the labor laws and that the SEC, acting through FINRA, has been delegated rulemaking authority under the securities laws. There is also little doubt that the statutes at issue do not speak directly to the question of arbitral class waivers. The agencies are thus entitled to deference in their interpretations of those statutes. In these cases, however, giving deference would mean contradicting Supreme Court pronouncements about the effect of the FAA. To date, the Supreme Court has never directly addressed an agency's ruling limiting arbitration, so it has not considered the role of *Chevron* deference under those circumstances. But the Court may soon face a version of that issue as a result of a circuit split over a Federal Trade Commission rule interpreting the Magnuson-Moss Warranty Act.

The FTC and Arbitration Under the Magnuson-Moss Warranty Act

The Magnuson-Moss Warranty Act is the federal law that governs warranties on consumer products. *See* 15 U.S.C. §§ 2301-2312 (2011). The FTC is the federal agency tasked with interpreting and enforcing the MMWA. The FTC has adopted a regulation stating that informal dispute settlement procedures under the MMWA cannot be legally binding on any person. *See* 16 C.F.R. § 703.5(j). The agency interprets this regulation to preclude the enforcement of mandatory arbitration agreements with respect to warranty claims.

In *Kolev v. Euromotors West/The Auto Gallery*, 658 F.3d 1024 (9th Cir. 2011), the Ninth Circuit relied on this regulation to refuse enforcement of a mandatory arbitration agreement in a used car sales contract. Applying *Chevron*, the court first found that the MMWA does not specifically address binding arbitration. The court then found the FTC's interpretation reasonable, because the agency had attempted to determine Congress's intent, because the interpretation advanced the statute's purpose of protecting consumers, and because the agency is entitled to deference based on its experience in the field.

Kolev creates a split between the Ninth Circuit and the Fifth and Eleventh Circuits, both of which have held that the FTC's proscription on

mandatory arbitration of MMWA claims is itself proscribed by the FAA, as construed by the Supreme Court. *See Walton v. Rose Mobile Homes LLC,* 298 F.3d 470 (5th Cir. 2002); *Davis v. S. Energy Homes, Inc.,* 305 F.3d 1268 (11th Cir. 2002). Relying on *McMahon* and *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), those courts echoed the Supreme Court's pronouncements about the strong Congressional preference for arbitration evidenced by the FAA and held that since the MMWA does not indicate an express desire to preclude arbitration, the agency may not supply a curb on arbitration. (The Fifth and Eleventh Circuits were unswayed by the fact that the MMWA was enacted at a time when it was widely assumed that rights created by federal statutes were simply not arbitrable.)

The Supreme Court may well decide to take *Kolev* if review is sought. If it does, the "federal policy favoring arbitration" may then carry the day. But that won't be the end of the matter. Unlike the FTC, the NLRB and FINRA are active promoters of arbitration. Both agencies are perfectly happy to compel arbitration of individual claims, as long as the right to proceed by collective action remains available. Where the FTC's interpretation of the MMWA prohibited all pre-dispute, binding arbitration agreements as applied to warranty claims, the NLRB and FINRA singled out only the class waivers. So even if the Court strikes down the FTC's rule against binding arbitration of individual claims, that ruling will not necessarily control with respect to the NLRB and FINRA's rules prohibiting class waivers.

The Endgame

The Federal Arbitration Act was not intended to apply to state courts, was not intended to apply to claims based on mandatory legal rules, and was not intended to apply to most contracts of employment. Those points are made unequivocally in the extensive legislative history of the Act. *See* Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 FLA. ST. L. REV. 99 (2006). Until the 1980s, they were widely accepted by the judiciary. *See Wilko v. Swan*, 346 U.S. 427 (1953); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974); *Southland Corp. v. Keating*, 465 U.S. 1 (1984)(O'Connor, J., dissenting). Since that time, the Supreme Court has fabricated a body of arbitration law unmoored from the underlying statutory command. The Court's protestations notwithstanding, the "federal policy favoring arbitration" is a creation of the Supreme Court, not Congress.

The NLRB, the SEC/FINRA, and the FTC are regulatory bodies

expressly given the authority to make federal law. To overrule their interpretations of the statutes they are Congressionally authorized to construe and enforce, the Court will have to find that its gloss on a short, eighty-five year old procedural rule trumps agency regulations interpreting far more comprehensive, substantive statutes enacted years or decades after the FAA, at a time when Congress could not have imagined that consumers and employees would be forced into arbitration. These cases will thus test the Court's willingness to impose its pro-business and anti-adjudicatory vision on the nation over the objections of federal regulators to whom the Court has for decades given deference in the interpretation of federal law.