Kluwer Arbitration Blog

Challenges to the Validity of Agreements to Arbitrate State-Law Claims for the Public Benefit

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I have written previously[1] about the preemptive effect of Section 2 of the Federal Arbitration Act ("FAA"), which provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.[2]

The U.S. Supreme Court has interpreted Section 2 to express a "liberal federal policy favoring arbitration."[3] Pursuant to the Supremacy Clause of the U.S. Constitution, the pro-arbitration policy expressed in Section 2 preempts state laws that prohibit "outright the arbitration of a particular type of claim" or "interfere[] with fundamental attributes of arbitration and thus create[] a scheme inconsistent with the FAA."[4] For instance, the Supreme Court recently held that the FAA preempts a state law that prohibits the arbitration of claims involving death or personal injury to residents of nursing homes.[5] The Supreme Court also has held, in the widely discussed *AT&T v. Concepcion* decision, that even state laws of general application may be preempted if they disproportionately impair the availability or operation of arbitration procedures.[6] In line with the Supreme Court's guidance, lower federal courts have applied Section 2 to sweep away state laws that interfere with the scope of arbitration agreements entered into between private parties.[7]

There are limits to the pro-arbitration policy in Section 2. For instance, Section 2 itself recognizes (in its savings clause) that arbitration agreements may be revocable "upon such grounds as exist at law or in equity."[8] The Supreme Court has explained that the savings clause allows arbitration agreements to be invalidated by "generally applicable contract defenses, such as fraud, duress, or unconscionability,"[9] so long as the defenses are not applied in a manner that disproportionately

affects arbitration.[10] The savings clause also necessarily limits the FAA's preemptive reach, such that generally applicable state-law defenses also may result in the revocation of otherwise valid arbitration agreements.[11]

A. The "Effective Vindication" and "Inherent Conflict" Exceptions to the FAA

Federal courts have, however, recognized that arbitration agreements may be invalidated even on grounds not covered by Section 2's savings clause. Specifically, in a line of cases that includes its recent decision in *Am. Express Co. v. Italian Colors Restaurant*, the Supreme Court has held that arbitration agreements are invalid to the extent that they interfere with the availability of rights provided for in federal statutes other than the FAA.[12] The logic behind this judge-made rule is straightforward: even if the savings clause in Section 2 is inapplicable, the presumption that arbitration agreements are valid is no less important than the policies that Congress has expressed in other federal laws.[13] As the Supreme Court explained in *Mitsubishi Motors v. Soler Chrysler-Plymouth*:

> Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable.[14]

The Supreme Court accordingly has held that an arbitration agreement is invalid, notwithstanding Section 2, if it prevents the "effective vindication" of a right contained in another federal statute.[15] Similarly, if Congress has evinced a specific intent that claims arising under a particular federal statute are inarbitrable, including as a result of an 'inherent conflict' between arbitration and the [statute's] underlying purposes," the FAA's presumption of validity does not apply.[16] In other words, parties may not use arbitration agreements to "extract backdoor waivers of [federal] statutory rights."[17]

B. California's *Broughton-Cruz* Rule

Unlike the exception for "generally applicable contract defenses" set out in Section 2, the "effective vindication" and "inherent conflict" exceptions do not appear to have any obvious effect upon the FAA's preemptive scope. These exceptions are designed to ensure only that other ***federal*** policies are properly balanced against the policies expressed in the FAA. As explained by Justice Kagan (in dissent) in *Italian Colors*:

> We have no earthly interest (quite the contrary) in vindicating [state] law. Our effective-vindication rule comes into play only when the FAA is alleged to conflict with another *federal* law, like the Sherman Act here. In that all-federal context, one law does not automatically bow to the other, and the effective-vindication rule serves as a way to reconcile any tension between them.[18]

Nevertheless, state and federal courts have attempted to justify the invalidation of arbitration agreements on the ground that such agreements prevent the effective vindication of rights under ***state*** statutes or that such agreements are in inherent conflict with state law. Indeed, in two significant and widely cited decisions, the California Supreme Court invoked the "inherent conflict" exception to invalidate agreements to arbitrate claims for injunctions under California's unfair competition, false advertising, and deceptive practices statutes. As the court explained in *Broughton v. Cigna Healthplan* and *Cruz v. Pacificare Healthsystems, Inc*., all three California statutes entitled private plaintiffs not only to seek redress for harms they suffered on an individual or class-wide basis, but also to operate as "private attorneys general" by requesting injunctions that would benefit the broader public (but not the plaintiffs themselves).[19]

The state court reasoned that claims for such "public injunctions" were inherently inarbitrable, for four reasons. ***First***, whereas arbitration is designed to "resolve a private dispute," a "public injunction" is designed to confer benefits not to the party requesting the injunction "but to the general public."[20] ***Second***, arbitrators lack courts' ability to retain jurisdiction over a case and to "supervise[] … an injunction" even after its issuance, thus ensuring that the "balance between the public interest and private rights" underlying the injunction is continually re-assessed by the issuing court.[21] ***Third***, because injunctions issued by courts have collateral estoppel effect upon third parties, a third party to the litigation (and a non-party to the arbitration agreement) could petition the issuing court to modify the terms of the injunction—an option unavailable to third parties seeking to modify an injunction entered by an arbitrator.[22] ***Fourth***, "publicly accountable judges, rather than arbitrators, are the most appropriate overseers of injunctive remedies expressly designed for public protection."[23]

C. The Ninth Circuit's Recent Decision in *Ferguson v. Corinthian Colleges*

The rule against the arbitration of public injunctions set forth in Broughton and Cruz immediately was the subject of extensive federal litigation. Courts disagreed as to whether the rule ran afoul of Supreme Court precedent by prohibiting outright the arbitration of particular types of **claims** or whether the rule only shielded certain types of ***remedies*** from arbitration.[24] Courts also disagreed as to whether the California rule could find refuge in the "effective vindication" and "inherent conflict" exceptions, even to the extent that the rule prohibited the arbitration of particular types of claims.[25]

In its October 28, 2013 decision in *Ferguson v. Corinthian Colleges*, the Ninth Circuit attempted to resolve these issues, by making clear that the *Broughton-Cruz* rule against the arbitration of requests for public injunctions is preempted by the FAA. In *Ferguson*, two former graduates of vocational academic institutions filed class actions against Corinthian, the academic institutions' common parent, alleging that Corinthian induced graduates to enroll in its programs by making false promises about cost, quality, financial aid, and career prospects.[26] The plaintiffs sought relief pursuant to various California state laws, and also sought injunctive relief under the three California statutes addressed in *Broughton* and *Cruz*.[27] Because the plaintiffs (and other members of the putative class) already had graduated, they did not stand to benefit from the requested injunctions.[28] Instead, like the plaintiffs in *Broughton* and *Cruz*, the plaintiffs in *Ferguson* sought to operate as "private attorneys general," requesting injunctive relief that would benefit only other

potential consumers of Corinthian's services.[29]

The plaintiffs' agreements with Corinthian and its subsidiaries included arbitration clauses, which in relevant part stated that any disputes arising from their "enrollments …, no matter how described, pleaded or styled, shall be resolved by binding arbitration.".[30] Corinthian accordingly moved to compel arbitration of the plaintiffs' claims. Citing *Broughton* and *Cruz*, the district court denied the motion as to plaintiffs' requests for public injunctions. The court reasoned that requests for public injunctions were ill-suited for resolution by an arbitrator because arbitrators lack the ability "to enter an injunction affecting nonparties" and "oversee injunctive remedies designed to protect the public as a whole."[31] Thus, the court concluded that there was an "inherent conflict" between arbitration and policies expressed by the California statutes that provide for the issuance of public injunctions.[32]

The Ninth Circuit disagreed. As an initial matter, the court rejected the argument that the *Broughton-Cruz* rule only qualified as a restriction on the arbitration of particular remedies, and not a prohibition on the arbitration of particular types of claims. The Ninth Circuit explained that "[w]e do not think that the Supreme Court intended such a technical reading of the word 'claim.'"[33] Indeed, as the court reasoned, the Supreme Court previously had held that state-law rules against the arbitration of certain types of remedies—in particular, punitive damages—were preempted by the FAA.[34]

The Ninth Circuit also held that the *Broughton-Cruz* rule's reliance on the "effective vindication" and "inherent conflict" exceptions was unavailing, because those exceptions only apply to other **federal** statutes, not state laws. Citing Justice Kagan's dissent in *Italian Colors*, the court explained that "[b]oth exceptions … rest on the principle that other federal statutes stand on equal footing with the FAA."[35]

D. The Ninth Circuit's Unfortunate *Dicta* Regarding the Effect of Limits on an Arbitrator's Authority to Enter Public Injunctions

Having held that the *Broughton-Cruz* rule impermissibly prohibited the arbitration of particular types of claims and that the "effective vindication" and "inherent conflict" exceptions did not apply, the Ninth Circuit should have compelled the plaintiffs to arbitrate all of their claims, including their requests for public injunctions. After all, the plaintiffs' contracts with *Corinthian* required the arbitration of those and other claims arising out of the parties' commercial relationship, and the California rule that partially invalidated those arbitration agreements indisputably was preempted by the FAA.

The Ninth Circuit, however, proceeded to consider the possibility that the arbitrator could "conclude[] that Corinthian has violated the [California statutes], and that entry of an injunction might be appropriate, but further determines that it lacks the authority under the agreements at issue to granted the requested injunction.".[36] The court held that, in such a circumstance, "Plaintiffs may return to the district court to seek their public injunctive relief."[37] The court further stated that it "express[ed] no opinion on any question that might arise at that time,"[38] though its reference to "return[ing] to the district court" clearly left at least the possibility of judicial redress

open to the plaintiffs. Echoing the rationale that underlies the "effective vindication" and "inherent conflict" exceptions, the Ninth Circuit appeared to conclude that the plaintiffs could seek judicial redress in the event that the parties' arbitration agreements effectuated a "backdoor waiver[]" of the plaintiffs' "statutory rights" to request public injunctions.

Contrary to the Ninth Circuit's statement, it had, in deciding the merits of the appeal, necessarily expressed an opinion on whether the plaintiffs could return to the district court to seek a public injunction in the event that their contracts precluded the arbitrator from entering such relief. In *Concepcion* and other Supreme Court case law regarding the preemptive effect of the FAA, upon which the Ninth Circuit expressly relied in *Ferguson*, the Court made clear that ***waivers*** of rights and remedies that appear in arbitration agreements are entitled to the same presumption of validity as the underlying agreements to arbitrate. Such waivers, like the class-action waiver in *Concepcion* and a potential public-injunction waiver in *Ferguson*, do not entitle plaintiffs to "return to the district court" (as the Ninth Circuit erroneously suggested). Instead, by waiving the right to obtain a particular remedy in arbitration but nonetheless agreeing to arbitrate all claims arising out of their agreement, parties agree in advance to waive the right to obtain the remedy at issue in ***any*** forum.[39]

E. Future Cases Involving Claims for the Public Benefit

Ferguson is unlikely to be the last word on the question of whether the FAA preempts state-law claims that seek to benefit the public, rather than (or, in addition to) the plaintiffs that bring such claims. Whereas the three California statutes at issue in *Broughton*, *Cruz*, and *Ferguson* entitled private plaintiffs to seek remedies for the benefit of the public (in addition to private relief), other state laws go even further in entitling private parties to bring entire claims on behalf of the public.

For example, another California statute—the state's "Private Attorneys General Act"—entitles certain classes of state employees to bring claims as "the proxy or agent of the state's labor law enforcement agencies."[40] The statute "deputiz[es]" private plaintiffs to bring claims that in large part are "for the benefit of the general public rather than the party bringing the action."[41] In addition, many states have enacted "false claims acts" that provide financial rewards to individual plaintiffs who bring claims on a *qui tam* basis to recover damages caused **to the state** by another party.[42]

To the extent claims arising under these state laws may be encompassed by an arbitration agreement, any such agreement (and any corresponding waiver of the right to arbitrate such claims) should, of course, be entitled to the presumption of validity set forth in Section 2 of the FAA. Any state law that holds otherwise is a clear prohibition on the arbitration of particular types of claims, and no federal interest in the effective vindication of rights provided under these laws shields them from preemption.

It is nonetheless easy to imagine that parties will continue to refer to the public benefits conferred by such laws as a basis for the invalidation of private arbitration agreements that encompass claims arising thereunder. State and federal courts should reject these arguments as inconsistent with the plain language of Section 2 of the FAA.

[1] See G. Born & C. Salas, The United States Supreme Court and Class Arbitration: A Tragedy of Errors, The Symposium, 2012 J. Disp. Resol. (2012). BACK TO POST

[2] 9 U.S.C. § 2.BACK TO POST

[3] Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).BACK TO POST

[4] AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740, 1747, 1748 (2011). BACK TO POST

[5] See Marmet Health Care Ctr., Inc. v. Brown, 132 S.Ct. 1201, 1203 (2012) (per curiam).BACK TO POST

[6] See Concepcion, 131 S.Ct. at 1750-1751.BACK TO POST

[7] Muriithi v. Shuttle Exp., Inc., 712 F.3d 173, 180-181 (4th Cir. 2013) (holding that FAA preempted Maryland law invalidating class action waivers); Murphy v. DirecTV, Inc., 724 F.3d 1218, 1225 (9th Cir. 2013) (holding that Concepcion has retroactive effect and that Section 2 preempts class action waiver in consumer contract); Mortensen v. Bresnan Commc'ns, LLC, 722 F.3d 1151, 1161 (9th Cir. 2013) (holding that FAA preempted Montana law invalidating adhesive agreements that run contrary to the reasonable expectations of the parties).BACK TO POST

[8] 9 U.S.C. § 2.BACK TO POST

[9] Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996).BACK TO POST

[10] Concepcion, 131 S.Ct. at 1747.BACK TO POST

[11] Concepcion, 131 S.Ct. at 1746-1748.BACK TO POST

[12] See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991); Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer, 515 U.S. 528 (1995); Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79 (2000); 14 Penn Plaza LLC v. Pyett, 556 U.S. 247 (2009).BACK TO POST.

[13] The Supreme Court also has recognized that Congress is free to effectively expand the savings clause in Section 2 by "overriding" the pro-arbitration policy in Section 2 through a "contrary congressional command" in another federal statute. See CompuCredit Corp. v. Greenwood, 132 S.Ct. 665, 669 (2012) (quoting Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 226 (1987)). Such a case may arise, for instance, if Congress expressly provides that the rights provided for under a federal law may not be arbitrated. See Mitsubishi Motors, 473 U.S. at 628 n. 19 ("We merely note that in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.").BACK TO POST

[14] Mitsubishi Motors, 473 U.S. at 627.BACK TO POST

[15] Mitsubishi Motors, 473 U.S. at 628 n. 19. For instance, in Green Tree Fin. Corp. Ala. v. Randolph, the Supreme Court held that an arbitration agreement could be invalid if the plaintiff could establish a likelihood of incurring prohibitively high arbitration fees, which would prevent the plaintiff from vindicating its rights under a federal statute. 531 U.S. at 90 (2000).BACK TO POST

[16] Gilmer, 500 U.S. at 26.BACK TO POST

[17] Italian Colors, 133 S.Ct. at 2315 (Kagan, J., dissenting).BACK TO POST

[18] Italian Colors, 133 S.Ct. at 2320 (Kagan, J., dissenting) (emphasis in original).BACK TO POST

[19] See Broughton v. Cigna Healthplans of Cal., 21 Cal.4th 1066 (1999) (addressing California statute prohibiting deceptive practices); Cruz v. PacifiCare Health Sys., Inc., 30 Cal.4th 303 (2003) (addressing California unfair competition law and false advertising law). BACK TO POST

[20] Broughton, 21 Cal.4th at 1080 (1999). Cruz summarily adopted each of the four reasons set forth in Broughton. See 30 Cal.4th at 316.BACK TO POST

[21] Broughton, 21 Cal.4th at 1081.BACK TO POST

[22] Broughton, 21 Cal.4th at 1081.BACK TO POST

[23] Broughton, 21 Cal.4th at 1082.BACK TO POST

[24] Compare Arellano v. T-Mobile USA, Inc., 2011 WL 1842712, at *2 (N.D. Cal. May 16, 2011) and Nelson v. AT&T Mobility, LLC, 2011 WL 3651153 (N.D. Cal. Aug. 18, 2011), with In re DirecTV, 810 F. Supp. 2d 1060 (C.D. Cal. 2011) and Ferguson v. Corinthian Colleges, 823 F. Supp. 2d 1025, 1035 (C.D. Cal. 2011); see also Davis v. O'Melveny & Myers, 485 F.3d 1066 (9th Cir. 2007).BACK TO POST

[25] See, e.g., Ferguson v. Corinthian Colleges, 823 F. Supp. 2d 1025, 1035 (C.D. Cal. 2011).BACK TO POST

[26] Ferguson v. Corinthian Colleges, Inc., ___ F.3d ___, 2013 WL 5779514, at *1 (9th Cir. Oct. 28, 2013).BACK TO POST

[27] See Ferguson, 2013 WL 5779514, at *2; see also Cal. Civ. Code § 1770, et seq.BACK TO POST

[28] See Ferguson, 2013 WL 5779514, at *2.BACK TO POST

[29] See Ferguson, 2013 WL 5779514, at *3. BACK TO POST

[30] Ferguson, 2013 WL 5779514, at *8. The Ninth Circuit held that the parties' arbitration agreements clearly encompassed the plaintiffs' claims for relief. Id. at *8-9.BACK TO POST

[31] Ferguson, 823 F. Supp. 2d at 1035-1036.BACK TO POST

[32] Ferguson, 823 F. Supp. 2d at 1036.BACK TO POST

[33] Ferguson, 2013 WL 5779514, at *5.BACK TO POST

[34] Ferguson, 2013 WL 5779514, at *5 (citing Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995)).BACK TO POST

[35] Ferguson, 2013 WL 5779514, at *6.BACK TO POST

[36] Ferguson, 2013 WL 5779514, at *9.BACK TO POST

[37] Ferguson, 2013 WL 5779514, at *7.BACK TO POST

[38] Ferguson, 2013 WL 5779514, at *7.BACK TO POST

[39] Although the outcome may be different under the "effective vindication" and "inherent conflict" exceptions where the waiver implicates a right under another federal law, the Ninth Circuit itself made clear (as explained above) that neither exception is concerned with protecting rights provided for under state law. See Ferguson, 2013 WL 5779514, at * 6.BACK TO POST

[40] Arias v. Superior Court, 46 Cal.4th 969, 986 (2009). See Cal. Civ. Code § 2699. BACK TO POST

[41] Brown v. Ralphs Grocery Co., 197 Cal. App. 4th 489, 501-502 (2011). In Brown, the California Court of Appeal held (in error) that an arbitration agreement containing waiver of the right to bring a claim in a representative capacity on behalf of other state employees was unenforceable. Id. at 502. The court held that Section 2 of the FAA does not preempt state laws that prohibit waivers of the right to bring representative claims as unconscionable. See id. at 500. The court reasoned that the Supreme Court, in Concepcion, appeared to rely on the fact that the state rule of unconscionability in that case (which prohibited waivers of class-wide claims) was inconsistent with the purposes of arbitration. See id. As I have previously explained, however, the Court's reasoning in Concepcion was misguided, and its application in Brown results in an equally flawed holding. The better view is that state rules against the waivers of either class action or representative claims are preempted by the FAA because they are not rules of general application, and therefore are not covered by Section 2's savings clause.BACK TO POST

[42] See, e.g., Cal. Civ. Code § 12650, et seq.; Fla. Stat. § 68.081, et seq.; N.Y. STF. Law § 187, et seq.; Va. Code § 8.01-216.3, et seq.BACK TO POST

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