

Commentary

Rent-A-Center West, Inc. v. Jackson —

Part II: Will The U.S. Supreme Court Allow Arbitrators To Be ‘Gatekeepers Of The Unconscionable’?

By

B. Ted Howes

and

Raquel A. Rodriguez¹

[Editor's Note: B. Ted Howes, a partner in the New York office of McDermott Will & Emery LLP, is head of the firm's worldwide International Arbitration Group. Mr. Howes has successfully defended U.S. and foreign companies in a wide variety of international commercial arbitrations, as well as in litigations in the New York courts. Raquel A. Rodriguez, a member of the firm's Trial Department, is a partner in the Miami office of McDermott Will & Emery LLP. Ms. Rodriguez focuses her practice on commercial and international dispute resolution and strategy, government strategies and crisis management. Part 2 of a two-part series. Copyright 2010 by Raquel A. Rodriguez and B. Ted Howes. Replies to this commentary are welcome.]

On April 26, 2010, the United States Supreme Court heard oral argument in the case of *Rent-A-Center West, Inc. v. Jackson*.² As explained in Part I of this article, which appeared in the April 2010 issue of *Mealey's International Arbitration Report*, the specific issue presented to the Supreme Court in *Rent-A-Center* was as follows:

Is the district court required in all cases to determine claims that an arbitration agreement subject to the Federal Arbitration Act (“FAA”) is unconscionable, even when the parties to the contract have clearly and unmistakably assigned this “gateway” issue to the arbitrator for decision?³

In other words, the Court was asked to decide whether parties can contractually agree to have arbitrators — rather than the courts — decide if an arbitration agreement is unenforceable due to “unconscionability.” The issue pits the autonomy of contracting parties (*i.e.*, the right of parties to contract as they wish) against the traditional duty of the courts to police arbitration agreements to ensure that the parties actually agreed to submit to arbitration in the first place. Is unconscionability a “gateway issue” reserved exclusively for the courts? Or may arbitrators tend this gate with the consent of the parties?

Part I of this article analyzed the arguments made by the parties in the briefs they submitted to the Supreme Court and “previewed” what issues and questions might arise during oral argument. In Part II of this article, we review what actually happened at oral argument on April 26. We then try to predict how the Justices will resolve the case in light of their questioning at argument.

Background

As set forth in detail in Part I of this article, the *Rent-A-Center* case arose out of an employee termination. Specifically, Antonio Jackson (“Jackson”) sued Rent-A-Center West, Inc. (“Rent-A-Center”) in the United States District Court for the District of Nevada after his employment at Rent-A-Center was terminated. Jackson alleged that his employment was illegally

terminated due to race discrimination and retaliation under 42 U.S.C. § 1981.

Upon being sued, Rent-A-Center moved to dismiss Jackson's lawsuit and compel arbitration pursuant to an Agreement to Arbitrate Claims (the "Arbitration Agreement") that Jackson signed as a condition to being hired. The Arbitration Agreement provided, among other things, as follows:

The Arbitrator and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement including, but not limited to any claim that all or any part of this Agreement is void or voidable.⁴

Thus, the Arbitration Agreement explicitly delegated to the arbitrator the "exclusive authority" to resolve all disputes regarding the enforceability — and even "the formation" — of the agreement. It likewise explicitly excluded the courts from exercising any such authority.

In response to Rent-A-Center's motion to dismiss, Jackson alleged that the Arbitration Agreement was substantively and procedurally "unconscionable" under Nevada law. Jackson argued the agreement was substantively unconscionable because it limited the parties' opportunities to take discovery and required each party to pay an equal share of the arbitration costs. He argued it was procedurally unconscionable because the parties had unequal bargaining power and the agreement was presented to him as a take-it-or-leave-it condition of employment.

The District Court granted Rent-A-Center's motion to compel arbitration and dismissed Jackson's Complaint. In so doing, the District Court relied on the undisputed fact that the Arbitration Agreement had delegated to the arbitrator the exclusive authority to decide whether or not the Arbitration Agreement was enforceable.⁵

On appeal, the Court of Appeals for the Ninth Circuit reversed the District Court's decision. By a 2-to-1 vote, the appellate court ruled that even "[w]here, as here, an arbitration agreement delegates the question

of the arbitration agreement's validity to the arbitrator, a dispute as to whether the agreement to arbitrate arbitrability is itself enforceable is nonetheless for the court to decide as a threshold matter."⁶ In so holding, the two-judge majority on the appellate court distinguished the Supreme Court's holding in the cases of *AT&T Technologies v. Communication Workers of America* and *First Options of Chicago, Inc. v. Kaplan* — *i.e.*, that where there is "clea[r] and unmistakabl[e] evidence" in the contract that the parties agreed to delegate the issue of arbitrability to the arbitrators, the courts must defer to the arbitrators.⁷ Although the majority acknowledged that the Arbitration Agreement between Jackson and Rent-A-Center "clearly assigned the arbitrability determination to the arbitrator" — as required by *AT&T* and *First Options* — the majority ruled that the issue before it was not whether there was ambiguity in the contract about who should decide arbitrability, but rather whether the parties entered into a valid agreement in the first place.⁸ The majority stressed that "as a matter of federal arbitration law, a court may not compel arbitration until it is 'satisfied that the making of an agreement for arbitration or failure to comply therewith is not in issue.' 9 U.S.C. § 4."⁹

The dissenting judge on the Ninth Circuit panel disagreed with the majority that its opinion did not run afoul of the Supreme Court's rulings in *AT&T* and *First Options*. As the dissenting judge remarked, the majority's decision made it "difficult to understand what the Supreme Court meant when it said that although the general rule gives the threshold question of arbitrability to courts, parties may provide for the arbitrator to decide the question instead if they do so 'clearly and unmistakably.'"¹⁰

Upon losing in the Ninth Circuit Court of Appeals, Rent-A-Center petitioned the U.S. Supreme Court for *certiorari* review, arguing, among other things, that the Ninth Circuit's decision was in conflict with the Supreme Court's decisions in *AT&T* and *First Options*.¹¹ In his brief in opposition to Rent-A-Center's petition to the Supreme Court, Jackson argued that "unconscionability" is grounds for revoking a contract and, therefore, Section 2 of the FAA requires that courts determine the defense of unconscionability before the arbitrator can decide whether or not the dispute is arbitrable.¹² In other words, Jackson argued that unconscionability precludes the very "making" of

a contract to arbitrate, thus falling outside the *AT&T* and *First Options* holdings.¹³

Review Of The Oral Argument

As predicted in Part 1 of this article, the April 26 oral argument focused almost exclusively, on the following issue: is unconscionability a defense that goes to *the very making* of a contract, or is it a post-contract-formation defense? In this respect, and as also predicted in Part 1 of this article, there appeared to be a unanimous consensus among the Justices (as well as the attorneys for both Jackson and Rent-A-Center) that defenses which necessarily challenge the making of an arbitration agreement — such as coercion/duress, forgery or fraud in the inducement — must be decided by the courts under Section 2 of the FAA. There did not, however, appear to be unanimous agreement on whether the unconscionability defense went to the “making of the contract.”

During oral argument, several of the Justices appeared to take the position that unconscionability *should* be considered a contract formation issue. Justice Ginsburg, for example, asked “why should unconscionability be treated differently” from fraud in the inducement.¹⁴ Likewise, Justice Kennedy commented that unconscionability is “almost like duress” and Justice Stevens appeared to equate unconscionability with “coercion.”¹⁵ Justice Breyer, similarly, noted:

The reason why we don't enforce unconscionable contracts is because the person who was the victim had no free will, he did not sign it of his own accord . . . I want to know why as a general matter of contract law an allegation of unconscionability, defense of unconscionability, is why is it not enough like the coercion defense or the inducement defense or the “I was in Alaska” defense? Isn't it enough like that they should be treated alike?¹⁶

In response to these questions, Rent-A-Center's counsel tried, repeatedly, to distinguish unconscionability from contract-formation issues. For example, he argued that unconscionability is not like the situation where “somebody puts a gun to somebody's head” and forces him to sign a contract under threat of violence.¹⁷ To the contrary, Rent-A-Center's counsel described unconscionability as a complaint about “the

fairness of the agreement” that the parties admittedly and voluntarily entered into.¹⁸

Rent-A-Center's counsel also tried to hang onto the holdings in *AT&T* and *First Options*, arguing that the language in the Arbitration Agreement “clearly and unmistakably” delegated all issues about the agreement's enforceability — including, by implication, any issues about unconscionability — to the exclusive jurisdiction of the arbitrator. This argument did not seem to convince Justice Breyer, however, who countered that Jackson is arguing that the Arbitration Agreement “is *itself* a product of unconscionability.”¹⁹ Justice Breyer suggested that even if a contractual provision delegating decision-making powers to the arbitrator is “clear and unmistakable” under *First Options*, the Court would still have to decide whether the parties actually agreed to this clear and unmistakable provision. Justice Breyer's view on *First Options* will likely carry weight since he was the author of the decision.

At the other end of the spectrum, Justice Scalia expressed skepticism that unconscionability can be considered a “contract formation” defense. This was evidenced, in particular, in one revealing exchange with Jackson's counsel:

JUSTICE SCALIA: Well, your — your position seems to be that unconscionability is the same as coercion in the making of the agreement. And I don't know that that's true.

MR. SILVERBERG: Well, Your Honor, respectfully, in *Doctor's Associates*, I think the Court spoke very clearly that fraud, duress, and unconscionability . . . are part of something that can be raised under Section 2 [of the FAA] . . .

JUSTICE SCALIA: No, I don't care what we said in dictum. It doesn't seem to me that unconscionability is the same as duress or the same as fraud . . .²⁰

Justice Scalia then gave the example of “a stupid person” who “voluntarily signs an unconscionable contract,” explaining that “the courts may protect you because you are stupid, but you haven't been

coerced.”²¹ In other words, Justice Scalia appeared to view unconscionability more as a fairness issue — did a smart person take advantage of “a stupid person” with a one-sided contract? — than an issue of contract formation. As he bluntly put it, “every unfair agreement is not a coerced agreement.”²²

In Part 1 of this article, we anticipated that some Justices might be concerned about the slippery slope created if the Court agreed with Jackson’s position. Consistent with our prediction, Justice Scalia expressed concern with the real-world implication of accepting Jackson’s argument. In particular, he noted that since employment agreements are commonly attacked as unconscionable, it “will not be much use [for an employer] signing an arbitration agreement” since the employer “is going to end up in court anyway.”²³ Justice Scalia worried about the possible “snowballing effect” of a ruling in favor of Jackson, stating that the legal world might as well “[k]iss good-bye to arbitration” if every agreement can be challenged in the courts on the ground of unconscionability.²⁴ On the other hand, Justice Scalia reasoned that there would be little, if any, negative consequences if arbitrators were permitted to decide unconscionability claims. He emphasized that arbitrators can be trusted because, just like judges, they are obliged to make their decisions based on the law, and in the event an arbitrator “totally disregarded all state law regarding unconscionability,” the courts could review and set aside the arbitration decision.²⁵ Part 1 of this article had speculated that the availability of judicial review would come up in oral argument.

Justice Kennedy, who has regularly voted to uphold arbitration clauses in the Court’s recent opinions, squarely put the question to Jackson’s counsel: If the parties can agree to arbitrate the issue of unconscionability after a dispute has arisen, why can’t they agree in advance to let the arbitrator decide whether an arbitration agreement is unconscionable? He also questioned the practicality of having a court decide the unconscionability of an arbitration agreement, if analysis of the clause requires determination of the whether the entire contract was unconscionable, which under the doctrine of separability is a question for the arbitrator.²⁶

Justices Breyer, Ginsburg and Stevens did not overtly question the validity of arbitration clauses in the

employment context, as we suggested in Part 1 they might. Justice Stevens, however, did focus on what he called an “elementary question” :

Are there cases out there that hold that an agreement can be partially unconscionable, that it is unconscionable for some clauses but not in its— in its entirety?²⁷

Jackson’s counsel asserted there were, but this elicited a comment from Chief Justice Roberts that it was “illogical” for Jackson’s counsel to argue unconscionability based on only certain provisions of the arbitration clause and not the agreement as a whole:

But once you are — in for a penny, in for a pound. If you agree to arbitrate, then it’s at least for the arbitrator to decide particular provisions, whether they are unconscionable.²⁸

There thus appeared to be a gap between the pole positions staked out by the Justices on the unconscionability defense and whether or not it went to the making of the arbitration agreement. Whether this gap can be narrowed depends, in part, on the newest Justice on the Court.

Predicting Justice Sotomayor’s Position

Although appointed to the Supreme Court only just last year, Justice Sotomayor has an established track record interpreting the FAA from her twelve-year tenure on the U.S. Court of Appeals for the Second Circuit (from 1997 to 2009). A review of several key FAA decisions that Justice Sotomayor authored while on the Second Circuit shows that she has taken a consistent pro-arbitration position in her rulings. Thus, if the past is any guide, Justice Sotomayor will try to forge a decision in *Rent-A-Center* that causes the least judicial interference with the arbitral process.

For example, in a 2004 decision issued in the case of *Phoenix Aktiengesellschaft v. Ecoplas, Inc.*, then Judge Sotomayor wrote that § 9 of the FAA — which explicitly requires the parties’ prior written consent to the judicial confirmation of an arbitration award — does not apply in cases brought pursuant to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”).²⁹ In other words, she found that

international arbitration awards may be confirmed, and enforced, in the U.S. courts even if the underlying arbitration agreement between the parties does not stipulate as such. In her novel interpretation of the FAA, then Judge Sotomayor reasoned that applying the § 9 consent-to-confirmation requirement to international arbitration awards would conflict with the Convention's goal of encouraging the recognition and enforcement of commercial arbitration agreements in international contracts.³⁰ The opinion also noted, more than once, that "the FAA's provisions 'manifest[ed] a liberal federal policy favoring arbitration agreements.'"³¹

To take another example, in a 2002 decision issued in the case of *Westerbeke Corp. v. Daihatsu Motor Co., Ltd.*, the Second Circuit reversed a lower court decision vacating an arbitration award on the alleged ground that the arbitrator had acted in "manifest disregard" of the law.³² Writing for the court, Judge Sotomayor took the lower court to task for second-guessing the arbitrator and emphasized that the judicial standard for overturning arbitral decisions is "severely limited."³³ This type of deference to arbitral decision-making is similar to Justice Scalia's aforementioned comments during oral argument in the *Rent-A-Center* case — *i.e.*, that the arbitrator can, and should, be trusted to render decisions on Jackson's unconscionability defense.

Of particular relevance to the *Rent-A-Center* case is Judge Sotomayor's 2002 opinion in *ACE Capital Re Overseas Ltd. v. Central United Life Ins. Co.*³⁴ In that decision, Judge Sotomayor refused to rule that fraudulent inducement of contract is a gateway defense that must always be decided by the courts rather than by arbitrators. On the one hand, she agreed that a claim that *an arbitration clause* was induced by fraud would be subject to the decision of the courts, as that issue necessarily goes to the making of the agreement to arbitrate.³⁵ On the other hand, she opined that "a claim or defense of fraudulent inducement, when it challenges generally the enforceability of a contract containing an arbitration clause rather than specifically the arbitration clause itself, may be subject to arbitration."³⁶

Based on this distinction, the court of appeals concluded that the lower court had erred in ruling that the arbitration clause in *ACE Capital* was not broad

enough to encompass the fraudulent inducement claim at issue and remanded the case to the lower court with an order to compel arbitration. As Judge Sotomayor reasoned:

ACE has never contended that CUL's alleged fraud was directed specifically to the arbitration clause, but instead has argued that the entire Agreement was fraudulently induced. Thus, ACE's claim of fraudulent inducement is not on its face precluded from arbitration.³⁷

In reaching this decision, Judge Sotomayor also relied on the settled policy that when the existence of an arbitration agreement is undisputed, doubts as to whether a particular claim falls within the scope of that agreement should be resolved in favor of arbitrability.³⁸

Justice Sotomayor's reasoning in *ACE Capital* suggests that to the extent she concludes that Jackson's unconscionability defense is merely an attack against certain one-sided provisions within the Arbitration Agreement, rather than an attack against the very existence of the agreement to arbitrate, she will conclude that the defense must be decided by the arbitrator. Indeed, during oral argument, Justice Sotomayor repeatedly tried to elicit from Jackson's counsel whether he was arguing that the arbitration agreement as a whole was unconscionable, or whether he was merely arguing that certain provisions of the arbitration agreement were unconscionable.³⁹

Predicting The Court's Decision

As discussed above, the questioning by the Justices during the April 26 oral argument seemed to expose a divergence of opinion on the question of whether or not unconscionability is a contract-formation defense. On the one hand, Justices Breyer, Ginsburg and Stevens seem to fall in the camp viewing unconscionability as a "meeting of the minds" issue similar to duress, coercion or fraud in the inducement. On the other hand, Justice Scalia, seems to fall in a camp viewing unconscionability as a post-contract-formation fairness issue. Although Justices Thomas and Alito asked no questions during oral argument, they historically have aligned with Justice Scalia's views on arbitration and the limited role of the courts in protecting parties from a bad bargain. Thus, it is

reasonable to predict that they would fall in Justice Scalia's camp on this issue.

Despite this apparent divergence of opinion, a potential compromise between the two camps of Justices could be detected in comments made by the Chief Justice during oral argument. In particular, Justice Roberts appeared to flatly telegraph his opinion as follows: "[M]y point is that once you get past the gateway issue of whether the formation of the contract was not unconscionable, then claims that particular provisions were unconscionable are by definition for the arbitrator to decide."⁴⁰ Thus, Justice Roberts drew a bright line between claims that the formation of an agreement to arbitrate was unconscionable and claims that provisions within such an agreement are unconscionable. Justice Roberts returned to this "compromise" theme several times during the argument.⁴¹

It is difficult to predict how the nine Justices will ultimately rule in *Rent-A-Center*. But our best guess is that the majority opinion will reflect the compromise position advocated by Justice Roberts. For one thing, this position dovetails with Justice Sotomayor's reasoning in *ACE Capital*, as well as with her own efforts during oral argument to parse out exactly what Jackson was claiming to be unconscionable. For another thing, glimmers of Justice Roberts' compromise position could be seen in the questioning of Justice Scalia (who conceded at one point that if Jackson had made the argument that the agreement was so unconscionable that he must have been coerced into it, this would *not* be an issue for the arbitrator) and Justice Breyer (who at one point asked Jackson's counsel why issues about "provisions within" the Arbitration Agreement cannot be submitted to the arbitrator).⁴²

If this prediction is correct, the Court could remand the case to the lower courts with instructions to decide whether Jackson made a valid claim that the formation the Arbitration Agreement was a product of unconscionability and, if not, to compel arbitration on Jackson's claims that provisions within the Arbitration Agreement (e.g., the discovery provision, the fee share provision, etc.) are unconscionable. Alternatively, if the Court is convinced that Jackson never in fact made the argument that the entire Arbitration Agreement was unconscionable, they could vote 9-0 to reverse and vacate the Ninth Circuit's opinion

based on the narrow ground that the argument was never raised. Either way, there is a good possibility of a decision with no dissenting opinions (although there may be concurring opinions where the Justices stake out their divergent views on the nature of the unconscionability defense).

Endnotes

1. Shruti Kumar Tejwani, a trial associate in the New York office of McDermott Will & Emery LLP, also assisted in the research and preparation of this article.
2. Case No. 09-497, United States Supreme Court.
3. Petition for Certiorari, at (i) (hereinafter, Pet. Cert., at ___).
4. Brief of Petitioner, at 5 (hereinafter, Pet. Br., at ___).
5. *Id.* at 1.
6. *Jackson v. Rent-A-Center, Inc.*, 581 F.3d 912, 919 (9th Cir. 2009).
7. 514 U.S. 938, 944 (1995) (quoting *AT&T Techs. Inc. v. Commc'ns Workers*, 475 U.S. 643, 649 (1986)).
8. 581 F.3d at 917.
9. *Id.* at 916.
10. *Id.* at 921 (quoting *AT&T*, 475 U.S. at 649).
11. Pet. Cert., at 9, 15.
12. Brief for Respondent, at 11.
13. *Id.*, at 18-29.
14. Oral Argument Transcript, at 4 (hereinafter Tr., at ___).
15. *Id.* at 5-6.

16. *Id.* at 19-20.
17. *Id.* at 9.
18. *Id.* at 8.
19. *Id.* at 15 (italics added).
20. Tr., at 46.
21. *Id.*
22. *Id.* at 10.
23. *Id.* at 52.
24. *Id.* at 52-53.
25. *Id.* at 30.
26. Tr., at 36, 40.
27. *Id.* at 49.
28. *Id.* at 44.
29. 391 F.3d 433 (2d Cir. 2004).
30. *Id.* at 436-38.
31. *Id.* at 435 (quoting *Ermenegildo Zegna Corp. v. Zegna*, 133 F.3d 177, 180 (2d Cir. 1998)).
32. 304 F.3d 200, 203-204 (2d Cir. 2002).
33. *Id.* at 208.
34. 307 F.3d 24, 26 (2d Cir. 2002).
35. *Id.* at 29.
36. *Id.*
37. *Id.* at 30.
38. *Id.* at 29.
39. Tr., at 26-27, 41-43.
40. *Id.* at 28.
41. *Id.* at 21.
42. *Id.* at 10, 34. ■