

Commentary

Rent-A-Center, Inc. v. Jackson — Who Is The Proper ‘Gatekeeper’ Of Arbitrability? Divided Supreme Court Reverses Ninth Circuit In Rent-A-Center, West, Inc. v. Jackson

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Near the close of its 2009-2010 term, the United States Supreme Court, by a 5-4 decision, applied the doctrine of separability² established in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*³ to hold that a challenge to an arbitration agreement as unconscionable must be decided by arbitrators, and not the courts, under the Federal Arbitration Act (“FAA”)⁴ if the arbitration agreement clearly and unmistakably so provides. Under the holding of the Supreme Court in *Rent-A-Center, West, Inc. v. Jackson*, litigants who wish to have an unconscionability defense determined by courts, rather than the arbitrators, must specifically challenge the validity of the provisions delegating the issue to the arbitrators, instead of attacking the arbitration agreement as a whole.⁵ This decision was

a clear “win” for the business community, which had weighed in heavily in support of upholding arbitration agreements as written and limiting court intervention. In the process, the Roberts Court continued on the path it has carved out in favor of freedom of contract.

The Supreme Court’s decision provides a road map to what litigants must do if they hope to have courts determine the validity a delegation provision, and possibly other provisions within an arbitration agreement. In most instances, such a challenge is unlikely to succeed, except under limited circumstances.

Background

The Respondent, Antonio Jackson, was an employee of the Petitioner, Rent-A-Center, West, Inc., and sued the company in United States District Court for the District of Nevada after he was terminated, alleging race discrimination and retaliation under 42 U.S.C. § 1981. Rent-A-Center moved to dismiss the complaint and compel arbitration pursuant to an Agreement to Arbitrate Claims (“Arbitration Agreement”) that Jackson signed as a condition to being hired. The Arbitration Agreement provided specifically:

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.

Jackson alleged in the District Court that the Arbitration Agreement itself was unconscionable under Nevada law and, therefore, unenforceable. He argued that it was *substantively* unconscionable because it limited discovery and required each party to pay an equal share of the arbitration costs. Jackson also claimed 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, however, granted Rent-A-Center's motion to compel arbitration and dismissed the complaint, finding that the Arbitration Agreement expressly delegated to the arbitrator the decision whether or not the Arbitration Agreement was enforceable.⁶

On appeal, the Court of Appeals for the Ninth Circuit reversed, holding that “[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.”⁷ Rent-A-Center successfully petitioned for certiorari review by the Supreme Court. The Supreme Court reversed the judgment of the court of appeals.

The Supreme Court Majority

Associate Justice Antonin Scalia wrote for the majority, joined by Chief Justice Roberts and Associate Justices Kennedy, Thomas and Alito. Justice Scalia began by reciting that the Court already “recognized that parties can agree to arbitrate ‘gateway’ questions of ‘arbitrability,’ such as whether the parties have agreed to arbitrate whether their agreement covers a particular controversy.”⁸ The majority further noted that both parties conceded that the agreement expressly delegated any decisions regarding the validity of the arbitration agreement to the arbitrators.⁹

In *Howsam v. Dean Witter Reynolds, Inc.*, the Supreme Court ruled that if the parties “clearly and unmistakably” agreed to delegate the issue of arbitrability to the arbitrators, issues regarding the validity of the agreement to arbitrate are for the arbitrators to decide.¹⁰ Jackson, however, argued that his unconscionability

argument went to whether he could be said to have “clearly and unmistakably” agreed to the delegation provision, and thus it should be decided by the courts. The majority rejected Jackson’s argument. The question of delegation, they ruled, is an objective one, not a question of fairness: Did the parties agree to submit the issue to the arbitrator or not? If they did, § 2 requires the court to enforce the agreement, “save upon such grounds as exist at law or equity for the revocation of any contract.”¹¹

The Court went on to find that for purposes of a § 2 analysis, it made no difference whether or not the delegation provision was contained in the Arbitration Agreement. An arbitration provision, the Court held, is no different from any other kind of agreement for purposes of § 2. Accordingly, the Court ruled that a provision assigning gateway issues, such as arbitrability, to the arbitrator is a separate arbitration agreement within the larger arbitration agreement, which the parties can ask the court to enforce under the FAA.¹²

Under the doctrine of separability, as announced in the *Prima Paint* case and reinforced in *Buckeye Check Cashing, Inc. v. Cartegna*,¹³ a challenge to the validity of a contract does not defeat the right to enforce an arbitration clause, unless a party alleges specifically that the arbitration clause itself was the product of fraud, duress or other grounds for revocation of a contract. In other words, when a party challenges the validity of a contract, the court may sever the arbitration clause from the rest of the contract and order arbitration pursuant to § 2 of the FAA. The arbitrators can then decide whether or not the contract was valid.

Similarly, the majority reasoned, a party challenging the validity of a delegation provision in an arbitration agreement must challenge the delegation provision specifically. Only a specific challenge to the validity of the delegation provision permits the courts, under § 2 of the FAA, to decide whether the delegation provision is valid. As the majority explained:

Here, the “written provision . . . to settle by arbitration a controversy,” 9 U. S. C. § 2, that Rent-A-Center asks us to enforce is the delegation provision — the provision that gave the arbitrator “exclusive authority to resolve any dispute

relating to the . . . enforceability . . . of this Agreement,” . . . The “remainder of the contract,” *Buckeye, supra*, at 445, is the rest of the agreement to arbitrate claims arising out of Jackson’s employment with Rent-A-Center. To be sure this case differs from *Prima Paint, Buckeye*, and *Preston*, in that the arbitration provisions sought to be enforced in those cases were contained in contracts unrelated to arbitration — contracts for consulting services, see *Prima Paint, supra*, at 397, check cashing services, see *Buckeye, supra*, at 442, and “personal management” or “talent agent” services, see *Preston, supra*, at 352. In this case, the underlying contract is itself an arbitration agreement. But that makes no difference. (footnote omitted). Application of the severability rule does not depend on the substance of the remainder of the contract. Section 2 operates on the specific “written provision” to “settle by arbitration a controversy” that the party seeks to enforce. Accordingly, unless Jackson challenged the delegation provision specifically, we must treat it as valid under § 2 . . .¹⁴

One of the questions that troubled the Justices at oral argument was whether Jackson’s counsel had, in fact, challenged the delegation provision specifically, as opposed to challenging the entire Arbitration Agreement as unconscionable.¹⁵ The majority ultimately concluded that Jackson’s challenge in the lower courts had focused solely on the unconscionability of the *entire* Arbitration Agreement, rather than the specific delegation clause.¹⁶ Any specific challenge to the delegation clause came only in his Supreme Court briefs, where he argued that the Court’s 2008 decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*,¹⁷ rendered the delegation provision unconscionable by invalidating under § 10 of the FAA a separate provision in the Arbitration Agreement that permitted plenary judicial review of any arbitration award. The majority deemed this challenge too late and refused to consider it.¹⁸ The decision, thus, left open a window to future litigants who timely challenge the validity of a delegation provision within an arbitration agreement.

The Dissenting Opinion

Associate Justice John Paul Stevens, in one of his final opinions prior to retirement from the Court, wrote for the dissent, in which Associate Justices Ginsburg, Breyer and Sotomayor joined. The dissent’s position was a simple one: there was but one Arbitration Agreement, and nothing in the Court’s prior arbitration jurisprudence requires or authorizes separating out the delegation provision from the rest of the Arbitration Agreement.¹⁹ To do otherwise, Justice Stevens argued, would require a never-ending peeling away of each of the sentences of the Arbitration Agreement:

Prima Paint and its progeny allow a court to pluck from a potentially invalid *contract* a potentially valid *arbitration agreement*. Today the Court adds a new layer of severability — something akin to Russian nesting dolls — into the mix: Courts may now pluck from a potentially invalid *arbitration agreement* even narrower provisions that refer particular arbitrability disputes to an arbitrator. . . . I do not think an agreement to arbitrate can ever manifest a clear and unmistakable intent to arbitrate its own validity. But even assuming otherwise, I certainly would not hold that the *Prima Paint* rule extends this far.²⁰

Thus, the dissent challenged the majority’s conclusion that the nature of the “container agreement” (here the Arbitration Agreement) made no difference to the application of the *Prima Paint* rule.²¹ As Justice Stevens put it: “That the subject matter of the agreement is exclusively arbitration makes *all* the difference in the *Prima Paint* analysis.”²² The dissent distinguished the justification for the *Prima Paint* severability rule for arbitration provisions from the instant case. Specifically, the dissent contended that when an agreement is being challenged as a whole, severability is required because having a court potentially invalidate the arbitration provision as part of the larger agreement defeats the “national policy favoring arbitration.”²³ Conversely, a court’s decision invalidating a provision delegating gateway issues to arbitrators has no effect on the merits of the issue regarding the validity of the underlying agreement. It merely resolves who gets to decide the merits of that particular issue.²⁴

The dissent also accepted Jackson's argument that a challenge to the arbitration agreement as unconscionable went to the very question of whether the parties ever entered into a valid agreement at all, and thus was a threshold issue under § 2. Because such issues are presumptively for the court to decide under the FAA, the court and not the arbitrator must decide whether unconscionable terms prevented a valid arbitration agreement from ever coming into force, including the question as to whether the parties' assent to the delegation provision was validly obtained as well.²⁵ The dissent argued that a "good faith" allegation of unconscionability under state contract law is enough to throw the entire issue to the court before any arbitrator can become involved.²⁶

Practical Impact Of The Decision

The *Rent-A-Center* decision dictates that litigants must ever more carefully read each provision of an arbitration agreement in order to determine whether a court will consider that provision to be a separate arbitration agreement. To be safe, a litigant seeking to avoid arbitration should specifically allege that every provision that could be considered a separate arbitration agreement within the larger arbitration agreement is not a valid agreement to arbitrate. Otherwise, the litigant will run the risk of being deemed to have waived that argument under *Rent-A-Center*. More specifically, litigants who wish Courts to decide the issue of arbitrability should be prepared to challenge both the validity of the arbitration agreement and the validity of any provision within the arbitration agreement delegating the issue of arbitrability to the arbitrators.

Apart from an agreement to arbitrate arbitrability itself through a delegation provision, it is difficult to imagine what other provisions could be considered separate arbitration agreements under the Supreme Court's ruling. Could a provision within an arbitration clause that provides that the arbitrators shall award attorney's fees to the prevailing party be considered a separate arbitration agreement? Can *Rent-A-Center* even apply beyond its specific facts? The majority opinion gave no indication that it was limiting the case to its facts. We can therefore expect that there will be future cases seeking to define the limits of the *Rent-A-Center* decision.

At least for a litigant challenging a delegation provision in court, the rule seems clear: he must spe-

cifically allege that the delegation provision itself is fraudulent, the subject of undue influence or duress, or unconscionable. Even then, such a tactic might get the litigant before a court initially, but it may be a case of winning the battle and losing the war. Proving that an entire arbitration agreement is unconscionable because arbitration provides for limited discovery may make sense. When attacking a delegation provision, however, the task becomes more difficult. Just how much discovery is needed with respect to the arbitration of arbitrability? Similarly, an argument that the fee-sharing rules of arbitration is unconscionable may lose potency when the arbitrator fees in question involve limited decisions on very narrow arbitrability issues that may not generate significant arbitrator fees.

As noted above, the majority did leave a narrow opening that could be used to challenge delegation provisions specifically. Parties to arbitration agreements that preceded the Court's decision in *Hall Street Associates*, and which provide for plenary judicial review of arbitration awards, may be able to argue unconscionability if they timely do so before the district court. Jackson's counsel belatedly argued that the delegation provision was a *quid pro quo* for the right to plenary judicial review.²⁷ Once the Supreme Court in *Hall Street Associates* struck down such clauses as violative of the FAA, a party in Jackson's position lost the benefit of the bargain and could argue it is manifestly unfair to hold him or her to the delegation provision. While Justice Scalia's opinion provided no clue whether the Court would accept such an argument, it nonetheless did not reject outright such grounds as a basis for finding the delegation provision itself unconscionable.

In the end, *Rent-A-Center* may be most important for what it says about the U.S. judicial view of arbitration itself. It is simply getting harder and harder for litigants to argue their way out of an arbitration agreement.

Endnotes

1. The authors thank Shruti Kuma Tejwani, associate, and Lisa Hirakawa, legal assistant, in the New York office of McDermott Will & Emery LLP, for their valuable assistance in the editing of this commentary.

2. United States courts also sometimes refer to the *Prima Paint* rule as “severability.” Both terms are used interchangeably throughout this commentary.
3. 388 U.S. 395 (1967).
4. 9 U.S.C. §§ 1 et seq.
5. *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S._____, 130 S.Ct. 2772 (2010).
6. 130 S.Ct. at 2780-81.
7. *Jackson v. Rent-A-Center, West, Inc.*, 581 F.3d 912, 919 (9th Cir. 2009).
8. 130 S.Ct at 2777 (citing *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83-85 (2002); *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444, 452 (2003) (plurality opinion)).
9. 130 S.Ct. at 2778 n.1.
10. 537 U.S. 79, 83 (2002).
11. 130 S.Ct. at 2778.
12. *Id.* at 2779.
13. 546 U.S. 440 (2006).
14. 130 S.Ct. at 2779.
15. Transcript of Oral Argument at 32-34.
16. 130 S.Ct. at 2780.
17. 552 U.S. 576 (2008).
18. 130 S.Ct. at 2781.
19. *Id.* at 2781-82.
20. *Id.* at 2786 (emphasis in original).
21. *Id.* 2787.
22. *Id.* at 2782 (emphasis in original).
23. *Id.* at 2788.
24. *Id.*
25. *Id.* at 2784-85.
26. *Id.*
27. *Id.* at 2781. ■