Dinsmore&Shohl LLP
ATTORNEYS

What Contracting Parties Can Take Away from the Supreme Court's Most Recent Arbitration Decisions

Granite Rock Co. v. International Brotherhood of Teamsters and Rent-A-Center, West, Inc. v. Jackson

July 26, 2010

Richard H.C. Clay

Disputes between parties as to whether or not a particular issue is arbitrable are not uncommon. The party seeking to avoid arbitration may assert both procedural and substantive defenses to claims that a dispute is arbitrable. Claims of procedural inarbitrability, such as a statute of limitations issue, are for the arbitrator. As a general rule, however, claims of substantive arbitrability (contract formation issues such as whether the dispute is within the scope of the arbitration agreement, whether the arbitration agreement is enforceable, or whether an agreement to arbitrate exists) are for the courts. There are exceptions to the general rule, however, and the determination of whether a court or an arbitrator is to resolve the dispute may become quite complex.

Two Supreme Court cases decided one day apart in June of 2010, *Rent-A-Center West v. Jackson* and *Granite Rock Co. v. International Brotherhood of Teamsters*, represent the most recent manifestations of two divergent, though often blurry, lines of judicial reasoning regarding who decides the arbitrability of an agreement.

The first line of cases holds that the question of arbitrability is undeniably an issue for judicial determination. The Supreme Court has found, in cases such as *AT&T Technologies Inc. v. Communication Workers of America*, that unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator. This statement reflects the Court's recognition, however, that, if the parties do clearly and unmistakably provide otherwise, issues of substantive arbitrability may, in some cases, be decided by the arbitrator rather than a court.

The second line of Supreme Court jurisprudence holds that an arbitrator should decide defenses, such as fraud in the factum or fraud in the inducement, that would render an established contract void or voidable. Cases such as *Prima Paint Corp. v. Flood & Conkling Manufacturing Co.* and *Buckeye Check Cashing, Inc. v. Cardegna* have held that, because an arbitration provision is severable from the remainder of the contract, the arbitrator determines the contract's validity (as opposed to its formation) unless one party separately claims the arbitration provision itself is invalid.

Rent-A-Center interweaves both lines of reasoning to find that an arbitrator decides the issue of arbitrability as long as the parties clearly and unmistakably provide for such a determination and the validity of their agreement to arbitrate such threshold issues is not specifically challenged. The facts are simple: Jackson, a former employee of Rent-A-Center filed an employment discrimination suit against Rent-A-Center in federal court. Rent-A-Center filed a motion under the Federal Arbitration Act ("FAA") to compel arbitration, arguing that the Rent-A-Center Mutual Agreement to Arbitrate Claims ("Agreement") that Jackson signed precluded Jackson from pursuing his claims in court. Jackson challenged the validity of the Agreement on grounds of unconscionability because it contained discovery provisions that were one-sided and a provision specifying

that the arbitrator's fee was to be shared equally by the parties and, procedurally, because it was presented to him as a non-negotiable condition of employment.

Critically, the Agreement contained a "delegation provision" stating that "[t]he 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 part of this Agreement is void or voidable."

Justice Scalia authored the majority opinion of a divided Supreme Court, holding that the issue of arbitrability is for the arbitrator in the first instance. The first section of the opinion explains that the FAA controls and treats arbitration as a "matter of contract, on an equal footing with other contracts." It provides that a written provision in a contract "to settle by arbitration a controversy thereafter arising out of such a contract...[is] valid, irrevocable and enforceable." As the delegation provision at issue clearly expressed the intent of the parties to arbitrate arbitrability, the Court found the inquiry over who decides such threshold question to be at an end.

In the second part of the opinion, the Court, relying on the second line of cases mentioned above such as *Prima Paint*, found that only challenges to the validity of the arbitration agreement itself are for a court. Agreements to arbitrate are severable from the remainder of the contract, and a party's challenge to another provision of the contract, or to the contract as a whole, does not prevent a court from enforcing a specific agreement to arbitrate. While such agreements to arbitrate can be challenged and such challenges must be decided by a court, a party must specifically assert that the agreement to arbitrate itself is invalid, as induced by fraud for example. The Court took the time to explain how Jackson might have directed his unconscionability claims specifically to the delegation provision, yet conceded that such a claim "would be … a much more difficult argument to sustain." As Jackson's claims were not limited to the delegation provision, however, this issue was ultimately moot.

In *Granite Rock*, the Court adhered to the first line of cases mentioned above and found that a court may order arbitration of a particular dispute only where the court is satisfied that the parties agreed to arbitrate that dispute. Granite Rock Company and the International Brotherhood of Teamsters ("IBT"), Local 287 were parties to a collective bargaining agreement that was set to expire on April 30, 2004. As Local 287 found certain provisions of the expiring agreement inadequate, no new agreement was reached as of June, 2004, and Local 287 went on strike. By July, the parties reached a tentative agreement on a successor contract that contained a broad arbitration clause requiring the parties to arbitrate "[a]ll disputes arising under the agreement." Local 287 members then allegedly ratified the successor agreement on July 2, 2004. On July 5, however, Local 287 members were instructed not to return to work by the IBT until Granite Rock agreed to a back-to-work agreement that would shield its employees from liability arising from the strike. Granite Rock refused and subsequently sued IBT and Local 287, seeking an injunction against the continuation of the strike and asserting that it breached the no-strike clause in the parties' agreement. Local 287 defended by asserting that the successor contract had never been ratified and did not exist. It moved to compel arbitration of the entire dispute, including the issue of whether Granite Rock and Local 287 had reached an agreement on July 2, 2004.

The Supreme Court split 7-2 on the arbitrability issue. Justice Thomas's majority opinion asserted the "well-settled" principle that where an issue of arbitrability turns on whether a contract was ever formed, "the dispute is generally for the courts to decide." Local 287, the party seeking arbitration, argued that the federal presumption in favor of arbitration mandated that any doubts concerning arbitral issues should be resolved in favor of arbitration, and that the severability principle, explained in *Rent-A-Center*, meant that the contract's arbitration clause should be applied to all disputes within its scope unless the validity challenge was to the arbitration clause itself. The Court, in response, found it necessary to "reemphasize the proper framework for deciding when disputes are arbitrable" under its precedents, finding that "courts should order arbitration of a dispute only where the court is satisfied that neither the formation of the parties' arbitration agreement nor (absent a valid provision specifically committing such disputes to an arbitrator) its enforceability or applicability to the dispute is in issue."

The Court ultimately decided that the presumption favoring arbitration in FAA and labor cases should be applied "only where it reflects, and derives legitimacy from, a judicial conclusion that arbitration of a particular dispute is what parties intended because their express agreement to arbitrate was validly formed and is legally enforceable and best construed to encompass the dispute." As this principle required the court to determine when the contract between Local 287 and Granite Rock was formed and what it covered, it compelled reversal of the Ninth Circuit's decision, which had relegated those issues to the arbitrator.

Both *Granite Rock* and *Rent-A-Center* involved the issue of the appropriate adjudicator of issues of arbitrability that arose under a written contract. Yet in *Rent-A-Center*, the Court held that the arbitrability issue was to be decided by the arbitrator. In *Granite Rock*, by contrast, it held that the arbitrability issue was to be decided by the court. Given these conflicting holdings and the unusual factual context of each case, it is hard to reconcile the two cases and draw conclusions, yet the cases appear to be explainable on two bases. First, *Granite Rock* involved an issue of contract formation while *Rent-A-Center* revolved around of the validity of a contract, the formation of which both parties conceded. Second, the agreement in *Rent-A-Center* expressly delegated to the arbitrator the issues of the enforceability and validity of the agreement to arbitrate, while the agreement in *Granite Rock* contained no such provision. Similarly, the arbitration provision in *Rent-A-Center* governed all "past, present or future" disputes arising out of Jackson's employment, while the language of the arbitration provision in *Granite Rock* pertained only to disputes "arising under" the agreement. Thus, the arbitration provision at issue in *Rent-A-Center* was much clearer and more inclusive.

Questions remain however, as to whether the Court would have sent the contract formation issue in *Granite Rock* to the arbitrator if, as in *Rent-A-Center*, it had contained a delegation provision. Also left unresolved is what would have been the outcome in *Rent-A-Center*, if Jackson had challenged the validity of the delegation provision itself. Regardless, the takeaway for parties favoring arbitration and seeking a more cost efficient, extra-judicial resolution of their dispute is to clearly and unmistakably draft their contracts so as to expressly delegate all conceivable issues they desire arbitrated to the arbitrator. As seen in *Rent-A-Center*, however, even this express language might not keep parties out of court. At the very least, a court will have to initially determine who determines arbitrability if the issue is contested. Additionally, as Justice Thomas suggested in *Rent-a-Center*, a party resisting arbitration may challenge the validity of the specific arbitration provision in the contract and, as the Supreme Court left this issue undecided, extensive litigation might be required to resolve the matter.

In the wake of *Rent-A-Center* and *Granite Rock*, arbitration provisions, provided they are clearly and unmistakably expressed and as broad in scope as possible, are somewhat less susceptible to a challenge in the court of law. When a dispute arises over a contract containing a delegation provision, parties wishing to have a court, rather than an arbitrator, decide the validity of the arbitration agreement will now have to specifically tailor their attacks on the delegation provision, rather than on the agreement as a whole, which will likely prove difficult.

The author is grateful for the assistance of James Gillenwater, a 2010 Dinsmore & Shohl summer associate. James is a graduate of Vanderbilt University, a Fulbright Scholar, and will be a second year law student at Duke University.