SULLIVAN & CROMWELL LLP

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# Class Arbitration

## U.S. Supreme Court Holds That an Ambiguous Arbitration Agreement Cannot Support Class Arbitration


### SUMMARY

The U.S. Supreme Court ruled earlier this week in *Lamps Plus, Inc.* v. *Varela*, 587 U.S. ____, 2019 WL 1780275 (Apr. 24, 2019) that the Federal Arbitration Act (FAA) does not allow courts to infer an agreement to arbitrate claims in the form of a class action from an arbitration clause that is ambiguous on the question of whether class treatment is allowed. The Court, in an opinion by Chief Justice Roberts, reversed the Ninth Circuit Court of Appeals and held that the rule of interpreting a contract against its drafter cannot be used to find an agreement to permit class arbitration. The Court determined that this interpretive rule is not a tool for inferring *intent*, but a rule of public policy based primarily "on equitable considerations about the parties' relative bargaining strength."[1] Four justices dissented.

The Court's decision relied heavily on its ruling nine years ago in *Stolt-Nielsen, S.A.* v. *AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010), where the Court held that courts cannot infer that parties to an arbitration agreement agreed to class arbitration from an agreement's silence on the issue, where the parties had stipulated that they had reached no agreement on class arbitration. As a practical matter, the Court's decision this week is likely to mean that agreements that do not mention class arbitration will rarely be held to permit that form of arbitration

The Court also held that the district court's order compelling class arbitration and dismissing the case without prejudice constituted "a final decision with respect to an arbitration" under Section 16(a)(3) of the FAA, such that the order was subject to immediate appeal.[2] The Court's ruling on jurisdiction appears to have increased the ability of litigants to appeal immediately orders compelling arbitration under the FAA.

## BACKGROUND

Like many employers, Lamps Plus, Inc. required new employees to sign arbitration agreements on their first day of work. Those agreements read in part: "the parties agree that any and all disputes, claims or controversies arising out of or relating to this Agreement, the employment relationship between the parties, or the termination of the employment relationship, that are not resolved by their mutual agreement shall be resolved by final and binding arbitration as the exclusive remedy." The agreement also provided that "[t]he Arbitrator is authorized to award any remedy allowed by applicable law," and that "arbitration shall be in lieu of any and all lawsuits or other civil legal proceedings relating to my employment." The agreement provided for arbitration under either the AAA or JAMS arbitration rules.

A hacking incident at Lamps Plus led to the disclosure of employee tax information; a fraudulent tax return was later filed in the name of an employee. That employee, Frank Varela, filed a putative class action in California federal court against Lamps Plus alleging violations of state and federal law. Lamps Plus responded to the complaint by moving to compel arbitration against Varela on an individual basis under the FAA or, in the alternative, to dismiss the complaint. The district court compelled arbitration, but ruled that the arbitration would proceed on a class basis. The district court reasoned that class action waivers "in the employment context" have "dubious enforceability," and the language of the arbitration agreement was ambiguous as to class claims and should be read against the drafter (Lamps Plus) to allow class arbitration.[3] Significantly, the court then dismissed (rather than stayed) Varela's claims without prejudice.

The United States Court of Appeals for the Ninth Circuit affirmed. The Ninth Circuit observed that some phrases in the arbitration agreement contemplated individualized arbitration while other phrases "were capacious enough to include class arbitration."[4] According to the Ninth Circuit, these conflicting phrases rendered the contract ambiguous on the class arbitration issue. Like the district court, the Ninth Circuit applied "California's rule that ambiguity in a contract should be construed against the drafter" (the doctrine of *contra proferentem*) and, therefore, concluded that the arbitration agreement permitted class arbitration.[5]

## THE SUPREME COURT'S DECISION

On the merits, the Court held that "[c]ourts may not infer from an ambiguous agreement that parties have consented to arbitrate on a classwide basis."[6] In doing so, the Court relied primarily on its 2010 decision in *Stolt-Nielsen*, which held that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so," and that an agreement's silence as to class arbitration did not provide such a basis.[7] The Court also relied on other rulings holding that the FAA, rather than state contract law principles, "provides the default rule for resolving certain ambiguities in arbitration agreements."[8]

Applying those principles, the Court deferred to the Ninth Circuit's ruling under California law that Lamp Plus's arbitration agreement was ambiguous on the issue of class arbitration, but rejected the circuit court's application of the *contra proferentem* doctrine to resolve that ambiguity. The *contra proferentem* rule, according to the Court, is "a last resort" doctrine based on public policy factors rather than the parties' actual intent. Recognizing the "'fundamental' difference between class arbitration and the individualized form of arbitration envisioned by the FAA," the Court found the use of the *contra proferentem* doctrine to compel the arbitration of class claims was "flatly inconsistent with 'the foundational FAA principle that arbitration is a matter of consent.'"[9] The FAA, the Court held, "requires more than ambiguity to ensure that the parties actually agreed to arbitrate on a classwide basis."[10]

Separately, the Supreme Court addressed Varela's somewhat belated challenge to the Ninth Circuit's—and, therefore, the Court's—appellate jurisdiction. According to Varela, the district court's order compelling class arbitration was not immediately appealable, because Section 16 of the FAA authorizes appeals from orders denying motions to compel arbitration, not orders granting them.[11] The Court found Varela's argument "beside the point" because the district court dismissed Varela's federal lawsuit as part of its order compelling arbitration, which made it "a final decision with respect to an arbitration," which is appealable under a different part of that Section, Section 16(a)(3).[12] The Court, as it had in a similar prior case, declined to reach the question of whether the district court *should* have stayed, rather than dismissed, the case.[13]

Justices Kagan, Ginsburg, Breyer and Sotomayor dissented, writing four separate opinions. Justice Kagan's opinion, joined in relevant part by all four of the dissenters, argued that the Court should have applied the *contra proferentem* rule on the ground that it is a neutral state-law rule of contract interpretation. In rejecting this argument, the Court held that even "a neutral rule that gives equal treatment to arbitration agreements and other contracts alike. . . . cannot save from preemption general rules 'that target arbitration either by name or by more subtle methods, such as by 'interfer[ing] with fundamental attributes of arbitration.'"[14] Justice Breyer would have held that the District Court should not have dismissed the case immediately and that in doing so, it could not create appellate jurisdiction under Section 16 of the FAA.

## IMPLICATIONS

With *Stolt-Nielsen* reaffirmed, courts are likely to disallow class arbitration claims under the FAA when an arbitration agreement is silent on the question. Although the Court did not specify what language—or, perhaps, extrinsic evidence—would overcome the "default rule" against class arbitration, it appears that simply agreeing to resolve "all disputes" or "claims" in arbitration, or referring to rules of an arbitral forum (like the AAA) that provide class action procedures, is insufficient.

The Court's jurisdictional ruling may open the door to more immediate appeals of district court orders compelling arbitration. When seeking to compel arbitration in federal court, litigants should carefully

consider whether it is in their best interests to seek a stay of the federal court action pending completion of the arbitration (which if granted would make the order compelling arbitration unappealable) or a dismissal (which may permit an immediate appeal).

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## ENDNOTES

1 *Lamps Plus*, 2019 WL 1780275, at *6.

2 *Id.* at *3.

3 *Varela* v. *Lamps Plus, Inc.*, 2016 WL 9110161, at *7 (C.D. Cal. July 7, 2016).

4 *Lamps Plus*, 2019 WL 1780275, at *3.

5 *Id.* at *6.

6 *Id.* at *8.

7 *Stolt-Nielsen S.A.* v. *AnimalFeeds Int'l Corp.*, 559 U.S. at 684.

8 *Lamps Plus*, 2019 WL 1780275, at *8.

9 *Id.* at *5, *7.

10 *Id.* at *4.

11 *Id.* at *3. *See also* 9 USC § 16(a)(1)(B) (orders denying petitions to compel arbitration); 9 U.S.C. § 16(b)(2) (orders granting petitions to compel arbitration).

12 *Id.* at *3 (quoting 9 U.S.C. § 16(a)(3)).

13 *Id.* at *4 & n.1 (citing *Green Tree Financial Corp.-Ala.* v. *Randolph*, 531 U.S. 79, 89 (2000)).

14 *Id.* at *7.

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