The High Court Speaks? A Summary of Recent Decisions from the U.S. Supreme Court Addressing Arbitration of Commercial Disputes

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During its most recent term, the United States Supreme Court decided four cases addressing the arbitration of consumer and commercial disputes. For those practitioners hoping for great insight from the High Court on the arbitration issues raised in these cases, there was reason for disappointment. In the three most closely-followed arbitration cases of the term - *Howsam v. Dean Witter Reynolds*, *Green Tree Financial Corp. v. Bazzle*, and *Pacificare Health Systems v. Book* - the Court avoided a decision on the ultimate issues between the parties, finding that they were not for the court to decide or otherwise not ripe for determination. On the whole, however, the four cases are important to counsel that draft arbitration clauses and for attorneys representing parties in arbitration proceedings, both for the questions they answer and the issues they leave unresolved. This paper summarizes the four decisions and the overriding policies of deference to arbitration and the authority of arbitrators to decide issues subject to arbitration that they reflect.

The Citizens Bank v. Alafabco, Inc.

An appropriate starting point is the U.S. Supreme Court's *per curiam* opinion in *The Citizens Bank v. Alafabco, Inc.* decided on June 2, 2003, in which the Court clarified the test by which courts will determine whether the transaction underlying an arbitration dispute involves interstate commerce so as to be governed by the Federal Arbitration Act ("FAA").

The specific issue presented in *Citizens Bank* was whether the debt-restructuring agreement between Citizens Bank - an Alabama lending institution - and Alafabco, Inc. - an Alabama fabrication and construction company - was a contract evidencing a transaction involving interstate commerce within the scope of the FAA.[1] The debt-restructuring agreement at issue in *Citizens Bank* contained an arbitration clause which stated that the FAA shall apply to its construction, interpretation, and enforcement.[2] By its express language, the FAA can only apply to an arbitration agreement contained in a contract "evidencing a transaction involving commerce [among the several States]."[3]

The dispute arose out of a series of commercial loan transactions between the parties made over a decade-long course of business dealings. After repeated (and ultimately unsuccessful) efforts to restructure its debt from these transactions, Alafabco filed suit against Citizens Bank in Alabama circuit court alleging, *inter alia*, that

[1] The Citizens Bank v. Alafabco, Inc., No. 02-1295, slip op. at 1 (June 2, 2003).
[2] *Id.*
[3] *Id.* at 4; 9 U.S.C. § 2 (2002) (The FAA provides that: "written provision in any maritime transaction or a contract *evidencing a transaction involving commerce* settle by arbitration a controversy thereafter arising out of such contract or transaction,. . ., shall be valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract.") (emphasis added).

Alafabco detrimentally incurred massive debt in reliance on commitments by Citizens Bank to provide capital sufficient to compete certain construction projects which later proved to be false.[4] Citizens Bank moved to compel arbitration of the dispute, invoking the arbitration clause contained in the parties' debt-restructuring agreements. The Circuit Court granted Citizen Bank's motion and Alafabco appealed.

The Supreme Court of Alabama reversed the Circuit Court's decision, finding that the debt-restructuring agreements did not have a sufficient nexus with interstate commerce such that the agreement to arbitrate was enforceable under the FAA.[5] In so holding, the Court placed great reliance on its prior decision in *Sisters of the Visitation v. Cochran Plastering Co.*, in which the Supreme Court of Alabama read prior U.S. Supreme Court precedent in *United States v. Lopez*, to require that "a particular contract, in order to be enforceable under the [FAA] must, by itself, have a substantial effect on interstate commerce."

The United States Supreme Court accepted Citizen Bank's petition for certiorari review and reversed the Alabama Supreme Court's decision, finding that the court gave inadequate breadth to the FAA statute. The U.S. Supreme Court interpreted the term "involving commerce" in the FAA as the equivalent of "affecting commerce"—words that signal the broadest permissible exercise of Congress' Commerce Clause power.[6] Because the FAA provides for coverage to the full reach of the Commerce Clause, the Court found that the FAA encompasses a wider range of transactions than just those deemed to be "in commerce."[7] Rather, the Court held that "Congress' Commerce Clause power 'may be exercised in individual cases without showing any specific effect upon interstate commerce' if in the aggregate the economic activity in question would represent 'a general practice . . . subject to federal control.'"[8]

Applying this rationale to the particular agreement in this case, the U.S. Supreme Court found that even though the debt-restructuring agreements were executed in Alabama by Alabama residents, they nonetheless satisfied the FAA's "involving commerce" standard. They did so because the parties' engaged in business throughout the southeastern United States using loans from the bank and because the debts were secured by Respondent's business assets, including its inventory of goods assembled from out-of-state parts and raw materials. The broad impact of commercial lending on the national economy and Congress' power to regulate that activity further justified the conclusion that the transactions involved interstate commerce, according to the Court.[9]

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[4] *Id.*
[5] *Id*. at 3.
[6] *Id.* (citing Allied-Bruce Terminix Cos. V. Dobson, 513 U.S. 265 (1995)).
[7] *Id.* at 4.
[8] *Id*. at 4-5 (citing Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219, 236 (1948); Perez v. United States, 402 U.S. 146, 154 (1971); Maryland v. Wirtz, 392 U.S. 183, 196-97, n. 27 (1968)).
[9] *Id.* at 5-6.

Howsam v. Dean Witter Reynolds, Inc.

In *Howsam v. Dean Witter Reynolds*, the U.S. Supreme Court took the opportunity to resolve the disagreement among the Courts of Appeal regarding the role of the judiciary in arbitration disputes involving the National Association of Securities Dealers' (NASD) Code of Arbitration and Procedure § 10304.[10]

The case before the U.S. Supreme Court in *Howsam* arose like most typical investor disputes subject to arbitration before the NASD. Pursuant to Respondent Dean Witter Reynolds' standard client agreement, Howsam submitted her dispute with the company over alleged investment losses to arbitration before the NASD. In submitting her claim to the NASD, Howsam signed the NASD's Uniform Submission Agreement which specified that the matter was submitted "in accordance with" the NASD's Code of Arbitration Procedure, including § 10304 of the Code which prohibits disputes from being submitted where six years have elapsed from the event giving rise to the dispute.[11]

Relying on this provision, Dean Witter filed suit in Federal District Court asking the court to declare that the dispute was ineligible for arbitration because it was more than six years old. Dean Witter also sought an injunction to prohibit Howsam from proceeding in arbitration.[12] The District Court dismissed the action on the ground that the NASD arbitrator, not the court, should interpret and apply the NASD rules.[13] The Tenth Circuit Court of Appeals reversed the district court, holding that application of time limitation was a "question of arbitrability," which is a decision for the courts.[14]

The U.S. Supreme Court accepted Howsam's petition and reversed the Tenth Circuit's decision, holding that the application of the NASD six-year limitation was not a question to be decided by the courts. The Court observed that arbitration is a matter of contract, and no party can be required to submit to arbitration any dispute which he or she has not agreed to submit.[15] The question whether parties have submitted an issue to arbitration ("the question of arbitrability"), is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.[16] Thus, the Court was faced with deciding whether the application of the NASD time limit was a question of arbitrability for the courts to decide.[17] It determined it was not.[18]

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[10] Howsam v. Dean Witter Reynolds, Inc., No. 01-800, slip op. at 1 (Dec. 10, 2002) (Thomas, J., concurring); NASD CODE OF ARBITRATION PROCEDURE § 10304 (1984).
[11] *Howsam*., No. 01-800, slip op. at 2 (Dec. 10, 2002) (citing NASD Code of Arbitration Procedure § 10304 (1984) (stating that "no dispute shall be eligible for submission . . .where six (6) years have elapsed from the occurrence or event giving rise to the dispute.")).
[12] *Id.* at 1-2.
[13] *Id.* at 2.
[14] 261 F.3d 956 (2001).
[15] *Howsam*, No. 01-800, slip op. at 3 (citing Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582 (1960)).
[16] *Id.* (citing AT & T Tech., Inc. v. Communications Workers, 475 U.S. 643, 649 (1986)).
[17] *Id.* at 3.
[18] *Id.*

The Court reasoned that, while one might call any potentially dispositive gateway question a "question of arbitrability," the Court's prior opinions make clear that the phrase "question of arbitrability" has a far more limited scope.[19] The phrase applies primarily when the parties are in disagreement about whether or not they agreed to arbitration. Thus, the dispute about whether the parties are bound to arbitration would be a "question of arbitrability" for the courts, but procedural questions which grow out of the dispute and bear on its final disposition are not "questions of arbitrability" for the courts, but decisions best made by the arbitrator.[20]

In making its ruling, the U.S. Supreme Court relied on the language and comments of the Revised Uniform Arbitration Act of 2000 (RUAA).[21] The RUAA states that "the arbitrator shall decide whether a condition precedent to arbitrability has been fulfilled."[22] The comments add that "in the absence of an agreement to the contrary, issues of substantive arbitrability . . . are for a court to decide and issues of procedural arbitrability, *i.e.*, whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met, are for the arbitrators to decide."[23] The Court followed this rule and held that the NASD time limit rule is a procedural question for the arbitrator, not a "question of arbitrability," and that NASD arbitrators are better able to interpret and apply their own rule.[24]

The U.S. Supreme Court also rejected Dean Witter's argument that the word "eligible" in the NASD Code's time limit rule indicated that the parties' intent was for the rule to be resolved by the court. The Court stated that parties to an arbitration contract would expect a forum-based decision-maker to decide gateway procedural matters.[25] It further ruled that placing anti-arbitration weight on the term "eligible" was offset by another rule empowering the arbitrator to interpret and determine the applicability of all provisions under the Code.[26]

Green Tree Financial Corp. v. Bazzle

In *Green Tree Financial Corp. v. Bazzle,*[27] the U.S. Supreme Court faced another issue concerning the interpretation of an arbitration clause contained in a contract and whether or not interpretation of that clause was an appropriate issue for the courts to decide. The dispute in this case centered on whether the arbitration provisions in question forbid class arbitration.

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[19] *Id.* at 3-4.
[20] *Id.* at 4-5.
[21] *Id.* at 5; Revised Uniform Arbitration Act of 2000 § 6(c), 7 U.L.A. 12-13 (Supp. 2002).
[22] *Ibid.*
[23] RUAA § 6(c), cmt. 2, 7 U.L.A. at 13.
[24] *Howsam*, No. 01-800, slip op. at 5-6.
[25] *Id*. at 6.
[26] *Id.*; NASD Code § 10324 (1984).
[27] Green Tree Fin. Corp. v. Bazzle, No. 02-634, slip op. at 1 (June 23, 2003) (Stevens, J., concurring in judgment, Rehnquist, C.J., dissenting, Thomas, J., dissenting).

In 1995, the Respondents - Bazzle, Lackey and Buggs - entered into separate contracts with Petitioner Green Tree Financial Corp. to secure home improvement loans. The contracts, each of which was governed by South Carolina law, stated that "all disputes, claims, or controversies arising from or relating to this contract or the relationships which result from this contract . . . shall be resolved by binding arbitration by one arbitrator selected by us with consent of you . . . ."[28] Respondents later alleged that at the time of the transactions, Green Tree failed to provide them with forms informing them of their right to name their own lawyers and insurance agents. Consequently, the Respondents filed separate actions in South Carolina state courts, complaining that this failure violated South Carolina law, entitling them to damages.[29]

In the *Bazzle* case, Respondents asked the South Carolina trial court to certify their claims as a class action, while Green Tree sought to compel arbitration. The trial court both certified the class *and* entered an order compelling arbitration.[30] Green Tree thereafter selected an arbitrator and the Bazzles consented to the selection. The arbitrator administered the proceeding as a class and eventually awarded the Respondent class $10,935,000 in statutory damages, as well as attorney's fees. The trial court confirmed the award and Green Tree appealed to the South Carolina Court of Appeals, claiming that class arbitration was impermissible under the terms of the parties' contract.[31] The same result occurred in the cases filed by Respondents Lackey and Buggs. However, in those cases the arbitrator, not the court, certified the case as a class and then proceeded to award the class damages. Green Tree appealed from these awards as well, claiming that class arbitration was impermissible.[32]

The South Carolina Supreme Court assumed jurisdiction over all three cases, and consolidated the proceedings. The South Carolina Supreme Court held that the contracts were silent in regard to class arbitration, and that they consequently authorized class arbitration.[33] The U.S. Supreme Court granted certiorari to consider whether that holding is consistent with the Federal Arbitration Act.

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[28] *Id.* at 2. The entire clause stated:

> ARBITRATION—All disputes, claims, or controversies arising from or relating to this contract or the relationships which result from this contract . . .shall be resolved by binding arbitration by one arbitrator selected by us with consent of you. This arbitration contract is made pursuant to a transaction in interstate commerce, and shall be governed by the Federal Arbitration Act at 9 U.S.C. section 1 . . .THE PARTIES VOLUNTARILY AND KNOWINGLY WAIVE ANY RIGHT THEY HAVE TO A JURY TRIAL EITHER PURSUANT TO ARBITRATION UNDER THIS CLAUSE OR PURSUANT TO COURT ACTION BY US (AS PROVIDED HEREIN) . . . The parties agree and understand that the arbitrator shall have all powers provided by the law and the contract. These power shall include all legal and equitable remedies, including, but not limited to, money damages, declaratory relief, and injunctive relief." App. 34 (capitalization in original)

[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id*. at 4.
[33] *Id.*

In a majority opinion written by Justice Breyer and joined by Justices Souter, Scalia, and Ginsburg, the U.S. Supreme Court determined that the issue was a matter of state law to be decided by an arbitrator, and was not appropriately before the courts.[34] Chief Justice Rehnquist filed a dissent arguing that the contract clearly prohibited class arbitration because it stated that disputes would be resolved by one arbitrator, selected by Green Tree, with the consent of Green Tree's customer, and thus by implication imposed a one customer per arbitration limitation.[35] The majority, however, held that the contracts were unclear in regard to class arbitration, and that it was not completely obvious whether the contracts impliedly prohibited class arbitration.[36] It reasoned that because the class arbitrator was selected by Green Tree with the consent of its customers, and that any other class members that agreed to proceed consented as well, the contracts may permit class arbitration.[37] Because this determination comes down to an interpretation of the terms of the parties' contracts, the question as to whether the agreement prohibits class arbitration is for the arbitrator to decide.[38]

The U.S. Supreme Court reiterated that a court should only assume that the parties intended courts, not arbitrators, to decide a particular arbitration-related issue in the absence of clear and unmistakable evidence to the contrary.[39] These typically involve matters of a kind that "contracting parties would expect a court" to decide, such as the validity of an arbitration agreement and whether a concededly binding arbitration clause applies to a certain type of controversy.[40]

The U.S. Supreme Court held that the question of whether the contracts forbid class arbitration did not fall into these narrow exceptions because it concerned neither the validity of the arbitration clause nor its applicability to the underlying dispute between the parties.[41] Instead, the question presented involved what kind of arbitration the parties agreed to. That question did not involve a state statute or judicial proceeding, but contract interpretation and arbitration procedures, which are best decided by an arbitrator.[42] "Given these considerations, along with the arbitration contracts' sweeping language concerning the scope of the questions committed to arbitration, this matter of contract interpretation should be for the arbitrator, not the courts, to decide."[43]

Curiously, despite the fact that in two of the underlying cases before it, the arbitrator *had in fact* decided the issue of whether class certification was proper, the U.S.

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[34] *Id.* at 1-2.
[35] *Id.*
[36] *Id*. at 5.
[37] *Id.*
[38] *Id.* at 6.
[39] *Green Tree*, No. 02-634, slip op. at 6 (citing AT &T Tech., Inc. v. Communications Workers, 475 U.S. 643, 649 (1986)).
[40] *Id.* (citing *Howsam*, 537 U.S. at 83; John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 546-47 (1964) (whether an arbitration agreement survives a corporate merger)).
[41] *Id.* at 7.
[42] *Id.*
[43] *Id.*

Supreme Court concluded that the parties had not yet obtained the arbitration decision contemplated by their contracts. The Court believed that, because class certification in the *Lackey* and *Buggs* arbitration proceedings had occurred *only after* the South Carolina trial court in *Bazzle* had decided that class treatment was permissible under the contract, the arbitrator in those cases did not make an independent interpretation of the contracts.[44] Instead, the Court reasoned that there was a strong likelihood the arbitrator's decisions were influenced by and thus merely reflected the trial court's interpretation of the contracts. Accordingly, the U.S. Supreme Court remanded the cases to arbitration so that the arbitrator could decide the ultimate question of whether the contract's terms forbid class certification, without regard to the *Bazzle* certification.[45]

Pacificare Health Systems, Inc. v. Book

In *Pacificare*, the U.S. Supreme Court missed an opportunity to resolve an important issue regarding whether arbitration clauses that prohibit awards of punitive damages are unenforceable with respect to claims under statutes that expressly provide for the award of treble damages.

Respondent physicians filed suit alleging that managed-healthcare organizations, including Petitioner, violated, *inter alia*, the Racketeer Influenced and Corrupt Organizations Act ("RICO") by failing to reimburse them for health-care services that they had provided to patients covered by the organization's plans. The petitioner moved to compel arbitration, but the federal district court refused because the arbitration agreement prohibited awards of "punitive damages," thus preventing the arbitrator from awarding treble damages as permitted under RICO. Accordingly, the district court deemed the arbitration agreements unenforceable. The Eleventh Circuit Court of Appeals affirmed based on this same reasoning.[46]

Before the U.S. Supreme Court, Respondents argued that the arbitration provisions were unenforceable as to the RICO claim because they limited the arbitrator's authority to award punitive damages, and thus prevented them from obtaining "meaningful relief" under the RICO statute, which authorizes treble damages.[47] The petitioner argued that whether the remedial limitations render their arbitration agreements unenforceable is not a "question of arbitrability" for the courts, and that even if it was; the remedial limitations at issue did not require invalidation of their arbitration agreements.[48]

In essentially a non-decision, the U.S. Supreme Court ruled that ambiguous questions regarding potential arbitration damages were speculative and not ripe for

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[44] *Id*. at 8.
[45] *Id.* at 8-9.
[46] Pacificare Healthcare Systems, Inc. v. Book, No. 02-215, slip op. at 1 (U.S. April 7, 2003).
[47] *Id*. at 2 (citing Paladino v. Avnet Computer Tech., Inc., 134 F.3d 1054, 1062 (11th Cir. 1998) (holding that where a remedial limitation in an arbitration agreement prevents a plaintiff from obtaining 'meaningful relief' for a statutory claim, the agreement to arbitrate is unenforceable with respect to that claim)); *see also* 18 U.S.C. § 1964(c).
[48] *Pacificare*, No. 02-215, slip op. at 3.

determination by the Court.[49] The Court reasoned that the prohibition of "punitive damages" did not necessarily preclude treble damages as allowed under RICO because treble damage provisions have been interpreted on a spectrum between purely compensatory and strictly punitive.[50] The Court further stated that treble damages serve both remedial and punitive purposes, and that the Court has repeatedly acknowledged the provision in RICO to be remedial in nature.[51] Since it was not clear that the parties intended the term "punitive" to encompass claims for treble damages, the Court did not know how the arbitrator would construe the remedial limitations. Thus, the questions of whether they render the parties' agreement unenforceable and whether it is for the courts or arbitrators to decide enforceability in the first instance was found to be unusually abstract and premature for the Court to address.[52] Following *Vimar*, the Court determined that the proper course of action is to compel arbitration.

[49] *Pacificare*, No. 02-215, slip op. at 2-6 (relying on Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer, 515 U.S. 528 (1995).
[50] *Id*. at 4-5.
[51] *Id.* at 5 (citing Agency Holding Corp. v. Malley-Duff & Assoc., Inc., 483 U.S. 143, 151 (1987) and Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 241 (1987)).
[52] *Id.* at 6.