

Insight

IN-DEPTH DISCUSSION

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Supreme Court Emphatically Defends Arbitration Agreements from State Interference

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On May 15, 2017, the U.S. Supreme Court reiterated the principle that the Federal Arbitration Act (FAA) requires states to treat arbitration agreements just as they treat other types of contracts. In *Kindred Nursing Centers L.P. v. Clark*, the Court reversed in part a decision of the Kentucky Supreme Court, which had instituted a new rule chipping away at the enforceability of arbitration agreements under certain circumstances.¹ Justice Kagan wrote the majority 7-1 opinion and, moreover, was joined by other liberal-leaning members of the Court.² While newly-confirmed Justice Gorsuch did not participate, the *Kindred Nursing Centers* decision reaffirms the Supreme Court's continued commitment to uphold arbitration agreements under the FAA to the greatest extent possible.

Background

The case stems from arbitration agreements entered into by relatives of two residents who lived in a nursing home, The Winchester Centre, operated by Kindred Nursing Centers. The two residents had executed powers of attorney granting their relatives authority to make contracts on their behalf and otherwise manage their affairs. Pursuant to that authority, the relatives executed arbitration agreements with Kindred Nursing Centers when completing paperwork for the residents to move into The Winchester Centre. Those arbitration agreements required the parties to submit all claims or controversies to binding arbitration.

The residents died the following year, and their estates (represented by their relatives) separately sued Kindred Nursing Centers for alleged substandard care. Kindred Nursing Centers sought dismissal of the lawsuits based on the arbitration agreements, but the Kentucky courts

¹ No. 16-32 (May 15, 2017). The Supreme Court's opinion is available at https://www.supremecourt.gov/opinions/16pdf/16-32_o7jp.pdf

² Only Justice Thomas dissented, based on his longstanding view that the FAA does not apply to state-court proceedings.

rejected the motions. The Kentucky Supreme Court consolidated the cases and, agreeing with the lower courts, invalidated the arbitration agreements. The Kentucky Supreme Court first explained that the language of the resident's power of attorney was not broad enough to authorize his relative to enter into an arbitration agreement on his behalf. The court then announced a new rule applicable to both—and all—powers of attorney. Based on the Kentucky Constitution, the Kentucky Supreme Court held that a power of attorney could never grant authority to execute an arbitration agreement unless it specifically said so.

Supreme Court Decision

The U.S. Supreme Court swiftly dismantled the Kentucky Supreme Court's "clear-statement" ruling. The Court stressed that the FAA requires equal treatment of arbitration agreements and "thus preempts any state rule discriminating on its face against arbitration."³ The Court went further, stating that the FAA "displaces any rule that covertly accomplishes the same objective by disfavoring contracts that (oh so coincidentally) have defining features of arbitration agreements."⁴ Because the Kentucky Supreme Court's rule was tailored to disfavor arbitration agreements, it "flouted the FAA's command to place those agreements on an equal footing with all other contracts."⁵ The Court therefore struck the Kentucky Supreme Court's rule and remanded the case to the Kentucky Supreme Court for further proceedings.⁶

While the *Kindred Nursing Centers* case arose in a narrow, consumer setting, the Supreme Court's opinion likely carries broader ramifications. Even without Justice Scalia, the Court shows no interest in retreating from its vigorous defense of arbitration agreements. If anything, the opinion indicates that the Court may be willing to intensify its scrutiny of state laws or legal interpretations that undermine the enforceability of such agreements. The Court rebuffed an argument, raised by the relatives, that the states should have the liberty to regulate contract formation, if not enforcement. The Court found that this reasoning "would make it trivially easy for [s]tates to undermine the [FAA]—indeed, to wholly defeat it."⁷ Overall, the Court seemed put off by Kentucky's attempts to discriminate against arbitration.

The Court's tough talk should apply with equal force to arbitration-related rules in the employment law context as well. For example, the principles espoused in *Kindred Nursing Centers* may bode ill for the newly-enacted section 925 of the California Labor Code. That provision, which took effect January 1, 2017, prohibits an employer from requiring an employee "who primarily resides and works in California, as a condition of employment, to agree to a provision that would . . . [d]eprive the employee of the substantive protection of California law." The law primarily targets choice-of-law and choice-of-venue provisions. Nonetheless, the legislative history indicates that the new law was intended in part to limit the freedom to enter into arbitration agreements, placing it in the crosshairs of *Kindred Nursing Centers*.⁸

The decision and its focus on calling out "covert" attempts to undermine arbitration could also bode well for attacks on California state and federal court's invalidation of Private Attorney General Act (PAGA) waivers. Recently, Bloomingdale's filed a petition for certiorari in *Bloomingdale's, Inc. v. Vitolo*, No. 16-1110. The Petition for Certiorari and Litter's Amicus Brief on behalf of the National Retail Federation argue that PAGA claims are nothing more than manufactured public policy exceptions to the Federal Arbitration Act. The

3 *Kindred Nursing Centers, L.P.*, No. 16-32 at 4.

4 *Id.* at 5.

5 *Id.* at 9.

6 Specifically, the U.S. Supreme Court held that Kentucky courts must enforce the arbitration agreement executed by one of the relatives (Janis) on behalf of one of the residents (Olive), given their ruling that the underlying power of attorney was broad enough to authorize Janis to make such an agreement. The Court vacated the judgment as to the arbitration agreement executed by the other relative (Beverly) on behalf of the other resident (Joe) because the Kentucky Supreme Court had concluded that the underlying power of attorney did not grant Beverly the same authority. The court instructed the Kentucky Supreme Court to review its prior interpretation of that power of attorney, now that the "clear-statement" rule had been eliminated. *Id.* at 9-10.

7 *Id.* at 8.

8 See Scott McDonald & Jim Hart, [New California Law Prohibits Choice of Law and Venue in Employment Contracts](#), Littler Insight (Oct. 3, 2016).

Kindred decision reiterates the preeminence of the FAA and the prohibition against states interfering with enforcement of private arbitration agreements.

Although the *Kindred* decision is a strong endorsement of the FAA, it is unclear if the 7-1 majority opinion will carry over into decisions affecting enforcement of class action waivers. In the upcoming October term, the Supreme Court will address the enforceability of class action waivers in employment arbitration agreements. *Ernst & Young LLP v. Morris*, 2017 U.S. LEXIS 689 (Jan. 13, 2017) (granting certiorari and consolidating with *Lewis and Murphy Oil*).

The *Kindred* decision is similar to the Supreme Court's recent opinion in *Directv, Inc. v. Imburgia*. In that decision, in which Justice Breyer was joined by Justice Kagan and four conservative justices, the Court also stressed the preemptive power of the FAA. These decisions seem to indicate strong support for arbitration and the FAA by a majority of the Court. However, in previous decisions addressing class waivers in arbitration, the liberal-leaning justices have uniformly opposed class waivers. This strong support for arbitration may or may not translate into support of class action waivers.