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ESSAY

THE MANDATORY CORE OF SECTION 4 OF THE FEDERAL ARBITRATION ACT

David Horton[*]

INTRODUCTION

IN April 2010, the U.S. Supreme Court will hear oral arguments in *Rent-a-Center v. Jackson*,[1] a case that has profound implications for the future of American dispute resolution. The issue before the Court is not the merits of Antonio Jackson's civil rights lawsuit against his former employer, nor even the validity of the mandatory arbitration contract that he was required to sign before he could begin work. Instead, the Court must decide whether Jackson—and the hundreds of millions of other employees, consumers, and franchisees who are subject to mandatory arbitration clauses—have a non-waivable right to challenge the fairness of such provisions in federal court. Because the Federal Arbitration Act ("FAA")[2] allows courts to nullify one-sided arbitration clauses under the unconscionability doctrine, the judiciary has traditionally served as a bulwark against harsh dispute resolution terms.[3] Yet the con-

[*] Associate Professor, Loyola Law School (Los Angeles). Thanks to Corina Valderrama for outstanding research assistance.

[1] Rent-A-Center West, Inc. v. Jackson, 130 S. Ct. 1133 (Jan. 15, 2010), http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/09-497.htm.

[2] Federal Arbitration Act, 9 U.S.C. §§ 1–16 (2006).

[3] See, e.g., Aaron-Andrew P. Bruhl, The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law, 83 N.Y.U. L. Rev. 1420, 1437–39 (2008) (surveying the kinds of terms in arbitration clauses that courts have invalidated under the unconscionability doctrine).

tract at issue in *Rent-a-Center* expressly gives the arbitrator, not courts, the sole authority to decide whether "any part of this Agreement is void."[4] If the Court enforces this clause, it will quickly become boilerplate in many standard form contracts,[5] giving arbitrators the exclusive right to determine whether an arbitration clause is unconscionable, and limiting the judiciary's role to little more than rubber-stamping motions to compel arbitration.

Every court that has grappled with a similar clause, including the Ninth Circuit in *Rent-a-Center*, has assumed that parties can delegate the issue of an arbitration clause's validity to the arbitrator as long as there is "clear and unmistakable" evidence that they wanted to do so.[6] The source of the "clear and unmistakable" criterion is based on *dicta* in several Supreme Court decisions.[7] These cases begin by noting that because arbitration is, first and foremost, a matter of contract, parties enjoy the freedom to customize the process. Thus parties can agree to arbitrate arbitrability: that is, they can make a contract that entrusts the arbitrator with defining the scope or rules of arbitration. Finally, even though there is a presumption that parties want courts, not arbitrators, to resolve these issues, this presumption will yield to a strong indication to the contrary.

The Ninth Circuit majority in *Rent-a-Center* noted that the arbitration clause expressly assigns the issue of the contract's validity to the arbitrator, but held that it did not satisfy the "clear and unmistakable" rule because it was a pre-printed standard form contract.[8] As the dissent noted, however, the majority's approach transforms the bare allegation of unconscionability into a "get out of arbitration free card" for arbitrability issues, a result that seems hard to square with the FAA's strong policy in

[4] Jackson v. Rent-a-Center West, Inc., 581 F.3d 912, 914 (9th Cir. 2009).

[5] Because most large companies enjoy the power to amend their employment, consumer, and franchise contracts unilaterally, they would also be able to insert such clauses into existing contracts. See, e.g., David Horton, The Shadow Terms: Contract Procedure and Unilateral Amendments, 57 UCLA L. Rev. 605, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1467904 (describing the widespread use of unilateral modifications to revise arbitration clauses).

[6] *Jackson*, 581 F.3d at 917; see also, e.g., Awuah v. Coverall North America, Inc., 554 F.3d 7, 10 (1st Cir. 2009); Terminix Int'l Co., LP v. Palmer Ranch Ltd. P'ship, 432 F.3d 1327, 1331–32 (11th Cir. 2005); Contec Corp. v. Remote Solution Co., 398 F.3d 205, 208 (2d Cir. 2005); Apollo Computer, Inc. v. Berg, 886 F.2d 469, 473 (1st Cir. 1989).

[7] See, e.g., First Options v. Kaplan, 514 U.S. 938, 944 (1995); AT&T Technologies, Inc. v. Comm. Workers of America, 475 U.S. 643, 649 (1986); United Steelworkers v. Warrior & Gulf Nav. Co., 363 U.S. 574, 583 n.7 (1960).

[8] See *Jackson*, 581 F.3d at 917.

favor of arbitration.[9] In addition, the Supreme Court has a long track record of formalistically enforcing arbitration terms as written and rejecting challenges grounded on the adhesive nature of the contract.[10] In fact, other circuits applying the Court's precedent have found "clear and unmistakable" evidence of the parties' wish to arbitrate the validity of the arbitration clause based on nothing more than the fact that their contract incorporates the rules of the American Arbitration Association, which allow arbitrators to resolve the issue.[11] Thus, without a theory about why the "clear and unmistakable" standard does not apply, the Court seems poised to hold that companies may freely require individuals to arbitrate any claim that the arbitration clause is unconscionable.

This Essay offers precisely such a theory. It argues that parties cannot arbitrate the issue of whether the arbitration clause is unconscionable, even when there is "clear and unmistakable" evidence of their intent to do so, because courts possess the exclusive right to decide whether all or part of an arbitration clause is valid. The judiciary's monopoly on settling this matter arises from Section 4 of the FAA, which provides that if the "making of the arbitration agreement" is "in issue," the "court shall proceed summarily to the trial thereof."[12] In fact, Section 4 only allows a court to submit a case to arbitration if it is "satisfied that the making of the agreement for arbitration . . . is not in issue." This language bars parties from contracting around the judicial duty to evaluate "the making of the arbitration clause." Moreover, this reading dovetails with the FAA's legislative history, which reveals that the statute's proponents cited this layer of judicial protection to allay concerns about privatizing a customary governmental function.

[9] Id. at 920–21 (Hall, J., dissenting).

[10] See, e.g., Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 32–33 (1991) (enforcing arbitration clause in an employment contract despite acknowledging that there is "often . . . unequal bargaining power between employers and employees"); Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 484 (1989) (rejecting in one sentence the plaintiff's claim that she did not meaningfully assent to an adhesion contract); Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 230 (1987) (noting commentators' arguments that "overreaching" can be grounds for invalidating an arbitration clause in a contract between a powerful brokerage and a customer but not pursuing the issue further).

[11] See, e.g., *Awuah*, 554 F.3d at 11 (holding that a franchise contract incorporating the AAA's rules constituted "clear and unmistakable" evidence of the parties' intent to arbitrate the issue of arbitration clause was enforceability); *Contec*, 398 F.3d at 208.

[12] 9 U.S.C. § 4 (2006).

I. Section Four and the "Making" of the Arbitration Clause

Section 4 of the FAA explains what courts must do when a party moves to compel arbitration:

> The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement . . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.[13]

Thus, the statute states that a court "*shall* hear the parties" and "*shall*" hold a mini-trial "[i]f the making of the arbitration agreement" is "in issue." On the other hand, a court can submit a case to arbitration only if it is "satisfied that the making of the agreement for arbitration . . . is not in issue."

The Court has previously recognized that one component of Section 4 is mandatory. In *Dean Witter Reynolds v. Byrd*, the Court held that Section 4 required the district court to order a plaintiff's state law claims to arbitration although he also alleged non-arbitrable federal claims.[14] The Court justified forcing the parties to bifurcate the case into simultaneous judicial and arbitration proceedings by reasoning that if Section 4's prerequisites are met, it "leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration . . . ."[15] Yet if Section 4 leaves no room for discretion when its prerequisites are met, why should it leave room for discretion when its prerequisites are *not* met? Indeed, if a court *must* order claims to arbitration when the "making" of the arbitration clause is not "in issue," then it also *cannot* order claims to arbitration if the "making" of the clause *is* "in issue." As the statute says, in the latter situation, the court "*shall* proceed summarily to the trial . . . ."

The fact that this language mirrors the FAA's other mandatory sections indicates that Congress did not wish parties to be able to contract around it. Section 2, the heart of the statute, declares that arbitration clauses "*shall* be valid, irrevocable, and enforceable, save upon such

[13] Id.
[14] 470 U.S. 213, 217 (1985).
[15] Id. at 218.

grounds as exist at law or in equity for the revocation of any contract."[16] No judge would enforce a provision that purported to alter this standard by immunizing an arbitration agreement from a particular legal or equitable defense to contract formation. Similarly, Section 9 states that the court "*must* grant" a motion to confirm an arbitral award "unless the award is vacated, modified, or corrected" under "Sections 10 and 11 of this title."[17] Recently, in *Hall Street Associates v. Mattel, Inc.*, the Court held that parties could not modify this scheme by contract, reasoning that Section 9 "does not sound remotely like a provision meant to tell a court what to do just in case the parties say nothing else."[18] Likewise, Section 4's commands that "the court *shall* hear the parties" and "[i]f the making of the arbitration agreement . . . be in issue, the court *shall* proceed summarily to the trial thereof" cannot be trumped by private arrangement. Indeed, a court has no power to submit a dispute to arbitration unless it is "satisfied that the making of the agreement for arbitration . . . is not in issue."

Although the FAA's legislative history does not speak directly to the question of whether parties can contract around Section 4, it does reveal that judicial scrutiny of "the making" of the arbitration clause was a vital part of the way that arbitration proponents presented the statute to Congress. The principal thrust of the FAA is to abolish the ouster doctrine, the ancient rule that arbitration clauses improperly deprived courts of their jurisdiction. Yet as the statute's architect, Julius Henry Cohen, testified before Congress, the ouster doctrine also safeguarded weaker parties from exploitation:

> But the fundamental reason for [the ouster doctrine], when you come to dig into the history of it—the real fundamental cause was that at the time this rule was made people were not able to take care of themselves in making contracts, and the stronger men would take advantage of the weaker, and the courts had to come in and protect them. And the courts said, 'If you let the people sign away their rights, the

[16] 9 U.S.C. § 2 (2006) (emphasis added).
[17] Id. at § 9 (emphasis added).
[18] 552 U.S. 576, 587 (2008). The Court also cited Section 5 of the FAA, which instructs courts to name an arbitrator only if "no method be provided" in the contract, as evidence that when Congress intended to create a default rule, it knew how to do so. Id. (quoting 9 U.S.C. § 5).

> powerful people will come in and take away the rights of the weaker ones.' And that still is true to a certain extent.[19]

Accordingly, partially to assuage unease about arbitration and overreaching and to defuse concern about funneling litigants outside the court system, Cohen emphasized that Section 4 "requires" judges to consider the issue of whether a party had truly agreed to arbitrate:

> At the outset the party who has refused to arbitrate because he believes in good faith that his agreement does not bind him to arbitrate, or that the agreement is not applicable to the controversy, *is protected by the provision of the law which requires the court to examine into the merits of such a claim*.[20]

In addition, two staunch FAA supporters, Charles L. Bernheimer and W. H. H. Piatt, defended judicial review of "the making" of an arbitration clause against criticism that it would derail the streamlined arbitration process.[21] Neither suggested that parties could simply opt out of this arrangement.

For these reasons, Section 4 is mandatory: a party who alleges that the "making" of the arbitration clause is "in issue" has a nonwaivable right to a judicial forum.

II. THE "MAKING" OF THE ARBITRATION CLAUSE AND UNCONSCIONABILITY

Even if Section 4 is mandatory, it is not immediately clear what kind of claim implicates the "making" of the arbitration clause. Arguably, the

[19] Bills to Make Valid and Enforceable Written Provisions or Agreements for Arbitration of Disputes Arising out of Contracts, Maritime Transactions, or Commerce Among the States or Territories or with Foreign Nations: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong. 15 (1924) [hereinafter Joint Hearings].

[20] Id. at 35 (emphasis added). Four years earlier, in an article about the New York statute that served as the blueprint for the FAA, Cohen similarly contended that "if there be any dispute regarding the making of the contract . . . a trial of that issue by the court . . . is preserved." Julius Henry Cohen, The Law of Commercial Arbitration and the New York Statute, 31 Yale L.J. 147, 149 (1921).

[21] See A Bill Relating to Sales and Contracts to Sell in Interstate and Foreign Commerce; and a Bill to Make Valid and Enforceable Written Provisions or Agreements for Arbitration of Disputes Arising out of Contracts, Maritime Transactions, or Commerce Among the States or Territories or with Foreign Nations: Hearing on S. 4213 and S. 4214 Before a Subcomm. of the S. Comm. on the Judiciary, 67th Cong. 5 (1923) [hereinafter Hearing].

word "making" only refers to doctrines such as forgery or fraud in the execution, where a party alleges that she literally never agreed to arbitrate. The Report of the House Committee on the Judiciary lends support to this reading by describing the FAA as offering "a method for the summary trial of any claim that no arbitration agreement ever was made."[22] Similarly, the defendant in *Rent-a-Center* advises the Court in its brief that "this case does not involve any issue regarding the making of the agreement for arbitration [because] Jackson does not allege fraud nor . . . that he did not execute the Arbitration Agreement."[23]

But this narrow reading cannot be correct. Instead, a litigant places the "making of the agreement to arbitrate . . . in issue" simply by arguing that it is void under any defense to contract formation. Section 2 instructs judges not to enforce arbitration clauses that are susceptible to a contract defense.[24] Section 4 must be understood as implementing this directive by providing a judicial forum for claims under Section 2. Otherwise, Congress went out of its way to create a judicial forum for the exceedingly rare assertion that no arbitration clause exists and yet neglected to specify where the parties must bring the vast majority of challenges to the validity of an arbitration clause.

With the exception of the House Report—which is a scant two pages—the FAA's legislative history indicates that Section 4 is keyed to Section 2. Senator Walsh, for example, criticized Section 4 for creating a risk of delay because it authorized courts to entertain all defenses to contract formation:

> The court has got to hear and determine whether there is an agreement of arbitration, undoubtedly, and it is open to all defenses, equitable and legal, that would have existed at law, and consequently the court is obliged, it seems to me you are obliged, to go to court . . . .[25]

Likewise, Cohen described Section 4 as empowering courts to decide a wide range of issues, including not only forgery or lack of proper execution, but also whether a contract "is a valid paper or not."[26]

[22] H. Judiciary Comm., Report to Accompany H.R. 646: To Validate Certain Agreements for Arbitration, H.R. Rep. No. 68-96, at 2 (1924).

[23] Brief for the Petitioner at 25 n.9, Rent-a-Center West, Inc. v. Jackson, No. 09-497 (Feb. 25, 2010), 2010 WL 711185 (internal quotation marks omitted).

[24] See 9 U.S.C. § 2 (2006).

[25] Hearing, supra note 21, at 5.

[26] Joint Hearings, supra note 19, at 17.

In sum, to contest "the making of the agreement to arbitrate"—and thus fall within Section 4's ambit—a party need only invoke a contract defense. Thus, a claim that an arbitration clause is unconscionable in whole or in part places "the making of the agreement to arbitrate . . . in issue" and can only be heard by a court.[27]

CONCLUSION

The conventional wisdom is that parties can agree to arbitrate the enforceability of an arbitration clause if there is "clear and unmistakable" evidence of their intent to do so. Conversely, this Essay argues that Section 4 of the FAA sets forth a bright line rule: parties cannot allow an arbitrator to decide questions that place "the making of the arbitration agreement . . . in issue." In turn, Congress intended that any defense to contract formation would put "the making of the arbitration agreement . . . in issue." Thus, the Court in *Rent-a-Center* should hold that judges, not arbitrators, must decide whether all or part of an arbitration clause is unconscionable.

[27] One might object that under my reading of Section 4, even sophisticated parties have a nonwaivable right to a judicial forum for a claim that an arbitration clause is invalid. Sophisticated parties, however, can rarely claim that "the making of the agreement to arbitrate" is "in issue." Under the "separability" doctrine, only challenges to the arbitration clause itself—not the larger "container contract" in which it is embedded—fall within Section 4. See, e.g., Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 (1967). Thus, the unconscionability doctrine—one of the rare contract defenses that can target specific provisions (as opposed to the entire agreement)—serves as the basis of the overwhelming majority of challenges to an arbitration clause. Sophisticated parties generally cannot prevail on an unconscionability claim. See, e.g., David Horton, Unconscionability in the Law of Trusts, 84 Notre Dame L. Rev. 1675, 1722 n.225 (2009). Thus, my interpretation of Section 4 would likely have little practical impact on contracts among large businesses.