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Policy in Favor of Arbitration May Have Reached Its Limit

Oxford Health and *Hirsch*: Are absent class members and nonsignatories bound to arbitrate?

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Courts have long favored arbitration when addressing disputes regarding arbitrability under the Federal Arbitration Act (FAA), and require that such disputes be decided in favor of arbitration. Arbitration is a creature of contract, subject to the same challenges as all contracts, and the FAA pre-empts certain state-law public policy legislation that would prohibit arbitration of specific types of claims. The FAA's preemption of certain state laws led to the impression that arbitration is the preferred means of dispute resolution over all others. However, two recent decisions—*Oxford Health Plans v. Sutter,* decided by the U.S. Supreme Court, and *Hirsch v. Amper Financial Services*, decided by the Supreme Court of N.J.—have brought the perceived "preference" for arbitration into focus. In fact, both *Oxford* and *Hirsch* are reminders that arbitration is a creature of contract and highlight the limits of arbitrability in situations where a party may not have agreed to arbitrate a dispute.

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The Federal Arbitration Act and Case Law

The FAA was enacted in 1925 to replace some courts' hostility to arbitration agreements with a "national policy favoring it and placing it on equal footing with all other contracts." *Hall Street Associates v. Mattel*, 552 U.S. 576, 582 (2008). Section 2 of the FAA provides that a written agreement to arbitrate is "valid, irrevocable and enforceable," provided that the contract involves a maritime transaction or a transaction involving "commerce."

Although the FAA has a "savings clause" that allows for an arbitration agreement to be deemed unenforceable due to traditional contract defenses (e.g., fraud, duress or unconscionability), an arbitration agreement cannot be declared unenforceable by defenses that apply only to arbitration or that only have meaning in the context of an arbitration. In fact, the Supreme Court has held that the FAA pre-empts numerous state laws that prohibited certain types of disputes from being arbitrated. See, e.g, *Perry v. Thomas*, 482 U.S. 483 (1987); *Preston v. Ferrer*, 552 U.S. 346 (2008); *Marmet Health Care Center v. Brown*, 132 S.Ct. 1201 (2012).

These cases reinforced the "federal policy in favor of arbitral dispute resolution," which created the impression that arbitration was a preferred method of dispute resolution over all others. On numerous occasions the U.S. Supreme Court noted that the FAA "embod[ied] a national policy favoring arbitrations." *Buckeye Check Cashing v. Cardeg-na*, 546 U.S. 440, 443 (2006). Relying on this recitation of public policy, some litigants seemingly strayed from the original intent of the FAA, which was to enforce arbitration *as consented to by contracting parties*.

Attempts To Bind Non-Parties

In the past judicial term, the United States Supreme Court and the New Jersey Supreme Court each added to the jurisprudence of arbitration, and continue to define the scope and limits of arbitrability. Specifically, in *Oxford Health Plans v. Sutter*, 133 S.Ct. 2064 (2013), the court considered whether an arbitrator's determination to employ class procedures exceeded his powers under the FAA. In *Hirsch v. Amper Financial Services*, 2013 WL 4005282 (2013), the N.J. Supreme Court clarified the applicability of the doctrine of equitable estoppel under which the courts may compel a nonparty to arbitrate a dispute. Both of these decisions raise important issues regarding the limits of arbitrability of disputes involving nonparties to the arbitration agreement or the class-wide reach of arbitration.

Oxford Health involved a purported class action filed by a pediatrician alleging that Oxford had failed to make

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full and prompt payment to doctors for medical services provided to Oxford's insureds. Oxford successfully moved to compel arbitration, and the parties asked the arbitrator to determine whether their contract authorized class arbitration. Although the arbitration provision in *Oxford Health* was silent on class arbitration, the arbitrator concluded that the parties implicitly agreed to class arbitration because the agreement prohibited all claims from being instituted in court. The Supreme Court held that, because they agreed to the arbitrator's interpretation, and the arbitrator made a good-faith attempt to interpret the arbitration contract, the arbitrator's decision was not vulnerable to more thorough review under the deferential judicial review provided by §10(a) of the FAA.

In the concurring opinion, Justices Alito and Thomas raised a significant problem with the contractual interpretation by the arbitrator. Although they concurred with the holding, Justice Alito wrote that under a de novo review of the arbitrator's decision, "we would have little trouble concluding that [the arbitrator] improperly inferred an implicit agreement to authorize class-action arbitration…from the fact of the parties' agreement to arbitrate." The concurring opinion also noted that there is no evidence that the absent class members agreed to class arbitration or "submitted themselves to the arbitrator's authority in any way," and therefore "it is far from clear that they will be bound by the arbitrator's ultimate resolution" of the dispute. Furthermore, the concurring justices did not think that the distribution of opt-out notices would "cure this fundamental flaw in the class arbitration proceeding in this case." Therefore, Justices Alito and Thomas concluded that the arbitrator's final determination would be "vulnerable to collateral attack" which would allow the absent class members to "unfairly claim the benefit from a favorable judgment without subjecting themselves to the binding effect of an unfavorable one." Thus, although *Oxford Health's* holding is limited by its procedural posture, the observations of the concurring opinion raise a significant issue regarding the scope of consent of absent class members in an arbitral dispute.

In *Hirsch*, the N.J. Supreme Court also confronted an arbitrability question involving compelling a nonparty to an arbitration agreement to arbitrate under the doctrine of equitable estoppel. In *Hirsh*, the plaintiffs allegedly lost money they had invested in securities that they claimed were part of a Ponzi scheme. In the course of making these investments, the plaintiffs had dealt with an individual, who was recommended by their accounting firm, and had two separate roles: one as a financial advisor at a wealth-management firm, and the second as a salesperson for a broker-dealer handling the securities transactions at issue.

The plaintiffs bought the allegedly fraudulent securities from the latter broker-dealer on the advice received from the individual in his role as financial advisor. The purchase agreement with the broker-dealer included an arbitration clause, but the agreement the plaintiffs held with the wealth-management firm did not. As such, the plaintiffs filed a FINRA arbitration against the broker-dealer and the individual, and a lawsuit in the Law Division against the wealth-management firm and the accounting firm.

In the Law Division action, the defendants filed a third-party complaint against the broker-dealer for indemnification and contribution. In turn, the broker-dealer filed a motion to compel arbitration, arguing, among other things, that the wealth-management and accounting firms are subject to the arbitration agreement under the doctrine of equitable estoppel. The defendants joined the motion to compel, but the plaintiffs opposed the motion. The third-party defendant cited the strong presumption in favor of arbitration, while the plaintiffs focused on the fact that they did not agree to arbitrate their disputes with the defendant wealth-management and accounting firms.

The *Hirsch* court acknowledged that under New Jersey contract law the doctrine of equitable estoppel can be relied upon to compel a nonsignatory to arbitrate a dispute, provided that the nonsignatory "engaged in conduct…that induced reliance and that [they] acted or changed their position to their detriment." In *Hirsch*, the N.J. Supreme Court clarified conflicting Appellate Division decisions, holding that mere "intertwinement" of facts is not sufficient to compel a nonsignatory to arbitrate without "detrimental reliance, or at a minimum an oral agreement to submit to arbitration." Ultimately, the *Hirsch* court held that the plaintiffs were not prohibited from pursuing their claims against the wealth-management and accounting firms in state court because they lacked an express agreement to arbitrate and had not met the common-law standard for equitable estoppel.

Both *Oxford Health* and *Hirsch* illustrate the trend of attempts to compel arbitration on parties that did not agree to arbitrate or where class-wide arbitration is unclear. In *Hirsch*, the N.J. Supreme Court reined in the "intertwinement" theory of equitable estoppel, and remained faithful to the concept of arbitration as a creature of consent. Although in *Oxford Health* the question of whether absent class members in a class arbitration may be bound where the arbitration agreement is silent on class arbitration was not procedurally before the court, the concurring opinion highlighted significant issues concerning class arbitrations for absent class members whose consent is in question.

Compelling a nonsignatory to arbitrate a dispute, or compelling a party to arbitrate in a manner not expressly agreed to, calls into question the fundamental principle of enforcement of an arbitration agreement under the FAA. The FAA did not create a blanket policy favoring arbitration over lawsuits in court; rather, the FAA created a policy favoring enforcement of arbitration agreements as consented to by the parties. The courts recognize this significant difference and focus on the contract as the touchstone for arbitrability analyses. As such, these decisions are a reminder that well-crafted arbitration clauses are essential to litigating a dispute in the forum of choice. Furthermore, these cases are also reminders that the oft-cited "policy in favor of arbitration" has its limits. ■