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CONSUMER NEWS

Supreme Court Spotlight: *Lamps Plus, Inc., et al. v. Frank Varela*

*James Orescanin, News Editor**

The Supreme Court has not finished hearing cases regarding arbitration clauses and class actions. Following numerous decisions on these key consumer issues in recent Supreme Court jurisprudence,¹ the Court recently slated an additional case on class actions and mandatory arbitration clauses: *Lamps Plus, Inc. v. Varela*.² Encompassing both issues in one fell swoop, the Court in *Varela* is tasked with determining whether the Federal Arbitration Act³ (“FAA”) forecloses a state-law interpretation of an arbitration agreement which would authorize class arbitration based solely on “general language commonly used in arbitration agreements.”⁴

BACKGROUND

Before going into the facts of the case, it is necessary to consider the FAA and its role in the Court’s recent decisions. The FAA was enacted in 1925 in response to “widespread judicial

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¹ See, e.g., *Stolt-Nielsen S.A. v. AnimalFeeds International Corp*, 559 U.S. 662, 687 (2010); *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 352 (2011); *CompuCredit Corp v. Greenwood*, 565 U.S. 95, 104-05 (2012); *Marmet Health Care Center, Inc. v. Brown*, 565 U.S. 530, 543 (2012); *Nitro-Lift Technologies, LLC v. Howard*, 568 U.S. 17, 22 (2012); *American Exp. Co. v. Italian Colors Restaurant*, 570 U.S. 228, 239 (2013); *DIRECTV, Inc. v. Imburgia*, 136 S.Ct. 463, 471 (2015); *Kindred Nursing Centers Ltd. Partnership v. Clark*, 137 S.Ct. 1421, 1429 (2017); *Epic Systems Corp v. Lewis*, 138 S.Ct. 1612, 1632 (2018).

² 701 Fed.Appx. 670, 673 (9th Cir. 2017), *cert. granted*, *Lamps Plus, Inc. v. Varela*, 138 S.Ct. 1697 (2018). The case is docketed at Supreme Court Case No. 17-988.

³ 9 U.S.C. §§ 1-16 (2018).

⁴ Petition for Writ of Certiorari at i, *Lamps Plus, Inc. v. Varela*, No. 17-988 (Jan. 10, 2018).

hostility to arbitration agreements.”⁵ As interpreted by the Court, the FAA reflects both “a liberal federal policy favoring arbitration” and the “fundamental principle that arbitration is a matter of contract.”⁶ Based on this interpretation, the Court has repeatedly held that the FAA prohibits courts from invalidating mandatory arbitration agreements in consumer contracts based on state law,⁷ a finding that the arbitration provision is unconscionable under a state’s precedent,⁸ or a finding that mandatory arbitration would conflict with other Federal law.⁹

The Court’s decisions enforcing mandatory arbitration clauses under the FAA have also diminished the ability of a consumer to bring a class action lawsuit. For instance, in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, AnimalFeeds brought a class action lawsuit against Stolt-Nielsen after learning that Stolt-Nielsen was engaged in an illegal price-fixing conspiracy.¹⁰ Because the parties had a commercial agreement which included a mandatory arbitration clause, the parties agreed that the dispute must be settled by arbitration.¹¹ However, AnimalFeeds demanded that the claims be resolved through class arbitration, and sought to represent the class of all direct purchasers of services and goods from Stolt-Nielsen who were affected by the alleged price-fixing.¹² Contrary to their demand, the Court held that AnimalFeeds was not authorized to compel class arbitration because the parties’ contract was silent as to the issue of class-action arbitration.¹³ According to the Court, in deciding this issue the question was not whether class arbitration was a “procedural mode” available to present AnimalFeeds’ claims, but

⁵ *Concepcion*, 563 U.S. at 339.

⁶ *Id.*

⁷ *Id.* at 341 (“When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA”).

⁸ *Id.* at 352; see also *Marmet Health Care Center, Inc.*, 565 U.S. at 534 (reversing a state’s prohibition against pre-dispute agreements to arbitrate personal injury or wrongful death claims against nursing homes); *Kindred Nursing Centers Ltd. Partnership*, 137 S.Ct. at 1426-27; *DIRECTV, Inc.*, 136 S.Ct. at 471.

⁹ *Epic Systems Corp.*, 138 S.Ct. at 1627 (noting that the Court has rejected every effort to displace the FAA by an allegedly conflicting federal statute, including claims of conflict between the FAA and the Sherman Act, the Credit Repair Organizations Act, the Securities Exchange Act of 1934, and the Racketeer Influenced and Corrupt Organizations Act).

¹⁰ 559 U.S. at 667.

¹¹ *Id.* at 668.

¹² *Id.*

¹³ *Id.* at 687.

“whether the parties agreed to authorize class arbitration.”¹⁴

Similarly, in *American Express Co. v. Italian Colors Restaurant*, Italian Colors filed a class action lawsuit against American Express alleging violations of the Sherman Act.¹⁵ The parties had a contractual agreement which included a mandatory arbitration clause, and the agreement specifically provided that neither party had a right for any claims to be arbitrated on a class action basis.¹⁶ In spite of this provision, Italian Colors filed a class action lawsuit and argued that the contractual waiver of class action claims should be unenforceable.¹⁷ It argued that the cost of proving an individual claim under the Sherman Act would range from several hundred thousand dollars to over a million dollars, while the maximum recovery for an individual claimant would be between just twelve thousand to thirty-eight thousand dollars, and thus, upholding the agreement would “contravene the policies of the antitrust laws.”¹⁸ The Court rejected Italian Colors’ argument and held that the contractual waiver of class action claims was enforceable.¹⁹ In reaching this conclusion, the Court explained that “the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim[.]” and noted that the Sherman Act did not make any mention of class actions.²⁰ Accordingly, the alleged antitrust violations could not be resolved through class actions, as that would contravene the FAA.²¹

Under the Court’s interpretation of the FAA, many scholars argue that the once prevalent consumer class action has been all but eliminated, at detriment to consumers.²² For instance, some studies have found that the banning of consumer class actions in arbitration has resulted in consumers simply neglecting to pursue their claims, given that the claims are for relatively small

¹⁴ *Id.* (“We think that the differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties’ mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings.”).

¹⁵ 570 U.S. at 231.

¹⁶ *Id.*

¹⁷ *Id.* at 231-32.

¹⁸ *Id.* at 232-34.

¹⁹ *Id.* at 239.

²⁰ *Id.* at 234-35.

²¹ *Id.* at 239.

²² See, e.g., James Morsch, *Unconscionability Should Not Be the Sole Arbiter of Whether to Enforce Mandatory Arbitration Provisions*, 30 LOY. CONSUMER L. REV. 24 (2017); Myriam Giles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373 (2005).

amounts.²³ This is detrimental to consumers “given that the purpose of class actions is to permit low value claims to be joined to make litigation of such claims worthwhile in order to hold corporate entities accountable for small harms that can collectively provide large corporate profits.”²⁴ In addition, some argue that even when consumers bring individual claims to arbitration, the corporate entities are likely to prevail due to being “repeat players” before the arbitrators.²⁵ Finally, commentators argue that barriers to class action lawsuits are detrimental to several public goals due to class actions’ unique ability to “fight racial discrimination, achieve equality in the workplace, and tackle consumer fraud.”²⁶

LAMPS PLUS, INC. V. VARELA

With the above background in mind, the importance of the present case can be readily seen. The facts of the case are not in dispute. The Respondent, Frank Varela (“Varela”), is an employee of the Petitioner, Lamps Plus, Inc. (“Lamps Plus”).²⁷ In March of 2016, a Lamps Plus employee inadvertently allowed a criminal to gain access to copies of W-2 income and tax withholding statements of approximately 1,300 of its employees, including Varela.²⁸ As a result, a fraudulent federal tax return was filed in Varela’s name.²⁹ Upon learning this, Varela filed suit in federal court in California, asserting federal and state law claims on behalf of a class of current and former employees of Lamps Plus, and others injured by the exposure of this information.³⁰ However, because Varela’s employment agreement contained a mandatory arbitration provision, Lamps Plus moved to compel arbitration and dismiss Varela’s claims.³¹

The District Court rejected Varela’s arguments against arbitration, finding that the dispute was within the employment agreement’s scope, and that there was nothing substantively

²³ Margaret Moses, *How the Supreme Court’s Misconstruction of the FAA Has Affected Consumers*, 30 LOY. CONSUMER L. REV. 1, 18 (2017).

²⁴ *Id.*

²⁵ Terry F. Moritz, *Can Consumers’ Rights Effectively Be Vindicated in the Post-AT&T Mobility World?*, 30 LOY. CONSUMER L. REV. 32, 42-43 (2017).

²⁶ Giles, *supra* note 22, at 430.

²⁷ Brief of Respondent at 2, *Lamps Plus, Inc. v. Varela*, No. 17-988 (Mar. 14, 2018).

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at 3.

³¹ *Id.*

unconscionable about the agreement.³² Thus, Varela was required to go to arbitration. However, the court found that the agreement also authorized class arbitration, despite no specific provision stating such.³³ The court recognized that under *Stolt-Nielsen*, a party may not be compelled to participate in class arbitration unless there was a contractual basis for concluding that it agreed to do so.³⁴ However, the court found that the language of the agreement was ambiguous as to whether it allowed arbitration of class claims.³⁵ Construing the agreement against the drafter, Lamps Plus, applying California state law, the court concluded that there was a contractual basis for class arbitration and granted Lamps Plus's motion to compel arbitration, without limiting the order to Varela's individual claim.³⁶

Lamps Plus appealed to the Ninth Circuit, who affirmed the district court's decision authorizing Varela's claims to be brought in class arbitration.³⁷ The court noted that the parties agreed that the employment agreement included no express mention of class proceedings, but found that this was not the type of "silence" contemplated in *Stolt-Nielsen*.³⁸ Looking to the language of the employment agreement which stated that "arbitration shall be in lieu of any and all lawsuits or other civil legal proceedings relating to my employment", the court found that class proceedings was included within the definition of a lawsuit or legal proceeding. The court further reasoned, "[t]hat arbitration will be 'in lieu of' a set of actions that includes class actions can be reasonably read to allow for class arbitration."³⁹ Finally, the court explained that a class action is a "procedural device for resolving the claims" rather than being a distinct claim.⁴⁰ Thus, because Varela surrendered his right to bring all lawsuits, civil actions, or proceedings, but was allowed to bring claims to be submitted to an arbitrator who could "award any remedy allowed by applicable law", the court concluded that those remedies included class-wide relief.⁴¹

³² *Id.* at 3-4.

³³ *Id.* at 4.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Varela*, 701 Fed.Appx. at 673.

³⁸ *Id.* at 672.

³⁹ *Id.*

⁴⁰ *Id.* at 673.

⁴¹ *Id.*

SUPREME COURT PROCEEDINGS

Lamps Plus filed a writ of certiorari to the United States Supreme Court, arguing that the Ninth Circuit's ruling was contrary to the Court's longstanding precedent, including *Stolt-Nielsen*.⁴² Lamps Plus argues that the Ninth Circuit "simply disregarded numerous terms in the parties' arbitration agreement that plainly contemplate bilateral arbitration" and that the court "purported to divine contractual consent to class arbitration from language found in virtually any standard arbitration clause."⁴³ Lamps Plus also argues that the Ninth Circuit's decision consisted of state-law "interpretive acrobatics" to support its own policy preference for class actions, which the Court has long rejected as being incompatible with the FAA.⁴⁴ In short, Lamps Plus's argument is that this decision contravenes the Court's clear holdings regarding the FAA, and that allowing this ruling would "empower courts and arbitrators to impose class procedures on unconsenting parties and create substantial practical problems."⁴⁵

Varela, on the other hand, first argues that the Court has no jurisdiction to hear Lamps Plus's appeal.⁴⁶ He argues that the district court's decision had two parts, and neither of those parts were appealable under federal law.⁴⁷ As to the merits of the case, Varela argues that the application of California contract law principles to determine the agreement was proper, as "the FAA does not displace generally applicable state contract-law rules."⁴⁸ He argues that under California contract law, the ambiguous language of the employment agreement should be construed against the drafter, and that "whether the lower courts correctly applied these [state law principles] is a question of state law ill-suited to resolution by this Court."⁴⁹

The case was recently argued on October 29, 2018, and the Court's ruling is impending. The impact of this ruling may affect

⁴² Petition for writ of certiorari at 3, *Lamps Plus, Inc. v. Varela*, No. 17-988 (Jan. 10, 2018).

⁴³ *Id.* at 4

⁴⁴ *Id.*

⁴⁵ *Id.* at 23.

⁴⁶ Brief of Brief of Respondent at 6, *Lamps Plus, Inc. v. Varela*, No. 17-988 (Mar. 14, 2018).

⁴⁷ *Id.* Interestingly, Varela seeks to use the FAA as a shield, given that the FAA expressly prohibits appeal of orders directing arbitration. See 9 U.S.C. § 16(b)(2).

⁴⁸ Brief of Brief of Respondent at 6, *Lamps Plus, Inc. v. Varela*, No. 17-988 (Mar. 14, 2018).

⁴⁹ *Id.* at 7.

consumers for years to come. If the Court were to rule in favor of Varela, it would allow other courts to use state law to potentially find ambiguities in arbitration agreements which manifest into “consent” to class arbitration. This, in turn, could reinvigorate the consumer class action lawsuit, at least until such time as these arbitration agreements are modernized to specifically exclude class arbitration. On the other hand, given the Court’s consistent, broad interpretation of the FAA, it is likely that the Court will find in favor of Lamps Plus, and hold that the contract must clearly show assent to class arbitration before such arbitration can be imposed on a party.