THE
NATIONAL LAW REVIEW

Supreme Court Update: Lamps Plus, Inc. v. Varela (No. 17-988), Thacker v. Tennessee Valley Authority (No. 17-1201), and Emulex Corp. v. Varjabaedian (No. 17-459)

Sunday, May 5, 2019

Greetings, Court Fans!

Last week, The Nine heard the final arguments of the term, so we're officially in the home stretch. We've got two decisions and a few orders to report to you today.

On to opinions. One theme that will likely be explored in any term-in-review presentation is the Supreme Court's infatuation with arbitration. The most recent example came in last week's decision in ***Lamps Plus, Inc. v. Varela (No. 17-988)***, where the Court held that parties can be compelled to participate in class arbitration only when their arbitration agreement clearly allows it. But unlike the term's earlier arbitration decisions, this one provoked a several dissents from the Court's more liberal justices, who argued that the interpretation of ambiguous arbitration agreements should be left to state law.

Article By David Roth
Tadhg A.J. DooleyWiggin and Dana LLP
Supreme Court Updates

Litigation / Trial Practice
ADR / Arbitration / Mediation
All Federal

Lamps Plus was tricked by a hacker into revealing the tax information of many of its employees. One of them, Frank Varela, sued Lamps Plus after a fraudulent tax return was filed in his name based on the data breach. Like most Lamps Plus employees, he had signed an arbitration agreement. Lamps Plus moved to compel arbitration of his claims under the FAA, and the California district court where his claim had been filed granted its motion. But the district court compelled Lamps Plus to arbitrate Varela's claims on a *class-wide*, rather than an individual, basis. Lamps Plus appealed the class-component of the district court's order, but the Ninth Circuit affirmed. It concluded that the arbitration agreement was ambiguous as to whether Lamps Plus had agreed to class arbitration, and under familiar rules of California contract law, ambiguous contracts are generally interpreted against the drafter of the employment agreement, Lamps Plus.

The Supreme Court reversed, by an opinion of the Chief, joined by Justices Thomas, Alito, Gorsuch, and Kavanaugh. The majority assumed the Ninth Circuit was right that, under California contract law, this arbitration agreement was ambiguous as to whether it allowed class-wide arbitration. The question, then, was whether an ambiguous agreement provides the necessary contractual basis to compel class arbitration under the FAA. According to the majority, that question had already been answered. The Court's prior decisions, chief among them 2010's *Stolt-Nielsen v. Animalfeeds International*, have recognized that class arbitration is fundamentally different from individual arbitration for FAA purposes. Because of those fundamental differences, *Stolt-Nielsen* held that parties could be compelled to resolve disputes through class arbitration only if they had mutually consented to do so; silence as to class arbitration is not enough. And if silence as to class-wide arbitration is not enough to compel parties to engage in it, then ambiguity isn't either.

What of the Ninth Circuit's application of *contra proferentem*, the rule that ambiguities in a contract should be resolved against the drafter? According to the Chief, that is a rule of public policy, based on considerations of fairness and the public interest. It is not a rule of contract interpretation used to determine what the parties actually intended in an agreement. Because *contra proferentem* is a rule of state public policy that impedes

arbitration, it is preempted by the FAA's rule that class arbitration can only be compelled when the parties manifested their consent to it. (Justice Thomas briefly concurred, stating that while the majority's decision correctly applied the Court's precedents, he had some doubts about the preemption precedents the Court relied on.)

Each of the Court's four more liberal justices penned separate dissents. Justice Ginsburg, joined by Breyer and Sotomayor, criticized the Court's general FAA case law. Nominally, this case law is based on the principle that arbitration is a matter of consent, not coercion. But the Court's cases, taken together, have allowed companies to compel consumers and employees to settle their claims through arbitration under contracts of adhesion where consumers and employees have no real choice in the matter. Justice Breyer, writing alone, questioned whether the Ninth Circuit had appellate jurisdiction over Lamps Plus's appeal, since the company was appealing an order that came out in its favor (at least in large part). Justice Sotomayor also wrote a solo dissent, criticizing *Stolt-Nielsen*'s rule that class arbitration is fundamentally different from bilateral arbitration.

The lead dissent, however, was penned by Justice Kagan, and joined by Ginsburg, Breyer, and (mostly) Sotomayor. Justice Kagan began with the principle that while the FAA provides a basis for federal courts to enforce arbitration agreements, it did *not* federalize basic contract law. Thus state law generally governs questions about whether (and how) the parties have agreed to arbitrate their claims. Turning to the terms of Varela's employment contract with Lamps Plus, she viewed the contract as more consistent with the interpretation that the parties *did* consent to class-wide arbitration of claims that were suitable to class treatment. But even if the agreement were ambiguous, as the Ninth Circuit thought, then the standard default rule of California contract law should kick in: ambiguous contracts should be construed against their drafters. True, Justice Kagan noted, the Court has held that state rules of contract law can be preempted by the FAA, but that is only when the rule in question *discriminates* against arbitration agreements. Thus, a state rule of contract law that treats arbitration contracts different from other contracts is preempted. But nothing about the rule of *contra proferentem* violates this "equal-treatment principle" of the FAA; the same rule applies to contracts of every type, whether they involve arbitration or something else.

But what about *Stolt-Nielsen*? Agreeing with the Ninth Circuit's decision below, Justice Kagan noted that in *Stolt-Nielsen*, the parties had *stipulated* "that they had not reached any agreement on the issue of class arbitration." An arbitration panel then compelled the parties in that case to participate in class arbitration, based not on some rule of contract interpretation, but on the panel's "own conception of sound policy." That, *Stolt-Nielsen* held, was not enough. But nothing in *Stolt-Nielsen* prevented courts from using ordinary state-law rules of contract interpretation of fill gaps where the parties' agreement did not specify whether they had resolved to settle their claims through class arbitration. Justice Kagan then turned *Stolt-Nielsen* against the majority: The basic problem with the arbitration panel's actions in *Stolt-Nielsen* was that it had compelled class arbitration based on its own policy judgment that class arbitration was a better procedure and not based on what the parties had agreed or intended. That, the dissenters argued, was more or less what the majority had done here by sparing Lamps Plus from participating in class arbitration based in part on the majority's view that class arbitration was a less efficient process, one fundamentally different from bilateral arbitration and requiring clear consent .

Unlike *Lamps Plus* and the term's other FAA decisions, ***Thacker v. Tennessee Valley Authority (No. 17-1201)*** is unlikely to occupy much time in any OT18 term-in-review presentation. But as we always say, a decision's a decision, no matter how small. And this one may in fact have some broader repercussions for the application of immunity doctrines to federal agencies.

Congress created the TVA in 1933 to supply electric power to millions of Americans (and to provide jobs in a region hard hit by the Great Depression). In the Act creating it, Congress stated that the TVA "[m]ay sue and be sued in its corporate name." As the Court has previously recognized, that type of sue-and-be-sued provision operates as a waiver of sovereign immunity, to one degree or another. Not long after creating the TVA, Congress enacted the Federal Tort Claims Act of 1946 (FTCA), which expressly waives sovereign immunity from tort suits involving federal agencies across the Government. The FTCA contains an exception for claims based on a federal employee's performance of a "discretionary function." The question in *Thacker*, is whether that exception, or something like it, should also be read into the TVA Act.

The TVA Act's sue-and-be-sued clause itself contains no discretionary-function exception and the FTCA expressly states that the TVA is excluded from its provisions (including the exception). "So how is this a case?," you might ask. Well, in *Federal Housing Administration v. Burr* (1940), the Court recognized that a sue-and-be-sued clause might be read to contain "implied exceptions," particularly where a particular suit "is not consistent with the statutory or constitutional scheme," or where the exception is "necessary to avoid grave interference with the performance of a government function." The Government argued that both these factors warranted an implicit discretionary-function exception to the TVA's waiver of sovereign immunity. Permitting suits involving discretionary functions, the Government argued, would offend separation of powers and pose a grave interference with a government function.

Writing for a unanimous Court, Justice Kagan "balk[ed] at using *Burr* to provide a government entity excluded from the FTCA with a replica of that statute's discretionary function exception." Congress made an explicit decision *not* to apply the FTCA to the TVA, so it would be improper to suggest that it *implicitly* intended the TVA to benefit from the same exception contained in the FTCA. The Court refused to "let the FTCA in through the back door, when Congress has locked the front one." In any case, she went on, permitting suits against the TVA even where discretionary functions are concerned does not offend the separation of powers. It is unquestioned that Congress has the power to waive a federal agencies immunity; doing so hardly raises separation-of-powers problems: "The right governmental actor (Congress) is making a decision within its bailiwick (to waive immunity) that authorizes an appropriate body (a court) to render a legal judgment." Justice Kagan also didn't buy the argument that allowing suits against the TVA based on discretionary conduct would *always* gravely interfere with government functions, in particular because the discretionary acts of the TVA are primarily commercial, not governmental, in nature. The Court remanded the case for the lower courts to determine whether the particular conduct complained of in this case was governmental or commercial in nature. If it was a governmental function, and if permitting suit actually would gravely interfere with the performance of that function, then an exception to the waiver of immunity could be implied. But if it was simply acting like any other electric company, then it can continue to "be sued."

That's all for opinions this week. However, the Court did dispose of one other case. In ***Emulex Corp. v. Varjabaedian (No. 17-459)***, the Court dismissed the writ of certiorari as improvidently granted. This leaves in place a Ninth Circuit decision holding that Section 14(e) of the Securities Exchange Act of 1934 supports an inferred private right of action based on negligent misstatements or omissions made in connection with a tender offer. The Court had granted cert to resolve a circuit split on that issue, but at oral argument a number of them suggested that Emulex had failed to raise its arguments in the lower courts.