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Ninth Circuit Slams the Door on Free Rider Attacks on Arbitration Agreements

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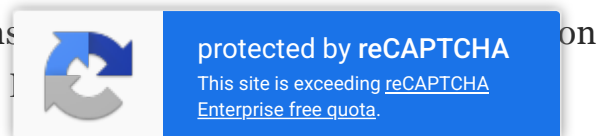


A party sues your company over a contractual dispute. The contract is one you use with other similar counterparties. The contract contains an arbitration clause requiring that any disputes be resolved in arbitration. Your company moves to compel arbitration, but the opposing party challenges the clause's validity. The clause also provides that an arbitrator, not a court, must decide that very validity question. The arbitrator ultimately concludes that the arbitration agreement is unenforceable. Can other contracting parties now act as "free riders" and invoke that ruling to argue that their arbitration agreements with your company are likewise invalid? According to the U.S. Court of Appeals for the Ninth Circuit's recent decision in *O'Dell v. Aya Healthcare Services, Inc.*, the answer is no.

Background

The defendant, Aya Healthcare, employed traveling nurses and matched them with hospitals. Aya Healthcare required its employees to sign arbitration agreements containing delegation clauses, which give arbitrators, not courts, the authority to decide whether the arbitration agreements themselves were materially the same for all Aya

Four former employees challenged the validity of their agreements in separate



arbitrations. Two arbitrators upheld the arbitration agreements, but two others found them unconscionable and thus invalid. When more than 250 additional employees later opted into the lawsuit, the federal trial court declined to compel arbitration of their claims. Instead, it relied solely on the two unfavorable arbitral rulings to conclude that Aya Healthcare was barred from enforcing any of the over 250 additional arbitration agreements at all. The trial court relied on a doctrine called “non-mutual offensive collateral estoppel,” which allows a new claimant who was not a party to an earlier proceeding to avoid litigating an issue by relying on a prior ruling against the same respondent. In other words, the trial court decided that because two arbitrators had already determined the arbitration agreements were invalid, that automatically meant that the arbitration agreements for the over 250 additional employees were also invalid.

The Ninth Circuit’s Holding

The Ninth Circuit Court of Appeals rejected that approach as incompatible with the Federal Arbitration Act (“FAA”). Although Section 2 of the FAA recognizes certain contract defenses to the enforceability of arbitration agreements, collateral estoppel is not a contract defense. The court also emphasized that “[a] hallmark of the FAA is the enforcement of arbitration agreements and the resolution of disputes in individualized, one-on-one proceedings. Doing away with such bilateral proceedings between mutually consenting parties, because *other* arbitrators in *other* proceedings involving *other* parties have already decided the issue, is anathema to the FAA.” Moreover, the court noted, the FAA “requires courts to enforce arbitration agreements as written,” and the arbitration agreements at issue required “individualized arbitration.” The court explained that allowing one arbitration to dictate outcomes for nonparties strips arbitration of its consensual nature and undermines the authority that the parties specifically granted to arbitrators through delegation clauses. And by letting a handful of arbitrations bind hundreds of non-parties, the district court’s ruling imposed a collective process that no party had ever agreed to – and did so without the procedural safeguards of a class action.

Practical Impact

The decision makes clear that early wins in other arbitrations cannot be leveraged to invalidate arbitration agreements involving nonparties. The decision also suggests that companies would be well-advised to specify in their arbitration agreements that individualized arbitration of disputes is required.

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