Arbitration developments that could affect UK investment in the US

Thomas Dubbs
Senior Partner
Labaton Sucharow

Mandatory arbitration is a subject of increasing controversy on both sides of the Atlantic. While provisions imposing mandatory arbitration are an effective device for corporations to avoid private litigation in civil courts, the practice also substantially diminishes shareholders' ability to seek redress for fraud and other misconduct. Indeed, recent decisions by the United States Supreme Court encouraging mandatory arbitration may ultimately undermine the appetite of both British and US investors for certain American securities.

Mandatory arbitration provisions require that disputes between parties be heard before a private panel rather than by a court. Arbitrators can set their own procedures, consider matters that courts would deem irrelevant, and render rulings with little or no explanation. Generally, the laws of evidence do not apply.

Another important implication of mandatory arbitration requirements is that they often effectively preclude class-style actions or other forms of collective redress such as the UK Group Litigation Order procedure. While some arbitration clauses will explicitly seek to bar parties from pursuing collective claims, the arbitration system itself is generally not amenable to such claims, making the forum itself a functional bar to collective organisation. Consequently, corporations can use arbitration clauses to escape liability for legitimate claims of misconduct that are not individually economical to pursue.

In the US, legislative support for arbitration is set out in the Federal Arbitration Act ("FAA," 9 U.S.C. § 1 *et seq.*), enacted in 1925, which provides that where parties to a contract have agreed to arbitrate disputes, they must observe that decision rather than resorting to the court system. The scope and power of these clauses has been the subject of intense litigation, in part because of arbitration's ability to preclude collective action.

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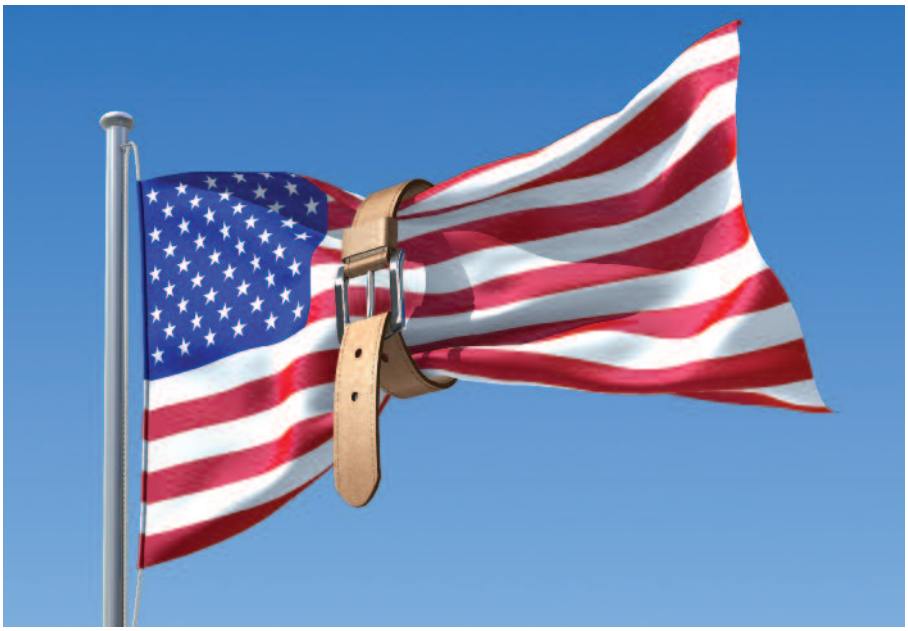

Because of this concern, efforts to use mandatory arbitration to preclude class action or other collective redress litigation pursuant to federal securities laws have not been embraced by regulatory bodies such as the US Securities and Exchange Commission ("SEC"). For example, in the well-publicised run-up to its initial public offering, private equity firm Carlyle Group sought to include in its offering documents one of the most restrictive terms regarding investor litigation. The SEC, while not issuing a final determination on this term, informed Carlyle Group that the review of company's registration statement could not proceed on an accelerated basis, effectively putting Carlyle Group's IPO on hold. Less than one month later, Carlyle Group withdrew the arbitration provision.

The US Supreme Court, on the other hand, has been much more receptive to such provisions. In *AT&T Mobility LLC v. Concepcion* (563 U.S. —, 131 S. Ct. 1740 (2011)) the Supreme Court reviewed the extent to which the FAA controlled these issues. Plaintiffs had brought a class action in federal court against their cellular telephone service provider alleging deceptive advertising pursuant to California state law.

The Supreme Court ruled that the FAA displaced California law ruling and the nonnegotiable cellular telephone contract term requiring arbitration precluding collective redress was enforceable. In *American Express Co. v. Italian Colors Restaurant* (570 U. S. —, 133 S. Ct. 2304 (2013)), the Supreme Court broadened this rule scope of the FAA further, allowing it to supplant federal law. Plaintiff was a restaurant that, in its service agreement with American Express, had agreed to resolve disputes by arbitration and that there would be "no right or authority for any Claims to be arbitrated on a class action basis."

The Supreme Court ruled that the FAA "reflects the overarching principle that arbitration is a matter of contract" and that the Court is therefore required to "rigorously enforce arbitration agreements according to their terms." This ruling is notable because the right of action created by Congress in the federal antitrust statutes was clearly intended to provide an incentive for private parties to enforce these laws.

It may be mistaken to read decisions like *AT&T Mobility and Italian Colors* as supporting all efforts to impose mandatory arbitration, however. Both cases turned on the effect of contractual provisions imposing mandatory arbitration. When such clauses are instead incorporated into company bylaws, for example, courts may conclude that state corporate law, not contract law, dictates the result. Such issues will likely be much litigated in the coming years.

The fierce US battles over mandatory arbitration may have consequences for investors in Britain as well. Often, investors in the UK have limited recourse for corporate fraud outside of the context of a securities offering, and have relied on American courts when claims can be brought here. They will need to closely watch legal developments in mandatory arbitration to determine whether US courts will remain open to them.