High Court Rejects State Exception to Federal Arbitration Act

Hon. Stephanie H. Klein (Ret.)

On May 15, 2017, the Supreme Court re-affirmed the Federal Arbitration Act (FAA), 9 U.S.C. section 2, as the law of the land and sharply turned back the Kentucky Supreme Court's ("court") attempt to fashion a state exception to it. *Kindred Nursing Centers L.P.* vs. *Janis Clark et al,* No 16-32 (May 15, 2017)

The decision arises out of two cases against Kindred Nursing Centers L.P. which operates nursing homes and rehabilitation centers. Janis Clark, daughter of decedent Olive Clark, and Beverly Wellner, wife of decedent Joe Wellner, sued Kindred in Kentucky state court, claiming their loved ones' deaths were due to substandard care.

However, when Kindred admitted Olive Clark and Joe Wellner, Janis and Beverly signed the necessary paperwork on their behalf. The paperwork in both contracts provided that all controversies or claims arising out of their stay would be resolved through "binding arbitration." Slip opinion at 2.

Both Olive Clark and Beverly Wellner held their decedent's powers of attorney but the language differed. The Wellner power of attorney gave Beverly expansive authority to take care of his estate, including filing legal proceedings and making contracts of "every nature in relation to both real and personal property." Id. In contrast, the Clark power of attorney gave Olive " full power… to transact, handle and dispose of all matters affecting

me and/or my estate in any possible way," including the right to "draw, sign and make" …contracts… Id.

Citing the arbitration clause in the nursing home admission contract, Kindred moved to dismiss the cases. The trial court, however, allowed the cases to proceed and the Kentucky Supreme Court agreed. *Extendicare Homes,, Inc.* v. *Whisman,* 476 S.W. 3rd 306 (2015).

The Kentucky Supreme Court analyzed these two cases differently, based on the different language in the powers of attorney. It found that the Wellner document failed to permit Beverly to enter into an arbitration agreement. Neither the provision permitting her to bring legal proceedings nor the provision permitting her to make contracts relating to real and personal property granted her that power, the court held. Id. at 3.

On the other hand, the Clark document was a different story. Since Janis had the authority to "dispose of all matters" affected her mother, entering into an arbitration agreement appears to be included. Id.

Yet the Kentucky Supreme Court found both agreements invalid because neither agreement gave a specific authorization to enter into an arbitration agreement. Since waiving access to the courts and trial by jury are guaranteed by the Kentucky Constitution, an agent could waive those rights only with a specific grant of the that authority - " a clear statement." Consistent with the FAA, the court held, the "clear statement rule" applies also to other contracts that implicate "fundamental constitutional rights." Id. at 3-4, citing 478 S.W. 3d 328.

Justice Kagan and the majority vigorously disagreed. They analyzed the FAA that states that arbitration agreements are "valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for any revocation of any contract. " 9 U.S.C. section 2, Id. at 4.

The net effect, the majority states, is that FAA establishes the principle of equality for arbitration contracts. Arbitration contracts may be declared invalid based on generally accepted defenses like "fraud or unconscionability " but "not on legal rules that 'apply only to arbitration or that derive their meaning from the fact that an agreement to arbitration is at issue, ' " Id., quoting *AT& T Mobility LLC* v. *Concepcion*, 563 U.S. 333, 339 , 131 S. Ct. 1740 (2011). See also *DIRECTTV Inc*. v. *Imburgia*, 577 U.S. _____, 136 S.Ct. 463 (2015),

Here the Kentucky Supreme Court adopted a rule that disfavored arbitration contracts compared to other contracts. In the guise of proclaiming that a power of attorney

must specifically reference the right to waive access to the courts, the court adopted a rule that clearly is meant only for arbitration contracts. In so doing, the Kentucky Supreme Court's ruling clearly runs afoul of *Concepcion* and the FAA by discriminating against arbitration contracts.

Janis and Beverly then advanced another argument based on contract formation. The "clear statement rule," they argued, affects only contract formation because it bars agents from entering into arbitration contracts without specific authorization. They claimed that the FAA does not govern contract formation and therefore it is not applicable. Accordingly, states have full authority to decide whether these contracts are valid *ab initio*.

The Court again disposed of this argument, viewing it as a ruse to get around the FAA's guiding principle that arbitration agreements must be viewed as "valid, irrevocable and enforceable." 9 U.S.C. section. 2. Its terms make it clear that the FAA deals not only with enforcement of arbitration agreements, but also their formation.

It cited *Concepcion,* supra*,* in drawing this conclusion. In *Concepcion,* the Court held that the defense of duress could not be used in a way that "disfavors arbitration. " Id. at 8, quoting *Concepcion,* 563 U.S. at 341. But the doctrine of duress involves the contract formation stage. *Concepcion* would make no sense unless the FAA also included contract formation.

In its conclusion, the Court found that the Kentucky Supreme Court "specifically impeded the ability of attorneys-in-fact to enter into arbitration agreements… thus flout[ing] the FAA's command to place those agreements on an equal footing with all other contracts." Id. at 9.

It vacated the Kentucky Supreme Court's decision with respect to Clark as the Kentucky Supreme Court specifically held that the Clark power of attorney was sufficiently broad to include signing an arbitration agreement. Accordingly its invalidation of the agreement was based solely on the "clear statement rule," which the Court had just struck down.

However, the Court remanded the Wellner case. The Kentucky Supreme Court found that the Wellner power of attorney did not give Beverly the power to sign an arbitration agreement. The Court stated that if that finding is independent of the "clear statement rule," then its decision would stand. However, if that ruling was based in whole or in part on the "clear statement rule," then the state court must review its decision in light of the Court's decision.

This decision comes on the heels of the injunction issued against the Center for Medicare and Medicaid Services' (CMS) rule banning use of arbitration clauses in nursing home contracts. *American Health Care Association* v. *Burwell*, Civil Action No. 3:16- CV-00233 (N.D. Miss. 11-7-16). The District Court found that hat *DIRECTTV Inc.*, supra, *Concepcion,* supra and the FAA would most likely mandate a finding that these rules are invalid.

Similarly, in May 2016 the Consumer Financial Protection Bureau (CFPB) proposed rules that would prohibit certain industries from including mandatory arbitration clauses in their contracts that preclude class actions. The CFPB rulemaking would also require that these industries submit certain arbitral records that the CFPB would study to determine whether further consumer protection measures were necessary. .81 FR 32829 (May 24, 2016), https://www.federalregister.gov/documents/2016/05/24/2016-10961/arbitration-agreements. With the change in administration in January 2017, it is unclear whether these rules will be finalized in their current state.

Both CFPB and CMS rulemaking reflect criticisms of mandatory arbitration clauses in consumer contracts. The Kentucky Supreme Court's attempt to create a "clear statement rule" and find an exception to the clear jurisprudence of the Supreme Court on the validity of arbitration clauses and the FAA appears to reflect that same viewpoint. The Supreme Court's repudiation of the Kentucky Supreme Court 's reasoning seems to put any further state court attempts to carve out an exception to the FAA to rest.

Kendrick will stifle further attempts to limit mandatory arbitration clauses in consumer contracts. Absent federal legislation amending the FAA, *Kendrick* sends a clear signal that such attempts will face an uphill battle if challenged in court. •

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