US Supreme Court Resolves "Controversy"

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Reprinted from
(2009) 75 *Arbitration* 462-464

Sweet & Maxwell
100 Avenue Road
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London
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(Law Publishers)

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1. INTRODUCTION

The United States, which famously litigates everything from hot coffee spills to election outcomes, now has a legal opinion adjudicating the meaning of "controversy". In *Vaden v Discover Bank*,[1] the Supreme Court examined the provision in s.4 of the Federal Arbitration Act (FAA).[2] The Court held 5:4 that, in determining federal jurisdiction to hear an arbitration petition, the term "controversy" refers to the entire dispute between the parties, not just the subset of issues potentially subject to arbitration.

Section 4 allows a party who seeks arbitration pursuant to a written agreement to petition a federal district court (trial court) for an order compelling arbitration. Consistent with policies favouring arbitration, it allows a party to file a petition related to a pending action (as occurred in this case), or with reference to matters not yet subject to court action. To consider the petition, however, the court must have an independent basis for federal jurisdiction as to the subject matter of the controversy. Section 4 specifies that the proponent of arbitration may petition for an order compelling arbitration in:

> "[A]ny United States district court which, save for [the arbitration] agreement, would have *jurisdiction* under title 28, in a civil action or in admiralty of the subject matter of a suit *arising out* of the *controversy between the parties*."

Vaden provides new guidance as to what constitutes the "controversy between the parties" under s.4 for the purpose of determining whether the federal court has the necessary jurisdiction to examine the petition. Notwithstanding the importance of arbitration, and the fact that the process sometimes relaxes the rules of procedure, the majority of the Court refused to carve out an exception to establish federal jurisdiction based on complete federal preemption of a counterclaim.

2. A DUCK-BILLED PLATYPUS OF A CASE, OR A BRIEF DESCRIPTION OF THE CLAIMS AND LOWER COURT PROCEEDINGS

The awkward procedural posture of the case contributed to its interest as a subject of appeal. The dispute before the Supreme Court involved several unusual features: the party petitioning for arbitration, Discover Bank, was the party that commenced the litigation by filing its claim in the state court; and the petition sought to arbitrate only some of the issues in dispute between the parties.

Originally, Discover Bank filed a "garden variety" breach of contract action in a Maryland state court against Vaden, its credit cardholder, to recover an unpaid balance and related fees of approximately US $10,000. Because of the subject matter and amount in dispute, the original suit could not have been filed in a federal court. Vaden filed an answer, asserting usury as an affirmative defence, and counterclaims to certify a class action under Maryland state credit laws. Presented with a potential class action challenge to its business practices, pursuant to s.4 Discover Bank petitioned the federal district court

[1] *Vaden v Discover Bank* 129 S.Ct. 1262 (March 9, 2009).
[2] Federal Arbitration Act (FAA) 9 U.S.C. s.4.

for an order compelling arbitration of Vaden's counterclaims, which were potentially of greater consequence to Discover Bank than the subject of the original lawsuit. Although the counterclaims were framed under state law, Discover Bank successfully urged that they were completely preempted by a federal statute that prescribes the interest rate which state-chartered, federally insured banks like Discover Bank may charge. Because federal preemption required dismissal of her state law counterclaims, Vaden could only proceed if her counterclaims were understood to allege an equivalent violation of the applicable federal law. Indeed, without a cognisable federal claim, it would serve no purpose for Discover Bank to compel arbitration. The Bank's petition did not seek to arbitrate its original state law debt collection claims.

As a practical matter, therefore, the controversy subject to the Bank's arbitration petition involved a putative class action lawsuit by Vaden alleging that the finance charges, interest and late fees Discover Bank charged its cardholders violated federal law.[3] Strictly speaking, however, the dispute consisted of state law counterclaims appended to a relatively minor state law debt collection suit. Only the fact that federal law completely preempted the state law counterclaims allowed Discover Bank to invoke the jurisdiction of the federal court to consider its petition to compel arbitration. As discussed in more detail below, the majority and dissent of the Supreme Court could not agree as to which of these two descriptions—the claim in substance or the claim in actual form—better described the "controversy" Discover Bank petitioned to arbitrate.

3. DEFENESTRATION OF THE "OUSTER" EXPLANATION

In its first order of business, however, the court needed to address the reference in the Act to "save for [the arbitration] agreement". In trying to apply s.4, lower courts immediately stumble over this archaic phrase. In determining federal jurisdiction "save for" the agreement, should the district court disregard the arbitration agreement (the "look through" approach), or merely the historic judicial hostility to arbitration agreements, which were believed to oust the jurisdiction of the court (the so-called "ouster explanation")? In other words, does "save for" direct the court to look past the arbitration agreement, or to look no further?

The majority of lower courts to consider the issue, adhering to the ouster explanation, deemed the relevant "controversy" as the parties' dispute over the arbitrability of their claims. This narrow consideration to determine federal jurisdiction, restricted to whether the claims are arbitrable under the agreement, corresponds to the district court's limited role under s.4 in deciding whether to grant specific performance of the agreement to arbitrate. Yet, the approach has "textually implausibility" and the "curious" practical consequence of requiring a party who wants to arbitrate rather than litigate to first file (or remove) a claim to federal court.[4]

The entire court agreed to toss out the ouster explanation and adopt the "look through" approach. It directed district courts to "look through" the arbitration petition and examine the parties' underlying dispute to determine its federal jurisdiction to consider the s.4 petition. After offering this clear view on the troublesome "save for" clause, the court proceeded to fracture over what dispute properly constitutes the underlying controversy.

4. "LOOKING THROUGH": TELESCOPE OR KALEIDOSCOPE

Once guided to "look through" the petition, the district court must focus on whether, absent the arbitration agreement, it "would have" federal jurisdiction over a suit "arising out" of the "controversy" between the parties. The majority, after examining the totality of the pending

[3] ("*Vaden* 129 S.Ct. 1262 at 1279 (dissent) . . . suit could be an action by Vaden asserting the charges violate [federal law]").

[4] *Vaden* 129 S.Ct. 1262 at 1275.

pleadings, held that under established principles of federal civil procedure, preemption of a counterclaim cannot establish federal jurisdiction:

> "Under the well-pleaded complaint rule, a completely preempted counterclaim remains a counterclaim and thus does not provide a key capable of opening a federal court's door."[5]

The majority's interpretation reflects the long-standing concern that s.4 petitioners will apply "artful dodges" or "manufacture a new controversy", in an effort to obtain a federal court's aid in compelling arbitration.[6] The majority also considered it a "bizarre way to proceed" to "disturb the state-court proceedings" by sending the counterclaim to arbitration, while allowing the debt collection action to remain pending in the state court.[7]

The dissent asserted that "controversy" in the text of the FAA refers just to the specific dispute asserted to be subject to arbitration, not the broader disagreement between the parties. The dissent argued that, consistent with the court's earlier decisions involving multiple claims when only some are covered by an arbitration agreement, Discover Bank properly sought to arbitrate just the issue of whether its fees violated federal law, not its original state law debt collection claim[8]:

> "The majority has been diverted off this straightforward path by the fortuity that a complaint happens to have been filed in this case. Instead of looking to the controversy the s.4 petitioner seeks to arbitrate, the majority 'asks whether "the whole controversy," as reflected in "the parties" state-court filings,' arises under federal law."[8a]

Emphasising that had Vaden filed her federal claim first, and Discover responded with a state law debt collection claim, the suit could be litigated in federal court, the dissent argued that focusing on the sequence in which the state court litigation had unfolded would produce inconsistent results and impose "procedural niceties" that arbitration is intended to avoid.[9]

Both the majority and the dissent wanted to reduce the uncertainty and cost of petitioning for arbitration in the federal court. According to the dissent, defining "controversy" by reference to just the specific issues the petitioner seeks to arbitrate would have provided a "more concrete and administrable approach".[10] The majority rejoined that the "fundamental flaw" in the dissent's analysis is that instead of focusing on the whole controversy as framed by the parties, the "dissent hypothesizes discrete controversies of its own design".[11] For the moment, the United States has resolved what constitutes "controversy" even as it fails to agree on how to avoid it.

[5] *Vaden* 129 S.Ct. 1262 at 1276.
[6] *Vaden* 129 S.Ct 1262.
[7] *Vaden* 129 S.Ct. 1262 at 1277.
[8] *Vaden* 129 S.Ct. 1262 at 1280 (dissent).
[8a] *Vaden* 129 S.Ct. 1262 at 1279 (dissent).
[9] *Vaden* 129 S.Ct. 1262 at 1281 (dissent).
[10] *Vaden* 129 S.Ct. 1262 at 1282 (dissent).
[11] *Vaden* 129 S.Ct. 1262 at 1276.