Arbitrator, Not State or Federal Courts, Must Decide the Validity of a Contract Containing an Arbitration Clause

By Lesley O'Connor*

I. Introduction

On November 26, 2012, in a unanimous *per curiam* decision, the United States Supreme Court reaffirmed that under the Federal Arbitration Act (FAA), an arbitrator, and not state or federal courts, must decide the validity of a contract containing an arbitration clause.[1] The decision in *Nitro-Lift Technologies, L.L.C. v. Howard*, vacated the Oklahoma Supreme Court's ruling that a non-compete agreement in an employment contract was void and unenforceable based on state public policy.[2] By summarily vacating a state court decision that did not enforce an arbitration clause, the Supreme Court again recognized the strong federal policy favoring arbitration. Employees who sign employment contracts agreeing to arbitrate disputes will have difficulty in avoiding such contracts.

The U.S. Supreme Court has made it clear that it is a staunch advocate of the FAA, and any state court that attempts to circumvent or weaken the FAA's provisions faces the possibility of a swift rebuke.

II. The Case

Nitro-Lift Technologies, L.L.C. (Nitro-Lift) is a company that works with oil and gas well operators to provide services that enhance production.[3] Nitro-Lift entered into a confidentiality and non-compete agreement with two of its employees, Eddie Lee Howard and Shane D. Schneider.[4] The agreement contained an arbitration provision requiring any dispute, difference, or unresolved question between Nitro-Lift and its employees to be settled by a single arbitrator.[5]

Howard and Schneider quit Nitro-Lift and began working for a competitor.[6] When it learned of Howard and Schneider's switch to a competitor, Nitro-Lift served the employees with a demand for arbitration, claiming that they had breached their non-compete agreements.[7] The employees responded by filing suit in Oklahoma district court, arguing that the non-compete agreements were null and void.[8] The court dismissed the complaint, finding that the arbitration clauses were valid, and an arbitrator, not the courts, must settle the parties' dispute.[9]

Howard and Schneider appealed to the Oklahoma Supreme Court, which reversed the lower court's decision, holding that the "existence of an arbitration agreement in an employment contract does not prohibit judicial review of the underlying agreement" and the non-compete agreements were "void and unenforceable as against Oklahoma's public policy" expressed by the state legislature's enactment of Okla. Stat., Tit. 15 § 219A (West 2011).[10]

In reaching its decision, the Oklahoma Supreme Court did not disturb the district court's finding that the arbitration clause was valid.[11] Rather, the Oklahoma Supreme Court stated that although it had considered federal and state precedent, its decision rested "squarely within Oklahoma law which provid[ed] bona fide, separate, adequate, and independent grounds" for its decision. [12]

The U.S. Supreme Court unanimously disagreed with the Oklahoma Supreme Court, and held that it was for the arbitrator to decide in the first instance whether the covenants not to compete are valid as a matter of applicable state law.[13] The Court stated that by "declaring the noncompetition agreements in two employment contracts null and void, rather than leaving that determination to the arbitrator in the first instance, the state court ignored a basic tenant" of the FAA's substantive arbitration law.[14]

Apparently displeased with the fact that the Oklahoma Supreme Court had ignored federal precedent, the Court stated that the Oklahoma Supreme Court must not only abide by the FAA, which is the "supreme Law of the Land," but also the Court's own opinions interpreting the FAA.[15]

III. Existing Law/Legal Background

Since the adoption of the Federal Arbitration Act by Congress in 1925, the U.S. Supreme Court has consistently rebuffed attempts by lower courts to weaken or circumvent the FAA. As seen in *Nitro-Lift*, the Court has little patience when state courts attempt to enforce their own state laws and policies in place of the FAA. Many of these cases framed the discussion in *Nitro-lift.*

For example, in *AT&T Mobility LLC v. Concepcion*, the Supreme Court reversed a Ninth Circuit decision that found class-action waivers in arbitration agreements to be unenforceable under state law.[16] The Court held that under the FAA, arbitration agreements must be enforced, even if the agreement requires the consumer to arbitrate individually. In *Nitro-Lift*, the Court also rejected attempts to avoid arbitration under state law principles. Similarily, in *Marmet Health Care Center, Inc. v. Brown*, the Court reiterated that where state law conflicts with the FAA, the FAA controls.[17] "When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA."[18]

In addition to its recent decisions regarding the FAA, the Court also looked to its 1984 holding in *Southland Corp. v. Keating*. In *Southland Corp.,* the Court held that the FAA applies in both state and federal courts.[19] The Court in *Nitro-Lift*, citing *Southland Corp.*, classified the FAA as an Act that "declares a national policy favoring arbitration."[20] The policy is supported by the language of the FAA which states that a "written provision in…a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction… shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." [21] The Court held it is a "mainstay of the Act's substantive law that attacks on the validity of the contract, as distinct from attacks on the validity of the arbitration clause itself, are to be resolved by the arbitrator in the first instance, not by a state or federal court."[22]

Finally, the Court referenced *Buckeye Check Cashing, Inc. v. Cardegna*, wherein it held that an "arbitration provision is severable from the remainder of the contract," and while its validity is subject to initial court determination, the validity of the remainder of the contract is for an arbitrator to decide.[23] Based on this principle, the Court in *Nitro-Lift* stated that the Oklahoma Supreme Court's ruling should be vacated, as the trial court had found the contract contained a valid arbitration clause, and the Oklahoma Supreme Court did not hold otherwise.[24]

IV. Conclusion

The Court's decision in *Nitro-Lift* represents another ruling by the U.S. Supreme Court in a long line of cases favoring arbitration under the FAA. *Nitro-Lift* and other recent Supreme Court cases make clear that arbitration agreements will be enforced according to their terms, and it is the arbitrator who makes the decision of whether the underlying contract is enforceable. Employers and businesses who want their arbitration clauses enforced will be satisfied with the Court's ruling. Properly drafted employment agreements and sales contracts with arbitration clauses avoid handling disputes through the court system. The clauses can also can create a ban on class actions, often the tail that wags the arbitration dog. The U.S. Supreme Court has made it clear that it is a staunch advocate of the FAA, and any state court that attempts to circumvent or weaken the FAA's provisions faces the possibility of a swift rebuke.

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[1] Federal Arbitration Act (FAA). 9 U.S.C.A. § 1 et. seq (West 2013).
[2] *Howard v. Nitro-Lift Techs.*, *L.L.C.*, 273 P.3d 20, ¶ 3, n. 21 (Okla. 2011).
[3] *Nitro-Lift Techs.*, *L.L.C.*, 133 S.Ct. 500, 501 (2012).
[4] *Id*. at 501-02.
[5] *Id*. at 502.
[6] *Id*.
[7] *Id*.
[8] *Id*.
[9] *Id*.
[10] *Howard v. Nitro-Lift Techs.*, *L.L.C.*, 273 P.3d 20, 23 (Okla. 2011).
[11] *Nitro-Lift Techs.*, *L.L.C.*, 133 S.Ct. 500, 503 (2012).
[12] *Id.* at 23, n. 5.
[13] *Nitro-Lift Techs.*, *L.L.C.*, 133 S.Ct. at 504.
[14] *Id*. at 501.
[15] *Id*. at 503.
[16] 563 U.S. __, 131 S.Ct. 1740, 179 L.Ed.2d 742 (2011).
[17] 565 U.S.__132 S.Ct. 1201, 1203, 182 L.Ed.2d 42 (2012) (*per curiam)*.
[18] *Marmet Health Care Center, Inc. v. Brown*, 132 S.Ct. 1201, 1203 (2012)(*per curiam)* (quoting *AT&T Mobility LLC v. Concepcion*, 563 U.S. __, 131 S.Ct. 1740, 1747, 179 L.Ed.2d 742 (2011)).
[19] 465 U.S. 1, 10, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984).
[20] *Nitro-Lift Techs.*, *L.L.C.*, 133 S.Ct. at 503.
[21] 9 U.S.C.A. § 2 (West 2013).
[22] *Nitro-Lift Techs., L.L.C.*, 133 S.Ct. at 503 (citing *Preston v. Ferrer,* 552 U.S. 346, 349, 128 S.Ct. 978, 169 L.Ed.2d 917 (2008) and *Prima Paint Corp. v. Flood & Conklin Mfg. Co.,* 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967))
[23] *Buckeye Check Cashing, Inc*., 546 U.S. 440, 445 (2006).
[24] *Nitro-Lift Techs.*, *L.L.C.*, 133 S.Ct. 500, 503 (2012).