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Class Action Arbitration Waivers After Stolt-Nielsen

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Class Action “Waiver” Provisions in Arbitration Agreements *After Stolt-Nielsen*

Presented by:

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RECAP OF DISCUSSION ONE YEAR AGO

- Focus on class action waiver arbitration cases decided on unconscionability and public policy grounds
 - Unconscionability
 - Procedural unconscionability
 - Substantive unconscionability
 - Against public policy

Unconscionability

- Two Elements
 - Procedural Unconscionability: surprise/oppression
 - Adhesion contract
 - This alone does not make it procedurally unconscionable
 - If clause is not mandatory, it can still be procedurally unconscionable
 - Consumer choice, by itself, does not make the contract non-adhesive
 - Substantive Unconscionability: exceedingly one-sided terms
 - Basic test: if it creates a “disincentive to litigate,” such as:
 - Unilateral or one-sided in effect
 - Cost of pursuing the claim outweighs potential relief
 - Attorneys’ fees usually irrelevant
 - No attorney fees provision may “magnify” the unconscionability
- Cases reviewed one year ago all invalidated the waivers, even when:
 - the signed document has references to arbitration
 - there is meaningful choice among arbitrators
 - consumer affirmatively read/signed/acknowledged the clause, and did not assent by inaction

Against Public Policy

- If waiver is of an unwaivable statutory right (e.g., right to minimum wage)
- Court typically undertakes inquiry under four factors:
 - modest size of potential individual recovery
 - potential for retaliation against members of the class
 - fact that class members might be ill-informed about rights
 - other obstacles to vindication of class members' rights
- Even large individual claims were allowed, such as \$26,500 or \$37,000
- Availability of attorney fees for prevailing party may not matter
- Focus on two public policy cases:
 - Homa v. Am. Express Co., 558 F.3d 225 (3d Cir. 2009)
 - In re: Am. Express Merchs.' Litig., 554 F.3d 300 (2d Cir. 2009)

Homa v. Am. Express Co., 558 F.3d 225 (3d Cir. 2009)

Facts:

- Plaintiff filed a class action in New Jersey against American Express and American Express Centurion Bank, asserting that AMEX misrepresented the terms of its “Blue Cash” credit card reward program [at 226-27]
- Cardholder Agreement included a provision requiring arbitration of all claims upon election of either party and specifically required all claims to “be arbitrated on an individual basis ... [with] no right or authority for any Claims to be arbitrated [as] a class action” [at 227]
- Utah law governed [at 227]

Posture: District Court dismissed action with prejudice because of arbitration agreement

Issue: Is waiver of class action in agreement governed by Utah Law enforceable under New Jersey law?

Held: No; waiver is against public policy and therefore unenforceable

Homa v. Am. Express Co. (continued)

Reasoning:

- Court analyzed the class waiver under Restatement (Second) of Conflicts of Laws § 187(2) [at 227]
 - Law of the chosen state (Utah) should apply unless it “would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue” [at 227-28]
- Court held that class waiver violates fundamental public policy of New Jersey because “the public interest at stake in ... Consumers’ ability to effectively pursue their statutory rights under [New Jersey’s] consumer protection laws’ constituted the ‘most important’ reason for holding a similar class-arbitration waiver unconscionable” [at 230]

Homa v. Am. Express Co. (continued)

Reasoning (continued):

- Adhesion contract – class waivers in consumer contracts of adhesion are “problematic” because “disputes between the contracting parties predictably involve small amounts of damages” [at 231]
- Court also noted that it must assume as true for a Rule 12(b)(6) motion to dismiss plaintiffs’ allegations that:
 - The “claims at issue are of low monetary value”; and
 - Because of the nature of the individual class members’ claims few, if any, could afford to seek legal redress if the case could not be resolved on a class basis [at 231]

In re: Am. Express Merchs.’ Litig., 554 F.3d 300 (2d Cir. 2009)

Facts:

– AMEX merchants sued AMEX on class basis for antitrust violations [at 304-08]

– AMEX’s merchant agreement stated:

IF ARBITRATION IS CHOSEN BY ANY PARTY WITH RESPECT TO A CLAIM, NEITHER YOU NOR WE WILL HAVE THE RIGHT TO LITIGATE THAT CLAIM IN COURT OR HAVE A JURY TRIAL ON THAT CLAIM FURTHER, YOU WILL NOT HAVE THE RIGHT TO PARTICIPATE IN A REPRESENTATIVE CAPACITY OR AS A MEMBER OF ANY CLASS OF CLAIMANTS PERTAINING TO ANY CLAIM SUBJECT TO ARBITRATION. THE ARBITRATOR’S DECISION WILL BE FINAL AND BINDING. NOTE THAT OTHER RIGHTS THAT YOU WOULD HAVE IF YOU WENT TO COURT MAY ALSO NOT BE AVAILABLE IN ARBITRATION [at 306-07]

Posture: District Court dismissed action because of arbitration agreement

Issue: Is waiver of class action enforceable under federal law?

Held: No; waiver is against public policy and therefore unenforceable

In re: Am. Express Merchs.’ Litig. (continued)

Reasoning:

- Court framed the issue as one of litigation costs, and Plaintiffs had expert testimony that:
 - Average recovery for an individual plaintiff would be about \$40,000 (after trebling damages) [at 317]
 - Expert fees alone for each individual case would exceed \$1 million [at 317]
- Relevant antitrust statutes provided for recovery of fees
 - Court found this unpersuasive because “the plaintiffs must include the risk of losing, and thereby not recovering any fees, in their evaluation of their suit’s potential costs” [at 318]

In re: Am. Express Merchs.’ Litig. (continued)

Reasoning (continued):

- Court found that the high cost of individual litigation means enforcement of the waiver gives AMEX “de facto immunity from antitrust liability” [at 320]
- Court provided two caveats:
 - Size of plaintiff is irrelevant, size of potential recovery vs. litigation costs for individual plaintiff is the key inquiry [at 320]
 - Arbitration agreements are not per se unenforceable [at 321]

MAYER • BROWN

Analyzing the Supreme Court's decision in *Stolt-Nielsen, S.A. v. AnimalFeeds Int'l, Inc.*

Prepared for Strafford Teleconference
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Background

- **Advantages of arbitration**

- Reduced transaction costs
- Less adversarial than litigation
- Fair, expeditious process to resolve disputes

- **Congressional and judicial support for arbitration**

- Federal Arbitration Act adopted in 1925 to reverse long-standing judicial hostility to arbitration
- Act provides that arbitration agreements must be enforced, unless there is a generally-applicable rule of state law that would authorize invalidating any contract
- Series of Supreme Court decisions in 1980s and 1990s holding that a variety of federal statutory claims are subject to arbitration and that anti-arbitration state law is preempted by the FAA produced significant growth in the use of arbitration, particularly in the consumer and employment context

Background leading up to *Stolt-Nielsen*

- Traditionally arbitration had been done on an individualized basis. Until 2003, most federal courts of appeal had held that arbitration takes place on an individual basis, and that class actions were not permitted
- In 2003, the Supreme Court appeared to conclude in a fractured plurality opinion in *Bazzle* that when an arbitration provision is silent as to whether class arbitrations are permitted, it is for an arbitrator to decide whether a class arbitration can go forward
- In the wake of *Bazzle*, many businesses made it explicit that their arbitration provisions precluded class arbitration
- But many arbitration provisions (both drafted before and after *Bazzle*) did not expressly state whether class arbitration was permissible.
- In addition, in a number of cases, courts declared that express class waivers were unenforceable and “severed” them, rendering them “silent” on the availability of class arbitration
- In these cases, arbitrators were charged with deciding whether it was possible for class arbitration to go forward.

The Supreme Court's decision in *Stolt-Nielsen*

- **Background:**

- This case involved a putative class action filed by AnimalFeeds (a shipper) alleging price fixing against major shipping companies. The lawsuit followed a DOJ criminal investigation.
- AnimalFeeds and Stolt-Nielsen were required to arbitrate the dispute pursuant to an arbitration clause in a standard form shipping contract that did not expressly state whether or not class arbitration was permissible
- In the meanwhile, the U.S. Supreme Court decided *Bazzele*, and AnimalFeeds sought to pursue class arbitration. In view of *Bazzele*, the parties agreed to allow a panel of arbitrators to decide whether the arbitration provision at issue “permits the arbitration to proceed on behalf of . . . a class.”
- The arbitrators determined that the clause allowed for class arbitration.
- The district court vacated the award, holding that the arbitrators’ decision was made in “manifest disregard” of federal maritime law.
- The Second Circuit reversed, concluding that *Bazzele* permitted arbitrators to determine whether a “silent” clause permits class arbitration.

The Supreme Court's decision in *Stolt-Nielsen*

- **Holding and rationale**

- The Supreme Court reversed by a 5-3 vote. (Justice Sotomayor was recused).
- Justice Alito authored the opinion for the Court
- **Arbitrators exceeded their authority:** After discussing the relevant standard of review (an issue I will address later), the Court explained that the basis for the arbitral panel's decision to permit class arbitration was "its own conception of sound policy," informed by how various arbitrators had read *Bazzele*.
- ***Bazzelebaffles*:** The Court noted that "the opinions in *Bazzele* appear to have baffled the parties in this case at the time of the arbitration proceeding." (The parties were not alone.)
 - For example, the Court explained that, while the parties had read *Bazzele* to require that "an arbitrator, not a court . . . decide whether a contract permits class arbitration," in fact that was just what the plurality said.
 - The Court also noted that, contrary to the parties' submissions to the arbitrator and the panel's conclusion, *Bazzele* never "establish[ed] the rule to be applied in deciding whether class arbitration is permitted." Instead, that question had been left open by *Bazzele*.

The Supreme Court's decision in *Stolt-Nielsen*

- **Consent matters**

- The Court then noted that, while interpreting arbitration agreements is generally governed by state law, “the FAA imposes certain rules of fundamental importance, including . . . that arbitration is a matter of consent, not coercion.”
- The Court explained that “parties are ‘generally free to structure their arbitration agreements as they see fit,’” and that “it is . . . clear from our precedents and the contractual nature of arbitration that parties may specify *with whom* they choose to arbitrate their disputes.”
- “From these principles,” the Court concluded that the FAA generally prohibits imposing class arbitration on a party unless there is a “contractual basis for concluding that the party *agreed* to do so.”
- By determining otherwise, the arbitral “panel’s conclusion is fundamentally at war with the foundational FAA principle that arbitration is a matter of consent.”

The Supreme Court's decision in *Stolt-Nielsen*

- **Class arbitration is a different animal**

- True, arbitrators can often engage in gap-filling to supply procedures that are not provided for in the parties' agreement.
- But superimposing class procedures without the affirmative agreement of the parties would frustrate the parties' core assumptions about arbitration.
- That is because class arbitration is fundamentally different from "bilateral" arbitration (i.e., arbitration between two parties): "Class-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator."
 - Parties agree to "bilateral arbitration . . . to realize the benefits of private dispute resolution," including "lower costs" and "greater efficiency and speed"
 - "The relative benefits of class-action arbitration are much less assured"
- "Fundamental changes brought about by the shift from bilateral arbitration to class-action arbitration"
 - Instead of resolving a single dispute, a single arbitrator "resolves many disputes between hundreds or perhaps even thousands of parties"
 - Presumption of privacy and confidentiality does not apply in class arbitration
 - "arbitrator's award . . . adjudicates the rights of absent parties"
 - "commercial stakes of class-action arbitration are comparable to those of class-action litigation, even though the scope of judicial review is much more limited"

The Supreme Court's decision in *Stolt-Nielsen*

• Standard of review

- Arbitral awards are generally subject to extremely limited review
- The Court recognized as much, stating that petitioners were required to “clear a high hurdle”: “It is not enough . . . To show that the [arbitral] panel committed an error—or even a serious error.”
- Instead, the Court held that *Stolt-Nielsen* was required to show that the arbitrators had “stray[ed] from interpretation and application of the agreement and effectively ‘dispens[ed their] own brand of industrial justice’”
- That is exactly what happened here, according to the Court.
 - Because an arbitrator’s job “is to interpret and enforce a contract, not to make public policy”—and because, in the Court’s view, “what the arbitration panel did was simply to impose its own view of sound policy regarding class arbitration”—the Court held that the panel had exceeded its powers.
 - That is a ground for vacating an arbitral award under Section 10(a)(4) of the FAA.
- The Court also noted in a footnote that the arbitrator’s decision would constitute a “manifest disregard” of the law standard (as characterized by *AnimalFeeds*), without deciding whether such a standard of review survives the Court’s 2008 decision in *Hall Street Associates LLC v. Mattel, Inc.*
 - That’s an issue that has caused a conflict among the courts of appeal.

The dissent in *Stolt-Nielsen*

- **Potential limits on the Court’s holding:** The dissent identifies two “stopping points” that (the dissenters say) are “qualifications” that “limit the scope of the Court’s decision.”
 - (1) **Is express consent necessary?** The parties in *Stolt-Nielsen* had stipulated that they had not agreed to arbitrate on a class-wide basis, leaving open the question of whether any facts, short of explicit consent, constitutes sufficient contractual basis from which to conclude that the parties had agreed to class arbitration.
 - (2) **Does the holding apply to form contracts?**
 - The parties in *Stolt-Nielsen* were both “sophisticated” businesses. Some parties may argue that *Stolt-Nielsen* does not apply to form consumer or employment arbitration agreements. The dissent states: “the Court apparently spares from its affirmative-authorization requirement contracts of adhesion presented on a take-it-or-leave-it basis.”
 - But other parties will likely contend that *Stolt-Nielsen*’s interpretation of the FAA applies equally in all settings. This seems to me to be the better view.
- **“Procedural” objections to decision:**
 - Whether arbitrators’ clause construction award was too preliminary to justify immediate judicial review under the FAA
 - Whether Section 10(a)(4) of the FAA—did the arbitrators exceed their power?-- authorized the Court to consider the correctness of the clause construction award

The dissent in *Stolt-Nielsen*

- **The wrong default rule?**

- The dissent argues that because the default rule when parties litigate in court is that class-action procedures are potentially available, the same default rule should apply to arbitration agreements that do not expressly provide otherwise
- The dissent suggests that class actions can be:
 - “When adjudication is costly and individual claims are no more than modest in size, class proceedings may be ‘the thing,’ *i.e.*, without them, potential claimants will have little, if any, incentive to seek vindication of their rights.”
 - “[D]isallowance of class proceedings severely shrinks the dimensions of the case or controversy a claimant can mount”
 - Foreshadows the debate over the enforceability of class-arbitration waivers

The impact of *Stolt-Nielsen*

- The decision clarifies that *Bazze* only empowers the arbitrator to determine whether the agreement was silent on whether class arbitration was permitted.
- The decision also indicates that when class arbitration is not affirmatively contemplated, imposing it would frustrate the intent of the parties.
- *Stolt-Nielsen* places into doubt the viability of many class arbitrations pending before arbitral organizations such as the AAA
- The next issue in many cases involving “silent” arbitration clauses is whether plaintiffs pursuing putative class arbitrations will be compelled into individual arbitration or will be able to pursue putative class action litigation in court.

RECENT ARBITRATION CASES BEFORE THE U.S. SUPREME COURT

- Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.,
130 S. Ct. 1758 (2010)
- In re: Am. Express Merchs.' Litig.,
No. 08-1473 (vacated and remanded May 3, 2010)
- AT&T Mobility LLC v. Concepcion,
No. 09-893 (cert. granted May 24, 2010)
- Rent-A-Center, West, Inc. v. Jackson,
No. 09-497 (decided June 21, 2010)

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758 (2010)

Facts:

- AnimalFeeds sued maritime companies for antitrust violations [at 1765]
- Pursuant to a written contract between the parties, the case was submitted to arbitration [at 1765]
- AnimalFeeds requested class arbitration even though the parties stipulated that (1) the arbitration clause at issue was “silent” with respect to class arbitration and (2) that meant “there’s been no agreement ... reached on that issue” [at 1766]
- The arbitrators ultimately concluded that the silent arbitration clause permitted class arbitration [at 1766]

Posture:

- District Court vacated the arbitrators’ award of class arbitration, holding that the arbitrators’ decision was made in “manifest disregard” of the law insofar as the arbitrators failed to conduct a choice-of-law analysis, which would have required them to apply maritime law “requiring that contracts be interpreted in light of custom and usage” [at 1766]
- Second Circuit reversed because the arbitrators’ decision was not in manifest disregard of federal maritime law given that AnimalFeeds had cited no authority that federal maritime law had a custom and usage against class arbitration [at 1766]

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Issue: Whether imposing class arbitration on parties whose arbitration clauses are silent on that issue is consistent with the Federal Arbitration Act

Held: No; the arbitration could not proceed on a class basis where the arbitration agreement was silent on the issue

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Reasoning:

- The arbitrators incorrectly relied on the U.S. Supreme Court’s decision in Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444 (2003), to order class arbitration [at 1768-70]
- According to the arbitrators, the issue was whether the arbitration clause, which was silent on class arbitration, “should be construed to permit class arbitration as a matter of public policy” [at 1768]
- The arbitrators relied on post-Bazzle decisions that “construed a wide variety of clauses in a wide variety of settings as allowing for class arbitration” [at 1768-69]
- But the arbitrators failed to account for the fact that the parties had stipulated that the arbitration agreement was silent on whether class arbitration thereunder was permissible [at 1769-70]
- Moreover, Bazzle “did not establish the rule to be applied in deciding whether class arbitration is permitted” [at 1772]

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Reasoning (continued):

- Imposing class arbitration on parties who have not agreed to authorize class arbitration is inconsistent with the FAA and its primary objectives [at 1773-75]
- Arbitrators derive their authority from the arbitration agreement itself, and therefore, the parties' intentions control. The arbitration agreement will govern not only what the parties arbitrate, but also with whom they will do so [at 1774]
- Arbitrators cannot force parties to arbitrate issues they did not agree to arbitrate, or with parties with whom it did not agree to arbitrate [at 1774-75]
- Thus, a “party cannot be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so” [at 1775-76]

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Reasoning (continued):

- Class arbitration is not merely a procedural question over which the arbitrators have discretionary authority [at 1775-76]
 - Class arbitration changes the nature of the arbitration, and thus, the arbitrators cannot infer authority or consent to class arbitration from the simple fact that the parties agreed to arbitrate bilaterally [at 1775]
 - “We think that the differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties’ mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings” [at 1776]

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Impact on Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444 (2003):

- Bazzle attempted to address three issues:
 - Whether the court or the arbitrator should decide whether a contract is “silent” on the issue of class arbitration
 - What standard should apply in determining whether a contract allows class arbitration
 - Whether, under the appropriate standard, class arbitration had been properly ordered
- Supreme Court in Stolt-Nielsen held that “Bazzle did not yield a majority decision on any of the three questions” [at 1772]
- Rather, the only majority view was that the order allowing class arbitration should be vacated and remanded [at 1771-72]
- The first issue – who decides whether a contract allows class arbitration – arguably remains open because the Court in Stolt-Nielsen declined to revisit the issue given the parties’ “agreement expressly assign[ing] this issue to the arbitration panel” [at 1772]
- The second issue – which rule applies in deciding whether class arbitration is permitted – was addressed in Stolt-Nielsen

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Impact on Hall Street Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008):

- Hall Street invalidated a contract provision because it broadened the grounds for vacating or modifying an arbitration award
- Supreme Court held that for arbitration awards made under the Federal Arbitration Act, Sections 10 and 11 of the Act “provide the FAA’s exclusive grounds for expedited vacatur and modification”
- In doing so, the Supreme Court in Hall Street recognized that some courts had adopted “manifest disregard of the law” as an independent basis for vacatur, relying on the Supreme Court’s statement in Wilko v. Swan, 346 U.S. 427, 436-37 (1953), that “the interpretations of the law by the arbitrators in contrast to manifest disregard of the law are not subject, in the federal courts, to judicial review for error in interpretation”

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Impact on Hall Street Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008) (continued):

- However, the Court in Stolt-Nielsen expressed doubt that it had intended to expand the grounds for vacating an arbitration award
- In Stolt-Nielsen, the Second Circuit held, as part of its decision allowing class arbitration, that the “manifest disregard” standard “survived” the Court’s Hall Street decision as “as a ‘judicial gloss’ on the enumerated grounds for vacatur of arbitration awards” under the FAA [at 1766]
- The Supreme Court in Stolt-Nielsen declined to address whether “manifest disregard” “survives [its] decision in Hall Street, as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. § 10” [at 1768 n.3]
- Thus, whether “manifest disregard” is an independent basis to vacate an arbitration award remains an open issue

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. (continued)

Other open issues:

- Express consent not necessarily required
 - Class arbitration may be ordered if “there is a contractual basis for concluding that the part[ies] agreed” to submit to class arbitration [at 1775]
- Evidence required to show parties agreed or did not agree to class arbitration
 - “We have no occasion to decide what contractual basis may support a finding that the parties agreed to authorize class-action arbitration” [at 1776 n.10]
- Adhesion and consumer contracts
 - Supreme Court noted that “the parties [here] are sophisticated business entities,” and “it is customary for the shipper to choose the charter party that is used for a particular shipment” [at 1775]

In re: Am. Express Merchs.’ Litig.,
No. 08-1473 (vacated and remanded May 3, 2010)

- Following its decision in Stolt-Nielsen, the Supreme Court vacated the Second Circuit’s decision in In re: Am. Express Merchs.’ Litig. and remanded “for further consideration in light of Stolt-Nielsen”
- Given clear class arbitration waiver, it will be interesting to see how Second Circuit addresses the public policy concerns it highlighted in its first decision
- Not a consumer case

AT&T Mobility LLC v. Concepcion, No. 09-893 (cert. granted May 24, 2010)

- Supreme Court granted cert. in AT&T, which presents the question of enforceability of a class arbitration waiver in the context of a consumer contract
 - “Whether the Federal Arbitration Act preempts States from conditioning the enforcement of an arbitration agreement on the availability of particular procedures – here, class-wide arbitration – when those procedures are not necessary to ensure that the parties to the arbitration agreement are able to vindicate their claims”
- Ninth Circuit held in underlying case that waiver was unconscionable under California law because:
 - (1) the agreement was a contract of adhesion;
 - (2) the plaintiffs’ claims were small; and
 - (3) the plaintiffs alleged that the defendant engaged in fraud
- Ninth Circuit held that the FAA did not preempt California law because California’s unconscionability principles were laws of “general applicability” for contracts

AT&T Mobility LLC v. Concepcion (continued)

- Likely that Supreme Court will either apply Stolt-Nielsen and uphold waiver or distinguish that case and agree with Ninth Circuit that California law applies and the waiver is unconscionable under the circumstances
- Current timeline
 - July 26, 2010 – Petitioner’s brief on the merits and joint appendix due
 - September 15, 2010 – Respondents’ brief on the merits due

Rent-A-Center, West, Inc. v. Jackson, No. 09-497 (decided June 21, 2010)

Facts:

- Jackson sued Rent-A-Center in federal court for employment discrimination [slip op. at 1]
- As a condition of his employment, Jackson executed a “Mutual Agreement to Arbitrate Claims,” which “provided for arbitration of all ‘past, present or future’ disputes arising out of Jackson’s employment with Rent-A-Center, including ‘claims’ for discrimination,” and stated that the arbitrator “and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement including, but not limited to any claim that all or any part of this Agreement is void or voidable” [at 1-2]
- Rent-A-Center moved to compel arbitration, and Jackson opposed, arguing that the arbitration agreement was unenforceable under Nevada law [at 2]

Posture:

- District Court granted Rent-A-Center’s motion because the arbitration agreement “clearly and unmistak[ably] gives the arbitrator exclusive authority to decide whether the Agreement is enforceable” [at 2]
- Ninth Circuit reversed because where “a party challenges an arbitration agreement as unconscionable, and thus asserts that he could not meaningfully assent to the agreement, the threshold question of unconscionability is for the court” [at 2-3]

Rent-A-Center, West, Inc. v. Jackson (continued)

Issue: Whether, under the Federal Arbitration Act, a district court may decide a claim that an arbitration agreement is unconscionable, where the agreement explicitly assigns that decision to the arbitrator

Held: No; when a plaintiff challenges the validity of an arbitration agreement as a whole, instead of the specific provision assigning that authority to the arbitrator, the arbitrator, not a court, must decide the plaintiff's claims

Rent-A-Center, West, Inc. v. Jackson (continued)

Reasoning:

- Section 2 of the Federal Arbitration Act requires courts to enforce arbitration agreements according to their terms “save upon such grounds as exist under law or in equity for the revocation of any contract” [at 6]
- The actual “controversy” between the parties involved only the validity of the “delegation provision,” which assigned to the arbitrator authority to decide the enforceability of the agreement, including whether it was unconscionable [at 8]
- Supreme Court’s prior decisions only allow district courts to resolve challenges contesting the validity of specific arbitration provisions, with challenges to the validity of the entire contract being reserved to the arbitrator for decision [at 6-7]
- Thus, Section 2 of the FAA required that the provision be treated as valid and enforceable unless Jackson specifically challenged it, rather than the entire agreement to arbitrate [at 7-9]
- Jackson did not argue that the delegation provision, as opposed to the entire agreement, was invalid until the case was before the Supreme Court, by which time it was too late [at 12]

LOWER COURT DISCUSSIONS OF STOLT-NIELSEN IN ADHESION CONTRACT CASES

- Litman v. Cellco P'ship, No. 08-4103, 2010 U.S. App. LEXIS 10405 (3d Cir. May 21, 2010)
- Fensterstock v. Educ. Fin. Partners, No. 09-1562, 2010 U.S. App. LEXIS 14172 (2d Cir. July 12, 2010)

Litman v. Cellco P'ship, No. 08-4103,
2010 U.S. App. LEXIS 10405 (3d Cir. May 21, 2010)

Facts:

- Plaintiffs filed a class action complaint alleging unlawful administrative charges on their mobile phone accounts [at *1-2]
- Defendant moved to compel individual arbitration pursuant to its customer agreements [at *2]
- Plaintiffs responded that the class arbitration waiver was unconscionable and unenforceable under New Jersey law [at *2]
- Defendant agreed that New Jersey law prohibited class arbitration waivers in adhesion contracts, but that the Federal Arbitration Act preempted Plaintiffs' argument [at *3]

Posture: District Court dismissed case in favor of arbitration

Issue: Is waiver of class arbitration in agreement governed by New Jersey law enforceable in light of the Third Circuit's Homa decision?

Held: No; waiver is against public policy and therefore unenforceable

Litman v. Cellco P'ship (continued)

Reasoning:

- During the appeal, the Third Circuit decided Homa, which invalidated a class arbitration waiver in an adhesion contract on public policy grounds [at *3-4]
- Applying Homa, the Third Circuit reached the same decision [at *4-8]
- Third Circuit cited Stolt-Nielsen and noted that it “does not alter our analysis and conclusion” because that case “addressed the specific question of ‘whether imposing class arbitration on parties whose arbitration clauses are ‘silent’ on that issue is consistent with the FAA’” and “did not consider the distinct issues of state law preemption and unconscionability” [at *8 n.5]

Fensterstock v. Educ. Fin. Partners, No. 09-1562, 2010 U.S. App. LEXIS 14172 (2d Cir. July 12, 2010)

Facts:

- Plaintiff alleged variety of California contract and tort claims arising from Defendant’s servicing of his student loans [at *2-6]
- Note at issue contained class arbitration waiver:
“Claims made as part of a class action or other representative action, and the arbitration of such Claims must proceed on an individual (non-class, non-representative) basis. If you or I require arbitration of a particular Claim, neither you, me, nor any other person may pursue the Claim in any litigation, whether as a class action, private attorney general action, other representative action or otherwise” [at *8]
- Arbitration provision also contained severability clause:
“If any portion of this arbitration provision is deemed invalid or unenforceable, the remaining portions shall nevertheless remain in force” [at *8]
- Defendant moved to compel arbitration on an individual basis [at *8-9]
- Plaintiff argued that the waiver was unconscionable and unenforceable under California law [at *6, 10]

Posture: District Court denied Defendant’s motion, holding that the Federal Arbitration Act did not preempt Plaintiff’s unconscionability arguments and, under California law, the adhesion contract at issue was unconscionable [at *10-13]

Issue: Is waiver of class action in agreement governed by California law enforceable under federal law?

Held: No; waiver is against public policy and therefore unenforceable

Fensterstock v. Educ. Fin. Partners (continued)

Reasoning:

- Second Circuit noted that the Federal Arbitration Act does not preempt “generally applicable contract defenses, such as fraud, duress, or unconscionability” [at *14-16]
- Under California law, arbitration agreements with class waivers are “on the exact same footing” as contracts barring class action litigation outside the arbitration context and, therefore, the FAA does not preempt California law on unconscionability [at *20-21]
- Unconscionability under California law turns on Discovery Bank and Shroyer factors:
 - (1) whether agreement is an adhesion contract;
 - (2) whether disputes over agreement would typically involve small amounts of damages; and
 - (3) whether it is alleged that the party with the superior bargaining power has carried out a scheme deliberately to cheat large numbers of customers out of individually small amounts of money [at *30-31]
- Ninth Circuit analyzed the note at issue and found these factors satisfied [at *31-37]

Fensterstock v. Educ. Fin. Partners (continued)

Reasoning (continued):

- Defendant argued that the severability clause would allow for class arbitration if the waiver provision was unconscionable [at *38]
- Ninth Circuit, applying Stolt-Nielsen, disagreed because the note expressly requires individual arbitration and, therefore, “the parties plainly did not agree that arbitration may be conducted on a classwide basis” [at *38-41]
- Absent agreement that arbitration could proceed on a class basis, the Ninth Circuit held that an order for classwide arbitration could not be premised on the note’s severability provision [at *41-42]

LEGISLATIVE UPDATES

- Dodd-Frank Wall Street Reform and Consumer Protection Act
- Arbitration Fairness Act of 2009

Dodd-Frank Wall Street Reform and Consumer Protection Act

- Passed on July 15, 2010
- Creates Bureau of Consumer Financial Protection
- **SEC. 1028. AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.**
 - (a) **STUDY AND REPORT.**—The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.
 - (b) **FURTHER AUTHORITY.**—The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).
 - (c) **LIMITATION.**—The authority described in subsection (b) may not be construed to prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person after a dispute has arisen.

Arbitration Fairness Act of 2009 (H.R. 1020 & S.B. 931)

- Lost in the shuffle behind Obama Administration's other initiatives this year
- But, still active – discharged to the House Committee on the Judiciary from the Subcommittee on Commercial and Administrative Law on June 21, 2010
- Section 4 of the Act provides:
 - “No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of – (1) an employment, consumer, or franchise dispute; or (2) a dispute arising under any statute intended to protect civil rights”



Questions or Comments?

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MAYER • BROWN

Drafting enforceable arbitration agreements

Prepared for Strafford Teleconference
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Limits on Arbitration

- Generally applicable state-law defenses to contract enforcement apply to arbitration clauses. The unconscionability doctrine is often raised as a challenge to enforcement of arbitration agreements in consumer and employment settings.
- Courts have repeatedly invalidated arbitration clauses that they conclude are unfair, citing a number of different factors, either alone or in combination. These include, for example:
 - Excessive costs to a non-business party
 - Unfair appointment of arbitrators
 - Requiring that arbitration be kept confidential
 - Limitations on arbitrator's ability to award relief available in court such as attorneys' fees, statutory remedies, or punitive damages
 - Shortening the statute of limitations period
 - Requiring arbitration to take place at a location inconvenient to the non-business party

Key Points on Drafting Enforceable Arbitration Provisions

- Arbitration provision should be designed to ensure that the arbitration process is fair and attractive to customers or employees; this creates a better process for the parties and increases the likelihood of court approval
- Here are some important elements:
 - **Low-cost or cost-free arbitration:** Make arbitration affordable for customers and employees. If possible, offer to pay the full costs of arbitration
 - **Do not impose limits on legal remedies.** Some of the concerns that we have mentioned should be avoided: For example,
 - Limiting the company’s punitive or consequential damages
 - Precluding recovery of attorneys’ fees, or
 - Imposing an unusually short statute of limitations
 - Offer a **convenient location** for the non-business party, and the option of a telephone or desk arbitration (particularly in consumer contracts)
 - Consider using premiums

Effect of recent Supreme Court decisions on drafting arbitration clauses

- **After *Stolt-Nielsen*, should drafters of arbitration provisions include express prohibitions of class arbitration?**
 - Some commentators suggest that, in view of *Stolt-Nielsen*, class arbitration waivers are implicit terms of every silent arbitration clause
 - Others continue to recommend that businesses (especially those using consumer and employment arbitration agreements) include express language prohibiting class arbitration in their contracts
 - Discussion

Effect of recent Supreme Court decisions on drafting arbitration clauses (cont.)

- **Should drafters of arbitration agreements provide that arbitrators rather than courts will decide the enforceability of arbitration clauses?**
 - *Rent-A-Center, West, Inc. v. Jackson*, No. 09-497 (2010):
 - when an arbitration clause expressly delegates the power to determine the enforceability of an arbitration clause to an arbitrator, such delegation clauses may be enforced
 - Accordingly, the default rule that courts decide questions of enforceability may be displaced except for challenges to the enforceability of the delegation clause itself
 - Many observers believe that drafters should not and will not include express delegation clauses in arbitration provisions
 - Discussion

Enforcement of Arbitration Clauses (Discussion)

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Move to compel arbitration and stay action

- Move early to avoid waiver argument
- Support with necessary evidence regarding
 - Formation of agreement
 - Specific language of arbitration clause
 - Rules that would apply to arbitration
 - Information on any fees that would apply
 - Information about parties and amounts at issue in case
- Consider moving to stay or defer consideration of arbitration motion until after ruling on *AT&T v. Concepcion*
- If motion denied, appeal and move to stay

Kaltwasser v. Cingular Wireless, 2010 WL 2557379 (N.D.Cal. June 21, 2010)

- Court had denied motion to stay based on *Concepcion* in earlier (June 8) order, finding entire class would not be precluded by finding that FAA preempts California law
- Requested briefing on deferring class certification hearing given effect on class
- Found that class could be made smaller and class period cut in half, requiring smaller scope of discovery and lower cost of notice among other things
- Held that class certification hearing is deferred until *Concepcion* is decided

McArdle v. AT&T Mobility, 2010 WL 2867305 (N.D.Cal. July 20, 2010)

- Motion to reconsider denial of stay of proceedings pending appeal of denial of motion to compel arbitration
- Based on Concepcion
- Stay not automatic in Ninth Circuit (it is in Third and Seventh)
- Party must show: (1) strong likelihood of success on the merits of appeal and irreparable harm, or (2) that serious questions regarding merits exist and the balance of hardships tips in its favor
- Court found test met and stayed action

Issues of Enforceability

- Courts have focused on several issues:
 - The nature of the transaction between parties
 - Formation of the agreement
 - Communication of the agreement
 - What arbitration fees are involved
 - State law that applies
 - Value of the claims versus difficulty of arbitration

Formation Issues

- Notice: Argue that the arbitration clause and class action waiver are clear as to their terms and effect and are reasonably conspicuous such that they would attract the attention of a reasonable person.
 - Bold Font
 - All Capital Letters
- Opt-Out Provision: Courts have suggested that where an arbitration agreement provides the consumer with an opportunity to freely opt out of the arbitration portion of the contract, the contract is not adhesionary and not unconscionable. See Guadagno v. E*Trade Bank, 592 F. Supp. 2d 1263 (C.D. Cal. 2008) (60-day opt-out period provided for in agreement).

Unconscionability Generally

The most common challenge to the enforceability of class action waivers is the common law doctrine of unconscionability.

- The unconscionability doctrine, in effect, tests the fundamental fairness of an agreement.
- The application of the unconscionability doctrine depends upon state law and varies from state to state.
- Unconscionability typically requires a finding of both:
 - “Procedural Unconscionability;” and
 - “Substantive Unconscionability.”

Dispute Between Contracting Parties Involves Small Amount of Damages

Determination of “small damages” is a case-by-case analysis that considers, for example:

- Potential recovery of an individual claim measured against the potential cost of litigation;
- The time, energy, effort and stress of litigation; and
- The type of claim asserted.
 - E.g., Antitrust claims are highly complex and generally expensive to litigate. See Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); In re American Express Merchants’ Litig., 554 F.3d 300 (2d Cir. 2009).

Availability of Statutory Damages, Punitive Damages, and/or Attorneys' Fees

The availability of statutory damages, punitive damages, and/or attorneys fees, whether by law or provided for in an arbitration agreement, may support the enforceability of a class action waiver.

- See Pleasants v. American Express Co., 541 F.3d 853 (8th Cir. 2008) (finding attorneys' fees, costs, statutory damages, and actual damages available to plaintiff under TILA "would likely exceed costs of pursuing" individual claim and thus that class action waiver was not unconscionable).
- But see Scott v. Cingular Wireless, 161 P.3d 1000 (Wash. 2007) (finding waiver unconscionable despite defendant's promise to pay filing, administrative, and arbitrator fees and attorneys' fees, under certain circumstances); see also Coneff v. AT&T Corp., 620 F. Supp. 2d 1248 (W.D. Wash. 2009) (same).

Forum Selection and Choice of Law

- Importance of Applicable Law: The enforceability analysis often turns on the applicable state, or federal, law applied to the class action waiver.
- Choice of law and forum selection issues are often critical to the enforceability analysis for any given class action waiver.
- Choice-of-law clauses are not dispositive.
 - Courts will “apply the choice-of-law rules of the state in which it sits” to decide whether to enforce the choice of law provision. Guadagno, 592 F. Supp. 2d 1263, 1269 (C.D. Cal. 2008).
 - Many jurisdictions apply the test from § 187 of the Restatement (Second) of Conflicts of Laws, though some variations do exist.

The Choice-of-Law Clause

Choice-of-law clauses are not dispositive.

- Courts will “apply the choice-of-law rules of the state in which it sits” to decide whether to enforce the choice of law provision. Guadagno v. E*Trade Bank, 592 F. Supp. 2d 1263, 1269 (C.D. Cal. 2008).
- Many jurisdictions apply the test from § 187 of the Restatement (Second) of Conflicts of Laws, though some variations do exist.

A two-pronged inquiry that applies the law of the state chosen in an agreement unless:

- The chosen state has no substantial relationship to the parties or transaction and there is no other reasonable basis for choice; or
- Application of the chosen state’s law would violate a fundamental policy of a state which both
 - Has a materially greater interest than the chosen state in determining the issue, and
 - Would be the state of applicable law absent an effective choice by the parties.