ENFORCING CLASS ARBITRATION WAIVERS: THE FAA AND UNCONSCIONABILITY

By John Pitblado

The Third Circuit Court of Appeals recently joined the Ninth Circuit in ruling that the Federal Arbitration Act is superseded by state common law principles of unconscionability as applied to an arbitration agreement's class action waiver provision, rendering the provision unenforceable. In *Homa v. American Express Company*, [1] the court held that the FAA was superseded by New Jersey common law, despite the fact that the parties agreed that disputes would be settled under Utah law. Likewise, in *Davis v. Chase Bank USA, N.A.*,[2] the court held that the FAA was superseded by California common law, despite the parties' agreement to resolve disputes under Delaware law. These rulings create a great deal of uncertainty for a party wishing to avoid class litigation by seeking agreement to arbitrate disputes on an individual basis, and expecting enforcement under the agreed-upon state law for dispute resolution.

In *Homa*, the case involved a putative class of credit card consumers alleging that American Express misrepresented the terms of a cash-back bonus award program. The cardmember agreements contained an arbitration provision, which specified that all claims "be arbitrated on an individual basis . . . [with] no right or authority for any claims to be arbitrated [as] a class action." *Id*. at 227. The agreements also contained a choice-of-law provision requiring that disputes be arbitrated under Utah law (the cards were issued by American Express Centurion Bank, a Utah corporation). A Utah statute explicitly deems class action waiver provisions in arbitration agreements to be enforceable.[3] Nevertheless, the Third Circuit Court found that New Jersey's public policy, as evidenced by its Consumer Fraud Act[4] statutes, strongly disfavored mandatory arbitration on an individual basis because it impeded state residents' rights to vindicate claims that predictably involve a small amount of damages.

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[1] *Homa v. American Express Co*., 558 F.3d 225 (3d Cir. 2009).

[2] *Davis v. Chase Bank USA, N.A*., 299 Fed. Appx. 662 (9th Cir. 2008). The Ninth Circuit recently released another decision in line with the *Davis* decision, which analyzes Oregon common law. *See Chalk v. T-Mobile USA, Inc.*, 560 F.3d 1087 (9th Cir. 2009).

[3] *See* Utah Code Ann. §70C-4-105. The *Homa* court noted that "Utah is, to our knowledge, the only state to have enacted such legislation [and] indicates a strong public policy in favor of the enforcement of the waivers. It is not unreasonable to assume that the Utah statute was enacted because of policies honoring freedom-of-contract principles and intending to protect Utah banks from unwarranted class-action suits." *Id.* at 232.

[4] The court describes the New Jersey Consumer Fraud Act, codified at N.J. Stat. Ann. 56:8-1 *et seq*., as having been intended by its legislature "to be one of the strongest consumer protection laws in the nation and should be construed liberally in favor of protecting consumers." *Id.*

Similarly *Davis*, decided a few months earlier, involved a putative class of credit card consumers alleging claims under California state law. The arbitration agreement included a class action waiver, and the parties had contracted to apply the law of Delaware to their disputes. However, the Ninth Circuit Court found that California had a "materially greater interest" than Delaware in determining the enforceability of the provision because "California has an interest in protecting its citizens from unconscionable class action waivers." *Id*. at 663. It thus found the provision unenforceable under state law as unconscionable.

Thus, even though a company may contract for disputes to be resolved under the laws of a state where class action waivers are enforced, when presented with a conflict with common law contract principles of the consumer's home state, a court may find the latter to have a more significant interest in the application of its laws, precluding enforcement of the waiver on unconscionability grounds, and thus removing the claims from the purview of the FAA.

Indicia of Unconscionability

The *Homa* and *Davis* courts both found the class action waivers unconscionable, thus precluding enforcement thereof. In *Homa*, the court noted that the cardmember agreements bore the hallmarks of a "contract of adhesion" presented on a take-it-leave-it basis. *Id*. at 231. The Court also noted that the named plaintiff's claim implicated less than five percent of his account balance, and thus "predictably involve[d] a small amount of damages." *Id*.

The *Davis* court noted that the class action waiver involved in that case was an amendment to a customer agreement in the form of a "bill stuffer" which would be deemed accepted if the customer did not close the account. It thus provided little or no "actual notice" or any "realistic opportunity to reject" the waiver. *Id*. at 664. The court also emphasized that the waiver "is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money." *Id*.

Query, however, whether a class action waiver in an arbitration agreement presented on a "take it or leave it" basis (a contract of adhesion), in a situation where claims will "predictably involve small amounts of damages," will be deemed unconscionable if it contains adequate consumer protections. A federal district court in Florida recently granted a defendant's motion to compel arbitration under the FAA in similar circumstances, and the plaintiff has filed a notice of appeal with the Eleventh Circuit Court of Appeals.

In *Cruz v. Cingular Wireless, LLC*,[5] the court analyzed wireless service agreements entered into by the named plaintiffs, which agreements included an arbitration provision with a class action waiver. The court emphasized, however, the consumer-oriented nature of the dispute resolution procedures: in the event of dispute, the company is responsible for all filing, administrative and arbitrator fees; if the award is higher than the company's last settlement offer, but less than $5,000, the company will pay $5,000, and double the claimant's attorney's fees; there are no limitations on damages and the arbitrators can grant injunctive relief; and, in the event the company prevails, it may not seek reimbursement of any fees or costs. *Id*. at 3. The court went so far as to cite the defendant's characterization in its brief that its arbitration provision is more "pro consumer than any other arbitration provision in the country." *Id*. at 6.

On the issue of the "predictably small amount of damages" involved in the individual claims, the court noted that because the agreement allows for the recovery of attorney's fees to a prevailing consumer, the small amount of damages involved would not necessarily deter potential legal counsel from pursuing such a claim. *Id*. at 7-8. The court thus found that the FAA was not superseded by Florida common law principles of unconscionability, and that because the FAA is to be construed strongly in favor of arbitration, the court granted defendant's motion to compel.

Thus, while the trend may not presently appear favorable to class-action waivers in the federal Circuit Courts, some lessons may be drawn. First, it is likely less important now to consider an agreement's choice-of-law provision, and more important to consider the unconscionability principles of the consumer's state of residence, when analyzing the validity of a class action waiver. Second, it is important to analyze any such agreement's arbitration provision for indicia of unconscionability, as the contractual right to arbitrate on an individual basis in an agreement with adequate consumer protections may well be enforceable under the FAA.

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[5] *Cruz v. Cingular Wireless, LLC*, Docket No. 2:07-cv-714-FtM-29DNF (M.D. Fla., Sept. 15, 2008).