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Class Action Arbitrations: A First Circuit Update

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Are prohibitions of class actions in arbitration agreements enforceable? The answer is clear: it depends. Recently, the First Circuit scrutinized three arbitration agreements in which class actions were specifically prohibited. The first was sent to arbitration after severing the class action prohibition, allowing the arbitration of a class action. *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006). The second was sent to arbitration after finding that the clause did not necessarily conflict with the plaintiff's statutory rights, which allowed the arbitrator to decide whether to enforce the class action prohibition. *Anderson v. Comcast Corp.*, 500 F.3d 66 (1st Cir. 2007). The third and most recent matter was sent to arbitration after striking the class action waiver, again allowing an arbitrated class action. *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49 (1st Cir. 2007). Thus, despite the explicit contractual language attempting to eliminate class-wide arbitration in all three cases, the result in two of them was precisely class-wide arbitration, and in the third case, empowerment of the arbitrator to make the class action decision.

Background

Arbitration clauses are commonly found in contracts of all types and in all industries. For many years, these arbitration agreements were contemplated to apply individually, unless they expressly provided for class-wide treatment. However, in consumer and employment disputes, plaintiffs often seek class treatment, because the individual claims may be too small or expensive to prosecute separately. Where the arbitration agreement was either silent or specifically prohibited class-wide arbitration, class action defendants could defeat class treatment by moving to compel arbitration of the class representative's claims. Courts did not have a consistent way to balance the parties' intent to arbitrate with possible class-wide claims.

In 2003, the Supreme Court addressed this in *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003), holding that if an arbitration agreement is silent as to whether class arbitration is permitted, the arbitrator has the authority to determine arbitrability.

Bazzle involved consumer complaints that the defendant bank failed to provide certain forms in connection with loan transactions. The plaintiffs sought class certification. In holding that the arbitrator must interpret the arbitration agreement, Justice Breyer wrote, "the parties agreed to submit to the arbitrator '[a]ll disputes... relating to this contract....' And the dispute about what the arbitration contract in each case means, (i.e., whether it forbids the use of class arbitration procedures) is a dispute 'relating to this contract' and the resulting 'relationships'. Hence the parties seem to have agreed that an arbitrator, not a judge, would answer the relevant question." *Bazzle*, 539 U. S. at 451-52.

Many businesses responded to *Bazzle* by including explicit class prohibitions in their contracts. Millions of credit card, cell phone, and banking consumers were notified of an amendment to their agreement, and told that continued use of the service was deemed to be acceptance of the new clause. The burden was on the consumer to cancel the contract and to attempt to find another vendor without such a prohibition. Predictably, most consumers did nothing. In employment agreements, many companies amended their standard employment contract and required existing employees to agree to the new terms as a condition of continued employment. *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49 (1st Cir. 2007), discussed below, provides an example of how such a clause was added to employment agreements.

Plaintiffs' lawyers have responded with arguments to invalidate these anti-class action clauses. One common argument is that the prohibitions are unconscionable under state contract law. Unconscionability either can be procedural (dealing with contract formation), or substantive (dealing with the actual limitations on rights or remedies). Another successful argument is that the enforcement of such a clause will prevent vindication of statutory rights.

In what the First Circuit has viewed as a "trilogy" of cases, the Supreme Court developed a framework to address whether clauses prohibiting certain items, such as treble damages and attorneys' fees, as well as prohibitions on class actions, would in fact prevent plaintiffs from vindicating their statutory rights. In *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002), the Court defined the threshold question as one of arbitrability: did the parties agree to arbitrate a particular claim? Citing prior decisions, the *Howsam* court held that the existence of an arbitration agreement allows a court to presume the intent to arbitrate. Therefore, the scope of issues that the court (not the arbitrator) is permitted to resolve is limited to matters that fit within "the interpretive rule": whether the parties submitted a particular dispute to arbitration. *Howsam,* 537 U.S. at 83 *Howsam* found that courts, not arbitrators, should resolve two types of "gateway" disputes: whether the parties are bound by an arbitration clause, and whether an arbitration clause applies to a particular type of controversy. *Id.* at 84.

Building on the presumption of arbitrability, the Supreme Court promptly decided two additional cases where the vindication of statutory rights was at issue. *PacifiCare Health Systems, Inc. v. Book*, 538 U.S. 401 (2003) and *Bazzle*, 539 U.S. at 444, discussed above. In *PacifiCare*, a group of physicians brought claims, including one under RICO, against a number of HMOs. The HMOs sought to compel arbitration. The physicians argued that they would not be able to obtain "meaningful relief" under RICO because their arbitration agreement explicitly prohibited the recovery of punitive damages (while RICO authorized treble damages). Holding that the ambiguity did not present a question of arbitrability, the Court compelled arbitration to let the arbitrator decide to what extent the agreement was enforceable. *PacifiCare Health Systems,* 538 U.S. at 406-07. As discussed above, *Bazzle* also allowed the decision to be made by the arbitrator.

The First Circuit Response

In *Kristian v. Comcast*, 446 F.3d 25 (1st Cir. 2006), cable customers sought class certification in state and federal courts alleging that Comcast engaged in antitrust violations resulting in inflated prices for its customers. Comcast sought to compel arbitration in both cases. The plaintiffs argued that the arbitration agreements, which contained limitations on discovery, a shortened statute of limitations, limits on damages, and prohibitions on class actions, prevented them from vindicating their federal statutory rights, violated public policy, and were unconscionable under state law.

Using the framework developed in the Supreme Court trilogy, the First Circuit held that the challenges to the arbitration agreement relating to discovery, the statute of limitations, and damages did not present questions of arbitrability, but were appropriately left for the arbitrator to resolve. With respect to the provisions limiting class actions, treble damages, and attorneys fees, the court found that if these prohibitions were to be enforced, Comcast would be shielded from consumer enforcement antitrust liability, which would prevent the plaintiffs from vindicating their statutory rights. *Kristian*, 446 F.3d at 61. However, since the arbitration agreement also contained a "savings clause" that permitted severance of the class action bar, the court severed that portion of the agreement and preserved arbitration as the forum "consistent with the federal policy favoring arbitration." *Id.* at 62. The court concluded, "arbitration must proceed on a class or consolidated basis." *Id.* at 65.

The First Circuit next addressed this issue in another Comcast case, holding that the arbitrator should determine whether to enforce the class action prohibition. *Anderson v. Comcast Corp.*, 500 F.3d 66 (1st Cir. 2007). In *Anderson,* a cable customer was required for many years to lease certain pieces of cable equipment that he did not need and did not use, and for which he was charged monthly fees. He filed a putative class action in Massachusetts Superior Court alleging that the imposition of monthly rental fees for the equipment violated M.G.L. c. 93A, in addition to violating general common law tort and contract law principles.

Comcast moved to compel arbitration under the arbitration agreement, which not only required the arbitration of customer disputes, but also shortened the statute of limitations, limited possible damages, shifted costs, and prohibited class actions. The contract also contained various clauses severing any terms that conflicted with applicable law.

Anderson argued that arbitration under those terms would effectively deny his ability to vindicate his statutory and common law rights. Relying on the *Kristian* framework and analysis, the district court severed the provisions barring an award of attorneys' fees, class actions, and multiple damages, and ordered the parties to arbitrate.

On appeal, each side challenged separate elements of the decision. Comcast argued that the district court erred in severing the arbitration agreement's bar on class actions and multiple damages awards as they related to Anderson's Chapter 93A claim. Among other things, Anderson argued that, although the court correctly found some provisions invalid, it should have found the entire arbitration agreement unconscionable and therefore unenforceable.

The First Circuit's analysis started by recognizing the court's obligation "to enforce private agreements into which parties had entered" including the requirement that it "rigor-

ously enforce agreements to arbitrate ..." *Anderson,* 500 F.3d at 70 (citing *Dean Witter Reynolds, Inc. v. Byrd,* 470 U.S. 213, 221 (1985)). The court continued, following the *Kristian* framework, by recognizing the narrow scope of *Howsam's* "interpretive rule":

> ...[T]he phrase 'question of arbitrability' has a far more limited scope. The Court has found the phrase applicable in the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, where reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate.

Anderson, 500 F.3d at 71 (citing *Howsam*, 537 U.S. at 83-84).

It is precisely these "narrow circumstances" that the *Anderson* court was asked to review: whether (among others) the terms in an arbitration agreement that prohibited class actions conflicted with the plaintiff's statutory rights, and whether the conflict precluded enforcement of the arbitration agreement. *Anderson,* 500 F.3d at 71 ("Having made the bargain to arbitrate, the party should be held to it unless [the legislature] itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.") (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth,* 473 U.S. 614, 628 (1985)). The second avenue of challenge –unconscionability – was also identified in *Mitsubishi.* "[C]ourts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.'" *Mitsubishi*, 473 U.S. at 627 (citations omitted).

True to the *Kristian* framework, the *Anderson* court's analysis started (and ended) with whether there existed a conflict between the statute and the agreement.

The *Anderson* arbitration agreement prohibited arbitration on a class basis – "unless the state's law provided otherwise." However, since Chapter 93A specifically provided for a class action procedure, the court found that there would be ambiguity as to whether "93A provides otherwise," and thus found it was an issue for the arbitrator to interpret. Quoting *PacifiCare Health Systems*, 538 U.S. at 406-07, the court stated: "Since we do not know how the arbitrator will construe the remedial limitations, the questions whether they render the parties' agreements unenforceable and whether it is for courts or arbitrators to decide enforceability in the first instance are unusually abstract . . . the proper course is to compel arbitration." *Anderson*, 500 F.3d at 72.

The most recent First Circuit decision to address class action waivers is *Skirchak v. Dynamics Research Corp.,* 508 F.3d 49 (1st Cir. 2007). Filed as a class action, *Skirchak* involved claims under the Fair Labor Standards Act ("FLSA"), 29 U.S.C. §§201, and under the Massachusetts Fair Wage Law, M.G.L. c. 151. Plaintiff claimed that the defendant had failed to pay overtime to employees categorized as "exempt." The company moved to compel arbitration under its newly adopted Dispute Resolution Program ("Program"), which contained language waiving class treatment of any claim. The First Circuit upheld striking the class action waiver on grounds of unconscionability under both state law and under the Federal Arbitration Act. Characterized by the court as a narrow ruling, the court left open whether class action waivers violate the FLSA or public policy.

The company had adopted the Program by sending out, on the Tuesday before Thanksgiving, a short email to all employees, asking them to read the three attached documents describing the Program. The email mentioned nothing about waiver of rights, including the right to a judicial forum or to participate in a class action. No response was required. Even if an employee read the first attachment, a two-page memorandum describing the program, the employee would see no mention of a class action waiver. To the contrary, "the memorandum reiterated that [t]he program *does not limit or change any substantive legal rights* of our employees . . . ." *Skirchak,* 508 F.3d at 50.

The second attachment to the email was a fifteen-page document with appendices. Buried inside the appendices were two class action waiver clauses. The court noted that even if an employee read assiduously the entire document, there could still be doubt and ambiguity concerning the scope of the waivers. An employee was deemed to have accepted the Program with the class action waiver merely by showing up for work on the Monday after Thanksgiving.

The court noted that under *Bazzle* and the First Circuit's own decision in *Anderson,* the question whether the waiver was unconscionable was normally reserved to the arbitrator. However, since the parties had requested the court to decide the unconscionability question, the court determined that it had jurisdiction to reach this issue and "in the interests of efficiency," it would do so. *Id.* at 55. The court then determined that the methods used by the company in adopting its Program were procedurally unconscionable. Accordingly, the court struck the clause and ordered the matter to arbitration, permitting it to proceed as a class claim.

The First Circuit went to great lengths to identify all of the issues that it was *not* deciding, including whether such class action waiver clauses are *per se* against public policy under either the FLSA or the Massachusetts Fair Wage Law.

Conclusion

Despite great strides clarifying the issues of unconscionability and the waiver of statutory rights, the law governing prohibitions on class-wide arbitration remains unsettled. If there is a discernable trend, it is to recognize that the answer in any given case requires careful consideration of the factors identified in these cases. Congress or the Supreme Court should provide a more definitive answer. Until or unless that occurs, counsel can be assured that such clauses can be defeated or enforced, depending upon the claims at issue and counsel's own skills as an advocate. ■