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Arbitration and Class Actions After JAMS' Flip-Flop

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On Nov. 12, 2004, JAMS The Resolution Experts — one of the "big three" arbitration providers,[1] surprised the defense bar by announcing that it would no longer enforce arbitration clauses that preclude consumer and employment class actions.

Such clauses have been in widespread use in credit card and similar financial services contracts and have been a generally effective tool in managing defense costs while providing consumers with a fair, expeditious and cost-effective means of resolving their claims.

Then, in a further surprise, JAMS revoked its new policy on Feb. 10, 2005, apparently nunc pro tunc. These announcements by JAMS provide an opportunity for a review of current law regarding arbitration and class actions, the possible consequences of JAMS' actions, as well as practical drafting tips for practitioners.

Class-Action Waivers

• Existing Law Regarding Class-Action Waivers in Arbitration. Substantially all major credit card issuers (including American Express, Chase/Bank One, Capital One, Citibank, Discover, Fleet and MBNA) and many mortgage lenders (such as GMAC and Countrywide) for loans that are not sold to Fannie Mae (FNMA — Federal National Mortgage Association) or Freddie Mac (FHLMC — Federal Home Loan Mortgage Corp.) — now routinely include arbitration clauses in their consumer agreements. By including such clauses, the lenders avoid marginal or entirely unfounded class claims asserted solely in hopes of rapid settlement. Some forums are notorious for providing opportunities for such abuses, including the Alabama state courts, as well as certain counties in Texas, Illinois and Florida. Arbitration provides an expeditious, fair and low-cost means of resolving bona fide disputes while avoiding the vexations and unfavorable publicity that may attend conventional litigation. Arbitration, unlike litigation, is generally conducted on a uniform procedural basis nationwide.

Section 4 of the Federal Arbitration Act (FAA), 9 USC §4, authorizes federal courts to require parties to arbitrate "in accordance with the terms of the agreement."[2] With the exceptions noted in the following paragraph, courts generally enforce such agreements that require claims to be arbitrated on an individual, rather than classwide, basis.

Some courts have rejected class-action waivers contained in arbitration clauses that contained multiple defects. However, to date, only a few states — California and West Virginia (Florida and Washington courts have also disapproved on similar grounds) — have been willing to invalidate arbitration clauses on the sole ground that a class-action waiver is deemed to be unconscionable. The draftsman of an arbitration clause must now provide for the very real possibility that enforcement of the clause will be tested in a jurisdiction that disfavors class-action

waivers.

'Bazzle'

Green Tree Fin'l Corp. v. Bazzle, 539 US 444 (2003), has its genesis in claims against the business now known as Conseco Financial Corp. arising from consumer loan agreements containing arbitration clauses silent on whether class actions would be permitted. The South Carolina Supreme Court had refused to vacate two multimillion-dollar class-action arbitration awards, rejecting the lender's argument that classwide arbitration was inappropriate unless specifically authorized by the parties in their arbitration provision.

The U.S. Supreme Court, in an unusually divided outcome, held in a plurality opinion authored by Justice Stephen Breyer and concurred in by Justices Ruth Bader Ginsberg, Antonin Scalia and David Souter that, absent direction from the parties in their agreement, decisions concerning class actions in the arbitration are the province of the arbitrator.[3] Despite urging by the lender and numerous amici, the court refused to pronounce a blanket rule that class actions were inconsistent with arbitration unless expressly authorized by the parties.

In response to *Bazzle,* many lenders have begun modifying their consumer arbitration clauses to include the following provisions:

• In addition to a waiver by the consumer of the right to bring or participate in a class action, an express statement that the arbitrator is not authorized to hear any claim in class form or to consolidate any claims of multiple parties without the consent of all parties (the arbitrator's exceeding his authority will generally be grounds for vacating the award; 9 USC §10[a][4]);

• A statement to the effect that the validity, effect and enforceability of the class-action waiver is to be determined solely by a court of competent jurisdiction and not by the arbitrator (this clause responds directly to Justice Breyer's plurality opinion in

Bazzle to the effect that the primary objective in enforcing an arbitration clause is to carry out the intentions of the parties);

• Finally, a severability clause that provides that if the court refuses to enforce the class-action waiver, then the entire arbitration clause is void, and the class action will proceed in court rather than in arbitration.[4]

These modifications, among others, remain appropriate in light of JAMS' pronouncement discussed infra.

JAMS' New Policy

JAMS announced on Nov. 12 that it would no longer enforce class-action waivers in arbitration cases of which it is the designated administrator:

JAMS takes the position that it is inappropriate for a Company [sic] to restrict the right of a consumer to be a member of a class action arbitration or to initiate a class action arbitration. Accordingly, JAMS will not enforce these clauses in class action arbitrations and will require that they be waived in individual cases. If a consumer arbitration clause which otherwise meets JAMS Minimum Standards of Fairness contains a class action preclusion clause, JAMS will handle such arbitrations in the following manner:

1. If the arbitration is an individual arbitration filed by a consumer against the Company [sic] imposing the clause, then JAMS will take the individual case if the Counsel [sic] for the Plaintiff [sic] waives the inclusion of the clause. If there is no waiver, JAMS will decline the case.

2. If the arbitration is an individual case referred to JAMS from a court after the plaintiff has first filed a law suit and the defendant has requested removal to arbitration, JAMS will take the individual case if Counsel [sic] for the Plaintiff [sic] waives the inclusion of the clause or the court has stricken the clause. If there is no waiver and the court has not stricken the clause, JAMS will decline the case.

3. If a class-action arbitration is filed at JAMS and there is a class action preclusion clause, JAMS will accept the case and not enforce the clause.

Apparently in response to inquiries pointing out the limited authority of an arbitration administrator (as opposed to a court or arbitrator) to interpret and enforce arbitration agreements, JAMS was forced to retrench and supplement its policy, which it did on Dec. 10. In the supplement, JAMS noted that "under [*Bazzle*], the Claimant [sic] is free to argue the invalidity of the preclusion clause to the arbitrator and, under *Bazzle,* the arbitrator has the authority to determine whether the arbitration can proceed as a class action. *Neither JAMS nor any other ADR (alternative dispute resolution) administrator [sic] has the authority to dictate a result to the arbitrator"* (emphasis added). JAMS pronounced that, with respect to class-action arbitrations filed with JAMS:>

a. JAMS will accept the case for arbitration administration and proceed to manage the appointment of an arbitrator.

b. At some point in this process, one of the parties may go to court to either enforce the preclusion clause or to have it declared unenforceable. This could happen either before or after the arbitration has been filed at JAMS.

1) If the court declares the preclusion clause to be valid and sends it back to JAMS as an individual case, JAMS will proceed on that basis and appoint an arbitrator.

2) If the court declares the preclusion clause to be invalid, then JAMS will proceed with the arbitration as a class action arbitration.

3) Obviously if neither party goes to court, JAMS will proceed with the administration of the arbitration as a class arbitration.

JAMS officials have stated repeatedly that it would promulgate class arbitration rules, but it never in fact issued such rules.

From the standpoint of the class-action defendant, the upshot of the revised announcement was that JAMS — and presumably arbitrators who are on JAMS' roster — would ignore the agreement of the parties and enforce the parties' arbitration clause as JAMS wanted, not as the parties manifestly intend. This repudiation by JAMS of the parties' agreement raised several legal and practical issues:

• Most frustratingly, JAMS unfairly surprised businesses that had agreed to use JAMS' services in reliance on JAMS' express policy of allowing the parties to modify JAMS' rules by agreement, and in reliance on JAMS' longstanding acceptance of class-action waivers. (Rule 7F of the JAMS Financial Services Arbitration Rules and Procedures remains unmodified as of this writing and provides, "Claims brought as a class action may be arbitrated only upon agreement between Responding Party(ies) and the purported class representatives.") Until recently JAMS actively marketed its services to businesses seeking to establish consumer arbitration programs and provided prescreening of such programs in which class-action waivers were readily accepted by JAMS. It is likely that such users will in the aggregate now need to incur millions of dollars of printing and mailing expenses to modify their arbitration clauses and to communicate those modifications to their respective customers.

• JAMS took upon itself the imposition of unilateral changes in the parties' arbitration agreements, placing its arbitrators in an impossible position of being required to exceed the authority granted to them by the parties in order to comply with JAMS' policies. Moreover, by unilaterally deeming a portion of a consumer agreement to be unfair, JAMS may unfairly prejudice its arbitrators' views of the remaining portions of the agreement.

JAMS unilateral determination to refuse to follow substantive state and federal law that allows the parties to waive class actions by agreement was troublesome and represented the first time that a major arbitration organization had refused to follow applicable law; JAMS could simply have refused to hear such cases, but instead it decided to blue-pencil the parties' class-action waivers that are completely lawful in the vast majority of jurisdictions. Logically JAMS' position made no more sense than if JAMS had refused to allow its arbitrators to award punitive damages where permitted by state law, or if JAMS had decided that the maximum interest rate it would allow on any debt were 3 percent.

While heralded by consumer advocates, it is doubtful that JAMS acted solely in the interest of consumer protection in making its announcement. JAMS is in the business of generating mediation cases for its distinguished panel of former jurists. By announcing that it would henceforth disregard the parties' class-action waivers, JAMS looks like a "hero" to consumer groups while placing itself and its panelists in a far more profitable position of handling only "meaty" cases and forcing marginally profitable work to other arbitration providers.

'Gipson'

The first judicial challenge to JAMS' policy arose in *Gipson v. Cross Country Bank*, 354 FSupp2d 1278 (M.D. Ala. 2005). Ms. Gipson sued in 2003, alleging that the application of payments to her Visa(r) card had been impermissibly delayed, in violation of the Fair Credit Billing Act, on behalf of a class of cardholders. Cross Country moved to compel arbitration pursuant to the JAMS rules, in accordance with the terms of the cardholder agreement containing a waiver of class claims; the court granted the motion and compelled non-class arbitration of Ms. Gipson's claims (294 FSupp2d 1251).

Shortly prior to JAMS' announcement, the arbitrator issued an order concluding that "[s]ince the question of enforceability of the class prohibition, as well as any other questions which do not go to the issue of the validity of the arbitration clause, are mine to determine, the prior determination of those issues by the District Court is of no moment." Cross Country immediately moved for enforcement of the court's prior non-class arbitration order, that plaintiff be enjoined from seeking to pursue class claims in arbitration, and, in response to Ms. Gipson's citation of JAMS' new policy, that the policy not be applied.

Judge Albritton began by distinguishing the express waiver of class actions contained in Cross Country's cardholder agreement from the clause in *Bazzle,* which was silent on class actions. Because Ms. Gipson had expressly and unambiguously waived class claims, the court determined that the class-action waiver was "enforceable as a matter of law, without a need for arbitrator interpretation." Relying heavily on the discussion contained in *Pedcor Mgt. Co., Inc. Welfare Benefit Plan v. Nations Personnel of Texas, Inc.,* 343 F3d 355, 359-60 (5th Cir. 2003), he found that enforceability of a class-action waiver is an issue for the court, not for the arbitrator. In a stinging rebuke of the arbitrator and JAMS' policy, Judge Albritton noted, "'Arbitrators . . . cannot inflate their authority beyond the boundaries of the . . . court's order of reference . . . [because they] derive . . . their powers from the . . . court's order.'" Ms. Gipson was enjoined from pursuing her claims on a classwide basis, and her efforts to enforce JAMS' policy were rejected.

JAMS Retracts New Policy

In response to an uproar from the defense bar and to what JAMS saw as a challenge to its "core value of neutrality," the no-class-action-waiver policy was rescinded on Feb. 10, 2005. JAMS has stated merely that "JAMS and its arbitrators will always apply the law on a case-by-case basis in each jurisdiction." This appears to mean that — under JAMS' now-revised policy stance — if a class claims are asserted and the arbitration clause contains class-action waiver, JAMS will administer the case as an individual arbitration only if applicable law holds that the class action waiver is valid. JAMS will presumably honor a prior judicial determination upholding a class action waiver; but in the absence of such a court order, the JAMS class-action rules give the arbitrator the opportunity to decide whether the validity of the class-action waiver is itself arbitrable, and, if so, to determine that issue.

The retraction of the November 2004 policy leaves several issues open. Prior to November, JAMS would not administer arbitrations in class form without the consent of all parties. Now, JAMS clarifies that it will accept all cases and determine on a case-by-case basis whether a class-action waiver is enforceable under applicable law. What law applies, exactly what is that law, and who makes the determination? It is predictable that class arbitrations will be filed with JAMS with respect to arbitration clauses involving class-action waivers where no prior court action has been involved. In such cases, a JAMS arbitrator will determine the validity of the class action waiver. (Although there has been speculation that JAMS might determine such matters administratively, Rule 2 of JAMS' February 2005 class-action procedures requires this determination to be made by the arbitrator.) Under JAMS' procedures, the arbitrator's determination "may," but need not, be subject to immediate judicial review.

(Presumably, as in *Gipson,* the respondent will wish to seek a court order staying class arbitration and compelling arbitration on an individual basis.) There will be uncertainty and controversy over whose determination — the court's or the arbitrator's — should control. If the class-action waiver is determined to be unenforceable, there will be doubt about whether the waiver alone should be blue-penciled or the entire arbitration clause struck.

Practice Pointers

JAMS' policy flip-flop will inevitably result in the filing of some claims based on preexisting clauses that cannot be modified. Because JAMS' "new, new" policy will render it uncertain whether a JAMS' arbitrator will observe the parties' agreement to waive class actions, respondents should consider making a court application for appointment of an arbitrator who will unequivocally follow the agreement, as provided for under §5 the FAA. Alternatively, a court should be willing to enter an "order directing that such arbitration proceed in the manner provided for in [the parties'] agreement" as required by §4 of the FAA, i.e., as an individual claim only.

Practitioners need to be mindful of the possibility that such a dispute may arise in the context of an arbitration clause that has not been updated, as suggested infra, to provide that any such issue will be resolved exclusively by a court and not by an arbitrator. The respondent in such a case may be faced with the assertion that the enforceability of JAMS' new policy should be determined by the arbitrator. However, a better position is that enforcement of an arbitration clause as written, including a class-action waiver contained in the clause, is strictly a "gateway matter" which the Supreme Court has instructed in *Bazzle* that courts and not arbitrators should decide.[5]

The following additional drafting guidelines should be considered:

• On the assumption that JAMS will not relent and once again agree unequivocally to enforce arbitration agreements in accordance with their terms, businesses should redraft their arbitration clauses to eliminate JAMS as an arbitration provider (as of this writing, JPMorgan Chase and Citigroup have dropped JAMS from their credit card arbitration agreements). Such revised clauses can be made applicable to disputes arising from facts in existence prior to the amendment and can, in the case of most credit cards, be communicated through change-in-terms notices to cardholders (the details of implementing revised arbitration clauses are beyond the scope of this article). As of this writing, only the National Arbitration Forum (NAF) has been unequivocal regarding its enforcement of class-action waivers;

• The revised arbitration clause should specify that in the event of any conflict between the arbitration clause and the rules of the arbitration provider, the former will control; and

• In the event that the arbitration provider and/or arbitrator declines, or has announced that it will decline, to enforce the entire arbitration clause as written, either party should be entitled to have the proceedings stayed and to select another arbitration provider or to engage in the selection of a new arbitrator, or to have an arbitrator appointed by a court.

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Endnotes:

1. The others are the American Arbitration Association and National Arbitration Forum (NAF). At present, the NAF rules preclude class arbitrations absent consent of the parties. NAF Rule 19A (http://www.arb-forum.com/code/070103.doc, visited Nov. 21, 2004). The AAA will presently administer class arbitrations only under these designated circumstances:

. . . if (1) the underlying agreement specifies that disputes arising out of the parties' agreement shall be resolved by arbitration in accordance with any of the Association's rules, and (2) the agreement is silent with respect to class claims, consolidation or joinder of claims . . . .The Association is not currently accepting for administration demands for class arbitration where the underlying agreement prohibits class claims, consolidation or joinder, unless an order of a court directs the parties to the underlying dispute to submit their dispute to an arbitrator or to the Association.

The arbitrability of class arbitrations where the parties' agreement precludes such relief is a developing area of the law, and the Association awaits further guidance from the courts on this issue.

http://www.adr.org/index2.1.jsp?JSPssid=15753&JSPaid=43408 (visited Nov. 21, 2004).

2. The FAA requires courts to enforce private arbitration agreements in accordance with their terms. Volt Info. Scis., Inc. v. Board of Trs., 489 US 468, 479 (1989); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 US 52, 53-54 (1995); Perry v. Thomas, 482 US 483, 492-93 n.9 (1987). Thus, proper drafting is essential to enforcement of such clauses.

3. Justice Breyer reasoned that the parties, in granting the arbitrator the ability to determine the scope of his authority, had impliedly agreed that the arbitrator could also determine whether class actions should be available. Justices Anthony Kennedy, Sandra Day O'Connor and William Rehnquist dissented and would have reversed. They urged that the determination to allow class actions so conflicted with the intent of the parties that the result violated the Federal Arbitration Act; they emphasized that a provision of the arbitration clause allowing the parties to choose an arbitrator in each individual case was inconsistent with the appointment of a single arbitrator, without the consent of each class member, to determine a class of cases. Justice John Paul Stevens filed a separate opinion that the decision to allow arbitration in class form was a matter of state law and therefore that the lower court's decision should be affirmed; he concurred in judgment, but not in plurality opinion. Finally, Justice Clarence Thomas said that the Federal Arbitration Act is inapplicable to state-court proceedings.

4. The inclusion of such a clause should be considered if the parties believe, as does the author, that administration of class proceedings in arbitration is inappropriate (the difficulties of class arbitration were expansively addressed in Southland Corp. v. Keating, 465 US 1 [1984]). As a general matter, arbitration clauses should not be subject to general severability provisions of a consumer agreement, since a result of such a provision is that a court might strike the class-action waiver and enforce the remaining provisions of the agreement.

5. See, e.g., Anders v. Hometown Mortg. Svcs., Inc., 346 F3d 1024, 1027 (11th Cir. 2003); Bellevue Drug Co. v. Advance PCS, 333 FSupp2d 318, 332 n. 6 (E.D. Pa. 2004).