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Expert Analysis

Class Arbitration—Dying but Not Dead

By **Edward M. Spiro**

And **Judith L. Mogul**

Many entities doing business with the public have long preferred arbitration as a forum for resolving disputes with their customers. Arbitration is generally faster and less expensive than litigation and offers an efficient and generally non-public forum for handling the complaints of unhappy clients and customers. For businesses whose client and customer relationships are based on contracts that include arbitration clauses, the Supreme Court's 2010 decision in *Stolt-Nielsen v. Animal Feeds International Corp.*[1] provided strong protection against class litigation.

Stolt-Nielsen held that a party cannot be compelled to arbitrate on a class-wide basis unless there is a contractual basis for doing so, and that an agreement that is silent on the topic of class arbitration does not constitute an agreement to arbitrate class disputes. By requiring arbitration of disputes arising out of the customer relationship, and declining to agree to class arbitration, businesses dealing with consumers can effectively foreclose the option of class litigation.

'Edwards v. Macy's'

Judge Colleen McMahon issued a decision in June in *Edwards v. Macy's*[2] demonstrating that even when a business holds all the cards in drafting an arbitration agreement with its customers, it can over-play that hand. The plaintiff in *Edwards* had opened a credit card account at a Macy's department store when making some purchases. The Macy's store credit card for which she applied was offered by DSNB, a subsidiary of Citibank that issues credit cards for retail stores. At the time she opened the account, the plaintiff was offered, and accepted enrollment in a 30-day free trial of DSNB's "Credit Card Protection Program." The Credit Card Protection Program's terms and conditions were contained in an amendment to the credit card agreement, both of which contained arbitration clauses.

Plaintiff acknowledged signing up for the program but alleged that she did not understand certain key aspects of the program. She thought the program protected her from someone hacking into her account, whereas the program actually provided debt cancellation or forgiveness in certain circumstances such as serious illness or injury or involuntary unemployment. Plaintiff was ineligible for the debt cancellation benefit under the latter circumstance because she was self-employed. Plaintiff also did not understand that after the first 30 days of the program, she would be charged a monthly amount based on her credit card balance. She realized that fact only four years after she enrolled, by which point she had paid $250 in fees.

'Edwards' serves as a reminder that trying to sweep third-party claims within the scope of an arbitration clause may radically reduce the protections such clauses are designed to provide.

Plaintiff cancelled her enrollment in the program. When she received only a partial refund of $17.12, she filed suit in federal court alleging individual and class claims sounding in fraud, unjust enrichment and unlawful trade practices. The defendants (Macy's and DSNB) moved to compel arbitration under the Federal Arbitration Act, but in an unusual twist, asked the court to order arbitration only as to plaintiff individually, asserting that they would rather litigate in the event the court declined to limit the arbitration to plaintiff's individual claims.[3]

Finding that plaintiff had agreed to arbitrate disputes related to the program, and that the arbitration agreement was valid on its face and not procedurally unconscionable, Judge McMahon issued an order compelling arbitration between plaintiff and the defendants. She declined, however, to grant defendants' request that she determine that arbitration proceed only against the plaintiff and not on a class-wide basis, noting: "That, I fear, I cannot do."[4]

Clause Requiring Consolidation With Third-Party Disputes May Authorize Class-Wide Arbitration. Judge McMahon held that whether the arbitration should proceed on an individual or class-wide basis was a question to be decided by the arbitrator, and not by the court—at least in the circumstances presented by that case. McMahon began her analysis with the proposition that under *Stolt-Nielsen*, "[a] party cannot be compelled to arbitrate on a class-wide basis unless there is a contractual basis for forcing him to do so."[5] She noted that in *Stolt-Nielsen* the arbitration agreement was silent on the question of class arbitration and the parties had stipulated that they had reached no agreement on the issue—a fact that the Supreme Court found dispositive, holding that in the absence of such an agreement there was no basis from which consent to class arbitration could be inferred.

By contrast, the agreement in *Edwards* had what Judge McMahon termed "a most unusual coda." Even though the agreement did not mention the word "class" or "class-wide arbitration," it provided broadly that in addition to arbitration of any

EDWARD M. SPIRO *and* JUDITH L. MOGUL *are principals of Morvillo Abramowitz Grand Iason & Anello P.C.and co-authors of "Civil Practice in the Southern District of New York," 2d Ed. (Thomson West 2014).*

dispute or controversy arising out of or relating in any way to the agreement, "[i]f we, a claimant, or a third party have any dispute that is directly or indirectly related to a dispute governed by the arbitration provision, the claimant and we agree to consolidate all such disputes."

Reasoning that the claims of putative class members arising from the same agreement arguably related to the plaintiff's arbitrable dispute with defendants, and that the term "consolidate" may also permit class arbitration, Judge McMahon concluded that "[t]his reference to consolidation of Plaintiff's dispute with related third party disputes can certainly be read to authorize class-wide arbitration." Acknowledging that there might be other ways to read the agreement, she held that under principles of contra preferentum, because defendants had drafted the agreement, it might be best to read it as a consent to class arbitration.[6]

Question of Class-Wide Arbitration Is for Arbitrators to Decide in the First Instance. Judge McMahon noted that before she could address the import of that "unusual language," the court needed to resolve the predicate question of whether it is the court or the arbitrators who should decide the question. She found that *Stolt-Nielsen* shed no light on this question because in that case the parties had stipulated that they had made no agreement on the subject. She noted that in writing for the majority, Justice Samuel Alito was careful to employ neutral terms, such as the appropriate "decisionmaker"—a question not presented to the court in that case.[7]

Without guidance from *Stolt-Nielsen*, McMahon found three independent bases for concluding that the issue of whether the agreement before her in *Edwards* authorized class arbitration should be decided by the arbitrators. First, she noted that the question of whether the parties' agreement encompassed class-wide arbitration is one of contract construction, and that *Stolt-Nielsen* had not altered the long-standing presumption that for broad arbitration agreements such as that at issue in *Edwards*, "the issue of contract construction is perforce arbitrable."[8]

Second, she pointed to the fact that the agreement between plaintiff and Macy's called for arbitration to be conducted in accordance with the rules of the American Arbitration Association (AAA), which expressly provide that "the arbitrators determine as a threshold matter" in the form of a partial final award "whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class."[9] Because the AAA rules also provide for immediate judicial review of such a determination, Judge McMahon found that the defendants did not risk being subjected to a potentially costly and cumbersome class-wide arbitration which might later be overturned based on a finding the arbitrators had exceeded their authority.[10]

Third, she found that although the Supreme Court had not directly addressed the question, the court had given an indication that it would favor submitting to the arbitrators the issue of whether a contract authorized class arbitration. She pointed to the plurality decision in *Green Tree Financial Corp. v. Bazzle*,[11] in which a plurality of four justices had concluded that in the context of a broad "any and all disputes" arbitration agreement, it was for the arbitrators to decide, at least in the first instance, whether an agreement contemplated class arbitration.

Although Justice John Paul Stevens did not join that opinion, Judge McMahon found it significant that he "indicated that 'arguably' an arbitrator should have made the initial decision on the matter." McMahon observed that "[w]hile qualified" Stevens' remark "does no more than reflect prevailing sentiment at the circuit level about the proper division of labor between courts and arbitrators in the face of a broad arbitration clause."[12]

Judge McMahon noted that the question of whether the parties' agreement encompassed class-wide arbitration is one of contract construction, and that 'Stolt-Nielsen' had not altered the long-standing presumption that for broad arbitration agreements such as that at issue in 'Edwards,'"the issue of contract construction is perforce arbitrable."

Judge McMahon noted that notwithstanding the factors pointing, in her view, toward leaving the decision to the arbitrators, since *Stolt-Nielsen* "some courts have concluded that the decision is for the courts, not arbitrators." She noted in particular that Southern District Judge Victor Marrero, in *Anwar v. Fairfield Greenwich*,[13] had compelled arbitration on an individual basis, finding that the question of whether an arbitration agreement is silent on class arbitration is a gateway issue for the court to decide.[14]

McMahon found no conflict between her conclusion in *Edwards* and Marrero's ruling in *Anwar*, agreeing that "a court can and should decide the issue of silence." She went on to reason that where a broad arbitration agreement is arguably not silent on this question, "the arbitrators, not the Court, should interpret the contract of the parties in the first instance," subject only to review by the court to ensure that the arbitrators have not exceeded their powers or manifestly disregarded the law.[15]

Judge McMahon closed with the observation that Macy's should not be heard "to suggest that implementation of the very rules by which it elected to proceed will harm it." She advised the parties that she was prepared to enter an order compelling arbitration, the first phase of which would be to decide whether the phrase in the arbitration agreement in which the parties agree to consolidate third-party disputes in the arbitration encompasses class arbitration. She provided the defendants the option to waive their right to arbitration if they preferred not to proceed under those conditions, directing that in that event the case would proceed, before her, with an answer, class discovery and class certification.[16]

Conclusion

Entities whose business relationships with the public are governed by form agreements such as the one at issue in *Edwards* have virtually complete control over the scope of the arbitration agreements to which their customers will be bound. *Stolt-Nielsen* made clear that a broad "any and all disputes" arbitration clause that is silent on the question of class arbitration does not permit class arbitration, and Judge Marrero's decision in *Anwar v. Fairfield Greenwich* provides strong support for the proposition that a court may compel an individual who has signed such an agreement to forgo class litigation and arbitrate his or her claims individually. *Edwards*, however, serves as a cautionary reminder that broader is not always better, and that trying to sweep third-party claims within the scope of an arbitration clause may radically reduce the protections such clauses are designed to provide.

1. 599 U.S. 662 (2010).
2. 2015 WL 4104718 (S.D.N.Y. June 30, 2015).
3. Id. at *3.
4. Id. at *9.
5. Id.
6. Id. at *10.
7. Id. (quoting *Stolt-Nielsen*, 559 U.S. at 680, 682).
8. Id. at **10-11 (citing *Collins & Aikman Prods. Co. v. Bldg. Sys.*, 58 F.3d 16, 23 (2d Cir. 1995)).
9. Id.
10. Id. at *12.
11. 539 U.S. 444 (2003).
12. 2015 WL 4104718, at *11.
13. 950 F.Supp.2d 633 (S.D.N.Y. 2013).
14. 2015 WL 4104718, at *11. Judge McMahon also cited *Opalinski v. Robert Half Inter.*, 761 F.3d 326 (3d Cir. 2014) and *Huffman v. Hilltop Companies*, 747 F.3d 391 (6th Cir. 2014) as examples of other circuits which have held that "silence raises a question of arbitrability that rests with a court."
15. Id. at *12 (citing *Collins & Aikman Prods. Co.*, 58 F.3d at 23).
16. Id. The defendants subsequently waived their right to arbitration and opted to proceed before Judge McMahon.