Green Tree Financial Corp. v. Bazzle: A New Day for Class Arbitrations?

KEVIN M. KENNEDY AND BETHANY APPLEBY

Roughly half of all leading franchisors' franchise agreements require arbitration of disputes.[1] One of the primary reasons that franchisors choose arbitration is the perception that arbitration awards are typically more rational than jury verdicts, and less likely to produce grossly excessive recoveries for franchisees. Arbitration has also been viewed as an effective risk management tool because of its utility as a "class action shield."[2] The overwhelming majority of federal appellate courts addressing the issue held that arbitrators lacked the authority to allow class arbitrations unless an arbitration clause specifically contemplated that result. As one commentator observed in a 1997 *Franchise Law Journal* article, "[s]ince many (and perhaps most) of the putative class members" may never pursue individual claims in separate arbitrations, "and because arbitrators typically do not issue runaway awards, strict enforcement of an arbitration clause [forbidding class action arbitrations] should enable the franchisor to dramatically reduce its aggregate exposure."[3] Accordingly, during the past decade, arbitration clauses have repeatedly enabled franchisors to "break up" attempts by franchisees to assert class or consolidated claims.[4]

For these reasons, franchisors with arbitration clauses must understand the significance of the recent decision of a sharply divided U.S. Supreme Court in *Green Tree Financial Corp. v. Bazzle*,[5] which held that when an arbitration clause is silent on class treatment, whether to certify a class is for arbitrators, not a court, to decide. For franchisors with arbitration clauses expressly forbidding class or consolidated arbitrations, the U.S. Supreme Court's decision will likely have little impact on the franchisor's ability to insist that disputes be resolved in individual cases. However, for franchisors whose agreements are silent on class treatment, *Green Tree* creates a potentially grave problem.

This article first reviews the state of the law before *Green Tree* to help explain how substantially the U.S. Supreme Court has now changed the law. It then offers some practical suggestions on how, after *Green Tree*, franchisors can persuade arbitrators to reject class arbitrations.

The Law Before *Green Tree*

The U.S. Supreme Court has repeatedly observed that the primary purpose of the Federal Arbitration Act (FAA) is to enforce arbitration agreements in accordance with their terms.[6] Section 2 of the FAA provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving [interstate][7] commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.[8]

Before *Green Tree*, whether, under the FAA, a class or consolidated arbitration was available appeared to be an issue for a court, not an arbitrator, to decide. In addition, the clear weight of federal authority held that absent an express agreement of the parties, there could be no class or consolidated arbitrations.[9]

The U.S. Court of Appeals for the Seventh Circuit's 1995 decision in *Champ v. Siegel Trading Co., Inc.*,[10] illustrates how federal appellate courts approached class arbitrations. There, an investor sued a brokerage firm in federal court, alleging violations of RICO and other federal and state statutes. The defendants moved to compel arbitration pursuant to section 4 of the FAA, and the district court granted the motion. The plaintiff then filed a motion requesting that the court certify her as a class representative in the arbitration. The district court ultimately denied the request, concluding that because the arbitration clause did not specifically authorize class treatment, it lacked the authority to grant the requested relief. Thereafter, other members of the putative class moved to intervene, contending that the district court should have certified the matter as a class action. The district court denied this request, and the investors appealed.

The central question on appeal was whether the district court had the authority to certify a class where the arbitration clause was silent on the issue. The Seventh Circuit emphatically answered "no," reasoning:

> [S]everal other circuits have addressed whether a district court has the authority to apply Fed. R. Civ. P. 42(a) and order consolidated arbitration where the parties' arbitration agreement is silent on the matter. The Second, Fifth, Sixth, Eighth, Ninth and Eleventh Circuits have held that absent an express provision in the parties[']arbitration agreement, the duty to rigorously enforce arbitration agreements "in accordance with the terms thereof" as set forth in section 4 of the FAA bars district courts from applying Rule 42(a) to require consolidated arbitration, even where consolidation would promote the expeditious resolution of related claims.
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> We have a similar situation here. The parties' arbitration agreement makes no mention of class arbitration. For a federal court to read such a term into the parties' agreement would "disrupt[] the negotiated risk/benefit allocation and direct[] [the parties] to proceed with a different sort of arbitration." We find no meaningful basis to distinguish between the failure to provide for consolidated arbitration and class arbitration. We thus adopt the rationale of several other circuits and hold that section 4 of the FAA forbids federal judges from ordering class arbitration where the parties' agreement is silent on the matter.[11]

Kevin M. Kennedy is a partner and Bethany Appleby is an associate in the New Haven office of Wiggin & Dana, LLP.

The Seventh Circuit recognized that its holding could result in inefficiency and perhaps even unfairness by denying the investors the right to pursue a class arbitration. The court emphasized, however, "that we must rigorously enforce the parties' agreements as they wrote it, 'even if the result is 'piece-meal' litigation.' "[12]

Champ and several other federal appellate decisions enabled franchisors with arbitration agreements to use the FAA to defeat class actions. For example, during the 1990s, a Subway franchisor stopped several putative class actions at an early stage by obtaining orders pursuant to section 4 of the FAA, compelling the class representatives to arbitrate their claims with the franchisor in individual proceedings.[13] As a practical matter, as long as there was complete diversity of citizenship between the parties and the amount in controversy exceeded $75,000, all a franchisor needed to do to avoid class or consolidated treatment of franchisee claims was to invoke section 4 of the FAA, and then seek a stay (or an injunction) of the pending class action.

U.S. Supreme Court's Decision in *Green Tree*

The U.S. Supreme Court's decision in *Green Tree* arose out of a dispute between a financing company and four consumers. According to the consumers, Green Tree Financial Corp. failed to follow certain loan disclosure procedures required under South Carolina law when it entered into a home improvement loan and related security agreements arising out of the sale of a mobile home.[14] The arbitration clause in Green Tree's contracts was substantially identical and provided:

> ARBITRATION—All disputes, claims, or controversies arising from or relating to this contract or the relationships which result from this contract . . . shall be resolved by binding arbitration by one arbitrator selected by us with consent of you. This arbitration contract is made pursuant to a transaction in interstate commerce, and shall be governed by the Federal Arbitration Act at 9 U.S.C. section 1. . . . THE PARTIES VOLUNTARILY WAIVE ANY RIGHT THEY HAVE TO A JURY TRIAL, EITHER PURSUANT TO ARBITRATION UNDER THIS CLAUSE OR PURSUANT TO COURT ACTION BY US (AS PROVIDED HEREIN). . . . The parties agree and understand that the arbitrator shall have all powers provided by the law and the contract. These powers shall include all legal and equitable remedies, including, but not limited to, money damages, declaratory relief, and injunctive relief.[15]

The four consumers, in two separate South Carolina state court lawsuits, sought class certification of their claims against *Green Tree*.[16] In the first action (against Bazzle), the court certified a class and entered an order compelling arbitration (at Green Tree's request) on the same day.[17] Following the trial court's directive, the arbitrator administered the proceeding as a class arbitration and awarded almost $11 million in statutory damages plus attorneys' fees, and the trial court confirmed the award.[18] The trial court later compelled the second group of consumers, named Lackey and Buggs, to arbitrate and the parties arbitrated the dispute before the same arbitrator who had heard the first action.[19] For reasons not apparent from the opinion, the arbitrator, not the court, certified the Lackey/Buggs class and administered that proceeding as a class arbitration as well.[20] Green Tree did not fare much better in the second case, with the arbitrator awarding the Lackey/Buggs claimants over $9 million in statutory damages plus attorneys' fees.[21] The trial court again confirmed the award.[22]

Green Tree appealed both arbitration awards, claiming among other things that permitting the class arbitrations was improper.[23] The South Carolina Supreme Court assumed jurisdiction, consolidated the appeals, and eventually held "that the contracts were silent in respect to class arbitration, that they consequently authorized class arbitration, and that arbitration had properly taken that form."[24] The U.S. Supreme Court "granted certiorari to consider whether that holding [was] consistent with the Federal Arbitration Act."[25]

The plurality opinion, written by Justice Breyer and joined by Justices Scalia, Souter, and Ginsburg, initially observed that if the arbitration clause expressly forbade class arbitration, then the South Carolina court's holding would have been "flawed on its own terms."[26] However, the Court held that, on the face of the clause, it was not "completely obvious" whether class treatment was available. Rather than wrestle with that question, the plurality concluded that this issue was for an arbitrator, not the South Carolina trial court, to decide. According to the U.S. Supreme Court, because the parties' arbitration agreement provided for arbitration of "all disputes, claims, or controversies arising from or relating to [the] contract or the relationships which result from [the] contract or the relationships which result from this contract," the clause required the arbitrator, not the court, to interpret the contract and determine whether it permitted class arbitrations.[27] Finding that there was "at least a strong likelihood" that the arbitrator's decision to conduct both proceedings as class arbitrations "reflected a court's interpretation of the contracts" rather than the arbitrator's own, the U.S. Supreme Court vacated and remanded the cases so that the arbitrator could independently interpret the parties' arbitration agreement and enforce those agreements on their terms.[28]

Justice Breyer's opinion did not even mention any of the earlier federal appellate decisions holding that the FAA prohibits class arbitrations where the parties' arbitration agreement is silent on the issue. It also did not address whether, as a matter of contract interpretation, an arbitrator should certify a class where there is no apparent authority in the parties' arbitration agreement or the governing arbitration rules that permits class treatment. Instead, the plurality simply opined that an arbitrator rather than a trial court should resolve these issues.

The Court's view of the proper outcome was badly splintered. Justice Stevens concurred in the judgment and dissented in part, opining that while "[a]rguably the interpretation of the parties' agreement should have been made in the first instance by the arbitrator, rather than the court," the trial court had correctly interpreted state law and there was therefore "no need to remand the case to correct that possible error."[29] Accordingly, Justice Stevens thought that the Court should have affirmed the South Carolina rulings. He nonetheless concurred in the judgment reversing the South Carolina decisions, explaining: "Were I to adhere to my preferred disposition of the case, however, there would be no

controlling judgment of the Court. In order to avoid that outcome, and because Justice Breyer's opinion expresses a view of the case close to my own, I concur in the judgment."[30]

Justices Rehnquist, O'Connor, and Kennedy dissented, concluding that the South Carolina Supreme Court misread the contract and that the U.S. Supreme Court should have denied class certification.[31] These Justices strongly disagreed with the plurality's view that class certification was a matter for the arbitrator rather than the court to decide. They also concluded that there was no basis, as a matter of contract interpretation, to read into the arbitration clause a right to class treatment:

> Here, the parties saw fit to agree that any disputes arising out of the contracts "shall be resolved by binding arbitration by one arbitrator selected by us with consent of you." Each contract expressly defines "us" as petitioner, and "you" as the respondent or respondents named in that specific contract. . . . The contract also specifies that it governs all "disputes . . . arising from . . . this contract or the relationships which result from this contract". These provisions, which the plurality simply ignores . . . make quite clear that petitioner must select, and each buyer must agree to, a particular arbitrator for disputes between petitioner and that specific buyer.[32]

In a separate dissent, Justice Thomas reiterated his longstanding opposition to the application of the FAA to state court proceedings, expressing his opinion that the South Carolina judgment should be left undisturbed.[33]

Franchisor Responses to *Green Tree*

Drafting Tips

In light of *Green Tree*, a franchisor seeking to avoid consolidated or class claims should obviously draft its arbitration agreements expressly to preclude such claims. As one of the authors of this article has previously noted, a clause that provides that "neither party shall pursue class claims and/or consolidate the arbitration with any other proceedings to which the franchisor is a party" should be sufficient.[34] However, as a result of recent decisions arising out of consumer disputes,[35] a franchisor electing to exclude class claims faces some (and perhaps a growing) risk that a court would hold that the clause is unconscionable.

The franchisor has several persuasive arguments why it is not unconscionable to preclude class arbitrations. First, unlike the consumer cases, in which arbitration clauses are often buried in fine print with little opportunity to review their terms, under federal law franchisees must receive a uniform franchise offering circular at least ten business days before the sale of the franchise. The offering circular contains a detailed written explanation of the dispute resolution provisions of the franchise agreement as well as a copy of the franchise agreement itself. Thus, as the Second and Seventh Circuits have observed, the circumstances under which a franchisee, unlike a consumer, agrees to arbitrate undercut the notion that the franchisees' waiver of this remedy is, in any sense, procedurally unconscionable.[36]

Second, the nature of franchise disputes also militates against a finding that a bar on class claims makes an arbitration clause unconscionable. Unlike consumer disputes, in which the amount in controversy is often less than $1,000 per case, the amount in controversy in a franchise dispute is typically much larger. Accordingly, in most instances a franchisee would be hard pressed to argue that a class action is the only practical vehicle through which he or she can pursue claims against the franchisor.

Finally, despite the notoriety of some recent antiarbitration rulings from the Ninth Circuit and certain state courts, most federal courts remain willing to follow the Supreme Court's directive that, as a matter of federal law, arbitration clauses are to be enforced in accordance with their terms. For these reasons, unless a franchisor is likely to be in a forum hostile to arbitration, the benefits gained by expressly prohibiting class actions are likely to justify the risk that the prohibition would cause a reviewing court to invalidate the arbitration clause.

Arguments to Advance to Arbitrators

According to a 2002 article in this *Journal*, as of 1999, only 53 percent of the franchise agreement arbitration clauses among the country's seventy-five largest franchise systems expressly precluded class claims.[37] Most of the remaining clauses were silent on the issue.[38] Since the survey did not review franchise agreement clauses in contracts executed before 1999, it probably understates the percentage of franchise contracts that do not expressly preclude class actions. Accordingly, for many franchisors that rely on arbitration to avoid class claims, *Green Tree* poses a significant potential risk.

For that reason, the next battleground over the class action issue is the arbitration tribunals themselves. Currently, the rules of the American Arbitration Association (AAA) and JAMS do not contemplate either class or consolidated arbitrations.[39] According to the AAA's website, the AAA "take[s] no position on the availability of class arbitrations" as this article goes to print, but anticipates publishing supplementary rules on the question in October 2003. In the interim, the AAA has deferred requests for class certification to individual arbitrators, to be resolved on a case-by-case basis. To date, JAMS has not published any position statement on whether it will permit class arbitrations.

Despite the new responsibility that the U.S. Supreme Court has placed in the hands of arbitrators, franchisors can still advance a series of compelling reasons why it would be inappropriate for an arbitrator to certify a class where the arbitration clause is silent on the issue. Those reasons follow.

As three Justices on the U.S. Supreme Court and most federal appellate courts have already concluded, as a matter of contract interpretation there is no basis to read into an arbitration clause the possibility of class claims, especially where the rules of the tribunal do not provide for class actions. Given the state of the law before *Green Tree*, any other outcome would "disrupt[] the negotiated risk/benefit allocation and direct[] [the parties] to proceed with a different sort of arbitration."[40]

Given the absence of any class certification standards under the leading commercial arbitration rules, there is no basis on which an arbitrator can determine whether a particular dispute is appropriate for class certification or that the claimants are appropriate class representatives.[41] Absent a clearly articulated set of rules to govern these threshold determinations, the arbitrator should simply decline to consider class treatment.

The absence of any established procedures makes it likely that the interests of the putative class will not be adequately represented or, in the alternative, that an award would not be binding on the class. For example, how would an arbitrator go about deciding when and how members of the putative class are notified of the various stages of the action? How would membership in the class be determined? Is the franchisee's choice of counsel appropriate to represent the interest of other franchisees in the system? Would each member of the putative class be required to pay a separate filing fee in order to proceed in the arbitration? Would a party's failure to "opt out" of a class action preclude it from arbitrating similar claims against the franchisor? The governing rules of most arbitration tribunals offer no guidance whatsoever to arbitrators or courts on how to resolve any of these critical issues.

Because of the limited discovery afforded in arbitration, neither the arbitrator nor the party opposing certification will be able to develop an adequate evidentiary record in advance of the arbitration hearings to determine whether the case should be certified as a class. Moreover, the absence of any meaningful appellate review of arbitration awards would make an arbitrator's error on the certification question virtually impossible to rectify.

Unlike the Federal Rules of Civil Procedure, which provide that a class action may not be dismissed or settled without court approval, under the AAA, for example, an arbitrator is not permitted to participate in (let alone approve) a proposed settlement between the parties.[42] Thus, in the event that the arbitrator certifies a class, there are absolutely no procedural safeguards for the arbitrator or any other third party to ensure that a later settlement is either fair to, or binding upon, members of the putative class.

Finally, as the Fourth Circuit's decision in *Broussard v. Meineke Discount Mufflers*[43] illustrates, class certification is rarely appropriate in franchise cases. Unlike certain consumer cases, franchise disputes usually involve case-by-case determinations on both liability and damages.

As the foregoing illustrates, there are many fundamental reasons why arbitrators should not rush to certify a dispute as a class action. Even if arbitrators perceive themselves as champions of the "little guy," any effort to create, out of whole cloth, a new set of rules that would be fair to the parties and the putative class members would be a daunting task, and runs the risk of jeopardizing the fundamental fairness, and preclusive effect, of the proceedings.

Conclusion

It is obviously too early to predict the extent to which *Green Tree* may undermine franchisor efforts to manage class action risks through franchise agreement arbitration clauses. With respect to future contracts, all a franchisor need do to avoid the problem is draft arbitration clauses that expressly preclude class actions. With respect to older contracts that are silent on the issue, the franchisor still can advance a variety of commonsense reasons why an arbitrator should be extremely reluctant to certify an arbitration for class treatment. But only time will tell how arbitrators and leading ADR providers will respond to the new responsibility that the U.S. Supreme Court has laid at their doorstep.

Endnotes

1. Christopher Drahozal, *Arbitration Clauses in Franchise Agreements: Common (and Uncommon) Terms*, 22 FRANCHISE L.J. 81 (2002) (determining that 45 percent of seventy-five leading franchisors' franchise agreements on file with the State of Minnesota in the summer of 1999 contained arbitration clauses).

2. Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 FRANCHISE L.J. 141 (Spring 1997).

3. *Id.*

4. *See, e.g.*, Doctor's Assocs., Inc. v. Qasim, 225 F.3d 645 (2d Cir. 2000) (table, text in WESTLAW: 2000 WL 1210868 (2d Cir. 2000) (affirming injunction prohibiting a group of franchisees from participating in a class action); Doctor's Assocs, Inc. v. Hollingsworth, 949 F. Supp. 77 (D. Conn. 1996) (enjoining state court class action in its entirety pending resolution of individual arbitrations); We Care Hair Dev. Corp. v. Engen, 180 F.3d 838 (7th Cir. 1999) (same); Bishop v. We Care Hair Dev. Corp., 738 N.E.2d 610 (Ill. App. Ct. 2000). Mr. Kennedy represented the franchisors in *Qasim*, *Hollingsworth*, *Engen*, and *Bishop*. For a more detailed review of the procedural history of these matters, *see* John F. Dienelt and Margaret E.K. Middleton, *Settling Franchise Class Actions*, 21 FRANCHISE L.J. 158–59 (2002).

5. 123 S. Ct. 2402 (2003).

6. *See, e.g.*, Volt Info. Sciences v. Bd. of Trustees, 489 U.S. 468 (1989); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983).

7. The definition of "commerce" in 9 U.S.C. § 1 makes clear that the FAA only applies to commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation or between the District of Columbia and any State or Territory or foreign nation. *Id.*

8. 9 U.S.C. § 2.

9. *See* Champ v. Siegel Trading Co., Inc., 55 F.3d 269, 275 (7th Cir. 1995); Johnson v. W. Suburban Bank, 225 F.3d 366, 377 n.4 (3d Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001); Deiulemar Compagnia di Navigazione S.P.A. v. M/V Allegra, 198 F.3d 473, 481–82 (4th Cir. 1999); Gov't of United Kingdom v. Boeing Co., 998 F. 2d 68, 74 (2d Cir. 1993); Am. Centennial Ins. Co. v. Nat'l Cas. Co., 951 F.2d 107 (6th Cir. 1991), *aff'd*, 761 F. Supp. 472 (N.D. Ohio 1991); Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp., 873 F.2d 281 (11th Cir. 1989); Del E. Webb Constr. v. Richardson Hosp. Auth., 823 F.2d 145 (5th Cir. 1987); Baesler v. Cont'l Grain Co., 900 F.2d 1193 (8th Cir. 1990); Weyerhauser Co. v. Western Seas Shipping Co., 743 F.2d 635 (9th Cir. 1983).

10. 55 F.3d 269 (7th Cir. 1995).

11. *Id.* at 274–76 (citations omitted).

12. *Id.* at 277 (quoting Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 221 (1985)).

13. *See generally* Dunham, *supra* note 2, at 141.

14. Green Tree Fin. Corp. v. Bazzle, 123 S. Ct. 2402, 2405 (2003).

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 2405–06.

20. *Id.* at 2406.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.* at 2407.

28. *Id.* at 2408.
29. *Id.*
30. *Id.* at 2408–09.
31. *Id.* at 2409–11.
32. *Id.*
33. *Id.* at 2411.
34. Kevin M. Kennedy, *Drafting an Enforceable Franchise Agreement Arbitration Clause*, 22 FRANCHISE L.J. 112 (2002).
35. *See, e.g.*, Szetela v. Discover, 118 Cal. Rptr. 2d 862 (Ct. App. 2002); BellSouth Mobility LLC v. Christopher, 819 So. 2d 171 (Fla. Dist. Ct. App. 2002).
36. *See, e.g.*, We Care Hair Dev. Corp. v. Engen, 180 F.3d 838, 843 (7th Cir. 1999); Doctor's Assocs., Inc. v. Jabush, 89 F.3d 109, 113 (2d Cir. 1996); Doctor's Assocs., Inc. v. Stuart, 85 F.3d 975, 981 (2d Cir. 1996); Doctor's Assocs., Inc. v. Distajo, 107 F.3d 126, 135 (2d Cir. 1997). *See also* Dienelt and Middleton, *supra* note 4, at 158–59.
37. Drahozal, *supra* note 1 (determining that 53 percent of seventy-five leading franchisors' franchise agreements on file with the State of Minnesota in the summer of 1999 expressly precluded class actions).
38. *Id.*
39. The AAA rules and the JAMS rules are available online at www.adr.org and www.jamsadr.com, respectively.
40. Champ v. Siegel Trading Co., Inc., 55 F.3d 269, 275 (7th Cir. 1995). *See also* Johnson v. W. Suburban Bank, 225 F.3d 366, 377 n.4 (3d Cir. 2000); Deiulemar Compagnia di Navigazione S.P.A. v. M/V Allegra, 198 F.3d 473, 481–82 (4th Cir. 1999); Gov't of United Kingdom v. Boeing Co., 998 F. 2d 68, 74 (2d Cir. 1993).
41. For an excellent discussion of the standards for class certification, and the special considerations of settling franchisee class actions, *see* Dienelt and Middleton, *supra* note 4, at 113.
42. The AAA's Guide to Commercial Arbitrators, for example, provides that "you should not participate in settlement discussions. If the parties wish to discuss settlement, you should be excused from the room."
43. 155 F.3d 331 (4th Cir. 1998) (reversing district court's certification of a class action in a franchise dispute arising from the franchisor's alleged misuse of franchisee advertising funds).