Beware Those Administration Rules

AAA Declines To Administer Consumer Case: Arbitration Clause Was Inconsistent with Consumer Protocol

Introduction

Once the United States Supreme Court decided that the Federal Arbitration Act could be invoked to enforce arbitration agreements involving employees or consumers, employers and consumer companies increasingly relied on arbitration to resolve disputes. Because arbitration agreements with these groups typically are contracts of adhesion, to which state law requires special scrutiny, they often ran into problems in the courts—procedural and substantive add-ins could be unconscionable or contrary to employee- or consumer-protective statutes and court decisions and were not always severable from the broader clause. To meet some of these "market" demands, the American Arbitration Association and other organizations (or forums) administering arbitrations developed special subject-specific rules.

Thus, the AAA and others not only had Commercial, Construction, and International rules; they also developed Consumer and Employment rules with special fee structures and Protocols [fn: E.g., https://www.adr.org/sites/default/files/document_repository/Consumer Due Process Protocol (1).pdf] that guided parties drafting clauses to meet fair standards the arbitration body would administer. Indeed, some forums offer to "register" clauses that, upon the forum's review, meet the forum's due process standards and protocols. Where a company had not registered its clause in advance of including it in its standardized agreements, the forum may still review the arbitration clause submitted with an arbitration demand, to determine if the clause meets the forum's standards. If the clause on which an arbitration demand does not meet the forum's standards, then the forum may seek agreement of the parties to the demand to conform the clause to the forum's protocol—by, e.g., waiving (or accepting) provisions limiting damages, shifting fees, or shortening the time within which a claim must be submitted — or, if not, declining to accept administration. Problems also may arise where companies that included an arbitration clause in their employment, sales or services contracts declined to pay the filing or other fees for the employee or consumer, or where the company has not paid a prior award or fees assessed against it. (As illustrated by Schorr v. Am. Arb. Ass'n Inc., 2022 U.S. Dist. LEXIS 231957 (S.D.N.Y. Dec. 27, 2022) (dismissing case), a forum also may terminate its administration of a case where the parties fail to pay deposits of arbitrator's fees or the parties or their attorneys violate the forum's "Standards of Conduct," by, for example, being abusive to forum staff.)

I suggest that too many plaintiff's lawyers and courts are not aware of these protocols and the forums' enforcement of fair standards.

As evidenced by a recent opinion from the Third Circuit, Hernandez v. Microbilt, Corp., ___ F.4th __, No. 22-3135, 2023 U.S. App.LEXIS 32072 (3d Cir. 2023), not all companies are aware of the protocols or the forums' enforcement authority either. Or, companies may assume that their contracts will be governed by the forum's commercial rules designated in the arbitration clause, only to find out that the forum may reserve the right to administer such cases under

the consumer rules (for example) and their more consumer-protective provisions.

Hernandez also shows that severance clauses will not necessarily save an arbitration clause that contains provisions that violate a forum's consumer protocols.

The First Hernandez Litigation

Maria Hernandez's application for a loan was denied, based on a verification report issued by MicroBilt Corp. that, unfortunately, confused Ms. Hernandez with others with the same name — one of whom was on a government watch list. When she learned of this error, she sued MicroBilt under the Fair Credit Reporting Act, 15 U.S.C. 1681, et seq.

MicroBilt moved to compel arbitration, relying on the MicroBilt terms and conditions to which Ms. Hernandez agreed as part of the loan application. In response, and before the court decided the motion, Ms. Hernandez dismissed her case and filed for arbitration with the American Arbitration Association — whose arbitration rules were specified in MicroBilt's arbitration clause. (The rules provide that by agreeing to arbitrate in accordance with the AAA rules, the parties are also agreeing to have their arbitration administered by the AAA—which the rules specify as an "essential" term.) Given the nature of the dispute, the AAA assigned the arbitration to be governed by its consumer rules and its Consumer Arbitration Due Process Protocol (the "Protocol").

The AAA's Administrative Review

As required by the Protocol, the AAA reviewed the specifics of the MicroBilt arbitration agreement and found that it did not comport with an important term of the Protocol. In this instance, the agreement prohibited punitive or consequential damages. But the Protocol requires that that the arbitrator be permitted to award the same damages as would be available in a court. When the AAA notified the parties that it could not administer an arbitration governed by MicroBilt's non-compliant provision, it also offered to go forward if MicroBilt waived this provision. It refused, and the AAA declined to administer the case.

Had MicoBilt recognized this when it specified the AAA rules for its standardized arbitration clause, it might have specified the rules of a different forum that does not include a similar consumer protocol (though others do have provisions similar to the AAA's). MicroBilt also could have submitted its clause to the AAA or other forum for pre-clearance or "registration," for which any non-compliant provisions would have to be excised.

The District Court

Although MicroBilt argued that Ms. Hernandez should file for arbitration with a different forum, she returned to court. When Microbilt then moved to require arbitration in a forum other than the AAA, she pointed out not only that the arbitration clause required the AAA, but also that its severance clause required "[i]f this arbitration provision is held to be invalid or otherwise enforceable for any reason," the parties must return to court in New Jersey "exclusive[ly]".

The District Court agreed with Ms. Hernandez in two primary respects. See Hernandez v. Microbilt Corp., No. 21-04238, 2022 U.S. Dist. LEXIS 199852 (D.N.J. Oct. 25, 2022). First, it noted that the AAA rules gave the AAA the authority to determine whether it would administer the case if,

in its view, the parties' arbitration clause did not comply with the AAA's Protocol. Nothing in the rules gave a party the right to require review of the AAA's decision. Second, it noted the provision in the AAA Protocol that permitted a consumer to seek redress in court if the AAA declined to administer the arbitration. Thus, when the consumer elected to go back to court once the AAA declined to administer the case, she was merely following the path permitted in her contract.

The Third Circuit

On appeal, the Third Circuit affirmed the district court. The Circuit took particular care to reiterate the jurisdictional limits imposed by the Federal Arbitration Act: MicroBilt based its motion on section 4 of the FAA, 9 U.S.C. § 4, which relates to an "alleged failure, neglect, or refusal of another to arbitrate under a written agreement." As the District Court held, Ms. Hernandez did not fit this situation: she had complied with the MicroBilt agreement, and consistent with both the agreement and the AAA consumer Protocol, she returned to court when the AAA declined to administer the case. MicroBilt, the Circuit held, had "exhausted its arbitration avenue."

Under different circumstances, a court may appoint an arbitrator pursuant to Section 5 of the FAA, 9 U.S.C. § 5, or its analog in the Revised Uniform Arbitration Act e.g., N.J.S.A. 2A:23B-11 (court may intervene where, among other things, the parties' choice failed).

Both federal and state cases recognize the authority of these statutes unless the designated forum is "essential" or would deprive the parties of a statutory right. But here, the consumer rules provides just that—not only was AAA administration essential, but also the rules provided that the "exclusive" contractual remedy if the choice of forum "failed" was to return to court. Without mentioning these statutes, the Circuit held that MicroBilt was bound by the contract it had written: the parties were to litigate the case in court in New Jersey.

Lessons Learned

As noted at the outset, parties must be aware of the specifics of any arbitration rules when drafting a dispute resolution clause and the consequences of those rules on any provisions of that clause.

Courts may sever a restriction on remedies, for example, that are inconsistent with statutes or caselaw. However, not only may courts refuse to enforce a clause where unconscionable terms are pervasive or intertwined with proper terms, but as shown by Hernandez, forums may refuse to administer an arbitration where the contract violates the forum's rules and protocols.

The wording of a severance clause may not save arbitration where other provisions or rules conflict. Even where a court may order arbitration and delegate to the arbitrator whether to enforce or sever any challenged provisions, the forum may refuse to administer a non-compliant arbitration; delegation may not save arbitration in such situations.

Finally, beware of boilerplate clauses, such as those referring to exclusive jurisdiction or venue in a particular court. Such clauses may frustrate what may be considered a general intent to require arbitration.