New York Law Journal
NEW YORK LAW JOURNAL SPECIAL REPORT
An ALM Publication
Litigation
WWW.NYLJ.COM
VOLUME 258—NO. 10
MONDAY, JULY 17, 2017

We Have an Arbitration Agreement. Now What?

Be mindful of key issues with enforcing consumer arbitration agreements.

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The U.S. Supreme Court, in recent years, has provided companies with a powerful tool to avoid class action lawsuits: arbitration. In a series of decisions, the Supreme Court has held that class action waivers in otherwise valid arbitration agreements are themselves enforceable. See *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2312 (2013); *AT&T Mobility v. Concepcion*, 563 U.S. 333, 352(2011). Accordingly, many companies have woven arbitration clauses with class action waivers into their websites' terms of use, warranties, and other consumer agreements with the hope that such arbitration clauses would void any efforts by consumers to file class action lawsuits.

On the surface, enforcing an arbitration clause appears to be fairly straightforward: A company would need to show that the parties have agreed to arbitration and the dispute at issue falls within the scope of the agreement. See, e.g., *Kirleis v. Dickie, McCamey & Chilcote, P.C.*, 560 F.3d 156, 160 (3d Cir. 2009); *Combined Energies v. CCI*, 514 F.3d 168, 171 (1st Cir. 2008); *Cap Gemini Ernst & Young, U.S. v. Nackel*, 346 F.3d 360, 365 (2d Cir. 2003).

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If only it were so easy. (Indeed, the enforceability of an arbitration provision in the terms and conditions provided to consumers by Uber Technologies is currently pending before the Second Circuit in *Meyer v. Kalanick*, No. 16-2750.) Because the terms of consumer arbitration agreements are generally not negotiable and the agreements themselves are not formed through the typical means of offer and acceptance, courts take great care in analyzing whether an arbitration provision should be enforced against a

consumer. Among other things, a court will examine whether: the consumer was on notice of the arbitration provision, the consumer agreed to its terms, and the terms are fair to the consumer. As discussed below, some of these and other issues are easily addressed, while others can be thornier. Regardless, a company should be mindful of these issues when seeking to enforce the arbitration provision it offers to consumers with its products.

Preliminary Issues

Before addressing the arbitration provision itself, the company will need to consider a few preliminary issues. First, the company may need discovery regarding the facts and circumstances surrounding the formation of the agreement to arbitrate. Second, in a diversity action, the company should carefully consider which state's laws will apply to the question of contract formation because variations in state law could affect the outcome.

Is Discovery Necessary? At the outset, the company should consider whether it will need any discovery before filing its motion to compel arbitration. Generally, the primary issue on a motion to compel arbitration is whether the consumer had constructive notice of the arbitration provision. Accordingly, when it is apparent on the face of the complaint and documents relied upon therein that the plaintiff received and did not reject the arbitration provision, the issues on a motion to compel arbitration can be decided without discovery (but, it may be necessary to submit with the motion an affidavit about the arbitration provision). See, e.g., *Nicosia v. Amazon.com*, 834 F.3d 220, 231 (2d Cir. 2016); *Guidotti v. Legal Helpers Debt Resolution*, 716 F.3d 764, 774-76 (3d Cir. 2013). Where, however, the consumer alleges, for example, that he or she did not receive the arbitration provision or took steps to opt out of its terms then discovery into the facts surrounding formation of the agreement may be necessary before the company can bring a motion to compel arbitration. See, e.g., *Hines v. Overstock.com*, 380 Fed. Appx. 22, 24 (2d Cir. 2010) (applying Rule 56 to determine motion to compel arbitration).

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Which State's Laws Apply to the Question of Contract Formation? An additional key consideration at the outset is which state's laws apply to the question of contract formation.

The Federal Arbitration Act (FAA) applies not only to the enforcement of arbitration agreements but also to the formation of such agreements. See *Kindred Nursing Ctrs. L.P. v. Clark*, 137 S. Ct. 1421, 1428 (2017) ("By its terms, then, the [FAA] cares not only about the 'enforce[ment]' of arbitration agreements, but also about their initial 'valid[ity]'—that is, about what it takes to enter into them."). Under the FAA, federal courts generally look to the relevant state law on the formation of contracts to determine whether there is a valid arbitration agreement. See *First Options of Chi. v. Kaplan*, 514 U.S. 938, 944 (1995). Where the consumer class action is styled as a diversity action, the court will have to undertake a choice of law analysis to determine which state's laws apply. Depending on the particulars of the case and the arbitration provision, there could be an important distinction in the forum state's laws and the laws of the competing state whereby the choice of law analysis could significantly alter the outcome of the motion. For example, some states have developed a low threshold for what constitutes constructive notice while others set the bar much higher. Compare *Hill v. Gateway 2000*, 105 F.3d 1147, 1148-49 (7th Cir. 1997) with *Norcia v. Samsung Telecomms. Am.*, 845 F.3d 1279, 1289-90 (9th Cir. 2017). Accordingly, when conducting the choice of law analysis, rather than comparing the formulaic rules of contract formation among the competing states' laws, it is critical to examine how each state has addressed the specific issues that the particular arbitration provision presents.

The Validity of the Agreement

The next step is to consider whether a valid agreement to arbitrate exists by assessing whether the consumer had notice of the arbitration provision and agreed to its terms.

Did the Consumer Have Notice of the Arbitration Provision? The critical question when seeking to enforce a consumer arbitration provision is whether the company provided notice of its terms to the consumer. Indeed, if the consumer did not have notice of the arbitration provision, then he or she could not have consented to its terms and a valid agreement to arbitrate (and waive any class action claims) would not have been formed.

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In examining whether a consumer had constructive notice, a court will consider the following non-exhaustive factors:

- When the arbitration provision was provided to the consumer (i.e., before or after the purchase);
- Whether the arbitration provision could be found on the outside and/or inside of the product's packaging;
- Whether there was any conspicuous language on the packaging or product website alerting the consumer to the existence of the arbitration provision;
- Whether there was any conspicuous language on the packaging or product website instructing the consumer to read certain documentation (containing the arbitration provision) prior to using the product;
- Whether a consumer would reasonably assume that the documentation containing the arbitration provision includes contract terms;
- Where within the product's documents the arbitration provision is located;
- Whether the arbitration provision was easy to find within the documentation (i.e., whether it was listed in the table of contents or index);
- Whether the arbitration provision is conspicuous such that it stands out from the surrounding language in the document (i.e., whether it was written in bold, italicized, capitalized, or larger font or appears under a heading); and
- Whether the terms of the arbitration provision are written in plain and understandable language (i.e., whether the provision properly informs the consumer that the dispute will not be decided by a judge or jury, what claims are covered by the agreement, and what the process entails).

None of these factors alone is dispositive as to whether constructive notice exists. For example, although it would bolster the argument if the company provided notice on the outside of the product's packaging, the company is not required to do so for a court to find adequate notice. See, e.g., *Schnabel v. Trilegiant*, 697 F.3d 110, 125 (2d Cir. 2012) ("Whether or not there is notice to the consumer on the outside of the packaging that terms await him or her on the inside, courts have found such licenses to become enforceable contracts upon the customer's purchase and receipt of the package and the failure to return the product after reading, or at least having a realistic opportunity to read, the terms and conditions of the contract included with the product."); see also *ProCD v. Zeidenberg*, 86 F.3d 1447, 1450-51 (7th Cir. 1996). Similarly, at least in some jurisdictions, courts will find notice even where the arbitration provision appears in a lengthy booklet and is not listed in the booklet's table of contents or index. See *McNamara v. Samsung Telecomms. Am.*, No. 14 C 1676, 2014 WL 5543955, at *1-2 (N.D. Ill. Nov. 3, 2014). In short, the key will be to demonstrate that a reasonable consumer would have been able to readily locate, identify, and understand the arbitration provision.

Did the Consumer Agree to Arbitration? Not only must the consumer be given notice of the arbitration provision, the consumer must have accepted its terms. A consumer can either affirmatively or passively agree to arbitrate.

First, a consumer may specifically agree to arbitration by signing an agreement at the point of sale or, in the case of online applications and some consumer electronics, clicking an icon consenting to certain terms and conditions that include an arbitration clause. Such "clickwrap" agreements are routinely enforced because the consumer is presented with the terms and has the opportunity to expressly and unambiguously manifest his or her assent prior to gaining access to the product. See *Register.com v. Verio*, 356 F.3d 393, 429 (2d Cir. 2004).

Second, and most commonly with consumer products, consumers may manifest assent simply by purchasing and keeping the product. Unless there is notice of the arbitration provision on the product's packaging, consumers will not receive notice of the arbitration provision until after they purchase the product and find its terms and conditions inside. Provided they had adequate notice of the arbitration provision, courts will uphold the agreement as formed. See, e.g., *Schnabel*, 697 F.3d at 122; *Hill*, 105 F.3d at 1150. In addition, some courts will enforce arbitration provisions where consumers were provided with a specific right to opt out of arbitration but did not do so. See, e.g., *Higgs v. Auto Warranty Corp. of Am.*, 134 Fed. Appx. 828, 831-32 (6th Cir. 2005); *Hill*, 105 F.3d at 1148-50. But see *Norcia*, 845 F.3d at 1290.

Scope of the Arbitration Agreement

Does the Dispute Fall Within the Scope of the Arbitration Agreement? Once the company establishes that there is an agreement to arbitrate, it will need to demonstrate that the dispute at issue falls within the scope of that agreement. The FAA "establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Mem'l Hosp. v. Mercury Constr.*, 460 U.S. 1, 24-25 (1983). Indeed, a claim is presumed to be within the scope of the arbitration agreement "unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute." *AT&T Techs. v. Commc'ns Workers of Am.*, 475 U.S. 643, 650 (1986). Thus, if the arbitration provision covers "all" or "any" dispute "arising out of" a transaction or relationship, a court should find the consumer's claims arbitrable. However, the company should make certain that, where a consumer asserts state statutory claims, there are no special rules regarding whether those claims must be specifically accounted for in some way within the arbitration clause.

The Unconscionability Defense

Is the Agreement Unconscionable? Finally, the company will need to be mindful of whether or not the consumer will be able to show that the arbitration provision is unconscionable under the controlling state law. Unconscionability may take two forms: (1) procedural unconscionability, which refers to the circumstances surrounding the adoption of the agreement; and (2) substantive unconscionability, which refers to the fairness of the arbitration provision itself.

The question of procedural unconscionability generally focuses on whether the formation of the arbitration agreement was tainted by some form of oppression or unfairness. This analysis will generally mirror the analysis regarding whether an agreement to arbitrate was validly formed, but the company should be aware of state laws regarding contracts of adhesion.

With regard to substantive unconscionability, the company should pay careful attention to the terms of the arbitration provision. Here, the company will want to emphasize the positive features of the arbitration clause. Indeed, other than the class action waiver, the arbitration clause may distinctly advantage the consumer by providing a low-cost means to quickly resolve his or her dispute with the company. In contrast, where the arbitration provision imposes draconian procedures upon the consumer, a court could hold the provision unconscionable and therefore unenforceable.

Conclusion

In sum, enforcing the arbitration provision will require the moving party to champion and defend the arbitration provision as (1) conspicuously located and presented in a manner that provided notice to the consumer of its existence, (2) broad enough to cover the claims at issue, and (3) sufficiently fair such that it cannot be found unconscionable. If successful, the company will be able to avoid protracted class action litigation and quickly resolve the individual consumer's issues.

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