AAA Releases Rules on the Administration of Class Actions

Lawrence J. Bracken II and Caroline H. Dixon

Arbitration clauses, widely used in franchise agreements, can be an effective method for resolving franchise disputes. In most instances, however, franchisors would prefer to have a class action decided in court, not by arbitrators. Moreover, many franchisors have sought to use arbitration clauses as a way of avoiding class actions altogether. Two recent developments may cause franchisors to reevaluate the desirability of requiring arbitration of all disputes. These two developments are a June 2003 ruling by the U.S. Supreme Court and the more recent release by the American Arbitration Association (AAA) of rules governing class actions. As a result of these developments, franchisors whose current agreements contain AAA arbitration clauses may unwittingly find themselves litigating class actions in an AAA arbitration forum.

On October 8, 2003, the AAA for the first time released rules for the administration of class arbitrations. The Supplementary Rules for Class Arbitrations (Class Arbitration Rules)[1] were propounded on the heels of the U.S. Supreme Court's June 23, 2003, decision in *Green Tree Financial Corp. v. Bazzle.*[2] Before release of the Class Arbitration Rules, AAA rules did not address arbitration on a class action basis. In *Green Tree,* the Supreme Court held that where an arbitration agreement is silent regarding whether classwide relief is available, an arbitrator, rather than a court, must decide whether class relief is permitted.[3] Before *Green Tree,* most federal courts had concluded that classwide arbitration is precluded when an arbitration clause is silent on that issue.[4]

Class Arbitration Rules

Under the Class Arbitration Rules, the AAA will administer demands for class arbitration if (1) the relevant agreement specifies that disputes shall be resolved in accordance with AAA rules and (2) a party submits a dispute to arbitration on behalf of or against a class or purported class.[5] If the parties dispute the availability of class relief, that dispute will be decided by the appointed arbitrators.[6] It is not clear from the rules themselves whether the AAA will accept demands for class arbitration where the agreement prohibits class claims, consolidation or joinder. However, the AAA's previous announcements stated that it will not do so.[7]

The Class Arbitration Rules are based in large part on Federal Rule of Civil Procedure 23. Notably, the rules explicitly apply to *pending arbitrations*. As a result, a claimant in a pending arbitration can assert a new claim on behalf of a purported class.[8] The prerequisites for a class arbitration under the AAA rules are taken almost verbatim from Federal Rule of Civil Procedure 23(a).[9] An additional prerequisite for class arbitration is that "each class member has entered into an agreement containing an arbitration clause which is substantially similar to that signed by the class representative(s) and each of the other class members."[10] Like Federal Rule 23(b)(3), the AAA rules require that common questions of law or fact predominate, and that a class action is superior to other available methods for adjudication of the claim.[11] The AAA rules do not appear to allow for certification of a "nonopt-out class" solely on the grounds provided for in Federal Rule 23(b)(1) or (b)(2). These grounds are situations where there is a risk of inconsistent adjudications, where there is a limited fund, or where the class seeks injunctive or declaratory relief as the predominant remedy. Class claims of this type must satisfy the predominance and superiority requirements. However, in "exceptional" circumstances, the arbitrator can order that class members not be allowed to request exclusion.[12] The examples given in Rule 5(c) of when exclusion is inappropriate are claims seeking injunctive relief or claims to a limited fund.

The provisions regarding notice to the class and approval of any settlement or dismissal track the language of the amended Federal Rule 23(c) and (e), which became effective December 1, 2003.[13] Like amended Federal Rule 23(e)(3), Class Arbitration Rule 8(c) provides that an arbitrator may require, as a part of a settlement, that class members who did not opt out after receiving notice of class certification be given another opportunity to request exclusion from the class.[14]

A major departure from usual arbitration procedure is the public nature of hearings conducted under the Class Arbitration Rules. There is no presumption of privacy and confidentiality in class arbitrations. Under the Class Arbitration Rules, hearings are open to the public, and pleadings are posted on the AAA's website.[15] All awards in class arbitrations, which must set forth the arbitrator's reasoning, are publicly available upon payment of a fee.[16] Accordingly, one of the potential advantages of arbitration proceedings—relative privacy and confidentiality of the proceedings—does not apply to AAA class arbitration practice.

The Class Arbitration Rules allow a party to petition a court to vacate the arbitrator's class-related decisions at two stages in the proceeding. First, the rules provide that, as a threshold matter, the arbitrator shall enter a "partial final award" deciding whether the applicable arbitration clause permits the arbitration to proceed on behalf of a class (Clause Construction Award).[17] The arbitrator then must stay the arbitration proceedings for at least thirty days to permit a party to move a court of competent jurisdiction to confirm or vacate the Clause Construction Award.[18] The same procedure applies after the arbitrator has ruled on class certification. On its face, this procedure would seem to grant trial courts the power to review the arbitrator's class-related decisions. However, the grounds for vacating an arbitration award under the Uniform Arbitration

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Act—which has been adopted by a majority of states—are very narrow. A court may vacate an arbitration award only if one of the following six circumstances is present: (1) the award was procured by corruption, fraud or other undue means; (2) the arbitrators exceeded their powers; (3) an arbitrator was biased or corrupt; (4) the arbitrators refused to postpone the hearing, even though sufficient cause was shown; (5) the arbitrators refused to consider material evidence; or (6) there was no valid agreement to arbitrate.[19] The grounds for vacating an award under the Federal Arbitration Act are similar. The Uniform Arbitration Act explicitly provides that the fact that the relief granted could not or would not have been granted by a court is not grounds for vacating an award.[20] Defendants involved in class arbitrations therefore will have little recourse in the courts.

Implications of *Green Tree*

The *Green Tree* decision and AAA's Supplementary Rules for Class Arbitrations may require franchisors to submit to class arbitration under their current agreements if the arbitration clauses do not specifically exclude class arbitration. The practical effect of the *Green Tree* decision and the Class Arbitration Rules is that arbitrators may interpret existing arbitration clauses to allow an arbitration demand to proceed on behalf of a class, at least in situations where there is a sufficiently large group of similarly situated franchisees.

The reasons franchisors should be concerned about arbitrating claims on a classwide basis are obvious. Arbitrators usually have greater latitude in the conduct of an arbitration proceeding than trial judges, and arbitrators' rulings can be vacated only on very limited grounds. The *Green Tree* decision and the Class Arbitration Rules confer broad authority on arbitrators. Accordingly, the new rules open up the possibility that class arbitrations will take place with far less certainty and consistency as to procedure and evidentiary rulings. Class arbitrations may result in large monetary awards, and perhaps interpretations of franchise agreements, that cannot be appealed or otherwise reviewed. These limitations will apply to class certification proceedings as well as to hearings on the merits. For example, it is often beneficial for class action defendants to submit testimony, affidavits, and other documents in opposition to class certification. With the abbreviated hearings and procedures associated with arbitrations, defendants may have fewer opportunities to present such evidence at the class certification phase of arbitration than is allowed in state or federal court.

Practice Pointers

More class claims are likely to be submitted to arbitration, and franchisors whose agreements contain arbitration clauses should consider the following suggestions in view of their own circumstantces:

- Franchisors should consider whether they should clarify or amend arbitration clauses. In many instances, franchisors will want to amend arbitration clauses to provide that an arbitrator is authorized solely to adjudicate claims brought by individual parties, not to preside over class claims. To the extent that franchisors seek to amend arbitration clauses in existing franchise agreements, their right to do so may be limited by the agreement itself. In addition, franchisees—that, historically, often have sought to invalidate arbitration clauses—may assert that state franchise "relationship" laws prohibit such amendments.
- Arbitration clauses in new franchise agreements should state unequivocally that only arbitrators are authorized to decide individual claims, not class claims. Failure to include such an express provision may result in an arbitration panel, rather than a judge, determining whether the agreement requires or permits classwide arbitration.
- Other provisions of the arbitration clause should be reviewed to determine their potential impact in light of the possibility that the underlying agreement to arbitrate may result in class arbitration. Such provisions include the number and qualifications of arbitrators, potential venues for litigation or arbitration, governing law, and conditions precedent to arbitration. In some instances, such as where industry-specific arbitrators would be appointed in the event of a dispute, the company may decide that class arbitrations would be beneficial because a classwide proceeding may resolve particular issues with respect to all franchisees similarly situated to the named claimant.

Even before *Green Tree* and the new AAA Class Arbitration Rules, many had challenged the conventional wisdom that franchisors should reflexively favor and that franchisees should automatically oppose resolving disputes by arbitration rather than by way of jury trials. At this juncture, there are more questions than answers about the combined effect on franchise dispute resolution of *Green Tree* and the Class Arbitration Rules. However, the determination of whether arbitration is the preferred method of dispute resolution has definitely become more complex than ever before—and more dependent upon the facts and circumstances of particular disputes, particular franchise systems, and the industries in which they operate.

End notes

1. The Supplementary Rules for Class Arbitrations can be found on the AAA's website at www.adr.org under the "Rules" link.
2. 123 S. Ct. 2402 (2003). For a detailed discussion of the *Green Tree* decision, see Kevin M. Kennedy and Bethany Appleby, Green Tree Financial Corp. v. Bazzle: *A New Day for Class Arbitrations?,* 23 FRANCHISE L.J. 84 (2003).
3. 123 S. Ct. at 2407.
4. The arbitration clause at issue in *Green Tree* provided that the parties would submit to arbitration "*[a]ll* disputes, claims, or controversies arising from or relating to" the underlying contract. *Id.* Similar language is commonly used in arbitration clauses in a variety of contracts. In a decision released on August 3, 2003, the Fifth Circuit Court of Appeals, applied *Green Tree* in vacating a district court's certification of a class for arbitration. In *Pedcor Management Co. Welfare Benefit Plan v. Nations Personnel, Inc.,* the Fifth Circuit ruled that, since the arbitration provision at issue that was similar in scope to the provision in the *Green Tree* case, did not clearly forbid arbitration, the question of whether class arbitration was permitted should be decided by the arbitrators. 343 F.3d 355, 359–60 (5th Cir. 2003).
5. Rule 1(a).
6. Rule 3.
7. *See AAA's Policy on Class Arbitration,* July 11, 2003. The policy can be found on the AAA's website at www.adr.org under the

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"Rules" link.
8. Rule 1(a).
9. *See* Rule 4(a)(1–5).
10. Rule 4(a)(6).
11. Rule 4(a)(1–5).
12. Rule 5(c).
13. *See* Rules 6 and 8.
14. Rule 8(c).
15. Rule 9(a)-(b).
16. Rule 10(b)
17. Rule 3.
18. *Id.*
19. UNIF. ARBITRATION ACT § 12 (amended 1956), 7 U.L.A. 280–81 (1997).
20. *Id.* at 281.

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