ARBITRATOR, I WANT MY MONEY BACK!

Why the Minority View that Product Warranty Claims May Not Be Arbitrated is Wrong

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The authors, who have represented businesses in litigation involving the Federal Arbitration Act and the Magnuson-Moss Warranty Act, argue that the Maryland high court's ruling in *Koons Ford v. Lobach* is wrongly decided, and that if the reasoning in that case is followed by other courts, business owners and consumers will be deprived of a fair and efficient method of resolving warranty disputes.

In recent years, there has been a growing divide over whether the federal Magnuson-Moss Warranty Act (MMWA)[1] permits warranty claims to be arbitrated under the Federal Arbitration Act (FAA).[2] The issue is important to businesses that have arbitration agreements with customers because arbitration can be quicker, less adversarial, and more efficient than litigation. The U.S. Supreme Court has held that the FAA embodies a strong congressional policy favoring arbitration. It has also recognized that arbitration is an appropriate means of resolving consumer disputes, observing that without enforceable arbitration agreements, the typical consumer, who has only a small damage claim, would be left with just a court remedy, "the costs and delays of which could eat up the value of an eventual small recovery."[3]

The majority of courts that have addressed the arbitrability of MMWA claims (including the 5th and 11th Circuits, as well as the Illinois, Texas, Michigan, and Alabama Supreme Courts) have held that these claims can be arbitrated,[4] but some courts, including the Mississippi Supreme Court and a number of federal district courts, have reached the opposite conclusion.[5] Recently, Maryland's highest court became the latest court to weigh in on the controversy, adopting the minority position. In this article, we discuss the rationale of that decision and why, in our view, its reasoning is flawed.

The *Koons Ford* Decision

In *Koons Ford of Baltimore v. Lobach*,[6] the Maryland Court of Appeals held that under the MMWA, "claimants may not be forced to resolve their claims through binding arbitration," and that the FAA does not supersede the MMWA in this regard. In its view, the language of the MMWA, congressional intent, and Federal Trade Commission (FTC) regulations all supported its holding.

The court focused on MMWA § 2310(a), which says that if a warranty calls for the use of an "informal dispute settlement mechanism," a consumer may not sue without first resorting to that procedure. The *Koons Ford* court concluded that arbitration is an informal dispute settlement mechanism as that term is used in the MMWA. Thus, it found that Congress intended to "prevent consumers from being forced into binding arbitration" and to preserve their ability to proceed in court.

The court also held that the FTC's regulatory pronouncements, which interpreted the MMWA to pre-

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clude arbitration of warranty claims,[7] were entitled to deference under *Chevron U.S.A. v. Natural Resources Defense Council*. *Chevron* set forth the criteria a court must consider when deciding whether to defer to a federal agency's interpretation of a statute that it administers.[8]

Analysis of the *Koons Ford* Court

In our opinion, the *Koons Ford* decision suffers from a number of critical flaws. First, it does not comport with the test announced in *Shearson/American Express v. McMahon*[9] for determining whether Congress intended to require claims under a particular statute to proceed in a judicial forum rather than in arbitration. Second, in analyzing Congress's intent, the Maryland court erroneously relied on an anti-arbitration Supreme Court case in effect when the MMWA was enacted but later overturned. Third, the court erroneously deferred to the FTC's anti-arbitration regulations, which conflict with the national policy favoring arbitration and are out of step with current law on arbitration.

Supreme Court Rulings on Arbitrability of Statutory Claims

The Supreme Court has not found a federal statutory claim to be incapable of being arbitrated in well over two decades. Quite the opposite: the Court has rejected such arguments on four separate occasions:

- in 1985 in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, — The Sherman Act.
- in 1992 in *Gilmer v. Interstate/Johnson Lane Corp.* — Age Discrimination in Employment Act of 1967;
- in 1987 in *Shearson/American Express, Inc. v. McMahon* — Securities Exchange Act of 1934 and the Racketeer Influenced and Corrupt Organizations Act (RICO); and
- in 1989 in *Rodriguez de Quijas v. Shearson/American Express* — Securities Act of 1933.

The *McMahon* Test

In *McMahon*, the Supreme Court acknowledged that congressional intent expressed in a statute could supersede the FAA's requirement that arbitration agreements be enforced. But the Court placed the burden on the party opposing arbitration to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue, explaining that Congressional intent must be "discernible from the text, history, or purposes of the statute."

A key difficulty with *Koons Ford* (and other decisions adopting the minority view) is that it improperly applied the *McMahon* rule. The Maryland court erroneously concluded that the MMWA was clear in treating arbitration as an "informal dispute settlement mechanism" that is a prerequisite to litigation.[10] But the fact is that the MMWA does not classify binding arbitration as an "informal dispute settlement procedure," nor does it contain a single reference to arbitration. Thus, it is a stretch to say that the MMWA expresses Congress's intent to preclude arbitration as an alternative to litigation.[11]

The MMWA's legislative history also undermines *Koons Ford*. This history indicates that Congress intended "informal dispute settlement procedures" to be a prerequisite, not a bar, to further pursuit of legal remedies under the statute. The 5th and 11th Circuits have so found, saying that the MMWA's legislative history does not indicate that Congress intended to preclude arbitration.[12]

More importantly, a Senate report describing an earlier version of the bill that became the MMWA strongly suggests that Congress did not intend to preclude arbitration. The report explains that Congress intended "warrantors of consumer products ... to establish informal dispute settlement mechanisms that take care of consumer grievances without aid of litigation or formal arbitration."[13] Recognizing the significance of this report, the Texas Supreme Court stated, "This passage arguably demonstrates that Congress contemplated a consumer's resort to courts or arbitration if the informal dispute settlement procedure did not resolve the dispute."

In light of this legislative history, it seems plain to us that, under *McMahon*, the MMWA does not reflect Congressional intent to preclude the arbitration of statutory claims.

The FAA and *Wilko v. Swan*

In *Koons Ford*, the Maryland Court of Appeals concluded that Congressional intent should be discerned by reference to Supreme Court precedent existing when the MMWA was enacted in 1975. This is significant because, at that time, the Supreme Court had not issued its pro-arbitration decisions. The leading precedent in 1975 was *Wilko v. Swan*,[14] in which the Court determined that claimants under the Securities Act of 1933 could not be forced to arbitrate their claims "because arbitration would disadvantage the consumer." While the Supreme Court subsequently rejected *Wilko* and embraced arbitration of statutory claims, the Maryland court characterized that turnaround as an "expansion" of the FAA, implying that this was an amendment of the statute. But this was not the case. The Supreme Court's pro-arbitration decisions may have represented a new perspective, but they could not amend the FAA. When the Supreme Court overruled *Wilko*, it recognized that *Wilko* had been

wrongly decided and must be overruled to conform to a proper understanding of the FAA. All the while, the FAA's actual meaning remained unchanged.

In addition, the Supreme Court implicitly rejected the notion that Congress's intent must be viewed in light of precedent existing when a statute is enacted by holding that claims under the Sherman Act (enacted in 1890),[15] the federal securities laws (enacted in the 1930s),[16] the Age Discrimination in Employment Act (enacted in 1967),[17] and the Racketeer Influenced and Corrupt Organizations Act (in 1970)[18] are arbitrable, even though these laws were enacted when the stance towards arbitration was less supportive.

FTC Regulations and "*Chevron* Deference"

Koons Ford held that the FTC's regulations interpreting the MMWA are entitled to deference under *Chevron* because they are based on a "permissible construction" of § 2310(a). In our view, reliance on the FTC's interpretation is misplaced.

In *Chevron*, the Supreme Court set out a two-part test for determining when courts should defer to an agency's construction of a statute. The first part of the test is whether Congress has "directly spoken to the precise question at issue" and whether its intent is clear. If Congress has not spoken to the question or if its intent is not clear, deference could still be accorded under the second part of the test, which asks whether the agency's answer to the question is based on a reasonable interpretation of the statute.

It is plain that the first part of the *Chevron* test is not met because the MMWA and its legislative history did not directly state that MMWA claims are inarbitrable. The MMWA makes "informal dispute settlement mechanisms" a precursor to litigation, not an alternative to it, and the legislative history supports this interpretation. Also, by providing a final, binding award, arbitration is, by definition, a replacement for litigation, not a condition precedent to it. So the FTC's interpretations, rather than being reasonable, make no sense.

The FTC's 1975 and 1999 regulations[20] said that even if binding dispute resolution mechanisms were contemplated by the MMWA, the commission was not convinced that guidelines for a binding dispute resolution process "could ensure sufficient protection for consumers."[19] But the assumption that arbitration would be inadequate to protect consumers is not reasonable, as the assumption directly conflicts with the strong federal policy favoring arbitration. The dissenting judge in *Koons Ford* observed that the FTC's "anti-arbitration bias ... is completely out-of-step with both Congress'[s] and the U.S. Supreme Court's views regarding arbitration not being inherently hostile to consumers' interests."[20]

The Supreme Court has said that mistrust of the arbitral process has been undermined by its recent arbitration decisions.[21] Those decisions expressly rejected "generalized attacks on arbitration" that rest on "suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants."[22] Yet the FTC's interpretations of the MMWA rest on that very suspicion. Thus, courts should not afford them deference under *Chevron*.

Conclusion

Whether federal warranty claims are subject to arbitration remains a very contentious issue—one that courts will continue to face. If arbitration is to remain a vital tool for businesses that provide warranties to consumers, and an accessible, cost-effective method for consumers to seek redress for their warranty claims, agreements to arbitrate such claims should be enforceable as long as consumers are able to vindicate their statutory rights. We anticipate that the Supreme Court will resolve this conflict when presented with an appropriate case. In our view, it should clarify that arbitration is a suitable means of resolving warranty claims, thereby benefiting businesses and consumers alike. ■

ENDNOTES

[1] 15 U.S.C. § 2301 *et seq.*

[2] 9 U.S.C. § 1 *et seq*.

[3] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995).

[4] See, e.g., *Walton v. Rose Mobile Homes LLC*, 298 F.3d 470 (5th Cir. 2002) *Davis v. S. Energy Homes, Inc.*, 305 F.3d 1268, 1275 (11th Cir. 2002); *S. Energy Homes, Inc. v. Ard*, 772 So. 2d 1131, 1135 (Ala. 2000); *Borowiec v. Gateway 2000, Inc.*, 808 N.E.2d 957, 965-66 (Ill. 2004); *Abela v. General Motors Corp.*, 677 N.W. 2d 325 (Mich. 1994); *In re Am. Homestar*, 50 S.W.3d 480 (Tex. 2001); *Walker v. DaimlerChrysler Corp.*, 856 N.E.2d 90, 93-99 (Ind. Ct. App. 2006).

[5] See, e.g., *Parkerson v. Smith*, 817 So. 2d 529 (Miss. 2002) (per curiam); *Rickard v. Teynor's Homes, Inc.*, 279 F. Supp. 2d 910 (N.D. Ohio 2003); *Browne v. Kline Tysons Imports*, 190 F. Supp. 2d 827, 831 (E.D. Va. 2002); *Wilson v. Waverlee Homes, Inc.*, 954 F. Supp. 1530 (M.D. Ala. 1997), abrogated by *Davis*, *supra* n. 4.

[6] 919 A.2d 722 (Md. 2007).

[7] 40 Fed. Reg. 60,168, 60,210-11 (1975), 64 Fed. Reg. 19,700, 19,708-09 (1999).

[8] 467 U.S. 837 (1984).

[9] 482 U.S. 220 (1987).

[10] See also *Browne*, *supra* n. *6*, 190 F. Supp. 2d at 831, which found that the MMWA clearly expressed Congress's intent "not [to] deprive any party of their right to have their written warranty dispute adjudicated in a judicial forum."

[11] *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) sheds light on Congress's intent when using the term "informal" in connection with dispute resolution. The case involved the Age Discrimination in Employment Act, which directs the Equal Employment Opportunity Commission to pursue non-binding "'informal methods of conciliation, conference, and persuasion'" to resolve statutory claims. The Supreme Court found that a provision mandating binding arbitration in no way conflicted with this provision.

[12] E.g., the *Walton* and *Davis* cases, cited *supra* n. 4.

[13] S. Rep. No. 91-876, at 22-23 (1970), quoted in *In re Am. Homestar*, *supra* n. 4, 50 S.W.3d at 488 (emphasis by the court).

[14] 346 U.S. 427 (1953), overruled by *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989).

[15] *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985)

[16] *Rodriguez de Quijas*, *supra* n. 14.

[17] *Gilmer*, *supra* n. 11.

[18] *McMahon*, *supra* n. 9.

[19] 40 Fed. Reg. at 60,210-11; 64 Fed. Reg. at 19,708-09.

[20] *Koon's Ford*, *supra* n. 6, 919 A.2d 738 (Harrell, J., dissenting).

[21] *Gilmer*, *supra* n. 11, 500 U.S. at 34 n.5.

[22] *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 89-90 (2000) (quoting *Rodriguez de Quijas*, *supra* n. 14.