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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Mass. At Last Acquiesces To High Court On Arbitration

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Robert M. Buchanan Jr.

When the U.S. Supreme Court decided AT&T Mobility LLC v. Concepcion, upholding an innovative strategy to thwart class actions by diverting claims to arbitration, the high court in Massachusetts declined to take that approach. Slowly but surely, the Massachusetts Supreme Judicial Court has realized that it has no choice. Its April 13, 2015, decision in Machado v. System4 LLC is the latest case in which arbitration clauses have trumped Massachusetts public policy favoring class actions. A similar process will likely play out in other states.

In Feeney v. Dell Inc., 454 Mass. 192 (2009) (Feeney I), the Supreme Judicial Court of Massachusetts struck down a waiver of class actions in an arbitration clause. The plaintiffs in Feeney claimed that Dell overcharged them for computer service contracts. The contracts contained an arbitration clause that prohibited class actions. The Massachusetts Supreme Judicial Court held that enforcing this clause would be "counter to our public policy" because the state's consumer protection statute expressly provides for class actions.

In 2011, the Supreme Court decided Concepcion, which held that a similar rule in California was preempted by the Federal Arbitration Act. AT&T's arbitration clause was well-crafted. The consumer plaintiff could submit a simple claim, and AT&T was required to respond promptly. If the arbitrator found that AT&T's offer was not adequate, then AT&T would be required to pay the plaintiff at least $7,500. As a result, the consumer was likely to receive an adequate recovery — and more than he or she would get in a class action. This clever design allowed Justice Antonin Scalia to marshal a majority of the Supreme Court to rule that the arbitration clause prevailed.

In response to Concepcion, the Massachusetts Supreme Judicial Court decided Feeney v. Dell, Inc., 465 Mass. 470 (2013) (Feeney II). Feeney II held that Massachusetts law still favored class actions, rendering the class action waiver unenforceable. The plaintiffs had demonstrated that the value of their claims was so small (and their claims were so complex) that they could not proceed on an individual basis. The majority in the Concepcion case would not have barred class claims in that scenario, the Massachusetts Supreme Judicial Court posited.

On the same day, the Massachusetts Supreme Judicial Court also decided Machado v. System4 LLC, 465

Mass. 508 (2013) (Machado I). In that case, the plaintiffs did not show their claims were too small to proceed on an individual basis. The Massachusetts Supreme Judicial Court sent the Machado case back down to consider arbitration.

The Supreme Court Strikes Again

Just eight days after Feeney II, the Supreme Court clarified its position in American Express Co. v. Italian Colors Restaurant. In another opinion written by Justice Scalia, the Supreme Court held that class action waivers in arbitration clauses must be enforced, even if the plaintiffs could show that it would not be economically reasonable to pursue their claims on an individual basis.

The majority "rejected the argument that class arbitration was necessary to prosecute claims that might otherwise slip through the legal system." Justice Scalia added that avoiding "the procedural morass" of class proceedings was more important than addressing every small claim. The dissent responded bluntly: "Amex has insulated itself from antitrust liability," Justice Elena Kagan wrote, "[a]nd here is the nutshell version of today's opinion. ... Too darn bad."

The Massachusetts Supreme Judicial Court, remarkably, condemned the American Express holding as "untenable." Nonetheless, to its credit, the Massachusetts Supreme Judicial Court acknowledged that "the Supreme Court explicitly rejected our reading of Concepcion," and it reversed its own Feeney II decision. See Feeney v. Dell Inc., 466 Mass. 1001 (2013) (Feeney III).

Looking for an Escape Clause

Seeking to escape Concepcion, class action plaintiffs around the country have tried to find defendants they can sue who have not signed arbitration clauses. See, e.g., In re Carrier IQ Inc. Consumer Privacy Litig., No. No. C-12-md-2330 EMC, 2014 U.S. Dist. LEXIS 42624 (N.D. Cal. Mar. 2, 2014) (putative class action against unauthorized transmittal of personal information); In re Titanium Dioxide Antitrust Litigation., 962 F. Supp. 2d 840 (D. Md. 2013) (putative class action alleging price-fixing).

Last month, in a new iteration of the Machado case, the Massachusetts Supreme Judicial Court ruled that the plaintiffs could not rely on this strategy to escape the reach of an arbitration clause, where their own claims relied on the contract that contained it.

In Machado, NECCS Inc. had entered into a franchise agreement with a group of janitorial workers. NECCS was to provide the workers with potential customer accounts. The workers were to service those accounts using trademarks and other branding of System4 LLC, the parent company of NECCS. The agreement required arbitration of "any claims between the [janitorial workers] and NECCS and its subsidiaries, affiliates, shareholders, officers, directors, managers, representatives, and employees, arising out of or relating to ... the franchise agreement [or] ... claims relating to the operation of the franchised business."

One of the janitorial workers sued in Massachusetts Superior Court, claimed to represent a putative class. He alleged breach of the agreement, and that NECCS and System4 had misclassified the putative class members as independent contractors, when actually they were employees. NECCS and System4 moved to stay the court proceedings pending arbitration. The Massachusetts Superior Court denied the motion, ruling that the arbitration clause was unenforceable. On appeal, the Massachusetts Supreme Judicial Court in Machado I had held that the agreement's waiver of class actions was not a reason to invalidate the arbitration clause, in light of Concepcion.

The Massachusetts Superior Court on remand held that the arbitration clause governed the claims against NECCS, but that System4 had not signed the agreement, and therefore could not enforce it. The trial court ruled that System4 would need to defend the class action in court.

The Massachusetts Supreme Judicial Court reversed. It applied the doctrine of equitable estoppel, noting that courts outside Massachusetts had compelled a signatory to proceed in arbitration: (1) when it "rel[ied] on the terms of the written agreement in asserting its claims against the nonsignatory"; or (2) "when a signatory raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract."

No reported Massachusetts decisions had previously applied the doctrine of equitable estoppel in this way. Nevertheless, the Massachusetts Supreme Judicial Court stated that it was the "theory with clearest application to the facts of [the] case." The Massachusetts Supreme Judicial Court ruled that the plaintiffs could not both sue on the agreement and avoid the agreement's arbitration clause. In addition to their claim for breach of contract, the plaintiffs' wage claims against System4 were also "inextricably intertwined" with the agreement, the court ruled.

Lessons

Several other objections raised by the plaintiffs were rejected by the Massachusetts Supreme Judicial Court:

- The plaintiffs argued that the governing arbitration rules required the cost of arbitration to be borne equally by the parties. The Massachusetts Supreme Judicial Court responded that an arbitrator would be able to apply state law, including law on fee-shifting.

- The plaintiffs argued that the agreement contained a one-year limitations period, which was shorter than the three years provided in the Massachusetts Wage Act. The Massachusetts Supreme Judicial Court responded that an agreed upon limitations period may be shorter than an otherwise applicable statute, so long as the shorter period did not violate public policy. There was no evidence, the court ruled, that the agreement's one-year limitations period was particularly troubling.

- The plaintiffs argued about a confidentiality provision in the agreement. The Massachusetts Supreme Judicial Court responded that the putative class of franchisees was "relatively small," and therefore the secrecy of the arbitral result would not deprive many future plaintiffs of helpful precedent.

The court also noted that there was a severability clause. Any portion of the agreement that turned out to be unenforceable could be severed, the court observed. This portion of the opinion suggests that where a company hopes to rely on an arbitration clause, it is generally prudent to include a severability clause as well.

In addition to class actions, many business-to-business disputes turn on agreements that contain arbitration provisions. Often these disputes involve multiple business entities. Counsel should identify who the necessary parties are, and whether they agreed to arbitration. For disputes with a nexus to Massachusetts, the Machado decision will be central in this analysis going forward.

As a result of the strategy advanced by Justice Scalia in Concepcion and American Express, arbitration clauses are throttling class actions step by step, both in state and federal courts. In Massachusetts, the state's high court candidly acknowledged that it was forced to accept this conclusion, even though it views this result as "untenable." Time will tell whether the courts in other states are similarly candid.

—By Robert M. Buchanan Jr. and Jesse Siegel, Choate Hall & Stewart LLP

Robert Buchanan Jr. is a partner in Choate Hall & Stewart's Boston office. Buchanan serves on the board of editors of the Boston Bar Journal. He is a past chairman of the Boston Bar Association's Ethics and Antitrust Committees.

Jesse Siegel is an associate in Choate Hall & Stewart's Boston office. Siegel served as assistant attorney general in the Criminal Bureau of the Attorney General's Office in Boston.