Does the Ninth Circuit's Reasoning In *Kolev* Provide a Possible Exception to *Concepcion*?

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Introduction

In September 2011, in *Kolev v. Euromotors West/The Auto Gallery*, 658 F.3d 1024, 1032 (9th Cir. 2011), *pet. for reh'g en banc filed*, Oct. 4, 2011, *order vacating decision issued* April 11, 2012, the Ninth Circuit ruled that written warranty provisions requiring binding arbitration are unenforceable under the Magnuson-Moss Warranty Act, 15 U.S.C. §2301 *et seq*. ("MMWA"). The Court found that the MMWA expressly delegated authority to the U.S. Federal Trade Commission ("FTC") to "prescribe rules setting forth minimum requirements for any informal dispute settlement procedure which is incorporated into the terms of a written warranty." 15 U.S.C. § 2310(a)(2). Pursuant to this express Congressional delegation, the FTC construed the MMWA as barring all pre-dispute mandatory arbitration provisions. Thus, consumer warranty claims under the MMWA may not be able to be arbitrated at all, and the preemption arguments normally raised would be inapplicable due to Congress' express delegation of authority to a federal agency that has provided an unequivocal arbitration bar, which construction of the MMWA has remained unchanged for more than 35 years.

This ruling was significant because, if either upheld or followed, such a ruling could create an exception to the Supreme Court's decision permitting companies to enforce certain anti-class action waiver provisions under the Federal Arbitration Act ("FAA") in *AT&T Mobility LLC v. Concepcion*, ___ U.S. ___, 131 S.Ct. 1740 (2011). However, on April 11, 2012, in lieu of ruling on the pending petitions for reconsideration and for re-hearing *en banc* the 3-judge panel in *Kolev* vacated the decision to await the outcome of a California Supreme Court decision in *Sanchez v. Valencia Holding Co. LLC*, 201 Cal.App. 4th 64 (2nd. Dist. Ct. App., Nov. 23, 2011, *rev. granted* Mar. 21, 2012). Since the opening brief in *Sanchez* has yet to be filed, further consideration by the *Kolev* panel is likely over a year away. What was particularly curious about the Order vacating the decision in *Koley* is that *Sanchez* addresses the question of

unconscionability under California state law in general, and specifically did not address the issue of the unconscionability of a class action waiver provision under *Concepcion*. Being that *Kolev* was a question of the interpretation of a federal regulation that prohibits arbitrations of consumer warranty claims generally, rather than an interpretation of state unconscionability law, facially it appears *Sanchez* may not to be relevant to the decision in *Kolev*. However, as discussed below, there may be another rationale underlying this Order.

This papers provides a summary of *Kolev* and one of the primary arguments made against it in terms of being superceded by a subsequent Supreme Court decision, the order vacating the decision and why it may not be as ominous as people may think, and a discussion why *Kolev*, although no longer citable as Ninth Circuit precedent, may provide a roadmap for litigants who may want to make similar arguments on warranty claims pending in state and federal courts.

The Background of *Kolev*

Diana Kolev brought suit against a car dealership (Euromotors West/The Auto Gallery, Motorcars West LLC and others) and Porsche when a used automobile she purchased from the dealership developed serious mechanical problems during the warranty period and the dealership refused to honor her warranty claims. She brought claims for breach of implied and express warranties under the MMWA, and breach of contract and unconscionability under California law. The sales contract, which appears to be the standard form contract used by most car dealerships in California, included an arbitration clause that mandated pre-dispute binding arbitration and stated that any warranties regarding the vehicle would be located in a separate written warranty; both parties and the district court assumed that such written warranty existed and that it referred to the arbitration clause. The district court granted the dealership's petition to compel arbitration pursuant to the mandatory arbitration provision contained in the standard sales contract, and then stayed the action against Porsche. After the arbitrator resolved most of her claims in favor of the dealership, the district court confirmed the arbitration award. Kolev's principal argument on appeal was that the MMWA, through 16 C.F.R. §703 *et seq*., which provides that "decisions of any Mechanism [defined as any "informal dispute settlement

procedure which is incorporated into the terms of a written warranty"] shall not be legally binding on any person" bars any contract provision mandating pre-dispute binding arbitration of any warranty claims. *Kolev*, 658 F.3d at 1025-26.

The Decision In *Kolev*

In a 2-1 decision (over a vigorous dissent by Judge Randy Smith that noted such a decision conflicted with decisions from the Fifth and Eleventh Circuits), Judges Reinhardt and Nelson reversed the initial decision of the district court compelling arbitration, holding the MMWA claims could not be compelled to arbitration. The MMWA directs the FTC to "prescribe rules setting forth minimum requirements for any informal dispute settlement procedure which is incorporated into the terms of a written warranty." 15 U.S.C. § 2310(a)(2). In turn, based on 16 C.F.R.§703 adopted by the FTC, it concluded written warranty provisions that mandate pre-dispute binding arbitration "are invalid" under the MMWA, and the district court erred "in enforcing [such] warranty clause by compelling mandatory arbitration" of the MMWA claims. *Kolev*, 658 F.3d at 1031.[1]

The Ninth Circuit found the MMWA "different in four critical respects from every other federal statute that the Supreme Court has found does not rebut the FAA's proarbitration presumption." *Kolev*, 658 F.3d at 1030. First, in none of these statutes "did an authorized agency construe the statute to bar pre-dispute mandatory binding arbitration." *Id.* Second, only in the MMWA "did Congress say anything about informal, non-judicial remedies, and do so in a way that would bar binding procedures such as mandatory arbitration." *Id.* Third, only in the MMWA "alone did Congress explicitly preserve, in addition to informal dispute settlement mechanisms, a consumer's right to press his claims under the statute in civil court." *Kolev*, 658 F.3d at 1030 (citing 15 U.S.C. § 2310(a)(3)(c)). Fourth, only the MMWA "sought as its primary

[1] Other courts that had reached similar conclusions include *Breniser v. Western Rec. Vehicles Inc.*, 2008 U.S. Dist. LEXIS 100807, *12 (D. Or. Dec. 12, 2008); *Rickard v. Teynor's Homes, Inc.*, 279 F. Supp. 2d 910, 921 (N.D. Ohio 2003); *Browne v. Kline Tysons Imports, Inc.*, 190 F. Supp. 2d 827, 831 (E.D. Va. 2002); *Pitchford v. Oakwood Mobile Homes, Inc.*, 124 F. Supp. 2d 958, 962-65 (W.D. Va. 2000).

purpose to protect consumers by prohibiting vendors from imposing binding, non-judicial remedies." *Id.* at 1031.

In overturning the trial court's order compelling arbitration, the Court relied primarily on the fact "Congress expressly delegated rulemaking authority under the [MMWA] to the Federal Trade Commission ('FTC'). Pursuant to this authority, the FTC construed the [MMWA] as barring pre-dispute mandatory binding arbitration provisions covering written warranty agreements and issued a rule prohibiting judicial enforcement of such provisions with respect to consumer claims brought under [the MMWA]". *Id.* at 1025 (citing 16 C.F.R. § 703.5; 40 Fed. Reg. 60167, 60210 (Dec. 31, 1975)). When it published Rule 703, the FTC explained:

> Several industry representatives contended that warrantors should be allowed to require consumers to resort to mechanisms whose decisions would be legally binding (e.g., binding arbitration). The Rule does not allow this for two reasons. First, as the Staff Report indicates, Congressional intent was that decisions of Section 110 Mechanisms not be legally binding. Second, even if binding mechanisms were contemplated by Section 110 of [the MMWA] , the [FTC] is not prepared, at this point in time, to develop guidelines for a system in which consumers would commit themselves, at the time of product purchase, to resolve any difficulties in a binding, but non-judicial, proceeding. The [FTC] is not now convinced that any guidelines which it set out could ensure sufficient protection for consumers.

Kolev, 658 F.3d at 1026-27 (citing 40 Fed. Reg. 60167, 60210 (Dec. 31, 1975)).

Applying the Supreme Court's test for reviewing agency regulations under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the court found "the FTC's interpretation of [the MMWA] as precluding pre-dispute mandatory binding arbitration is a reasonable construction of the statute." *Kolev*, 658 F.3d at 1029. In enacting the MMWA, the court explained, "Congress expressly delegated authority to the FTC to 'prescribe rules setting forth minimum requirements for any informal dispute settlement procedure which is incorporated into the terms of a written warranty.'" *Id.* at 1026 (quoting 15 U.S.C. § 2310(a)(2)). Through this express delegation of Congressional authority, "the FTC promulgated Rule 703, which provides that '[d]ecisions of [any] Mechanism shall not be legally binding on any person,' 16 C.F.R. § 703.5(j) ... The FTC's explanation ... concluded that 'reference within the written

warranty to any binding, non-judicial remedy is prohibited by the Rule and the Act.'" *Id.* at 1028.

The Court also pointed to subsequent FTC action as further support for the FTC's construction of the MMWA and deference to that decision under *Chevron*. "In 1999, the FTC restated its position that mandatory pre-dispute binding arbitration clauses are invalid under [the MMWA] and affirmed that 'this interpretation continues to be correct.'" *Kolev*, 658 F.3d at 1028 (quoting 64 Fed. Reg. 19700, 19708 (Apr. 22, 1999)). "Expressly declining to amend 16 C.F.R. § 703.5(j) to permit binding arbitration," the court observed, "the FTC concluded that 'Rule 703 will continue … to prohibit warrantors from including binding arbitration clauses in their contracts with consumers to submit warranty disputes to binding arbitration.'" *Id.* at 1028-29 (quoting 64 Fed. Reg. at 19708-09).

Based on these and other facts, the *Kolev* court found "three reasons why the FTC's interpretation of [MMWA] as precluding pre-dispute mandatory arbitration is a reasonable construction of the statute." *Id.* at 1029. "First," the Ninth Circuit declared, "the FTC sought in devising Rule 703 to implement Congress's intent, based on evidence from the legislative history of the [MMWA]." *Id.* The "Subcommittee Staff Report on which the FTC based its independent interpretation of Congress's intention makes clear that consumers must be made aware of their rights, including their right to pursue litigation, because otherwise 'the fate of aggrieved consumers usually rests with the seller/manufacturer and its willingness to live up to its promises.'" *Id.* "The FTC's reliance on such legislative history in seeking to implement Congress's intent," explained the court, "is the first reason that its rule barring judicial enforcement of pre-dispute mandatory binding arbitration agreements is a reasonable construction of [the MMWA]." *Id.*

"Second," the court reasoned, "the FTC's interpretation that [the MMWA] bars pre-dispute mandatory binding arbitration advances the statute's purpose of protecting consumers from being forced into involuntary agreements that they cannot negotiate." *Kolev*, 658 F.3d at 1029. Through the MMWA, "Congress sought to address the extreme inequality in bargaining

power that vendors wielded over consumers by 'providing consumers with access to reasonable and effective remedies' for breaches of warranty, and by 'provid[ing] the Federal Trade Commission (FTC) with means of better protecting consumers.'" *Id.* (quoting H.R. Rep. No. 93-1107, at 24 (1974)). Based on Congressional intent, added the court, the FTC construed the MMWA "'as prohibiting vendors from including provisions that mandate arbitration of disputes over breaches of warranty before a dispute arises, in order to prevent them from depriving consumers of the right that it guaranteed them to litigate breaches of warranty." *Id.*

Third, the court stated it was following the Supreme Court's directive that "'a court may accord great weight to the longstanding interpretation placed on a statute by an agency charged with its administration,'" because "'agency interpretations that are of long standing come before us with a certain credential of reasonableness, since it is rare that error would long persist.'" *Kolev*, 658 F.3d at 1029 (quoting *NLRB v. Bell Aerospace Co. Div. Textron Inc.*, 416 U.S. 267, 274-75 (1974) and *Smiley v. Citibank*, 517 U.S. 735, 740 (1996)). "That a quarter century passed between the FTC's initial construction of the [Magnuson-Moss Act] as barring pre-dispute mandatory binding arbitration and its most recent reaffirmation of that conclusion," reasoned the court, "merits that consistent FTC construction of the statute strong deference. Moreover, that Rule and its concomitant construction of [Magnuson-Moss] by the agency charged with the statute's enforcement remains in effect to this day." *Kolev*, 658 F.3d at 1029.

Thus, the Court found the FTC's interpretation of the MMWA reasonable because: (1) "the FTC interpreted the statute consistent with its carefully reasoned understanding of the enacting Congress's intent, as evidenced by the statute's language and legislative history"; (2) "the FTC's construction advances the [Magnuson-Moss Act's] purpose to protect consumers from predatory warrantors and to provide them with fair and informal pre-filing procedures that preserve their rights to enforce their claims for breach of warranty through civil litigation in the state or federal courts"; and (3) "the persistence of the FTC's rule that the [Magnuson-Moss Act] bars pre-dispute mandatory binding arbitration—expressly reaffirmed more than a decade after the Supreme Court held that the FAA 'mandates enforcement of agreements to arbitrate statutory

claims' absent 'contrary congressional command—requires that the courts afford the agency's construction particularly strong deference." *Kolev*, 658 F.3d at 1031.

In *Kolev*, the court set forth conditions that must be considered for deference to be accorded the FTC's interpretation of the MMWA:

> If Congress' intent is not clear under [a] statute and if "Congress delegated authority to the agency generally to make rules carrying the force of law, and [ ] the agency interpretation claiming deference was promulgated in the exercise of that authority," then we must defer to the agency's reasonable construction of the ambiguous statutory provision.

Kolev, 658 F.3d at 1026 (quoting *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001)). The *Kolev* court acknowledged "the Supreme Court's repeated holdings that Congress established a 'liberal federal policy favoring arbitration agreements' when in 1924 it enacted the Federal Arbitration Act," but then also pointed to other Supreme Court's guidance that "the FAA's mandate to enforce arbitration agreements, '[l]ike any statutory directive, may be overridden by a contrary congressional command.'" *Id.* (quoting *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 226 (1987)). Thus, because it believed Supreme Court precedent such as *Chevron* compelled the court "to defer to the reasonable construction of a statute by the agency that Congress has authorized to interpret it," the court concluded that it agreed "with the FTC's longstanding interpretation of the [MMWA] that it bars judicial enforcement of warranty provisions that mandate pre-dispute binding arbitration and that [the MMWA] evinces a 'contrary congressional command' sufficient to override the FAA's presumption in favor of arbitration." *Kolev*, 658 F.3d at 1030 (quoting *McMahon*, 482 U.S. at 226). "More important," the court explained, "under *Chevron*, we are bound by it." *Id.* .

The Order Vacating *Kolev* and What It May (Or May Not) Mean

Has the Underlying Reasoning of *Kolev* Been Overruled?

Some companies have argued that the recent Supreme Court decision in *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665 (2012), effectively overruled the reasoning in *Kolev*. In

CompuCredit, the Supreme Court addressed whether the Credit Repair Organizations Act ("CROA"), 15 U.S.C. §§ 1679 *et seq.*, prohibits arbitration of CROA claims in light of the CROA's silence on the matter and its reference to permitting consumers a "right to sue" for relief. Finding no congressional command overriding the FAA's mandate to enforce arbitration agreements, the Supreme Court held claims under the CROA are subject to mandatory arbitration if an agreement so provides. *Id.* at 670-73. However, *CompuCredit* neither addressed the MMWA nor involved a statute in which Congress delegated express rulemaking authority to a federal agency. As noted in *Kolev*, 658 F.3d at 1030-31, this was a material distinction in the mind of the majority in *Kolev*.

Congress's express delegation of authority to the FTC also leads to a different standard of review -- unlike *Kolev*, *CompuCredit* involved no Congressional delegation of rulemaking or implementing regulations, which led the Supreme Court to employ a different analytical framework in *CompuCredit* than required in *Kolev*. *Compare CompuCredit*, 132 S. Ct. at 670-73 (reviewing the CROA interpretation *de novo*) *with Kolev*, 658 F.3d at 1025-31 (employing the analysis of *Chevron* and *Mead* giving required deference to the FTC interpretation). This is an important distinction between the two cases, since as the Ninth Circuit recently explained in another case, "However, if the statute does not address the specific issue before us, or does so ambiguously, the question for the court is whether the agency's answer is based on a permissible construction of the statute. The agency's construction must therefore only be reasonable and need not be the same as the construction the court itself would have embraced had it reviewed the statute *de novo*. The court does not simply impose its own construction on the statute." *North Plains Res. Council, Inc. v. Surface Transp. Bd.*, 668 F.3d 1067, 1076 (9th Cir. 2011). Nothing in *CompuCredit* ever questions whether the *Chevron* analysis is proper in engaging in an analysis of a statute under the FAA.

Kolev and *CompuCredit* also were premised on two different statutory provisions. *See*, *Kolev*, 658 F.3d at 1030 ("only in the [MMWA] and in none of these other statutes did Congress say anything about informal, non-judicial remedies, and do so in a way that would bar binding

procedures, such as mandatory arbitration."). The Supreme Court in *CompuCredit*, 132 S. Ct. at 675, found the CROA's disclosure provision simply described the cause of action created elsewhere in the CROA as a "right to sue"—language easily comprehensible for a layperson, and therefore necessarily imprecise. The *CompuCredit* respondents, unlike the appellants in *Kolev*, "identif[ied] nothing in the legislative history or the purpose of the [CROA] that would tip the balance of the scale in favor of their interpretation." 132 S. Ct. at 675 (Sotomayor, J., concurring); *see also id.* at 670 (majority decision) (explaining that "mere formulation of the cause of action" by use of terms calling to mind a judicial proceeding is not "sufficient to establish the 'contrary congressional command' overriding the FAA").

Finally, *Kolev* actually relies on the same Supreme Court precedent underlying the *CompuCredit* decision. *Compare CompuCredit*, 132 S. Ct. at 670-71 (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 21, 28 (1991), *McMahon*, 482 U.S. at 240, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985), as examples of cases where the Supreme Court held arbitration agreements enforceable with respect to causes of action created by federal statutes) *with Kolev*, 658 F.3d at 1030 (citing statutes discussed in cases including *Gilmer, McMahon* and *Mitsubishi Motors* and finding Magnuson-Moss distinguishable from such statutes).

Conclusion

Unfortunately for all sides who would like certainty on the issue, the *Kolev* debate is still far from over. It will remain unclear for at least another year, and even then may not be resolved depending on the outcome of *Sanchez*. While *Kolev* is no longer of precedential effect, its reasoning is still valid for consideration where a party asserts warranty claims under the MMWA in either state or federal court. Thus, both sides of a warranty dispute can expect, and should be prepared to address, the continuing question whether 16 C.F.R. §703 precludes companies from inserting and attempting to enforce anti-class action waiver/arbitration clauses in various types of form agreements where claims for breach of consumer warranty may be at issue.