Court of Appeals Compels Arbitration, Not Class Litigation

January 26, 2012 by Sean Wajert

The role of alternative dispute resolution mechanisms in alleged consumer product defect cases continues to be a hotly disputed issue. Plaintiff lawyers prefer the class action device, with its ability to pressure blackmail settlements, while product makers continue to require in product literature that consumers go the quicker and cheaper route of ADR.

The Third Circuit held last week that a putative class of computer customers should arbitrate, not litigate, their product defect claims against Dell Inc., even though the arbitration forum originally named in the computer purchase "terms and conditions" was no longer available. See Raheel Ahmad Khan, et al. v. Dell Inc., No.10-3655 (3d Cir.).

This appeal involved a matter of first impression for this court– whether Section 5 of the Federal Arbitration Act (FAA) required the appointment of a substitute arbitrator when the arbitrator designated by the parties was unavailable. The district court denied Dell's Motion to Compel Arbitration, based on the belief that the arbitration provision was rendered unenforceable because it provided for the parties to arbitrate exclusively before a forum that was unavailable when plaintiff commenced suit. The district court also refused to appoint a substitute arbitrator, finding that it could not compel the parties to submit to an arbitral forum to which they had not agreed.

Khan purchased a Dell computer through Dell's website; he alleged that his unit suffered from design defects, causing his computer to overheat and thereby destroy the computer's motherboard. Khan allegedly replaced the motherboard multiple times. Eventually, the warranty expired. In 2009, Khan filed a putative consumer class action on behalf of himself and other similarly situated purchasers and lessees of the allegedly defectively designed computers.

But to complete the purchase, plaintiff had been required to click a box stating “I AGREE to Dell's Terms and Conditions of Sale.” Just beneath was a box requiring "BINDING ARBITRATION ADMINISTERED BY THE NATIONAL ARBITRATION FORUM (NAF)." However, at the time the lawsuit was filed, the NAF had gotten out of the business of conducting consumer arbitrations pursuant to a Consent Judgment, which resolved litigation brought by the Attorney General of Minnesota. Although Khan suggested that Dell must have chosen the NAF based on its alleged corporate-friendly disposition, the record did not show that Dell was aware of the practices challenged by the state AG at the time that it selected the NAF as the arbitral forum governing Khan's purchase, or that Dell selected the NAF for any improper reason.

The arbitration provision did not designate a replacement forum in the event that NAF was unavailable for any reason. But, the product Terms and Conditions did incorporate the Federal Arbitration Act. The court of appeals noted that, because this was a question of arbitrability, it was governed by the FAA. Congress passed the FAA in response to widespread judicial hostility to arbitration agreements. The FAA reflects a liberal federal policy favoring arbitration. The federal courts have regularly noted that questions of arbitrability must be addressed with a healthy regard for this federal policy favoring arbitration.

The particular problem presented in this case – the unavailability of the NAF – was addressed in section 5 of the FAA, which provides a mechanism for substituting an arbitrator when the designated arbitrator is unavailable. In determining the applicability of Section 5 of the FAA when an arbitrator is unavailable, courts have focused on whether the designation of the arbitrator was “integral” to the arbitration provision or was merely an ancillary consideration. Only if the choice of forum is an integral part of the agreement to arbitrate, rather than an ancillary logistical concern, will the failure of the chosen forum preclude arbitration. In other words, a court will decline to appoint a substitute arbitrator, as provided in the FAA, only if the parties' choice of forum is so central to the arbitration agreement that the unavailability of that arbitrator brings the agreement essentially to an end. In this light, said the court, the parties must unambiguously express their intent not to arbitrate their disputes in the event that the designated forum became unavailable.

Plaintiff stressed that the NAF's rules were incorporated into the contract, and that these rules provide that all arbitrations must be conducted by the NAF or an entity having an agreement with it. The court found this requirement ambiguous as to what should happen in the event that the NAF was unavailable. The NAF's rules provided that they shall be interpreted in a manner consistent with the FAA and that, if any portion of the NAF rules were found to be unenforceable, that portion shall be severed and the remainder of the rules shall continue to apply. This suggested the possibility of substitutions.

The dissent argued that it was important why the NAF was not available to arbitrate. But, the terms and conditions clearly contained an agreement to resolve disputes through arbitration, rather than through litigation. And the reason the forum was not available was not dispositive.