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Ninth Circuit Panel Withdraws Opinion Holding That Magnuson-Moss Warranty Act Prohibits Mandatory Arbitration Clauses in Consumer Sales Contracts

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California is a difficult jurisdiction for sellers of consumer products, due in part to the pro-consumer Song-Beverly Consumer Warranty Act, which expands the consumer rights codified in the federal Magnuson-Moss Warranty Act ("MMWA"). Things seemed to be getting even tougher for sellers when the United States Court of Appeals for the Ninth Circuit issued its September 20, 2011 Opinion in *Kolev v. Euromotors West/The Auto Gallery*, Case No. 09-55963, in which the court effectively barred mandatory arbitration provisions in consumer warranty contracts. In a belated victory for sellers, however, on April 11, 2012 the panel that decided *Kolev* entered an order withdrawing its prior Opinion and implicitly restoring the validity of mandatory arbitration provisions in consumer product warranties.

Case History

Plaintiff Diana Kolev purchased a pre-owned Porsche from the defendant dealership. The sales contract contained a mandatory arbitration provision that encompassed all warranty disputes with the dealer. After the vehicle developed significant mechanical problems, Kolev alleged that the dealership refused to honor her warranty claims, and she brought suit under the MMWA. The district court granted the dealership's motion to compel arbitration, and the arbitrator resolved most of Kolev's claims in the dealership's favor; the district court subsequently confirmed the arbitration award. Kolev appealed, arguing that the MMWA barred the mandatory arbitration provision. Prior to this decision, the Fifth and Eleventh Circuits had reviewed this question, and both held that the MMWA did not bar similar mandatory arbitration provisions. *See Walton v. Rose Mobile Homes LLC*, 298 F.3d 470, 475 (5th Cir. 2002); *Davis v. S. Energy Homes, Inc.*, 305 F.3d 1268, 1278 (11th Cir. 2002).

The Majority Opinion

On appeal, Circuit Judge Reinhardt, writing for the majority, held that the MMWA barred mandatory arbitration provisions in consumer warranties pursuant to Federal Trade Commission ("FTC") Rule 703, which provides that "decisions of any Mechanism shall not be legally binding on any person." FTC Rule 703.1 defines a "Mechanism" as an "informal dispute settlement procedure which is incorporated into the terms of a written warranty." Under that definition, once the informal procedure (or "Mechanism") is complete, a consumer can pursue legal remedies if she is not satisfied with a Mechanism's outcome.

The majority opinion relied on the Supreme Court's decision in *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 226 (1987), which held that the Federal Arbitration Act's ("FAA") mandate

to enforce arbitration agreements "may be overridden by a contrary congressional demand." The majority concluded that Congress' delegation of rulemaking authority to the FTC for "informal dispute settlement procedures" allowed the FTC's Rules on "Mechanisms" to serve as a "contrary congressional demand." In resolving the apparent conflict between the FTC rules and the FAA, the majority held that FTC Rule 703 barred mandatory arbitration provisions in consumer product warranties.

The Dissent

Circuit Judge N.R. Smith dissented on several grounds. Judge Smith expressed concern that the majority's opinion would have the effect of nullifying "every binding, non-judicial warranty dispute remedy adopted by private parties in this circuit." Most importantly, he posited that the form of arbitration required by the agreement between Kolev and the dealership was not a "Mechanism" as defined by FTC Rule 703. Under his view, the MMWA authorized the FTC to create rules regarding only "informal settlement dispute procedures" ("ISDM"), but not arbitration proceedings.

In noting that the arbitration agreement at issue in this case was not an ISDM, Judge Smith noted that Rule 703 provides that non-binding prerequisites to arbitration are "Mechanisms," but that contractual provisions that provide binding *alternatives* to litigation operate outside of the optional ISDM procedures are therefore, not "Mechanisms." Judge Smith noted that the FTC has, on several occasions, stated that Rule 703 does not bar binding arbitration of warranty claims, and that most forms of ADR exist outside the purview of Rule 703. In other words, while all Mechanisms are ADR, not all forms of ADR are Mechanisms.

Judge Smith stated further that the deference to statutes enunciated by the Supreme Court in *Chevron U.S.A., Inc. v. Nat. Res. Defense Council, Inc.*, 467 U.S. 837 (1984), was not relevant to this case, because Congress delegated authority to the FTC solely to address warranty dispute-resolution devices recognized as Mechanisms by the MMWA. FTC commentary on other forms of ADR is not entitled to judicial deference, he argued, because Congress established the judiciary as the adjudicator of private rights arising under the MMWA. Judge Smith, thus, concluded that nothing in the MMWA overrode the FAA's policy favoring rigorous enforcement of arbitration agreements.

The April 11, 2012 Order

The panel's April 11, 2012, order withdrawing the panel opinion was issued without any reasoning or opinion. The order provided merely that the panel opinion was withdrawn and could not be cited as precedent. The precise reasons underlying the panel's action are unknown. What is known, however, is that there are only two federal appellate court opinions on this issue—*Walton* and *Davis* from the Fifth and Federal Circuits—both of which agree with Judge Smith that mandatory arbitration provisions in consumer product warranties are valid and not barred by the MMWA. Thus, further explanation is likely necessary.

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