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Fourth Circuit Enforces Arbitration Clause Over Franchisee Challenge

Muriithi v. Shuttle Express, Inc., 712 F.3d 173 (4th Cir. 2013)

In a recent case involving three different challenges to an arbitration clause in a franchise agreement, the U.S. Court of Appeals for the Fourth Circuit held that the arbitration clause was enforceable despite the agreement's inclusion of (1) a class-action waiver, (2) a fee-splitting clause, and (3) a one-year limitations provision.

In *Muriithi v. Shuttle Express, Inc.*, 712 F.3d 173 (4th Cir. 2013), the plaintiff, Samuel Muriithi, was a driver for defendant Shuttle Express, a shuttle service operating in the area of the Baltimore/Washington International Thurgood Marshall Airport. Muriithi filed suit in federal court against Shuttle Express, asserting claims under the federal Fair Labor Standards Act (FLSA) and under Maryland law. He alleged that in 2007 Shuttle Express had induced him to sign a "Unit Franchise Agreement" based on misrepresentations about his compensation and further alleged that the franchise agreement wrongly classified him as an "independent contractor" or "franchisee" instead of an "employee." Muriithi sought to bring the claims as a class action against Shuttle Express.

Shuttle Express moved to dismiss the complaint for failure to state a claim or, in the alternative, to compel arbitration under the Federal Arbitration Act, 9 U.S.C. ? 4, based on the following arbitration clause in the parties' franchise agreement:

> Except as provided below, any controversy arising out of this Agreement shall be submitted to the American Arbitration Association at its office in or nearest to Baltimore, Maryland, for final and binding arbitration in accordance with its commercial rules and procedures which are in effect at the time the arbitration is filed.

Id. at *3-4. As noted, the agreement also contained a class-action waiver, a fee-splitting clause, and a one-year limitations provision.

The district court denied the request to compel arbitration, holding that although the claims brought by Muriithi were within the scope of the arbitration clause, the arbitration clause was unenforceable. Specifically, the district court concluded that three provisions were unconscionable: First, the court addressed the arbitration provision's fee-splitting clause, which provided "[t]he parties shall bear their own costs including without limitation attorney's fees, and shall each bear one-half (1/2) of the fees and costs of the arbitrator." *Id*. at *4. Based on the district court's review of Muriithi's 2009 federal income tax return and in light of Muriithi's argument that the arbitration fees for which he would be responsible would be more than the amount he could recover at arbitration, the district court found that the cost of arbitration would be prohibitively expensive and would improperly deter arbitration.

Second, the district court found that the class-action waiver within the arbitration clause was unconscionable because individual suits were an unrealistic alternative, given that the potential recovery of each claimant would be less than the arbitration fees.

Third, the district court considered a provision in the franchise agreement setting a one-year limitations period on claims relating to the agreement. The district court held that the contractual limitations period impermissibly interfered with Muriithi's statutory rights because the FLSA provides a two-year statute of limitations.

The district court found that the three provisions were substantively unconscionable and "so permeated" the arbitration clause that they could not be severed. As a result, the court held that the arbitration clause was unenforceable and denied Shuttle Express's motion to compel arbitration.

The Fourth Circuit reversed, addressing each of the three provisions in turn and finding that none was unconscionable. First, the Fourth Circuit addressed the class-action waiver. It explained that, subsequent to the district court's decision, the U.S. Supreme Court decided *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), which "prohibited application of the general contract defense of unconscionability to invalidate an otherwise valid arbitration agreement" when the defense is based merely on the agreement's inclusion of a class-action waiver. *Id*. at *13. In doing so, the Fourth Circuit expressly declined to limit Concepcion to the California state law with which it dealt.

Second, the Fourth Circuit addressed the fee-splitting clause and found that Muriithi had failed to establish that the arbitration would be prohibitively expensive. The court explained that Muriithi was required to make three showings: "(1) the cost of arbitration; (2) his ability to pay; and (3) the difference in cost between arbitration of his dispute and litigation." *Id*. at *15. The Fourth Circuit explained that the arbitration clause could be found unconscionable and therefore unenforceable if Muriithi met the "substantial evidentiary burden" of showing that the costs would be "'so prohibitive as to effectively deny the employee access to the arbitral forum.'" *Id*. at *16-17 (quoting *Bradford v. Rockwell Semiconductor Sys., Inc.*, 238 F.3d 549, 554 (4th Cir. 2001)).

Muriithi, however, failed to meet that burden, according to the Fourth Circuit. The court found Muriithi had failed to present any evidence of the costs of arbitration because his only proffer was based on arbitration fees charged by three arbitrators in an unrelated matter in the Virgin Islands. The Fourth Circuit also found Muriithi had failed to establish the value of his claims, which is necessary in order to calculate fees under the rules of the American Arbitration Association. Because Muriithi failed to make those showings, the Fourth Circuit concluded he had not met his burden of demonstrating prohibitive costs. The court noted that its conclusion was further supported by the offer made by Shuttle Express, at oral argument, to pay all arbitration costs; the court warned, however, that the issue of prohibitive costs would not be made moot by an "eleventh hour" agreement to disregard the fee-splitting provision.

Finally, the Fourth Circuit addressed the one-year limitations provision. It found the limitations provision was not within the arbitration clause. This was a crucial finding, the court explained, because a court's determination of whether an arbitration clause is enforceable under the FAA is based on a challenge to the arbitration clause in particular, not to the agreement as a whole. Challenges to the agreement (as opposed to the arbitration provision) must be raised to the adjudicator (whether court or arbitrator) only after the court decides the motion to compel arbitration.

The one-year limitations provision, by its own terms, applied to "any arbitration, suit, action or other proceeding relating to this

Agreement," not solely to arbitrations. The Fourth Circuit further noted there was no "overlap" between the limitations period and the arbitration clause, and the arbitration clause itself was silent as to a limitations period. The Fourth Circuit therefore concluded that issues related to the limitations provision would be reserved for the arbitrator.

Based on its separate analysis of each of the three provisions at issue, the Fourth Circuit concluded the arbitration agreement was enforceable. It therefore reversed the opinion of the district court, vacated the judgment and remanded the matter with instructions to compel arbitration?-- with all costs of arbitration to be paid by Shuttle Express.

This case provides valuable guidance for understanding the circumstances under which an arbitration clause may be found to be enforceable and, more specifically, the standards under which challenges to such provisions are reviewed by the courts. First, relying on Concepcion, the Fourth Circuit has now clearly stated that the mere existence of a class-action waiver is insufficient for a finding of unconscionability. Second, a party challenging an arbitration provision on the grounds of prohibitive costs must satisfy a demanding evidentiary standard. Third, in determining whether an arbitration clause is enforceable, a court may consider only the clause itself, not the agreement as a whole. A final lesson is that a party's offer to disregard a fee-splitting provision, if made too late, may not prevent a court from considering whether a fee-splitting clause is unconscionable, but may bind the party to pay all costs.