Bloomberg Law Reports® Alternative Dispute Resolution

The Future of Mandatory Pre-Dispute Consumer Arbitration

Brooke A. Alexander and Jeremy Vest, Boies, Schiller & Flexner LLP

One year ago, Minnesota Attorney General Lori Swanson filed suit against the National Arbitration Forum, Inc., the National Arbitration Forum LLC, and Dispute Management Services, LLC, d/b/a Forthright (collectively NAF) alleging violations of the Consumer Fraud Act, the Uniform Deceptive Trade Practices Act, and the False Statements in Advertising Act (the Minnesota Suit). The Minnesota Suit alleged that these privately held, for-profit entities hid their ties to the debt collection industry and were not neutral.[1]

The Minnesota Suit was resolved only three days after it was filed. In a Consent Judgment, NAF admitted no liability but agreed to cease accepting new consumer arbitrations within seven days.[2] In a press release dated July 20, 2009, the Attorney General is quoted as stating, "[T]he company said it was impartial, but behind the scenes, it worked alongside credit card companies to get them to put unfair arbitration clauses in the fine print of their contracts and to appoint the Forum as the arbitrator. Now the company is out of this business."[3]

Consumer advocates had long charged that the modern consumer debt arbitration system, which had grown in size and significance, proportionate to the dramatic expansion of consumer credit in the mid-1990s, was "do-it-yourself tort reform" that heavily favored companies over consumers. By July 2009, their criticisms were well known: by requiring consumers who want such commonplace items as cell phones, credit cards, and car loans to sign, without negotiation, a contract prepared by the company, which often includes a "mandatory pre-dispute arbitration clause" obligating the parties to arbitrate any dispute in front of the named arbitration body, consumers are deprived of an opportunity to obtain relief from a court; additionally, as these contracts often include a related provision which prohibits participation in any class action lawsuit or class arbitration, consumers are further prevented from vindicating their rights because it is prohibitively expensive to arbitrate disputes involving a small amount of damages on an individual basis. However, it was not until the Minnesota Suit exposed the extensive affiliations between credit card companies and other creditors and their chosen arbitration provider, that the system showed signs of collapse.

Nevertheless, while the Consent Judgment resolved the case against NAF, sounding an alarm heard throughout the arbitration industry, it did not definitively resolve the debate regarding the propriety of mandatory pre-dispute arbitration clauses. It was

---

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P in the Vol. 1, No. 3 edition of the Bloomberg Law Reports—Alternative Dispute Resolution. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.

The discussions set forth in this report are for informational purposes only. They do not take into account the qualifications, exceptions and other considerations that may be relevant to particular situations. These discussions should not be construed as legal advice, which has to be addressed to particular facts and circumstances involved in any given situation. Any tax information contained in this report is not intended to be used, and cannot be used, for purposes of avoiding penalties imposed under the United States Internal Revenue Code. The opinions expressed are those of the author. Bloomberg Finance L.P. and its affiliated entities do not take responsibility for the content contained in this report and do not make any representation or warranty as to its completeness or accuracy.

unknown whether consumer debt arbitrations would continue with a different arbitration association filling the void as the largest volume player exited or whether the Minnesota Suit represented a decisive step towards voiding the clauses altogether and permitting consumers back into the courthouse.

As the one-year anniversary of the Minnesota Suit passes, the future of consumer debt arbitration remains unclear. The consumer debt arbitration system is still under attack, but the most far-reaching legislative reforms appear stalled in Congress, few industry players have substantially changed their practices, those that have pulled mandatory pre-dispute clauses from their contracts are free to reinstate them in a couple of years, and follow-on litigation is still in its nascent stages. Fortunately, however, the coming year should bring some much-needed clarity.

Legal Decisions to Watch

Interested parties should pay careful attention to the outcomes of two suits currently pending: *In re National Arbitration Forum Trade Practices Litigation* in the District of Minnesota, consolidated from actions in the District of Minnesota, the Middle District of Alabama, the Middle District of Florida and the Western District of Washington, and *AT&T Mobility v. Concepcion* awaiting argument in the U.S. Supreme Court. Additionally, parties should review the recent Supreme Court opinion in *Jackson v. Rent-a-Center* Inc.

On February 3, 2010, the U.S. Judicial Panel on Multidistrict Litigation chaired by John G. Heyburn, II, consolidated 10 similar actions, each brought in or around October 2009 disputing the arbitration of credit-card debt, unpaid utility bills, consumer leases, or health care debt in front of NAF as a result of mandatory pre-dispute arbitration clauses.[4] The consolidated action, *In re National Arbitration Forum Trade Practices Litigation* (D. Minn.), moved forward against NAF with 10 counts: (1 and 2) Racketeer Influenced and Corrupt Organizations Act, (3) Federal Arbitration Act, (4) due process, (5) Minnesota Consumer Fraud Act, (6) Minnesota Unlawful Trade Practices Act, (7) Minnesota Deceptive Trade Practices Act, (8) tortious interference with contract, (9) fraud, and (10) "unfair trade practices and consumer protection violations under the laws of all 50 states."[5] All except counts four and seven survived a motion to dismiss, originally filed in December 2009, on February 22, 2010. On April 12, 2010, Judge Paul Arthur Magnuson denied NAF's motion for a stay pending appeal on the grounds of immunity and preemption.[6] Even if NAF prevails in this matter, it is precluded from resuming administration of consumer debt arbitrations by the settlement terms of the Minnesota Suit. A finding for the consumer, however, at least to the extent it is rooted in NAF's financial incentive to favor the corporate party, could cast a long shadow over other for-profit arbitration service providers.

In May 2010, the Supreme Court agreed to hear *AT&T Mobility v. Concepcion*[7] in which Vincent and Liza Concepcion sought to overturn a mandatory pre-dispute arbitration provision in their cell phone contract with AT&T because it contains a ban on class-action litigation. On October 27, 2009, the U.S. Court of Appeals for the Ninth Circuit held, in the case of *Laster v. AT&T Mobility LLC*,[8] that pre-dispute class action bans were unconscionable and unenforceable under California law, and the FAA did not preempt California law regarding unconscionability. On May 24, 2010,

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P in the Vol. 1, No. 3 edition of the Bloomberg Law Reports—Alternative Dispute Resolution. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.

the Supreme Court granted certiorari and will hear argument during the 2010-2011 term, under the name *AT&T Mobility v. Concepcion*. The Supreme Court's forthcoming decision in *AT&T Mobility* arguably could, if it upholds the Ninth Circuit's rejection of an express class arbitration waiver on the ground that it is unconscionable as a matter of state contract law, clear the way for state courts to invalidate on the same grounds (hundreds of thousands of) arbitration provisions that are silent on the issue.

In June 2010, the Supreme Court heard oral argument on April 26, 2010, in *Jackson v. Rent-a-Center West Inc.*, an employment discrimination case involving an unconscionability challenge to a mandatory pre-dispute arbitration clause.[9] Prior to appeal, the Ninth Circuit held that unconscionability is an issue to be determined by the district court, and not the arbitrator, despite the contract at issue granting that power solely to the arbitrator.[10] On appeal, the Supreme Court considered the following question: "whether, under the Federal Arbitration Act (FAA or Act), 9 U. S. C. §§1–16, a district court may decide a claim that an arbitration agreement is unconscionable, where the agreement explicitly assigns that decision to the arbitrator." On June 21, 2010, the Supreme Court reversed the Ninth Circuit's determination, holding that the arbitrator is empowered under these circumstances to make the threshold determination about whether an arbitration agreement as a whole is unconscionable.[11] The Supreme Court's ruling thus maintains its pro-arbitration orientation and further strengthens the enforceability of mandatory pre-dispute arbitration clauses.

It is also worth noting that our northern neighbors have considered the issue of mandatory pre-dispute arbitration clauses in the last year. On January 20, 2010, the Court of Appeal for Ontario dismissed two appeals seeking to stay a pending class action as a result of mandatory pre-dispute arbitration clauses contained in consumer agreements. Defendant Dell Canada Inc. applied for leave to appeal, which was denied by the Supreme Court of Canada on May 21, 2010. The Supreme Court's ruling forecloses the possibility of enforcing the mandatory pre-dispute arbitration clauses and permits the class action to move forward into discovery.

Industry Developments

Shortly after NAF agreed to cease conducting consumer arbitrations, the American Arbitration Association (AAA) followed suit. Despite not being implicated in the suit against for-profit competitor NAF, the non-profit AAA announced that it would cease administering consumer debt-collection disputes until new guidelines are established. At this time, the AAA has not announced when it will resume administering these disputes.

A few months later, as a result of yet another lawsuit, numerous major credit card issuers began dropping mandatory pre-dispute arbitration clauses from their contracts.

In *Ross v. Bank of America*, part of *In re Currency Conversion Fee Antitrust Litigation*, plaintiffs brought suit against Bank of America, N.A., Capital One Bank, Capital One, F.S.B., J.P. Morgan Chase, Chase Bank USA, N.A., Citigroup, Inc., Citibank (South Dakota) N.A., Citibank USA, N.A., Universal Bank, N.A., Universal

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P in the Vol. 1, No. 3 edition of the Bloomberg Law Reports—Alternative Dispute Resolution. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.

Financial Corp., Citicorp Diners Club, Inc., HSBC Finance Corp., HSBC Bank, Nevada, N.A., MBNA America Bank, N.A., MBNA America (Delaware), N.A., Novus Credit Services, Inc., Discover Financial Services, Inc., and Discover Bank,[12] alleging "antitrust claims aris[ing] from an alleged conspiracy to impose arbitration clauses in cardholder agreements."[13]

Without admitting any wrongdoing, JP Morgan Chase was the first to settle. In November 2009, JP Morgan Chase agreed to, among other things, remove any mandatory pre-dispute arbitration clauses from its current contracts and refrain from their use for three and one-half years. In December 2009, without admitting any wrongdoing, Bank of America and Capital One followed suit, agreeing to, among other things, remove mandatory arbitration clauses from its contracts until at least 2013. In January 2010, a press release issued by class counsel for the plaintiff, Berger & Montague, P.C., announced a tentative settlement with HSBC, containing similar terms. These four settlements were preliminarily approved by the Court on March 18, 2010, and a hearing will be held in the Southern District of New York on July 15, 2010, in order to certify the settlement. The case is still proceeding against non-settling defendants Discover, Citibank, and NAF.[14]

JAMS, for its part, has given no signal that it intends to withdraw from the consumer debt arbitration business, though it is unclear how many of these disputes it actually administers. JAMS did announce, however, effective July 15, 2009, that it would only administer arbitrations pursuant to mandatory pre-dispute arbitration clauses between companies and consumers that complied with its Consumer Arbitration Minimum Standards. These standards, which require, among other things, a neutral arbitrator, consumer participation in arbitrator selection, a right to an in-person hearing in the consumer's hometown area, availability of the same remedies as in court, and limitations on fees paid by the consumer, likely provide some insight into what mandatory pre-dispute arbitration clauses may look like if the credit card industry reinstates them in 2013.[15]

Legislative Proposals

Several legislative proposals pending in both the U.S. House of Representatives and Senate contain provisions that would eliminate or significantly curtail mandatory pre-dispute arbitration clauses in consumer and certain other types of contracts.

The Arbitration Fairness Act of 2009 (AFA), introduced in the House by Representative Hank Johnson (D-Ga.) on February 12, 2009, (H.R. 1020) and in the Senate by Senator Russ Feingold (D-Wis.) on April 29, 2009, (S. 931), if enacted into law, would effect perhaps the most profound changes to U.S. arbitration law since enactment of the Federal Arbitration Act of 1925. The House and Senate bills, currently pending before the House Judiciary Subcommittee on Commercial and Administrative Law and the Senate Judiciary Committee, respectively, would make invalid and unenforceable—retroactively—any mandatory pre-dispute arbitration agreement in an "employment," "consumer," and "franchise" dispute as defined by the statute. In a reversal of long-standing Supreme Court precedent,[16] the AFA would also give courts—not arbitrators—the power to determine whether an arbitration agreement is valid and whether a specific dispute is arbitrable.

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P in the Vol. 1, No. 3 edition of the Bloomberg Law Reports—Alternative Dispute Resolution. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.

Also pending consideration in the House and Senate are the Fairness in Nursing Home Arbitration Act of 2009, sponsored in the House (H.R. 1237) by Representative Linda Sanchez (D-Calif.), and in the Senate (S. 512) by Senators Mel Martinez (R-Fla.) and Herb Kohl (D-Wis.), which would invalidate any mandatory pre-dispute arbitration agreement between a nursing home and a resident (or anyone acting on the resident's behalf).

Prospects for passage of these proposals by the current Congress are doubtful. Both bills remain stalled in committee, and a nearly identical version of the AFA introduced in 2007 languished in prior Congresses. However, Congress is acting on broader financial reform measures that could lead to restrictions on mandatory pre-dispute arbitration agreements.

On May 20, 2010, the Senate passed the Restoring American Financial Stability Act of 2010 (RAFSA), which proposes to amend the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–80b-21, and the Securities Exchange Act of 1934 as amended, 15 U.S.C. §§ 78a-78nn, to give the Securities and Exchange Commission (SEC) the authority to prohibit or limit use of mandatory arbitration to resolve disputes arising out of brokerage or investment advisory contracts. RAFSA, however, also gives the SEC the authority to reaffirm the existing use of mandatory arbitration agreements. In contrast, the House's counterpart bill, The Wall Street Reform and Consumer Protection Act (WSRA),[17] mandates that the SEC initiate rulemaking to prohibit or restrict mandatory pre-dispute arbitration agreements with clients of breaker-dealers and investment advisers. Further, while the Senate bill would create a Bureau of Consumer Financial Protection inside the Federal Reserve, whereas the House version would create a new independent, stand-alone agency, both proposals would create a new consumer financial protection regulator with authority to protect consumers from unfair, deceptive, and abusive practices in connection with financial products and services, including forbidding the inclusion of mandatory arbitration provisions in credit card, mortgage, and other financial product agreements. On June 25, 2010, the House-Senate Conference Committee reached agreement on a compromise bill, with House conferees acquiescing to the Senate's framework for the new consumer protection regulator to be housed within the Federal Reserve. Final passage of the compromise bill is expected in both chambers of Congress.

Congress's passage of a financial reform bill creating a new consumer protection regulator will substantially increase the likelihood of broad restrictions on mandatory pre-dispute arbitration clauses, as that regulator will be more insulated from the political considerations that may have contributed to Congress's inaction on the AFA.

The Shifting Policy Debate

Meanwhile, as Congress deliberates over this legislation, there is evidence that the policy debate may be shifting away from eliminating mandatory pre-dispute arbitration clauses and towards developing enhanced procedural safeguards for consumer debt and other arbitrations.

New empirical studies challenging the core premise underlying each of the legislative proposals—that individuals fare worse in arbitration than litigation—have strengthened claims that arbitration, at least when conducted in accordance with

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P in the Vol. 1, No. 3 edition of the Bloomberg Law Reports—Alternative Dispute Resolution. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.

certain procedures, is a cost-effective, fair, and efficient way to resolve consumer disputes.

Most prominently, in March 2009, the Consumer Arbitration Task Force of the Searle Civil Justice Institute (SCJI), part of the Searle Center at Northwestern Law School, released a Preliminary Report on *Consumer Arbitration Before the American Arbitration Association*.[18] Among the SCJI Study's key findings are:

- Claimants paid an average of $96 in arbitrator and administrative fees to resolve disputes worth less than $10,000 and $219 for disputes between $10,000 to $75,000;
- In 301 cases, consumer claimants won some relief 53 percent of the time and recovered an average of $19,255 whereas business claimants won relief 84 percent of the time and recovered an average of $20,648; and
- In 98.2 percent of cases reviewed by the AAA, the arbitration clause either complied with the Consumer Due Process Protocol, a set of principles designed by a group of officials from government, nonprofits, the bar, and consumer organizations in the mid-1990s to assure procedural fairness in arbitrations, or the AAA properly identified and responded to the non-compliance.

The Federal Trade Commission (FTC), following up on its February 2009 Report, Collecting Consumer Debts: The Challenges of Change – A Workshop Report, which recommended that the debt collection regulatory system be reformed, has hosted a series of regional roundtables involving representatives from the debt-collection industry, government officials, consumer advocates, scholars, and other interested parties to address various issues relating to debt-collection litigation and arbitration.[19] These roundtables appear to reflect an emerging consensus that many of the most serious problems facing consumers in consumer debt disputes are not unique to arbitration, but are equally, if not more, present in litigation.

Conclusion

In July 2009, consumer advocates had good reason to predict the imminent demise of the modern consumer debt arbitration system. Today, however, it appears that the system, and the mandatory pre-dispute arbitration clauses on which it depends, may yet survive—albeit subject to added regulation. Dwindling state budgets and skyrocketing delinquencies and defaults on U.S. credit cards have created new incentives for all interested parties to work together to remedy the problems associated with consumer debt arbitration rather than redirect all consumer debt disputes—into an already over-burdened court system.[20]

As the debate on whether to dismantle the consumer debt arbitration system rages on, several proposed reforms that aim to better protect consumer rights without unduly burdening the arbitration industry are under consideration. These reforms include efforts to, among other things, reduce the rate of non-appearance by consumers in debt collection arbitrations; limit the number of cases an arbitrator may hear involving the same corporate party to eliminate the appearance of "repeat player" bias; improve arbitrator training and recruitment; and create greater transparency regarding the results of consumer arbitrations. It remains to be seen,

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P in the Vol. 1, No. 3 edition of the Bloomberg Law Reports—Alternative Dispute Resolution. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.

however, whether these and other proposals will be sufficient to stem the tide of public, judicial, and legislative hostility that emerged in full view only one year ago.

Brooke Alexander practices complex commercial litigation in the Armonk, New York office of Boies, Schiller & Flexner LLP. She can be reached at balexander@bsfllp.com.

Jeremy Vest practices complex commercial litigation in the Armonk, New York office of Boies, Schiller & Flexner LLP. He can be reached at jvest@bsfllp.com.

---

[1] Complaint, *Minn. v. Nat'l Arbitration Forum, Inc.*, No. 27-CV-09-18559 (Minn. Dist. Ct. July 14, 2009), *available at* http://www.ag.state.mn.us/PDF/PressReleases/SignedFiledComplaintArbitrationCompany.pdf.

[2] Consent Judgment, *Minn. v. Nat'l Arbitration Forum, Inc.*, No. 27-CV-09-18559 (Minn. Dist. Ct. July 14, 2009), *available at* http://pubcit.typepad.com/files/nafconsentdecree.pdf.

[3] Press Release, Office of Attorney General Lori Swanson, National Arbitration Forum Barred from Credit Card And Consumer Arbitrations Under Agreement with Attorney General Swanson (July 20, 2009), *available at* http://www.ag.state.mn.us/consumer/pressrelease/090720nationalarbitrationagremnt.asp.

[4] *In re Nat'l Arbitration Forum Antitrust Litig.*, 682 F. Supp. 2d 1343 (J.P.M.L. 2010).

[5] *In re Nat'l Arbitration Forum Trade Practices Litig.*, No. 09-01939, 2010 BL 37500 (D. Minn. Feb. 22, 2010).

[6] *In re Nat'l Arbitration Forum Trade Practices Litig.*, No. 09-01939, 2010 BL 80925 (D. Minn. Apr. 12, 2010).

[7] No. 09-00893, 2010 BL 115513 (U.S. May 24, 2010).

[8] 584 F.3d 849 (9th Cir. 2009).

[9] 130 S. Ct. 1133, 2010 BL 9655 (2010).

[10] 583 F.3d 912 (9th Cir. 2009).

[11] *Rent-a-Center, West, Inc. v. Jackson*, No. 09-00497, 561 U.S. __, 2010 BL 138828 (2010) (June 21, 2010).

[12] MDL No. 1409, No. M 21-95, 05-cv-07116, at *1n.1 (S.D.N.Y. Jan. 21, 2009).

[13] MDL No. 1409. No. M 21-95, 05-cv-07116, at *2 (S.D.N.Y. Oct. 6, 2009).

[14] For information on the hearing and copies of all settlement agreements, visit the class website at http://www.arbitration.ccfsettlement.com/.

[15] To view the full list, visit www.jamsadr.com/consumer-arbitration.

[16] *See, e.g.*, *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 945-46(1995).

[17] H.R. 4173, 111th Cong. (2009).

[18] *See* Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association: Preliminary Report, *available at* www.searlearbitration.org.

[19] *See, e.g.*, Federal Trade Commission, Protecting Consumers in Debt Collection Litigation and Arbitration: A Roundtable Discussion, http://www.ftc.gov/bcp/workshops/debtcollectround/index.shtm.

[20] For perspective, according to the Minnesota Attorney General, NAF administered an estimated 214,000 of these disputes in 2006 alone. Press Release, *supra* note 3.

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P in the Vol. 1, No. 3 edition of the Bloomberg Law Reports—Alternative Dispute Resolution. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.