

ARBITRATION

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On July 19, 2009, a tsunami swept over the consumer credit market, washing many potential claims out of arbitration and into the courthouse. On that day the National Arbitration Forum (NAF), under pressure from the Minnesota State Attorney General, announced that it was withdrawing from the field of consumer credit arbitration, effective July 24. It will, however, continue to administer credit matters filed before July 24, 2009. On July 27, 2009, the American Arbitration Association (AAA) announced a self-imposed moratorium applicable to any new consumer credit cases brought by a creditor. The impact will be felt for years to come.

In the short term decisions will need to be made quickly about how best to resolve the literally thousands of potential disputes already contracted to proceed before the NAF and AAA. A parallel concern should be the development of strategies about how best to draft consumer agreements to account for the forthcoming shift from private justice to the courthouse.

In this article we will examine just a few of the many likely scenarios, with an eye toward preparing clients and attorneys alike for the resolution of a class of disputes that will no longer be candidates for resolution by arbitration.

What This Is All About

For years consumer groups have objected to the practice of many credit card companies and telecom providers of imposing, by way of adhesion, mandatory arbitration on customers. These groups believe that mandatory arbitration is "lawless," rigged, and designed

to deny consumers an assortment of essential rights – jury trials, class action status, discovery, to name a few – all to the benefit of the credit card and telecom companies. In large measure, the focus of their discontent has been NAF, which became the largest provider in the United States of consumer arbitration services as a result of its claims of absolute neutrality. These consumer groups point to an assortment of NAF actions that, they say, suggests (at the very least) an appearance of partiality:

- NAF solicits credit card companies, and others, urging them to designate NAF as the forum for arbitration;
- NAF unilaterally creates the rules for the administration of arbitration;
- NAF charges the credit card companies, and others, fees for processing claims against consumers; and
- NAF pays the arbitrators it assigns to resolve a dispute.

NAF has therefore been the target of numerous private lawsuits seeking to establish the existence of a direct connection between NAF and the companies NAF serves and, worse yet, the attorneys representing these institutions before NAF arbitrators. None of these efforts has yielded conclusive proof of partiality and wrongdoing by NAF.

In September 2007, the Washington D.C.-based Public Citizen released a report titled *"The Arbitration Trap: How Credit Card Companies Ensnare Consumers."*¹ Relying on disclosures by NAF mandated by California law, the report claimed to have identified a pattern of behavior by NAF arbitra-

tors, evidencing rubber-stamping of the demands of credit card companies. NAF refuted the claim, pointing out that in the vast majority of the cases in question the debtor had defaulted, leaving the arbitrator no choice but to recognize the claims. NAF maintained that identical results would have been achieved had the forum been the courthouse.

In the spring of 2008, the San Francisco City Attorney brought an action against NAF and two of its clients in the Superior Court in San Francisco,² claiming violations of numerous California consumer laws such as the California Fair Debt Collection Practice Act,³ as well as claims for unfair and deceptive marketing practices. The relief sought was a permanent injunction, substantial fines and costs. For the most part, the factual statements in the complaint track those laid out in the Public Citizen report, described above. One of the client-defendants has settled, agreeing in effect not to use NAF for arbitration within California without the consent and supervision of the city attorney. NAF and the remaining client defendant have continued to fight the claims.

Meanwhile the Minnesota State Attorney General opened an investigation into the activities of NAF and a group of companies that NAF works with closely in providing arbitration services to clients of NAF. The attorney general had jurisdiction because all the targets were entities formed under Minnesota law and had their principal places of business offices at the same address in Minneapolis. On July 10, 2009, an action was commenced in the district court in Hennepin County

seeking relief similar to that being sought by the San Francisco City Attorney. Many of the recited factual allegations also track the Public Citizen report. But, in addition, the attorney general claimed to have uncovered a web of connections suggesting that NAF was anything but impartial because it is partially owned by a group of attorneys who regularly represent the credit card claimants in proceedings before NAF arbitrators. Within a week NAF, while not admitting any wrongdoing, entered into a stipulation of settlement and agreed to withdraw from the consumer credit arbitration business, nationwide, effective July 24. There is no doubt this agreement will result in a flood of

the viability of the Financial Industry Regulatory Authority (FINRA) programs. Both of these bills are, at the time of this writing, still in committee.

Thus, even if the pending bills don't become law, at least in matters involving credit cards and other forms of consumer credit previously addressed by NAF and AAA, mandatory arbitration is, for the foreseeable future, dead in the water.

What the Practitioner Needs to Consider

Attorneys representing parties with existing contracts providing for mandatory arbitration need to immediately review these agreements to decide how best to counsel their clients.

Moreover, there aren't many other providers of arbitration administration equipped to handle these claims, especially if the volume is substantial.

Similarly, if you represent clients who receive notice of the commencement of an arbitration proceeding, you need to immediately determine if the matter involves consumer credit and the provider is either the NAF or the AAA. If the answer to both questions is yes, NAF is now obligated to refuse to accept the matter, and the AAA simply will refuse. Still, the claimant may attempt to initiate arbitration before another provider, in which case careful thought has to be given to whether your client's consent is required. If it is, your client may be in good position

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new cases appearing in courthouses around the country. According to the complaint⁴ filed by the attorney general, in 2006 NAF processed 214,000 consumer debt collection arbitration claims across the United States.

While all of this was going on, bills have been introduced into the U.S. House of Representatives⁵ and the Senate⁶ designed to curb mandatory arbitration. While the details differ, both bills would render any pre-dispute mandatory arbitration clause *unenforceable*, no matter when entered into, if found in a contract involving a consumer, employment or franchise transaction. The Senate version also includes any dispute arising under the U.S. Constitution, any state constitution or any federal or state law involving discrimination on the basis of race, sex, disability, religion, national origin, or any invidious basis in education, employment, credit, housing, public accommodations and facilities, voting, or program funded or conducted by the federal government or any state government. Neither bill defines precisely what is meant by a consumer agreement giving rise to questions about

Practitioners currently considering including such a clause in a consumer contract, employment contract or agreement involving a franchise, need to carefully consider the advisability of doing so given the actions of NAF and the AAA, as well as the possibility that Congress may pass the Arbitration Fairness Act at some point in the relatively near future. Particular attention needs to be given to agreements involving employment, discussed below.

Consumer Credit

First, there are literally tens of millions of contracts for credit cards and other forms of consumer credit requiring mandatory arbitration. If you represent a potential claimant, the first question would be whether the clause requires arbitration before either the NAF or the AAA. If the answer is yes, the client is going to have to look someplace else if arbitration is still desired, and it may not be easy to substitute another provider. Unless the clause gives the client the exclusive right to select an alternate provider, a provision that at present is probably not unconscionable,⁷ consent by each respondent will be required.

to bargain for favorable settlement. If an immediate settlement isn't possible, thought should be given to the appropriateness of a court proceeding to stay the arbitration.

The inquiry should not stop at consumer credit. The stipulation that the NAF has agreed to covers "Consumer Arbitration," defined as "any arbitration involving a dispute between a business entity and a private individual which relates to goods, services, or property of any kind allegedly provided by any business entity to the individual, or payment for such goods, services, or property. The term includes any claim by a third party debt buyer against a private individual."⁸

Employment, a Special Situation

Both bills before the Congress would bar enforcement of a mandatory arbitration clause in *any* employment agreement, without concern for the relative bargaining positions of the parties or when an agreement was entered into. This may prove problematic for lawyers representing high-earning individuals.

Studies have shown that high earners prefer arbitration because they believe that they are more likely to prevail in an arbitration than before a jury.⁹ Those individuals are almost always represented by counsel when negotiating an employment contract, so there is almost never a question about sophistication and/or equality in bargaining power. But the bills under consideration fail to recognize this reality, with the result that this class of individuals is lumped together with all other employees and is denied the right to negotiate a pre-dispute mandatory arbitration provision. If you represent a high earner in a contract negotiation, you need to explain this to the client and explore with him or her other alternatives for dispute resolution. And you need to point out

that an existing clause mandating arbitration may also be unenforceable.

Conclusion

The ability to insist on pre-dispute mandatory arbitration is likely to be limited with the result that both counsel and clients need to review existing agreements involving consumer, employment and/or franchise transactions with an eye toward finding other ways to resolve disputes. Whether this wave of change will improve access to justice is something that only time will tell. For the moment, counsel's job is to be aware of the new limitations and keep clients advised of the rapidly changing nature of the landscape. ■

1. Available at www.citizen.org/publications/release.cfm?ID=7545.

2. Case no. cgc-08-473569 available at www.webaccess.sftc.org.

3. Cal. Civ. Code §§ 1788 et seq.

4. District Court, 4th Judicial District, County of Hennepin, Minnesota, Civ. 27-09-18550, par. 3.

5. H.R. 1020, 111th Congress (2009), available at Thomas.Loc.gov.

6. S. 931, 111th Congress (2009), available at Thomas.Loc.gov.

7. *Sablosky v. Edward S. Gordon Co.*, 73 N.Y.2d 133, 538 N.Y.S.2d 513 (1989); *1210 Colvin Ave., Inc. v. Tops Markets*, 30 A.D.3d 995, 816 N.Y.S.2d 639 (4th Dep't 2006).

8. Consent Judgment, Court File No. 27-CV-09-18550, District Court, 4th Judicial District, Hennepin County, Minn., pp. 1-2; see press release re settlement, the Office of Attorney General Lori Swanson, available at www.ag.state.mn.us.

9. Stewart J. Schwab & Randell S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Executives Bargain For?*, 63 Wash & Lee L. Rev. 231, 238 (2006).

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