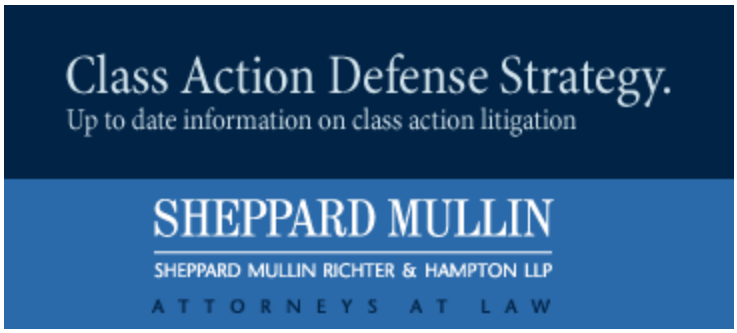

Class Action Defense Strategy

Posted at 11:58 AM on October 2, 2009 by Sheppard Mullin

The Recent Assault on Consumer Arbitration Clauses

After years of growth, the Federal Arbitration Act ("FAA"), and numerous court decisions emphasizing the strong public policy in favor of arbitration as a cost-effective means of resolving disputes, arbitration now appears to be under siege—particularly in the consumer context. Many consumer contracts, including those involving cellular phones, credit cards, and other consumer finance products, such as automobile retail installment contracts, contain mandatory arbitration provisions requiring consumers to resolve any disputes through arbitration rather than through the courts. In many cases, these contracts have attempted to establish arbitration an alternative to the high cost, slow pace, and uncertainty of class action litigation. Now consumer arbitration itself has become the focus of public entity investigations and class action lawsuits. Ultimately, consumer arbitration will likely survive, perhaps with new guidelines and consistent rules governing the process so companies know when their arbitration agreements will be enforced.

The recent publicity has related principally to the National Arbitration Forum ("NAF")—one of the three major arbitration providers in the United States. Established in 1986 by a small group of legal experts, including litigators, mediators and former judges, NAF was the United States' largest administrator of consumer arbitrations, employing a "panel of over 1,600 former judges and seasoned lawyers" to arbitrate disputes.[1]Until recently, the privately-held company handled around 200,000 cases a year, the majority of which concern consumer debt.[2] However, there has recently been a flood of criticism (and lawsuits) against NAF, alleging that it failed to disclose corporate ties to debt collectors that initiated arbitrations through NAF, thus, casting doubt on the impartiality of the arbitrations.

Minnesota Attorney General's Lawsuit Against NAF

The most publicized lawsuit against NAF was filed by the Minnesota Attorney General on July 14, 2009, alleging financial ties between the NAF and collection agencies. Shortly thereafter, NAF settled with Minnesota, without admitting any wrongdoing. NAF agreed to *permanently* cease arbitration of consumer disputes.[3] In a press release announcing the settlement, NAF stated that although it "remains committed to consumer arbitration as the best and most

affordable option for consumers to resolve disputes quickly and efficiently," "[m]ounting legal costs, a challenging economic climate, and increased legislative uncertainty surrounding the future of arbitration have prompted [NAF] to exit the consumer arbitration arena. At this time, the costs of providing consumer arbitration services far exceed the revenue generated. Until Congress resolves the legal and legislative uncertainty, the cost is simply too high for users and providers of consumer arbitration."[4]

San Francisco City Attorney's Lawsuit Against NAF

The Minnesota Attorney General's lawsuit was not the first brought against NAF by a public entity. On March 24, 2008, the San Francisco City Attorney filed suit in California state court, *People of the State of California v. National Arbitration Forum, Inc. et al.,* San Francisco Superior Court No. 473-569, against NAF for "unfair and unlawful business practices that favor lenders over cardholders in arbitration proceedings."[5] The suit alleged that NAF, "made it too easy for companies to garnish wages or secure liens on properties without giving people enough of a chance to defend themselves."[6] Reports at the time of the Minnesota settlement suggested that NAF may have chosen to settle with the Attorney General in its home state because of adverse rulings in the San Francisco litigation.[7]

New Private Lawsuit Against NAF

The private class action bar is now piggybacking on the Minnesota and San Francisco public lawsuits against NAF. In *Magnone v. Accretive LLC, Agora Fund I GP, LLC, National Arbitration Forum Inc., National Arbitration Forum, LLC., Dispute Management Services, LLC d/b/a Forthright Solutions*, United States District Court, Central District of California, No. CV09-6375 GAF (CWx), filed September 1, 2009, plaintiffs seek to invalidate and obtain disgorgement of all amounts collected from persons against whom NAF issued an arbitration award, since June 1, 2006. Plaintiffs allege that "NAF, as a major beneficiary of these mandatory arbitration provisions, sought to quell consumers' (well founded) fears by offering false assurances of integrity and impartiality . . ." *Magnone* Class Action Complaint at ¶ 45. The claims relate to NAF's alleged improper assertions of independence, when in "reality, NAF and Mann Bracken [a collection law firm] worked in tandem for the collections industry, their interests strictly aligned with credit card companies against consumers by virtue of their common owner, Defendant Accretive, LLC." *Id*. ¶ 4. Plaintiffs allege that, had consumers known of the NAF's alleged conflict, they would not have entered into the arbitration agreements. *Id*. ¶ 74.

There are several key weaknesses in plaintiffs' theory, both with respect to class certification and the merits. As to the allegation that putative class members would not have entered into their contracts if they had known of the alleged financial ties between NAF and debt collectors, causation will be difficult to establish. Common sense dictates that few customers would reject a contract for a product or service they desire for such an abstract reason. And if the consumer's debt were nonetheless legitimate, it would seem unlikely that another arbitrator (or a court) would have reached a different result than the NAF, regardless of its supposed bias. At a minimum, these issues, among others, would necessarily require a class-member-by-class-member analysis, thus providing a substantial hurdle to class certification.

Where Do We Go From Here?

In light of the NAF problems, the American Arbitration Association ("AAA") also announced it would stop handling consumer debt-collection cases,[8] as did several financial institutions. Several financial institutions announced they were either suspending enforcement of their consumer arbitration clauses, or reassessing their use.[9] The Judicial Arbitration and Mediation Service ("JAMS"), on the other hand, has bucked the trend, recently reversing a 2004 policy to not enforce class action waivers in consumer contracts.[10]

To add to the confusion, the Obama administration and Congress have set forth various proposals for reform. Currently, the Senate and House are considering bills called the Arbitration Fairness Act of 2009 and the Fairness in Nursing Home Arbitration Act, and the House is considering legislation to create a Consumer Financial Protection Agency ("CFPA").[11] The CFPA would have the power to either restrict or eliminate consumer arbitration. The CFPA "should be directed to gather information and study mandatory arbitration clauses in consumer financial services and products contracts to determine to what extent, and in what contexts, they promote fair adjudication and effective redress. If the CFPA determines that mandatory arbitration fails to achieve these goals, it should be required to establish conditions for fair arbitration, or in necessary, to ban mandatory arbitration clauses in particular contexts, such as mortgage loans."[12]

Conclusion

The attacks on consumer arbitration should not be fatal. As plaintiffs in the *Magnone* lawsuit even concede, "[a]rbitration is a form of alternative dispute resolution that can offer *substantial benefits in judicial access and efficiency*." *Magnone* Complaint at ¶ 32 (emphasis added). Let's not forget that only a few years ago, Congress passed the Class Action Fairness Act, in part because of concerns about the fairness of class action settlements. Low-cost consumer arbitrations were seen as a fairer alternative. Any proposal for reform of consumer arbitration should not “throw out the baby with the bathwater” by banning arbitration clauses in consumer contracts, but rather seek to improve transparency and provide consistent guidelines for fairness and enforceability.

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[1] National Arbitration Forum website, available here (last accessed 9/10/09); "National Arbitration Forum to Cease Administering All Consumer Arbitrations in Response to Mounting Legal and Legislative Challenges," Businesswire (July 19, 2009).

[2] "Banks v. Consumers (Guess Who Wins)," by Robert Berner and Brian Grown, BusinessWeek (June 5, 2008).

[3] Tom Abate, "Dispute firm is calling it quits; Debt collection,San Francisco Chronicle, Business; pg. C1 (July 22, 2009); "National Arbitration Forum to Cease Administering All Consumer Arbitrations in Response to Mounting Legal and Legislative Challenges," Businesswire (July 19, 2009).

[4] *Id*.

[5] "City Attorney Herrera Hails Federal Protections for Credit Cardholders, But Warns of More Problems," US State News (August 24, 2009).

[6] Tom Abate, "Dispute firm is calling it quits; Debt collection," San Francisco Chronicle, Business; pg. C1 (July 22, 2009).

[7] A Theory On Minnesota's Quickie (Settlement) With the National Arbitration Forum," Legal Pad, a Cal Law Blog, July 20, 2009, available here.

[8] Maria Aspan, "B of A Ends Mandatory Arbitration," American Banker (Aug. 14, 2009).

[9] Id.

[10] *"JAMS reverses field, now says classwide arbitration waivers OK," Consumer Financial Services Law Report, v. 12, n. 21 (May 13, 2009);* "Forthright Launches New Informational Website to Help Consumers Navigate the Arbitration Process; Consumer Resource to Answer Questions on the Basics of Arbitration, Arbitration in Contracts, and How to File and Respond to a Claim," PR Newswire (April 2, 2009).

[11] "National Arbitration Forum to Cease Administering All Consumer Arbitrations in Response to Mounting Legal and Legislative Challenges," Investment Business Weekly (Aug. 9, 2009).

[12] "Financial Regulatory Reform A New Foundation: Rebuilding Financial Supervision and Regulation," Department of the Treasury, available here.