The End of the Arbitration Clause?

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In order to avoid the substantial risks of class action litigation, many financial service providers – both traditional and non traditional – require that customer agreements contain an arbitration clause and a waiver of the customer's right to bring a class action. However, recent court decisions and pending legislation suggest that certain types of these arbitration clauses may no longer be viable.

The overwhelming body of case law upholds the enforceability of such arbitration and class waiver provisions. See *Adler v. Dell, Inc.*, No. 08-CV-13170, 2008 WL 5351042 (E.D. Mich. Dec. 18, 2008) (enforcing consumer arbitration provision with class waiver); *Jenkins v. First Am. Cash Advance of Ga., LLC*, 400 F.3d 868 (11th Cir. 2005) (class waiver in borrowers' payday loan agreements did not render arbitration agreements unconscionable or unenforceable); and *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002) (rejecting argument that arbitration agreement was unenforceable as unconscionable due to class waiver).

However, recently some courts have taken issue with these provisions and deemed them unconscionable. A recent example of such a case is *Homa v. American Express Co.*, No. 06-02985, 2009 WL 440912 (3rd Cir. Feb. 24, 2009).

In *Homa*, plaintiff brought a putative class action suit against American Express and its Centurion unit, alleging that they misrepresented the actual terms of the Blue Cash card rewards program and that defendants failed to award him the promised amount of cash back in violation of the New Jersey Consumer Fraud Act. However, the credit card member agreement that accompanied the Blue Cash card contained an arbitration and class waiver provision. Further, the agreement contained a choice-of-law provision indicating that any disputes arising out of the agreement would be governed by Utah law. Defendants argued that the plaintiff should be required to arbitrate his claims on an individual basis, because Utah law expressly allows arbitration and class waiver provisions in consumer credit agreements. On the other hand, the plaintiff argued that New Jersey law applied, because, as the application of Utah law would violate New Jersey's public policy against certain class-arbitration waivers, New Jersey choice-of-law principles dictated that the agreement's choice of Utah law was invalid. The district court sided with the defendants and dismissed plaintiff's complaint.

The Third Circuit Court of Appeals reversed the trial court's decision. In the opinion, the Third Circuit held that that the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, did not preclude the district court from applying New Jersey unconscionability principles to void the arbitration and class waiver clause, and therefore, plaintiff was entitled to pursue a class action against defendants in federal court in New Jersey. In so doing, the Court relied on the holding in a New Jersey state court decision styled *Muhammad v. County Bank of Rehoboth Beach, Delaware*, 912 A.2d 88 (N.J. 2006), that "'[t]he public interest at stake in . . . consumers['] [ability to effectively] pursue their statutory rights under [New Jersey's] consumer protection laws' constituted the 'most important' reason for holding a similar class-arbitration waiver unconscionable." Further, the Third Circuit held that this interest "overrides" a defendant's right to seek enforcement of a class-arbitration waiver in an agreement, particularly where the claims at issue are of such a low value as effectively to preclude relief if pursued individually. The case is now back in the district court.

Furthermore, this issue may be resolved by pending federal legislation that seeks to ban certain types of arbitration provisions. The Arbitration Fairness Act of 2009 would ban provisions requiring arbitration of (1) an employment, consumer, or franchise dispute, or (2) a dispute arising under any statute intended to protect civil rights. See H.R. 1020 The bill, which was referred to the House Judiciary Committtee on Feb. 12, 2009, currently has 43 co-sponsors, including that Committee Chairman Conyers (D-MI). A recent Legal Times report noted the plaintiffs bar's efforts to push the arbitration legislation on Capitol Hill. If enacted, the Act could start a wave of litigation in the consumer financial services sector.

The bottom line is that businesses should re-examine their customer agreement’s arbitration and class waiver provisions, paying particular attention to any choice of law provisions, and monitor these legal developments on a state-by-state basis. *Homa* tells us that the same arbitration and class waiver provision, while being upheld in one state, could be rejected in another.

Stay tuned for future posts analyzing cases decided in the wake of *Homa* and reporting on further developments with the Arbitration Fairness Act of 2009.