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Financial Services Litigation
ALERT

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Second Circuit Casts Doubt On The Continued Viability Of Mandatory Arbitration Clauses And Class Action Waivers In Consumer Credit Card Contracts

By Theresa E. Loscalzo

Financial services providers have more and more frequently over the last decade employed the use of mandatory arbitration clauses in agreements with customers. Generally, the clauses provide that the customer's continued use of the credit card is tantamount to an agreement to accept the mandatory arbitration clause. Most agreements also provide that the arbitrator's decision is final, and there is no right of appeal. Some also provide for a waiver of the ability to bring a class action.

The use of mandatory arbitration clauses and class action waivers in consumer contracts has triggered much controversy. Consumer advocates argue that the inability to file suit in a court of law, with all applicable appeal rights, unfairly skews the playing field in favor of financial service providers, while financial service providers answer that mandatory arbitration achieves faster, more efficient and less expensive dispute resolution, especially in comparison to class litigation.

In July 2007, Senator Russell Feingold and Congressman Hank Johnson sponsored legislation known as the Arbitration Fairness Act of 2007 (H.R. 3010 and S.1782) to limit the use of mandatory arbitration by amending the Federal Arbitration Act to make unenforceable any pre-dispute arbitration agreement involving an employment, consumer, or franchise dispute; or a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power. The Bill has been referred to the Senate Judiciary Committee.

Now, the Second Circuit Court of Appeals, in *Ross v. Bank of America, N.A.*, ___ F.3d ___ (2d Cir. April 25, 2008), has cast doubt on the continued viability of mandatory arbitration clauses and class action waivers in credit card contracts. In *Ross*, the plaintiffs, on behalf of a putative class, alleged that, beginning in late 1998 or early 1999, a group of banks met and agreed to include mandatory arbitration clauses with class action bans in all of their credit card agreements. *Slip op*. at 4-5. The complaint also alleged that defendants "participated in a group boycott by refusing to issue cards to individuals who did not agree to arbitration." *Id.* at 5-6. The plaintiffs claimed that the conspiracy and group boycott violated federal antitrust laws, specifically, Section 1 of the Sherman Act (15 U.S.C. § 1). *Id*. at 5-6.

Plaintiffs sought to nullify existing mandatory arbitration clauses, and to force the banks to withdraw all pending motions to compel arbitration. *Id.* at 6. Defendants moved to dismiss the class action under Rule 12(b)(1) and (b)(6) on the grounds that plaintiffs lacked standing to prosecute the antitrust class action claims. The district court granted defendants' motion to dismiss, holding that the plaintiffs lacked Article III standing because no defendant had threatened to enforce a collusively-formed arbitration provision against them. *Id.* at 6-7.

The Second Circuit reversed and remanded for further proceedings holding that the plaintiffs demonstrated the necessary "injury in fact" to establish Article III standing. Specifically, the Second Circuit concluded that in at least two respects the cardholders alleged an illegal conspiracy that resulted in a present injury:

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"According to the cardholders, the conspiracy among the banks was designed to limit the choice of terms offered to cardholders, resulting in at least two ways in their receiving objectively less valuable cards than would otherwise have been the case. First, because the banks conspired not to offer cards permitting class actions, the cardholders will be forced to expend time and legal fees to monitor the legality of the banks' behavior, whereas if the cardholders had access to a card that permitted class actions, they would have the option of relying on motivated class action attorneys to perform this function. If the cardholders chose not to monitor the banks – which would perhaps be more likely because, as the Complaint observes, actions that result in significant aggregate revenue to the banks (concerning, e.g., late fees, overlimit fees, foreign transaction fees, APR, etc.) generally harm individual consumers in only small amounts – they would still lose the services of class action attorneys. Either way, the cardholders would have been forced to accept a less valuable card as a result of the banks' alleged collusion.

Second, the alleged conspiracy to limit the cardholders to cards that require arbitration of disputes also diminished the present value of the cards offered to the cardholders. A card that limits the holder to arbitration is less valuable (all other factors being equal) than a card that offers the holder a choice between court action or arbitration. Even assuming that the cardholders might be able to void that limitation when an actual dispute arises by opposing the banks' motion to compel arbitration via a claim of antitrust collusion, that possibility is more theoretical than real for two reasons. The cost of litigating the antitrust issue when the particular dispute arises will almost certainly be disproportionate to the dispute. (A plaintiff will not spend a hundred thousand dollars in legal fees to litigate a five thousand dollar dispute.) Furthermore, the cardholders' ability to prove the illegal collusion may well have evaporated with the passage of time, due to the deaths, retirements, changes of jobs, and fading memories of the participants and observers of the conspiratorial meetings, as well as the loss and destruction of documents.

We believe that at least in these two independent respects the cardholders have alleged an illegal conspiracy that resulted in a present injury by requiring them to accept less valuable cards than would otherwise have been available, but for the illegal collusion."

Id. at 10-12 (emphasis added).

While the ruling is a narrow one that addresses only plaintiffs' standing under Article III, it likely will fuel the fire, driving consumer advocates to press for legislative changes to the Federal Arbitration Act to prevent these types of clauses in consumer contracts.◆

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