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Developments and Ideas For the Practice of Consumer Law

Special Issue: Ten stunning practice implications of NAF withdrawal from all consumer arbitrations

Ten Stunning Practice Implications of NAF Withdrawal from All Consumer Arbitrations

In a stunning development, the National Arbitration Forum (NAF) has entered into a consent order with the Minnesota Attorney General, agreeing to cease administering any consumer arbitrations nationwide as of July 24.[1] The consent agreement was reached just three days after AG Lori Swanson filed suit against NAF for bias and deception.

Millions of credit card and other credit agreements select the NAF as the required arbitration forum.[2] The consent order applies both to arbitrations to collect consumer debts and those initiated by consumers to challenge corporations.

The Minnesota suit alleges that, in 2007, corporations controlled by a hedge fund obtained ownership interests in both NAF and Mann Bracken, a large national debt collection law firm.[3] Mann Bracken filed over 100,000 collection complaints with NAF a year, while NAF held itself out as independent and unaffiliated with any party. The Minnesota complaint also alleges that NAF behind the scenes persuaded credit card issuers to place arbitration clauses in their contracts, appointing NAF as the arbitration forum.[4]

1. Arbitration Clauses Naming NAF As the Sole Forum May Now Be Unenforceable

The NAF consent order means that consumer arbitration agreements specifying NAF as the sole arbitration forum may now be unenforceable, since the agreement cannot be carried out according to its terms. Either the court must take over the role of the arbitration forum (appoint an arbitrator, and arrange rules, costs, and other procedures) or rule the arbitration clause unenforceable.

Case law is divided whether, under these conditions, a court throws out the arbitration requirement,[5] or instead appoints the arbitrator.[6] The Federal Arbitration Act (FAA) § 5[7] specifies conditions where the court "shall designate and appoint an arbitrator."[8] The relevant condition for purposes of NAF arbitrations is "for any other reason there shall be a lapse in the naming of an arbitrator ... or in filling a vacancy."

The more persuasive case law holds that, by its very terms, this provision applies only to a lapse in naming an arbitrator, not to the designated arbitration forum's failure to administer the arbitration.[9] The arbitration forum is distinct from the arbitrator and does far more than just select arbitrators. "When parties designate a specific arbitral forum, such designation has wide-ranging substantive implications that may affect, *inter alia*, the arbitrator-selection process, the law, procedures, and rules that govern the arbitration, the enforcement of the arbitral award, and the cost of the arbitration."[10]

Other courts, though, find FAA § 5 authorizes them to appoint an arbitrator where the chosen forum is unavailable.[11] But even these courts also rely on their finding that the contract's designation of a particular arbitration forum was merely an ancillary logistical concern, and not integral to the agreement.[12] Where courts instead find the designation integral, they refuse to enforce the arbitration requirement.[13]

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[1] The complaint and consent order are found at www.consumerlaw.org/unreported.

[2] *See* Swanson v. Nat'l Arbitration Forum, Inc. (Minn. Dist. Ct. complaint filed July 14, 2009), *available at* www.consumerlaw.org/unreported (hereinafter NAF Complaint).

[3] NAF Complaint at ¶¶ 2, 3.

[4] *Id.*

[5] *In re* Salomon Inc. Shareholders' Derivative Litig. 91 CIV. 5500 (RRP), 68 F.3d 554 (2d Cir. 1995); Dover Limited v. A.B. Whatley, Inc., 2006 WL 2987054 (S.D.N.Y. 2006); Martinez v. Master Protection Corp., 118 Cal. App. 4th 107 (2004); Alan v. Superior Court, 111 Cal. App. 4th 217 (2003); Magnolia Healthcare, Inc. v. Barnes, 994 So. 2d 159 (Miss. 2008); Grant v. Magnolia Manor-Greenwood, Inc., 678 S.E.2d 435 (S.C. 2009). *See also* Provencio v. WMA Securities, Inc., 125 Cal. App. 4th 1028 (2005).

[6] Brown v. ITT Consumer Fin. Corp., 211 F.3d 1217 (11th Cir. 2000); Estate of Eckstein v. Life Care Ctrs. of Am., Inc., 2009 WL 1605312 (E.D. Wash. June 3, 2009); McGuire, Cornwell & Blakey v. Grider, 771 F. Supp. 319 (D. Colo. 1991); Zechman v. Merrill Lynch, Pierce, Fenner & Smith, 742 F. Supp. 1359 (N.D. Ill. 1990); Warren v. American Home Place, Inc., 718 So. 2d 45 (Ala. 1998); New Port Richey Med. Investors v. Stern, 2009 WL 1563424 (Fla. Dist. Ct. App. June 5, 2009); *In re* Brock Specialty Servs., Ltd., 2009 WL 1546935 (Tex. Ct. App. May 29, 2009). *Cf.* Inter@ctivate, Inc. v. Cubic Transp. Sys., Inc., 2007 WL 178429 (Cal. Ct. App. Jan. 25, 2007) (designation was a mistake); Owens v. National Health Corp., 263 S.W.3d 876 (Tenn. 2008) (arbitration will proceed where forum would conduct arbitration if ordered to by a court).

[7] 9 U.S.C. § 5.

[8] State law generally follows the same approach. *See* Uniform Arbitration Act § 3; Revised Uniform Arbitration Act § 11.

[9] *In re* Salomon Inc. Shareholders' Derivative Litig. 91 CIV. 5500 (RRP), 68 F.3d 554 (2d Cir. 1995); Dover Limited v. A.B. Whatley, Inc., 2006 WL 2987054 (S.D.N.Y. 2006); Martinez v. Master Protection Corp., 118 Cal. App. 4th 107 (2004); Alan v. The Superior Court, 111 Cal. App. 4th 217 (2003); Grant v. Magnolia Manor-Greenwood, Inc., 678 S.E.d2d 435 (S.C. 2009). *Cf.* Zechman v. Merrill Lynch, Pierce, Fenner & Smith, 742 F. Supp. 1359 (N.D Ill. 1990).

[10] Singelton v. Grade A Market, Inc., 607 F. Supp. 2d 333 (D. Conn. 2009).

[11] Brown v. ITT Consumer Fin. Corp., 211 F.3d 1217 (11th Cir. 2000); McGuire, Cornwell & Blakey v. Grider, 771 F. Supp. 319 (D. Colo. 1991); Warren v. American Home Place, Inc., 718 So. 2d 45 (Ala. 1998); New Port Richey Med. Investors v. Stern, 2009 WL 1563424 (Fla. Dist. Ct. App. June 5, 2009); Owens v. National Health Corp., 263 S.W.3d 876 (Tenn. 2008); *In re* Brock Specialty Servs., Ltd., 2009 WL 1546935 (Tex. Ct. App. May 29, 2009).

[12] Brown v. ITT Consumer Fin. Corp., 211 F.3d 1217 (11th Cir. 2000); McGuire, Cornwell & Blakey v. Grider, 771 F. Supp. 319 (D. Colo. 1991); Warren v. American Home Place, Inc., 718 So. 2d 45 (Ala. 1998); New Port Richey Med. Investors v. Stern, 2009 WL 1563424 (Fla. Dist. Ct. App. June 5, 2009) (no evidence presented that the selection of the forum was integral part of the agreement); *In re* Brock Specialty Services, Ltd., 2009 WL

Selection of NAF as the arbitration forum is no mere ancillary matter. NAF rules indicate it is a low-cost forum compared to other forms of arbitration. While consumers often have discovered that NAF did not provide the low-cost forum it promised, they should be entitled to take these assurances at face value when arguing that selection of NAF is integral.

Courts that decide to select a substitute arbitrator may instead consider designating an alternative forum, such as the American Arbitration Association (AAA) or JAMS, and ask the forum to select the arbitrator. But this is not authorized by FAA § 5: "the court shall designate and appoint an arbitrator...." The statute only authorizes the court to designate an arbitrator, not an alternative arbitration forum that in turn would select the arbitrator and administer the case.

2. Any Arbitration Substituting for NAF Arbitration Should Meet Strict Cost Standards

NAF's advertised cost structure should help a court find that NAF's designation is integral to the agreement. If a court instead selects a substitute arbitrator, the same advertised cost structure should shape the nature of that alternative arbitration.

NAF charges a $242 basic fee for matters under $1500, $285 for matters under $3500, and $375 for matters under $8000. A participatory hearing costs between $125 and $225 extra. "Consumers who meet the United States Federal poverty standards need not pay arbitration fees."[14] NAF, not the individual arbitrator, determines all fee waiver requests.[15]

Contrast this with typical arbitration fees of thousands of dollars a day, with no exception for indigent parties. This appearance of low-cost arbitration is integral to a consumer's agreement to binding arbitration—even if consumers later discover that NAF's practice is quite different.

Court-appointed arbitrators should be paid within the above NAF guidelines, and these fees should be waived for indigent consumers. If a defendant offers to pay arbitration costs, this should apply whether the consumer prevails or not, because NAF rules provide at least the appearance that a losing consumer will have only minimal exposure for arbitration costs—again, even if NAF's actual practice is very different. The court should also shield its selected arbitrator from knowledge as to who is paying, particularly where arbitrator fees are not paid until after the arbitration. Numerous courts have found forcing a consumer into an unaffordable arbitration to be substantively unconscionable,[16] and a court should not itself require an unaffordable arbitration.

3. Demise of NAF Consumer Arbitration Breathes Additional Life into Class-Wide Arbitrations and Class Actions in Court

Increasingly, consumers are bringing class-wide arbitrations, particularly where AAA or JAMS is the arbitration forum.[17] NAF, on the other hand, prohibited opt-out classes. NAF's demise as a forum for consumer arbitrations is good news for those wishing to bring class arbitrations.

Where NAF is the sole designated forum, the arbitration clause may be unenforceable (see #1, above), allowing a class action to proceed in court. If a court instead appoints the arbitrator, a neutral individual with no repeat player bias will determine if the arbitration clause allows class-wide relief, if the class should be certified, and if the class should prevail. There will be very limited judicial review of those decisions or the procedures the arbitrator utilizes. The action may progress faster than in court, with fewer opportunities for the defendant to stall. Defendants may find a class-wide proceeding before such an arbitrator to be an undesirable option, and may argue for court-based class actions instead.

4. Bank of America Drops Its Arbitration Requirement!

On August 13, Bank of America announced it would no longer require consumers to arbitrate disputes relating to credit cards, auto loans, deposits, or other bank business. Consumers retain the right to arbitrate disputes with the bank, at least until the bank amends its contracts. Press reports indicate other major banks are considering similar changes.

5. Companies' Attempts to Amend the Arbitration Forum May Be Futile

Where NAF is the sole arbitration forum listed in a company's standard form contracts, one can expect new contracts will be re-drafted to select AAA or another forum. The company will have more difficulty amending *existing* contracts—a party cannot unilaterally amend most contracts, such as contracts involving motor vehicle or manufactured home sales, or payday, home mortgage or other closed-end loans. Consumers must affirmatively consent to any change.

On the other hand, credit card issuers will unilaterally amend their contracts and argue that continued use of the credit card indicates implied assent to the changed terms.[18] Whatever the merits of this argument, it does not apply to litigation where the consumer has already stopped using the credit card, such as litigation against debt buyers. The creditor declined the consumer future use of the card, and sold the account to a debt buyer. The debt buyer cannot rely on a card issuer's future change in terms because the consumer has not accepted by continuing to use the card, and the creditor is unlikely to have sent a change of terms notice to a sold account. The debt buyer also has no basis on its own to unilaterally change the arbitration agreement.

Even an effective unilateral change in terms will not apply to disputes occurring prior to the change if the amendment's own language applies only to future disputes. Even without language applying a change only prospectively, courts rule that an arbitration clause does not apply to disputes occurring prior to the clause's adoption, and certainly not to litigation filed prior to the clause's adoptioni date.[19]

1546935 (Tex. Ct. App. May 29, 2009). *See also* Estate of Eckstein v. Life Care Ctrs. of Am., Inc., 2009 WL 1605312 (E.D. Wash. June 3, 2009); Inter@ctivate, Inc. v. Cubic Transp. Sys., Inc., 2007 WL 178429 (Cal. Ct. App. Jan. 25, 2007) (designation was a mistake). *But see* Zechman v. Merrill Lynch, Pierce, Fenner & Smith, 742 F. Supp. 1359 (N.D. Ill. 1990) (apparently finding authority to appoint an arbitrator where the choice of forum is ancillary even if FAA § 5 does not apply).

[13] *In re* Salomon Inc. Shareholders' Derivative Litig. 91 CIV. 5500 (RRP), 68 F.3d 554 (2d Cir. 1995); Martinez v. Master Protection Corp., 118 Cal. App. 4th 107 (2004); Alan v. Superior Court, 111 Cal. App. 4th 217 (2003); Grant v. Magnolia Manor-Greenwood, Inc., 678 S.E. 2d 435 (S.C. 2009). *See also* Magnolia Healthcare, Inc. v. Barnes, 994 So. 2d 159 (Miss. 2008).

[14] NAF Rule 5L.

[15] NAF Rule 45.

[16] *See* NCLC, Consumer Arbitration Agreements Ch. 6 (5th ed. 2007 and 2008 Supp.).

[17] *See* NCLC, Consumer Class Actions Ch. 2 (6th ed. 2006 and 2009 Supp.).

[18] *Id.* § 5.7.2.

[19] *See id.* §§ 7.3.5, 7.3.6.

6. New Collections via Arbitration Are Dead for the Foreseeable Future

Starting July 25, 2009, there will be no new arbitrations to collect from consumers. Creditor arbitration clauses typically list NAF or AAA as the required forum. NAF is legally required to cease, and AAA states that it will not initiate arbitrations to collect from consumers until appropriate standards are developed.[20]

Without amending those contracts, the creditor or collector's only option would be to ask a court to appoint an arbitrator, hardly a cost-effective means to collect small consumer debts. Even if credit card agreements are amended to name a new forum willing to administer collection actions via arbitration, such amended agreements will not apply to consumer defendants for some time. As described in item #5, *supra,* a unilateral amendment is not effective where the consumer's card privileges have been revoked—which will be the case for collection actions. Already, Bank of America and Chase have announced they will not pursue new collections via arbitration.

7. Consumers Now May Have an Effective Defense to a Collector's Confirmation of an Existing Award

Tens of thousands of pending or existing NAF arbitration awards have not yet been confirmed in court (collectors often wait up to a year to seek to confirm an award). While the Minnesota consent order only stops future NAF consumer arbitration proceedings, it may have a profound effect when collectors seek to confirm existing NAF awards.

Ordinarily, within 90 days of an award (or even less in some states), consumers lose almost all rights to object to confirmation.[21] When consumers seek legal representation to defend a confirmation proceeding, it usually is already too late. Because of the Minnesota lawsuit, the consumer may now have a new defense to confirmation that can be timely brought.

Under both the Uniform Arbitration Act (UAA) and the Revised Uniform Arbitration Act (RUAA), where an award is procured through corruption, fraud, or undue means, consumers have 90 days to vacate an award *after such grounds are known* or should have been known.[22] Consumers are likely to discover NAF's corruption only when seeking an attorney to defend the confirmation action, when informed of the fact by their attorney—the Minnesota consent order does not require consumers be notified of NAF's relationship with Mann Bracken. Thus raising the close connection between NAF and Mann Bracken or between NAF and creditors in general will be a timely defense to the confirmation action.

Common ownership of Mann Bracken and NAF was created in 2007, so virtually all awards not yet confirmed will have been initiated while common ownership existed. The consumer's case is strongest in the majority of cases where Mann Bracken brought the arbitration action, even if Mann Bracken is not bringing the confirmation action.

The individual arbitrator hearing the case need not be corrupt, since both the UAA and RUAA state that a ground to vacate is that "the award was procured by corruption, fraud, or other undue means." Hidden common ownership of one party's law firm and the arbitration forum should be enough to show the award was procured by corruption, even without evidence of arbitrator misconduct. NAF picks and decides whether to disqualify the arbitrator, establishes the rules, interprets the rules, provides notice to the consumer, determines the fees, and administers the arbitration.

The Minnesota AG complaint provides a roadmap in establishing the collusion between NAF and Mann Bracken and other creditors. The complaint itself is *not* sufficient evidence, and it may not be practical in an individual case to obtain that evidence independently. The Minnesota AG's office states its information is not public because of a pending investigation. Perhaps such information will be obtained in private litigation and shared with others. (*See* item # 10, *infra.*) One approach is serving requests for admission and interrogatories on the collector in the confirmation action.

In any event, raising such issues in the confirmation action will require a hearing, and the confirmation will not be the rubber stamp process the collector is counting on. At the moment, it is unknown how aggressively collectors will pursue confirmation actions in the face of such challenges. One prediction is that confirmation actions for existing NAF collection awards will continue unabated, but that if a consumer appears with representation and raises the corruption and undue influence defense, the case may be dropped. If the case is not dropped, the consumer's attorney must be prepared to address novel issues as to whether the undisclosed common ownership is sufficient to vacate an award, and how to prove that common ownership.

8. Consumers May Be Able to Unwind Even Confirmed NAF Arbitration Awards

The NAF complaint and consent order may provide grounds to set aside NAF awards that have already been confirmed. Standards for re-opening judgments vary by state, but many states have rules similar to FRCP 60,[23] allowing relief from a judgment where there is newly discovered evidence that could not have known at the time, where there is fraud, misrepresentation, or misconduct by an opposing party, or "any other reason that justifies relief." Under the federal rule, an action based upon newly discovered evidence or on fraud or misconduct must be brought within one year from entry of the confirmation award, but an action based upon "any other reason" does not have such a deadline. Courts often limit the "any other reason" grounds to exceptional situations, but NAF and Mann Bracken's corruption may be viewed as such a situation. Courts also place no time limits on setting aside judgments involving fraud upon the court.[24]

Before re-opening a judgment, courts like to see some probability of success on the underlying matter. Since the consumer can raise corruption, fraud, or undue means for 90 days after its discovery, this should be available as grounds to vacate the award once the confirmation judgment is set aside—assuming the consumer acts quickly to re-open the judgment after discovering the corruption. In the action to set aside the judgment, the consumer need only allege with some particularity this meritorious defense, and need not prove that the consumer will prevail on the defense.[25] The allegation can be made by affidavit and there need not be a

[20] *See* www.adr.org, "Notice on Consumer Debt Collections."
[21] An extremely important exception is that courts increasingly allow, even after 90 days, a challenge that an enforceable arbitration agreement never existed. *See* NCLC, Consumer Arbitration Agreements § 12.5.3.3 (5th ed. 2007 and 2008 Supp.).
[22] Unif. Arbitration Act §§ 12, 13 (1956); Unif. Arbitration Act §§ 23, 24 (2000).
[23] *See* NCLC, Collection Actions § 13.2 (2008 and 2009 Supp.).
[24] 11 Wright & Miller, Federal Practice and Procedure 413 (2009).
[25] *See* NCLC, Collection Actions § 13.2.2 (2008 and 2009 Supp.).

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mini-trial of the facts. Thus, while the consumer will have to develop significant evidence to prevail in a subsequent motion to vacate the award, setting aside the confirmation should require less evidence. Once the confirmation is set aside, the collector cannot continue with any post-judgment remedies until it again confirms the award in a new proceeding.

9. Vacating NAF Arbitration Awards on a Class-Wide Basis

More resources can be devoted to developing evidence of corruption and fraud if an action to vacate NAF arbitration awards is brought on a class-wide basis. This should be brought within 90 days of the class becoming aware of the fraud or corruption.

To vacate awards not yet confirmed, the action should be specific to a certain creditor or debt buyer, and to a specific state. To seek to set aside confirmed awards on a class-wide basis is difficult, since state procedure may require that the action to set aside a confirmation be brought in the same court as issued the judgment.

Two other approaches for class-wide relief may be more practical. One, described in item #10, *infra*, is to bring a class action against a creditor under fraud, RICO, UDAP, or other affirmative claims, seeking damages and restitution, and also injunctive or equitable relief to undo arbitration awards, even if confirmed. Another approach open to those without the resources to bring a major class action is to urge the state attorney general, state supreme court, or an administrative judge to investigate the fraud upon the state's courts, and for the courts themselves to take appropriate steps to undo the fraud by voiding judgments and resisting new confirmation actions. For example, N.Y. C.P.L.R. § 5015(c) allows an administrative judge to initiate a proceeding to undo a large number of judgments in one proceeding.

10. Monitoring Class Actions against NAF, Mann Bracken, and Creditors

A number of class actions have already been filed against NAF, Mann Bracken, and creditors utilizing NAF arbitration,[26] and other class actions may be filed as well. These actions seek money damages, restitution, and equitable and injunctive relief to void confirmed and unconfirmed awards. The actions have several practice implications for consumers who were defendants in NAF collection actions.

If a class action is settled, class members may receive a financial recovery or arbitration awards against them may even be nullified. On the other hand, the settlement will require class members to waive certain rights. Attorneys representing individual class members should consider if a waiver prevents pursuit of individual relief described in items #7 and #8, *supra,* and should then weigh the benefits of the settlement against forfeiture of those avenues of relief.

These class actions should also justify the resources to independently develop evidence of the matters alleged in the Minnesota AG complaint, or may successfully press for release of such information from the Minnesota AG. Any information that makes its way into the public domain will have great utility for anyone pressing the avenues of relief described in items #7– #9, *supra*.

It is also possible that an individual consumer missing a deadline to vacate an award or to set aside a confirmation judgment can use a pending class action as justification for the delay. Normally, statutes of limitations for individual class members are tolled from the filing of a class action complaint until denial of class certification.[27] This is because class members may believe that their rights will be protected by the class case and not bring separate actions.

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[26] *See, e.g.*, Sydnes v. National Arbitration Forum, Inc. (D. Minn. complaint filed July 24, 2009) (also naming eleven creditors as defendants; plaintiffs represented by six different law firms, including Gustafson Gluek P.L.L.C., located in Minneapolis); Bergquist v. Mann Bracken, L.L.P. and FIA Card Servs., #09CH23423 (Ill. Cir. Ct. Cook Cty. complaint filed July 14, 2009) (Edelman, Combs, Latturner & Goodwin, L.L.C, located in Chicago, for the plaintiffs).

[27] *See* Am. Pipe & Constr. Co. v. Utah, 414 U.S. 538 (1974).