

Recent Decisions and Pending Litigation Could Limit Value of Arbitration Provisions in Consumer Contracts

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Many businesses see great value in arbitrating consumer disputes rather than airing those disputes in court. Arbitration can be a faster, less intrusive, less disruptive, and less costly way to resolve disputes. In addition, unlike judicial decisions, arbitration decisions are generally confidential. As businesses have increasingly included arbitration provisions in consumer contracts, the topic has become a subject of contentious debate, with groups such as Consumers Union arguing that arbitration clauses are unfair and should be eliminated. Indeed, a bill recently introduced in Congress would substantially curtail any use of such provisions in consumer contracts. In this context, recent decisions of the U.S. Supreme Court and the Second and Third Circuit Courts of Appeals that address the ability of corporate defendants to invoke arbitration clauses found in consumer contracts take on particular significance.

On March 9, the Supreme Court held in *Vaden v. Discover Bank, et al.* ([found here](#)) that when a federal court is asked to enforce an arbitration provision, it should “look through” the petition and consider the underlying controversy between the parties, but only to examine the well-pleaded complaint, not counterclaims. Because many consumer disputes do not raise issues that implicate federal jurisdiction, the Supreme Court’s decision will likely limit the availability of a federal court as a forum to vindicate a contractual right to arbitrate. Instead, businesses will have to trust state courts to enforce valid arbitration agreements, rather than federal courts, which are often perceived as more receptive to arbitration petitions.

In potentially very significant decisions, the Second and Third Circuits have both recently limited the ability of a company to enforce arbitration provisions that bar class actions. The Third Circuit’s

decision in *Homa v. American Express Co.* ([found here](#)), decided on February 24, concluded that arbitration provisions that bar class arbitrations violate New Jersey state contract law and are therefore unenforceable in contracts governed by New Jersey law. The Second Circuit’s decision in *In re American Express Merchants’ Litig.* ([found here](#)), decided on January 20, also restricts enforcement of arbitration provisions that bar class arbitrations. In that case, the Second Circuit held that if a plaintiff can demonstrate that he will incur prohibitive costs if forced to arbitrate under a class action waiver, then federal law bars enforcement of a class action waiver in an arbitration provision.

Particularly in light of the on-going debate about the value of arbitration, these cases could indicate a trend in which courts prove reluctant to enforce arbitration provisions that either explicitly or implicitly restrict the availability of a class action as a remedy. If so, that could diminish the value of arbitration for many businesses, which often view the ability to avoid class actions as a significant benefit of arbitration.

Any question about the value of arbitration of consumer disputes could soon be mooted by the Arbitration Fairness Act of 2009 ([found here](#)), a bill introduced in the House of Representatives on February 12. That bill would invalidate all pre-dispute arbitration agreements mandating the arbitration of any employment, consumer, or franchise dispute, as well as any disputes arising under any civil rights statutes. Thus, if the bill were to pass, the only way to arbitrate a consumer dispute would be for all parties to agree to arbitration after the dispute had arisen, a situation that would give businesses much less certainty about their ability to control costs or secure other benefits associated with arbitration.

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