ARBITRATION

ARBITRATION AGREEMENT WITH CHOICE OF LAW CLAUSE IS UNCONSCIONABLE

Luis Del Rio v. CreditAnswers LLC, ____ F. Supp. 2d ____ (S.D. Cal. 2010).

FACTS: Plaintiff filed a complaint alleging that CreditAnswers' claims to provide debt-relief misrepresented its actual purpose of collecting payment without providing any services. The complaint sought damages and to have the parties' Debt Settlement Agreement ("Agreement") rescinded and canceled. Defendant filed a Petition to Compel Arbitration ("Petition"). It sought to enforce the Agreement's arbitration provision that claims or disputes be governed by the laws of the State of Texas, under which the arbitration clause would likely be enforceable. Plaintiff opposed the Petition, arguing that the choice-of-law provision was unenforceable and that California law applied.
HOLDING: Denied.
REASONING: Under the Federal Arbitration Act ("FAA"), arbitration agreements "shall be valid, irrevocable, and enforceable . . ." 9 U.S.C. § 2. The court applied the forum state's choice-of-law rules to determine the controlling substantive law. CreditAnswers was a Texas limited liability company, with its principal place of business in Texas. Therefore, the court found that Texas had a substantial relationship to the parties or their transaction, and there was a reasonable basis for the parties' choice of law.

However, the court determined that Texas law was contrary to a fundamental policy of California. Under Texas law, an arbitration clause with a class action waiver would likely be enforceable. Under California law, if a contractual provision is found to be unconscionable, it is unenforceable. Therefore, if the class action waiver in the Agreement was unenforceable in California, but enforceable in Texas, California's fundamental policy would be implicated. The court concluded that the class action waiver in the arbitration provision was unconscionable under California law because the waiver was in a standard consumer contract of adhesion; the dispute between the parties predictably involved a small amount of damages; and the complaint sufficiently alleged that the party with the superior bargaining power, CreditAnswers, had carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money. Accordingly, because the class action waiver was unconscionable and unenforceable under California law, Texas law was contrary to a fundamental policy of California.

The court then determined that California had a strong interest in the litigation because the putative classes consisted only of California residents, and the complaint alleged claims brought pursuant to the California Consumer Legal Remedies Act and the California Business and Professions Code. The only interest of Texas was the enforcement of a contract made by one of its corporate citizens. While Texas' interest was not inconsequential, the court found that California had a materially greater interest than Texas. Therefore, the choice of law provision was deemed unenforceable, and the arbitration provision would be governed by California law.

Because the class action waiver was found to be unconscionable under California law, the remaining issue was whether it could be severed from the remainder of the arbitration provision. The court held that it could not be severed because it was central to the arbitration provision. The court declined to assume the role of contract author rather than interpreter and held that the class action waiver rendered the entire arbitration provision unenforceable. The Defendant's motion to compel arbitration was denied.

ARBITRATION CLAUSE WITH CLASS ACTION WAIVER UNENFORCEABLE

Joshua Fensterstock v. Education Finance Partners & Affiliated Computer Services, Inc., 611 F.3d 124 (2nd Cir. 2010).

FACTS: Consumers filed a class action suit against Education Finance Partners and Affiliated Computer Services, Inc. ("ACS"), for deceptive solicitation, consolidation, and servicing of student loans. Fensterstock alleged that the case should be classified as a class action because the group is large enough that bringing all the members by joinder or individual actions would be legally inefficient and economically impractical. The complaint also alleged that although the Note contains an arbitration clause stating that claims made as a class action are subject to arbitration and must proceed on an individual, non-class basis, the clause is part of a contract of adhesion and should be declared void as against public policy. The appeal comes from the United States District Court for the Southern District of New York, denying the ACS's motion to stop the current action and compel arbitration on a class basis.
HOLDING: Affirmed.
REASONING: The court used the three-part test created by the Ninth Circuit court to determine if a class action waiver in a consumer contract is unconscionable. *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007). First, is the agreement a consumer contract of adhesion drafted by a party that has superior bargaining power? The court stated "such class action or arbitration waivers are indisputably one-sided. Although styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact [the party with superior bargaining power]." *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005). Specific to this case, the court noted that the take-it-or-leave-it clause presented by ACS was oppressive and satisfied the adhesion requirement.

Second, the court asked, did the agreement occur in a setting where disputes between the contracting parties predictably involve small amounts of damages? The amount of damages, while only small amounts each month, would have become a lump sum payment at the end of the repayment term that would be thousands instead of the original $335.00. Waiting until the amount becomes larger might hinder prosecution because "a fraud claim accrues upon the victim's discovery of the fraud" and the alleged misallocation is discoverable by borrowers from the ACS monthly statements. *Hobart v. Hobart Estate Co.*, 159 P.2d 958, 971-72 (Cal. 1945).

Finally, the court asked, is it alleged that the party with

the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money? In this case ACS had, over the course of 16 payments, misallocated only an average of $17 a month. The complaint alleged that these misallocations were done deliberately to the numerous consumers included in the action.

The court also upheld the denial of compelled class-based arbitration, because "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so." *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 130 S. Ct. 1758, 1775 (2010). In instant case, the arbitration clause specifically states that claims must be on a non-class basis, and did not mention the permissibility of class basis arbitration in the event the clause is invalidated. Therefore, under *Stolt-Nielsen*, the court had no authority to order class-based arbitration, and affirmed the order of the district court.

ARBITRATION AWARD CAN NOT BE CHALLENGED ON THE BASIS OF NON-STATUTORY, JUDICIALLY-CREATED GROUNDS

Patricia Frazier v. CitiFinancial Corp., LLC, 604 F.3d 1313 (11th Cir. 2010).

FACTS: In a mortgage dispute, Patricia Frazier appealed a ruling from the Northern District of Alabama confirming an arbitration award in favor of CitiFinancial ("Citi"). Frazier filed a complaint against Citi, asserting claims for breach of contract, fraud, misrepresentation, and violations of the Truth-in-Lending Act; in addition, Frazier sought rescission of the mortgage. Frazier's husband obtained a loan from Citi's predecessor-in-interest, HomeSense Financial Corporation of Alabama; he signed several documents in connection with the loan, including an arbitration agreement. It was later determined by the arbitrator that Mr. Frazier forged his wife's name, but this finding had no effect on the arbitrator's decision. The arbitrator found all of Frazier's claims to be unavailing, and awarded over $30,000 in damages to Citi. The district court declined to vacate, modify, or correct the award, and found Frazier was bound by the arbitration agreement.
HOLDING: Affirmed
REASONING: Under the Federal Arbitration Act ("FAA") there are a limited number of circumstances that permit a court to disturb an arbitrator's award. Section 9 explicitly says "[a] court *must* confirm an arbitrator's award unless it is vacated, modified, or corrected in accordance with sections 10 and 11 of the statute." (emphasis in original). Section 10 permits a vacatur of an arbitration award in four narrow circumstances. Under section 11 an arbitration award may be corrected and/or modified in only three situations.

The court found none of the statutory justifications that would allow a court to vacate and/or modify an award were present in Frazier's case. After determining sections 10 and 11 did not apply to Frazier's situation, the court considered three non-statutory grounds for vacatur and/or modification that it had recognized in prior cases. In the past, if an award was arbitrary and capricious, in violation of public policy, or made in manifest disregard for the law, the court may have permitted a vacatur. However, in light of the recent Supreme Court decision in *Hall Street Assoc., LLC v. Mattel, Inc.*, 552 U.S. 576 (2008), the court was forced to reevaluate its position on vacating and/or modifying an arbitration award based on non-statutory grounds.

In *Hall Street*, the Court held that section 9 of the FAA is not flexible; section 9 states the court "must grant" the order "unless it is vacated, modified, or corrected as prescribed in section 10 and 11 of this title." Based on the language of section 9, the Supreme Court found that sections 10 and 11 "provide the FAA's exclusive grounds for expedited vacatur and modification." The *Hall* court reasoned its strict interpretation of sections 9-11 was in accordance with the "national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway."

Hall Street prohibits all extra-statutory grounds for vacatur—whether judicially-created or contractually agreed-upon.

Although the circuit courts differed in their application of *Hall Street*; the Frazier court agreed with the Fifth Circuit's interpretation that *Hall Street* prohibits all extra-statutory grounds for vacatur—whether judicially-created or contractually agreed-upon. The court held that all judicially-created bases for vacatur are no longer valid. The court found the language in *Hall Street* to be categorical and it believed *Hall Street* compelled its decision to affirm the district court's ruling. Because Frazier could not establish any statutory grounds existed to permit a vacatur and/or modification, the district court was bound by section 9 to confirm the arbitration award.

A BORROWER MUST ARBITRATE A CLAIM THAT HIS LENDER VIOLATED THE FAIR CREDIT REPORTING ACT, EVEN THOUGH THE UNDERLYING DEBT WAS DISCHARGED IN BANKRUPTCY

Green Tree Servicing, LLC v. Brian D. Brough, 930 N.E.2d 1238 (Ind. Ct. App. 2010).

FACTS: Plaintiff Brian Brough obtained a $24,483.48 loan for the purchase of a mobile home from the predecessor of Green Tree Servicing pursuant to a "Retail Installment Contract, Security Agreement, Waiver of Trial by Jury, and Agreement to Arbitration or Reference or Trial by Judge Alone" ("Contract"). In the Contract, Brough agreed that Green Tree, through its processor in interest, could share information about [him] and [his] account with credit reporting agencies. Brough defaulted on the Contract. Subsequently, Brough filed for bankruptcy and the bankruptcy was discharged in November 2008. Green Tree brought suit against Brough for defaulting on the contract and Brough filed a counterclaim alleging a violation of the Fair Credit Reporting Act ("FCRA"). Brough claimed Green Tree reported to credit agencies that he still owed Green Tree a debt under the Contract even though the matter was discharged in bankruptcy. In December 2008, the trial court granted Green Tree's request to stay the case and compelled the parties to attend arbitration pursuant to the Contract. After a hearing, the trial court granted Brough's request to vacate the arbitration order in August 2009.
HOLDING: Reversed and Remanded.
REASONING: The court considered whether the parties intended to agree to arbitration for credit disputes. Based on the

plain language of the credit contract, the court decided that the parties in fact, agreed to arbitration. Moreover, the court gave weight to Brough's trial testimony that "[had] the bankruptcy not happened, the arbitration would have been [carried out]." The contract as a whole, the court reasoned, was not voidable due to the bankruptcy discharge.

"SHOCKING" ARBITRATION AWARD CANNOT BE OVERTURNED BY COURT

Zev Lagstein v. Certain Underwriters at Lloyd's, London, 607 F.3d 634 (9th Cir. 2010).

FACTS: After Lagstein ("insured") developed heart problems and became permanently disabled from practicing medicine, he filed a claim for benefits under his disability policy. Insured brought suit against Certain Underwriters at Lloyd's London ("insurer") after nearly two years without a decision. Under the policy, the dispute was to be settled through arbitration. The majority of the arbitration panel found for the insured, granting him full policy benefits, emotional distress damages, and punitive damages. The total amount resulted in over $6 million. The United States District Court of Nevada vacated the award. Insured appealed, and the Court of Appeals held that arbitrators did not "exceed their powers" under the Federal Arbitration Act ("FAA").
HOLDING: Reversed.
REASONING: The court's ruling is governed by the FAA which "enumerates limited grounds on which a federal court may vacate, modify, or correct an arbitral award." The FAA states four grounds on which an arbitration award can be vacated by the district court. The court stated reasons on why the arbitration award could not be vacated in this case. A district court may not vacate an arbitration award simply because the court finds the size of the award "shocking." The district court did not show any evidence that the large amount signified a bias or a disregard of public policy. The arbitrators were not shown to be more partial to the insured. To show partiality, evidence needs to show "actual bias toward or against a party." Failing to disclose a matter that occurred more than a decade ago that would be of interest to some party is not enough to show bias.

A district court may not vacate an arbitration award simply because the court finds the size of the award "shocking." The district court did not show any evidence that the large amount signified a bias or a disregard of public policy.

Arbitrators do not "exceed their powers" when they merely misinterpret or apply the governing law incorrectly. The award needs to be "completely irrational," or demonstrate a "manifest disregard of the law." This case shows neither. The large size of the award did not demonstrate a manifest disregard of the law. In order for the award to be vacated on this ground, it would have to be shown that the arbitrators had recognized the applicable law, but chose to ignore it. No applicable law was cited in this case. The facts in this case were also not so firmly established that failing to acknowledge them would be a manifest disregard of the law. To show that an award is completely irrational, it has to be shown that the arbitrators failed to draw the essence of the award from the agreement. An arbitration award "draws its essence from the agreement if the award is derived from the agreement, viewed in light of the agreement's language and context, and as well as other indications of the parties' intentions." The court did not have the scope to determine whether the arbitrators' findings were supported by facts. Charges that the majority of the arbitration panel may have misinterpreted certain policies were also not enough to show the award to be "completely irrational". As long as the arbitrator's interpretation of its power was plausible, the award will not be vacated based on a mistaken interpretation of the contract. The court concluded that it was important to follow the grounds listed in the FAA so that objective grounds will be followed for vacating arbitration awards—no matter how "shocking" the amount is.

COURT, NOT ARBITRATOR, DECIDES VALIDITY OF CLASS ACTION WAIVER

Francis J. Puleo v. Chase Bank USA, N.A., 605 F.3d 172 (3rd Cir. 2010)

FACTS: Credit card holders filed putative class action against Chase Bank USA, N.A. ("Chase") challenging retroactive interest-rate increases on credit card account balances. In addition to a severability clause, the Chase Bank Cardmember Agreement contained a sweeping "Arbitration Agreement" that effectively forced arbitration while barring class action or other representative actions. The Puleos argued the class action waiver was unconscionable, a question properly decided by the arbitrator. Granting Chase's motion, the District Court concluded the class action waiver challenge was a question of arbitrability for the court to decide, and, the entirety of the arbitration agreement was enforceable. Puleo appealed.
HOLDING: Affirmed.
REASONING: The court organized the opinion around questions of arbitrability, which arise in two circumstances 1) when there is a threshold dispute over "whether the parties have a valid arbitration agreement at all," and 2) when the parties are in dispute as to "whether a concededly binding arbitration clause applies to a certain type of controversy." Procedural questions that grow out of the dispute and bear on its final disposition are presumptively for the arbitrator. By contending that one or more of the arbitration agreement's terms is unconscionable, a party challenges the validity of the agreement itself. Thus, an unconscionability challenge to the class action waiver is a question of arbitrability for the court to decide.

Unless there is a question of arbitrability, the FAA requires courts to enforce privately negotiated agreements to arbitrate in accordance with their terms. In order to present their class claims to an arbitrator, the Puleos needed to obtain a court order that invalidated the waiver and that compelled class arbitration. This ignored the explicit terms of the agreement and the FAA. The class action waiver designates a clear boundary of arbitral authority, which arbitrators are neither well suited, nor generally permitted to assess the existence and scope of his or her own

jurisdiction. A challenge to this provision necessarily calls into question the very authority of the arbitrator to preside over the dispute and the validity of the agreement itself. Further, because the terms explicitly restrict class arbitration, the contracting parties would likely have expected a court to decide whether that very provision was unconscionable. The severability clause provides a two-step analysis: First, assess whether any provision of the Arbitration Agreement is unenforceable, and if so, then assess the severability of the unenforceable provision. Because the District Court held the waiver provision was not unconscionable, there was no trigger for severability analysis.

Questions of arbitrability are presumptively committed to the court unless the parties have "clearly and unmistakably" agreed that the arbitrator should decide the issue of arbitrability. While parties can contract for the arbitrator to decide questions of arbitrability, the burden is onerous. Both parties agreed the retroactive rate increase fell within the scope of the Arbitration Agreement but disagreed about whether the class action waiver provision was valid. Because there was no dispute in this case regarding the applicability of this Arbitration Agreement to the substantive dispute between the parties, the provision did not clearly and unmistakably show the parties intended to arbitrate the validity of the class action waiver.

The dissent argued the arbitrability of the dispute was not at issue and the presence of the class action waiver did not affect the formation of the agreement to arbitrate, or its validity.

CONSUMER CREDIT

ECONOMIC LOSS RULE BARS NEGLIGENCE CLAIM AGAINST CREDIT CARD COMPANY

Francis H. Azur v. Chase Bank, USA, N.A., 601 F.3d 212 (3rd Cir. 2010).

FACTS: Francis H. Azur filed suit against Chase Bank, USA and his personal assistant, Michele Varnek. Azur filed a suit against Chase Bank for allegedly violating 15 U.S.C. §§ 1643 and 1666 of the Truth in Lending Act as well as common law negligence for failure to detect fraud which resulted in economic loss. Varnek withdrew funds from Azur's credit card without authorization on a daily basis from November 1999 to March 2006. To avoid detection, Vanek paid the credit card bills by either writing a check by forging Azur's signature or paying the bill via online payments from Azur's checking account. A few of the transactions were detected by Chase's fraud detection. As a result, Chase tried to contact Azur by leaving a message three times to verify the transactions. The transactions were validated a few days after the messages were left. Azur eventually discovered what Varnek was doing and terminated her employment immediately. He disputed all the unpaid charges on the Chase credit card as well as all the prior fraudulent transactions. On the negligence claim, U.S. District Court for the Western District of Pennsylvania granted summary judgment in favor of Chase Bank.

HOLDING: Affirmed.

REASONING: The court focused on Pennsylvania's economic loss doctrine. The doctrine "provides that no cause of action exists for negligence that results solely in economic damages unaccompanied by physical or property damage." The court rejected Azur's claim that the exception built in another case, Bilt-Rite, precluded the court from imposing the economic loss doctrine. *Bilt-Rite Contractors, Inc. v. The Architectural Studio*, 866 A.2d 270 (Pa. 2005). The court explained that the *Bilt-Rite* exception is a narrow one. The exception to the economic loss doctrine only applies when one party is supplying information to others for a pecuniary gain like in *Bilt-Rite*. In this case, the court reasoned that because Chase was not in the business of providing Azur with information for pecuniary gain and because Azur's economic loss was not accompanied by physical or property damage, the economic loss doctrine applies. The court further reasoned that the imposition of liability against Chase is against public policy because it was Azur that was in the best position to prevent the fraud.

Along the same line, the court also rejected Azur's argument that the economic loss doctrine should not apply because he did not have a contractual remedy. The court rejected this because the fact pattern of this case did not fall into the *Bilt-Rite* exception. In this case, Chase was not a business which provided services and/or information knowing that it would be relied on by Azur. Therefore, the exception did not apply. The court ultimately held that the economic loss doctrine barred Azur's negligence claim against Chase Bank.

CREDIT REPORTING AGENCIES MUST REASONABLY INVESTIGATE CONSUMER CLAIMS

CONSUMER AWARDED $150,000 FOR FCRA CLAIM

Sandra Cortez v. Trans Union, LLC., ____F.3d. ____(3rd Cir. 2010).

FACTS: Sandra Cortez went to a car dealership to purchase a vehicle. Upon checking her credit, the dealer found that there were warnings on her credit report. The warnings indicated that she was a part of a list designated for nationals that were alleged terrorists, drug traffickers, and/or international misfits. The federal government forbade companies from dealing with potential consumers on that list. Cortez was not the person reported on the Specially Designated Nationals list; she merely had a similar sir name to that of a listed national. The report that Cortez downloaded for herself did not show the warnings that the dealership's report showed. The reports were obtained from two different third parties, who were vendors to Trans Union. Cortez filed four complaints with the credit report compilation company, Trans Union. Trans Union denied that the misinformation was in Cortez's report, did not investigate the complaint, and maintained its company policy not to investigate such consumer complaints/inquiries. Trans Union announced a new product that screened consumers and provided grantors with downloadable credit reports. Consumers however, utilized another method to