June 14, 2010

Third Circuit: Challenge to Class Action Waiver in Arbitration Agreement in Bank's Cardmember Agreement Presents a Question for the Court, Not an Arbitrator

On May 10, 2010, in a 6-4 decision authored by Chief Judge Theodore A. McKee, the United States Court of Appeals for the Third Circuit held that a challenge by two credit card holders to the class action waiver contained in the arbitration provisions of their cardmember agreements presented a question of arbitrability for the District Court for the Eastern District of Pennsylvania ("District Court") rather than the arbitrator. As a result, the Third Circuit affirmed the District Court's order compelling the card holders to arbitrate their claims against their bank on an individual basis. In *Puleo v. Chase Bank USA, N.A.*, 2010 U.S. App. LEXIS 9497 (3d Cir. 2010), two individual credit card holders ("Card Holders") commenced a putative class action against Chase Bank ("Chase") in Pennsylvania state court on behalf of themselves and other similarly situated Chase credit card holders in Pennsylvania, challenging Chase's practice of retroactively increasing interest rates on the account balances of its credit cards. The Card Holders did so despite an express ban on class actions contained in Chase's Cardmember Agreement. Specifically, the Cardmember Agreement included an "Arbitration Agreement" that required either Chase or a card holder to submit any claim, dispute or controversy arising from or relating in any way to the Cardmember Agreement to arbitration rather than litigation. The Arbitration Agreement also expressly barred class actions, whether as part of litigation or arbitration. Absent a court order compelling it to do so, the American Arbitration Association will not accept a demand for class arbitration where the underlying agreement prohibits class claims. As a result, the Card Holders had no choice but to initiate their class action in court rather than arbitration.?Chase removed the Card Holders' state court complaint to the District Court and filed a motion to compel arbitration and dismiss the action. Chase further sought an order directing the Cardholders to submit their individual claims to arbitration pursuant to the Cardmember Agreement. In response, the Card Holders argued that the District Court should enter an order referring the issue of whether or not the class action waiver was unconscionable and therefore unenforceable to an arbitrator to determine. The District Court granted Chase's motion in its entirety, compelling arbitration of the Card Holders' individual disputes and holding that the validity of the class action waiver was a question for the court to decide. The District Court also upheld the validity of the class action waiver and rejected the Card Holders' position that the class ban was unconscionable. The Card Holders appealed the District Court's conclusion that their challenge to the enforceability of the class action waiver was a question for the court to decide, but not the District Court's substantive determination that the class action waiver was not unconscionable.?As a result, the only question before the Third Circuit was whether the court or the arbitrator should decide whether or not the class action waiver was unenforceable. After a panel of the Third Circuit heard argument, the court elected *sua sponte* to rehear the matter *en banc* and affirmed the District Court's decision.?The Third Circuit noted that, absent a clear and unmistakable agreement to the contrary, questions of arbitrability are issues for judicial determination. A question of arbitrability arises only when the validity of the arbitration agreement is challenged or there is a dispute as to whether a concededly binding arbitration agreement applies to a certain type of controversy. The Third Circuit further noted that the Courts of Appeals are unanimous in recognizing that an unconscionability challenge is a question of arbitrability that is presumptively for the court, not an arbitrator, to decide.?Accordingly, the Third Circuit concluded that a challenge to the enforceability of an explicit class action waiver within an arbitration agreement was a challenge to the validity of the parties' agreement to arbitrate and thus a question for the court to decide. In dissent, Circuit Judge Marjorie O. Rendell opined that the majority failed to consider the "unique" situation in that both the Card Holders and Chase agreed that the case should go to arbitration and that neither party argued that the presence of the class action waiver affected either the formation of the agreement to arbitrate or its validity. Judge Rendell said that, under those circumstances, the Card Holders' challenge to the class action waiver did not

raise an issue of arbitrability and should have been referred by the District Court to the arbitrator. The Third Circuit's decision will likely make it more difficult for credit card holders and other individuals bound by an arbitration agreement that contains a class action waiver to challenge the enforceability of that waiver in arbitration. Indeed, such card holders and other individuals will face an uphill battle in persuading a court to refer such a challenge to an arbitrator despite an express ban on class claims.

Should you have any questions or concerns about how the Third Circuit's decision may affect your company, please do not hesitate to contact the authors of this alert.