Arbitration Up for Debate: New Rules Propose Banning the Use of Class-Prohibitive Arbitration Provisions

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The Consumer Financial Protection Bureau (CFPB), the consumer financial oversight body created by the Dodd-Frank Wall Street Reform and Consumer Protection Act, proposed rules on May 5, 2016, that would restrict the use of arbitration clauses in consumer financial contracts.

From credit cards to bank accounts to private student loans, the proposal would prohibit financial companies from using mandatory arbitration clauses as a way to block class-action lawsuits, though companies would still be able to require consumers to enter arbitration to resolve individual disputes.

Mandatory arbitration clauses, which require plaintiffs to resolve disputes with a company through an arbitration process in lieu of the court system, have become standard boilerplate for many financial companies, bolstered by the U.S. Supreme Court's ruling in the case of *AT&T Mobility LLC v. Concepcion* (563 U.S. 333) in 2011, which held that the Federal Arbitration Act preempts state statutes which condition the enforcement of an arbitration clause on the availability of class-wide procedures.

In March 2015, the CFPB released the findings of a study of arbitration clauses in the consumer finance field, which included over 850 consumer finance agreements and tens of thousands of dispute proceedings and outcomes.

The study indicates that mandatory arbitration clauses were included in 53% of credit card loan contracts, 86% of private student loan agreements and 44% of depository banking institution contracts. Additionally, the arbitration clauses appeared in 92% of prepaid card agreements and 99% of payday loan contracts in certain states.

The study also found that consumers file few arbitration cases. Over a review period of 2010 to 2012, the study showed that only 1,847 individual arbitration disputes were filed with the American Arbitration Association (AAA), the largest administrator of arbitration agreements in the consumer finance field.

Of these cases, only about 25 per year involved a claim amount under $1,000 – the average claim amount was $27,000. The study further showed an average of just over 1,150 individual cases were filed per year in federal court and similar numbers for small claims court cases.

In contrast, the study found that class litigation may provide means of securing relief for a larger number of consumers – pursuant to class settlements approved in federal courts between 2008 and 2012 totaling $540 million per year, at least 32 million class members were eligible for relief.

However, many of the mandatory arbitration clauses in use today prohibit arbitration on a class-wide basis. The study showed only two class arbitration disputes filed in the three-year period from 2010 to 2012. Individual arbitration claims studied by the CFPB revealed a consumer success rate of only 20%.

The CFPB claims the proposal is in line with several recent restrictions introduced by the Dodd-Frank Act, which prohibit arbitration agreements in connection with mortgage loans and whistleblower proceedings, as well as authorized the Securities and Exchange Commission (SEC) to regulate such agreements with respect to contracts with broker-dealers and investment advisors.

Indeed, a number of regulations have also been proposed or adopted in recent years restricting the use of arbitration agreements with respect to lending to military members, the processing of livestock and poultry under federal agriculture law, contracts involving educational institutions which receive federal funding, and long-term care facility contracts in the medical field.

CFPB Director Richard Cordray has stated that many financial companies "avoid accountability" by using mandatory arbitration clauses to block consumer class actions, adding that "signing up for a credit card or opening a bank account can often mean signing away your right to take the company to court if things go wrong."

But not everyone shares this view. Rob Nichols, president of the American Bankers Association, released a statement on the proposal, stating that consumers "will get less and pay more" under the proposed rules.

Nichols also noted that many banks resolve most disputes quickly and amicably, and that arbitration, "when needed…is an efficient, fair and low-cost method of resolving disputes in a fraction of the time – and at a fraction of the cost – of expensive litigation." Indeed, despite the study's general claim that arbitration agreements are detrimental to consumers, some in the industry point out that, in reality, the data in the study confirms that arbitration is a faster and less expensive option for consumer dispute resolution.

The proposal is heralded by some as a boon to class-action trial lawyers, but while plaintiffs' attorneys expect an uptick in class-action lawsuits, they do not anticipate the flood of litigation that bankers and others may fear. Further, the proposal would require reporting of certain data with respect to arbitration claims, the goal being to make the arbitration process fairer.

Covered by the proposed rule are a number of financial products, including credit cards, prepaid cards, checking and savings accounts, money-transfer services, certain auto and title loans, payday and installment loans, and student loans.

The rule would affect contracts entered into 210 days after the effective date of the rule, which is expected to occur sometime in 2017. Banks and other financial institutions seeking to include arbitration clauses in consumer contracts should monitor the progress of the rule and consult with counsel for a complete assessment of whether contracts need to be revised or updated in light of the proposal. ■

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