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FINANCIAL SERVICES LITIGATION AND CLASS ACTION

ALERT

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THE CFPB TAKES AIM AT ARBITRATION CLAUSES IN CONTRACTS FOR CONSUMER FINANCIAL PRODUCTS

By Monica Clarke Platt

The Consumer Financial Protection Bureau (CFPB) last week issued two proposals aimed at weakening and discouraging arbitration clauses in contracts for consumer financial products. First, the CFPB proposes prohibiting the application of arbitration clauses to class actions proceeding in court. Specifically, the Bureau is considering a requirement that arbitration clauses in covered consumer financial contracts provide that the arbitration agreement is inapplicable to putative class actions filed in court unless and until class certification is denied or the class claims are dismissed. This proposal could significantly increase putative class claims in the consumer finance sector (indeed, increasing access to class litigation appears to be the Bureau's goal). Second, the Bureau seeks to require entities that use arbitration agreements in their contracts to submit to the Bureau notice of claims filed in arbitration proceedings and arbitration awards, potentially for publication.

The requirements would apply to arbitration agreements entered into at least 180 days from the effective date of any final regulation. The Bureau may exempt from regulation several categories of products and services. These include products already subjected to SEC or CFTC arbitration rules; those provided by persons not regularly engaged in business activity; those provided by the federal government; and those provided by state, local, and tribal governments and governmental entities to persons in their jurisdiction, or to persons outside their jurisdiction if not credit that is subject to TILA or Regulation Z; and credit a business extends for the consumer's purchase of its own nonfinancial goods or services when covered by Dodd-Frank Act section 1027(a)(2)(B)(ii).

The proposals are the result of a study of arbitration clauses, litigation, and arbitrations related to consumer financial contracts across several financial services industries. In March 2015, the Bureau released the results of the study, reporting that in the credit card industry, larger banks were more likely than small banks and credit unions to include pre-dispute arbitration clauses. Thus, while only 16% of credit card issuers use arbitration clauses, they appear in approximately half of all agreements. In the checking account market, only 8% of banks use arbitration clauses, but this accounts for 44% of insured deposits. Arbitration clauses are almost always included in contracts for prepaid cards, payday loans, private student loans, and mobile wireless third-party billing agreements. Significantly, nearly all of the arbitration clauses studied prohibited class arbitration. Although most permitted litigation in small claims court without resorting to arbitration, some also waived a consumer's ability to proceed in a class action in court. A handful of contracts without arbitration clauses also included such class action waivers. Additionally, most clauses contained a non-severability provision providing that if the no-class-arbitration provision were held unenforceable, the entire clause should be deemed unenforceable. However, the Bureau found that arbitration agreements were more likely to be used to prevent class litigation than individual litigation, and that companies had a great deal of success in using arbitration agreements to stay or dismiss class litigation.

According to the Bureau, consumers often have incorrectly assessed their ability to bring a claim, class or otherwise, in court, and the impact of arbitration. The Bureau says that consumers are frequently unaware of the existence of arbitration clauses. According to the Bureau's statistics, when consumers were asked whether they could sue their bank or credit union in court, approximately half said they did not know and 42% said that they could. The results were similar when consumers were asked about suing their credit card issuers, and applied whether or not the contract actually contained an arbitration clause. With respect to contracts that did include arbitration clauses, 55% of individuals stated they did not know if they could sue in court, and 39% stated that they could. Only a small number of individuals who believed they had a right to sue in court correctly assessed that they would have to do so in small claims court or that the bank could force the case into arbitration in the event of a lawsuit. Even while the great majority (78%) of study participants understood arbitration as a dispute method, only 21% of those people understood that it meant that a third party would decide the dispute. Lastly, more than half of those surveyed whose agreements contained arbitration clauses incorrectly believed that they could participate in class proceedings.

The Bureau maintains that recent litigation regarding arbitration clauses had some effect on their prevalence. In the credit card market, a settlement in *Ross v. Bank of America*, No. 05-civ-7116 (S.D.N.Y.), in which the settling defendants agreed to stop using arbitration clauses for a period of three-and-one-half years accounted for a significant decline in the use of arbitration clauses. However, *AT&T Mobility, LLC v. Concepcion*, 563 U.S. 333 (2011), appears to have had a far smaller impact on the inclusion of arbitration clauses than originally anticipated, with the report noting approximately 15% annual increase in their inclusion in credit card contracts in each year since the decision. With respect to checking accounts, the Bureau had limited data with which to analyze the effect of *Concepcion*, but noted a small increase in the percentage of institutions using arbitration clauses since *Concepcion*.

In making its proposals, the Bureau stated its belief—based on the data analyzed—that consumers take few complaints to court or arbitration not because they do not have disputes, but because the individual injuries are likely too small to make it worth the time or expense to pursue a remedy or find an attorney. Additionally, the Bureau believes that some consumers may not know they have suffered a harm because the harm suffered may not be readily apparent to a nonlawyer or was caused by practices that an individual cannot detect. The study showed that litigation (typically on a class basis) provided significant benefits to consumers through settlement, and possibly as a deterrent. Although the Bureau did not address the merits of class claims that had been settled or the stage in the litigation at which claims were settled, the Bureau pointed out that class settlements benefit companies by providing finality with respect to customers who do not opt out. The Bureau, therefore, found that consumers would be better protected and the market fairer if consumers could obtain relief in the class context. Notably, the Bureau pointed out that that "[c]lass litigation procedures were developed in part because 'the amounts at stake for individuals may be so small that separate suits would be impracticable.'"

Going forward, the Bureau is seeking input from small businesses before the proposals are finalized. The Bureau plans, along with the Office of Management and Budget and the Small Business Administration Office of Advocacy, to convene a Small Business Review Panel to consider the impact the proposals may have on small businesses. Additionally, the Bureau is seeking input from small entity representatives on three potential cost centers: administrative costs related to revisions of noncompliant arbitration agreement; costs related to additional potential class litigation exposure; and costs of compliance with existing consumer finance laws or other laws relating to an attempt to minimize class litigation exposure.◆

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