Client Alert: CFPB Attacks Pre-Dispute Arbitration Clauses

Related Attorneys

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The Consumer Financial Protection Bureau (CFPB) released a study on March 10, 2015 that concludes that pre-dispute arbitration agreements restrict a consumer's relief. This study is the latest step in the CFPB's analysis of lenders' arbitration practices[1] and is widely regarded as a precursor to new regulations.

Pre-dispute arbitration clauses that are often found in credit card, bank account and other consumer finance contracts, require consumers to pursue disputes through a binding arbitration process, and often contractually prevent consumers from filing class actions.[2] The CFPB found that very few consumers individually seek relief through arbitration or the courts, while millions of consumers obtain relief each year through class actions.

The CFPB's study makes two significant findings. First, the study purports to show harm resulting from pre-dispute arbitration agreements. The study finds that class actions resulted in the greatest windfall for consumer-plaintiffs – at least $220 million per year in settlement funds to consumers who brought actions in federal court over the five year period studied. By design the pre-dispute arbitration clauses allow lenders to block class actions in court (by requiring arbitration), and in over 90 percent of the agreements lenders expressly prohibit class actions in arbitration. The CFPB study found that lenders disproportionately invoke the arbitration clause to block class actions as opposed to individual lawsuits (65 percent of the time verses less than 1 percent of the time). As a result, the total amount of relief obtained by consumers in arbitration was minimal when compared to class action recovery.[3]

Second, the study found "no statistically significant evidence" that pre-dispute arbitration clauses lowered prices for consumers. The CFPB looked at whether companies that include arbitration clauses in their contracts offer lower prices because they are not subject to class action lawsuits. The CFPB analyzed changes in the total cost of credit paid by consumers of some credit card companies that eliminated their arbitration clauses and of other companies that made no change in their use of arbitration provisions. The CFPB found no statistically

significant evidence that the companies that eliminated their arbitration clauses increased their prices or reduced access to credit relative to those that made no change in their use of arbitration clauses.

Finally, the study noted that while the CFPB could not quantify the nonmonetary benefits, an added benefit to consumers in class action settlements is that frequently the settlements include requirements that companies change their behavior in order to prevent future problems.

With this study in hand, the CFPB may take steps either to bar class arbitration prohibitions or the pre-dispute arbitration clauses, or both, completely. Notably the U.S. Supreme Court has twice ruled that the Federal Arbitration Act of 1925 (FAA) permits both, even where the proposed class of plaintiffs proves that it would be economically infeasible for individuals to pursue arbitration on their own. *See AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011) and *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304 (2013).

Stay tuned for future updates on whether the CFPB acts on its findings, and how any regulations will be interpreted by courts should any new regulations conflict with the FAA and the Supreme Court's holdings in *Concepcion* and *Italian Colors*.

If you have questions about this case or related financial institution or lender/servicer issues, please contact: Lisa Forbes (Cleveland; 216.479.6105); Rodney Holaday (Columbus; 614.464.8356); Chris Santagate (Columbus; 614.464.5477); or your Vorys lawyer.

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[1] The CFPB released a preliminary report in December 2013 that was criticized by the industry as being one-sided.

[2] Congress banned the use of pre-dispute arbitration clauses in mortgage contracts in the Dodd-Frank Act and gave the CFPB the authority to review their use in credit card, checking account and payday loan agreements, as well as to choose to restrict their use.

[3] Under $400,000 total was awarded in relief and debt forbearance to consumers who filed for arbitration with the American Arbitration Association in 2010 and 2011. Companies obtained decisions requiring consumers to pay $2.8 million in cases filed during this same time period, predominantly for disputed debts.