Client Alert

December 17, 2013

CFPB Builds its Case Against Arbitration Clauses

By James McGuire and Kay Fitz-Patrick

INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) mandated a Consumer Financial Protection Bureau (CFPB) study on the use of pre-dispute arbitration clauses in consumer financial products and services with a report of its findings sent to Congress. The Dodd-Frank Act also authorized the CFPB to prohibit or impose conditions or limitations on the use of arbitration clauses if the CFPB determines that it is in the public interest and for the protection of consumers. The CFPB first launched a public inquiry on arbitration clauses in April 2012.

On December 12, 2013, the CFPB published its Arbitration Study Preliminary Results: Section 1028(a) Study Results to Date (Preliminary Results). The CFPB has indicated these results are only an initial portion of the statutorily-mandated report and are subject to revision and further analysis. The CFPB has indicated that its report to Congress will contain additional analyses that the CFPB is planning to conduct but for which CFPB does not yet have preliminary results. The CFPB claims that its Preliminary Results are not indicative of its ultimate assessment; however, its findings bode ill for those exercising their rights under the Federal Arbitration Act. The CFPB seems poised to conclude that consumers are better served by the class action system, despite its well-documented abuses.

PRELIMINARY RESULTS

The CPFB focused its research on three markets: consumer credit card, checking account, and general purpose reloadable prepaid cards.

The CFPB studied the incidence and features of arbitration clauses.

- Only 17% of credit card issuers included arbitration clauses in their credit card agreement. Of those, 58% of the 50 largest bank issuers used arbitration clauses.
- 7.7% of banks, including 62% of the top 50 banks, included arbitration clauses in their checking account contracts.
- Most consumers agreed to arbitrate disputes as a result of the use of arbitration clauses by large institutions.
- 9 out of 10 arbitration clauses barred class proceedings.

The CFPB studied various forms of legal dispute resolution available to consumers.

- 72% of consumer arbitration filings were initiated by the consumer.
- The Preliminary Results identified 870 credit card cases brought by consumers in small claims court against

large credit card issuers compared to 41,000 cases brought by these issuers against consumers in small claims court.

- The Preliminary Results identified total class settlement recoveries in excess of $350 million for more than 13 million class members, resulting in an average recovery of $27 per class member. By comparison, the Preliminary Results indicated that the average alleged amount in dispute for consumer arbitration filings was $13,418.

The CFPB discussed the use of class proceedings as a benchmark for comparison.

- The Preliminary Results cited a low opt-out rate for class settlements as an indication of consumer reluctance to proceed with arbitration.
- The CFPB noted that class litigation stands to provide some benefit to all income and demographic segments.

FUTURE STUDIES

The Preliminary Results indicated that the CFPB has a number of phases of work in progress or under consideration. They include studies of other consumer financial products or services, such as private student loans. The CFPB also plans to research the incidences and outcomes of litigation where companies invoke arbitration agreements; consumer benefits and transaction costs in consumer financial services class actions; whether class actions exert improper pressure on defendants to settle meritless claims; and the possible impact of arbitration clauses on consumer products.

POLITICAL CLIMATE

As indicated in the Preliminary Results, there has been increased criticism of the inclusion of arbitration clauses, especially those that contain class waivers, in consumer contracts since the Supreme Court has twice "rejected the argument that class arbitration was necessary to prosecute claims that might otherwise slip through the legal system" – in *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011) and in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013). The hostility towards the decisions is further evidenced by the hearing held by the Senate Committee on the Judiciary entitled "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?" on December 17, 2013. Senator Al Franken presided over the hearing. On May 7, 2013, Senator Franken reintroduced legislation, entitled the Arbitration Fairness Act, seeking to ban mandatory arbitration clauses. He had originally introduced the legislation in 2011.

PREDICTIONS

The Preliminary Results addressed a wide swath of issues beyond the language used in arbitration provisions for consumer financial products and services. Though the Preliminary Results touched upon each opportunity for legal dispute resolution, its findings, particularly the focus on class proceedings, seem to be geared towards the conclusion that class proceedings are needed to protect consumers – the argument that the Supreme Court rejected in *Concepcion* and *Italian Colors*. We can expect that, after completing its study, the CFPB will issue a rulemaking that either bans or limits the use of arbitration clauses with class waivers in connection with financial products.

Client Alert

Contact:

James R. McGuire
(415) 268-7013
jmcguire@mofo.com

Kay Fitz-Patrick
(415) 268-7885
kfitzpatrick@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for 10 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.