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CFPB Proposal Could Snuff Out Arbitration Even Without Ban

By **Evan Weinberger**

Law360, New York (May 2, 2016, 8:19 PM ET) -- The Consumer Financial Protection Bureau is not expected to outright ban arbitration requirements in consumer finance contracts when it releases a hotly anticipated proposal later this week, but the watchdog's actions could ultimately have that effect, experts say.

At a hearing Thursday in Albuquerque, New Mexico, the CFPB is anticipated to release a proposed rule that would bar banks and other firms from including class action bans in their contracts, but would stop short of banning the practice of forcing consumers to arbitrate disputes over credit cards, bank accounts and other types of financial products.

Even so, firms would likely respond by curbing their use of arbitration to settle disputes, because the combined costs of arbitrating, which are largely covered by the companies, and of fending off class actions would be too much for many firms, according to Mayer Brown LLP partner Andrew Pincus.

“They don’t want to have to pay twice,” he said.

Banks and other consumer financial firms have included mandatory arbitration clauses in their contracts for many years. The clauses bar consumers from taking firms to court to dispute charges or other practices and ban the use of class action litigation or arbitration. The provisions are often buried deep inside those contracts.

Consumer advocates have long said that those clauses have essentially cut off customers from seeking redress for wrongs committed by banks, while the industry has argued that arbitration allows for quick and cost-effective resolution of disputes.

The 2010 Dodd-Frank Act required the CFPB to study the effects of mandatory arbitration and to make rules restricting the practice if the agency deemed the clauses harmful to consumers.

Most observers had assumed that the bureau would move to gut mandatory arbitration clauses directly following the release of a study in March 2015 that found the clauses **prevented consumers** from even seeking recoveries from banks and other firms. Instead, the CFPB in October released an outline that called for an end to class action bans in those agreements.

The CFPB’s outline would let banks offer consumers the option to go to arbitration for individual complaints, but also give consumers the chance to go to court en masse.

The industry, however, says such an arrangement would never work in practice.

“The middle course in the real world is going to be a ban,” Pincus said.

The industry’s argument comes down to a simple matter of arithmetic, according to BuckleySandler LLP partner Walter Zalenski.

Banks and other consumer financial firms cover arbitration costs, including the majority of costs for consumers who are seeking to recover from the companies. If they also have to pay to fight off class actions, firms would likely be unwilling to shoulder those arbitral costs, he said.

And for consumers, the loss of arbitration as an option could come at a price as well, Zalenski said.

Many of the disputes they have are over less than the filing, legal and other fees consumers would have to shell out if they brought an individual action to court, while arbitration alleviates those costs, he said.

“In an individual action, the consumer costs and benefits of arbitration as opposed to a court proceeding are pretty plain and are in fact demonstrated by the CFPB’s own study,” Zalenski said.

Consumer advocates say that there’s no reason for banks and other firms to dump arbitration as an option for consumers, even if the firms potentially face a restriction on class action bans.

“It’s ultimately up to them whether they continue to push arbitration in the individual context,” Amanda Werner of Americans for Financial Reform said.

Threatening to remove the arbitration option reveals the “industry’s hand,” she added.

If consumers benefit from arbitration, then they will choose that option to settle disputes, Werner said.

“People should be able to choose arbitration on their own if it’s such a better option,” she said.

In its March 2015 report, the CFPB had found that arbitration’s benefits to consumers were overstated.

The report said that arbitrators awarded a combined total of under $175,000 in damages and less than $190,000 in debt forbearance in 1,060 cases filed in 2010 and 2011. Arbitrators also reportedly ordered consumers to pay a total of $2.8 million in that period, largely over disputed debts — companies can take consumers to arbitration.

Litigation filed by individuals saw similar meager recoveries, the CFPB said.

In contrast, around 32 million consumers were able to recover approximately $2.7 billion in class action settlements over a five-year period, the CFPB said.

“What the numbers consistently show is we either have class actions or individual suits, or we have nothing,” said Werner, who would like to see the CFPB go farther than removing class action bans.

The industry has disputed the CFPB’s findings.

The CFPB's moves to eliminate the class action ban from arbitration clauses come as the U.S. Supreme Court has made it harder for consumers to win in class actions and has backed arbitration in a series of recent rulings.

But for banks and other consumer financial companies, removing the bans eliminates their best defense, Zalenski said.

"It is important to recognize that the most effective defensive weapon against class actions has been the use of arbitration clauses, and financial services firms that have relied on that will no longer have that defensive weapon at their disposal," he said.

Despite the new barriers put in place by the Supreme Court, consumers will have a new weapon at their disposal if and when the CFPB's rules for arbitration come into force, Werner said.

"I'm not too worried again about any effective door-closing that was not available to consumers in the first place," she said.

--Editing by Edrienne Su.
