Please Pass the Gravy

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On February 18, the Consumer Financial Protection Bureau's director, Richard Cordray, made remarks to the American Constitution Society regarding the ills of mandatory pre-dispute arbitration clauses, particularly those containing class action waivers. It was a friendly audience; the ACS is the liberal corollary to the conservative Federalist Society. Put another way, Justices Ginsberg and Sotomayor are to ACS what Justices Scalia and Thomas are to the Federalist Society.

The director's remarks were long on rhetoric, intended to make the case for why class action waivers should be excised from arbitration agreements and the bigger implication that arbitration is bad for consumers. For example:

"These important [arbitration] clauses have often been buried deep in the fine print of contracts for consumer financial products and services, such as credit cards, bank accounts, payday loans, and private student loans," and

"Arbitration clauses, as they are used today both in the field of consumer finance and more generally, often have been deliberately designed to block Americans from effective means of vindicating their rights. Some of the broader ramifications are surprising and even breathtaking in their scope."

What the director fails to acknowledge is that consumer arbitration clauses have evolved over time and have been effectively monitored by the courts. Today's arbitration clauses are pretty conspicuous (if consumers bothered to read the documents they sign, they'd see how conspicuous legally compliant arbitration clauses are) and provide substantial consumer protections. Do they eliminate access to the courts? Absolutely. Is that a bad thing? Absolutely not.

The director's focus on class action waivers begs the question: Who is the CFPB trying to protect? Is it consumers or trial lawyers? The CFPB's own study revealed that consumers, on average, collected $5,389 in arbitration awards and $32.35 in class actions. Put another way, consumers obtained 166 times more money in arbitration than they did in court actions. How is that bad for consumers?

The director noted that the CFPB's study found that class action settlements totaled "$2.7 billion in cash, in-kind relief, fees, and expenses." What the director did not say is that $424 million of that total went to trial attorneys in the form of legal fees. Nor did he mention what portion of the $2.7 billion went to other fees, expenses, and in-kind relief. Apparently it was a lot since the average cash award was less than the admission to a movie theater for a family of four.

Consider the following remarks:

"In our study, we took a close look at the impact of these clauses … how many consumers pursued and got relief in arbitration procedures or in individual litigation when they challenged company behavior they believed to be wrongful. We found that very few consumers used the arbitration procedures. Only about 25 disputes per year involved affirmative consumer claims of $1,000 or less, and only a handful of those achieved any relief whatsoever. *We also found that consumers generally did not use the court system – including small claims courts – to obtain redress for individual matters*." (emphasis added).

What this finding says to me is that most consumers did not believe it was worth their time to go after a small amount of money. Just like many consumers will not complain about small errors in a dinner order, a grocery order, a repair order, etc. The dollar amounts just may not be important enough. Then, there's this:

"Finally, our study examined the extent to which consumers are aware of arbitration clauses and understand their implications. In our survey of 1,000 consumers with credit cards, we found that of those consumers who said they knew what arbitration was, three out of four reported that they did not know if they were subject to an arbitration clause. Of those who said they did know, more than half were wrong about whether their agreements actually contained an arbitration clause.

Taken together, these results show that arbitration clauses severely limit consumers' options to pursue a just resolution of their disputes, to their detriment and without their knowledge."

Whether he realizes it or not, the director is not describing a harm issue. He's describing a financial literacy issue. I suspect most of those consumers in the survey are also unaware of what other remedies are in their card agreements. Or exactly what their own obligations are. And I'm confident none of the consumers surveyed could recount their rights to go to court or anything about the costs and time involved in bringing a suit.

Arbitration clauses allow financial institutions to control costs and avoid class action awards and outrageous attorneys' fees for what often amount to little more than minor technical violations. Eliminating class action waivers subjects good businesses that have strong economic incentives to treat their customers well to potential liability that is the equivalent of executing someone for running a stop sign. But punishing evil financial institutions is politically expedient right now. Who cares if consumers don't benefit as long as the banks get hurt? And if we can put more money in the pockets of consumer-advocates- turned-trial-attorneys, well, that's just gravy.