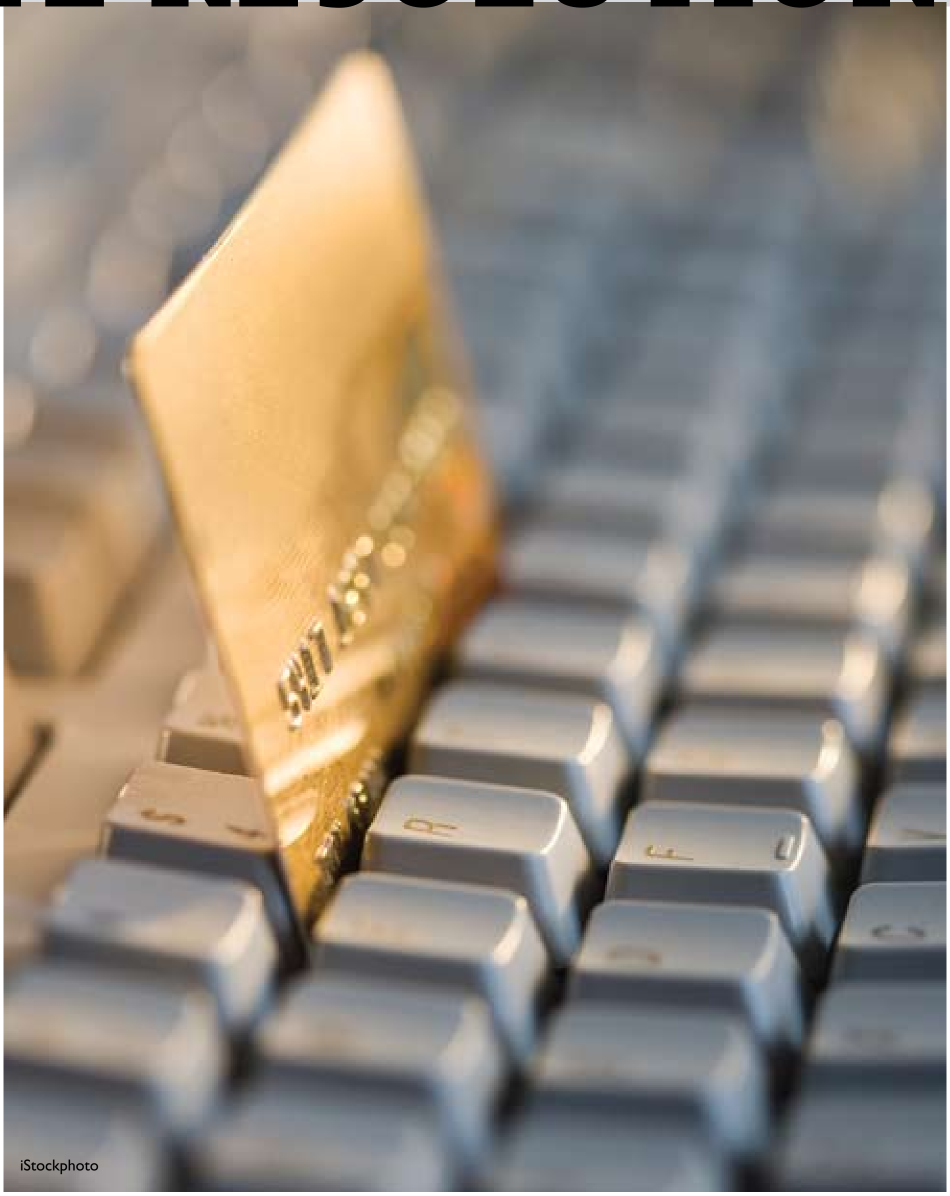
by Olivier André

Dispute Resolution

The Use of Arbitration in the Credit Card Industry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The fine print in most credit card agreements states that any dispute with a credit card issuer has to be resolved through arbitration.

Arbitration is a dispute-resolution mechanism that enables parties to resolve their disputes out of court. Instead of having a judge adjudicate disputes, the parties may put in their contract a process for appointing an arbitrator—or choose a neutral arbitrator or arbitration panel. By making stipulations in their contract, the parties choose both substantive and procedural rules, decide where the arbitration will take place, and who will pay the fees and expenses. An arbitral decision, unlike a judicial decision, is final and binding upon the parties. The grounds for appeal to the courts are limited, and a judge may vacate or modify the award on only the narrowest grounds.

Growing Popularity

For many years after 1925, when Congress enacted the Federal Arbitration Act (FAA), arbitration was used primarily by businesses—to resolve maritime, international trade, labor, and securities disputes. In the past 10 years, though, mandatory arbitration clauses began appearing in many consumer contracts, notably in the financial and credit card industry. By 2004, more than 69 percent of financial consumer contracts, including credit card contracts, had arbitration clauses.[1] In a study that included mostly credit and financial-services industries, 76 percent of the contracts contained arbitration clauses in 2008.[2]

Challenges for Consumers

According to card issuers, arbitration is cheaper, faster, and more efficient to resolve disputes than traditional litigation. According to advocates, however, consumers unwittingly give up their constitutional right to a trial and are forced to sign contracts featuring mandatory arbitration if they want a card.

Critics believe that arbitration favors the card issuers, in part because arbitrators are usually hired by the issuers through independent companies such as the National Arbitration Forum (NAF) and the American Arbitration Association (AAA). Consumer advocates argue that arbitrators may have an incentive to rule in favor of the issuers—and continue to be hired.

Another challenge has to do with confidentiality, a cornerstone of arbitration. Arbitrators do not have to publish their decisions and have been reluctant to provide information regarding the outcome of cases. For consumers, that translates into lack of access to empirical data and greater difficulty proving their allegations.

A consumer group called Public Citizen (www.citizen.org) recently analyzed data pertaining to 34,000 arbitration cases conducted by NAF in California between 2003 and 2007.[3] The results show that consumers lost cases 94 percent of the time. Public

Citizen points to the fact that 90 percent of the cases were handled by just 28 arbitrators, usually corporate attorneys. One attorney handled 68 cases in one day, an average of one case every seven minutes, assuming an eight-hour day.

Differing Viewpoints

The Institute for Legal Reform (ILR), a business organization, refutes the allegations of bias. It analyzed the same data as Public Citizen shortly thereafter and reached a different result.[4] ILR concluded that consumers lost only 68 percent of the cases, an outcome identical to cases that go to court and suggesting that arbitrators, like impartial judges, neutrally apply the law to the facts. The divergent readings of the data resulted from different methodologies. ILR counted all dismissed cases as victories for the consumers whereas Public Citizen considered only decisions adjudicated on the merits by arbitrators.

Credit card issuers maintain that arbitration enables borrowers and lenders to resolve their disputes at greatly reduced cost, that a faster, simplified process means lower attorney fees, and that the limitations on discovery rules can result in savings for both parties.[5] Issuers contend that the savings ultimately benefit all borrowers because lenders often pass on the cost savings to customers.

Advocacy groups counter that arbitration is more expensive for consumers. First, arbitrators' fees are high, and they are paid by the hour. Second, arbitration does not eliminate litigation costs when a consumer, unaware of having signed an arbitration agreement, asks a court to declare the agreement unenforceable. Third, it is costly for losing parties to get a court to review arbitral awards. Finally, most arbitration agreements provide that the parties will divide the expenses of arbitration equally, which many consumers cannot afford.

Consumer advocates also argue that consumers do not realize that they are giving up their constitutional right to a court trial when signing credit card agreements. Even if they wanted to, they could not negotiate the exclusion of arbitration from the boilerplate contracts drafted by the five dominant credit card issuers.[6] Advocates also wonder why, if companies think arbitration is a better way to resolve disputes, they do not choose it when dealing with other companies. According to one study, arbitration is used in 69.2 percent of financial contracts between companies and consumers but in fewer than 10 percent of the same companies' contracts with businesses.[7]

In fact, some advocates argue that increased cardholder litigation in the 1990s is the real reason behind issuers' preference for consumer arbitration. It also could explain why so many consumer arbitration agreements contain class arbitration waivers preventing class actions.

Reacting to consumer concerns, several members of Congress have introduced bills which, for the most part, aim at prohibiting "predispute" arbitration clauses in several industries. For instance, the Fairness in Nursing Home Arbitration Act of 2008 would, if passed, invalidate any predispute agreement between a long-term care facility and a resident. The Automobile Arbitration Fairness Act of 2008 would prohibit arbitration agreements in a motor vehicle consumer sale or lease unless the parties agree to arbitration after a dispute arises.

Consumers need to be aware of arbitration provisions in their contracts and understand what might be the effect of those provisions should a dispute with a credit card company arise.

The Fair Contracts for Growers Act of 2007, if passed, would allow arbitration in livestock and poultry contracts only if the parties agree to arbitration in writing after the dispute arises. The most important bill currently pending, in terms of its implications and its status in the legislative process, is the Arbitration Fairness Act of 2007. This bill would prohibit any predispute agreement for employment, consumer, and franchise disputes, or disputes between parties of "unequal power."[8]

Credit card issuers argue that such bills would significantly impair arbitration. They contend that parties are unlikely to agree to arbitration after a dispute has arisen and that consumers would have to go to court. They hold that dispute resolution would be more difficult and costly for consumers—and that the laws would have negative consequences at the international level.[9]

Looking Ahead

Whatever the outcome of this debate turns out to be, one thing is certain: consumers need to be aware of arbitration provisions in their contracts and understand what might be the effect of those provisions should a dispute with a credit card company arise.

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Endnotes

1 Linda J. Demaine and Deborah R. Hensler, " 'Volunteering' to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer Experience," *Law and Contemporary Problems* 67 (2004): 55, 63-64.

2 T. Eisenberg, G.P. Miller, E. Sherwin, "Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts," *University of Michigan Judicial Law Reform* 41 (2008): 871, 890.

3 California is the only state requiring arbitration providers to disclose arbitration results.

4 See the analysis at http://www.instituteforlegalreform.com/index.php?option=com_ilr_issues&issue_code=ADR&view=ilr_issue.

5 But consumer advocates say that less discovery makes it harder to prove a case against a big corporation.

6 D. Akers, J. Golter, B. Lamm, and M. Solt, "Overview of Recent Developments in the Credit Card Industry," *FDIC Banking Review* 17, no.3 (2005): 25.

7 T. Eisenberg, G.P. Miller, and E. Sherwin, "Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts," *University of Michigan Journal of Law Reform* (2007): http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1076968.

8 None of the aforementioned bills was passed during the 110th Congress, which ended on January 4, 2009. As a result, the bills have been cleared from the books and have not yet been reintroduced by their sponsors at the time of going to press.

9 The Federal Arbitration Act applies to international arbitration as well as domestic. International arbitration is predominantly used between companies—generally sophisticated parties of equal power who deliberately choose arbitration for dispute resolution. One of the main reasons for companies choosing this approach is that it enables them to avoid the unpredictability of a potentially biased foreign court. Additionally, international arbitral awards can be enforced almost anywhere in the world, thanks to a widely ratified international treaty, whereas there is no international treaty on the recognition of judicial decisions.