

Stacked Deck: **A Statistical Analysis of Forced Arbitration**

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May 2009



www.responsiblelending.org

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EXECUTIVE SUMMARY

Almost all credit card contracts with major issuers contain a hidden “forced arbitration” clause. Other loan contracts, such as auto loans, often require forced arbitration as well. Settling disputes through arbitration has been presented as an alternative to the traditional court system. Issuers of these clauses claim arbitration can save time and money, however, in many cases it does neither. Perhaps more importantly, when carefully analyzed, forced arbitration (FA) rulings can be extremely unfair, with little option for appeal. This is particularly the case when a lender inserts FA clauses into contracts, forcing consumers into arbitration rather than giving them their “day in court” before a jury of their peers.

A recent poll found that the practice of forced arbitration runs counter to what Americans feel is fair. American consumers believe they should have the right to legal recourse and decisions grounded in law.

Arbitration cases can be unfair not only because consumers have no choice in the matter, but also because prior results from Public Citizen research suggests that consumers may win only 4% of the time. The relationship as currently structured gives arbitration forums and arbitrators a strong incentive to side with “repeat players” that control the flow of ongoing business, rather than a consumer seen only once. In the credit card context as well as many other consumer transactions, it is very difficult to find a product without a forced arbitration agreement hidden somewhere in the fine print.

The Public Citizen report, *“The Arbitration Trap: How Credit Card Companies Ensnare Consumers,”* noted the trend towards unfair outcomes using descriptive data as well as qualitative information. This report subjects the same dataset, which consists mostly of credit card cases and was compiled by Public Citizen in 2007, to rigorous statistical analysis and indeed finds systematic bias in arbitration decisions.

The availability of useable data was limited to a single arbitration forum in the state of California, suggesting the need for better public reporting. While it could be argued that other forums may differ, this is of no comfort since the choice of eligible forums in forced arbitration clauses is typically dictated by the firms unilaterally creating these contracts and imposing them upon consumers. This report also includes results of an original survey regarding the use of arbitration in auto loans.

More specifically, this study finds:

Finding 1: Companies that have more cases before arbitrators get consistently better results from these same arbitrators.

This result remains after controlling for the specific arbitrator and the type of case, confirming that arbitrators do appear to favor companies that they expect to give future business. At the outset, the deck is stacked against consumers.

Finding 2: Individual arbitrators who favor firms over consumers receive more cases in the future.

This gives arbitrators a very strong incentive to side with firms because there is benefit to the bottom line.

Finding 3: Most consumers did not know whether their auto loan had forced arbitration, and those that did have FA paid higher rates.

When looking specifically at auto loan contracts, over two-thirds (68%) of consumers surveyed did not know if their auto loan agreement included FA clauses. Without knowing if the clause is even present, it would be impossible to negotiate it out of the contract's fine print. Arbitration also did not reduce the cost of lending as its supporters claim. In fact, people with forced arbitration in their contract paid a significantly higher rate.

Ironically, while auto dealers typically use FA clauses in their contracts with customers, these same dealers lobbied the federal government for The Motor Vehicle Franchise Contract Arbitration Fairness Act of November 2002, preventing auto manufacturers from requiring the use of FA to resolve franchise disputes with dealers.

The current system lacks accountability for companies that display a lack of responsibility for their actions through arbitration.

Policy Recommendations

Arbitration clauses are complex, typically buried in the fine print of a contract, and difficult for consumers to understand. Furthermore, since most data on consumer arbitration results is not publicly available, even a savvy customer has no way of knowing just how much a forced arbitration clause would affect their ability to get a fair hearing in the event of a dispute. Arbitration case records are typically not publicly available, leaving consumers with little ability to determine the fairness of an arbitration forum or the record of a specific arbitrator.

Congress should ban forced arbitration clauses from credit card and auto loan contracts. Arbitration should only be agreed to after a dispute arises, when both parties can choose freely whether it provides a better process for seeking a resolution to their conflict. If the decision to use arbitration is only able to be made after a dispute arises, this levels the playing field because arbitrators would be forced to satisfy both parties, not just the one who writes the contract.

Information regarding the results of arbitration of disputes needs to be made public.

Current California legislation requiring reporting of results is a good model. However, even here the data reported by some firms is virtually meaningless due to missing information. Even when data is present, results are provided in a way that renders collection labor intensive. Reporting should be mandatory and consistent in all states, in a manner that enables a consumer to make an informed decision to choose arbitration for dispute resolution at all.

Recommendations for Borrowers

While borrowers often have few options under current state or federal law, there are some steps they can take to counteract the hazards of forced arbitration:

Know that your rights are only as good as their enforcement: When evaluating the promises provided in any consumer contract, be aware that such promises may mean nothing if you cannot hold a company accountable in court. If your contract contains a FA clause, be aware of its impact, and try to protect yourself in other ways (such as not authorizing a lender to withdraw money directly from your bank account).

Opt-out up front if possible: When getting an auto loan at a dealership, it is sometimes possible to negotiate to eliminate the arbitration clause up front. Also, some credit card issuers may offer the right to “opt-out” of forced arbitration if you respond in the first 30 days. This right to opt-out is usually a secret to consumers because it is buried deeply in fine print, but is retained in some agreements so that the FA agreement reflects an appearance of a voluntary action by the consumer. Look for this opt-out option when you first get your loan contract and exercise your right to do so before it expires, most likely before the first month ends.

Realize that the forced arbitration clause may not always be binding: If you have a dispute with a lender that insists your only option is arbitration, know that it is possible that the arbitration clause may not be enforceable. You should contact an attorney knowledgeable about consumer law to discuss whether there may be some grounds for challenging the arbitration clause. In some circumstances, for example, some courts have found the clauses to be unconscionable

BACKGROUND

Most consumers feel secure knowing that they have certain legal protections against harm in using a credit card account. For example, cardholders generally feel reassured knowing that they are protected from liability in cases of fraud or identity theft for amounts above \$50, or that their payments will be credited correctly and on time. But those protections are only as good as the legal system's enforcement, and borrowers are often unaware they lack access to the courts if a credit card issuer ignores fraud and identity theft rules. Instead, the customer must settle the dispute in an arbitration forum, which adheres to its own rules and where consumers may have only a 4% chance of winning.¹ This is just one of many potential situations where consumers often do not realize how vulnerable they are due to the forced arbitration clause in their contracts. As described in examples from Public Citizen's report *The Arbitration Trap*, even evidence of fraud or a personal history of never having opened a credit card account can be inadequate when a consumer is held responsible for credit card charges against a stolen card in an arbitration forum.²

Almost every major credit card issuer includes a FA clause in the fine print of the credit card agreement. These clauses are also almost universal in auto loans, according to anecdotal reports.³ While defenders of FA sometimes claim that industry would have trouble surviving without these clauses, the truth is that they have only proliferated in the last ten years, and the consumer lending business had been quite profitable for lenders even before FA became commonplace.

CRL has noted in the mortgage arena that repeat players in arbitration have an edge over "newcomer" consumers. Equally concerning is the connection between arbitration forums and their corporate clients, who serve as directors and members of the very forums that resolve their disputes with consumers. By 2004, both Freddie Mac and Fannie Mae stopped investing in subprime mortgages containing mandatory arbitration clauses, virtually ending the practice in home loans.

The arbitration process has been presented as an alternative to the traditional court system that can save time and money, however, in many cases it does neither. It can be extremely unfair in its rulings, with little option for appeal.⁴ This is particularly the case when a company inserts forced arbitration clauses into its contracts, forcing consumers to use the arbitration process rather than having their case heard in court. These cases can be particularly unfair not only because consumers have no choice in the matter, but also because the company has the power to select the arbitration forums and arbitrators they will use in large numbers of transactions. These arbitration forums and arbitrators have a strong incentive to side with a firm that controls the flow of ongoing business, rather than a consumer who they will see only once, since their livelihood depends on this repeat business.

Consumers Lack Rights in Binding Mandatory Arbitration [Forced Arbitration]: Snapshot of BMA [FA] Versus the Courts

In Court

- **Service of process required:** Due process requires actual notice through an official process server to initiate a claim.
- **Neutral decision-maker:** Jury of peers or impartial, publicly employed judge with public record of decisions.
- **Open, public process** that sets precedent.
- **Due process rights to fair and reasonable discovery of information;** hearings and motions filed at little or no cost.
- **Contingency fee system,** generally in negligence cases or product liability cases, means plaintiffs' attorneys, not consumer-plaintiffs, take on financial risks for duration of case.
- **Right to appeal a loss on the merits** of the case or other grounds.

In Binding Mandatory Arbitration [Forced Arbitration]

- Certified mail with signed receipt or by private carrier with receipt signed by "person of suitable age and discretion" deemed sufficient notice for arbitration even though many consumers remain unaware of cases pending against them.
- Biased decision-maker: Arbitrator chosen from a limited panel and paid by an arbitration provider selected and compensated by the company; no public record of prior decisions generally available to consumers.
- Closed, secretive process without public record or precedential value.
- Little discovery, at discretion of arbitrator. Other due process rights must be paid for on an à la carte basis.
- Pay-to-play payment system means individual must shell out costs up-front at every twist and turn in case; Loser pays rule may further financially burden consumers when imposed.
- Very limited grounds for appeal, typically limited to fraud or corruption of arbitrator, unconscionable clause or contract, or failure of company to prove that consumer agreed to BMA [FA].

Thanks to Public Citizen for the use of this information.

Besides evidence of biased decisions, arbitration forums limit other rights that normally exist in the traditional legal system. The arbitration forum typically limits the discovery process, during which the company would be forced to turn over evidence relevant to the case. This makes it difficult for consumers to obtain proof of wrongdoing, particularly when a systematic pattern may exist, such as if a lender manipulated late fees across a large number of accounts or illegally discriminated against groups of borrowers. Arbitration clauses can waive the borrower's right to pursue class action lawsuits. Class action suits may be the only cost-effective remedy to address abuses but where the amount involved for each consumer is small enough to make individual lawsuits economically unfeasible (such as a credit card issuer improperly charging fees). Arbitration does not make these small lawsuits any more economically feasible; in fact, arbitration typically costs more money than the public court system for people seeking to hold a lender accountable. Arbitration may also prevent consumers from an appeal of their case. These and other potentially harmful consequences of FA are discussed in more detail in two reports from Public Citizen, *The Arbitration Trap* and *The Arbitration Debate Trap*.⁵

CRL advances Public Citizen's research by performing sophisticated statistical analysis on the same data. This report subjects the same dataset, which consists mostly of credit card cases and was compiled by Public Citizen, to rigorous statistical analysis and finds systematic bias in arbitration decisions. While the prior work by Public Citizen has provided important insight into the nature of forced arbitration, it has been criticized by a set of industry-backed reports.⁶ A subsequent report by Public Citizen shows the self-serving, biased and inaccurate nature of the industry response. However, our report uses statistical techniques that negate any remaining criticisms of the original research, confirming Public Citizen's general conclusions. This report also looks at new survey data regarding arbitration in auto loans.

Data Used in This Study

Arbitration rulings are typically kept secret. However, a law passed in California required arbitration forums to disclose the results of their cases involving consumers starting in January 2003. Public Citizen compiled data on about 34,000 cases between 2003 and 2007. All cases were conducted by the National Arbitration Forum (NAF). While there is incomplete information in some of NAF's data, the only public data from other arbitration forums in California has even larger gaps.⁷ For example, Public Citizen reviewed data from the American Arbitration Association (AAA) and found that they could determine which party prevailed in only 7% of cases.⁸ As a public service, Public Citizen has made its excel dataset publicly available. This study relies on that public data. However, the accuracy of the dataset was verified by checking 100 randomly selected records compared to the original NAF dataset, with no errors being found.⁹ We added new variables for statistical analysis, such as running cumulative success rates for each arbitrator and company using all public history to date, and we reaggregated data to get results for arbitrators over a period of time.¹⁰

The vast majority of cases in the data involve credit card debt. The bulk of the data comes from two issuers, with MBNA cases representing 43% of the dataset, and Chase Bank, 19%. The combined total of 62% of the results comes from these two issuers.¹¹ Although there were cases from a number of other sectors, the majority of the remaining cases also originated from the financial industry, or collection agencies working on their behalf. Over 99% of the cases in the NAF data were labeled as “collection” cases.¹²

It is important to note that all of the data analyzed in this report represents arbitration cases that involved a consumer. There have been prior studies that statistically analyzed arbitration cases for a “repeat player effect” where parties who repeatedly go before an arbitrator receive more favorable outcomes,¹³ with the aggregate conclusion of this literature being somewhat open to interpretation.¹⁴ However, none of the prior studies have reflected consumer cases, the vast majority of which addressed collections issues. This is noteworthy since consumers are in a uniquely weak position in contract negotiation for services such as obtaining a loan. Even when a consumer can shop for loans, they typically cannot renegotiate the key terms of the standard contract. They have no choice or control over which arbitration forums can be used in a forced arbitration clause. Furthermore, borrowers often are not aware of these clauses in their contracts, and even when they are, they have little knowledge of the impact of these terms on the fairness of outcomes.

Additional data on FA clauses in auto loan contracts was obtained from an original survey commissioned by the Center for Responsible Lending and conducted by Macro International as part of its regular CARAVAN® survey. The survey was conducted among a national probability sample of 1,007 adults. A more detailed description of the survey data is contained in the appendix.

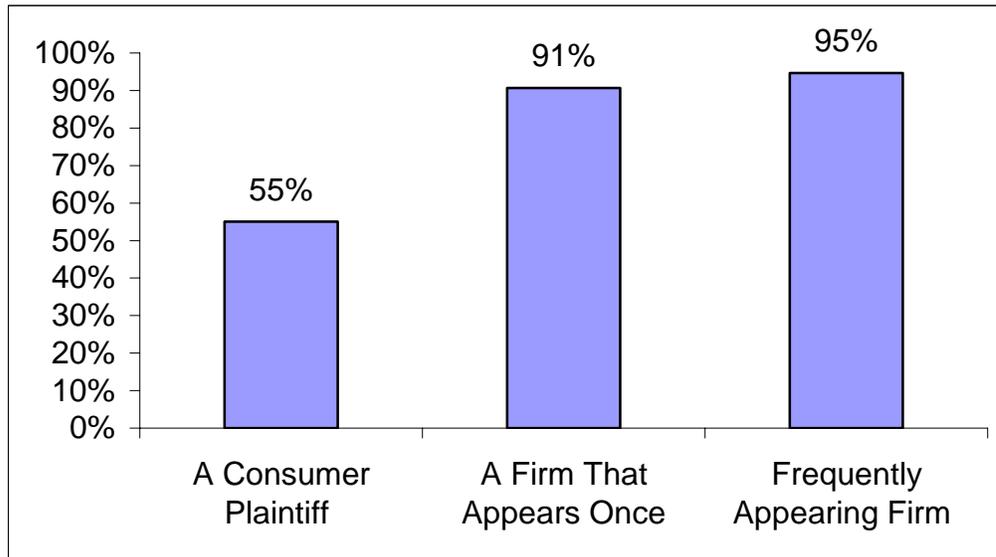
Finding 1: Companies that have more cases before arbitrators get consistently better results from these same arbitrators. This result remains after controlling for the specific arbitrator and the type of case, confirming that arbitrators do appear to favor companies that they expect to give them future business.

For each case going into arbitration, the number of prior cases brought by that particular company was tabulated and divided by the number of weeks of history available. This results in a historical frequency of how many cases per week a company brought before the arbitration forum. From the arbitration forum’s perspective, this can be considered a measure of how valuable a client each company using arbitration has been.

Success in arbitration was tabulated based on the amount awarded to the plaintiff as a percent of the amount requested to eliminate any arbitrariness in defining who “won” a case that results in a reward less than 100%.

Firms that had a history of bringing frequent business to an arbitration forum tended to get better results, with each case per week a firm brings to the arbitration forum resulting in monetary awards that are 4 percentage points higher (as a percent of the amount requested). An even bigger difference was found between consumer plaintiffs and firm plaintiffs after controlling for the type of case. For collection cases, a consumer plaintiff on average receives a 36% lower amount than a firm plaintiff before accounting for how frequently the parties had appeared in court.¹⁵ Figure 1 shows results from the analysis for an average consumer, a firm who appears once, and a frequently appearing firm (such as MBNA).

Figure 1: Award Amount as Percent of Amount Requested in a Collection Arbitration Case



Part of the difference between a consumer plaintiff and a firm plaintiff could arguably be due to less compelling cases, inexperience or unrealistic award expectations. However, there is equal reason to believe that a consumer would not go through the unfamiliar and potentially costly arbitration process unless they had a particularly strong case. The

statistically significant difference still exists if the dependent variable is changed to focus on the dollar amount of the award instead of the percent of the requested amount, refuting the possibility that the result is due to consumer plaintiffs tending more frequently to overstate their damages. The fact that frequent appearances made a difference for firms is an indicator that none of these alternatives can fully explain the statistical results.¹⁶

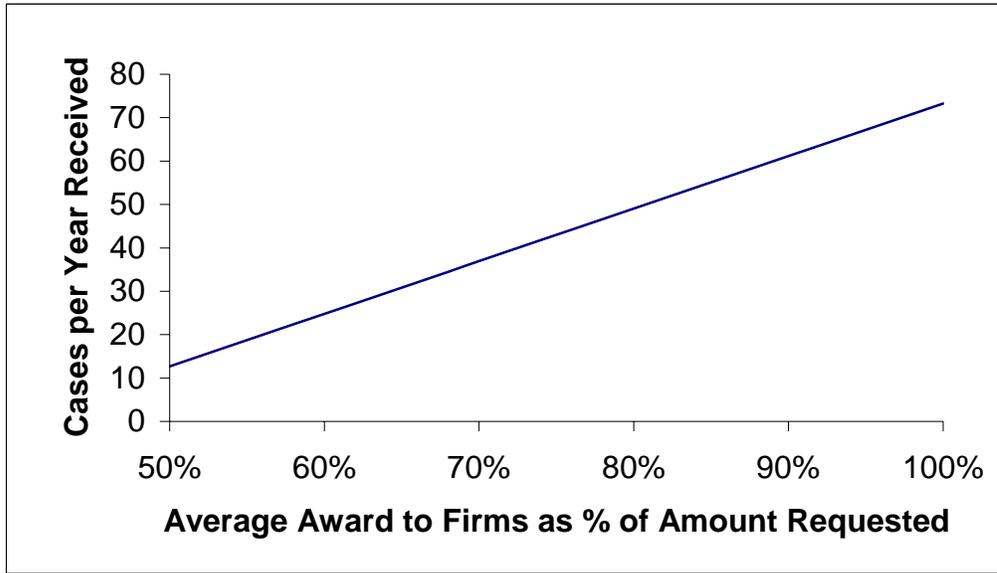
One potential explanation for the results is that the most experienced firms were simply superior at selecting favorable arbitrators. However, the results shown here include only the 28 arbitrators who had the most cases, and variables were added to account for the individual arbitrator.¹⁷ Therefore the results shown here are not due to the selection of the arbitrator. Instead, the **results show that firms with more experience (and firms in general compared to consumers) get better results with the same arbitrator.**

Finding 2: Individual arbitrators who favor firms over consumers receive more cases in the future. This gives arbitrators a very strong incentive to side with firms.

While Finding 1 shows evidence of bias, Finding 2 provides statistical evidence that there is an incentive for arbitrators to render biased decisions*. It has been reported that some arbitrators who side with consumers too often or for too large an amount soon find themselves without any cases.¹⁸ In testimony before the United States Senate, Harvard law professor Elizabeth Bartholet alleges that her future cases were removed when she decided for the first time to rule in favor of a consumer in a dispute with a credit card company.¹⁹ Arbitrators have a strong incentive to favor firms over consumers if they want to continue to earn a living as an arbitrator. It is difficult to see how the arbitration process could possibly be fair if arbitrators lose future cases for siding with consumers. However, up to this point, the reports have been purely anecdotal. By looking at the number of cases arbitrators received during each semi-annual period and then looking at their cumulative record up to that point, we were able to confirm these anecdotes statistically.

Specifically, the money awarded to firms was expressed as a percentage of the money firms had sought in that case, and then averaged up to the current period.²⁰ CRL found that arbitrators that have a history of giving larger awards to firms receive more new cases in the current period, (where the current period is defined by cutting the data into six month intervals).²¹ If Arbitrator A has an average amount awarded to firms that is 10% higher (as a percentage of the amount requested) than Arbitrator B, then Arbitrator A will get 12 more cases per year than Arbitrator B. This result was statistically significant at the 99.9% confidence level. The same result held when credit card companies alone were considered, or when MBNA alone, the most common plaintiff in the database, was considered. The results were also robust to changing the structure of the statistical model.²²

Figure 2: The Payoff to Arbitrators for Business-Friendly Decisions



The statistical analysis was run for both history at the individual firm level and for the history of each arbitrator with all firms globally. Interestingly, while the cases an arbitrator receives from a given firm are significantly related to their record with that particular firm, the number of cases received from that firm is more strongly related to the overall record of the arbitrator.²³ In other words, which arbitrators get more cases with a firm depends on how cases with all firms have turned out, not just the cases with that particular firm. Both parties in a dispute may have some direct say in which arbitrator is chosen, but unlike a consumer who has no useful information about arbitrators, a firm with a history in a forum could easily track the record of each particular arbitrator with them and may be able to select the arbitrator that has been most favorable to them. But the results here suggest that while this may occur, there is more to this increased number of cases received by business-friendly arbitrators. It appears that either information is being shared across firms, that the arbitration forum is sharing information on arbitrator record with the firms purchasing their services, or that the arbitration forums themselves are selecting business-friendly arbitrators to receive the majority of cases.²⁴ Otherwise, an arbitrator's record with a particular firm would be a better predictor of how often that arbitrator is selected by that firm. However, here it was found that an arbitrator's over all record was a better predictor.

All of these may be true to some extent. This would suggest a deeper problem than an advantage from personal experience on the part of companies who go repeatedly into arbitration. It suggests that in addition to having generally business-friendly arbitrators and having personal experience with the process and the arbitrators, companies that are good clients are given extra help to make sure the odds are tipped even further in their favor.

Previous studies on the repeat player effect have looked at the impact of a firm having more cases arbitrated on the win rate, while Finding 2 addresses something different. In particular, this finding suggests strongly the cause for differences in “win” rates. It shows that arbitrators have a strong motive to actively favor firm interests over consumer interests that has nothing to do with alternative explanations for repeat player effect such as increased expertise in firms that bring many cases into arbitration.

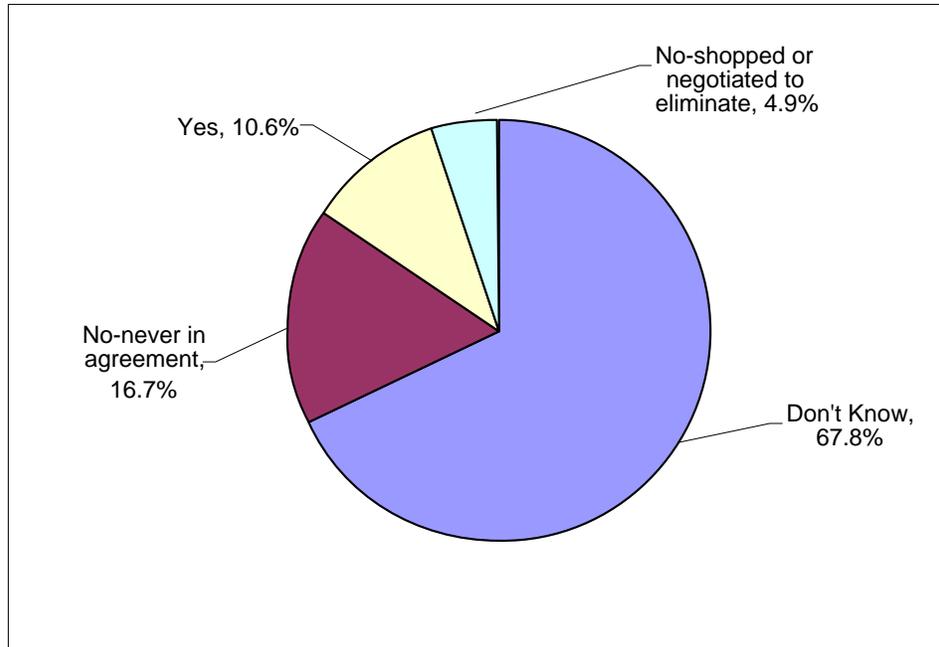
Finding 3: Most consumers did not know whether their auto loan had forced arbitration, and those that did have FA paid higher rates.

Ironically, while auto dealers typically use FA clauses in their contracts with customers, these same dealers lobbied the federal government for The Motor Vehicle Franchise Contract Arbitration Fairness Act of November 2002, preventing auto manufacturers from requiring the use of FAs to resolve franchise disputes with dealers.²⁵

The prevalence of FA in auto loans may be understated when using survey data because these clauses are typically buried in the fine print of the contract. Looking specifically at auto loan contracts using survey data,²⁶ over two-thirds of consumers (68%) stated that they did not know if their contract had a FA clause after this clause was described to them. Five percent of people stated that they successfully negotiated or shopped to eliminate the clause and 11% of people are aware that there is such a clause in their agreement. An additional 17% of consumers who got an auto loan from a dealership stated that there was never an arbitration clause in their loan agreement. However, typically these agreements are in fine print that often goes unnoticed by the consumer. In addition, there is anecdotal evidence that it may be very difficult to find a loan from a dealership without a forced arbitration clause.²⁷

Conversations with experts familiar with these contracts suggest that many of the people who thought there was no arbitration in their contract likely were mistaken. While the 5% who specifically stated that they shopped or negotiated to eliminate the arbitration clause must have been aware of the clause, it is quite likely that many of the 17% who stated it was never in their contract simply never noticed the arbitration clause. If this is true, then the percentage of people who have such a clause in their contract and do not realize it may be closer to 84% (with an additional 11% knowing they have such a clause, and only 5% not having an arbitration clause).

Figure 2: Percentage of Consumers Accepting Loans with Forced Arbitration



The sample size of people who were aware that their contract was subject to FA is small (28 consumers). However, 27% of this group stated that they actively tried to avoid the forced arbitration clause by either shopping for better loan terms or negotiating this aspect of the contract with their dealer. Since this group all ended up with a forced arbitration clause, presumably they were unable to shop or negotiate their way out of it.

Consumers who did not know whether their loan contained a forced arbitration clause were also asked hypothetically how they would react if they knew at the time of sale that such a clause were in their loan. About half (49%) indicated that they would either shop or try to negotiate for better terms that excluded FA. Only about 8% of people reported that they actually did attempt to negotiate, consistent with the premise that most car buyers are unaware that they would be subject to forced arbitration.²⁸

Supporters of forced arbitration claim that avoiding the court system saves the lenders money which trickles down to the consumer in the form of lower interest rates. However, just the opposite turns out to be the case. **Average non-incentive loan rates were higher for contracts that included a forced arbitration clause.** Several multiple regression models were run, which are summarized in Table 1. Risk was accounted for in all models, and income was added as an additional risk factor in one. Some regressions exclude APRs below 5% since they probably indicate the presence of factory incentives. As discussed previously, some people who thought their loan never included FA may have been mistaken. Therefore, for people without FA, two regressions include only the 5% of people who specifically shopped or negotiated to eliminate it. All five regressions show a higher average APR for FA. Two of these are not significant, but this is not surprising given the small sample size in these regressions.²⁹ Among the 3 of 5 regressions with a significant coefficient, having FA in the contract raises the APR 2.1 to 2.5 percentage points after controlling for risk. **Perhaps most importantly, in none of**

these regressions was FA associated with a lower APR for consumers. Despite claims of saving money over the court system, any savings from FA are obviously not passed down to the customer, but instead pocketed by the dealer and lender.

Table 1: The Impact of FA on Interest Rate

	Model 1	Model 2	Model 3	Model 4	Model 5
Dependent Variable	APR (any)	APR (any)	APR (any)	Non-Incentive APR	Non-Incentive APR
Arbitration Variable Definition					
All people with definitive answer	---	2.12 (1.07)*	2.18 (1.08)*	2.51(1.20)*	---
"No" includes only those who shopped/negotiated	1.28 (2.16)	---	---	---	.042 (2.70)
Credit risk factors					
Income	---	---	-0.21 (0.26)	---	---
Credit rating	2.74 (1.21)*	1.94 (0.62)*	1.85 (0.63)*	1.19 (0.66)	0.75 (1.48)

Note: First term is regression coefficient, term in paranthesis is standard error

* Significant at 95% confidence level

In addition to having a higher APR, borrowers with FA tend to have more questionable practices in general in their loan terms. This was determined using a “questionable practices scale” described further in the Appendix (including definitions of these practices). In particular, loans with FA tend to have more controversial traits such as a yo-yo, multiple add-ons, and a higher APR given the individual’s risk.

While the higher rate and more questionable practices for contracts with forced arbitration was not consistent with what proponents of arbitration state, it is consistent with a model of lending in which questionable practices tend to be clustered together in transactions involving particularly aggressive lenders or vulnerable buyers. Overall, analysis of our survey results also demonstrates that the appearance of one of four auto loan abuses has a high correlation with the appearance of other abuses in the same loan (this is discussed further in the Appendix). This implies that dealerships will pile on the questionable terms, either because a borrower is vulnerable, the dealership is aggressive and manipulative, or both.

CONCLUSIONS

The results of this research show new and compelling evidence of anti-consumer bias in forced arbitration.

Prior research using California data has shown that arbitrators decide in favor of firms over individual consumers 94% of the time.³⁰ While this seems to suggest an imbalanced process, critics argue that this is not persuasive since the majority of this database consists of firm debt collection cases and therefore they claim do not present a great deal of controversy.³¹ But our statistical analysis finds evidence that bias clearly exists even within collection cases brought by firms, with firms that bring the most business into arbitration forums getting consistently better results. Furthermore, we find that arbitrators who decide in favor of firms get more cases in the future, which also cannot be explained by the high prevalence of collection cases. The ability to control for various factors statistically also eliminates the need to directly compare to the traditional court system, since we can detect patterns within the dataset of arbitration cases.

Other arguments previously made – the database is primarily debt collection cases and is limited to one particular arbitration forum in California also – do little to detract from the importance of the results. The data shows that most consumer arbitration cases (at least for National Arbitration Forum in California) are from debt collection cases. Furthermore, we have no objection to limiting the scope of our conclusions to the consumer lending and debt arena. Regarding the data being limited to a single arbitration forum in California, we urge that complete data on all forums should be made publicly available nationwide. However, we see no reason to believe that California is unique in the existence of bias (if anything, arbitration forums in California would make an effort to be more objective given the state’s disclosure requirements). And while it is possible that NAF is more biased than some other arbitration forums, this is of no comfort. The choice of eligible forums in forced arbitration clauses is normally dictated by the firms unilaterally creating these contracts and imposing them upon consumers. If the arbitration market is competitive, standard economic theory would suggest that other arbitration forums would have to behave similarly to NAF in order to retain firm clients.

The results also show that most auto loan purchasers are unaware that they have a FA clause in their contract. Additionally, auto loans with FA clauses have a higher interest rate than those that do not. This is in direct contradiction to the claims of lenders and dealers that FA reduces costs and that these savings are passed on to consumers.

Policy Recommendations

Arbitration clauses are complex, typically buried in the fine print of a contract, and difficult for consumers to understand. Since most data on consumer arbitration results is

not publicly available, even a savvy consumer has no way of knowing just how much a forced arbitration clause affects their ability to get a fair hearing in the event of a dispute.

Congress should ban forced arbitration clauses from credit card and auto loan contracts.³² If the arbitration process truly has all the advantages that the industry claims, then arbitration forums should be able to successfully attract parties to a dispute without making participation mandatory for a party with little power to negotiate this clause out of a contract up front. Simply making the process voluntary would in itself cause the process to become fairer, since arbitration forums would have more of an incentive to appear objective. If the decision to use arbitration is determined after a dispute arises, arbitrators would be forced to satisfy both parties, not just the one who writes the contract, thus leveling the playing field.

Information regarding the results of arbitration of disputes needs to be made public. The California legislation requiring reporting of results is a good model. However, even in California the data reported by some forums is virtually meaningless due to missing information. Even when data is present, results are provided in a way that makes collection labor intensive. Reporting should be done in all states, and in a way that allows a consumer to make in an informed decision with a reasonable amount of effort on whether to choose arbitration at all. And, and if arbitration who to choose when options are presented. This information policy is particularly important now that one-sided arbitration contracts are binding. But even if forced arbitration is banned, information on case results would be necessary for consumers to make informed decisions whether to voluntarily participate in the arbitration process. If by being more efficient FA is truly the win-win situation for all parties that the arbitration forums claim, then information sharing will only serve to bring in voluntary clients. An alternative dispute resolution process that is both fair and cheaper than court should be able to thrive under a voluntary selection system where information regarding results and costs are mandated by a disinterested third party.

Recommendations for Borrowers

While borrowers often have few options under current law, there are some things they can do to counteract the hazards of forced arbitration:

Know that your rights are only as good as their enforcement: When evaluating the promises in any consumer contract, be aware that such promises may mean nothing if you cannot hold a company to their agreement in court. If your contract contains a forced arbitration clause, be aware of its impact, and try to protect yourself in other ways (such as not authorizing a lender to withdraw money directly from your bank account).

Opt-out up front if possible: When getting an auto loan at a dealership, it is sometimes possible to negotiate to eliminate the arbitration clause up front. Also, for some credit card contracts, you may have the right to “opt-out” of forced arbitration if you respond in the first 30 days. This right to opt-out is usually buried deeply in fine print and rarely known to consumers, but is retained in some agreements so that the forced arbitration agreement retains a façade of being a voluntary choice. Look for this opt-out option when you first get your loan contract and exercise your right to do so before it expires.

Realize that the forced arbitration clause may not always be binding: If you have a dispute with a lender that insists your only option is arbitration, know that it is possible that the arbitration clause may not be enforceable. You should contact an attorney knowledgeable about consumer law to discuss whether there may be some grounds for challenging the arbitration clause. In some circumstances, for example, some courts have found the clauses to be unconscionable

APPENDIX: Data description and statistical models

Data for Findings 1 and 2 was downloaded from Public Citizen’s publicly-accessible dataset of arbitration cases in California by the National Arbitration Forum. For Finding 1, each case with a resolution was a data point, and the prior history for a particular company was compiled up to the start point of the case in question to get an estimate of how much business that company had brought to the arbitration forum (in terms of cases per day). Table 2 below shows results of the regression model discussed in the report, with the dependent variable being the award amount as a percentage of the amount requested.

Table 2: Regression for Finding 1

	Constant	Historical Cases/Day by Firm	Collection Case w/Firm Plaintiff Dummy	Collection Case w/Consumer Plaintiff Dummy	Arbitrator with High Case Volume (100+)
Beta Coefficient	40.97*	0.60*	49.6	14.11*	0.04
Standard Error	1.28	0.01	1.28	1.42	0.10

* Significant at 99.9% confidence level

Data for Finding 2 was reaggregated by period and arbitrator, using semi-annual periods. For each data point, the prior history of the arbitrator in terms of amount awarded to firms when deciding cases and in terms of average fees charged to firms was calculated. In the regression results shown, data points with insufficient history (less than 10 prior cases) were discarded. However, results are similar when this screening is removed. The dependent variable in the regression is the number of cases received by the arbitrator per period. As Table 3 shows, arbitrators are chosen more frequently if they have a more business-friendly history in terms of award amounts. Arbitrators who charge lower fees to firms also get more cases.

Table 3: Regression for Finding 2

	Constant	Average Fee Charge to Firms	Average Award to Firms (as % of Amount Requested)
Beta Coefficient	-23.88	-0.02*	0.61*
Standard Error	14.07	0.00	0.15

* Significant at 99.9% confidence level

All variables used for statistical analysis in the auto loan survey (Finding 3) came from a telephone survey commissioned by the Center for Responsible Lending. The survey was conducted among a national probability sample of 1,007 adults (505 men and 502 women 18 years of age and older) living in private households in the continental United States. Interviewing for the survey was completed during the period November 21-24, 2008.

Of people taking the survey, 81% owned a car or truck. White consumers were significantly more likely to own a vehicle than African-American or Latino consumers. About a quarter of the survey population (27%) used a loan at the dealership to purchase their car or truck. The remainder of the survey focused on this subpopulation, leaving a sample size for these questions of 268 respondents (with a smaller sample size used for analyses involving questions where some respondents chose not to answer).

The survey was conducted by Macro International as part of its regular CARAVAN® survey. All CARAVAN interviews are conducted using Macro International's computer assisted telephone interviewing (CATI) system. Macro International utilizes an unrestricted random sampling procedure that controls the amount of serial bias found in systematic sampling to generate its random-digit-dial sample. The sample is fully replicated and stratified by region. Only one interview is conducted per household. Unlike published directories, the probability telephone sample includes both unlisted numbers and numbers issued after publication of the directories. All sample numbers selected are subject to up to four attempts to complete an interview. Completed interviews are weighted by four variables: age, sex, geographic region, and race, to ensure reliable and accurate representation of the total population, 18 years of age and older. The raw data is weighted by a custom designed program which automatically develops a weighting factor for each respondent. All regressions shown in this report are for weighted results.

A cut-off of 5% was used to come up with a non-incentive APR. In the first half of 2008, the average rate for borrowers with a credit score above 720 (the highest category) was 6.1%, making it unlikely that many unsubsidized (by the manufacturer) loans have rates lower than 5%.³³

In order to test the apparent result that questionable loan terms are associated with other questionable terms in loans, a 4-point "controversial practices scale" was created. The controversial practices scale consisted of four items, each with a value of 0 or 1, with a 1 indicating a controversial practice. The factors are high APR (relative to others of the same risk), the presence of forced arbitration, yo-yo scams, and having 2 or more add-ons.³⁴ Add-on products, which often offer little value relative to the cost charged by the dealership, include "gap" insurance (designed to protect the buyer when the vehicle is destroyed or stolen and the value of the car is less than the remaining loan amount), vehicle service contracts, credit life and disability insurance, and theft deterrent packages. In a "yo-yo" scam, the buyer is unwittingly placed in a conditional sale agreement rather than a final sale. After they drive the vehicle home, the dealer claims to be unable to fund the loan at the agreed-upon terms. The customer is required to return the car and renegotiate—often without any option of getting back either all of their down payment or traded-in car. An individual item in the scale having a value of "1" may not necessarily mean a loan is exploitative (for example, having 2+ add-ons). However, when these factors are taken as a whole, a high number on the scale is suggestive that the practices involved in a loan may be more questionable. The scale sums a value of 0 or 1 for each of the 4 factors. For the controversial practices scale, high APR was defined using a

regression with three risk factors: self-reported credit score risk category, income, and renter vs. homeowner. A high APR loan was defined as one that has an APR at least one percentage point above the APR that would be expected from these risk factors. This was done using a residual value of 1 or more from a multiple regression. Four add-on products were included in the survey, with more than one add-on being considered suggestive of a loan with controversial practices.

While we feel our interpretation of the results is the most likely cause of the statistical results, it should be noted that any survey has the potential for bias. This bias becomes more important if it can be a source of correlation between individual questions. For example, if people have a tendency to either believe or state their situation is more positive than it is, they may indicate their credit rating is better than it is, their income is higher than it is, and also indicate their APR is lower than it is. This would cause an appearance in this case of risk based pricing even if there was not any. This could also affect the finding that controversial practices are correlated with each other, since people who are more honest about experiencing one practice may also be more honest about experiencing others. On the other hand, optimistic responses will also tend to reduce the stated prevalence of controversial practices. Forced arbitration, unsuccessful and other adverse indicators may be more common than the survey results suggest. Lack of knowledge may also play a role in survey interpretation.

Table 4 shows the correlation of each item with the scale, after eliminating that individual item from the scale. All of the numbers are positive, implying that each item moves in the same direction as the rest of the scale.³⁵ All of the items are also statistically significant at the 95% confidence level or greater. This suggests that each individual practice is more likely to occur in loans with other questionable practices. In particular, loans with FA tend to have more controversial practices in terms of being a yo-yo loan, including multiple add-ons, and having a higher APR given the individual’s risk.

Table 4: Correlation between Questionable Loan Practices and "Controversial Practices Scale"

	Loan with High APR for Risk*	Included Binding Mandatory Arbitration	Had Yo-Yo Loan	2+ Add-ons
Exploitation Scale**	0.20****	0.012***	0.19****	0.15***

* Defined by loan with APR at least 1 percentage point higher than average for customers with same risk.

** Sum of all four factors (0 or 1 for each) less the factor used in comparison.

***Statistically significant at 95% confidence level

****Statistically significant at 99% confidence level

NOTES

¹ John O'Donnell, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, Public Citizen (2007), available at <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

² Throughout this document, there are two types of companies discussed: (1) the lenders and other companies with a dispute that bring their cases into arbitration, and (2) the arbitration firms. To reduce confusion, throughout this document “firm” or “company” is used to refer to lenders and other corporate plaintiffs/defendants in a dispute, and “forum” is used to refer to the arbitration firms.

³ Stephanie Mencimer, *Suckers Wanted: How Car Dealers and Other Businesses are Taking Away Your Right to Sue*, in *Mother Jones* (November 26, 2007); and Stephanie Mencimer, *The Quest for a Car, Sans Arbitration Clause*, in *Mother Jones* (December 14, 2007).

⁴ In fact, the Supreme Court has stated that even if a ruling in arbitration is just plain “silly,” this still is not grounds for overturning it in the public court system. *Major League Baseball Players Assn. v. Garvey*, 532 U. S. 504 (2001) (per curiam) 532 U.S. 504, 509 (2002).

⁵ John O'Donnell, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, Public Citizen, (2007), available at <http://www.citizen.org/documents/ArbitrationTrap.pdf>; and Taylor Lincoln & David Arkush, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration*, Public Citizen, (2008), available at <http://www.citizen.org/congress/civjus/arbitration/articles.cfm?ID=17199>.

⁶ Such as Peter B. Rutledge, *Arbitration - A Good Deal for Consumers: A Response to Public Citizen*, Chamber of Commerce Institute for Legal Reform, (2008).

⁷ These large gaps exist despite the fact that California law requires the reporting of results of arbitration disputes between firms and consumers.

⁸ Taylor Lincoln & David Arkush, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration*, Public Citizen (2008), available at <http://www.citizen.org/congress/civjus/arbitration/articles.cfm?ID=17199>.

⁹ As required by California law, the original data from NAF is also publicly available. However it is available only in a series of large PDF files, making compiling data awkward and labor-intensive without Public Citizen's efforts.

¹⁰ Results for time-aggregated data here use a semi-annual period, but quarterly and annual periods were also tested yielding similar results.

¹¹ While it is likely that the majority of the cases from MBNA and Chase Bank are credit card cases, the data do not allow us to determine whether some of these cases are from other types of loans. Included in these totals are entities that later merged into one company (for example, Washington Mutual cases for Chase Bank) as well as collection firms that are specifically working as an assignee of Chase or MBNA. Totals for MBNA and other firms vary from the original Public Citizen report because percentages discussed here are from records that contain all the information needed for analysis (such as an outcome).

¹² While most of the cases in the database were collection cases from MBNA and Chase, this does not mean that all credit cards routinely go through the arbitration process when they intend to legally enforce collections claims. At least one major issuer has informed us in a personal communication that they go directly to the public court system for collections cases rather than using FA for this purpose.

¹³ Much of this literature focuses on labor contracts, for example, see Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, *McGeorge Law Review* (Winter), (1998). A few studies focus on areas such as internet domain licensing, for example, Michael A. Geist, *Fair.com?: An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, SSRN (August 2001).

¹⁴ In Peter B. Rutledge, *Arbitration - A Good Deal for Consumers: A Response to Public Citizen*, Chamber of Commerce Institute for Legal Reform, (2008), Rutledge argues that the evidence does not show a repeat player effect or that in cases where such a repeat player effect exists it is due to factors outside of bias. However, Taylor Lincoln & David Arkush, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration*, Public Citizen, (2008), available at <http://www.citizen.org/congress/civjus/arbitration/articles.cfm?ID=17199>, makes a more convincing case that Rutledge's interpretation of the prior literature is inaccurate and that the evidence for a repeat player

effect is quite strong. As stated in the text, debates on this prior literature are of limited relevance here since they do not concern consumer cases.

¹⁵ Both the increased success rate for frequent plaintiffs and the difference between consumer and firm collection plaintiffs were statistically significant at the 99.9% confidence level.

¹⁶ While it could be argued that firms with a smaller number of cases have less expertise, there is no reason these firms (which tended overall to be large firms even if they had fewer cases) could not outsource for legal counsel with the same level of expertise in the arbitration process as the firms that are frequent plaintiffs. In fact, according to standard economic theory, this is what we would expect to happen.

¹⁷ Only arbitrators who had decided more than 100 cases were included in this analysis. Ninety percent of cases were decided by these 28 arbitrators. The results of the regression were similar when all arbitrators were included. The results shown here also exclude cases from the first year since a dynamic case frequency for a company up to a given point in time is used. For the first year, the frequency of a company bringing a case to arbitration has a large component of random error. However, the conclusions of this study would not change if regression results including all data were reported.

¹⁸ John O'Donnell, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, Public Citizen, (2007), available at <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

¹⁹ Elizabeth Bartholet, *Hearing before the United States Senate Committee on the Judiciary: "Courting Big Business: The Supreme Court's recent decisions on Corporate Misconduct and Laws Regulating Corporations,"* (July 23, 2008), Washington DC, available at <http://judiciary.authoring.senate.gov/hearings/testimony.cfm>.

²⁰ Awards with consumer plaintiffs were inverted to get a scale that was consistent in direction. For example, if a firm was the plaintiff, asked for \$10,000 and received \$9,000, the value on the scale was 90.0%. On the other hand, if a consumer was the plaintiff, asked for \$10,000 and received \$9,000, the value would be $100.0-90.0=10.0\%$. This leads to an average number where the higher the number, the more favorable the result to business regardless of who the plaintiff was.

²¹ Results were very similar when the period was either lengthened or shortened. Although periods were defined in six months intervals in the results reported, the change is stated in cases per year for ease of interpretation.

²² For example, results were robust to changing the dependent variable to a dollar award amount or a chance of winning, to changing the period over which data is aggregated, to changing additional variables in the model, and to screening the data. For the results discussed above, the data was screened to only include periods where there was at least 10 historical cases to get an accurate record for the arbitrator, and the additional explanatory variable of the amount of average historical business fees charged by the arbitrator is included in the model. Arbitrators that charge businesses more fees were also found to get chosen less frequently, with a \$100 increase in fees being associated with 3 less cases in the following year.

²³ This finding is based on separate regressions of firm-level vs. global-level arbitrator records as an explanatory variable. Including the same global and firm-level explanatory variable in a single regression was found to create a statistical multicollinearity problem due to high correlations between the two measures.

²⁴ The latter explanation is consistent with anecdotal evidence presented in John O'Donnell, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, Public Citizen, (2007), available at <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

²⁵ Automobile dealers were given an exemption from the Federal Arbitration Act (FAA) through the passage of H.R. 2215 in 2002, and as now codified in 15 U.S.C. § 1226, arbitration may only be used to settle a dispute arising out of a vehicle contract between automobile manufacturers and automobile dealers if both parties consent, in writing, and only after the dispute arises.

²⁶ While we acknowledge the shortcomings of survey data on terms hidden in fine print, this is still the only source of data available to us to study the prevalence of these clauses. Requiring public reporting of the use of these clauses by firms would lead to more reliable information on this topic.

²⁷ Stephanie Mencimer, *Suckers Wanted: How Car Dealers and Other Businesses are Taking Away Your Right to Sue*, in Mother Jones (November 26, 2007); and Stephanie Mencimer, *The Quest for a Car, Sans Arbitration Clause*, in Mother Jones (December 14, 2007).

²⁸ How people would respond to this question depends very much on how positively or negatively FA is portrayed. An introductory statement to questions on arbitration agreements strived to present a neutral tone rather than emphasizing the many potential negative consequences of such agreements, while at the

same time somewhat remaining informative on this issue. Specifically, the introduction read: “As you may know, some auto loans include an arbitration clause in the contract. Arbitration can in some cases be cheaper or faster than going to court. However, when the contract includes a clause requiring that any disputes be decided by an arbitrator, the consumer typically loses their right to sue or be heard in court if sued.” In a sense, this neutral tone may be biased in favor of FA, if anything, since FA is often more harmful to consumers than this description indicates.

²⁹ Specifically, the two regressions that excluded people who said FA was never in their contract. Making this exclusion reduces the population of those without FA to 13 respondents, making achieving statistical significance in the regression difficult even if a relationship exists.

³⁰ John O’Donnell, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, Public Citizen, (2007), available at <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

³¹ In Peter B. Rutledge, *Arbitration - A Good Deal for Consumers: A Response to Public Citizen*, Chamber of Commerce Institute for Legal Reform (2008).

³² The concept of FA applying to consumer contracts was something that was never clearly decided by the legislature. When Congress passed the Federal Arbitration Act in 1925, it was probably primarily with contracts between businesses in mind. However, a series of Supreme Court rulings have shifted the original intent of the law such that FA is now commonly applied to contracts between businesses and consumers where the consumers often have little negotiating power or knowledge of the terms in the legal contract.

³³ *2008 Automotive Finance Study: An Analysis of 2008 Mid-Year Data*, Consumer Bankers Association (2008).

³⁴ For a more detailed description of these questionable auto lending practices and how they were identified in the survey, see Delvin Davis & Joshua M. Frank, *Car Trouble: Predatory Auto Loans Burden North Carolina Consumers*, Center for Responsible Lending (April 2009).

³⁵ In statistical terms this is used in assessing the scale’s “reliability.”

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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