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Arbitration Agreements - Not Always Good All the Time

June 11, 2018 | Thomas B. Hudson

I have long urged dealers to consider incorporating mandatory pre-dispute arbitration agreements into their sales, credit sales and lease documents. The case for doing so is, in my view, compelling.

An arbitration agreement is the dealer's first and best line of defense against class action lawsuits. If you think that isn't reason enough, have a word with the many South Carolina dealers sued in class actions over allegedly improper doc fees who were able to have the class actions dismissed, with individual plaintiffs left with claims in arbitration. Dealers who did not use arbitration agreements paid millions of dollars to their customers and the customers' class action lawyers.

That makes the use of arbitration agreements nearly a no-brainer. "Nearly," because there are a few downsides to the things.

First, in order to make sure arbitration agreements between dealers and consumers will be enforced by courts, and even by those courts who bend over backward to rule for consumers, lawyers for dealers who draft the agreements make them as consumer-friendly as possible. One of the consumer-friendly provisions that you'll often see is one by which the business undertakes to pay some or all of the consumer's costs in arbitration. I've written these "cost-shifting" provisions into arbitration agreements used by dealers only to have the dealer push back, saying something like, "Why do I want to pay the consumer's cost of bringing a claim against me?" Good question!

The short answer has two parts. The first is that a dealer electing to arbitrate against a consumer is almost certainly doing so as a defensive strategy - the dealer can decide whether it's worth it to pay the freight for the consumer in order to gain a defensive edge. But consumers in general tend not to initiate arbitration proceedings. Lawyers for consumers, confronted with documents signed by their clients and containing arbitration agreements tend to lose interest in pursuing the consumer's claim. Perhaps these lawyers are unfamiliar with how to handle an arbitration proceeding, or perhaps they are of the view that they can't get a decent award of attorneys' fees from an arbitrator.

Whatever the reason, consumers have historically not initiated arbitration proceedings with much frequency. The second part is related - dealers can afford to pay their customers' arbitration costs in those very rare instances in which the customer initiates an arbitration proceeding because that cost ends up being a sensible price to pay for the

class action protection.

A final downside is that occasionally, a lawyer will take on an arbitration proceeding for a client, learn the arbitration ropes, get comfortable with the process and will no longer feel deterred when he discovers that arbitration agreement among the forms his client has signed.

Consider the outcome of a recent arbitration proceeding.

The consumer's principal claim against the dealer revolved around the dealer's pricing of the car. The consumer alleged that the dealer marked up the price of the car because of the consumer's poor credit record, and that the additional markup was a disguised finance charge. Because the Truth in Lending disclosures provided to the consumer did not include the additional markup in the calculation of the finance charge and the APR, claimed the consumer, the dealer violated the federal Truth in Lending Act and state law.

The arbitrator agreed, awarding the consumer $2000.00 on his TILA claim. The arbitrator was not stingy in awarding additional amounts, throwing in a punitive damages award of $50,000.00, an attorneys' fee award of $49,917.50, and expenses in the amount of $2,979.16. That's over $100,000, and remember that the dealer had to pay the costs of its own lawyer on top of these amounts.

Lessons? First, this consumer found an able, bright lawyer who analyzed the facts of the car finance transaction and concocted good arguments supporting the consumer's claims. If word of successful claims like this one spread to other consumer lawyers, we may well see the frequency of consumer-initiated claims rise.

Second, an arbitration agreement won't do you a whole lot of good if your underlying businesses practices violate the law. If the allegation here - that the dealer increased the car price because the buyer had poor credit - is true, that's about as basic as TILA violations get. All the arbitration agreements in the world won't help a dealer whose business practices flagrantly violate the law.

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7037 Ridge Road, Suite 300, Hanover, Maryland 21076
410.684.3200

hudsoncook.com