Podcast: *Payments Pros – The Payments Law Podcast*
Episode: Mass Arbitration: Managing the Risk for Payments and Fintech Companies
Host: Carlin McCrory
Guest: Justin Weber
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Carlin McCrory (00:04):
Welcome to another episode of *Payments Pros*, a Troutman Pepper Locke podcast focusing on the highly regulated and ever-evolving payment processing industry. This podcast features insights from members of our fintech and payments practice, as well as guest commentary from business leaders and regulatory experts in the payments industry. I'm Carlin McCrory, one of the hosts of the podcast. Before we jump into today's episode, let me remind you to visit and subscribe to our financial services hub at troutmanfinancialservices.com. And don't forget to check out our other podcasts on troutman.com/podcasts. We have episodes that focus on trends that drive enforcement activity, digital assets, consumer financial services, and more. Make sure to subscribe to hear the latest episodes.

Today, I'm joined by my colleague Justin Weber to discuss arbitration and the growing challenge of mass arbitration for payments and fintech companies. We'll cover the role arbitration plays in resolving consumer disputes, the issues companies are facing as mass arbitration becomes more common, and practical considerations for managing arbitration risk. Justin is a partner in our business litigation practice with significant experience representing clients in complex disputes across a range of industries. His practice also includes advising companies on arbitration and mass arbitration, from structuring arbitration provisions to managing risk and navigating mass arbitration claims. Justin, thanks so much for joining me today.

Justin Weber (01:44):
Good afternoon. I'm glad to be here.

Carlin McCrory (01:46):
I'm really excited to be talking with you about arbitration clauses. I frequently dole out arbitration clause review to Justin on our team, so he'll have great insights for the podcast. Baseline, let's start with what is arbitration and how does it differ from going to court?

Justin Weber (02:04):
Arbitration is a private contractual form of dispute resolution where the parties agree and choose to have a neutral, often the arbitrator, decide their dispute instead of having it decided by a court or a jury, and the arbitration results in a binding award. So what I like to emphasize to clients and folks who are considering arbitration is that you are

defining, you are the master of your domain, you are defining the contours of how you would like to resolve disputes, and arbitration provides you with that flexibility. There are great reasons to use arbitration, especially if you have specific subject matter or would like your fact-finder or your decision-maker to have specific expertise. Arbitration provides you with the flexibility of determining who is going to hear and what type of expertise the person who will hear and decide the dispute has. Typically, it's in its most ideal form, faster, cheaper, and more efficient than a more formal court-oriented process. So that's arbitration in a nutshell. It's a creature of contract where the parties get to determine the rules of the forum to a large extent.

Carlin McCrory (03:29):
So why do payments and fintech companies use arbitration provisions? And perhaps more importantly, what makes a good clause versus a bad clause?

Justin Weber (03:39):
Why is arbitration used? I think from the business's perspective, and I'll talk mostly about consumer-facing arbitration at the moment, it's about a couple of factors. Number one, you typically see in arbitration agreements class action and jury trial waivers. So you can limit, for the majority of claims, the way that a claim will be heard and eliminate class action exposure. And you can also eliminate potential jury trials. Obviously, jury trials both come with risk, not knowing what a jury is going to do, and you talk about runaway juries or sometimes the unpredictable nature of juries, but you also have the time and expense that's associated with a jury trial. Those are very formal and very expensive proceedings. So oftentimes we see clients wanting to help to control the risk associated with jury trials. But the class action and jury trial waiver, I think, is one of the prime reasons why companies often seek arbitration provisions, so that there can be a single consumer dispute that's decided rather than deciding things on a larger class basis and also controlling some of the risk that comes with jury trials.

In addition, confidentiality can also be key. Arbitrations can be confidential, unlike typically the court process where the dockets are public, where proceedings are public. Arbitration can be confidential and often doesn't result in precedential decisions because the decisions involve the parties before the arbitrator and the decision doesn't act as precedent for other arbitrations. So clients typically use it for those reasons, along with the anticipated efficiency and cost savings that are ideals for arbitration. What makes a good arbitration provision relate to those things? You certainly want to make sure that you are providing the protections and the benefits that you can have when you have an arbitration provision. But I think it's also important to ensure that the arbitration provision is enforceable. Arbitration provisions are typically attacked, when they are attacked, as being unconscionable. And so ensuring that the provision is drafted in a way that will be enforceable so that the party seeking to enforce it gets the benefit of the class action waiver, maybe the jury trial waiver, and those benefits that are going to come along with an efficient and more informal process are realized, as opposed to having the clause determined to be unconscionable because it was one-

sided or otherwise overreaching on typically the business's perspective, the party who drafted the provision. So careful drafting is important. I think it's something that companies should pay attention to if they haven't reviewed their arbitration provisions recently. As case law continues to develop and courts further define or identify what may be unconscionable, it's important to look at your arbitration clause to make sure that you don't run afoul of some type of prevailing trend or recent decision that might limit the enforceability of the clause.

Carlin McCrory (07:23):
Those are all great points. It seems like an area that's really been evolving as to enforceability over the past several years as to what will be acceptable and what won't. Justin, what are some of the considerations for consumer-facing versus B2B arbitration provisions?

Justin Weber (07:42):
That's a great question. The majority of the provisions that we see are consumer-facing. But if you have a line of business that's business-to-business, it's really important to think carefully about your arbitration provision because you can have more protective provisions in it than you would otherwise be able to have with a consumer. So for instance, both JAMS and AAA, two often-used administrators, have consumer due process standards, and those are helpful for informing what will be enforced in a consumer arbitration. And so there are things like carve-outs for small claims court, or they do not typically allow fee shifting. So the prevailing party... Having a provision that says the prevailing party is going to receive their fees, and if the prevailing party is the business, it's typically not going to work in a consumer provision. But there are a lot of those type of provisions that are perfectly acceptable in a business-to-business arbitration agreement that may be unconscionable or may violate an administrator's consumer due process standards if they were applied in the consumer context. So really important, if you are considering a business-to-business arbitration provision, you have more freedom to define the type of process, the location, some of the fee shifting, and other things where you may not have that same freedom because you're confined by some of the unconscionability case law that's out there when it's the business-to-consumer-facing agreement.

Carlin McCrory (09:36):
A little bit to follow up on that point you made, we haven't gotten into the details yet of mass arbitration, but you hear a lot about it, and why has it become such a significant issue, particularly for consumer-facing payment companies?

Justin Weber (09:53):
Mass arbitration is something that businesses certainly want to pay attention to because if you haven't been hit with... If you have an arbitration provision and you haven't been hit with a mass demand yet, you might be. The reason why mass arbitration... And maybe it's helpful if I step back and just articulate what mass arbitration is. So mass

arbitration is typically where a claimants' firm will advertise on social media or otherwise collect a large number of plaintiffs, and those plaintiffs or claimants will then bring individual claims in an arbitration. Those are separate individual claims, but perhaps 1,000 claimants might assert claims, each individual claims, and file those claims in arbitration. The base for mass arbitration and its threat is really the leverage of filing fees. So when we talk about unconscionability, one of those components, most administrators have their fees set up in a way where the business bears the majority of the fee. So, if a filing fee is $2,500, the consumer may pay $250 of that. The remainder is borne by the business. The rationale of that is that the consumer shouldn't be paying any more than they would be paying if they were filing a claim in court. It's one of those things to make sure that the agreement and the process is enforceable. But with respect to mass arbitration, take that, let's say, $2,000 filing fee the business has to apply, and if there were 1,000 individual claims that were filed, that's going to be a significant amount the business has to pay just to buy a ticket to defend each of those claims. And so while on the individual basis, if you look at one or two, that might not be extensive, but if you have 1,000 or more, you're looking at potentially $2 million in paying filing fees just to be able to defend those claims. And that's what claimants' attorneys will use, that leverage, the millions of dollars of filing fees is what they use to leverage to attempt to get a resolution of the claims. And unfortunately, what we saw early on, especially before mass arbitration rules and fee schedules were created by the administrators, is that claimants were using those mass arbitration threats and using those filing fees to try to obtain resolutions even where there were claims without significant merit, or I dare say hardly any merit. But it's that leverage of the filing fee, and that's what drives the mass arbitration approach.

Carlin McCrory (12:56):
So how should a company respond when mass arbitration demands arrive? And how can companies redesign their provisions to manage this risk that you're talking about?

Justin Weber (13:09):
The best way to address mass arbitration is by controlling your domain. As I mentioned, arbitration is a creature of contract. And so you can create certain ways that help to limit the risk for mass arbitrations. As I mentioned, both JAMS and AAA have revised their rules. JAMS did, I believe, in May of '24, and AAA, the American Arbitration Association, did so in January of 2024. They revised their rules to provide for mass arbitration rules. And in doing that they also revised their fee schedules. That helps to moot some of the or address some of the mass arbitration filing fee leverage that we talked about. But there's some important differences. For example, JAMS does not apply its mass arbitration rules unless the parties have previously pre-dispute agreed to it, or if the parties after the dispute is filed agree to it. Whereas AAA will apply the rules that are in effect at the time the dispute is filed. So if a party, for example, uses JAMS as their administrator, but their form of agreement does not require the use of mass arbitration rules, if those rules are triggered, that would be a provision that somebody would want to take a look at and revise to ensure that they are incorporating in the mass arbitration

rules for any type of claim. In addition, it's really helpful to have other types of provisions, protectionary provisions, to allow a party to address claims as early as possible, to know that there are claims coming, to potentially have those claims addressed and resolved before an arbitration is filed and before those filing fees are triggered. The most frustrating cases in defending, in my experience, are those where there is very little merit to a claim, a very small dollar amount, and the fees, the filing fees, would dwarf any potential recovery by the plaintiff.

But there are a large number of plaintiffs, and the filing fees are out of whack with the potential recovery or the potential harm that any individual consumer is alleging. Those can be the most frustrating. And by taking a look at your arbitration agreement in advance and determining ways that you might be able to address that with meet and confer, with other types of provisions meant to initially resolve or at least address claims before they're filed, I think companies can do well to limit some of their mass arbitration risk. The other issue that we saw, at least early on with mass arbitrations, are large numbers of consumers being included in a mass arbitration demand, but the company, the business, not having any idea or familiarity with some of those customers. That is, there's a customer, Jane Smith is listed, and the business has no record of Jane Smith ever having been a client or a customer of the business. Fortunately, there are some ways that you can address that, both in terms of drafting arbitration provisions to help eliminate some of those claims, or at least to require claimants' counsel to have a good faith basis and suffer some repercussions if they don't. But the mass arbitration rules that the providers have adopted have also helped provide opportunities for process arbitrators to be involved early to hopefully weed out some of those claims. So coming back to where we started, the best way to protect a business, an entity, or any counterparty against mass arbitration risk is thinking back where we started, controlling the framework and the agreement and how arbitration is going to occur. The wonderful thing is that in many portions of arbitration, you get to control it by contract, but obviously within the rules set forth by various case law and statutory schemes.

Carlin McCrory (17:44):
Justin, can you talk a little bit about, from selecting the arbitrator to the hearing room, how does arbitrating a case differ from litigating a case?

Justin Weber (17:57):
My background, I am a litigator, so I'm a trial lawyer and I enjoy being in court. And my background and my involvement in arbitration stems from that side. It didn't start on the corporate side navigating drafting of different documents. I start from litigating and seeing what doesn't work and what could be done better and then having that inform the contours of an arbitration agreement from a very practical perspective. And so again, arbitration is very different and less formal than certainly being in state or federal court. It's about doing that work on the front end, shaping the agreement and the type of arbitration that you want to have. I think what I would say as the biggest difference is that flexibility. It's similar to getting to draft your own rules of civil procedure. Now, each

administrator has their procedural rules that will apply, but the parties, to the extent that they're not unconscionable, can vary those. They can create their own process that they want to use in order to shape that dispute or the resolution of the dispute in what is hopefully the most efficient and practical way possible. In state or federal court, you don't have that opportunity. This becomes even more important, as I mentioned earlier, because if you have a very specific subject matter, choosing an arbitrator or requiring that an arbitrator have 15 years of experience in a certain payment area or whatever the specialty is that might be helpful and background knowledge in deciding a dispute, you can do that. You don't get that opportunity when you're in state or federal court to select the experience that your judge has and certainly not the experience of your jurors.

So getting that control that parties have at the outset, I believe is one of the most important. You also have different evidentiary rules and flexibility. And certainly in arbitration, if we think about a jury trial as being the most formal and most time intensive, and bench trials perhaps being less so, arbitration is even further to the right on that scale in terms of flexibility and ability of the parties to hopefully be efficient in having the dispute resolved. The last point I would make with respect to the difference is also that while parties can create their own appeal rights and what when appeals are permitted or who would hear an appeal, typically in arbitration without a form of agreement, there's going to be very limited appeal rights. So it's unlike if you receive a court decision where a judge errs as a matter of law and you have an automatic right of appeal. Arbitration doesn't have that same set of robust appeal rights. So you have to be careful when you are arbitrating a case to understand that this is your one opportunity. It's flexible, it's efficient, but it's also in many respects final. But it can be a great opportunity for, and we've found it's a great opportunity for our clients, efficiently and quickly managing disputes.

Carlin McCrory (21:23):
Well, Justin, thanks so much for joining us today. This has been incredibly insightful. And thanks to our audience for tuning in to this episode. Don't forget to visit our Financial Services hub at troutmanfinancialservices.com and subscribe to stay up to date on the latest developments. Please also make sure to subscribe to this podcast on whatever platform you use. We look forward to having you join us next time.

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