Clients&FriendsMemo

CFPB Targets Mandatory Arbitration Clauses to Protect Consumer Class Actions

May 10, 2016

On May 5, 2016, the Consumer Financial Protection Bureau ("CFPB") issued a proposed rule to prohibit providers of certain consumer financial products and services from using arbitration clauses to block consumers from filing or participating in class action lawsuits.[1] In addition, the proposed rule would impose a reporting obligation on providers of covered consumer financial products or services, requiring that certain materials filed in arbitration cases be submitted to the CFPB.[2] The stated purpose of the proposed rule, according to Director Richard Cordray, is to prevent "banks and financial companies [from avoiding] accountability by putting arbitration clauses in their contracts that block groups of their customers from suing them."[3]

Arbitration Clauses – A CFPB Priority

Arbitration provisions have become common in consumer contracts as a series of court rulings upheld businesses' use of pre-dispute arbitration clauses to limit the ability of consumers to file class action lawsuits.[4] Limiting the use of these pre-dispute arbitration provisions that the CFPB has characterized as "effectively den[ying] groups of consumers the right to seek justice and relief for wrongdoing" has been a priority of the CFPB since its inception.[5]

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1 *See* CFPB, Notice of Proposed Rulemaking, Arbitration Agreements 361 (May 5, 2016), http://files.consumerfinance.gov/f/documents/CFPB_Arbitration_Agreements_Notice_of_Proposed_Rulemaking.pdf [hereinafter Proposed Rule].

2 *Id.* at 362-63.

3 Press Release, CFPB, CFPB Proposes Prohibiting Mandatory Arbitration Clauses that Deny Groups of Consumers their Day in Court (May 5, 2016), http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-proposes-prohibiting-mandatory-arbitration-clauses-deny-groups-consumers-their-day-court/ [hereinafter CFPB Press Release].

4 *See, e.g.*, AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 344 (2011) (holding that the Federal Arbitration Act preempts state laws that prohibit the enforcement of class action waivers in consumer arbitration agreements).

5 CFPB Press Release, *supra* note 1; *see* Yuka Hayashi & Christina Rexrode, *Proposed Rule Would Allow Consumers to Sue Banks, Credit-Card Companies*, THE WALL STREET JOURNAL, May 5, 2016, http://www.wsj.com/articles/cfpb-unveils-proposed-rule-to-let-consumers-sue-banks-credit-card-companies-1462420862 [hereinafter Hayashi & Rexrode].

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") directed the CFPB to study the use of pre-dispute arbitration agreements by providers of certain consumer financial products and services.[6] The CFPB released preliminary results of its study in late 2013, and, in March 2015, the CFPB published and delivered to Congress its completed 728-page report.[7] In its May 5, 2016, press release announcing the proposed rule, the CFPB highlighted the 2015 study's finding that class actions bring "hundreds of millions of dollars in relief to millions of consumers each year and cause companies to alter their legally questionable conduct" and noted that mandatory pre-dispute arbitration clauses can block class actions.[8]

In addition to studying the issue, Dodd-Frank also authorized the CFPB to issue regulations restricting or prohibiting the use of pre-dispute arbitration agreements if the CFPB found that such rules would be in the public interest and for the protection of consumers.[9]

The Proposed Rule

The CFPB's proposal stops short of banning pre-dispute arbitration clauses altogether. Under the proposed rule, companies still would be able to use pre-dispute arbitration clauses to require consumers to resolve individual disputes through arbitration. However, such clauses could not be used to prevent consumers from filing or participating in a class action lawsuit.

To accomplish this, each agreement would be required to contain the following provision: "We agree that neither we nor anyone else will use this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action even if you do not file it."[10]

The proposed rule would apply to contracts between consumers and providers of certain consumer financial products or services. The proposed rule contains a broad definition of "covered consumer financial products and services" that includes credit cards, checking and deposit accounts, prepaid cards, money-transfer services, certain auto and auto title loans, payday and installment loans, student loans, and other types of consumer credit products and services.[11]

In addition to requiring the pre-dispute arbitration clauses to include a carve-out for class actions, the proposed rule also would require providers of covered consumer financial products and

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6 *See* 12 U.S.C. § 5518(a).

7 *See* CFPB, Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) (2015), http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

8 CFPB Press Release, *supra* note 1.

9 *See* 12 U.S.C. § 5518(b).

10 Proposed Rule, *supra* note 2, at 361.

11 *See id.* at 357-60; Hayashi & Rexrode, *supra* note 5.

services to submit to the CFPB certain records related to arbitration cases to "allow the [CFPB] to monitor consumer finance arbitrations to ensure that the arbitration process is fair for consumers."[12] Providers would be required to submit the initial claim and any counterclaim, the arbitration agreement, any judgment or award, and other documents related any arbitration cases concerning covered consumer financial products or services.[13] The CFPB is considering whether this information would be made publicly available.[14]

Pre-dispute arbitration agreements are unlikely to be affected by any final rule until sometime in 2017. After the proposed rule is published in the *Federal Register*, the public will have 90 days to submit comments. The CFPB is proposing an effective date of 30 days after a final rule is published in the *Federal Register*, and "[c]onsistent with the Dodd-Frank Act, the proposed rule would apply only to agreements entered into after the end of the 180-day period beginning on the regulation's effective date."[15]

Implications for Arbitrations

Taken together, the two prongs of the CFPB's proposed rule appear to be an effort to chill arbitrations. The requirement that pre-dispute arbitration clauses preserve a consumer's ability to file or participate in a class action lawsuit will fundamentally change a company's risk analysis when deciding whether to include any arbitration provision in consumer contracts. If pre-dispute arbitration clauses can commit only individual disputes to arbitration, but still leave companies facing the potential expense of defending against class action lawsuits, businesses ultimately may decide to do away with arbitration for an even broader class of consumer disputes than those directly affected by the proposed rule.

The requirement that certain records relating to arbitral proceedings be submitted to the CFPB could similarly have a chilling effect on arbitrations generally, including arbitrations of individual consumer disputes. The CFPB has indicated that it "intends to publish these materials on its website in some form, with appropriate redactions or aggregation as warranted, to provide greater transparency into the arbitration of consumer disputes."[16] The ability to resolve disputes through arbitration in a less public forum than a courtroom is another factor that companies consider when deciding to commit consumer disputes to arbitration. The CFPB's proposal to collect and potentially publish records of arbitration proceedings appears to be an effort to chill arbitrations –

[12] CFPB Press Release, *supra* note 1; *see* Proposed Rule, *supra* note 2, at 362-63.

[13] *See* Proposed Rule, *supra* note 2, at 362-63.

[14] *See* CFPB Press Release, *supra* note 1.

[15] *See* Proposed Rule, *supra* note 2, at 5.

[16] *Id.* at 4.

which is inconsistent with the general federal policy of enforcing arbitration agreements codified in the Federal Arbitration Act.[17]

Conclusion

The CFPB has long signaled its desire to reign in perceived abuses of arbitration clauses, and the proposed rule represents a significant step toward that goal. While the precise language of any final rule could change, the proposed rule makes clear that the CFPB's strategy to police perceived abuses of pre-dispute arbitration agreements is focused on protecting consumers' ability to file and participate in class action lawsuits. Without a way to avoid the prospect of defending against class action lawsuits, companies will be forced to make a different cost-benefit calculation when deciding whether to offer arbitration to individual consumers or seek resolution of all consumer disputes – both individual and class actions – in the courts.

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If you have any questions regarding the foregoing, please contact the authors below.

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[17] *See* 9 U.S.C. §§ 1-14.