Client Alert

October 20, 2015

CFPB Announces Intent to Commence Arbitration Rulemaking

By James R. McGuire and Nancy R. Thomas

On October 7, the Consumer Financial Protection Bureau (CFPB) announced that it is considering two rulemaking proposals that would severely limit the use of pre-dispute arbitration clauses in consumer financial service contracts. Ignoring the well-documented problems and abuses associated with class action litigation, the Bureau has concluded that because class actions effect a greater aggregate transfer of wealth from alleged "wrongdoers" to plaintiffs' class action lawyers and plaintiff classes than does arbitration, it is in the *public* interest and for the benefit of *consumers* to eliminate arbitration clauses that would limit its use. The Bureau has also concluded, as it must under the Dodd-Frank Act, that imposing such limitations by regulation would be consistent with its recent Report to Congress.

BACKGROUND

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) mandated a CFPB study on the use of pre-dispute arbitration clauses in consumer financial products and services, with a report of its findings sent to Congress.

The Dodd-Frank Act further authorized the CFPB to prohibit or impose conditions or limitations on the use of arbitration clauses by regulation if the CFPB determined that it would be in the public interest and for the protection of consumers to do so. However, any such regulation must be consistent with the findings of the CFPB's study.

The CFPB commenced its process in 2012, and from the beginning, it has appeared that the CFPB would target arbitration clauses requiring individual arbitration. The Supreme Court held that state laws barring these agreements were preempted by the Federal Arbitration Act in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).[1] On March 10, 2015, the CFPB released its Final Report to Congress which removed all doubt. As we wrote in our Client Alert at the time, the "Report's conclusion, and Director Richard Cordray's remarks, were as expected: consumers are better served by litigation—and particularly, class action litigation—than by agreements to arbitrate disputes."

The CFPB's October 7 announcement of the planned rulemaking seeks to implement this conclusion.

THE CFPB'S PROPOSALS

The Bureau announced that it is considering two proposals. First, the Bureau proposes to require an arbitration provision "to say explicitly that it does not apply to cases brought on behalf of a class unless and until the class certification is denied by the court or the class claims are dismissed in court." It does this to "prohibit companies from blocking group lawsuits through the use of arbitration clauses in their contracts."

[1] *See* Client Alert "CFPB Builds Its Case Against Arbitration Clauses" (Dec. 17, 2013).

The Bureau's first proposal is based on its view that its Report to Congress shows that class litigation, unlike current arbitration practices, is in the "public interest" and will "benefit consumers."

It is hard to understand how the Report could support those conclusions. The Bureau's Report to Congress, like the materials accompanying its proposed regulations, assiduously avoids addressing the hard questions about the true public interest value of the class action litigation. Reasonable people could differ about that value, both in general and in particular cases. The Bureau simply ignores that question. Instead, the Bureau focuses on which approach results in a greater aggregate shift of wealth from financial institutions to plaintiffs' class action lawyers and plaintiff classes. Indeed, the Bureau devotes a lone sentence in its outline to the topic, using the passive voice to note only that "class lawsuits have been subject to significant criticism" but noting that the Bureau "believes" that "consumer are significantly better protected from harm by consumer financial service providers when they are able to aggregate claims." Others, however, believe that there is at least the potential for abuse:

> Judge Friendly, who was not given to hyperbole, called settlements induced by a small probability of an immense judgment in a class action "blackmail settlements." *Henry J. Friendly, Federal Jurisdiction: A General View* 120 (1973). Judicial concern about them is legitimate, not "sociological," as it was derisively termed in *In re Sugar Antitrust Litigation*, 559 F.2d 481, 483 n. 1 (9th Cir. 1977).

In re Rhone-Poulenc Rorer, Inc., 51 F.3d 1293, 1298-99 (7th Cir. 1995). The CFPB has simply accepted, uncritically, one side of this debate.

Nor does the Bureau's Report seem to support its conclusion that consumers benefit from class litigation any more than they do from individual arbitration. As we explained in our earlier Client Alert, the Bureau's Report does not support the conclusion that consumers are better served by class action litigation than by arbitration. Instead, the Report showed that, while consumers do not much care about dispute resolution provisions, the market offers consumers significant choice as to whether to enter into an agreement with a business that employs arbitration and that many consumers whose consumer financial product agreements include an arbitration clause can pursue their claims in court. It further showed that the arbitration clauses in consumer financial product agreements rarely place limits on a consumers' recovery or require confidentiality with respect to the proceedings, that arbitrations take place in locations convenient to the consumers and that, in general, arbitration is less expensive and speedier than litigation.

Second, the Bureau is considering requiring those entities that continue to use arbitration agreements "to submit initial claim filings and written awards in consumer finance arbitration proceedings to the Bureau through a process the Bureau would expect to establish as part of [its] rulemaking" and is also considering whether "to publish the claims or awards to its website, making them available to the public."

Although the Bureau's first proposal suggests that it will not impose a total ban on arbitration clauses, the second proposal seems designed to do just that by inflicting a reporting obligation on any institution seeking to use it in the limited circumstances in which it would remain "permissible." It is difficult to understand how it is in the "public interest" to burden what is supposed to be a cheap and efficient process with these requirements. Nor were these requirements the subject of the Bureau's Report to Congress, which may mean this proposal is ultra vires.

NEXT STEPS

In its outline of proposals, the CFPB indicated that it would convene a Small Business Regulatory Enforcement Fairness Act (SBREFA) panel. The panel will include representatives from the Bureau, the Small Business Administration and Office of Management and Budget, who will meet with "small entity representatives" (SERs) to obtain feedback on the potential economic impacts of complying with the proposed regulations. It has since been announced that the panel will be convened during the week of October 19, and a list of questions has been published. According to the CFPB, the panel will issue a report within 60 days of convening.

It thus appears that the Bureau will be in a position to issue a proposed rule in early 2016 and finalize such a rule before the end of that year. As the Bureau notes, and as Congress required, any such rules will apply only to arbitration agreements entered into 180 days after the effective date of any final rule. For companies providing consumer financial products whose agreements include arbitration clauses, this prospective application of the rule will mean different customers will be governed by different arbitration terms based on when those customers opened their accounts.

THINGS TO DO

Financial service companies that employ arbitration provisions in their customer agreements will be impacted by the Bureau's proposed rules. Such companies should consider participating in the rulemaking process so that their views can be heard and made part of the administrative record. Such companies should also begin to consider how they will manage what will eventually be two customer populations—those with whom they have an arbitration agreement and those with whom they don't. Providers of consumer financial services products and services that do not currently use arbitration for dispute resolution, may want to consider adding arbitration clauses to their agreements before the application date of any Final Rule.

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