Banking and Finance Law Daily Wrap Up, TOP STORY—CFPB proposes to ban mandatory arbitration 'gotcha' clauses, (May 5, 2016)

Banking and Finance Law Daily Wrap Up

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The Consumer Financial Protection Bureau has issued a proposed rule that would ban mandatary arbitration clauses that "deny groups of consumers their day in court." The proposal prohibits companies from putting mandatory arbitration clauses, referred to by the bureau as "gotcha contracts," in new contracts that prevent class action lawsuits. Under the proposed rule, companies would be able to include arbitration clauses in their contracts, but for contracts subject to the proposal, the clauses would have to say explicitly that they cannot be used to stop consumers from being part of a class action in court. The proposed rule would provide the specific language that companies must use.

The bureau also is proposing to adopt official interpretations to the proposed regulation. The CFPB is requesting public feedback on the proposal for 90 days after publication in the Federal Register.

"Signing up for a credit card or opening a bank account can often mean signing away your right to take the company to court if things go wrong," said CFPB Director Richard Cordray. "Many banks and financial companies avoid accountability by putting arbitration clauses in their contracts that block groups of their customers from suing them. Our proposal seeks comment on whether to ban this contract gotcha that effectively denies groups of consumers the right to seek justice and relief for wrongdoing."

Mandatory arbitration clauses. According to the CFPB, mandatory arbitration clauses typically provide that either the company or the consumer can require that disputes between them be resolved by privately appointed arbitrators except for cases brought in small claims court. Either party generally can block lawsuits from proceeding in court. These clauses also generally bar consumers from bringing group claims through the arbitration process. No matter how many consumers are injured by the same conduct, consumers must proceed to resolve their claims individually against the company.

Preparing for rulemaking. As required by Section 1028(a) of the Dodd-Frank Act, the CFPB conducted a study of pre-dispute mandatory arbitration clauses that was published in March 2015. The CFPB's study showed that very few consumers bring individual actions against their financial service providers either in court or in arbitration and that class actions provide a more effective means for consumers to challenge problematic practices by these companies. According to the study, class actions succeed in bringing hundreds of millions of dollars in relief to millions of consumers each year and cause companies to alter their legally questionable conduct. However, when mandatory arbitration clauses were in place, companies were able to block class actions.

In October 2015, the CFPB published an outline of the proposals under consideration and convened a Small Business Review Panel to gather feedback from small companies. The bureau also sought input from the public, consumer groups, industry, and other stakeholders before continuing with the rulemaking. That process concluded in December 2015 with a written report to CFPB Director Richard Cordray. The bureau released the report in conjunction with its proposal.

Proposal provisions and benefits. The proposed rule would create a new 12 CFR Part 1040 to govern mandatory arbitration clauses. In addition to requiring that the clauses explicitly state that they cannot be used to stop consumers from being part of a class action in court, the proposed rule would require that companies with arbitration clauses submit to the CFPB claims, awards, and certain related materials that are filed in arbitration cases. The bureau said that this requirement would allow it to monitor consumer finance arbitrations to ensure

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that the arbitration process is fair for consumers. The CFPB added that it is considering publishing information it would collect in some form so the public can monitor the arbitration process as well.

According to the bureau, the proposed rule would not only provide consumers with their day in court, but would act as an incentive to companies to comply with the law and avoid group lawsuits. “Arbitration clauses enable companies to avoid being held accountable for their conduct. When companies know they can be called to account for their misconduct, they are less likely to engage in unlawful practices that can harm consumers,” noted the CFPB. Finally, the proposed rules would make the individual arbitration process more transparent by requiring companies that use arbitration clauses to submit any claims filed and awards issued in arbitration to the CFPB.

Cordray on arbitration. The CFPB held a field hearing on arbitration in Albuquerque, N.M., on May 5, 2016. In his prepared remarks, Cordray said that the practice of using pre-dispute arbitration clauses “has evolved to the point where it effectively functions as a kind of legal lockout.” According to the CFPB director, companies insert these clauses into their contracts for consumer financial products or services and “with the stroke of a pen” can prevent consumers from filing class action lawsuits. Through the studies it has conducted, the bureau has come to understand that consumers know very little about these clauses and how they can block them from their day in court.

Cordray stated that Congress spoke on mandatory arbitration clauses by directing the CFPB to conduct a study and provide a report to Congress on the use of mandatory arbitration clauses in other consumer financial contracts. Once the study was completed, “Congress stated that ‘[t]he Bureau, by regulation, may prohibit or impose conditions or limitations on the use of ‘such arbitration clauses in consumer financial contracts if the Bureau finds that such measure’ is in the public interest and for the protection of consumers’ and such findings are ‘consistent with the study’ we performed.”

The CFPB director said that “the essence” of the proposed rule is that it would “prevent mandatory arbitration clauses from imposing legal lockouts to deny groups of customers the right to pursue justice and secure meaningful relief from wrongdoing.”

U.S. Chamber of Commerce. In oral testimony at the field hearing, Travis Norton, Executive Director for the U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, called the CFPB’s proposed rule “a back-door attack on arbitration, taking the form of a prohibition on class action waivers” that is “no more in the public interest than a direct prohibition on arbitration.” Travis stated that if companies that currently subsidize arbitration programs for their customers are also required to reserve millions for class action defense, many of them will stop funding their arbitration programs. “No rational company is going to pay more to provide customers less.”

Hensarling statement. House Financial Services Committee Chairman Jeb Hensarling (R-Texas), referring to the CFPB director as the “de facto dictator,” said that the proposed rule would restrict consumers’ ability to resolve financial contract disputes through arbitration. “This move—which will apply to some of the most common financial contracts including credit cards, checking accounts, and even cell phones—essentially hands over the keys of the CFPB’s luxury office building to the wealthy, powerful, and politically well-connected trial lawyer lobby.” Hensarling stated that the proposal was based on the bureau’s 2015 arbitration study that “was met with widespread criticism from academics and industry alike for failing to make useful comparisons between the outcomes of the various permutations of individual and class litigation versus similar claims under arbitration, as well as awards versus settlements.

Proskauer weighs in on proposal. Timothy Karcher, Proskauer Rose LLP, commented, “No one who has been actively watching the CFPB for the past several years should be surprised by the proposed rulemaking. This has been on the CFPB’s agenda for a long time—Section 1028 of the Dodd-Frank act directed the CFPB to study the use of arbitration clauses, and these proposed rules come directly from that mandate.” After conducting the study, the CFPB concluded that as long as the risks of class action are low, the incentive for non-compliance is too great, he said. “It’s very hard to argue with that.” Karcher stated further, “The likely result may be more

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class-action type lawsuits, but the CFPB asserts that the mere threat of a class action will make compliance with consumer protection laws a greater priority."

Regarding criticism of the proposal, Karcher said, "This is not about whether the CFPB has too much power or unchecked authority. Boilerplate agreements designed to deprive consumers of access to the courts should raise concern among CFPB supporters and critics alike. I welcome any rule that prohibits depriving consumers of the option to seek redress in the courts."

Consumer reviews. Several consumer groups released a joint statement commending the CFPB on its proposed rule "to restore consumers' right to join together to hold corporations accountable when they break the law." The groups noted in their statement that the proposed rule would limit the financial industry's use of forced arbitration, which they referred to as "an abusive practice in which corporations bury 'ripoff clauses' in the fine print of take-it-or-leave-it contracts to block consumers from challenging predatory practices such as hidden fees, fraud, and other illegal behavior."

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