
Arbitration Provisions Mauled by Consumer Watchdog

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Companies offering payment services or financial products to consumers are facing a proposed rule from the CFPB that would prohibit class action waivers in binding pre-dispute arbitration agreements. Although the information used to support the rule is thin, a broad range of consumer-facing companies should consider this potential new reality and prepare for it.

In what may arguably be its most sweeping rulemaking proposal to date, on May 5, the Consumer Financial Protection Bureau (CFPB) announced its long-awaited proposed rule that would prohibit most consumer financial services providers from requiring consumers to waive class action rights in binding pre-dispute arbitration agreements. It would also require these companies to turn over information regarding private arbitrations that they do conduct to the CFPB for tracking, analysis and publication. A key issue clouding this proposed rule is whether it would strengthen protections for consumers, or rather, whether it would merely provide a windfall for the class action plaintiffs' bar. Whether consumers stand to benefit is not merely academic, as the legality of the proposed rule hinges upon it. In this alert, we discuss the background surrounding the proposed rule; the CFPB's proposed requirements; and some of the gaps in the CFPB's methodology for its theory regarding consumer benefit. We conclude by suggesting steps companies should consider in the immediate term, in light of this pending development.

Background for the CFPB's Proposed Rule

The U.S. Congress, in Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), requires the CFPB to study pre-dispute arbitration agreements. If warranted by the findings of this study, the Dodd-Frank Act authorizes the CFPB to issue regulations that either restrict or prohibit the use of arbitration agreements, provided such regulations are in the public interest and for the protection of consumers. See 12 U.S.C. § 5518.

Following its mandate, the Bureau took these key steps leading up to its proposed rule:

On December 12, 2013, the CFPB published a 168-page preliminary report, *Arbitration Study Preliminary Results: Section 1028(a) Study Results To Date*, in which it signaled its antipathy toward the use of arbitration agreements in contracts between financial services providers and consumers.

On March 10, 2015, the Bureau issued a 728-page final report, *Arbitration Study: Report to Congress Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)*. Here, the CFPB hardened its position that, compared to class actions, the pre-dispute arbitration system is unfair to consumers, finding that consumers rarely avail themselves of arbitration, but instead, are foreclosed from pursuing class action remedies and suffer as a result.

On October 7, 2015, the CFPB announced that it was considering a proposed rule that would prohibit companies from requiring consumers to waive class action rights in pre-arbitration agreements, and would require companies that use arbitration clauses to report information to the CFPB about claims filed and awards issued.

On May 5, 2016, the CFPB released its proposed rule, aligning with the October 7 preview.

Quite ironically, the CFPB's proposal comes only several years after a seminal U.S. Supreme Court decision that stood for the exact opposite proposition. In 2011, the Court, in *ATT Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) held that a California Supreme Court decision that invalidated class action waivers in arbitration agreements (referred to as the *Discover Bank* rule) is preempted by the Federal Arbitration Act, 9 U.S.C. §§ 1-16, and thus invalid. The Court affirmed the federal policy favoring arbitration over class-wide relief, citing that “the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate morass than final judgment.” *Id.* at 1751.

While the CFPB's proposed rule mentions this Supreme Court holding, it avoids the inconvenient topic of the justification for its proposal's marked departure from what is settled law and public policy. A review of both the preliminary and final reports shows that the Bureau was conducting its research and review of arbitration at and after the time of the *Concepcion* decision.

The Proposed Rule

At the heart of the proposal, the CFPB would ban consumer financial services providers from requiring consumers to waive class action rights in connection with pre-dispute arbitration clauses. (In a minor victory for the industry, the CFPB has not outright banned pre-dispute arbitration agreements—at least not yet.)

In connection with this substantive requirement, the CFPB has proposed a disclosure that covered companies must deliver to consumers, whenever such companies use pre-dispute arbitration agreements. The draft disclosure is very broad and requires companies to pledge that they will not stop consumers from being part of a class action case in court AND that they will take steps to prevent “anyone else” from using the arbitration agreement to prevent participation in class actions. The CFPB explains that “[r]equiring a provider's arbitration agreement to contain such a provision would ensure that consumers, courts, and other relevant third parties, including potential purchasers, are made aware when reading the agreement that it may not be used to prevent consumers from pursuing class actions concerning consumer financial products or services covered by the proposed rule.” Thus, courts would be precluded from following the Supreme Court's guidance in *Concepcion* and its progeny if anyone attempts to enforce a class action waiver in a consumer contract governed by the proposed rule.

The class action waiver ban (and related disclosure requirement) would apply prospectively to agreements between consumers and companies starting 180 days after the effective date of a final regulation. As such, covered companies may continue to enforce their current agreements with existing customers, requiring any disputes to be brought in an arbitral forum on an individual basis. It remains to be seen, however, whether the CFPB would use its broad authority to prohibit unfair, deceptive, or abusive acts and practices (UDAAP) to assert claims against these companies on behalf of all consumers that were otherwise precluded from participating in litigation subject to an arbitration clause with a class action waiver.

In addition to the class action waiver ban, the Bureau's proposed rule would require companies to report information about individual arbitrations. Specifically, companies would be required to disclose the following (otherwise private) data pertaining to arbitrations that they participate in:

- The initial claim (whether filed by a consumer or the company) and any counter-claim;
- The pre-dispute arbitration agreement filed with the arbitrator or arbitration administrator;
- The award, if any, issued by the arbitrator or arbitration administrator;
- Any communications from the arbitrator or arbitration administrator relating to a refusal to administer, or dismissal of a claim, due to the company's failure to pay required fees; and
- Any communications related to a determination that an arbitration agreement does not comply with the administrator's fairness principles.

The CFPB plans to publish this otherwise private information on its website "in some form" with "appropriate redaction or aggregation as warranted." "Appropriate redaction," however, would apparently be limited to redacting information about the *consumer*—the name of the company and the private arbitrator would apparently not be redacted. Indeed, the Bureau contemplates that consumers, public enforcement agencies, and class action plaintiffs' attorneys would review these records to identify situations that "warrant further action." If the ban on consumer class action waivers is cake for the plaintiff's bar, consider this to be the serving fork.

The CFPB would not only use this private information to evaluate systemic issues it perceives to be unfair to consumers underlying the arbitration process (as an aggregated, de-identified data collection effort would suggest), but would also use the data to determine what types of allegations are being lodged against specific companies. In essence, these disclosures would provide the CFPB another backdoor mechanism to conduct *de facto* investigations regarding companies' perceived compliance with federal consumer financial laws—without having to go through an individualized request for information.

The proposed rule would not be limited to one industry, but would affect providers of consumer financial products and services in the core markets of lending money, storing money, and moving or exchanging money. Among others, companies offering credit cards, bank accounts, consumer loans, credit reporting services, money transmission services, or debt collection services, would be affected by the proposed rule. Under the Dodd-Frank Act, arbitration agreements are already prohibited in mortgage loan documents, so mortgage industry participants are not covered by the proposal.

Notably, the CFPB hypocritically exempts itself, and all of its governmental brethren, from the ban on class action waivers in pre-dispute arbitration agreements.

Reactions and Criticisms

To survive legal scrutiny, the CFPB's proposed rule must be consistent with the evidence and results of its own study; must be shown to serve the public interest; and must be required for the protection of consumers. Significant doubt has already been cast upon whether the CFPB's proposal would satisfy even one of these required elements.

As discussed in a prior [client alert](#), the CFPB's 2013 preliminary report was immediately critiqued by industry participants as being biased, using an ends justify the means approach. For instance, a key industry concern was that nearly all of the arbitration clauses that the CFPB studied included class action waivers, suggesting a self-selection bias in the first instance.

As predicted, the more detailed 2015 report was met with even more nuanced criticism. A recent [George Mason University academic study](#) illuminates several areas where the CFPB's conclusions depart from sound empirical support. First and foremost, the recent study concludes that the CFPB does not make a fair comparison between the benefits of arbitration as opposed to class actions, as the study only compares arbitration awards to class action *settlements*. In fact, most arbitrations result in settlements (similar to litigation), rather than formal awards. By evaluating only formal arbitration awards, the CFPB's study makes an apples-to-oranges comparison that omits consideration of the primary outcomes in arbitration. Imagine if one tried to understand the practical outcomes of consumer litigation by only studying published court judgments.

The George Mason study also finds that the CFPB's method for evaluating the consumer benefits of class actions are biased and flawed. Specifically, in determining the claims rate (i.e., the number of consumers receiving a payment under a settlement) and the ratio of attorneys' fees to overall settlement amounts, the study concludes that the CFPB's research is unduly skewed by about six unusual settlements with outsized results that favor consumers. In contrast, the majority of class action cases result in nominal consumer participation, lower consumer rewards, and a higher ratio of attorneys' fees to settlement amount. By using an aggregate average approach, though, these typical results are masked by an "average" that is weighed heavily by several outlier results.

Even as the CFPB attempts to negatively characterize arbitration, a close look at the CFPB's data even supports that arbitration is a generally effective dispute resolution mechanism. For example, the data show that unrepresented plaintiffs actually fare better in arbitration than in civil litigation, and that arbitration procedures are inexpensive for consumers (in the range of \$200). The CFPB breezes past these data points, in a thinly veiled effort to build its house of cards upon a theory that multi-million dollar class action settlements are more beneficial to consumers than arbitration (when in fact, the true winners in class action settlements are the plaintiffs' attorneys).

So What Comes Next?

As an offensive measure, companies have 90 days to comment on the CFPB's proposal once it is published in the Federal Register (which will be in the coming weeks). In addition to challenging the proposal's consumer disclosure and public reporting aspects, companies wishing to challenge the core ban on class action waivers are encouraged to offer as much empirical evidence as possible to support that binding arbitration is an effective means of redress for consumers. The Bureau's proposal must be *in accordance with its study on arbitration*. To the extent that private actors can empirically contradict the CFPB's evidence and conclusions, this should weaken the CFPB's legal bases for issuing the proposed rule—even if such challenges arise *post hoc* in court.

Assuming the CFPB moves forward with its proposal (which seems likely under the circumstances), there no doubt will be legal challenges. As noted above, the countervailing federal public policy supports arbitration, including class action waivers. The Supreme Court (and other courts) has made this point clear. What is more, the same type of evidence that may be presented to the CFPB to urge it not to adopt the proposal (e.g., that the proposal is not supported by the CFPB's study) may be used in court as a basis for challenging the legality of the proposal.

In light of the CFPB's expressed attitude towards arbitration, the reality is that companies face enforcement risk under the CFPB's UDAAP authority, regardless of whether the proposed rule is adopted. Recent UDAAP actions by the CFPB demonstrate that the CFPB will continue to use UDAAP even when a particular practice is not specifically proscribed by a specific consumer financial services law (such as the Truth in Lending Act, Real Estate Settlement Procedures Act, etc.). The CFPB certainly will not be thwarted from using its UDAAP authority where a covered company is able to avoid class actions because of its use of arbitration provisions with a class action waiver. As we discuss in an earlier [client alert](#), the CFPB's criticisms regarding certain aspects of arbitration agreements provide insight into the type UDAAP enforcement it may take.

The Bureau has drawn its line in the sand, unequivocally voicing its distaste for pre-dispute arbitration clauses in consumer financial services and products contracts. With or without a formal rule, companies should take a close look at their consumer dispute mechanisms.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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