CONSUMER FINANCIAL SERVICES LAW REPORT

FOCUSING ON SIGNIFICANT CASELAW AND EMERGING TRENDS

AUGUST 29, 2017 | VOLUME 21 | ISSUE 8

VIEW TO THE NEWS

THE CFPB FINAL RULE ON ARBITRATION: THIS GAME IS FAR FROM OVER

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Football season is upon us. Fans from coast to coast will closely watch dueling gridiron heroes as they seek victory over their rivals. The atmosphere is full of excitement and unpredictable outcomes.

Likewise, the Consumer Financial Protection Bureau's final rule on arbitration agreements in consumer contracts is facing a battle for survival. The venue for dispute resolution — whether in court or in arbitration — comes with it different rules, different referees, and different levels of public participation and scrutiny.

The controversial arbitration rule faces a gauntlet of challenges. If enacted, it would ban financial service companies from using mandatory arbitration clauses to prevent consumers from participating in class actions. The final rule was immediately met with strong criticism from the financial services industry, Congress, and a leading federal supervisory agency, among others.

The rule is slated to go into effect on September 18, 2017, and covered institutions must then reflect the mandated changes in all agreements entered into on or after March 19, 2018. House Republicans have already voted to repeal the rule and its fate now rests in the Senate. The competition is fierce for both the rule's supporters and opponents, and the final outcome is far from certain.

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No class action waivers, mandatory arbitration reporting

Pre-dispute arbitration agreements appear in millions of contracts for financial products and services, such as agreements for credit cards, student loans and car leases. They allow parties to resolve disputes through arbitration, often in the hope of bypassing the typical delays and costs associated with suing in court.

Congress, recognizing the legitimacy of arbitration, passed the Federal Arbitration Act in 1925. The FAA was designed to ensure the ready enforceability of agreements to arbitrate, especially in light of historic judicial hostility to it. But arbitration has long been opposed by powerful groups such as trial lawyers, who have made opposition to it a top political priority, especially over the last two decades.

The arbitration issue came to the fore with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which created the CFPB in the wake of the financial crisis. The act banned the use of arbitration in most mortgage transactions and directed the bureau to study the use of arbitration agreements elsewhere in the financial services industry. The agency's findings were reported to Congress in 2015.

The CFPB found that by agreeing to arbitrate their individual disputes, consumers were effectively blocked from participating in class actions. The bureau concluded that these agreements were not in the best interest of consumers. As a result, the CFPB used the additional authority granted to it under Dodd-Frank to develop a rule in response to its study. The CFPB issued a proposed rule in May 2016 which provoked more than 110,000 comments.

Despite the many comments, the rule issued on July 10, 2017 (12 CFR part 1040) is largely the same as the proposed rule. It primarily accomplishes two things:

- Prohibits providers of certain consumer financial products and services from enforcing individual arbitration agreements to prevent those same consumers from participating in class actions.
- Requires covered companies who use pre-dispute arbitration agreements to submit to the bureau records related to actual arbitration proceedings for continued monitoring.

The CFPB claims that the rule does not bar arbitration altogether. Rather, it requires new contracts to explicitly provide that the agreement to arbitrate individual disputes cannot be used to block consumers from pursuing class actions.

Critics have been quick to point out that the rule would indeed effectively end arbitration in this area, as economically rational companies would likely not agree to undertake arbitration with a consumer only to also have to pay for the defense of a class action lawsuit.

The choice: Battle in court or a private forum

Not surprisingly, the CFPB's rule has received strong resistance from the financial services industry and allied trade organizations. One of the primary criticisms is that the rule will open the floodgates for class action lawsuits — proceedings that critics say are needlessly expensive and overwhelmingly benefit attorneys rather than consumers. Indeed, the CFPB estimates the rule will provoke an additional 6,000 class actions to be filed every five years.

Opponents also strongly disagree with the rule's assumptions about the potential benefits from class actions. They say arbitration is a far less expensive, more efficient, and typically a more lucrative option for consumers. On the political front, many have criticized the timing of the rule as designed to aid CFPB Director Richard Cordray in his long-rumored plan to leave the agency to run for governor in Ohio this fall.

Concerns about the cost impacts of the rule led acting Comptroller of the Currency, Keith Noreika, to

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raise questions about whether it would imperil the safety and soundness of financial institutions. Noreika requested the CFPB share the data it used to develop its final rule.

Cordray responded dismissively, noting that the rulemaking process took more than two years during which time the OCC had not raised these concerns. When the OCC's Noreika asked the CFPB to delay publication of the final rule, the CFPB quickly rejected that idea. Noreika ultimately said that while he would not move to set aside the rule, he encouraged lawmakers to take action.

As part of its study, the CFPB said it reviewed more than 850 agreements for financial products and services, 1,800 consumer financial services arbitrations, 3,500 individual consumer finance cases in federal and state courts, 562 consumer finance class actions from a three-year period, and 40,000 small claims court filings from a one-year period, among other documents. Both those in favor of the rule and those against it point to the study's own findings for support.

The CFPB argues, for example, that arbitration clauses deprive consumers of a more effective way to fight financial institutions' alleged low-dollar abuses. The supplementary information for the rule quotes the observation that "[o]nly a lunatic or a fanatic sues for $30." The bureau for that reason argues that the availability of class actions — which, if they meet rigorous standards, allow one or more representatives to sue on behalf of all similarly situated consumers — is essential.

The CFPB predicts that under the rule, consumers will receive more than $342 million through class actions brought in federal court. The CFPB also claims that class actions will better promote deterrence, leading businesses to change abusive practices instead of resolving individual complaints with less risk of being held accountable for continuing to harm others.

But those opposed to the new rule draw very different conclusions, starting with the CFPB's own study.

They cite, for example, the bureau's findings that where consumers prevailed with an award in arbitrations, the average recovery was $5,389. On the other hand, the average relief in class actions that eventually settled was $32 — a paltry take especially when compared to the substantial transaction costs routinely incurred in class litigation.

Corroborating that view, the CFPB study shows that the real winners of class action lawsuits are the attorneys — the average payout to plaintiffs' attorneys is more than $1 million per class settlement, according to the CFPB's study. Some opponents of the rule take the position that the fact that individuals have little incentive to sue on a $30 claim makes alternative dispute resolution more, and not less, important.

The CFPB has instituted a robust complaint system designed to prompt financial institutions to timely respond. The complaint system also was designed to allow the CFPB to identify trends that might warrant follow-up supervisory or enforcement activity by the agency. These informal resolution systems, critics say, are the most appropriate ways for consumers and companies to deal with lower value but important disputes.

They add that the monitoring of those complaints, paired with investigatory and enforcement powers that Dodd-Frank consolidated within the CFPB itself, provide an effective means for any systemic issues to be remedied. Many opponents view the CFPB rule as needlessly delegating its core oversight and enforcement functions to private parties whose assessments of which claims to bring and what terms to settle upon are often made with financial incentives potentially at odds to those of the consumer, unlike the agency itself.

The interested folks on the sidelines

Trade associations have weighed in, voicing to Congress that the rule "severely undermines the ability of our organizations to continue to offer this convenient, simple, and efficient dispute resolution process to our customers." They have called the study incomplete and said the rule is contrary to the public interest.

Further, they said arbitration is faster and far more likely to reach a decision on the merits. They cite as support the CFPB study itself, which indicated that more than 80 percent of the class-action lawsuits studied failed to result in consumer benefits, despite racking up enormous costs for the defendants.

Longtime observers of arbitration debates point out that the CFPB's rhetoric about "forced arbitration" and protecting each consumer's right to a "day in court" mimics the general hostility toward arbitration that Congress intended to quash over 90 years ago through the passage of the FAA. Since then, many of these policy arguments against arbitration have been repeatedly rejected by the Supreme Court in FAA cases — perhaps most notably in *AT&T Mobility v. Concepcion*, 536 U.S. 333 (2011), which upheld the enforcement of consumer agreements that ban class actions by holding that the FAA trumps conflicting state laws that consider such clauses unconscionable.

Although the arbitration system might not be perfect, opponents of the rule argue that the inefficient class action device is hardly a better solution. Furthermore, arbitration providers have for many years offered consumer-specific procedures to ensure that even unrepresented and low income individuals have favorable venue, claim initiation, and fee waiver rules available to pursue their grievances.

Sudden death: The Congressional Review Act

The Congressional Review Act gives Congress the ability to overrule new regulations through a joint resolution passed by a simple majority within 60 legislative days of the new rule. Prior to the Trump administration, the CRA, which was signed into law in 1996, had been used just once to undo a regulation. Together with the White House, the Republican-controlled House and Senate have turned the act into a flying wedge of sorts, successfully using it to kill more than a dozen agency rules this year.

Rep. Keith Rothfus (R-Pa.), following the CFPB's release of its final rule, introduced in the House on July 20, 2017 a joint resolution providing for congressional disapproval of the arbitration rule. The resolution was co-sponsored by all 34 Republican members of the House Financial Services committee. Ahead of the vote, Rep. Jeb Hensarling (R-Texas), chairman of the House Financial Services Committee, cautioned that "making consumers pay more for less is the exact opposite of consumer protection, but it is exactly what this regulation means for every American."

Hensarling, in a press release on the results of the vote, referred to the rule as the "CFPB's Trial Attorneys Relief Act." Rep. Maxine Waters (R-Calif.), the ranking Democrat on the committee, called the resolution to kill the rule "an affront to hardworking Americans across the country."

The resolution passed 231-190, primarily along party lines. No Democrats voted in support of the resolution, and just one Republican — Rep. Walter Jones (R-N.C.) — voted against it.

Senate Republicans need full team strength to block rule

The CRA resolution in the Senate was sponsored by Sen. Mike Crapo (R-Iowa), chairman of the Banking, Housing, and Urban Affairs Committee, and 23 co-sponsors. The Senate received the House resolution on July 25, but has yet to vote on it. Republicans hold a slim majority in the Senate with 52 Republicans. There are 46 Democrats and two Independents who caucus with the Democrats in the Senate. Thus, the Republicans will need almost unanimous support — or support from a few Democrats — to pass the resolution.

Sen. Tom Cotton (R-Ark.) had said he hoped to overturn the rule before the August recess, but that deadline has passed.

"The last thing Americans need is more anti-business regulation that will prompt frivolous lawsuits while hurting consumers," Cotton said in a statement. Sen. Sherrod Brown (D-Ohio), on the other hand, ranking member of the Senate Committee on Banking, Housing and Urban Affairs, has promised a "hell of a fight" over the rule being overturned.

If the Senate is successful in repealing the rule through the CRA when it returns from recess, the CFPB cannot simply revise it and try again. Under the CRA, if Congress rolls back a rule, an agency cannot reissue it in "substantially the same form" unless Congress specifically authorizes it to do so through subsequent legislation.

Adding to the uncertain forecast, some have noted that Congress failed to undo the CFPB's rule on prepaid cards, although the CFPB has delayed its implementation. While Republicans in both chambers sought joint resolutions of disapproval, the resolution was not passed before the deadline.

On top of that, Congress is busy. Debate on health care reform and tax cuts may take top priority. The White House, for its part, has said it "strongly supports" the House resolution to nullify the arbitration agreements rule.

"If allowed to take effect, the CFPB's harmful rule would benefit trial lawyers by increasing frivolous class-action lawsuits; harm consumers by denying them the full benefits and efficiencies of arbitration; and hurt financial institutions by increasing litigation expenses and compliance costs (particularly for community and mid-sized institutions)," the White House said in a statement of Administration policy. If the House resolution were presented to President Trump as-is, his advisors would recommend he put his signature on it.

New director could affect outcome

Beyond the action (or lack thereof) in Congress, there are other movements on the horizon that may affect the fate of the arbitration rule.

President Trump is no fan of the CFPB's current structure. The administration filed an amicus brief in March 2017 in the closely-watched *en banc* review of the *PHH* decision by the D.C. Circuit. There, the administration appeared to endorse the view that the Bureau's constitutionality depended on striking the "for cause" limit on presidential authority to remove its director.

Others have suggested that if the D.C. Circuit upholds the trimming of CFPB independence in *PHH*, the bureau unavoidably would become an executive agency, and the arbitration rulemaking may have to be submitted to the cost-benefit analysis required of executive branch rulemaking. Finally, if Cordray steps down as CFPB director to run for governor in Ohio as expected, it is unclear what impact a new director appointed by President Trump would have. Many suspect a new director could seek to delay or undermine the rule's effectiveness in a variety of ways.

Just like in football where the season is long and early wins do not ensure future success, the CFPB's arbitration rule will face continued competition in other venues and the game is far from over. Should the rule survive Congressional review under the CRA over the short term, lawsuits from industry organizations are widely expected to follow.

Strap on the helmets and get ready to rumble if you choose to play in this arena.