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Chapman Client Alert

July 12, 2017

Current Issues Relevant to Our Clients

The CFPB's Final Arbitration Rule: A Deadly Blow to the Class Action Waiver

More than a year after the Consumer Finance Protection Bureau (*"CFPB"*) submitted a proposed rule to limit consumer financial services contract arbitration clauses, the CFPB sounded the death knell on July 10, 2017, when it released its long-awaited final rule (the *"Final Rule"*).[1] The Final Rule significantly restricts the contents of arbitration clauses used by banks, credit unions, credit card companies, and other loan providers in consumer financial services contracts. In addition, the regulations include additional onerous reporting requirements for companies offering covered products.[2]

Previously, under Supreme Court precedent, class action waivers contained in arbitration agreements were enforceable under the Federal Arbitration Act (*"FAA"*) and, in fact, were often enforced, even in the face of state law provisions that threatened to curtail their use.[3] Thus, the Final Rule is a stark departure from established law and upends the litigation path for consumer-related disputes.

Compelling cases into arbitration has long helped banks and other financial companies avoid potentially long, involved, and costly class action litigation. Contractual arbitration clauses allowed financial institutions to compel arbitration at the outset of litigation and shifted cases from court venues to consumer arbitration forums, like the AAA, JAMS, and others. In arbitration, companies could keep costs down, work within a more flexible framework, and often expedite dispute resolution. These arbitration clauses eventually evolved to be an effective tool for stopping class actions before they started by moving the forum of the case before a class could be certified. These clauses, including the class action waiver, essentially "busted" classes before they could even be certified because the lead plaintiff would be moved into solo arbitration.

The CFPB's Final Rule is expansive and covers all consumer credit products, including credit cards, deposit agreements, auto loans, payday loans, credit reports, and even mobile phone services that provide third-party billing.[4] As mentioned above, the Final Rule "prohibits providers from using a pre-dispute arbitration agreement to block consumer class actions in court and requires most providers to insert language into their arbitration agreements reflecting this limitation."[5] In other words, these companies must write arbitration clauses in their loan or credit agreements in ways that don't bar consumers from joining class action lawsuits. Thus, unlike previous practice, where many such consumer loan or credit agreements included class action waivers in their arbitration clauses, banks and other credit providers will need to explicitly explain that the arbitration clause contained in the agreement does not waive the borrower's right to participate in a class action lawsuit. **This means that almost all consumer credit arbitration clauses that are used now will need to be revised.**

The Final Rule will therefore make it less likely that banks and other financial institutions that make consumer loans or extend consumer credit will be able to avoid large class action lawsuits. This opens the door to potentially more expensive and lengthy lawsuits that are likely to drive up the cost of credit, putting credit further out of reach for many Americans. An additional likely effect is that consumers who want to circumvent previous class waivers can close current accounts and open new ones after the effective date.

In addition, the Final Rule compels covered companies to provide information about "initial claims and counterclaims, answers to these claims and counterclaims, and awards issued in arbitration" to the CFPB to decide if such rulings are "fair." This places a heavy burden, especially on larger lenders, to provide a potentially large quantity of information to the CFPB, which will again cost both time and money for financial service providers. It will also likely slow down the business of the CFPB, which will be inundated with a large number of documents that it will have to pore through. In addition, the CFPB has committed to making these documents (in redacted form) available to the public, which will result in more work and regulatory oversight.

The Final Rule will take effect 60 days from the date of publication in the Federal Register but applies only to agreements entered into after the end of the 181-day period after the effective date. Thus, companies that provide loans and extend credit to consumers must be careful to revise the language contained in those agreements in order to comply with the Final Rule, most likely by March 2018.

Notably, the Final Rule has drawn criticism from Congress, which could attempt to use the Congressional Review Act (*"CRA"*) to hijack the rule, which lawmakers have used this year to roll back a number of the previous administration's agency rules. The CRA allows Congress to nullify agency regulations with a simple majority and avoid a Senate filibuster. Given that the CFPB has drawn and continues to draw fire from the current administration, it remains to be seen whether the Final Rule will be subject to a challenge and, if so, if it will survive. However, prudent consumer credit providers should begin reviewing their arbitration clauses and preparing for the Final Rule. We note that arbitration clauses in effect prior to the March 2018 effective date remain valid.

For More Information

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1 Arbitration Agreements, 81 Fed. Reg. 32830 (May 24, 2016) (to be codified at 12 CFR Part 1040) *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-05-24/pdf/2016-10961.pdf.

2 Arbitration Agreements, ___ Fed. Reg. ___ (July 10, 2017) (not yet published in the *Federal Register*) *available at* http://files.consumerfinance.gov/f/documents/201707_cfpb_Arbitration-Agreements-Rule.pdf.

3 *See, e.g., DIRECTV, Inc. v. Imburgia*, No. 14-462, 577 U.S. ___, 2015 WL 8546242 (2015) (not yet published in the *Federal Register*); *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 131 S. Ct. 1740 (2011) (expressly rejecting California's "unconscionability" standard and holding that class action waivers are enforceable under the FAA); *see also Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 683, 130 S. Ct. 1758, 1774 (2010) ("[A] party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so."); *Am. Exp. Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2310, 186 L. Ed. 2d 417 (2013) (class action waivers are enforceable and do not deny a plaintiff any substantive right simply because individual claims of nominal value would more effectively proceed on a class basis).

4 The Final Rule applies to providers of certain consumer financial products and services in the core consumer financial markets of lending money, storing money, and moving or exchanging money, subject to certain exclusions specified in the Final Rule. For a full listing, please see http://files.consumerfinance.gov/f/documents/201707_cfpb_Arbitration-Agreements-Rule.pdf.

5 Arbitration Agreements, ___ Fed. Reg. ___ (July 10, 2017) (not yet published in the *Federal Register*) *available at* http://files.consumerfinance.gov/f/documents/201707_cfpb_Arbitration-Agreements-Rule.pdf.

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