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Trials &Tribulations

Ban of mandatory arbitration clauses opens door to class action lawsuits

On July 10, 2017, the Consumer Financial Protection Bureau (CFPB) passed a rule banning mandatory arbitration clauses in consumer banking and lending contracts. These arbitration provisions, also known as class action waivers, have the effect of preventing consumers from filing class action lawsuits against credit card companies and banks. Once the regulations become effective, consumers entering new credit and banking agreements will have the option of filing a class action lawsuit to dispute anything from overdraft fees to corporate wrongdoing.

Congress previously banned similar clauses for mortgage and real estate contracts pursuant to the Dodd Frank Act. The Dodd Frank Act also created the CFPB and granted it the power to issue regulations on the use of arbitration clauses in other areas of the consumer finance market.

Consumer rights advocates have heralded the passage of this rule (which has been a prime target of the CFPB since the agency's inception), as a major victory for consumers. Companies impacted by this rule—including banks and credit card companies, as well as their advisors—need to be informed on its various provisions. See 12 C.F.R. 1040, et seq. A full copy of the Federal Register publication of this rule can be found at https://www.federalregister.gov/documents/2017/07/19/2017-14225/arbitration-agreements.

The rule includes specific form language that companies will need to use in any arbitration clause they include in their new consumer contracts. See 12 C.F.R. 1040.4(a). The rule does not apply retroactively for existing consumer contracts, and it goes into effect in March 2018.

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The rule will also require companies to submit certain pleadings and records to the CFPB once a lawsuit or arbitration over a consumer financial contract has been commenced. See 12 C.F.R. 1040.4(b). Documents that must be provided include initial claims and counterclaims, answers and any awards issued in arbitration. The CFPB also requires companies to turn over all correspondence they receive from arbitration administrators regarding non-payment of arbitration fees or failure to follow the arbitrator's fairness standards. The CFPB has committed to reviewing the documents submitted to determine whether there are other issues that raise consumer protection concerns, which warrant further action. Beginning in July 2019, the CFPB plans to begin publishing these materials in a redacted format on its website, for the purpose of providing transparency in the arbitration of consumer disputes.

Consumer protection groups have pointed to recent fraudulent actions taken by financial companies' employees, including Wells Fargo bank, in support of this rule. Wells Fargo was sued in a class action lawsuit based on thousands of its employees setting up over two million fraudulent customer accounts without customers' permission. When the scandal first broke and lawsuits were filed, Wells Fargo initially tried to block class action lawsuits by citing arbitration clauses in the contracts customers signed with the bank. While Wells Fargo ultimately agreed to settle a class action lawsuit for $142 million, rather than pursuing its arbitration clause defense, many have argued this only occurred because Wells Fargo faced serious pressure from Congress. Consumer advocates insist that this rule is necessary to ensure that other companies have adequate incentive to avoid such abuses in the future.

Prior to issuing this rule, the CFPB issued a study in March 2015 reviewing the impact of mandatory arbitration clauses in the financial industry, and in October 2015, published an outline of the proposals under consideration. A proposed draft of the rule was released for comment in May 2016, and received over 110,000 comments. The Federal Register publication of the new rule is over 700 pages long and incorporates

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the history of arbitration proceedings, class actions, findings of the 2015 study and responses to many of the individual, industry and consumer group comments from 2016. The rule purports to prevent credit card companies and banks from continuing to include mandatory arbitration clauses in consumer contracts, which prevent class actions from being filed.

Congress has the power to repeal the CFPB's rule, and if recent Congressional action is an indication, repeal is very possible. The Congressional Review Act (CRA), allows Congress to repeal a federal agency's rules, where both houses are able to obtain a majority vote to repeal within 60 days of the rule being published (in this case July 19, 2017). The CRA permits the repeal of a regulation or rule of an executive agency by means of a "yes" or "no" vote, without the opportunity for amendment or filibuster.

The House of Representatives voted on July 25, 2017 to repeal the new CFPB rule (231 to 190).

On July 20, 2017, a dozen members of the Senate, including members of the Senate Banking Committee introduced a similar resolution to repeal the new CFPB rule, although the Senate has not yet voted on the resolution. It is predicted that the vote will be close and along party lines. The Senate will need to act by Sept. 18, 2017, to repeal the rule.

In the event the Senate fails to vote in favor of repeal by Sept.18, 2017, the rule will go into effect and apply to all contracts entered into with consumers more than 180 days after that deadline. This provides banks and credit card companies with about six months to update their consumer contracts with the new arbitration clauses and put processes in place to deal with the new documentation requirements.

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