Advisory: McGlinchey Stafford Insights on the CFPB's Arbitration Rule

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I. Strategies to Consider if the Rule Survives

The fate of the Consumer Financial Protection Bureau's (CFPB) final rule on arbitration agreements (the Rule) has been the subject of much speculation, given the possibility of both Congressional Review Act (CRA) override and judicial scrutiny. If the Rule survives, however, covered providers should consider retaining arbitration agreements in their financial services contracts, even if that means that covered providers will not be able to prevent consumers from joining class action lawsuits.

We believe, however, that arbitration agreements without enforceable class action waivers will still be useful. We note that many putative class action claims will not ultimately be able to be certified as class actions based upon the stringent requirements for class certification under Rule 23.

Recent U.S. Supreme Court decisions such as *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338 (2011), which requires strict commonality of claims among class members, and *Spokeo, Inc. v. Robins*, 136 S.Ct. 1540 (2016), which requires actual harm rather than technical statutory violations for standing, may have reduced the danger posed by putative class actions.

Thus, many putative class claims may still be required to be resolved on an individual basis, which would allow those claims to be subject to arbitration. Those individual claims may still be compelled to arbitration after "the presiding court has ruled that the case may not proceed as a class action."

Presumably, the provider would prefer to resolve the dispute in a non-public forum where the parties have agreed that punitive damages would not be allowed, as is typically the case in arbitration agreements.

II. Background on the Rule

On July 19, 2017, the CFPB published the Rule in the Federal Register (82 Fed. Reg. 33210). The 2010 Dodd-Frank Act called for the newly-minted CFPB to study the impact of arbitration provisions, and specifically class action waivers contained therein, and to then take whatever action it deemed necessary to protect consumers. The CFPB began its study in earnest in 2012, which it completed in 2015, and published a proposed rule in May of 2016. The proposed rule generated approximately 110,000 comments received from industry groups, consumer groups, and the general public. The Rule includes the CFPB's response to those comments, but, as expected, the Rule is very similar to the proposed rule in that it prohibits the use of any provision in a pre-dispute arbitration agreement that would prevent a consumer from joining a class action with respect to a covered consumer financial product or service.

The effective date of the Rule is September 18, 2017, but mandatory compliance with the Rule is not required until March 19, 2018 (Compliance Date). As a practical matter, the Rule will apply to contracts "entered into" on or after the Compliance Date, assuming that the Rule will actually take effect. As we discuss below, whether the Rule will actually take effect is uncertain. We therefore advise consumer financial product providers to become familiar with the Rule's requirements, and do some contingency planning, but they should consider holding off revising their arbitration agreements at this time.

III. Uncertain Future of the CFPB Arbitration Rule

The Congressional Review Act

Despite its long gestation, the Rule may have a short and/or uneventful life, for several reasons.

First, Congress may block implementation of the Rule pursuant to the CRA. Under the CRA, Congress may override any agency regulation via simple majority vote in both houses and the president's signature. The House of Representatives has already passed a resolution disapproving the Rule, and a companion resolution has been introduced in the Senate under the stewardship of Senate Banking Chairman Mike Crapo (R-ID) and Senator Tom Cotton (R-AR.).

With its much slimmer Republican majority, however, passage in the Senate is far from certain. Sens. Lindsey Graham (R-SC), John Kennedy (R-LA), and Susan Collins (R-ME) have all indicated they either have not yet decided to support the resolution or have decided to oppose it.

In addition, 19 state attorneys general have signed a letter urging the Senate to reject the resolution, adding to the political pressure. Compounding matters is Sen. John McCain's (R-AZ) absence for cancer treatment until after Labor Day. Under the CRA, the Senate must pass the resolution within 60 "legislative days" of publication of the Rule by the CFPB.

Due to the use of pro forma sessions during its August recess, the Senate will have a tight window in which to act when it returns to working sessions after Labor Day. If the resolution passes, it is expected that the president will sign it. At that point, the Rule is a nullity, and a substantially similar rule may not be promulgated by the CFPB without specific congressional authorization.

Litigation

Assuming the Rule survives the CRA, the American Bankers Association, the Financial Services Roundtable and other financial services trade organizations are prepared to challenge the Rule in court. Both Dodd-Frank and the Administrative Procedures Act require that the Rule be supported to some degree by the evidence, which the CFPB argues is provided in its study.

In reality, however, the CFPB's study revealed that actual consumer recovery in class actions is a small fraction of the typical arbitration award, and that the financial and administrative barriers to obtaining a class action recovery are often greater than those in an arbitration. In short, the supposed "risks" to consumers the Rule is intended to prevent are largely belied by the data collected by the CFPB in its study.

The Rule may also be challenged as an impermissible end run around the Federal Arbitration Act which, as an act of Congress that has long been interpreted by the Supreme Court to give rise to a strong presumption in favor of arbitration, may not be subverted by agency regulations. Other constitutional and procedural arguments may be raised as well. The litigation strategy will certainly be to initially persuade the court that the plaintiffs have a high degree of eventual success on the merits, so the court should issue an injunction preventing the CFPB from implementing the rule until the case is decided on the merits. If a court grants such an injunction, and the injunction survives interlocutory appeal, implementation of the Rule would, at a minimum, be long-delayed, perhaps to point that the Rule will likely never take effect.

More Possibilities

There are several other considerations that may affect the Rule. Even if the Senate is unable to pass a CRA resolution disapproving the Rule, other factors may either kill the Rule or delay its implementation.

CFPB Director Richard Cordray's dismissal under the new administration has been expected to varying degrees of certainty since January (suffice it to say that predicting this administration's personnel decisions is difficult at best). Director Cordray has also been rumored to be eyeing a run for governor of Ohio; if he does so, he will assuredly step down well before the expiration of his term on July 18, 2018.

When Director Cordray's tenure ends, it is safe to assume that his replacement will be amenable to reconsidering the rule and/or delaying its implementation. It should be noted, however, that the D.C. Circuit Court of Appeals recently invalidated EPA Administrator Scott Pruitt's attempt to delay implementation of a final rule published last year regarding monitoring of methane emissions from oil and gas wells, on the grounds that any reconsideration of a final rule must comply with the Administrative Procedures Act, including its requirements for notice and comment. *Clean Air Council v. Pruitt*, __ F.3d __; 2017 WL 2838112 (D.C. Cir. July 3, 2017). Accordingly, the extent to which a new Director (or Acting Director) can hamper implementation of the Rule may be limited.

Another variable relevant to the Rule's implementation is the D.C. Circuit's *en banc* rehearing of *PHH Corp. v. CFPB*, 839 F.3d 1 (D.C. Cir. 2016), in which the D.C. Circuit three-judge panel found the CFPB's structure constitutionally invalid. The *en banc* panel heard oral argument on May 24, 2017, and a decision is expected by early next year, prior to the Compliance Date. Whether the *en banc* panel will also find the CFPB constitutionally infirm, and if so what remedy it will order, are open questions, but at the very least the case represents a chance that all regulations promulgated by the CFPB may be subject to challenge.

Finally, the Office of the Comptroller of the Currency (OCC) initially indicated that it intended exercise its ability under Dodd-Frank to petition the Financial Stability Oversight Council (FSOC) to invalidate the Rule as impinging on the safety and soundness of regulated financial institutions. The acting Comptroller, however, ultimately backed off of that position and allowed the deadline to file such a petition to expire. The episode shows, however, that the Rule faces challenges from a wide variety of fronts.

IV. Scope of the Rule

If, as the Compliance Date approaches, it appears likely that the Rule will survive, we will supplement this alert with a more detailed analysis of the Rule. In the meantime, we will summarize the Rule's provisions and possible strategies for dealing with its challenges. We will begin with a review of the Rule's scope.

Generally speaking, the Rule applies to covered persons who are providers of certain consumer financial products who, on or after the Compliance Date, enter into arbitration agreements that bar consumer from filing or participating in a class action lawsuit. Those covered consumer financial products and services that are those that are subject to the CFPB's jurisdiction as specified in Dodd-Frank *and* that are listed in the Rule. The Rule lists as covered products and services extensions of credit (including servicing, acquiring, or purchasing or referring extensions of credit), automobile leasing, debt management or debt settlement and credit repair services, consumer credit reporting, deposit accounts, money transfers, payment services, and check cashing. As such, the Rule will not apply to commercial or business transactions.

While certain entities—including auto dealers, attorneys, merchants, and retailers—are technically exempt from the CFPB's jurisdiction, a covered person who services those entities' products will not be able to enforce any terms in those entities' arbitration agreements that limit consumers' class action rights. Practically, this may cause organizations not actually covered by the CFPB's rulemaking authority to comply with the Rule so that their covered person providers can continue to service their contracts. As a point of example, the CFPB highlighted that indirect automobile lenders and debt collectors, who are covered persons, could not enforce any prohibited terms of an arbitration agreement issued by an automobile dealer, a non-covered person.

Having said that, many questions have already arisen concerning the scope of the Rule, such as the Rule's applicability to vehicle service contracts and other ancillary products sold in connection with motor vehicle financing. Based on comments made by the CFPB in the Supplemental Information to the Rule in connection with the sale of auto club memberships, we anticipate that the CFPB would assert that the Rule applies to ancillary products that were sold and financed in connection with an extension of consumer credit.

Second, the Rule applies to contracts for covered products and services that are "entered into" on or after the Compliance Date. Note that the CFPB is using the phrase "entered into" in a way that is not necessarily intuitive. The CFPB interprets "entered into" to include "any circumstances in which a person agrees to undertake obligations or gain rights in an agreement."

The CFPB gives three examples of when a provider enters into a pre-dispute arbitration agreement.

1. When the consumer is provided a new product or service subject to an existing pre-dispute arbitration agreement and the provider is a party to the agreement. Note that this does not include new charges on an existing credit card agreement.

2. When the provider acquires or purchases a product or service that is covered by rule that is subject to a pre-dispute arbitration agreement and becomes a party to that agreement, even if the person selling the product or service is excluded from coverage.

3. When the provider adds a pre-existing arbitration agreement to an existing product or service.

The CFPB excluded from "enters into" a situation when the provider merely amends or modifies the terms of service, without providing a new product or service.

Based on those aspects of the Rule, we have several practice pointers that providers should consider:

1. The "entered into" date is not based on the date of the pre-disputed arbitration agreement, but may be based on when the product or service is provided.
   Modification of a pre-Compliance Date contract will not trigger the Rule. Offering a "new" product or service, such as the creation of new accounts, e.g., deposit or credit accounts, new closed-end credit transactions, or refinancing, will trigger application of the Rule to the new product or service.

2. The Rule applies to a providers who purchase or acquire covered products or services after the Compliance Date where the purchaser becomes a party to the arbitration agreement, even if the buyer did not offer any "new" product or service and even if the seller was not covered by the Rule. *Therefore, purchasers must track whether the purchased products and services are subject to an existing pre-dispute arbitration agreement.*

3. The Rule may apply to post-Compliance Date buyers who are not parties to an arbitration agreement. For example, a person who solely purchases a product agreement and not a separate arbitration agreement (commonly called "de-coupling" in auto finance) is not a party to the arbitration agreement. The purchaser is merely a third-party beneficiary of the arbitration agreement, and is prohibited from relying on the pre-March 19 arbitration agreement that bans a consumer class. Note that these buyers are subject to the Rule's reporting requirements discussed below.

V. Requirements of the Rule

The Rule's ban on class action waivers notwithstanding, some providers will wish to use continue using arbitration agreements after the Compliance Date. In that case, covered providers will have to comply with two substantive requirements of the Rule. The first is the banning of class action waivers (and the required disclosure of the consumer's right to participate in a class action) and the second is compliance with reporting requirements.

Disclosure Requirements

If a provider elects to continue to use an arbitration agreement on and after the Compliance Date, the agreement must include specific disclosures informing consumers of their rights to seek class action redress in the courts. Providers will need to revise any arbitration agreement used on or after the Compliance Data to disclose the following:

We agree that neither we nor anyone else will rely on this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action filed by someone else.

If the arbitration agreement applies to multiple products and services, but not all are subject to the Rule, the following alternative disclosure may be provided:

We are providing you with more than one product or service, only some of which are covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau. The following provision applies only to class claims concerning the products or services covered by the Rule: We agree that neither we nor anyone else will rely on this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action filed by someone else.

One or more of the following sentences, as applicable, may be added at the end of either of the disclosures above:

- *This provision does not apply to parties that entered into this agreement before March 19, 2018.*
- *This provision does not apply to products or services first provided to you before March 19, 2018 that are subject to an arbitration agreement entered into before that date.*
- *This provision does not apply to persons that are excluded from the Consumer Financial Protection Bureau's Arbitration Agreements Rule.*
- *This provision also applies to the delegation provision.*

New disclosure requirements will also apply to any arbitration agreement that previously existed between other parties, but are entered into by the current parties on or after the Compliance Date, that does not contain either provision above. The arbitration agreement must be amended to include the applicable provision above or the following written notice must be provided to the consumer to whom the agreement applies:

We agree not to rely on any pre-dispute arbitration agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action filed by someone else.

If the pre-dispute arbitration agreement applies to multiple products or services, but not all are covered by the Rule, this written notice may include the following additional optional language:

This notice applies only to class action claims concerning the products or services covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau.

The arbitration agreement must be amended, or the notice must be provided to the consumer within 60 days of "entering into" an arbitration agreement. A provider may elect to provide any of the disclosures required above in a language other than English if the arbitration agreement is written in that other language.

Reporting to the CFPB

After the Compliance Date, whenever an arbitration claim is filed by or against the provider or any case is filed in court against the provider, the provider must submit certain records to the CFPB. The provider may have someone else, such as an arbitration administrator or an agent of the provider, submit the records on the provider's behalf. However, the provider remains obligated to ensure that the records are submitted in compliance with the Rule.

The provider must submit records such as the arbitration claim, a copy of the arbitration agreement and the arbitration award, to the CFPB within 60 days after the provider files such records with the arbitrator, arbitration administrator or court and within 60 days of the provider's receipt of such record filed or sent by someone other than the provider, such as the arbitration administrator, the court, or the consumer.

The provider must also submit to the CFPB, when applicable, any communication received from an arbitrator or arbitration administrator related to a determination that the provider's arbitration agreement does not comply with the administrator's fairness principles, rules, or similar requirements. What constitutes these principles should be broadly interpreted. Examples include the American Arbitration Association's Consumer Due Process Protocol and JAMS Policy on Consumer Arbitration Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness.

Before submitting any of these records to the CFPB, the provider must redact the from the records information that would identify the individual consumers involved, such as names, addresses, telephone numbers, account numbers, Social Security numbers, and the numbers associated with driver's licenses and other government-issued identification documents.

Providers may arrange for another party, such as the arbitration administrator or the provider's agent, to redact the records. However, the provider remains responsible for ensuring that the other person's redaction complies with the Rule.

Covered persons should also note that records submitted to the CFPB will be easily accessible to and retrievable by the public. No later than July 1, 2019, the CFPB will post on its internet site all of the records that all providers have submitted to it up until that date, pursuant to the Rule. The CFPB will annually make submitted records available each year thereafter for documents received by the end of the prior calendar year.

Penalties for Non-Compliance With the Rule

The Rule does not contain any penalty provisions that would apply if a provider were not in compliance with the Rule. Therefore, it appears that the CFPB will enforce compliance with the Rule by exercising its supervisory and enforcement powers with respect to unfair, deceptive, or abusive acts and practices. There is no private right of action for violation of the Rule.

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