Morgan Lewis

CFPB ARBITRATION RULES WEBINAR 1.0

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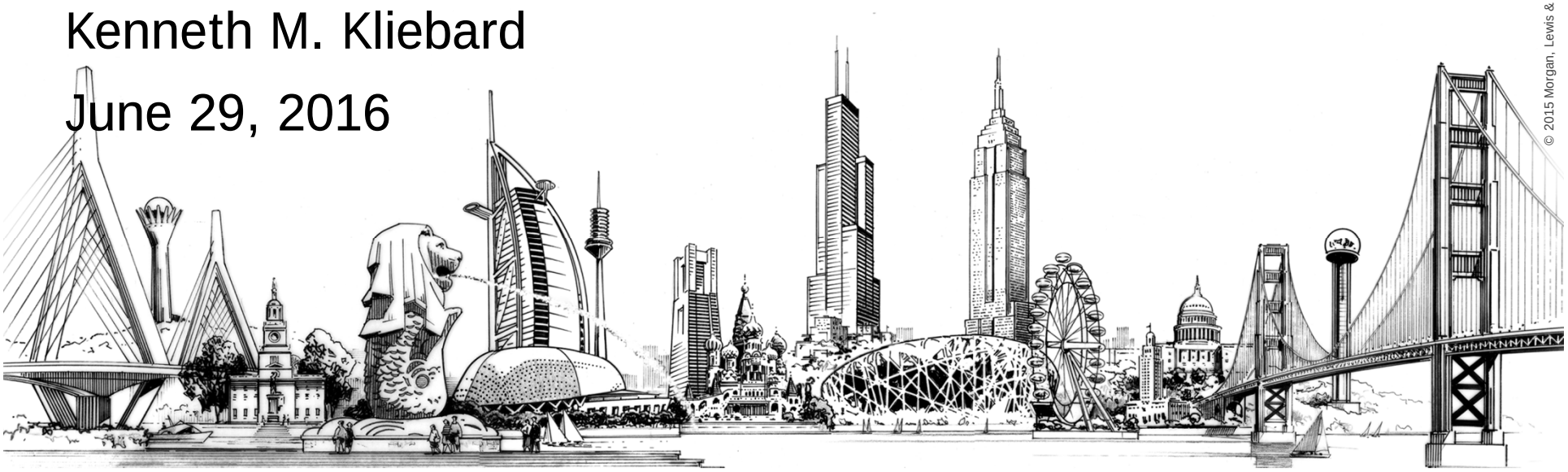

Summary

- The CFPB's Proposed Rules Prohibiting Mandatory Arbitration Clauses.
- Where is There Still Room for Arbitration?
- What Should a Covered Business Do to Prepare for Increased Class Action Defense?

The CFPB and Pre-dispute Arbitration Rules

- Consumer Financial Protection Bureau (CFPB) authorized by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), 15 U.S.C. §780, *et seq*.
- Dodd-Frank directed the CFPB to study pre-dispute arbitration agreements and after study, to issue appropriate regulations. Dodd-Frank at §1028(a)
- The same provision requires that the rules be consistent with the conclusions of the study.
- CFPB document is 377 pages. It need not have been. *Id.*

Definitions

- Provider – “A person ... that engages in offering or providing any **CONSUMER FINANCIAL PRODUCTS OR SERVICES** [generally involving an extension of credit, a lease acquiring, servicing, or selling either, debt settlement, accounts subject to the Truth in Savings Act, remittances, exchanging, exchanging banking data, check cashing, debt collection, and debit collectors], or their affiliates. Excluded from the definition are brokers providing services subject to SEC rules providing for pre-dispute arbitration, tribal governments to the extent that they are providing services to a resident of that government’s own territory, and certain non-financial retailers. Sec. 1040.2-3 (internal citations omitted).
- Detailed inclusions and exclusions require carefully parsing this provision before determining that a given business is not covered.

What Does the Proposed Rule Do?

- First – It prohibits **COVERED PROVIDERS** of **CONSUMER FINANCIAL PRODUCTS AND SERVICES** from using a mandatory arbitration agreement which bars a consumer from filing or participating in a class action with respect to that product or service.

What Does the Proposed Rule Do?

- Second, it would require the provision of certain records relating to each arbitration to the CFPB, thereby establishing a central database of arbitral results.

The CFPB Study

- In March 2015, the CFPB published the study required by Section 1028(a), "Arbitration Study, Report to Congress, pursuant to Dodd-Frank Wall Street reform and Consumer Protection Act §1028(a)." (Study) (Link Here).
- The Study concluded that mandatory arbitration worked to the disadvantage of consumers and that recoveries in class actions were significantly greater and that consumers were accordingly better off if they could exercise a class action cause of action in the first instance.
- The Study did not differentiate between class action recoveries and individual consumer recoveries in those class actions. That data would be useful to demonstrate that while class action recoveries may be greater, that the lion's share of such recoveries goes to plaintiff's attorneys, not to consumers. If so, it would render suspect the basis of the Proposed Rules.

Operation of the Rule

- “A provider shall not seek to rely in any way on a pre-dispute arbitration agreement entered into after the [effective] date with respect to any aspect of a class action that is related to any [covered] consumer financial product or service including to seek a stay or dismissal of particular claims or the entire action, unless and until the presiding court has ruled that the case may not proceed as a class action and, if that ruling may be subject to appellate review on an interlocutory basis, the time to seek such review has elapsed or the review has been resolved.” §1040.4

How Does This Work?

- While it makes no sense to include contractual provisions on which you may not act and doing so may violate other CFPB authorities, as well as federal and state consumer protection laws enforced by the Federal Trade Commission and the State Attorneys General, the operation of this Rule comes into play after the Complaint seeking class action certification is filed.
- It may be a violation of the CFPB's rules and result in an enforcement action against a civil defendant, if that defendant files a motion for a stay or dismissal in a covered "class action" matter in federal or state court.
- It may be a basis for a plaintiff to argue that a defendant's motion be stricken as undertaken in violation of this Rule promulgated under the authority of Dodd-Frank.
- This is uncharted territory and it remains to be seen how a federal judge would react to the argument that a party may not file a motion permitted by the rules of his court as the result of an administrative rule promulgated by an independent federal agency.

How Can Companies Protect Themselves From Class Actions?

- Consumer arbitration agreements with class action waivers emerged in the late 1990's.
- At that time, consumer-facing businesses were struggling with defending themselves against frivolous class actions, many of which were filed in state courts in "Judicial Hellholes," such as Madison County, Illinois, Texas, & Alabama.
- Often companies were stuck in those state courts with no chance of removing the case to federal court.
- Easy to get railroaded: "Drive-by" class certification.
- Created an uneven playing field that arbitration sought to combat.

How Can Companies Protect Themselves From Class Actions? – Con't.

- But, things have changed dramatically in favor of corporate defendants since the days when consumer arbitration was first deployed.
- Companies now have a lot of new tools in their arsenal.
- It is important for financial services firms to leverage these tools so they can mount a vigorous defense to the expected wave of class action lawsuits.

How Can Companies Protect Themselves From Class Actions? – Con't.

Tool #1: The Class Action Fairness Act of 2005

- Generally allows defendant to remove large class actions to federal court.

- Defendants are, as a general matter, likely to prefer a federal forum and the additional procedural protections.

How Can Companies Protect Themselves From Class Actions? – Con't.

Tool #2: The Twombly/Iqbal Pleading Requirements (2007, 2009)

- Changed the landscape and placed a much higher burden on class action plaintiffs.
- Requiring a plaintiff to include enough facts in the complaint to make it plausible, and not merely possible, that the plaintiff will be able to prove facts to support the lawsuit's claims.
- Helps avoid the frivolous lawsuit followed by the discovery fishing expedition.

How Can Companies Protect Themselves From Class Actions?" – Con't.

Tool #3: Courts' Rigorous Review of Class Certification Requirements

- Sea change: Since 2000 there has been a nearly universal movement by courts to a rigorous review of the class certification requirements and not one that, as in the past, relied only on the well pleaded allegations of the complaint. See, e.g., *Szabo v. Bridgeport* (7th Cir. 2001).
- Reaffirmed in the Supreme Court's *Comcast Corp. v. Behrend* decision --district courts must undertake a "rigorous analysis" of whether a putative class satisfies the predominance criterion set forth in Federal Rule of Civil Procedure 23(b)(3).

How Can Companies Protect Themselves From Class Actions? – Con't.

Tool #4: Other Challenges to Class Certifications

- Increased emphasis on Rule 23's commonality requirement following the Supreme Court's decision in *Wal-Mart Stores v. Dukes.*
- Focus on using expert witnesses at the class certification stage, including the application of *Daubert* .

How Can Companies Protect Themselves From Class Actions? – Con't.

Tool #5: Interlocutory Appeal of Class Certification Orders

- Rule 23(f) was added December 1, 1998.
- Allows a party to seek interlocutory appellate review on an order granting or denying class certification.

A Few Things You Can Do Now

- Risk Assessment: Work with experts to assess your company's consumer products and services. Focus on high-risk areas that have been the subject of suits against competitors or regulatory/enforcement matters. This is where plaintiff's class action lawyers hunt for new lawsuits.
- Quality Control: Make sure consumer disclosures are up-do-date and accurate. Make sure employee training is up-to-date. Ensure procedures for handling customer complaints are in place and adequate to identify issues and trends. Consider a "secret shopper" program. Work with internal or external auditors to ensure that procedures around high-risk areas are in place and are adhered to.
- Insurance: Ensure you have the right insurance in place to protect against potential class action exposure.
- Be Prepared for Litigation: Think about how your company will defend itself in a class action. Are records, such as customer disclosures and customer agreements, preserved and maintained in a way that is readily accessible. Does your company provide helpful information on its website in a consumer-friendly way so that your defense counsel will have a good story to tell?

Arbitration Reporting Requirements

- Must submit a report to the CFPB.
- Within sixty days of award.
- Must provide key details of the matter.

What Does This Mean?

- Arbitration is functionally public.
- The value of disposing of a matter in a non-public setting is gone.
- Plaintiffs have a database of your “tells.”
- CFPB has more metrics which it may allege are “unfair.”

Challenges?

- Overall authority of the Director. *PHH vs. CFPB* (pending decision in DC Circuit on question of whether CFPB Director is too removed from any form of review).
- Quality of the Study. Dodd-Frank required the Rule to be consistent with the Study. The Study's central conclusion, e.g., that class action is better for consumers than arbitration, is suspect. If that falls, does the Rule.
- Congress?
- A new President?

THANK YOU