Bloomberg BNA

BNA's Banking Report™

Arbitration

This article examines how the U.S. Supreme Court has addressed class-action waivers in consumer agreements for financial or financial-related services and determine what, if any, guidance they offer on how courts might treat the CFPB's proposal to prohibit class-action litigation waivers in the consumer financial services setting. The authors also review a recent case in the U.S. District Court for the Southern District of New York involving Uber that may preview future lines of debate in this arena.

BNA INSIGHTS: How Supreme Court Precedent May Affect the CFPB's Pre-Dispute Arbitration Proposal

By Michael Baratz, Matthew Kulkin and Lisa Southerland

On May 24, 2016, the Consumer Financial Protection Bureau (CFPB) proposed a new rule aimed at governing the use of pre-dispute arbitration agreements between consumers and certain consumer financial products and services providers.[1] The CFPB's proposed rule would, in part, preclude such providers "from using a pre-dispute arbitration agreement to block consumer class actions in court."[2] Covered providers would have to include the following provision in their arbitration agreements with consumers:

> We agree that neither we nor anyone else will use 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 even if you do not file it.[3]

The CFPB's proposed language must also comport with the Federal Arbitration Act (FAA).[4] Section 2 of the FAA provides that arbitration agreements are generally "valid, irrevocable, and enforceable," but it also includes a "saving clause" that permits courts to invalidate an arbitration agreement based "upon such

[1] Arbitration Agreements, 81 Fed. Reg. 32,830 (May 24, 2016).
[2] *Id.*
[3] *Id.* at 32925-26.
[4] 9 U.S.C. § § 1-16 (2012).

 ISSN 0891-0634

grounds as exist at law or in equity for the revocation of any contract.''[5]

The CFPB's latest proposal faces an uncertain path forward. The bureau continues to face significant political criticism and is the subject of a series of legislative proposals either to amend its structure or to repeal its authorizing statute.[6] At the same time, the CFPB's budget and use of resources remains fodder for critics on Capitol Hill.[7]

If adopted, this regulation would affect a wide range of consumer financial services companies, ''including those related to the core consumer financial markets that involve lending money, storing money, and moving or exchanging money.''[8] The public comment period closed Aug. 22, 2016.[9] Since its publication three months ago, we have seen regulated entities and consumer protection advocates line up in opposition to, and support for, respectively, the CFPB's proposal.[10] The submission public comments filed this week indicate that there has not been a material shift in these sentiments.[11]

This article explores the judicial precedent surrounding the use of arbitration agreements and waivers to class-action lawsuits. The Supreme Court addressed many of these issues in *AT&T Mobility LLC v. Concepcion*,[12] *American Express Co. v. Italian Colors Restaurant*,[13] and *DIRECTV, INC. v. Imburgia*.[14] We examine how these cases have addressed class-action waivers in consumer agreements for financial or financial-related services and determine what, if any, guidance they offer on how courts might treat the CFPB's proposal to prohibit class-action litigation waivers in the consumer financial services setting. We also review a recent case in the U.S. District Court for the Southern District of New York involving Uber that may preview future lines of debate in this arena. Finally, we consider alternative measures the CFPB could use to achieve similar public policy objectives as stated in the proposed rule.

Federal Arbitration Act Requirements

The FAA reflects Congress' desire for courts to treat arbitration agreements the same as other contracts.[15] The Supreme Court has consistently found that the FAA requires courts to ''rigorously enforce'' the terms of arbitration agreements.[16] However, the saving clause in Section 2 allows courts to invalidate an arbitration agreement based on ''generally applicable contract defenses, such as fraud, duress, or unconscionability.''[17] Nevertheless, lower courts grappled with the scope of the FAA and how it applied to defenses such as state unconscionability doctrines until the Supreme Court's 2011 decision in *Concepcion*.

Unconscionability of Class Arbitration Waivers and FAA State Law Preemption

Prior to 2011, courts were divided on whether arbitration agreements with class-action waivers were unconscionable, and therefore unenforceable. Delaware and North Dakota courts, for example, found that class arbitration waivers were not unconscionable,[18] while California, Missouri and North Carolina courts, for instance, found the opposite.[19] Some courts went further and explicitly found that the FAA did not preempt their state unconscionability doctrines.[20] But since its decision in *Concepcion*, the Supreme Court has consistently found that the FAA requires courts to enforce arbitration agreements according to their terms, even when those terms preclude class arbitration.

AT&T Mobility LLC v. Concepcion.

In *Concepcion*, certain consumers responded to AT&T's advertisement for services that included free phones. They entered into a service agreement with the company and received the phones. They did not pay the retail value for them, but they did have to pay sales tax based on the phones' value. Based on that payment, the consumers filed a complaint against AT&T alleging false advertisement and fraud for its claim of ''free'' phones. That complaint was later consolidated with a putative class action.[21]

---

[5] *Id.* § 2.

[6] *See, e.g.*, Fin. CHOICE Act of 2016, Discussion Draft, 114th Cong. House Fin. Servs. Comm. (May 23, 2016); Repeal CFPB Act, S. 1804, 114th Cong.

[7] Appropriations Committee Approves FY2017 Financial Services & General Government Appropriations Bill, United States Senate Committee on Appropriations (June 16, 2016); *see also* Fin. Servs. & Gen. Gov't Appropriations Act, 2017, H. Res. 794, 114th Cong. (as passed by House on July 5, 2016).

[8] Press Release, Consumer Financial Protection Bureau, CFPB Proposes Prohibiting Mandatory Arbitration Clauses that Deny Groups of Consumers Their Day in Court (May 5, 2016).

[9] Public comments are available at https://www.regulations.gov/docket?D=CFPB-2016-0020.

[10] *See* Rob Nichols,ABA Statement on CFPB Proposed Arbitration Rule, (May 5, 2016); *See also* Press Release, Americans for Financial Reform, CFPB Makes a Compelling Case for Banning Forced Arbitration (Mar. 10, 2015).

[11] *See* Credit Union National Association, CFPB Arbitration Changes Against Members' Best Interests: CUNA (Aug. 18, 2016); *See also* Press Release, Better Markets, CFPB Stops Industry From Forcing Injured Consumers to Give Up Legal Rights (Aug. 22, 2016).

[12] 563 U.S. 333 (1996).

[13] 133 S. Ct. 2304 (2013).

[14] 136 S. Ct. 463 (2015).

[15] *See Concepcion*, 563 U.S. at 339 (discussing congressional intent behind enacting the FAA).

[16] *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985); *see also, e.g.*, *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 67 (2010) (''The FAA reflects the fundamental principle that arbitration is a matter of contract.''); *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989) (explaining that the FAA requires courts to enforce arbitration agreements according to their terms).

[17] *Concepcion*, 563 U.S. at 339 (quoting *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (internal quotation marks omitted)).

[18] *See, e.g.*, *Strand v. U.S. Bank N.A.*, 693 N.W.2d 918 (N.D. 2005); *Edelist v. MBNA Am. Bank*, 790 A.2d 1249 (Del. Super. Ct. 2001).

[19] *See, e.g.*, *Brewer v. Mo. Title Loans, Inc.*, 323 S.W.3d 18 (Mo. 2010) (en banc); *Tillman v. Commercial Credit Loans, Inc.*, 655 S.E.2d 362 (N.C. 2008); *Discover Bank v. Super. Ct.*, 113 P.3d 1100 (Cal. 2005).

[20] *See, e.g.*, *Feeney v. Dell, Inc.*, 908 N.E.2d 743, 767-69 (Mass. 2009); *Discover Bank*, 113 P.3d at 1110-17.

[21] 563 U.S. at 337.

  BBR ISSN 0891-0634

AT&T moved to compel arbitration under the terms of its contract with the consumers.[22] The contract specifically provided for arbitration of all disputes in an ''individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding.''[23] The consumers opposed the motion based on the *Discover Bank* rule, through which the California Supreme Court had extended the state's unconscionability doctrine to class-action waivers in arbitration agreements.[24]

The Supreme Court held that the FAA preempted California's *Discover Bank* rule, and therefore its unconscionability doctrine, to the extent that the rule would require companies to permit arbitration on a class basis.[25] The Supreme Court based its reasoning on three principles: (1) allowing a party to ''demand'' class arbitration after the fact would impede parties' ability to design ''efficient, streamlined'' dispute resolution procedures;[26] (2) class arbitration would require formal procedures to protect the interests of absent class members;[27] and (3) class arbitration would impose additional and unaccounted-for risk on defendants due to its informality and absence of extensive review procedures.[28] The *Concepcion* court reasoned that ruling otherwise would allow state courts to do what state legislatures could not: To use generally applicable contract defenses to frustrate the objectives of the FAA.[29]

American Express Co. v. Italian Colors Restaurant.

The Supreme Court addressed the enforceability of class-action arbitration waivers again in 2013 in *Italian Colors*. This time, the Supreme Court specifically considered whether the FAA also required courts to enforce class arbitration waivers for federal law claims when claimed damages were only for small amounts per individual.[30]

In *Italian Colors*, various merchants brought a class action against American Express, which they claimed violated federal antitrust laws by using its extensive control over the credit card market to charge the merchants unfairly high credit card rates.[31] American Express moved to compel individual arbitration pursuant to the agreement it had with the merchants, which included a provision waiving any ''right or authority for any Claims to be arbitrated on a class action basis.''[32]

The merchants opposed the motion by essentially arguing the ''effective vindication'' exception.[33] The exception, established in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[34] allows the court to find that an arbitration agreement is unenforceable as ''against public policy'' if it ''operate[s] . . . as a prospective waiver of a party's right to pursue statutory remedies . . . .''[35] The merchants claimed that the class-action waiver was just the type of prospective waiver that the court contemplated in *Mitsubishi Motors*: The high cost of individual arbitration relative to any possible award of damages prevented the merchants from pursuing their individual claims under the Sherman Act.[36] They submitted an economist declaration estimating that the most damages a merchant would receive in individual arbitration was $38,549, whereas the expert analysis necessary to prove that merchant's antitrust claims would cost from several hundred thousand dollars to more than $1 million.[37]

That argument, however, failed to persuade the Supreme Court, which held that the class-action waiver was binding.[38] In its reasoning, the Supreme Court highlighted the difference between a ''right to pursue statutory remedies'' and ''the fact that it is not worth the expense involved in proving a statutory remedy . . . .''[39] It found that restricting the means by which a party could vindicate statutory rights, such as only through individual arbitration, was not the same as completely foreclosing the right to a remedy, such as might be the case if the arbitration agreement prohibited outright a consumer from asserting statutory rights or required filing and administration fees so high that a consumer had no practical access to the forum.[40]

DIRECTV, Inc. v. Imburgia.

In *Imburgia*, the Supreme Court addressed the enforceability of a class-action arbitration waiver in California. That waiver included a provision invalidating the entire arbitration agreement ''if the 'law of your state' makes the waiver of class arbitration unenforceable.''[41] Lower courts, interpreting the contract according to California law, found that the terms of the arbitration agreement made it unenforceable.[42] They explained that even though the FAA preempted the *Discover Bank* rule that rendered class arbitration waivers unconscionable (and therefore unenforceable) under California law, the rule was still part of California state law.[43]

On review, however, the Supreme Court overturned the lower courts and held that the arbitration agree-

[22] *Id.*
[23] *Id.* at 336.
[24] *Id.* at 340-42 (citing CAL. CIV. CODE § 1670.5(a) (West 1985); *Discover Bank v. Super. Ct.*, 113 P.3d 1100, 1110 (Cal. 2005) (establishing the *Discover Bank* rule, which found class-action arbitration waivers to be unconscionable contracts of adhesion when: (1) they appeared in contexts known for disputes over small damages claims, and (2) one party alleged that the other used its ''superior bargaining power'' to ''deliberately cheat large numbers of consumers out of individually small sums of money'')).
[25] *See Concepcion*, 563 U.S. at 348, 352.
[26] *Id.* at 346.
[27] *Id.* at 349.
[28] *Id.* at 350.
[29] *Id.* at 341; *see also id.* at 347 n.6.
[30] *See* 133 S. Ct. at 2307; *see also Concepcion*, 563 U.S. at 351 (acknowledging the dissent's argument that class-action arbitration was ''necessary'' to prevent ''small-dollar claims'' from ''slip[ping] through the legal system'').
[31] 133 S. Ct. at 2308.
[32] *Id.* (quoting *In re Am. Express Merchants' Litig.*, 667 F.3d 204, 209 (2d Cir. 2012) (internal quotation marks omitted)).
[33] *Id.* at 2308, 2310.
[34] 473 U.S. 614 (1985).
[35] *Id.* at 637 n.19.
[36] *Id.* at 2310.
[37] *Id.* at 2308.
[38] *See id.* at 2309, 2312.
[39] *Id.* at 2310-11.
[40] *Id.*
[41] 136 S. Ct. 466.
[42] *Id.*
[43] *Id.* at 467.

ment was enforceable.[44] It reasoned that interpreting the contract according to preempted California law would conflict with the FAA's intent for courts to interpret arbitration agreements according to ''grounds as exist at law or in equity for the revocation of any contract'' because it would provide a remedy under California law that did not necessarily exist for other contracts.[45]

Together, these cases indicate that the Supreme Court has largely upheld class-action *arbitration* waivers.[46] But it has not directly addressed whether it will also uphold class-ction *litigation* waivers. This distinction may or may not prove significant in the eyes of the Supreme Court, as recent lower court decisions have shown.

Application of Supreme Court Precedent to CFPB's Proposed Rule

Whether the CFPB may preclude consumer financial products and services providers from having consumers waive their right to class-action litigation through predispute arbitration agreements remains open. The U.S. District Court for the Southern District of New York recently examined class-action litigation waivers, or those outside the context of arbitration, in *Meyer v. Kalanick*.[47] In that case, an Uber customer filed a complaint in a putative class action against the CEO of Uber, a California company.[48]

The customer alleged that the CEO conspired with Uber drivers in a price-fixing scheme, thereby violating federal and state antitrust laws.[49] Uber's CEO moved for a partial reconsideration of the court's determination that the customer had not waived his right to class action when he signed up to use Uber and accepted Uber's user agreement.[50] The user agreement contained a provision stating that,

> ''You acknowledge and agree that you and Company are each waiving the right to a trial by jury or to participate as a plaintiff or class User in any purported class action or representative proceeding.''[51]

The court denied the CEO's motion for partial reconsideration solely on procedural grounds.[52] But it still went on to address whether the class-action waiver, if binding independent of the arbitration clause, would be enforceable under California law.[53]

The court reviewed *Concepcion* and *Italian Colors* and concluded that, while the FAA preempted California's *Discover Bank* rule as applied to class-action waivers, it only did so in the context of arbitration.[54] Specifically, the *Concepcion* court noted that class arbitration slowed the dispute resolution process, cost more, required formal procedures and inadequately protected the rights of defendants.[55] However, the *Kalanick* court distinguished class litigation from class arbitration, explaining that litigation inherently both ''accepts'' the increased risk of proceeding on a classwide basis and requires ''procedural formality,'' despite the fact that it prolongs proceedings.[56] It therefore concluded that the *Discover Bank* rule as applied to class litigation did not clearly ''interfere[] with fundamental attributes of arbitration.''[57]

The court also noted that, in *Italian Colors*, the Supreme Court precluded the use of federal antitrust laws and Federal Rule of Civil Procedure 23 as bases for arguing that Congress did not intend for the scope of the FAA to extend to class-action waivers.[58] It went on to find, however, that those statements did not provide sufficient authority to preempt California state law unconscionability doctrine.[59] It thought that to do so would be ''a dramatic extension'' of FAA case law to ''independent class action waivers.''[60]

This case distinguishes class-action arbitration waivers, discussed in *Concepcion* and *Italian Colors*, from class-action litigation waivers, but the case law concerning the enforceability of class-action litigation waivers is still underdeveloped.[61] It is therefore difficult to gauge how courts might balance the competing interests of the FAA and consumer protection if, or when, they need to assess the constitutionality of the CFPB's proposed language preserving rights to class-action litigation.

Guidance from Courts and Federal Agencies

The CFPB's proposed rule stems from its concern that ''individual dispute resolution mechanisms'' do not adequately ensure that companies adhere to consumer financial protection laws and respect consumer financial contracts.[62] If the CFPB sought an alternative approach to achieve its stated policy goals, we can look to courts and other federal agencies for guidance.

The CFPB can encourage companies to follow consumer financial protection laws and to provide access to remedies for consumers by regulating the content of class-action litigation waivers. The Supreme Court, for example, looked favorably on the arbitration agreement in *Concepcion*.[63] It noted several provisions favoring the consumer, including that: (1) AT&T had to ''pay all costs for non-frivolous claims''; (2) ''arbitration must take place in the county in which the customer is billed''; (3) AT&T could not seek attorneys' fees; and (4) AT&T would pay consumers at least $7,500 and double their attorneys' fees if the consumers' arbitration award

---

[44] *Id.*
[45] *See id.* at 469-71 (quoting 9 U.S.C. § 2; *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006) (noting a goal of the FAA was to place arbitration agreements ''on equal footing with all other contracts'')).
[46] *See Imburgia*, 136 S. Ct. at 469; *Italian Colors*, 133 S. Ct. at 2310-12; *Concepcion*, 563 U.S. at 352.
[47] No. 15 Civ. 9796, 2016 WL 2659591 (S.D.N.Y. May 9, 2016).
[48] *Id.* at *1-2.
[49] *Id.* at *1.
[50] *Id.*
[51] *Id.*
[52] *See id.* at *2 (observing that the CEO's motion made the same substantive arguments that he presented in his motion to dismiss).
[53] *Id.* at *3.
[54] *Id.* at *7.
[55] 563 U.S. at 347-50.
[56] No. 15 Civ. 9796, 2016 WL 2659591, at *7.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *See id.* at *6-8.
[62] 81 Fed. Reg. at 32855.
[63] 563 U.S. at 351-52.

  BBR ISSN 0891-0634

was worth more than the company's last settlement offer.[64]

The CFPB could similarly require covered providers to include in their class-action litigation waivers features such as: (1) opt-out provisions; (2) key provisions written in bold or large font; (3) statements clearly explaining the differences between arbitration and litigation, and individual and class action; (4) pro-consumer cost- and fee-sharing provisions; and (5) provisions for a claimant-friendly forum. Such a regulatory scheme might be found to respect the FAA's preference for arbitration, yet ensure that companies respect consumers' rights and consumer financial protection laws.

Another example is the Commodity Futures Trading Commission's framework that requires that all predispute arbitration clauses in customer agreements for CFTC-regulated products and services be voluntary.[65] Such agreements must also disclose several facts to consumers, including that they may still receive the product or service if they do not sign the agreement, and that they are only subject to the arbitration provision if they sign it separately.[66] While not a consumer finance-focused regulation, this regulatory scheme would both encourage compliance with consumer financial protection laws and preserve parties' freedom to contract for favorable and mutually agreeable dispute resolution mechanisms.

Conclusion

While the Supreme Court has largely clarified that the FAA requires precise enforcement of arbitration agreements, including those with class arbitration waivers, it has not yet spoken on whether or how the FAA applies to class-action litigation waivers. Consumers are making novel legal arguments and forcing courts to explore whether the reasons and public policy concerns for denying a right to class arbitration also apply to class litigation. It is unclear how or whether courts will apply rulings on class arbitration to the CFPB's proposed rule regarding class litigation.

---

[64] *Id.* at 337.

[65] 17 C.F.R. § 166.5(b).

[66] *Id.* at § 166.5(c).