



## Is the CFPB's Proposed Arbitration Ban Legal?

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Last week, the Consumer Financial Protection Bureau (CFPB) announced that it was considering the introduction of a new regulation banning the so-called “free pass” arbitration clauses that prevent consumers from filing lawsuits in groups to obtain relief against financial services companies.

“Consumers should not be asked to sign away their legal rights when they open a bank account or credit card,” said CFPB Director Richard Cordray. “Companies are using the arbitration clause as a free pass to sidestep the courts and avoid accountability for wrongdoing. The proposals under consideration would ban arbitration clauses that block group lawsuits so that consumers can take companies to court to seek the relief they deserve.”

After the announcement came out, *Litigation Daily* founding editor and Reuters legal columnist Alison Frankel viewed the potential enactment of this proposal as historic, with CFPB reversing a pair of U.S. Supreme Court rulings related to arbitration clauses.

“What the U.S. Supreme Court took away from consumers in its pro-arbitration decisions in *AT&T Mobility v. Concepcion* and *American Express v. Italian Colors*, the [CFPB] intends to give back,” Frankel wrote for Reuters. Frankel added that the proposed rule “followed the agency’s release last March of an arbitration study mandated in the 2010 Dodd-Frank financial reform law [and] would restore consumers’ right to band together to sue banks, credit card companies, payday lenders and other financial services businesses.”

And this raises a new question: does the CFPB have the legal authority to overturn Supreme Court rulings related to arbitration? The answer, according to industry experts, depends on how you view the CFPB’s actions.

John Councilman, CMC, CRMS, president of NAMB—The Association of Mortgage Professionals and president of Fort Myers, Fla.-based AMC Mortgage Corporation, noted that from a layman’s perspective, the law appears to be in the CFPB’s favor.

“I don’t intend to play lawyer, but a quick look at this appears to indicate arbitration may not be impinged upon when a federal statute does not force arbitration or prevents arbitration,” he stated. “But, if the statute prohibits arbitration, it is banned ... So, Dodd-Frank prohibits

arbitration on mortgages, making it easy for the CFPB to issue to ban on arbitration. Sec 1414 of Dodd-/Frank states: ‘No residential mortgage loan and no extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer may include terms which require arbitration or any other non-judicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction.’”

Les. R. Kramsky, a real estate attorney based in Marlboro, N.J., noted that the Dodd-Frank Act gave the CFPB the authority to venture into the question of arbitration.

“The Dodd-Frank Act does permit the CFPB the authority to study the use of arbitration clauses for financial products and services,” Kramsky explained. “The CFPB can ban the so-called ‘free pass’ arbitration clause if it determines that it is in the public interest and for the protection of consumers. Therefore, the CFPB can prohibit ‘free pass’ arbitration clauses in the contracts of banks, credit card companies and any other financial services business despite the two U.S. Supreme Court rulings—AT&T Mobility v. Concepcion and American Express v. Italian Colors—that favored the arbitration clauses the agency is trying to ban.”

Yet Alan S. Kaplinsky, head of the Consumer Financial Services Group at Ballard Spahr LLP, questioned whether the CFPB took its congressionally mandated responsibility a bit too far.

“Congress authorized the CFPB to conduct a study on arbitration in consumer financial services institutions and said that if it found arbitration is not in the public interest, then the bureau has a right to issue a regulation to prohibit it,” he said. “This does not mean they can regulate out of thin air – they can only regulate if their study shows it is necessary to protect consumers. But their own study showed that arbitration is in the public interest and consumers were being protected by it. The regulation they are thinking of issued would be invalid – not because of the Supreme Court cases, but because it was contrary to their study.”

Whether the CFPB moves forward on this potential new rule remains to be seen – Kaplinsky recently spoke at a Denver-based field hearing sponsored by the bureau to weigh the pros and cons of the matter. And while current law prevents the inclusion of mandatory arbitration clauses in mortgage agreements, the addition of a ban on “free pass” arbitration could bring about a new wave of litigation against lenders and servicers.

“I suspect the CFPB is going to say they have oversight over federally regulated mortgages and with this oversight they can institute certain requirements such as banning arbitration clauses in federally related mortgages,” said Marx Sterbcow, managing attorney at The Sterbcow Law Group LLC in Harahan, La. “I’m not sure if this additional CFPB anti-arbitration requirement would apply to loans originated after they implement this proposed requirement.”

In the event that the CFPB decides to enact this proposal as a new regulation, at least one industry expert is eager to see the legal challenge to its implementation.

“I am looking forward to this litigation,” said Adam Leitman Bailey, a New York City-based real estate attorney. “The government will argue that in this specific situation there is a special governmental need to regulate these provisions to protect American citizens. The lenders will argue that this violates their right to enter contracts.”

And another observer believed the CFPB leadership will not lose sleep in determining the legality of such a regulation.

“Given original nature of Cordray's appointment, it's not like the guy views the Constitution as a constraint, said Mark A. Calabria, director of financial regulation studies at the Cato Institute in Washington, D.C.