The Continuing Assault on Contractual Arbitration Clauses; A Further Examination

By Richard M. Mitchell

Last fall, I wrote in this space about the status of the enforceability of contractual arbitration agreements in commercial and employment contracts. My partner, David Saperstein, followed this with a discussion of such clauses in the context of the Financial Industry Regulatory Authority ("FINRA"). This area of law continues to evolve and, thus, so does our examination of it.

Efforts by creative counsel to defeat these clauses have been extensive. While arbitration agreements appear in a wide range of commercial contracts, many plaintiffs have argued they neither read nor understood them and unknowingly forfeited access to the judicial system. Arguments against them have included allegations that (1) arbitration clauses lack consideration and do not represent a bargained-for exchange,[1] (2) that such clauses are unconscionable,[2] (3) and that they constitute a waiver of a trial by jury.[3] We have discussed these issues in detail in prior columns. We now turn to some more recent developments.

The Consumer Financial Protection Bureau

One of the most important issues involving the enforceability of arbitration agreements involves the Consumer Financial Protection Bureau ("CFPB"). On May 5, 2016, this consumer watchdog issued a proposed rule that would preclude arbitration clauses regarding class action lawsuits against financial institutions. This is extremely significant in that an array of commercial agreements contain such language. Arbitration clauses can be found in credit card applications, insurance applications and banking transactions. If the rule is implemented in the context proposed by the CFPB, the precedent it sets for future actions by other governmental agencies may be quite broad.

It is anticipated that the rule may take effect in 2017 after expiration of the notice and comment period and issuance of a final rule. The rule would not affect claims brought by individuals. Recent studies have shown, however, that most claims against financial service institutions do not involve claims by single

individuals.[4] Precluding enforcement of arbitration clauses in such contracts would allow consumers to pool their resources in seeking judicial relief. The CFPB maintains this rule would increase transparency and provide greater opportunities to obtain relief in the legal system.[5] If the rule takes effect, financial institutions will likely argue that it increases their costs, which ultimately will be passed on to consumers.

Additional Arbitration Developments

Subsequent case law has also addressed this topic. In *Nesbitt v. FCNH, Inc.*,[6] the 10th Circuit upheld denial of a motion to compel arbitration based on the "effective vindication" exception to the general enforceability of arbitration clauses. The Court held the arbitration requirement was prohibitively expensive for the plaintiff.

Nesbitt involved a student studying at a for profit massage therapy institution. As part of her curriculum, she was required to perform massage therapy on patients free of charge. Prior to enrollment, she executed an agreement that contained an arbitration clause that governed any disputes that arose between her and the institution, including issues involving the Fair Labor Standards Act. The clause further required the parties to share in the cost of arbitration.

The Court stated that, under the effective vindication exception, it could invalidate on "public policy grounds" arbitration agreements that "operate … as a prospective waiver of a party's right to pursue statutory remedies…." *Id*. at 377. The Court found the exception applied in this case because the arbitration agreement was ambiguous as to whether plaintiff could be awarded her costs and fees if she prevailed in a subsequent dispute. Because of this ambiguity, the Court concluded it was unlikely that a party "faced with the mere possibility of being reimbursed for arbitrator fees in the future, would risk advancing those fees in order to access the arbitral forum." *Id*. at 380 381. Essentially, this ambiguity acted as a deterrent to litigation against the institution.

In *Hayes v. Delbert Services Corp.*,[7] the Court refused to enforce an arbitration agreement that plaintiff alleged precluded enforcement of certain federal statutory rights. Plaintiff received a payday loan from Western Sky Financial, LLC. Plaintiff eventually brought suit against the loan servicer, Delbert Services Corporation, alleging that its debt collection practices violated federal law. Delbert moved to compel arbitration.

Western Sky's loan agreement stated that the agreement "is subject solely to the exclusive laws and jurisdiction of the Cheyenne River Sioux Tribe, Cheyenne River Indian Reservation." The agreement further held that any disputes must be resolved by binding arbitration conducted by a representative of the Cheyenne Tribe. The Court struck the agreement, holding that it "fails for the fundamental reason that it purports to renounce wholesale the application of any federal law to the plaintiff's federal claims." *Id*. at 673

Conclusion

Arbitration clauses have become commonplace in commercial and employment agreements. The attack on their enforceability is nothing new. The arguments made by creative attorneys, however, have gained some strength and provide insight into how the drafters of those contracts might preclude a court from striking them. In particular, federal regulation poses a dilemma for certain institutions, which may well grow as time progresses. Prudence demands keeping an eye on this ball as it keeps rolling, which we will continue to do.

[1] Tillman v. Macy's, 735 F.3d 453 (6th Cir. 2013)

[2] Walker v. Ryan's Family Steakhouse, 400 F.3d 370 (6th Cir. 2005)

[3] Cooper v. MRN Investment Company, 367 F.3d 493 (6th Cir. 2004)

[4] Jessica Silver Greenburg and Michael Corkery, *Rule on Arbitration Would Restore Right to Sue Banks*, NY Times, May 5, 2016

[5] *Id.*

[6] 811 F.3d 371 (10th Cir. Jan. 5, 2016)

[7] 811 F.3d 666 (4th Cir. 2016)