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The CFPB's Two Faces On Avoiding The Courts

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Eric J. Mogilnicki

The Consumer Financial Protection Bureau appears to have two positions on resolving legal disputes without going to court: it is unfair except when the bureau does it. As if to prove that point, the bureau has scheduled an upcoming field hearing on arbitration on May 5, just a few weeks after a panel on the U.S. Court of Appeals for the D.C. Circuit expressed concerns with the bureau's administrative enforcement proceeding against PHH Corp. The contrast is jarring because the bureau's harsh criticisms of arbitration agreements apply with similar force to its own use of administrative proceedings.

During the May 5 hearing, the bureau is likely to announce a proposal to do away with the use of mandatory arbitration clauses in contracts for consumer financial goods and services. Judging from the bureau's arbitration study, and Director Richard Cordray's past remarks on this issue, the new rule will rely in large part on assertions about the unfairness of arbitration as a forum. In particular, the bureau has apparently concluded that arbitration agreements are unfair because they channel disputes out of the courts and into a forum where the process differs from courts in ways that favor one party. Such a forum is unacceptable to the bureau.

On the merits, the bureau's case against arbitration is open to serious dispute. However, the outline of its arguments is already reasonably clear.

First of all, Cordray has criticized arbitration as "not subject to negotiation." Consumers who sign contracts with arbitration clauses may have no opportunity to insist that their disputes should be resolved in a court.

Second, the bureau has noted that arbitration's procedural rules are different from those in court. For example, the rules are simpler, pretrial discovery is sharply limited, juries are not available, and appeals from a decision are unlikely to succeed.

Third, Cordray has expressed concern that requiring arbitration can effectively preclude a party from vindicating a right they could have pursued in a state or federal court.

Fourth, the bureau has argued that arbitration results are routinely more favorable to one side when compared to results in court. Citing these differences, Cordray has said that requiring arbitration is how companies "rig the game" and "sidestep the legal system."

This unsparing criticism of arbitration leaves the distinct impression that the bureau believes that only state and federal courts dispense real justice. However, when it suits the bureau, it may avoid those same courts and channel its enforcement actions into a very different type of proceeding.

The case of PHH v. CFPB, in which the U.S. Court of Appeals for the District of Columbia heard oral argument in April, neatly illustrates how administrative proceedings work. In that case, CFPB enforcement attorneys decided to avoid court altogether. With the approval of the bureau's director, bureau staff brought charges against PHH before an administrative law judge rather than in court. That administrative law judge found for the bureau, and ordered $6.4 million in disgorgement. When PHH sought to appeal that ruling, its appeal was heard by the bureau's director (who had previously authorized the enforcement action). The bureau director rejected PHH's appeal, but granted the bureau's cross-appeal, and ruled that the bureau should have instead recovered over $109 million. That decision is now before the court of appeals.

The multiple roles of different bureau officials — bringing the case, choosing an administrative forum, arguing the administrative appeal and hearing the administrative appeal — raise serious questions about the fundamental fairness of the bureau's administrative proceedings. An active debate about similar processes at the U.S. Securities and Exchange Commission is ongoing, and has already led to valuable reforms. But what's unique about the bureau is that its criticisms of arbitration establish tests for dispute resolution that its own procedures flunk.

First of all, the bureau's decision to use an administrative forum is not subject to negotiation. Individuals and financial institutions alike have no opportunity to insist that their disputes with the bureau should be resolved in a court. The bureau alone decides.

Second, an administrative hearing's procedural rules are different from those in court. For example, the rules are simpler, pretrial discovery is sharply limited, juries are not available, and appeals from a decision are unlikely to succeed.

Third, an administrative proceeding can effectively preclude a party from vindicating a right they could have pursued in a state or federal court. In the PHH administrative proceeding, the bureau took the position that PHH could not invoke a statute of limitations, even though the limitation is part of the federal law being enforced against PHH. Indeed, Cordray's decision concedes that the statute of limitations would have been available as a defense if PHH were defending itself in court.

Fourth, the results in administrative hearings are routinely more favorable to one side when compared to results in court. As U.S. District Judge Jed. S. Rakoff has pointed out, the SEC won 100 percent of the administrative hearings it brought in fiscal year 2014 compared to only 61 percent of its court cases during the same period. A cynic could argue that administrative hearings are how agencies "rig the game" and "sidestep the legal system."

Such cynicism would be misplaced. A decision to use a streamlined dispute resolution system need not reflect a desire to gain an unfair advantage. Instead, administrative proceedings and arbitration alike reflect good-faith efforts to remedy recognized shortcomings in the speed, efficiency and cost of judicial proceedings. These alternative systems have flaws of their own, and require modification over time to correct those flaws. The bureau should work with all interested parties to improve both systems, rather than banning arbitration on the basis of standards that the bureau's own procedures fail to meet.

—By Eric J. Mogilnicki, Covington & Burling LLP

Eric Mogilnicki is a partner in Covington & Burling's Washington, D.C., office. He focuses his practice on CFPB investigations, examinations and enforcement actions.