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3 Notification Pitfalls To Avoid With Arbitration Provisions

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Companies implementing arbitration provisions should ensure that they adequately inform customers about the existence of the provision and their options for opting out.

In early January, the U.S. Court of Appeals for the Second Circuit reaffirmed the importance of doing so in Lipsett v. Popular Bank, finding a bank's arbitration provision unenforceable over a decade after it was first implemented.[1]

Background

The plaintiff in this case, Frankie Lipsett, opened an account with Popular Bank in 2004. At that time, the bank's customer account agreement did not have an arbitration provision. That changed in 2008 when the bank updated its account agreement for the first time to require that customers arbitrate any claim related to the agreement or account.[2]

More than a decade later, Lipsett filed a class action lawsuit challenging overdraft fees that the bank charged on his account, but he did not appear to have any basis to litigate his claims in federal court. No one disputed that the bank's 2008 arbitration provision encompassed claims like Lipsett's.

The same arbitration provision also appeared in subsequent updates to the account agreement in 2014, and then again in 2021. And the overdraft fees that Lipsett was challenging were imposed in 2021.

The bank moved to compel Lipsett to arbitrate his claims, but the U.S. District Court for the Southern District of New York denied that motion on the grounds that Lipsett had no meaningful opportunity to opt out and so found the arbitration provision to be unenforceable.

The Second Circuit Finds the Bank's Arbitration Provision Unenforceable

The Second Circuit affirmed the denial of the bank's motion to compel arbitration, but it did so for a more basic reason: Lipsett "did not receive sufficiently clear notice that he was bound by the arbitration provision" in the first place.[3]

According to the panel, only the 2014 account agreement can produce an arbitration contract.[4] That is

because, as it turned out, Lipsett never received the 2008 and 2021 updates. The bank conceded the 2014 update was the only account agreement with an arbitration provision actually sent to Lipsett; that update had been mailed to Lipsett with an accompanying notice.

The 2014 documents did not create an enforceable agreement, the panel determined, because they did not contain a "definite" offer to arbitrate. The panel reached that conclusion because the documents don't give accountholders the information they need to reject arbitration.[5]

Pitfalls to Avoid When Implementing Arbitration Provisions

The Second Circuit identified three issues with the language in the 2014 account agreement and accompanying notice that were mailed to Lipsett, which provide helpful guidance for companies seeking to implement arbitration provisions going forward.

1. Unclear Notice as to Whether the Arbitration Provision Applies

It can be difficult for a company to obtain customers' express assent to every update the company makes to a customer agreement.

Companies frequently resort to the less cumbersome practice of notifying their customers about important changes to an agreement — for example, by sending a letter or email summarizing the changes, and by informing customers that their continued use of the company's services reflects their agreement to the changes.

Lipsett reaffirms the importance of a carefully drafted notice, especially when those important changes include the addition of an arbitration provision.

Popular Bank stated in a notice accompanying the 2014 account agreement that there continued to be a mandatory arbitration provision.[6]

According to the panel, this statement signaled to existing customers like Lipsett, who was not previously informed of the arbitration provision, that the arbitration provision "does not apply to him and that his agreement with the Bank remained effectively unchanged."[7]

2. Ambiguous Opt-Out Procedures

Consumers' ability to opt out of a company's arbitration provision can play an important role in whether the arbitration provision will be enforced. If a consumer has an option to opt out of an arbitration agreement, that may provide a powerful defense to a challenge that an arbitration agreement is unenforceable.

Lipsett instructs that how the opt-out procedure is communicated is just as important.

Popular Bank's notice accompanying the 2014 account agreement included an opt-out procedure, but the panel found one problem: The notice made it unclear whether the opt-out procedure actually governed. The notice stated that the opt-out procedure applied to an existing customer like Lipsett asked to enter into a new deposit agreement.

But the panel found it unclear whether the 2014 account agreement was new:[8] The notice "states

both that the enclosed [2014] agreement 'replaced' prior agreements and that [it] is an 'Amended Account Agreement.'"[9]

3. Inconsistencies Across Different Communication Channels

Companies today may have many options to notify customers about the existence of an arbitration agreement. Although Lipsett involved a more traditional communication channel — mail — it highlights the importance of communicating consistently across different channels.

The panel found the separate notice Popular Bank mailed to Lipsett to be inconsistent with the 2014 account agreement it accompanied. Whereas the bank stated in the notice that Lipsett could opt out only by "closing his account and withdrawing his funds from the Bank within sixty days," the 2014 account agreement stated that he could opt out without having to close his bank account.[10]

This was a problem, the panel concluded, because it meant that the bank did not clearly notify Lipsett "about the terms on which he could ... decline the arbitration provision."[11]

Conclusion

Lipsett underscores the need for any company intending to rely on an arbitration agreement to focus not only on the substantive terms of the agreement but also on how notice of that agreement is communicated.

When done right, a notice can strengthen the enforceability of an arbitration provision. Lipsett is an example of how a notice can also undo the benefits of an otherwise strong arbitration provision.

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[1] Lipsett v. Popular Bank, No. 22-3193, 2024 WL 111247 (2nd Cir. Jan. 10, 2024) ("Lipsett II"), https://www.law360.com/articles/1784517/attachments/0.

[2] Lipsett v. Banco Popular N. Am., 2022 WL 17547444, at *2 (S.D.N.Y. Dec. 9, 2022)

[3] Lipsett II, 2024 WL 111247, at *1.

[4] Id.

[5] Id. at *2.

[6] Id.

[7] Id.

[8] Id.

[9] Id.

[10] Id.

[11] Id.