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federal arbitration act alert

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Dodd-Frank Act Gives SEC and New Consumer Agency Power to Invalidate Arbitration Agreements

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd-Frank Act"). The Act makes monumental changes to the regulation of a variety of industries. According to the President, it includes "the strongest consumer financial protections in history." Little noticed in the extensive law are provisions that signal a retreat from the robust federal policy in favor of arbitration.

The Dodd-Frank Act gives the SEC rulemaking authority to limit or prohibit the arbitration of disputes arising under the federal securities laws. The Act also establishes a Federal Reserve Bureau of Consumer Financial Protection, which is authorized to limit or prohibit agreements to arbitrate disputes regarding consumer financial products and services. These provisions have the potential to bring significant changes to federal arbitration law.

The Federal Law of Arbitration

The Federal Arbitration Act, enacted in 1925, was intended to reverse the longstanding judicial hostility to arbitration. Under 9 U.S. C. § 2, a written arbitration agreement in a contract affecting interstate commerce is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The Supreme Court has recognized that Section 2 "is a congressional declaration of a liberal federal policy favoring arbitration agreements."[1] This pro-arbitration policy requires courts to enforce agreements to arbitrate a wide variety of disputes, including those arising under the federal securities laws.[2]

Arbitration-Related Provisions of the Dodd-Frank Act

The Dodd-Frank Act restricts arbitration in two important areas: (1) disputes between clients and brokers, dealers, or investments advisors arising under the federal securities laws; and (2) disputes relating to the provision of consumer financial products or services.[3]

Disputes Arising Under the Federal Securities Laws

Section 921(a) and (b) of the Dodd-Frank Act amends the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 to authorize the SEC to:

"prohibit, or impose conditions or limitations on the use of, agreements that require consumers or clients of any broker, dealer, . . .

municipal securities dealer[, or investment adviser] to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such . . . limitations are in the public interest and for the protection of investors."

Disputes Relating to Consumer Financial Products or Services

Section 1028 of the Act bestows similar authority on the newly established Bureau of Consumer Financial Protection within the Federal Reserve. The Bureau is required to "conduct a study of, and . . . provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services." The Bureau is empowered to enact regulations to limit or prohibit such agreements to arbitrate, if consistent with its study.

A "covered person" is defined as "any person [or affiliate of a person] that engages in offering or providing a consumer financial product or service." [4] The Act defines "consumer financial product or service" to mean, among other things, the extension of credit and servicing of loans; real-estate settlement services; financial advisory services not related to securities; the collection and provision of consumer report information, including information relating to credit history; and deposit-taking activities.[5]

The Future of Consumer and Employment Arbitration

As we reported in a prior Federal Arbitration Act Alert, momentum has been building in Congress to restrict enforcement of consumer and employment arbitration agreements. The Arbitration Fairness Act, versions of which have been introduced in both the House and Senate, would invalidate predispute agreements to arbitrate consumer, employment, and franchise disputes, even if state law would enforce such agreements. The findings accompanying the proposed act express concern that arbitration agreements are often unfair to employees and consumers and that arbitration undermines the development of the law in important areas.

The anti-arbitration provisions of the Dodd-Frank Act represent a major step toward eliminating consumer arbitration in the financial-services industry and may herald additional restrictions in other industries as well. Companies that routinely include arbitration clauses in their consumer or employment contracts should take note that broad changes may be coming.

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1. *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).
2. *See Rodriquez de Quijas v. Shearson/Am. Exp., Inc.,* 490 U.S. 477 (1989).
3. The Act also prohibits companies and employers from requiring arbitration of disputes related to residential mortgage loans and certain whistleblower claims. *See* Dodd-Frank Act, §§ 748, 922, 1057(d), 1414.
4. Dodd-Frank Act, § 1002(6).
5. *Id*. § 1002(5), (15).

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