August 22, 2016

Ms. Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

**Re: Notice of Proposed Rulemaking on Arbitration Agreements (Docket ID No. CFPB-2016-0020; RIN 3170-AA51)**

Dear Ms. Jackson:

This letter is submitted on behalf of the U.S. Chamber of Commerce ("the Chamber") by its Center for Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR"). The Chamber is the world's largest business federation, representing the interests of more than three million companies of every size, sector, and region. The Chamber created CCMC to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, faster, and fairer for all participants.

We write regarding the regulation proposed by the Consumer Financial Protection Bureau ("the Bureau") to regulate the use of arbitration in contracts for consumer financial products and services.[1] Arbitration of consumer disputes has been a common practice for decades. Currently, there are hundreds of millions of consumer contracts that contain arbitration provisions. These provisions, by reducing transaction costs and facilitating speedy and efficient dispute resolution, provide significant advantages to consumers and the public at large. Yet as a practical matter, the proposed rule would drastically limit, if not eliminate, the use of arbitration in consumer financial contracts while conferring little to no benefit on consumers in return.

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[1] *Arbitration Agreements; Proposed Rule*, 81 Fed. Reg. 32,830 (May 24, 2016).

In crafting this proposed rule, the Bureau ignored data from its own study demonstrating both the benefits of arbitration to consumers and the failure of class-action lawsuits to provide meaningful benefits to consumers—and did so after gerrymandering its study to ignore a large quantity of additional data providing further confirmation of the benefits of arbitration and the lack of benefit from class actions. The Bureau similarly has closed its eyes to the inevitable real-world consequence of its proposed rule: the elimination of arbitration, which would leave consumers without any means of redressing the injuries they most often suffer.

The only possible conclusion is that the Bureau has been driving this regulatory process to a pre-determined conclusion—that class actions are worth any cost to consumers. The chief beneficiaries of that result are not consumers, but rather the plaintiffs' lawyers who file class action lawsuits and the defense lawyers businesses are forced to retain. The Bureau's proposed rule would harm both consumers and businesses without any public benefit. If promulgated, it would violate the procedural and substantive limits on the Bureau's authority imposed by both the Dodd-Frank Act and Administrative Procedure Act.

In this letter, we make the following key points:

- The Bureau's 2015 study ***ignored critical questions*** relevant to making a fair assessment of whether the proposed rule is in the public interest and for the protection of consumers. (See pages 6-11, below.) In large part, this failure was due to the Bureau's unwillingness to allow sufficient public comment on the study's design, execution, and preliminary conclusions. Because the study forms the foundation for any subsequent rulemaking, the Bureau's proposed rule is fatally flawed at its inception. In particular, the Bureau's study:
    - fails to consider the dramatic adverse consequences for the availability of arbitration that will be the inevitable results of regulations of the type proposed by the Bureau;
    - fails to determine whether the types of injuries that consumers themselves seek to remedy can as a practical matter be remedied only through arbitration;

  - exaggerates the supposed benefits of attorney-driven class actions while ignoring the grossly disproportionate gains reaped by plaintiffs' lawyers; and

  - ignores the significant role that government enforcement—including the CFPB's own enforcement and supervision authority—plays in protecting consumers and deterring unlawful conduct.

- Arbitration—including arbitration of consumer financial disputes—confers significant benefits on consumers. That is because ***arbitration gives consumers the ability to bring claims that they could not realistically bring in court—and those are most of the claims that consumers themselves care about***.

  - A study of the Bureau's own Consumer Complaint Database demonstrates that the claims consumers that care about are small (typically involving several hundred dollars) and individualized—more than 90% could not be brought in class actions. (See pages 13-14 and Appendix A.)

  - Realistically, arbitration is the ***only*** forum where consumers—proceeding with or without counsel—can vindicate these garden-variety consumer claims. Consumers require a lawyer to navigate complex procedures in court, but most claims fall far short of the amount that would justify that expense, or attract contingent-fee counsel. And courts are overcrowded, resulting in lengthy delays—especially in small claims courts. (See pages 14-19.)

  - Unlike litigation, arbitration is fast: consumers can receive a decision in months rather than years. It also offers procedures that are more streamlined and accessible than courts. And courts and arbitration providers oversee arbitration procedures to ensure fairness; unfair arbitration provisions are consistently invalidated. (See pages 19-26.)

- Unsurprisingly, therefore, studies show that ***consumers do at least as well in arbitration as in litigation***, particularly when the unique pre-arbitration incentives for settlement are taken into account.

- The Bureau has expressed some skepticism about arbitration, but those comments rest entirely on the blinkered nature of its study, which ignored the extensive use of arbitration—and benefits to claimants such as consumers—in a number of sectors of the economy, from employment to health care to securities. And it ignored the undisputed fact that arbitration promotes pre-arbitration settlements that benefit consumers. (See pages 26-35.)

- The Bureau's conclusions regarding class actions are just as flawed—but in the other direction: its serious undervaluing of arbitration's benefits is complemented by a rose-colored view of class actions that is undermined by the Bureau's own study. The undisputed fact is that the overwhelming majority of claims consumers care about cannot be brought in class actions and, in addition, ***most class actions lead to no recovery for absent class members at all***, and those that do quite often provide only minimal benefits. (See pages 35-50.)

  - Class actions also take years to resolve (even compared to individual litigation); are prone to abuse and collusion; and rarely uncover independent evidence of wrongdoing. (See pages 50-62.)

  - Moreover, the outcomes of class litigation bear little relationship to the merits of the underlying claims. The aggregate potential liability for companies—which often includes hefty attorneys' fees—is so staggering that virtually no class actions are resolved on the merits; they function more like a tax on business with much of the proceeds going to lawyers rather than serving as a meaningful source of deterrence. (See pages 62-66.)

  - Finally, ***the Bureau's claim that class actions provide needed deterrence ignores the deterrent effect of the Bureau's own extensive supervision and enforcement programs***. The Bureau's study used a time period gerrymandered to end before those programs became fully functional. A recent study of the Bureau's enforcement activity through the end of 2015 found that the Bureau had brought more than 120 public enforcement actions producing ***$11.2 billion*** in consumer relief. And the Bureau has used its supervisory authority to conduct hundreds of examinations.

- o The entire reason for creating the Bureau was to increase enforcement of consumer laws: the Bureau's existence, combined with the numerous other state, local, and federal enforcement agencies, underscores that class actions have little, if any, role to play in this context—unless the Bureau does not believe that its significant resources and authority will provide consumers with extensive additional protection. (See pages 66-68.)

- The Bureau's proposed rule would effectively ***eliminate*** arbitration. Even though the Bureau claims not to be prohibiting arbitration agreements entirely, companies will not maintain dual systems of dispute resolution, as the proposed rule would require. (See pages 68-73.)

- The Bureau's analysis completely ignores that fundamental consequence of its proposed rule. ***It, therefore, never addresses the key policy question: whether the elimination of the only method for vindicating the claims consumers care about is justified by the interest in promoting class actions that rarely provide any benefit to consumers but do provide large recoveries for lawyers.*** In addition, the proposed rule would inevitably produce higher prices and reduced access to credit as well. These harms would far outweigh any benefits. (See pages 73-78.)

- The Bureau's proposal is all the more perplexing because there are alternative approaches never even considered by the Bureau that would preserve arbitration while enhancing the ability of consumers to vindicate small claims. For example, tools exist for ensuring that consumers have the ability to vindicate small, individual claims in arbitration (perhaps including minimum recoveries and awards of attorneys' fees, or express authorization of coordination among claimants). Yet, ***the Bureau did not even examine***

***these alternatives before proposing its de facto ban on arbitration***. (See pages 73-81 and 83-88.)

- Given these flaws, it is clear that the Bureau's proposal, if adopted, would be set aside by the courts, because it violates the statutory standards governing the Bureau's rulemaking authority in multiple ways. (See pages 89-91.)

Instead of proceeding with its misguided proposal, the Bureau should re-open its arbitration study process, consider ways to improve its data collection and analysis, and then, in the sunlight, hold a public discussion on whether a rulemaking is needed. If a transparent study process identifies ways in which arbitration could be improved for the benefit of consumers, the Bureau should proceed cooperatively with stakeholders to improve arbitration. But the Bureau should abandon its present proposal to double down on our broken class action system. Even if arbitration were in need of improvement, no improvement is achieved by putting consumer welfare in the hands of the class action trial bar.

## I. The Proposal Should Be Withdrawn Because It Rests On A Study That Is The Fatally-Flawed Product Of An Unfair And Closed Process.

Section 1028(a) of the Dodd-Frank Act instructed the Bureau to "conduct a study of…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."[2] Based on the results of that study, the Bureau is permitted to decide whether to regulate arbitration in the context of consumer financial products and services. In fact, the statute specifies that "[t]he findings in such rule shall be consistent with the study conducted under subsection (a)."[3] But the Bureau also must find "that such [action] is in the public interest and for the protection of consumers."[4]

The study that the Bureau published in March 2015 turned this congressionally-mandated process on its head by failing to seek out, or even to consider, evidence that

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[2] Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), Pub. L. 111-203, 124 Stat. 1376 (201), § 1028(a).
[3] *Id.* § 1028(b).
[4] *Id.* § 1028(b).

is relevant—indeed, absolutely necessary—to a fair assessment of the public interest and the protection of consumers.

Because the proposed rule is based on this study, it necessarily violates both the Administrative Procedure Act and Section 1028 of the Dodd-Frank Act. In directing the Bureau to conduct a study and then base its rulemaking on the results of that study, Congress plainly required a study that is adequate to serve its intended purpose. By failing to conduct a study sufficient to provide the information needed to assess the impact of a proposed rule, and nonetheless relying on the study to formulate the proposed rule, the Bureau has violated both Section 1028 and the Administrative Procedure Act's prohibition of agency action that is "arbitrary, capricious … or otherwise not in accordance with law."[5]

The Bureau's failure to conduct an adequate study is due in large part to the Bureau's closed study process. The Bureau solicited public comment once, at the outset of the study process, but never again for the three years that the study was underway. The Bureau never informed the public of the topics it had decided to study and never sought public comment on them—even though a number of commenters had suggested that the Bureau utilize that procedure. The Bureau never convened public roundtable discussions on key issues, as many other agencies routinely do. And the Bureau never sought public input on its tentative findings.

The Chamber and other stakeholders repeatedly asked the CFPB for more opportunities to provide feedback on the study process. For example, in June 2012, the Chamber urged the Bureau to prepare and publish a draft study plan describing the substantive issues to be addressed in the study, to employ roundtables with interested stakeholders, and to solicit additional input on its draft conclusions before releasing its final study.[6] The American Bankers Association, Consumer Bankers Association, and Financial Services Roundtable also urged the Bureau "to follow an open and transparent process in designing and conducting the Study."[7] And the

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[5] 5 U.S.C. § 706(2).

[6] *See* Letter from David Hirschmann & Lisa Rickard to Monica Jackson 3-4, *Re: "Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*," Docket No. CFPB-2012-0017 (June 12, 2012), http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0051.

[7] Letter from Nessa Feddis, Steven Zeisel, & Richard Whiting to Monica Jackson 2, *Re: Comments on Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements,* Docket No. CFPB-2012-0017" (June 22, 2012), https://www.regulations.gov/document?D=CFPB-2012-0017-0030.

Chamber echoed its request for additional public input in a supplemental letter submitted in December 2013.[8]

But the Bureau did none of those things. To the contrary, the final version of the study discussed several topics that were not even included in the preliminary results—an opaque process that prevented any meaningful public input on those topics.

Indeed, the Bureau's unwillingness to seek public input continued even *after* the study was complete. In May 2015, the Chamber, joined by the American Bankers Association, American Financial Services Association, Consumer Data Industry Association, and Financial Services Roundtable, wrote to request that the Bureau solicit public comment on the study prior to initiating rulemaking proceedings. As the letter noted, prior opportunities for comment had been woefully inadequate.[9]

Yet even though a formal public comment period could have been conducted in parallel with the statutorily mandated Small Business Review Panel, the Bureau issued its proposed rule without ever providing the requested public comment period.

Shortly after the study was released, 13 Senators and 61 Representatives wrote the Bureau to stress that "the process that led to the Bureau's *Arbitration Study* has not been fair, transparent, or comprehensive."[10] As they explained,

> The Bureau ignored requests from senior Members of Congress for basic information about the study preparation process. The Bureau also ignored requests to disclose the topics that would be covered by the study, and failed to provide the general public with any meaningful opportunities to provide input on the topics. Because the materials were kept behind closed doors, the final *Arbitration Study* included entire

[8] Letter from David Hirschmann & Lisa Rickard to Monica Jackson 2-3 & n.5, *Re: "Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*," Docket No. CFPB-2012-0017 (Supplemental Submission) (Dec. 11, 2013)

[9] Letter from the American Bankers Ass'n et al. to Richard Cordray 2, *Re: Comment on CFPB Arbitration Study* (May 21, 2015), http://www.aba.com/Advocacy/commentletters/Documents/cl-Joint-Arbitration2015May.pdf.

[10] Letter from Patrick McHenry & Tim Scott to Richard Cordray 1, *Re: Comment on CFPB Arbitration Study* (June 17, 2015), http://mchenry.house.gov/uploadedfiles/mchenry-scott-to-cordray-letter-re-arbitration.pdf.

> sections that were not included in the preliminary report that was provided to the public.

These 74 Members of Congress called on the Bureau to "reopen the study process, seek public comment, and provide the necessary cost-benefit analysis" for the determination required by Section 1028(b) of the Dodd-Frank Act. But the Bureau did not do so.

Unsurprisingly, without the opportunity for meaningful public comment, the Bureau's study failed to consider important aspects of arbitration that did not fit with the Bureau's seemingly pre-determined narrative that class actions are superior to arbitration.

Among other things, the Bureau's study:

- ignores the practical benefits of arbitration procedures as compared to the courts for vindicating the types of disputes that consumers most often have—and whether such disputes can as a practical matter be vindicated only through arbitration;

- fails to consider the benefits that arbitration can provide to injured parties in a variety of contexts—including consumers, when they are not discouraged by plaintiffs' lawyers and others from invoking arbitration;

- fails to consider the reduced transaction costs resulting from arbitration, which under basic economic theory produce lower prices for consumers;

- fails to consider the dramatic adverse consequences for the availability of arbitration that will be the result of regulations of the type proposed by the Bureau;

- exaggerates the supposed benefits of attorney-driven class actions while ignoring the grossly disproportionate gains reaped by plaintiffs' lawyers; and

- ignores the significant role that government enforcement—including the CPFB's own enforcement and supervision authority—plays in protecting consumers and deterring unlawful conduct.

A critique by two prominent academics[11] highlighted additional flaws that prevent the study from informing the policy determinations the Bureau must make in deciding whether to regulate arbitration. The academics wrote that the study:

- neglected to collect data on the size of arbitral settlements—"the likely outcome in the majority of arbitrations that the CFPB studies" and a critical factor in assessing arbitration's true benefits to consumers[12];

- compared the award-only data about arbitration to class action settlements—"a false apples-to-oranges comparison between class action *settlements* and arbitral awards";[13] and

- relied on aggregate averages that "tend[] to overweight data from only half a dozen huge class action settlements."[14]

As a result of these methodological errors, the authors wrote, "[s]ubstantially more and different evidence would be necessary to conclude that consumers are harmed by arbitration or that they would benefit from unleashing class action litigation more routinely."[15] Yet the CFPB's recent notice of proposed rulemaking offers no response to these scholars' extensive critique.

The Bureau has argued that the study provides a wide range of data regarding arbitration and class actions. But a study that uses data focused on the wrong issues, and that lacks data about the relevant questions, is one that is patently and legally inadequate. And those flaws pervade the study that the Bureau performed here.

[11] Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique* 49-50, Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA (Aug. 2015) ("the numbers that the CFPB does report invite a misleading comparison of class settlements to arbitral awards").
[12] *Id.* at 6.
[13] *Id.*
[14] *Id.* at 7.
[15] *Id.*

All of these flaws, which are discussed in more detail below, naturally infected the Bureau's proposed rule as well. It is not surprising, therefore, that the effect of the CFPB's proposal is directly at odds with the Bureau's consumer-protection mission: the closed, nontransparent process that gave birth to the proposed rule was flawed from the start.

Because the Bureau failed to carry out Congress's directive and instead produced an incomplete and misleading study, the Bureau should withdraw the rule, conduct an appropriate study, and only then decide whether, and to what extent, regulation in this area would further the public's and consumers' interests.

## II. Arbitration Benefits Consumers By Providing A Simple And Fair Means Of Resolving Disputes That Consumers Cannot Practically Pursue In Court.

In civics classes—and in law schools—the judicial system is depicted as a fair, accessible means of resolving disputes. For that reason, "take them to court" and "I'll see you in court" are often used as synonyms for "obtaining justice."

But these descriptions of the judicial system are based on an idealized view that obscures how the court system actually operates in the real world. Litigation in court is extremely expensive, immensely time-consuming, and highly complicated.

Arbitration offers a much-needed alternative. Compared to litigation:

- arbitration is inexpensive—most consumers pay $200 or less to file a claim in arbitration, and many pay nothing at all;[16]

- arbitration is efficient—plaintiffs can expect to receive a decision on their claim in a matter of months rather than years; and

- arbitration is simple to use—consumers often represent themselves, obtaining results as good as, if not better than, consumers who are represented by counsel.

[16] AAA Consumer Arbitration Rules at 33, https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&; *see also* note 283 below and accompanying text.

Indeed, as Justice Stephen Breyer has recognized, the accessibility and efficiency of arbitration is often the only thing that makes vindicating a consumer claim economically rational. Without the possibility of arbitration, he explained, "the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)" would be left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery."[17]

Even if class actions were not significantly flawed—and they are, as we discuss below[18]—they would provide no answer. The vast majority of injuries suffered by consumers are individualized and, therefore, cannot be asserted in class actions, where the governing standard (embodied in Federal Rule of Civil Procedure 23 and similar state-law standards) requires that common issues predominate for a class to be certified.

In short, because consumers have little hope of a prompt and economical resolution to their claims in traditional litigation, their choice in practice is not arbitration or litigation, but arbitration or nothing. Arbitration is an essential, low-cost, accessible, and easy-to-use means of obtaining resolution of claims that would be left unaddressed in the absence of arbitration.

The Bureau ignored these significant consumer benefits in crafting its proposed rule—which would have the practical effect of eliminating arbitration,[19] and therefore will harm consumers by depriving them of what in the majority of cases is their only realistic option for obtaining redress for injuries.

### A. Most Consumer Claims Cannot Be Pursued In Court.

The harms that consumers themselves care about and seek to remedy are usually relatively small and individualized—excess charges on a bill, a defective piece

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[17] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995). Dean Peter Rutledge has observed that, without access to arbitration, consumers would be "far worse off, for they would find it far harder to obtain a lawyer, find the cost of dispute resolution far more expensive, wait far longer to obtain relief and may well never see a day in court." Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 Cardozo J. Conflict Resolution 267, 267 (2008).

[18] See pages 36-68 below.

[19] See pages 68-73 below.

of merchandise, and so on. That fact is demonstrated by consumers' submissions to the Bureau's own Consumer Complaint Database. These submissions are strong evidence of the types of injuries that consumers suffer and seek to remedy; after all, they are submitted to the Database by consumers themselves.

Information in the Bureau's Database confirms:

- These consumer claims are small: when complaints are resolved through voluntary monetary payments by the companies involved, the median payment is just over $130.[20]

- The issues raised by consumers are highly individualized. We reviewed Database submissions on ten days selected at random, examining all complaints containing "consumer complaint narratives" describing the gist of the consumer's complaints. The Database's descriptions of complaints are not detailed, but applying conservative criteria, more than 90% of narratives submitted clearly involved typically individualized issues (most commonly inaccuracies on a credit report or attempts to collect a debt that either had been paid or was not owed) that virtually always are not eligible for class-wide or collective resolution.[21]

***Litigation in court, with its formality and intricate procedures, simply is not a realistic option for resolving these claims.***

The first obstacle to pursuing an individualized, small-value claim in court is the cost of hiring counsel. Unrepresented parties have little hope of navigating the complex procedures that apply to litigation in court, yet a lawyer's hourly billing rate may itself exceed the amount at issue in the vast majority of consumer claims. In any event, many consumers do not have the resources to hire counsel, and those that do often face the added hurdle of having to locate and retain a lawyer before even setting foot inside a courthouse.

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[20] Bureau of Consumer Fin. Prot., *Consumer Response Annual Report* (2016) tbl. 16, http://files.consumerfinance.gov/f/201604_cfpb_consumer-response-annual-report-2015.pdf.
[21] The review of the Database is described in detail in the Appendix.

Meanwhile, many lawyers, especially those working on a contingency basis, are unlikely to take cases when the prospective of a substantial payout is slim. Research demonstrates that lawyers accept contingent-fee cases only if the claim promises both a substantial recovery and a substantial percentage of that recovery as a legal fee. Studies indicate that a claim must exceed $60,000, and perhaps $200,000, in order to attract a contingent-fee lawyer.[22] Indeed, the Bureau itself recognizes that "[t]here is a large unmet need for legal services for low-income individuals who want legal help in consumer cases."[23]

A second, and more daunting, obstacle is time. Even if consumers find a lawyer willing to represent them, litigation is notoriously slow. In March 2016, the average civil lawsuit in federal court took 26.7 months to reach trial.[24] State courts, which handle many more cases than federal courts, have even worse backlogs.[25] And in recent years, budget and administrative crises have put more pressure on our overloaded state and federal judicial systems.

The San Diego County Bar Association warned in 2013 that "local courts—long the shining example statewide of judicial efficiency—have now been hobbled to such an extent that extensive delays, the closure of courtrooms, the unavailability of essential court services, and long wait times now characterize those court systems instead."[26] Those conditions persist: in 2015, the Judicial Council of California stated that California's courts *still* had not fully recovered, estimating that "2.1 million

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[22] Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 783 (2003). In some markets, this threshold may be as high as $200,000. Recommendations of the Minnesota Supreme Court Civil Justice Reform Task Force 11 (Nov. 23, 2011), http://www.mnbar.org/sections/outstate-practice/11-23-11%20Civil%20Justice%20Reform.pdf.

[23] 81 Fed. Reg. at 32,857 n.366.

[24] *U.S. District Courts—National Judicial Caseload Profile* (2016), http://www.uscourts.gov/file/19995/download.

[25] State courts reported around 17 million new civil cases filed in 2013, while federal courts reported over 284,000 new civil cases filed that same year. *Compare* Nat'l Ctr. for State Courts, Court Statistics Project, *Examining the Work of State Courts: An Overview of 2013 State Court Caseloads* 7 (2015), http://courtstatistics.org/~/media/Microsites/Files/CSP/EWSC_CSP_2015.ashx (state courts in 2013), *with* Administrative Office of the U.S. Courts, *Judicial Business of the U.S. Courts 2013*, http://www.uscourts.gov/statistics-reports/us-district-courts-judicial-business-2013 (federal courts in 2013). The pressures on state courts have been percolating for years. Forty states had to cut funding to their courts in 2010, according to a report by the American Bar Association's "Task Force on the Preservation of the Justice System," which was co-chaired by David Boies and Theodore B. Olson. Am. Bar. Ass'n ("ABA"), *The Growing Crisis of Underfunding State Courts*, Mar. 16, 2011; *see also* G. Alan Tarr, *No Exit: The Financial Crisis Facing State Courts*, 100 Ky. L.J. 786, 787 (2011-2012).

[26] San Diego County Bar Association, *2013 State of the Judiciary in San Diego County*, https://www.sdcba.org/temp/ts_DAFFCDF9-BDB9-505B-DB71DEEC48C1B816DAFFCE09-BDB9-505B-DF72E0368E012958/CFAC%20Annual%20Report-6-7-2013%5BRS%5D.pdf.

Californians have lost access to a courtroom in their community."[27] Los Angeles County, the state's largest, reported that its remaining courts are facing "unmanageably high" workloads, resulting in "intolerable delay" in civil cases.[28]

A recent report by the New York City Bar similarly noted that vast numbers of clerks had been eliminated for budgetary reasons, causing "extensive difficulties":

> In Brooklyn, the motion support office, which was previously staffed by 18 clerks, is now staffed by 3. Stacks of papers wait to be entered or processed, including judgments. Many judges do not have fulltime clerks, and the courts are often staffed by clerks "de jour" who are unfamiliar with procedures in the parts to which they are assigned. In Manhattan, there is a six week delay in entering judgments. In many counties, it takes several months to get a divorce judgment signed after the papers have been submitted. In Queens Supreme Court, litigants cannot obtain orders and other critical case documents because there are not enough clerks to file and scan the papers. In one case, a settlement was "so ordered" on December 2, 2015, and as of January 22, 2016, the defendant's counsel was unable to obtain a copy of the order.[29]

Meanwhile, the federal courts also have extraordinarily high caseloads, especially at the trial-court level, where the backlogs for civil cases are particularly severe because speedy-trial requirements dictate that criminal cases take precedence.[30] The Brennan Center for Justice has found that in numerous districts, "judges or court administrators observed that the vacancies had caused delays due to heavier

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[27] Marisa Lagos, *Cutbacks Still Felt Deeply In California's Civil Courts*, KQED News, Mar. 11, 2015, http://ww2.kqed.org/news/2015/03/12/court-budget-cuts-delay-justice.

[28] Judicial Council of Cal., *2015 Budget Snapshot: County of Los Angeles* (Feb. 2015), http://www.courts.ca.gov/partners/documents/County_Budget_Snapshot_Combined_2015.pdf

[29] New York City Bar, *Report in Support of the Judiciary's 2016–17 Budget Request*, at 2 (Jan. 2016), http://www2.nycbar.org/pdf/report/uploads/20073039-2016BudgetJudiciaryJudicialAdminReportFINAL1.29.16.pdf

[30] Chief Judge Ruben Castillo of the Northern District of Illinois said that budget constraints have created "a crisis" for U.S. district courts, and that he is essentially being asked: "Which limb do you want amputated?" Michael Tarm, *New Hispanic Chief Judge: Need More Jury Diversity*, Associated Press, July 2, 2013; *see also* Michelle R. Smith & Jesse J. Holland, *Budget cuts cause delays, concern in federal court*, Associated Press, April 25, 2013, http://bigstory.ap.org/article/budget-cuts-cause-delays-concern-federal-court ("Federal budget cuts have caused delays in at least one terror-related court case in New York and prompted a federal judge in Nebraska to say he is 'seriously contemplating' dismissing some criminal cases.").

caseloads," with most of the delay concentrated on the civil docket.[31] The number of civil cases pending in federal courts in as of March 2015—some 340,000[32]—was up more than 20% from 2004, and as of late 2014 "[t]he number of cases awaiting resolution for *three years or more* exceeded 30,000 for the fifth time in the past decade."[33] One federal judge comments, "Over the years I've received several letters from people indicating, 'Even if I win this case now, my business has failed because of the delay. How is this justice?,"[34]

Small-claims courts, which were developed to make it easier for individuals to proceed with low-value claims, do not offer a realistic alternative to a court system that is bursting at the seams. Budget cuts have severely hobbled small-claims courts, as well. Last year, Alabama's administrative director of courts called proposed budget cuts "crazy" and "devastating," noting that dockets in "small claims courts … will be heavily decreased or suspended for who knows how long."[35] And years of budget cuts in California have taken their toll, shuttering 79 courtrooms across Los Angeles and "limiting where people can contest…small claims cases."[36]

This issue is one that has existed for years. For example, as of May 2013, cases filed in San Joaquin County, California's small-claims court in September 2012 had still not been *scheduled* for trials. The court's presiding judge explained: "In our county, if you file a small claims case it simply sits in the proverbial box waiting to get a trial date. Your case sits and goes nowhere. It's not right, but you have to have sufficient resources to get those cases done, and we don't have those resources."[37] Meanwhile, some states have been abolishing small-claims courts altogether. A Texas law that went into effect in August 2013, for example, "abolish[ed] small claims courts across the state, meaning all those small-price-tag cases—seeking no more than

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[31] Alicia Bannon, *The Impact of Judicial Vacancies on Federal Trial Courts* 3-4, Brennan Ctr. for Justice, 2014, http://www.brennancenter.org/publication/federal-judicial-vacancies-trial-courts.
[32] Admin. Office of the U.S. Courts, *Federal Judicial Caseload Statistics 2015*, http://www.uscourts.gov/statistics-reports/federal-judicial-caseload-statistics-2015.
[33] Joe Palazzolo, *In Federal Courts, The Civil Cases Pile Up*, Wall St. J., Apr. 6, 2015, http://www.wsj.com/articles/in-federal-courts-civil-cases-pile-up-1428343746.
[34] *Id.* (internal quotation marks omitted).
[35] Brian Lawson, *Proposed budget cuts for Alabama courts 'crazy, devastating'*, AL.com (May 5, 2015), http://www.al.com/news/huntsville/index.ssf/2015/05/proposed_cuts_for_alabama_cour.html.
[36] Marisa Lagos, *Cutbacks Still Felt Deeply In California's Civil Courts*, KQED (Mar. 11, 2015), http://ww2.kqed.org/news/2015/03/12/-court-budget-cuts-delay-justice
[37] Emily Green, *Budget Woes Mean Big Delays For Small Claims Courts*, Nat. Pub. Radio, May 15, 2013, http://www.npr.org/2013/05/17/182640434/budget-woes-mean-big-delays-for-small-claims-courts.

$10,000—[would now] be handled by justice of the peace courts, some of which already are buried under dockets teeming with minor civil matters."[38]

For many consumers, moreover, simply finding time to bring an action in small claims court can be a significant obstacle. A 2014 report noted that a "severe reduction in evening hours in Small Claims Court from four nights a week to one night in most boroughs [of New York City] and to only one or two nights a *month* in Richmond County" had made "the Small Claims Court basically unavailable to claimants who cannot take time off during the day to appear."[39] Even when litigants do appear, moreover, the pace of justice can be glacially slow. The same report noted that in small claims courts in Brooklyn and Manhattan, "it may now take up to several years to get a judgment."[40]

### B. Arbitration, In Contrast To Litigation, Provides A Fair, Efficient Remedy For Consumers With Claims That Realistically Can't Be Addressed In Court.

Arbitration allows consumers to resolve claims quickly through procedures that are more user-friendly—and therefore accessible to consumers acting without a lawyer—than litigation. "'The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices.'"[41] These characteristics are enormously valuable to consumers who otherwise would be relegated to the unrealistic option of pursuing litigation through the impenetrable procedures used by overburdened state and federal courts—and, inevitably, to drop their claims entirely.

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[38] Kiah Collier, *Little-known state law doing away with small claims courts*, Houston Chronicle, June 23, 2013, http://www.houstonchronicle.com/news/houston-texas/houston/article/Little-known-state-law-doing-away-with-small-4616571.php; see also *Adoption of Rules for Justice Court Cases*, Misc. Docket No. 13-9023 (Tex. Feb. 12, 2013), http://supreme.-courts.state.tx.us/MiscDocket/13/13902300.pdf.

[39] N.Y. Cnty. Lawyers' Assoc., Task Force on Judicial Budget Cuts, *Courts in Crisis* 7 (Jan. 3, 2014), http://www.nycla.org/siteFiles/Publications/Publications1666_0.pdf (emphasis added).

[40] *Id.* These problems are not new; they have been reported on for years. *See* William Glaberson, *Despite Cutbacks, Night Court's Small Dramas Go On*, N.Y. TIMES, June 2, 2011, http://www.nytimes.com/2011/06/03/nyregion/despite-cutbacks-new-york-small-claims-courts-trudge-on.html.

[41] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) (quoting H.R. Rep. No.97-542, at 13 (1982), *reprinted in* 1982 U.S.C.C.A.N. 765, 777); *see also*, *e.g.*, *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1749 (2011) ("[T]he informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution.").

### 1. Arbitration enables consumers to bring claims without a lawyer.

Arbitration empowers consumers: it is easy for a consumer to bring a claim in arbitration without the help of a lawyer. Although a party always has the choice to retain an attorney, arbitration procedures are simple and streamlined enough that no attorney is necessary.

To initiate an arbitration with the American Arbitration Association (AAA), for instance, a plaintiff need only submit the relevant documents and a common-sense statement of why she is entitled to relief; and an arbitration demand may be submitted online.[42] Indeed, studies show that parties who represent themselves in arbitration do as well, if not *better*, than represented parties. As a recent study by two prominent law professors concluded, "hiring an attorney offers little value to a [claimant in arbitration] and is often unnecessary."[43]

Even when consumers do retain a lawyer, moreover, arbitration's streamlined procedures mean that the cost to the consumer is often less than if the consumer had brought the same claim in court. And the presence of favorable fee-shifting rules (discussed below) make it even easier for plaintiffs utilizing arbitration to obtain representation if they so desire.

### 2. Arbitration saves consumers both time and money.

Arbitration is significantly cheaper than litigation. Under the AAA's consumer procedures, consumers cannot be asked to pay more than $200 in total arbitration costs; businesses shoulder all remaining fees.[44] By comparison, the cost of merely

[42] AAA Consumer Arbitration Rules at 11-12, https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&; https://www.adr.org/cs/idcplg?IdcService=GET_FILE-&dDocName=ADRSTAGE2034889&RevisionSelectionMethod=LatestReleased.

[43] Johnston & Zywicki, *supra* note 11, at 25-26 ( (observing that "self-represented plaintiffs were seven times *more* likely than represented plaintiffs to get an AAA arbitrator's decision in their favor" (emphasis added)).

[44] Am. Arb. Ass'n ("AAA"), *Costs of Arbitration (Including AAA Administrative Fees)* 1, March 1, 2013, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTAGE2009593&RevisionSelectionMethod=LatestReleased.

initiating civil suit in a federal district court has recently risen to $400 or more.[45] Indeed, in practice a large percentage of individuals who bring claims in arbitration pay exactly *nothing* in fees to pursue their claim—no filing fees and no attorneys' fees.[46]

Arbitration is also much more convenient for time- and cash-strapped consumers. An arbitration plaintiff need not ever make a personal appearance to secure a judgment; claims can be adjudicated based solely on written submissions or on the basis of a telephone conference.[47] In court, by contrast, a claimant is often obligated to appear, wait in line, and perhaps return another day if the court is unable to get through its docket. Even for those litigants who can afford to take time off work or family obligations, these inconveniences can eat into an already meager recovery.

Finally, and importantly, arbitrations are resolved quickly. For example, consumer arbitrations administered by the AAA are typically resolved in four to six months.[48] A prior study by the California Dispute Resolution Institute likewise found that consumer and employment disputes were resolved in an average of 104 days in arbitration.[49] That is a huge improvement over the years that it often takes for civil lawsuits to reach trial, where long days considerably increase the costs of dispute resolution and make an eventual victory less valuable to the plaintiff.

### 3. Plaintiffs do at least as well in arbitration as in litigation.

All of the relevant data shows that arbitration is at least as likely, and often more likely, to result in positive outcomes for plaintiffs than litigation in court. Data

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[45] Judicial Conference of the United States, *District Courts Miscellaneous Fee Schedule* (approving a $50 "administrative" filing fee on top of the previous $350 filing fee), http://www.uscourts.gov/FormsAndFees/Fees/DistrictCourtMiscellaneousFeeSchedule.aspx.

[46] Hill, *supra* note 16, at 802 (lower-income employees "paid no forum fees" in 61% of the cases studied; employees also paid no attorneys' fees in 32% of the cases).

[47] See, for example, AAA, *Consumer Arbitration Rules* 22, Sept. 1, 2014, https://www.adr.org/aaa/-ShowProperty?nodeId=/UCM/ADRSTAGE2021425&.

[48] The Bureau's study, for example, found that parties could expect a decision on the merits in arbitration within 180 days. Consumer Fin. Protection Bureau, *Arbitration Study: Report to Congress 2015*, at section 5, page 73, http://www.consumerfinance.gov/data-research/research-reports/arbitration-study-report-to-congress-2015/ ("*CFPB Study*"). That was significantly shorter than the average timeline for litigation in state or federal court. *Id.* at section 6, page 58.

[49] California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure* 19 (Aug. 2004), http://www.mediate.com/cdri/cdri_print_Aug_6.pdf.

on success rates reveal that plaintiffs obtain relief to their satisfaction in a significant proportion of arbitrations. "From the individual's perspective," therefore, arbitration has the distinct advantage of "provid[ing] an affordable forum with superior chances for obtaining a favorable result."[50]

A 2010 study by scholars Christopher Drahozal and Samantha Zyontz of claims filed with the American Arbitration Association found that consumers win relief 53.3% of the time.[51] This rate compares favorably with the success rate of plaintiffs in state and federal court, who prevail roughly 50% of the time.[52] And just as in court, plaintiffs who win in arbitration are able to recover not only compensatory damages but also "other types of damages, including attorneys' fees, punitive damages, and interest."[53] In particular, Drahozal and Zyontz found that 63.1% of prevailing consumer claimants who sought attorneys' fees were awarded them. Another study by the two authors found that consumers prevailed *as or more often* in debt collection arbitration than in court—although in 2010 AAA imposed a moratorium on debt collection arbitrations in part at the urging of so-called consumer advocates.[54]

The Drahozal and Zyontz studies are consistent with a 2005 study by Ernst & Young LLP examining sample AAA case files involving consumer-initiated cases filed with the AAA. The E&Y study concluded that consumers prevailed more often than business—55% of the time—and received a favorable result (including outcomes like settlements) almost 80% of the time. Almost 70% of consumers surveyed by E&Y said they were "satisfied" or "very satisfied" with the arbitration process.[55]

These results are also consistent with the experience of arbitration in other contexts. For example, a study comparing employment discrimination suits in

[50] Rutledge, *supra* note 17, at 279.

[51] Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 896-904 (2010).

[52] *See, e.g.,* Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991-92, plaintiffs won 51% of jury trials in state court and 56% of jury trials in federal court, while in 1979-1993 plaintiffs won 50% of jury trials).

[53] Drahozal & Zyontz, *supra* note 51, at 902.

[54] Christopher R. Drahozal & Samantha Zyontz, *Credit Claims in Arbitration and in Court*, 7 Hastings Bus. L.J. 77, 80 (2011); *see also* Am. Arbitration Ass'n, *Notice on Consumer Debt Collection Arbitrations*, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTAGE2017016&RevisionSelectionMethod=LatestReleased.

[55] Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* (2005).

arbitration and federal court found that 46% of those who arbitrated won, as compared to only 34% in litigation; the median monetary award in arbitration was higher; only 3.8% of the litigated cases studied ever reached a jury trial; and the arbitrations were resolved 33% faster than in court.[56] In 2004, the National Workrights Institute compiled all available employment-arbitration studies, and concluded that employees were almost 20% more likely to win in arbitration than in litigated employment cases. It also concluded that in almost half of employment arbitrations, employees were seeking redress for claims too small to support cost-effective litigation. Median awards received by plaintiffs were the same as in court, although the distorting effect of occasional large jury awards resulted in higher average recoveries in litigation.[57]

### 4. Arbitration guarantees basic fairness.

Arbitration is fair. Arbitration providers and the courts both ensure that arbitration provisions will be enforced only if they meet basic guarantees of fairness and due process. And companies increasingly have opted to make arbitration provisions even more favorable to consumers.

The nation's two leading arbitration service providers, the AAA and JAMS, each have standards to ensure that arbitrations are conducted fairly. The AAA's Consumer Due Process Protocol requires independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court.[58] The AAA will not administer a consumer arbitration unless the arbitration is consistent with the Due Process Protocol. Likewise, JAMS will administer a pre-dispute arbitration clause between a company and a consumer only if the contract clause complies with "minimum standards of fairness."[59] Both entities recognize that independence, due process, and reasonable costs to consumers are vital elements of a fair and accessible arbitration system. They adhere to standards,

[56] Michael Delikat & Morris M. Kleiner, *Comparing Securities Awards and Trial Verdicts in Employment Disputes*, 58 Disp. Resol. J. 56, 58 (Nov. 2003).
[57] National Workrights Institute, *Employment Arbitration: What Does the Data Show?* (2004), https://web.archive.org/web/20090423052708/http://www.workrights.org/current/cd_arbitration.html.
[58] AAA, *Consumer Due Process Protocol*, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTG_005014&RevisionSelectionMethod=LatestReleased.
[59] JAMS, *JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness*, http://www.jamsadr.com/consumer-arbitration.

therefore, that establish basic requirements of fairness that provide strong protections for consumers and employees—and refuse to administer arbitrations unless the operative clause is consistent with those standards.

The courts provide another layer of oversight. State and federal courts are empowered by Congress to invalidate arbitration clauses that run afoul of generally-applicable state law contract principles, such as unconscionability.[60] Courts have not hesitated to strike down arbitration provisions that subject consumers to unfair procedures. For example, courts routinely invalidate arbitration provisions that purport to limit consumers' substantive rights to recover certain types of damages permitted them by state and federal law;[61] require excessive fees to access the arbitral forum;[62] unreasonably shorten statutes of limitations;[63] or mandate that arbitration take place in inconvenient locations.[64]

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[60] *See, e.g.*, 15 U.S.C. § 2; *Marmet Health Care Center, Inc. v. Brown*, 132 S. Ct. 1201, 1204 (2012) (stating that courts may invalidate arbitration provisions under standards "that are not specific to arbitration).

[61] *See, e.g.*, *Venture Cotton Coop. v. Freeman*, 395 S.W.3d 272 (Tex. Ct. App. 2013) (provision barring damages or attorney fees under the state's consumer protection act); *Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003) (provision barring punitive damages); *Woebse v. Health Care & Retirement Corp. of Am.*, 977 So. 2d 630 (Fla. Dist. Ct. App. 2008) (same).

[62] The Supreme Court has held that a party to an arbitration agreement may challenge enforcement of the agreement if the claimant would be required to pay excessive filing fees or arbitrator fees in order to arbitrate a claim. *See Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 90-92 (2000). Since *Randolph*, courts have aggressively protected consumers and employees who show that they would be forced to bear excessive costs to access the arbitral forum. *See, e.g., Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 923-25 (9th Cir. 2013) (refusing to enforce an arbitration agreement that required the employee to pay an unrecoverable portion of the arbitrator's fees "regardless of the merits of the claim"); *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2310-11 (2013) (reaffirming that a challenge to an arbitration agreement might be successful if "filing and administrative fees attached to arbitration . . . are so high as to make access to the forum impracticable" for a plaintiff). Courts also have reached the same conclusion under state unconscionability law. *See, e.g., Brunke v. Ohio State Home Servs., Inc.*, 2008 WL 4615578 (Ohio Ct. App. Oct. 20, 2008); *Liebrand v. Brinker Rest. Corp.*, 2008 WL 2445544 (Cal. Ct. App. June 18, 2008); *Murphy v. Mid-West Nat'l Life Ins. Co. of Tenn.*, 78 P.3d 766 (Idaho 2003).

[63] *See, e.g.*, *Zaborowski v. MHN Gov't Servs., Inc.*, 2013 WL 1363568 (N.D. Cal. Apr. 3, 2013); *Adler v. Fred Lind Manor*, 103 P.3d 773 (Wash. 2004) (180 days); *see also Gandee v. LDL Freedom Enters., Inc.*, 293 P.3d 1197 (Wash. 2013) (refusing to enforce arbitration agreement in debt-collection contract that required debtor to present claim within 30 days after dispute arose); *Alexander*, 341 F.3d at 256 (same, for an employee); *Stirlen*, 60 Cal. Rptr. 2d at 138 (rejecting provision that imposed shortened one-year statute of limitations).

[64] *See, e.g., Willis v. Nationwide Debt Settlement Grp.*, 878 F. Supp. 2d 1208 (D. Or. 2012) (travel from Oregon to California); *College Park Pentecostal Holiness Church v. Gen. Steel Corp.*, 847 F. Supp. 2d 807 (D. Md. 2012) (travel from Maryland to Colorado); *Hollins v. Debt Relief of Am.*, 479 F. Supp. 2d 1099 (D. Neb. 2007) (travel from Nebraska to Texas); *Philyaw v. Platinum Enters., Inc.*, 54 Va. Cir. 364 (Va. Cir. Ct. Spotsylvania Cnty. 2001) (travel from Virginia to Los Angeles); *see also, e.g., Dominguez v. Finish Line, Inc.*, 439 F. Supp. 2d 688 (W.D. Tex. 2006) (travel from Texas to Indiana); *Swain v. Auto Servs., Inc.*, 128 S.W.3d 103, 108 (Mo. Ct. App. 2003) (travel from Missouri to Arkansas); *Pinedo v. Premium Tobacco Stores, Inc.*, 102 Cal. Rptr. 2d 435 (Ct. App. 2000) (travel from Los Angeles to Oakland).

At the same time, the vast majority of arbitration agreements do not contain these sorts of defects. Indeed, as companies have gained more experience with arbitration, they have sought to include provisions that make arbitration even *more* favorable for consumers, not less. Nowadays, many companies voluntarily shoulder the entire costs of arbitration, including the $200 or $250 filing fee and any arbitrator fees.[65] Others agree to pay for the plaintiffs' expert witness fees, attorneys' fees, or discovery costs if the plaintiff obtains an award greater than the company's last settlement offer.[66] Still others allow plaintiffs the exclusive choice whether to conduct the arbitration in-person, via telephone, or solely on the documentary record.[67]

Even the Solicitor General of the United States has recognized that "many companies have modified their agreements to include streamlined procedures and premiums designed to encourage customers to bring claims."[68] The United States' amicus brief in *American Express v. Italian Colors Restaurant* explained that instances where individuals are unable to bring their claims in arbitration "remain rare":

> AT&T Mobility modified its arbitration agreement during the course of the litigation to include cost- and fee-shifting provisions and premiums designed to ensure that *customers could bring low-value claims on an individual basis*. These modifications left consumers '*better off under their arbitration agreement*' *than they would have been in class litigation*. And by

[65] *See, e.g.*, AT&T, *Dispute Resolution by Binding Arbitration*, http://www.att.com/disputeresolution ("AT&T will pay all AAA filing, administration and arbitrator fees for any arbitration" under $75,000); Amazon.com, *Terms of Use*, http://www.amazon.com/gp/help-/customer/display.html/?nodeId=508088 ("We will reimburse [arbitration] fees for claims totaling less than $10,000 unless the arbitrator determines the claims are frivolous.").
[66] *See, e.g.*, AT&T, *supra* note 65 ("If, after finding in your favor in any respect on the merits of your claim, the arbitrator issues you an award that is greater than the value of AT&T's last written settlement offer made before an arbitrator was selected, then AT&T will . . . reimburse any expenses (including expert witness fees and costs), that your attorney reasonably accrues for investigating, preparing, and pursuing your claim in arbitration."); Santander Bank, *Personal Deposit Account Agreement* § 7(o), https://dmob.santanderbank.com/csdlv/BlobServer?blobcol=-urldata&blob-header=application%2Fpdf&blobheadername1=Content-Disposition&blob-headervalue1=in-line%3Bfilename%3DB000215-_Jul2015_new-PDAA_r17_Final_Print+Dwn.pdf&blob-key=id-&blobtable=MungoBlobs&blob-where=1354963014673&ssbinary=true (providing for $7,500 "Special Payment" to customers who win as much or more in arbitration as they demanded from the company).
[67] *See, e.g.*, Netflix, *Terms of Use*, https://www.netflix.com/TermsOfUse ("If your claim is for US$10,000 or less, we agree that you may choose whether the arbitration will be conducted solely on the basis of documents submitted to the arbitrator, through a telephonic hearing, or by an in-person hearing."); Ticketmaster, *Terms of Use*, http://www.ticketmaster.com/h/terms.html (same).
[68] Brief for the United States as Amicus Curiae Supporting Respondents at 28-29, *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) (No. 12-133), 2013 WL 367051 (emphasis added).

> obviating a potential objection to enforcement of the arbitration agreement, those modifications simultaneously served the company's interest in avoiding litigation.[69]

Many other companies have adopted arbitration provisions with similarly pro-consumer features that ensure that arbitration is fair for their customers.

### C. The Bureau's Concerns About Arbitration Are Baseless.

In both its study and explanation of the proposed rule, the Bureau studiously avoided any clear conclusion about arbitration's utility—but it suggested various reasons why arbitration might not be an effective means of enforcing consumer protection laws. Those implicit criticisms of arbitration are contradicted by the relevant evidence, including evidence in the Bureau's own study.

#### 1. Arbitration's fairness and efficiency.

The Bureau states that it "does not believe that, based on the evidence currently available to the Bureau, it can determine whether the mechanisms for arbitration of individual disputes between consumers and providers of consumer financial products and services . . . are more or less fair or efficient in resolving these disputes than leaving this disputes to the courts."[70]

That statement contradicts the Bureau's own study, which concluded that individual arbitrations "proceed relatively expeditiously, the cost to consumers … is modest, and at least some consumers proceed without an attorney."[71] In addition, the Bureau stated, "those consumers who do prevail may obtain substantial individual awards," with an average recovery by prevailing consumers of "nearly $5,400."[72]

These findings are consistent with the wealth of scholarship discussed above, and demonstrate that arbitration is an effective method for consumers to vindicate their rights.

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[69] *Id.*
[70] 81 Fed. Reg. at 32,855.
[71] *Id.*
[72] *Id.*

What's more, ***none*** of the Bureau's reasons for questioning arbitration's "fairness" or "efficiency" as compared to traditional litigation are remotely convincing.

*First*, the Bureau states that a number of arbitrations in its sample were initiated by companies, not consumers. But that fact does not mean that those arbitrations are conducted unfairly—nor does it mean that arbitrations initiated by consumers fail to vindicate consumers' rights. To the contrary, the Bureau's own study showed that consumers do prevail in arbitration.[73]

*Second*, the Bureau notes that companies prevailed more frequently in its two-year sample than consumers did. That finding not only is contrary to scholarship discussed above,[74] which the Bureau did not address, but says precisely nothing about arbitration's fairness—and also could easily indicate that companies settle claims they are likely to lose, but that consumers do not. As the Bureau acknowledges, "[t]he Study did not suggest why companies prevail more often than consumers."[75]

*Third*, the Bureau observes that companies are almost always represented by attorneys in arbitration. But the same could be said of litigation in court. The relevant question is whether arbitration's procedures provide unrepresented *consumers* a fair opportunity to pursue their claims. And the answer is clear: *only* in arbitration does an unrepresented consumer stand a reasonable chance at prevailing on his or her claim.

*Fourth*, the Bureau states that prevailing consumers and prevailing companies recovered attorney fees in roughly equal proportions of cases (14.4% versus 14.1%) in its sample. It is hard to see why the fact that prevailing companies and consumers recover attorneys' fees at essentially the *same* rate is evidence of unfairness. In any event, the study did not indicate how often attorneys' fees were requested, nor what proportion of these awards were in cases initiated by consumers.

[73] *See* Johnston & Zywicki, *supra* note 11, at 27 ("the data that the CFPB has reported in its 2015 is not consistent with the claim that arbitration yields worse outcomes for consumers").
[74] *See supra* notes 50-57 and accompanying text. The Bureau itself recognized that "research suggests that companies prevail more often than consumers because of a difference in the relative merits of such cases." 81 Fed. Reg. at 32,855 n.351.
[75] 81 Fed. Reg. at 32,855 n.351.

*Finally*, the Bureau mentions "isolated" instances of unfair provisions in arbitration agreements. Isolated provisions are hardly an indictment of arbitration—particularly when the Bureau recognizes in the same breath that courts refuse to enforce those provisions when challenged.[76]

**2. The number of completed arbitrations.**

The Bureau also concludes that arbitration is not an effective method of vindicating consumers' rights because the number of adjudicated arbitrations in its sample is small.[77] That conclusion too is deeply flawed.

The Bureau simply fails to mention—much less analyze—the extent to which arbitration creates incentives for companies to settle individual claims or disputes ***before*** the filing of a formal arbitration proceeding. *First*, because businesses subsidize most or all of the costs of arbitration—under AAA consumer rules, for example, a business must cover at least $1,500 in filing fees[78]—it is economically rational for every business that is subject to an arbitration provision to settle disputes of less than $2,000-5,000 before an arbitration is commenced. That incentive is absent when a consumer is relegated to court, because the cost burden falls on the consumer.

*Second*, many arbitration agreements contain provisions that require bonus payments to customers who do better in arbitration than a company's last settlement offer (providing, for example, that the customer will be awarded a minimum amount, often $5,000-10,000, plus attorneys' fees and, often, other costs). It is thus a straightforward matter of economics that, if a consumer has a dispute with a company involving less than the potential minimum payment—and the claim is not frivolous or abusive—the company has every reason to settle by offering a payment (often for the full amount of the claim plus an amount for attorneys' fees) that satisfies the customer.

As the Supreme Court explained in *AT&T Mobility v. Concepcion*, the consumers' claim in that case was "most unlikely to go unresolved" because the arbitration

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76 *Id.* at 32,855 n.353 (discussing cases in which federal courts refused to compel arbitration or to enforce the unfair provision).
77 *Id.* at 32,856.
78 AAA Consumer Arbitration Rules at 34, https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&.

provision at issue provided that the company would pay the Concepcions a minimum of $7,500 and twice their attorneys' fees if they obtained an award "greater than AT&T's last settlement offer."[79]

The advantages of pre-arbitration settlement are considerable, but were completely ignored by the Bureau when it studied only arbitrations that are filed and adjudicated. The Chamber previously urged the Bureau to study pre-arbitration settlements to gain a fuller picture of arbitration's benefits.[80] The Bureau chose not to do so.

The Bureau also ignored the fact that consumers' claims are often resolved before a customer finds it necessary to invoke a formal arbitration agreement. Individuals who file arbitration demands—just like those who file small claims court cases or lawsuits in court—are almost always a very small group of consumers whose concerns were not resolved through less-formal customer service mechanisms. When companies have millions of customers, it is likely that thousands—perhaps tens of thousands—of customers will at some point in their relationship have concerns that may or may not develop into full-fledged disputes. But the vast majority of those customer concerns are resolved through informal channels, such as customer service processes, negotiation, or mediation, before a concern ripens into a dispute and a formal arbitration demand is filed.

The record in *Concepcion*, for example, indicated that AT&T awarded more than $1.3 *billion* to customers in pre-arbitration compensation during a twelve-month period.[81] Moreover, the Bureau's own complaint database shows that companies responded to more than 500,000 customer complaints in the past five years (a number

[79] 131 S. Ct. 1740, 1753 (2011).
[80] Letter from David Hirschmann & Lisa Rickard to Matthew Burton & PRA Office, *Re: "Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements,"* Docket No. CFPB-2013-0016 (Aug. 6, 2013), http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0016-0015 ("Arbitration is virtually always accompanied by a prior process of mediation or informal negotiation …. Ignoring these successful uses of the non-litigation dispute resolution process will produce skewed and inaccurate results.").
[81] *Laster v. T-Mobile USA, Inc.*, 2008 WL 5216255, at *3 (S.D. Cal. Aug. 11, 2008); *see also Ting v. AT&T*, 182 F. Supp. 2d 902, 915 (N.D. Cal. 2002) ("The undisputed testimony is that 99% of all customer complaints about billing and service are resolved through informal contact with customer representatives.").

that is rising each year), and approximately 2/3 of consumers who received a response did not dispute the company's resolution.[82]

As the two professors (from the University of Virginia and George Mason Law Schools) explain in their critique of the Bureau's study, it is good business for a company to resolve as many consumer disputes as possible informally: when consumers are dissatisfied, they can and do "take their . . . business elsewhere."[83] Indeed, the scholars found that at one bank they examined, consumers who sought voluntary refunds from the bank successfully obtained them 68% of the time.[84] Thus, they concluded, it may well be that "the overwhelming number of meritorious complaints" against businesses are "resolved consensually rather than by conflict" and that "those denied a refund do not arbitrate [because] their complaints lack merit."[85]

Lastly, the Bureau lacks a reliable basis to extrapolate from its study findings to arbitration in general. The period studied by the Bureau coincided with a concerted campaign to invalidate arbitration agreements. Plaintiffs' lawyers vigorously resisted arbitration (with success in certain "magnet" jurisdictions for class actions) before the Supreme Court decided *Concepcion* in 2011, and continued to search for ways to avoid their clients' agreements to resolve their disputes in arbitration. The unfortunate effect of these widespread efforts is that lawyers who represent consumers—and their allies in consumer advocacy organizations—have discouraged consumers from pursuing their disputes in simplified, often cost-free arbitration. It is thus unsurprising that the number of adjudicated arbitrations would be low. [86]

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[82] *See* Bureau of Consumer Fin. Prot., *Consumer Response Annual Repor*t (2016) at 46-47, http://files.consumerfinance.gov/f/201604_cfpb_consumer-response-annual-report-2015.pdf (stating that 65% of consumers "did not dispute the response during the feedback period" and another 14% did not provide feedback); Bureau of Consumer Fin. Prot., *Consumer Response: Complaints By the Numbers*, http://files.consumerfinance.gov/f/201503_cfpb_complaints-by-the-numbers.pdf (indicating that the CPFB had handled 558,000 complaints as of March 1, 2015).

[83] Johnston & Zywicki, *supra* note 11, at 30.

[84] *Id.* at 38.

[85] *Id.*

[86] What is more**,** the Bureau examined the records of just one arbitration provider, the AAA, ignoring the other arbitral forums open to consumers. Consumers are increasingly using online dispute resolution providers to handle their small claims: one such online company, Modria, handles more than ***60 million disputes per year***. By focusing solely on the AAA, the Bureau failed to capture a significant portion of the arbitrations that happen today. *See* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0019 (Modria comment submitted to CFPB June 19, 2012).

In other areas of the economy where arbitration has been allowed to flourish, by contrast, arbitration is used frequently, to all parties' benefit. Numerous studies of awards in employment arbitration have shown impressive results. In addition to the two studies discussed above—showing that employee claimants in arbitration cases did at least as well, if not better, than their counterparts in court.[87] One study of 200 AAA employment awards concluded that low-income employees brought 43.5% of arbitration claims, most of which were low-value enough that the employees would not have been able to find an attorney willing to bring litigation on their behalf. These employees were often able to pursue their arbitrations without an attorney, and won at the same rate as individuals with representation.[88]

A later study of 261 AAA employment awards from the same period found that for higher-income employees, win rates in like cases in arbitration and litigation were essentially equal, as were median damages. The study attempted to compare "apples" to "apples" by considering separately cases that involved and those that did not involve discrimination claims. With respect to discrimination and non-discrimination claims alike, the study found no statistically significant difference in the success rates of higher-income employees in arbitration and in litigation. For lower-income employees, the study did not attempt to draw comparisons between results in arbitration and in litigation, because lower-income employees appeared to lack meaningful access to the courts—and therefore could not bring a sufficient volume of court cases to provide a baseline for comparison.[89]

Yet another study of arbitration of employment-discrimination claims concluded that arbitration is "substantially fair to employees, including those employees at the lower end of the income scale," with employees enjoying a win rate comparable to the win rate for employees proceeding in federal court.[90]

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[87] Delikat & Kleiner, 58 Disp. Resol. J. at 58; National Workrights Institute, *Employment Arbitration: What Does the Data Show?* (2004), https://web.archive.org/web/20090423052708/http://www.workrights.org/current/cd_arbitration.html.
[88] Hill, *supra* note 16, at 785-88 (summarizing results of past studies by Lisa Bingham that lacked empirical evidence proving the existence of an alleged "repeat player" and "repeat arbitrator" effect).
[89] *See* Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 Disp. Resol. J. 44, 45, 47-50 (Nov. 2003-Jan. 2004).
[90] *See* Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 Disp. Resol. J. 9, 13 (May/July 2003) (reporting employee win rate in arbitration of 43 percent); *see also* Eisenberg & Hill, 58 Disp. Resol. J. at 48 tbl. 1 (reporting employee win rate in federal district court during the same time period was 36.4 percent).

Arbitration has seen great success in other contexts too. The Financial Industry Regulatory Authority ("FINRA") has used arbitration to settle both industry and customer disputes for years; arbitration in the securities industry generally dates back to at least 1872.[91] Over the past decade it has closed just under 5,000 cases a year, many of them customer cases.[92] Customers were awarded relief in a significant proportion of closed cases.[93]

Another arbitration system—the arbitration system for the Kaiser Foundation Health Plan in California—has more than seven million members. It gets high marks from members who have been involved in arbitration proceedings, most of them over medical malpractice claims. According to a 2013 survey conducted by Kaiser's independent arbitration administrator, almost 50% of the parties and attorneys who went through arbitrations that year reported that the arbitration system was better than going to court, another 38% reported that it was the same as going to court—and only 14% reported it was worse.[94]

### 3. Consumer awareness of dispute resolution agreements.

The Bureau's study also touts the results of a telephonic survey in asserting that consumers are uninformed about the dispute resolution terms of their credit card agreements. But that survey is completely irrelevant to determining whether arbitration offers benefits to consumers.[95]

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[91] Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* 6 (Nov. 4, 2002), https://www.sec.gov/pdf/arbconflict.pdf.

[92] FINRA, *Dispute Resolution Statistics*, http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics#historicalarbstats (last visited Aug. 11, 2016) (average of cases closed from 2006-2015).

[93] FINRA, *Dispute Resolution Statistics*, http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics#resultscustomerclaimant (last visited Aug. 11, 2016) (percentage of cases where customer awarded damages ranges from 38% to 45% for the 2011-16 period); *see also* Perino, *Report to the SEC*, at 31-33 (finding investors prevailed in about 50-60% of securities arbitration cases).

[94] Annual Report of the Office of the Independent Administrator of the Kaiser Foundation Health Plan, Inc. Mandatory Arbitration System for Disputes with Health Plan Members, January 1, 2014 – December 31, 2014 at 44, http://www.oia-kaiserarb.com/pdfs/2014-Annual-Report.pdf. Similarly, a recent study by Aon Global Risk Consulting concluded that arbitration in the long-term care setting resolved claims three months faster, and at 7% less cost, than claims where the was no arbitration agreement in place. Aon Risk Solutions, *Long Term Care: General Liability and Professional Liability Actuarial Analysis* 10 (Nov. 2015), https://www.ahcancal.org/research_data/liability/Documents/2015%20General%20Liability%20and%20Professional%20Liability%20Actuarial%20Analysis%20Report.pdf.

[95] The Bureau also cites a paper describing a web survey that was authored by Professor Jeff Sovern of St. Johns' Law School (among others). But the Bureau's discussion of that study fails to disclose (as Professor Sovern does) that the study was paid for from a grant by the American Association of Justice—*i.e.*, the trial lawyers who benefit from class

The Bureau refused to obtain information about consumers' baseline level of knowledge of other key provisions of their card agreements.[96] Without that comparative baseline, the Bureau cannot determine whether consumers pay greater, less, or the same attention to dispute resolution clauses as to other clauses important to them—and why that might be so. As a result, the Bureau was not able to place information regarding dispute resolution systems in context—and thereby derive information that might be relevant to assessing consumers' relative awareness of arbitration agreements versus other credit card contract provisions. The Bureau's failure to elicit such information renders the survey data meaningless.

The only data that the Bureau's study delivers is that, unsurprisingly, consumers are not focused on arbitration clauses: Not one consumer (of 1,007 who completed the survey) volunteered dispute resolution procedures as a feature relevant to selection of their credit card. Even when asked to respond to each of nine listed elements, dispute resolution was the least-selected choice.[97]

That finding is entirely unsurprising. As discussed above, businesses have a strong incentive to resolve consumer disputes internally in order to keep consumers' business. Thus, as the University of Virginia and George Mason scholars explain, "consumers prefer the market to [a] legal response for perceived service failures"; if they do not get satisfaction from a company, they simply take their business elsewhere. And "[g]iven the effectiveness of this market response, consumers do not

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action attorneys' fee awards and therefore are invested in maintaining the class action system. Moreover, Sovern's web survey also fails to ask participants about any contract provision ***other*** than the arbitration clause. It is telling (and quite unfortunate) that the Bureau's survey suffers from the same problem that the trial-lawyer-funded Sovern study does. *See CFPB Study* at section 3, pages 7-8 (citing Jeff Sovern, Elayne E. Greenberg, Paul F. Kirgis, & Yuxiang Liu, *"Whimsy Little Contracts" With Unexpected Consequences: An Empirical Analysis of Respondent Understanding of Arbitration Agreements* (Oct. 29, 2014), http://ssrn.com/abstract=2516432).

[96] The Chamber repeatedly urged the Bureau to obtain such information, but the Bureau refused to do so. *See* Letter from David Hirschmann & Lisa Rickard, *Re: "Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements,"* Docket No. CFPB-2013-0016 (June 30, 2014), http://www.regulations.gov/#!documentDetail;D=CFPB-2014-0011-0015; Letter from David Hirschmann & Lisa Rickard to Matthew Burton & PRA Office, *Re: "Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements,"* Docket No. CFPB-2013-0016 (Aug. 6, 2013), http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0016-0015.

[97] *CFPB Study* at section 3 at 14-15.

*need* to know anything about"[98] whether their agreement with a company provides for arbitration or litigation.[99]

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According to an article published in the *Stanford Law Review* surveying the empirical research on arbitration, "[w]hat seems clear from the results of these studies is that the assertions of many arbitration critics were either overstated or simply wrong."[100] That is even more true today. There simply is no empirical support for the contention that arbitration leads to unfair or subpar outcomes when compared with litigation. Rather, the overwhelming weight of the evidence establishes that consumers and employees can obtain redress more quickly and less expensively through arbitration—and for claims that they could not as a practical matter litigate in court.[101]

## III. Overwhelming Evidence Shows That Class Actions Provide Very Little, If Any, Real-World Benefit To Consumers.

The Bureau's primary reason for regulating pre-dispute arbitration agreements has little to do with arbitration. Nor could it, given (a) the Bureau's own admission

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[98] Johnston & Zywicki, *supra* note 11, at 30, 32.

[99] Class action proponents may invoke a recent study by the Pew Charitable Trusts that purports to show that consumers "want[] access to the justice system, including the right to join and pursue a class action," for resolving disputes with banks. Pew Charitable Trusts, *Consumers Want the Right to Resolve Bank Disputes in Court* 1, Aug. 2016, http://www.pewtrusts.org/~/media/assets/2016/08/consumerswanttherighttoresolvebankdisputesincourt.pdf. But that study offers no basis for concluding that consumers prefer courts to arbitration, because the study *never asked about arbitration*: participants were simply asked whether they "should or should not be allowed" to take a list of various actions to resolve a dispute, and the list omitted arbitration entirely. *Id.* at 8. Tellingly, when asked what they *would* do in response to a dispute, 75% of survey participants said they would ask to speak to a bank manager to resolve the dispute informally, while only 23% said they would take legal action—confirming the scholars' findings that most consumers do not value access to courts in choosing financial products and services. *Id.* at 9.

[100] David Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 Stan. L. Rev. 1557, 1567 (2005).

[101] Many of the criticisms of arbitration debunked above were also advanced by class action proponents in a series of articles in the *New York Times*. But those articles, too, were based on erroneous data and flawed examples, as the Chamber explained in a series of responses, which we incorporate by reference. *See* Institute for Legal Reform, *The New York Times Doesn't Like Arbitration, But It Really Likes Plaintiffs' Lawyers* (Jan. 7, 2016), http://www.instituteforlegalreform.com/resource/the-new-york-times-doesnt-like-arbitration--but-it-really-likes-plaintiffs-lawyers; Institute for Legal Reform, *New York Times Part 2: Arbitration Responsible for All of the World's Ills (Well, Just About All)* (Nov. 4, 2015), http://www.instituteforlegalreform.com/resource/new-york-times-part-2-arbitration-responsible-for-all-of-the-worlds-ills-well-just-about-all; Institute for Legal Reform, *Dog Bites Man: New York Times Prefers Lawyer-Controlled Class Actions over Fair Arbitration that Enables Individuals to Protect Themselves* (Nov. 2, 2015), http://www.instituteforlegalreform.com/resource/dog-bites-man-new-york-times-prefers-lawyer-controlled-class-actions-over-fair-arbitration-that-enables-individuals-to-protect-themselves.

that its study does not show that individual arbitration is any less fair or efficient than individual litigation[102]—and (b) ***the abundant evidence not addressed by the Bureau demonstrating beyond any doubt that arbitration is at least as fair as litigating in court, and much more efficient and much more accessible to consumers.***[103]

The entire justification for the Bureau's proposed regulation is, instead, the Bureau's objection to the fact that arbitration agreements require individual arbitration, which prevents consumers from participating in class action lawsuits. The Bureau's proposal could be defensible, therefore, only if class actions provide significant, demonstrable benefits to consumers—benefits so substantial that they justify eliminating the benefits consumers can gain from arbitration.

The Bureau's explanation focuses on the ***theoretical*** benefits of class actions, describing them as a "more effective means through which large numbers of consumers are able to obtain monetary and injunctive relief in a single case."[104] It also asserts that "class action liability deters potentially illegal conduct and encourages investments in compliance."[105] The Bureau concludes that agreements to arbitrate on an individual basis must be banned, because they "block[] a significant portion of class action claims that are filed" and "suppress[] the filing of others."[106]

But while the features of class actions that the Bureau describes may sound appealing in theory, even the Bureau's own study confirms that ***in reality, these benefits are very rarely, if ever, realized***. It comes as no surprise that the study leads to that conclusion, because it is confirmed by a mountain of other evidence. Instead of making injured consumers whole, or providing any meaningful relief at all to consumers, most class actions provide no benefit at all to class members.

And instead of targeting businesses that act illegally and deterring their wrongful conduct, class actions serve as a litigation tax on ***all*** businesses—whether they have broken the law or not—because virtually every class action that survives preliminary procedural steps is settled, without any judicial finding of malfeasance.

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102 80 Fed. Reg. at 32,855.
103 See pages 12-26 above.
104 *Id.* at 32,858.
105 *Id.* at 32,862.
106 *Id.* at 32,859.

There is accordingly no distinction between defendants who engaged in wrongdoing and those who did not: everyone pays.

In sum and as more fully discussed below,[107] the Bureau's claims about class actions' theoretical benefits to consumers simply are not supported by the real-world evidence.

There is however, one group that is an indisputable beneficiary of class actions: the plaintiffs' attorneys who file them and receive large fees when the cases are settled. The Bureau's solicitude for class actions will have the inevitable effect of benefiting these lawyers and harming consumers, ***an outcome that is squarely inconsistent with the mission and the statutory standard governing its regulatory authority.***

### A. Class Actions Provide Little Compensation For Injured Class Members.

Clear evidence, including the Bureau's own study, demonstrates that class-action reality varies dramatically from the theory of class actions: these cases in fact provide little or no actual benefit to most consumers:

- The vast majority of class actions provide ***nothing*** to absent class members;
- In the very small percentage of class actions that settle, few consumers file claims—and the amounts they receive, after long delays, are small;
- Class actions are often designed by, and litigated in the interests of, the lawyers who file them rather than the class members who are the supposed beneficiaries. That is why they are plagued with abusive practices, which are largely a product of plaintiffs' lawyers' conflict of interest, together with the courts' lack of tools to police that conflict effectively;
- Class actions neither uncover wrongdoing nor deter future wrongdoing; and

[107] See pages 36-46 below.

- The Bureau's generalized claim that class actions benefit consumers rests largely on the results of a single group of related cases—and ignores the characteristics, and outcomes, of the vast majority of class action cases.

### 1. Most class actions do not produce *any* recovery for absent class members.

The overwhelming majority of cases filed as putative class actions provide no benefit at all to absent class members. ***According to the Bureau's own data, 87% of resolved class actions (which does not include any claims affected by arbitration agreements) resulted in no benefit to absent class members. They were either dismissed by the court or settled with the named plaintiff only.*** The Bureau found that only 13% of putative class actions were finally approved for class-wide settlement during the study period.[108]

That is an even smaller percentage than that observed in another study of class actions, conducted in 2013 by Mayer Brown LLP on behalf of the Chamber.[109] That study found ***approximately two-thirds of cases studied were dismissed on the merits by the court, or dismissed voluntarily by the plaintiff***.

A new empirical study published this year, and focused on class actions under consumer protection statutes, yielded similar findings: that ***60-80% of class actions under those statutes did not lead to any recovery for the class***.[110] In short, the available data indicate that in the vast majority of cases, class actions do not result in a class-wide judgment or settlement and thus do not benefit absent class members.

The Bureau's proposal does not dispute that most class actions fail to result in recovery for absent class members; rather, it asserts that this fact is irrelevant. In the Bureau's view, "the best measure of the effectiveness of class actions for all consumers is the absolute relief they provide, and not the proportion of putative class

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[108] *CFPB Study* at section 6, page 37.
[109] Mayer Brown LLP, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 11, 2013) ("*Chamber Study*"), http://www.mayerbrown.com/files/uploads/-Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf.
[110] Jason Scott Johnston, *High Cost, Little Compensation, No Harm to Deter: New Evidence on Class Actions Under Federal Consumer Protection Statutes* (Univ. of Va. Sch. of L., L. & Econ. Research Paper Series 2016-9, May 2016), http://ssrn.com/abstract=2777618.

cases that result in individual settlements or potential individual settlements."[111] That is so, the Bureau asserts, because when class actions settle on an individual basis or are dismissed, other similarly situated consumers are not bound by the judgment and thus remain free to bring their own class actions.[112]

That assessment is arbitrary and capricious, and contrary to the interests of consumers, for two basic reasons. First, there is no evidence that any such subsequent class actions are brought, and for good reason. Typically, class actions fail because the claim is dismissed as legally insufficient or the court concludes that a class cannot be certified. In those circumstances, why would a lawyer invest resources in bringing the same claim again? The Bureau cites no examples to the contrary.

Second, the Bureau focuses only on the potential benefit of class actions to consumers who are class members without also accounting for the ***costs*** that class actions impose on all consumers. Every class action, whether resolved on a class basis or not, imposes costs on businesses, including the fees of defense lawyers and the costs of discovery if the lawsuit survives a motion to dismiss.[113] These costs are inevitably passed on to consumers. In short, focusing only on the aggregate amount of recovery in the small fraction of class actions that settle on a class-wide basis obscures the fact that most class actions are generating costs with *no* corresponding benefits for anyone except (at most) the named plaintiff and the attorneys involved in the litigation.

Even if considered on its own, deficient terms, however, the Bureau's analysis is fatally flawed: settled class actions provide little benefit to consumers actually injured by violations of law.

[111] 81 Fed. Reg. at 32,859.
[112] *Id.*
[113] *See, e.g.*, Br. of Intel Corp. as Amicus Curiae at 8, *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338 (2011) (No. 10-277), 2011 WL 288897 (citing the "steep costs associated with litigating class action[s]" and explaining that "[p]retrial discovery . . . is especially costly in class actions, and tends to cost defendants far more than plaintiffs"); Linda Mullenix, *Ending Class Actions as We Know Them: Rethinking the American Class Action*, 64 Emory L.J. 399, 416 (2014) (discussing the "substantial ongoing litigation expenses" for class action defendants).

### 2. The few class actions settled on a class-wide basis provide little compensation to injured consumers.

The Bureau's fundamental justification for its proposal—the supposed benefits of the few class actions settled on a class-wide basis—rests on analysis that is arbitrary and capricious.

To begin with, the Bureau assumes—without justification—that every settlement payment redresses a wrong suffered by consumers and therefore is properly classified as a "benefit" to injured consumers that, if eliminated as a result of arbitration, would diminish overall consumer protection. But courts have long recognized that defendants agree to pay settlements in class actions even when they have a strong chance of prevailing on the merits—either because the costs of defense (which will not be recovered even if the defendant prevails) are higher than the costs of settling or because of the downside risk of a large adverse verdict (which would produce adverse publicity, brand damage, and additional litigation costs, including the costs of an appeal bond).[114]

A settlement payment in a case in which the underlying claim lacks merit represents a failure of the litigation system, not a legitimate use of the class action mechanism. In assessing the actual benefits of class actions, therefore, the Bureau should have examined the underlying claims to determine whether the settlements were tied to a meritorious, or at least likely meritorious, claim. Its failure to do so renders its conclusions about the claimed benefits of class actions arbitrary and capricious, and eliminates any legitimate basis for the proposed rule.

Moreover, the Bureau's approach of looking only at aggregate recoveries across many cases fails to answer the question, critical under Section 1028(b), whether eliminating arbitration would be in the best interest of most consumers. Because 87% of class actions do not settle or proceed to judgment on a class-wide basis, the likelihood is quite low that any particular consumer will be in a class action that does settle (or end in a judgment for plaintiffs) on a class-wide basis. The Bureau does not acknowledge this fact, let alone address it—even though it shows that while a very small handful of consumers may be eligible to recover in class action settlements, the vast majority will not.

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[114] See pages 62-65 below.

Even for those consumers in the 13% of cases that settle, moreover, the benefits are largely illusory.

**a. Very few consumers bother to file claims.**

Most class action settlements do not involve automatic distribution of settlement payments to absent class members.[115] Settlements therefore routinely require a class member affirmatively to submit a claim form to receive any settlement payment. ***The vast majority of class members do not file claims for payment from these settlement funds.***[116]

The Bureau's study attempts to conceal this reality by touting the purportedly large number of class members "eligible" for relief, but that figure is completely misleading.[117] The only metric relevant in determining whether class actions yield benefits for consumers is the rate at which "eligible" class members actually submit claims and receive monetary relief.

Surprisingly in light of the flood of statistics that the Bureau provided on other topics—including the absolute numbers of class members eligible for relief when cases settle—the Bureau's report obscures rather than highlights the proportion of eligible class members who ***actually*** submitted claims. And, even though the Bureau could have attempted to gather this information from class action settlement administrators, courts, or parties, it did not do so.

Where statistics were available, the Bureau's study reported a "weighted average claims rate" of 4%.[118] That figure comports with the Chamber's study, which found that (in the handful of cases where statistics were available, and excluding one outlier case involving individual claims worth, on average, over $2.5 million) the claims rates were minuscule: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.[119] It also corresponds to academic studies, which regularly conclude that only "very small percentages of class members actually file and receive compensation from settlement

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[115] *See, e.g.*, *CFPB Study* at section 8, page 20 (63% of settlements in sample did not include an automatic cash distribution).
[116] *See* notes 118-121 and accompanying text.
[117] *See, e.g.*, *CFPB Study* at section 8, page 21.
[118] Id. at section 8, page 30.
[119] *Chamber Study* at 7 & n.20.

funds."[120] And finally, it matches the real-life experience of federal courts, one of which has observed that "'claims made' settlements regularly yield response rates of 10 percent or less."[121]

Thus, the available evidence, including the Bureau's own study, confirms that ***even in the small fraction of class actions that settle on a class-wide basis, most class members receive no benefit—because they do not file claims to receive a settlement payment***. A recent empirical study explains that "[a]lthough 60 percent of the total monetary award may be available to class members, in reality, they typically receive less than 9 percent of the total." The author concluded that class actions "clearly do[] not achieve their compensatory goals…Instead, the costs…are passed on to consumers in the form of higher prices, lower product quality, and reduced innovation."[122]

The Bureau could have—and should have—used its study data to make a more robust calculation of the overall likelihood that a class member will receive a benefit in a class action, an obviously-important factor in assessing whether class actions benefit consumers. But even a back-of-the-envelope estimate using the Bureau's own figures outlined above suggests that so-called "claims-made" settlements provide very little to the broader set of individuals on whose behalf plaintiffs seek to bring class actions. If an average of 4 percent of class members (weighted by size of the class) made claims in settlements and only 13 percent of class actions result in settlements to begin with, then only a very, very tiny percentage of the members of potential classes ever receive any recovery.

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[120] Mullenix, *supra* note 113, at 419.

[121] *Sylvester v. CIGNA Corp.*, 369 F. Supp. 2d 34, 52 (D. Me. 2005).
That is a conservative estimate: in many reported cases, the claims rate is far lower. For example, in one 2012 class action, a payment-card processor settled a lawsuit arising out of a breach of its computer systems. The class consisted of over 100 million cardholders, but despite what the court called "a vigorous notice campaign," only eleven people filed valid claims—a claims rate of less than one millionth of one percent. *In re Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig.*, 851 F. Supp. 2d 1040, 1047 (S.D. Tex. 2012). In another 2008 case, a video game maker settled a lawsuit brought by plaintiffs who purchased a video game that could be modified by third-party software to display sexual content. The class consisted of some 10 million purchasers of the game, but despite a notice campaign that led to more than 100,000 hits on the settlement fund's website, only 2,676 class members filed claims—a minuscule claims rate of less than one thousandth of one percent. Defs.' Mem. In Support of Pls.' Mot. for Final Approval of Class Action Settlement, *In re Grand Theft Auto Video Game Consumer Litigation (No. II)*, No. 06-md-1739 (S.D.N.Y. May 27, 2008), PACER No. 124.

[122] Joanna Shepherd, *An Empirical Study of No-Injury Class Actions* 5 (Emory Univ. Sch. of L. Legal Studies Research Paper Series No. 16-402, Feb. 1, 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2726905.

This fact is relevant for two reasons. First, it undermines the claimed benefits of class actions—they plainly cannot be justified as providing broad compensation to consumers.

Second, the huge percentage of nonparticipating class members indicates that consumers viewed the claimed "injury" as irrelevant, or minor; or found the potential settlement payment not worth their time. Either indicates that the class action did not provide a benefit that consumers found valuable—which is perhaps the best evidence that consumers themselves do not view this litigation as advancing their interests. But the Bureau never even addressed the important evidence provided by this huge gap.

**b. A disproportionate share of settlement proceeds is distributed to lawyers, not to consumers.**

Consumers get little benefit from class actions, but the lawyers who file these cases profit handsomely. Those payments to lawyers, of course, are subtracted from the funds available to consumers, and therefore are highly relevant in assessing the benefit that class actions provide to consumers.

The Bureau focuses in its study on the *aggregate* amount of payments to class members, which it calculated to be "a total of $1.1 billion in 251 settlements" studied. But the Bureau's analysis obscures, rather than illuminates, the reality of class actions.

To begin with, a disproportionate amount of this "$1.1 billion" is attributable to a single set of class actions, the *Overdraft* cases. As we discuss below,[123] the Bureau's reliance on a single atypical case renders its entire study capricious and arbitrary.

Moreover, the "$1.1 billion" figure sounds large in the abstract, but the study elsewhere says that 236 settlements involved 34 million class members "who received, or will receive, a cash payment." Thus, even if one assumes that the extra 15 cases included in the first total and not in the second had *no* class members, the average settlement payment in these 251 settlements was $32.35.[124] In the proposed rule, the Bureau quibbles with this math—although not identifying any alternative—but

[123] See pages 47-49 below..
[124] *CFPB Study* at section 8, pages 27-28.

ultimately concedes that "$32-per-class-member…is a reasonable estimate."[125] While class members receive little, the lawyers who bring class actions do very well. The total attorneys' fees in the cases studied by the Bureau added up to $424 million for 419 cases, which works out to an average of more than $1 million per case.[126] Based on the Bureau's study, the average fee paid to plaintiffs' lawyers—as a percentage of the *announced* settlement (not the smaller amount actually distributed to class members)—was 41%, with a median of 46%. It is not possible, based on the data released by the Bureau, to calculate the legal fees' relationship to the amounts actually distributed to class members, but it obviously is a much larger percentage.

Moreover, in many class actions the plaintiffs' lawyers receive *more* than the class itself: a RAND Corporation study found that this happened in three out of ten class actions studied.[127] Examples of such class actions remain commonplace:

- In a class action alleging that the defendants improperly interfered with the medical care of injured employees, the defendants (who denied wrongdoing) were required to make an $8 million fund available to compensate more than 13,500 class members. But class counsel received over $4.5 million out of the $8 million— more than 55 percent of the fund.[128]

- In a class action against the National Football League, retired players alleged that the league was using their names and likenesses without compensation. The class action was settled, but the named plaintiffs themselves opted to object to the settlement because it provided no direct payout to the retired players. Instead, money would be diverted to a new charitable group—while the class counsel received more than $7.7 million in fees and expenses.[129]

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[125] 81 Fed. Reg. at 32,849 n.305; *see also id.* at 32,858 n.376 (conceding that $32 per class member is "a roughly accurate approximation").
[126] *CFPB Study* at section 8, page 33.
[127] Deborah R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain (Executive Summary)* 21 (1999), http://www.rand.org/content/dam/rand/pubs/monograph_reports/2005/MR969.1.pdf.
[128] *See*, Plaintiffs' Unopposed Motion for Order Preliminarily Approving Class Action Settlement at 8, *Gianzero v. Wal-Mart Stores, Inc.*, No. 09-cv-00656 (D. Colo. Nov. 21, 2011), PACER No. 464 (settlement providing that plaintiffs' attorneys would receive more than $4.5 million of the $8 million settlement fund).
[129] Alison Frankel, *Retired NFL stars reject settlement of their own licensing class action*, Reuters, Mar. 25, 2013, http://blogs.reuters.com/alisonfrankel/ 2013/03/25/retired-nfl-stars-reject-settlement-of-their-own-licensing-classaction/ (settlement awarding plaintiffs' lawyers $7.7 million while class members received no direct compensation).

- In a class action against the makers of Duracell batteries alleging that they were misleading labeled "longest-lasting," class members filed claims for just $344,000 worth of coupons for new batteries, while the plaintiffs' lawyers were awarded more than $5.6 million in fees.[130]

- In a class action against Subway alleging that its "Footlong" sandwiches were not really 12 inches long, class members received *nothing* apart from Subway's promising to take certain quality control measures, while the plaintiffs' lawyers got more than $500,000 in fees.[131]

- In a class action against a gym company for allegedly improper fees, class members ultimately received about $1.6 million in cash, whereas the plaintiffs' lawyers received $2.39 million in fees and costs.[132]

The Bureau completely ignores these realities in its assessment of class actions.

#### c. The value to consumers of the minimal relief actually obtained in class actions is further diminished by the long time it takes to resolve class actions.

Class actions typically take significantly longer to resolve than arbitrations. That means consumers must wait much longer to obtain relief.

According to the Bureau's study, class actions that actually produced a class-wide settlement took an average of nearly two years to resolve.[133] (The Chamber's class action study found that some class actions take even longer; 14% of the class actions that the Chamber examined were still pending *four years* after they were filed, with no end in sight).[134] The two-year average duration calculated by the Bureau, moreover, may not even include the time needed for consumers to submit claims and receive payment *after* a settlement is reached.

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130 Pet. for a Writ of Certiorari at 16, *Frank v. Poertner*, No. 15-765, 2015 WL 8765974.
131 Adam Schulman, *Subway Footlong Sandwich Settlement Now on Appeal*, Competitive Enter. Inst., Mar. 30, 2016, https://cei.org/blog/subway-footlong-sandwich-settlement-now-appeal.
132 *See Gascho v. Global Fitness Holdings, LLC*, 822 F.3d 269, 274 (6th Cir. 2016).
133 *CFPB Study* at section 8, page 37.
134 *Chamber Study* at 1.

The Bureau itself found that arbitrators take between four and eight months to resolve on the merits. When arbitrations were settled, the process took a mere two to five months.[135]

This difference matters in assessing whether and to what extent consumers benefit because, as one court has explained, even when a class action actually results in monetary relief, a long "delay … [can] make the relief eventually awarded the class worth much less in present-value terms."[136] A rational assessment of arbitration and class actions must therefore account for the long duration of class actions. The Bureau's analysis completely ignores this consideration.

#### d. The Bureau's claim that class actions generally benefit consumers rests largely on a ***single*** case out of the hundreds it studied.

Much of the Bureau's analysis of the purported benefits of class actions—both in its study[137] and in the explanation of its proposed rule[138]—focuses on a case study of a single multidistrict case, *In re Checking Account Overdraft Litigation*. The Bureau trumpets the facts that in this litigation, class members received a total of $1 billion in cash relief; the relief was paid automatically, rather than through a claims process; and certain banks were ordered to change their overdraft practices.[139]

But this single case study offers no support for the Bureau's proposed rule, for multiple reasons.

*First*, to justify an across-the-board rule, the Bureau should have evaluated the benefits of a ***typical*** class action, but the *Overdraft* cases were ***atypical*** for multiple reasons:

- The *Overdraft* cases were resolved on a class-wide basis, whereas the Bureau's study found 87% of class actions are not.[140]

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[135] *CFPB Study* at section 5, page 72.
[136] *Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277, 284 (7th Cir. 2002).
[137] *CFPB Study* at section 8, pages 39-46.
[138] 81 Fed. Reg. at 32,850.
[139] *CFPB Study* at section 8, page 40.
[140] *Id.* at section 6, page 37.

- These cases generally involved automatic settlement payments, whereas the Bureau's study found that most class actions are claims-made settlements where consumers must file a claim form to obtain relief (which very few bother to do).[141]

- The settlement amount is orders of magnitude larger than in any other class action in the Bureau's study. Although the Bureau's Study does not provide precise information, these cases appear to have accounted for more than half of the total $1.1 billion in settlements—which would indicate that roughly $400 million or less was shared among 200+ other individual cases. That confirms how dramatically atypical the *Overdraft* cases are, and underscores the statistical malfeasance that the Bureau has committed by relying on such outlier cases as the basis for determining that class actions generally benefit consumers.

- They involved a high-profile issue that today would be the subject of government enforcement actions, as demonstrated by the Bureau's enforcement focus on overdraft issues.[142]

The question for the Bureau under Section 1028(b) is whether, as a general matter, effectively prohibiting individual arbitration in the consumer finance industry in favor of class actions is in the public interest and for the protection of consumers. ***That question cannot be answered by focusing almost entirely on one specific set of class actions—particularly one that the Bureau's own data show is unrepresentative of most class actions.*** The Bureau's decision to base its study on an atypical case renders the study, and therefore the proposed rule, capricious and arbitrary, and completely undermines the Bureau's conclusion that consumers benefit from class actions.

*Second*, the Bureau failed to address critical questions about the *Overdraft* cases: how long did the cases take to resolve and what was the net present value to

[141] *Id.* at section 8, page 20.
[142] *See, e.g.*, *In re Santander Bank, N.A.*, CFPB No. 2016-CFPB-0012 (addressing subject bank's overdraft fee practices); *In re Regions Bank*, CFPB No. 2015-CFPB-0009 (same).

consumers of the eventual settlements?[143] How much were the plaintiffs' attorneys awarded in fees? Without answers to these questions, the Bureau has no basis for arguing that the *Overdraft* case shows that class actions provide greater benefits for consumers than arbitration does.

*Third*, the Bureau does not assess the extent to which customer complaints were resolved through informal channels before the class actions commenced—and how many could and would have been resolved in that manner if the class action did not proceed.[144]

* * * *

In short, the Bureau's own study findings confirm what many observers of class actions have long known:

- Most class actions result in ***no*** relief for absent class members;

- Most class actions that ***do*** lead to class-wide settlements are claims-made cases where only a tiny fraction of class members submit claims;

- The average payment to class members is small, while the average amount of attorneys' fees in class actions is massive; and
- Class actions take several times longer to resolve than arbitration proceedings.

As one scholar put it, it is highly questionable whether the small compensatory awards that *some* class members *sometimes* receive "are worth the bother"[145] of adjudicating these lengthy and massive cases (many of which will never lead to class-wide relief), paying plaintiffs' lawyers a substantial cut of the recoveries, and going

[143] At least some of the cases were quite lengthy. One of the overdraft class actions cited by the Bureau, *Gutierrez v. Wells Fargo Bank, N.A.*, No. 3:07-cv-05923-WHA (N.D. Cal.), commenced in November 2007 (see Compl., ECF No. 1) and did not reach judgment until almost three years later (see Judg., ECF No. 498), after a bench trial. Appeals and other post-trial proceedings followed, with the result that the court only recently—in May 2016, more than eight years after the case commenced—authorized the plan for distributing relief to class members to go forward. See Order, ECF No. 700.
[144] The Bureau acknowledges that it does not know how many customer complaints about overdrafts were resolved informally; it simply infers that the number must have been small because the eventual settlements accounted for claims that had already been resolved and still totaled $1 billion. 81 Fed. Reg. at 32,850 & n.313.
[145] Mullenix, *supra* note 113, at 422.

through the costly and laborious process of distributing settlement payments to the few class members that request them. Yet the Bureau makes no attempt to perform a serious analysis, instead focusing arbitrarily on the aggregate amount of relief that has been awarded in certain class actions. The Bureau's refusal to engage in a reasonable analysis to determine the actual benefit consumers obtain from class actions fatally undermines the proposed rule.

### B. Class Actions Frequently Are Filed And Litigated To Benefit Lawyers Rather Than Consumers, Which Results In A Myriad Of Abusive Practices—None Of Which The Bureau's Study (Or Proposal Justification) Addresses.

The empirical evidence regarding class actions itself demonstrates that the reality of this device usually fails to live up to the theoretical promise of delivering meaningful relief to class members. But the drawbacks of class actions are far more extensive than data alone can describe. Class actions today are marked by a number of abusive practices, through which plaintiffs' lawyers—the true beneficiaries of class action lawsuits—put their own interests ahead of the interests of class members. The Bureau's study completely fails to address these problematic practices, all of which provide strong evidence that consumers do not derive any significant benefit from class actions.

#### 1. The decision to file a class action often rests on lawyers' self-interest rather than consumers' interest.

Professor Martin Redish has recognized that "[t]he real parties in interest" in class actions are "the plaintiffs' lawyers, who are the ones primarily responsible for bringing th[e] proceeding."[146] Most class actions today are driven not by injured consumers seeking redress but by entrepreneurial plaintiffs' lawyers looking to make easy money.

The RAND study reached the same conclusion: "what drives damage[s] class actions" today is "the opportunity they offer lawyers to secure large fees by

[146] Testimony of Martin H. Redish at 7, U.S. House of Representatives, Committee on the Judiciary, Subcommittee on the Constitution, *Hearing: Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), http://judiciary.house.gov/_files/hearings/Hearings%202012/Redish%2006012012.pdf.

identifying, litigating, and resolving claims on behalf of large numbers of individuals…most of whom play little or no role in the litigation process. These financial incentives produce significant opportunities for lawyers to make mischief, to misuse public and private resources for litigation that does not serve a useful social purpose."[147]

Indeed, "no sooner does any product defect or consumer issue emerge than attorneys file multiple, repetitive class actions across the country."[148] In order to move this quickly, plaintiffs' lawyers frequently have to recruit plaintiffs for their class action, rather than waiting for potential class members to come to them.

For example, in one class action against 5-Hour Energy highlighted recently in *Forbes*, the lead plaintiff admitted in a deposition that "she had been recruited to serve as a plaintiff by her cousin, who worked for a Texas lawyer [whom plaintiffs' counsel] knew; had purchased two bottles of 5-Hour Energy specifically to sue the manufacturer; had never complained to the company or sought a refund; and had signed a backdated retainer agreement with [plaintiffs' counsel] the week before the deposition in order to comply with California law, months after she'd lent her name to his lawsuit."[149]

Plaintiffs' lawyers may make improper payments to potential plaintiffs under the table in order to get them to serve as lead plaintiff.[150] Or they may work with "'professional plaintiff[s]'"—clients who have "appeared in literally hundreds of other [class] actions"—specifically for the purpose of ginning up claims.[151] And failing these options, plaintiff's lawyers may just recruit a relative or friend or even an employee of the law firm. In one consumer class action, for example, the lead plaintiff was the lead plaintiff's attorney's father-in-law—an arrangement that the court decried as marked

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[147] Deborah R. Hensler et al., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 6-7 (2000).
[148] Mullenix, *supra* note 113, at 435.
[149] Daniel Fisher, *Collapse Of 5-Hour Energy Case Reveals The Secrets Of Class Action Lawyers*, Forbes (Nov., 17, 2015), http://www.forbes.com/sites/danielfisher/2015/11/17/collapse-of-5-hour-energy-case-reveals-secrets/#3ba849971aa4.
[150] *E.g.*, *Swift v. First USA Bank*, 1999 WL 1212561, at *6 (N.D. Ill. Dec. 15, 1999) (refusing to certify class because plaintiffs' attorneys had initially agreed to pay lead plaintiff's husband a portion of their attorneys' fees as a "finder's fee"); Press Release, United States Dep't of Justice, Milberg Weiss Law Firm, Two Senior Partners Indicted in Secret Kickback Scheme Involving Named Plaintiffs in Class-Action Lawsuits (May 18, 2006), http://online.wsj.com/public/resources/documents/milbergpress05182006.pdf (announcing 20-count indictment against Milberg Weiss and two of its senior partners).
[151] John C. Coffee, Jr., *Rethinking the Class Action: A Policy Primer on Reform*, 62 Ind. L.J. 625, 632 (1987).

by a "grave conflict of interest" and "palpable" "impropriety."[152] In another, a plaintiffs' firm was disqualified from representing a putative class because the named plaintiff was a lawyer at the firm. The trial court had found that during a two-year period, the firm had filed ten class actions in which "an attorney from [the firm] or a relative of one of the attorneys was the named plaintiff."[153]

Not only do the named plaintiffs and absent class members have very little role in bringing most consumer class actions, they also do very little to monitor or supervise class counsel once the lawsuit is underway. That is so for two reasons: *First*, class members generally do not expect a sufficient recovery to justify the cost of monitoring. If class members stand to gain, at most, a few dollars from a class action, it simply is not economically rational for them to spend time and energy trying to make sure that class counsel is acting in their best interests.[154] And *second*, "even if [class] plaintiffs wanted to monitor the litigation, they would experience severe difficulties in doing so because they are often entirely unaware that the litigation is pending until after a settlement has been reached."[155]

In short, plaintiffs' lawyers have taken control of the consumer class action mechanism and turned it into a big "business that uses the threat of expensive litigation and potentially ruinous damages to pry billions of dollars in settlements and hundreds of millions of dollars in legal fees from businesses each year."[156] Thus, as Judge Richard Posner has observed, in most class actions, "the lawyers for the class, rather than the clients, have all the initiative and are close to being the real parties in interest."[157]

### 2. Settlements are structured to benefit lawyers rather than consumers.

Even when class action settlements result in actual relief for absent class members, their terms are often unfavorable for absent class members. The reason is

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152 *Eubank v. Pella Corp.*, 753 F.3d 718, 722, 724 (7th Cir. 2014).
153 *Apple Computer, Inc. v. Superior Court*, 126 Cal. App. 4th 1253, 1262 (2005).
154 Coffee, *supra* note 151, at 633; *see also, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 19-20 (1991).
155 Macey & Miller, *supra* note 154, at 20.
156 Fisher, *supra* note 149.
157 *Mars Steel Corp. v. Cont'l Ill. Nat'l Bank & Tr. Co. of Chi.*, 834 F.2d 677, 678 (7th Cir. 1987).

simple. As one court has observed, there is an "acute conflict of interest between class counsel, whose pecuniary interest is in their fees, and class members, whose pecuniary interest is in the award to the class."[158] This conflict of interest frequently leads plaintiffs' lawyers to "agree to settlements that better serve their own interests—and the defendants who should be their adversaries—than those of class members."[159]

Class counsel's willingness to trade away their clients' interests can take many forms. The most obvious is that the plaintiffs' lawyers may agree to settle a case early, before they invest too much time in the case—"even if the settlement is significantly less than what might be expected if counsel pursued the case more vigorously."[160] Class-action plaintiffs' lawyers have an especially strong interest in seeking this kind of settlement because their business models are often based on taking on a high volume of cases and "achiev[ing] a less-than-optimal resolution for class members in each of these suits" rather than pursuing any one suit too aggressively.[161] In short, as one commentator bluntly puts it, "the class-action lawyer is not above dropping his case in exchange for a fee."[162]

Plaintiffs' lawyers may also inflate the notional dollar amount of a settlement while agreeing to settlement terms that provide that any money left unclaimed reverts to the defendant. Class counsel's fees are based on the total amount in the settlement fund—irrespective of how much is *actually paid* to class members[163]—so they have no incentive to oppose procedures that make it difficult for class members to submit claims.[164]

Finally, plaintiffs' lawyers may seek to have defendants enter into "clear sailing" agreements, which commit defendants not to object to fee awards up to a certain

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[158] *Pearson v. NBTY, Inc.*, 772 F.3d 778, 787 (7th Cir. 2014); *see also* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. Chi. L. Rev. 877, 883 (1987); *see also, e.g.*, Mullenix, *supra* note 113, at 434 (noting that, in class actions, "attorney fee incentives are so substantial as to invite unethical professional conduct or old-fashioned champerty").
[159] Hensler et al., *supra* note 147, at 79.
[160] Michael E. Solimine & Christine Oliver Hines, *Deciding to Decide: Class Action Certification and Interlocutory Review by the United States Courts of Appeals under Rule 23(f)*, 41 Wm. & Mary L. Rev. 1531, 1545 (2000).
[161] Hensler et al., *supra* note 147, at 79.
[162] Daniel Fisher, *Study Shows Consumer Class-Action Lawyers Earn Millions, Clients Little*, Forbes, Dec. 11, 2013, http://www.forbes.com/sites/danielfisher/2013/12/11/with-consumer-class-actions-lawyers-are-mostly-paid-to-do-nothing/.
[163] *See Boeing Co. v. Van Gemert*, 444 U.S. 472, 479-81 (1980).
[164] *Cf.* Hensler et al., *supra* note 147, at 81-82.

ceiling. Plaintiffs' lawyers value these agreements highly because they provide assurance that the plaintiffs' lawyers will receive a hefty fee without opposition from defense counsel.[165] But as Judge Newman of the Second Circuit has noted, there is a great "likelihood that plaintiffs' counsel, in obtaining the [clear-sailing agreement], will *bargain away something of value to the plaintiff class*."[166] The usual function of these agreements, therefore, is to enrich class counsel at the expense of their clients.

In theory, various procedural protections in the class action system should prevent class action settlements that are unfair to class members. Rule 23 requires the judge to review any proposed class action settlement for fairness,[167] and individual class members are permitted to file objections to settlements that they think are inequitable.[168] But in practice, these mechanisms may provide weak protection for class members. One scholar explains that "the hydraulic pressure for courts to approve settlements routinely leads courts to rubber stamp…class action settlement agreements."[169] And individual "objectors to dubious class settlements have proven to be relatively weak protectors of class interests, as most courts summarily dismiss objections to settlements."[170] In many cases, the only real check on the ability of plaintiffs' lawyers to sell out their clients is the lawyers' own imagination.

Two techniques employed to elevate lawyers' interests over consumers' are worth special mention.

#### a. "Cy pres" relief allows lawyers to collect fees while class members get nothing.

A so-called "cy pres" settlement provides that the settlement fund is distributed not to injured class members but to a third party, such as a charity. Cy pres remedies originated as a means of distributing settlement money that "remain[ed] unclaimed following efforts to pay class members their respective shares"—the idea being to

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[165] *See* William D. Henderson, *Clear Sailing Agreements: A Special Form of Collusion in Class Action Settlements*, 77 Tul. L. Rev. 813, 814, 827 (2003).
[166] *Malchman v. Davis*, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring).
[167] *See* Fed. R. Civ. P. 23(e)(2) ("If the [settlement] proposal would bind class members, the court may approve it only after a hearing and on finding that it is fair, reasonable, and adequate.").
[168] *See id.* 23(e)(5).
[169] Mullenix, *supra* note 113, at 430.
[170] *Id.* at 435.

"serve the interests of the absent class members 'as near as possible.'"[171] But in an increasing number of cases, "no effort [is] made to pay even a portion of the settlement fund to the absent class members" before the cy pres distribution occurs.[172]

A recent class action against Facebook illustrates the serious fairness issues raised by cy pres settlements. In 2008, plaintiffs brought a class action against Facebook under federal and state privacy laws seeking to represent millions of Facebook users, alleging that Facebook had violated their privacy by collecting information about users' activity on other websites.[173] The case ultimately settled for $9.5 million.[174] $3 million went to pay the plaintiffs' lawyers fees and the named plaintiffs' incentive payments. Then, "because distributing the [remaining] $6.5 million among the large number of class members would result in too small an award per person to bother," that money was given to a new charitable foundation "that would help fund organizations dedicated to educating the public about online privacy."[175]

In dissent from the decision upholding this settlement on appeal, one appellate judge summed up the problems with this settlement perfectly, explaining that "class members get no compensation at all. They do not get one cent…Their purported lawyers get millions of dollars…"[176]

The Supreme Court ultimately decided not to review the Facebook case, but Chief Justice Roberts wrote a statement on the denial of review noting that there are several "fundamental concerns surrounding the use of [cy pres] remedies in class action litigation, including *when, if ever*, such relief should be considered," and suggesting that "[i]n a suitable case, [the] Court may need to clarify the limits on the use of such remedies."[177]

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[171] *See* Rhonda Wasserman, *Cy Pres in Class Action Settlements*, 88 S. Cal. L. Rev. 97, 100 (2014); *see also* Martin H. Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617, 631 (2010).
[172] *Id.*
[173] *See Marek v. Lane*, 134 S. Ct. 8, 8 (2013) (Roberts, C.J., respecting the denial of certiorari).
[174] This was only a fraction of the potential damages claimed, reflecting the weakness of the claims. In approving the settlement, the district judge noted that the class's claims rested on "novel legal theories" and that the class's "expectation of . . . recovery [was] speculative at best." *Lane v. Facebook, Inc.*, 2010 WL 9013059, at *4-5 (N.D. Cal. Mar. 17, 2010).
[175] *Marek*, 134 S. Ct. at 9.
[176] *Lane v. Facebook, Inc.*, 696 F.3d 811, 835 (9th Cir. 2012) (Kleinfeld, J., dissenting).
[177] *Marek*, 134 S. Ct. at 9 (emphasis added).

Plaintiffs' lawyers are only too happy to agree to cy pres distributions rather than cash relief for class members because class counsel's fee "is typically determined as a fraction of the settlement fund regardless of the portion that is actually claimed by absent class members"—which means that their "interest in maximizing [their] fees is satisfied regardless of whether the settlement funds are paid to class members or distributed cy pres."[178] In other words, "the class attorneys' financial interest will be wholly divorced from their efforts to compensate individual class members."[179]

Absent class members lose out, however, because as one court has put it, there is not even any "indirect benefit from the defendant's giving the [settlement] money to *someone else*."[180] These class members' claims are simply extinguished—without their receiving any benefit in exchange.

**b. Problematic coupon settlements are common.**

Another form of worthless class-action settlement—the coupon settlement—is also disturbingly routine. In a coupon settlement, rather than receiving cash, class members instead get coupons or vouchers toward the purchase of products or services from the very company that class members have been suing.

For example, in one class action, students who attended certain youth conferences around the 2009 presidential inauguration sued the company that organized the conferences, alleging that they did not receive all the services they were promised. When the class action settled, the student class members received only vouchers—to be used toward future conferences hosted by the same company they alleged had broken its promises. Meanwhile, the plaintiffs' lawyers got nearly $1.5 million in fees.[181]

Similarly, in another class action involving claims that a brokerage company breached its fiduciary duty to its clients, the class members who were still account holders with the brokerage got no direct compensation in the settlement, receiving

178 Wasserman, *supra* note 171, at 101, 123.
179 Redish et al., *supra* note 171, at 650.
180 *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004) (emphasis added).
181 *See Radosti v. Envision EMI, LLC*, 717 F. Supp. 2d 37, 46-48 (D.D.C. 2010).

only vouchers toward future brokerage fees. Class counsel, however, got $21 million in fees.[182]

As a congressional report on the Class Action Fairness Act (CAFA) recognized, most coupon settlements are "valueless" to consumers; "the real winners in [a coupon] settlement are the lawyers who sued the company, who will be paid in cash, not coupons."[183]

Congress sought to correct the problem of coupon settlements when it enacted CAFA, by imposing additional restrictions to make it harder for coupon settlements to win federal court approval.[184] But as one commentator has observed, "parties have circumvented CAFA's intent to eliminate notorious coupon settlements"—including "by creating surrogate remedies that mimic coupons but are not so designated."[185] Thus, coupon settlements remain alive and well despite Congress's attempt at reform.

Meanwhile, in state court class actions, where CAFA's restrictions on coupon settlements do not apply, coupon settlements are also still rampant. The recent settlement of a 13-year-old class action against Ticketmaster over allegedly excessive fees is a perfect example. Under the terms of the settlement, reached in 2011, class members can receive roughly $2 discounts on future tickets, $5 discounts on courier delivery of tickets, or free tickets to certain concerts. But as the *New York Times* reported, "how and when those vouchers can be used has befuddled people," and the limited number of free tickets were quickly claimed—"leaving most people unable to redeem their vouchers and feeling pretty irritated."[186]

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[182] *See Bachman v. A.G. Edwards, Inc.*, 344 S.W.3d 260, 264-65 (Mo. Ct. App. 2011).
[183] S. Rep. 109-14, at 30 (2005); *see also, e.g.*, Rob Berger, *The CFPB Declares War on Arbitration*, Forbes, Oct. 18, 2015, http://www.forbes.com/sites/robertberger/2015/10/18/the-cfpb-declares-war-on-arbitration (noting that in a coupon settlement, "[t]he lawyers ha[ve] a nice payday and most of the class members pitch[] the coupons into the trash").
[184] *See* 28 U.S.C. § 1711 note (criticizing class actions in which "counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value"); *id.* § 1712 (measures addressing coupon settlements).
[185] Mullenix, *supra* note 113, at 430 (collecting sources offering advice to defendants seeking to implement coupon settlements post-CAFA).
[186] Daniel Victor, *Why You Probably Won't Get to Use Your Ticketmaster Vouchers*, N.Y. Times, June 21, 2016, http://www.nytimes.com/2016/06/22/business/media/ticketmaster-lawsuit-vouchers.html.

The result is that coupon settlements will continue to enrich plaintiffs' lawyers while offering class members nothing more than what one commentator aptly calls "the illusion of relief."[187]

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The Bureau's study assumed that all class actions are motivated by the goal of redressing harm that consumers view as actual injuries that warrant redress in court. In reality, that assumption simply is not true: too many class actions are motivated and engineered by lawyers, not consumers. The Bureau's failure to evaluate that phenomenon and consider it in determining whether class actions are so beneficial to consumers that they warrant a ban on arbitration renders its study, and its proposal, arbitrary and capricious, and contrary to Section 1028(b).

### C. Class Actions Do Not Uncover Wrongdoing.

Unable to rely solely on the compensatory function of class actions to justify its ban on individual arbitration agreements, the Bureau argues that class actions are a means of enforcing the consumer protection laws it oversees. The Bureau contends that class actions supplement government enforcement activity by uncovering wrongdoing that would otherwise not be discovered. As support for this claim, the proposed rule cites the results of the Bureau's study, which asserted that in most consumer finance class actions, there is no overlapping government enforcement action.[188]

But this argument is simply wrong. And the analysis on which it is based is arbitrary and capricious.

Many commentators have explained in detail that class actions rarely uncover wrongdoing that has not already come to light. Rather, "class action lawyers predominantly file 'copycat' or 'coattail' lawsuits that follow on the heels of *government*

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[187] David Segal, *A Little Walmart Gift Card for You, a Big Payout for Lawyers*, N.Y. Times, Jan. 30, 2016, http://www.nytimes.com/2016/01/31/your-money/a-little-walmart-gift-card-for-you-a-big-payout-for-lawyers.html.
[188] 81 Fed. Reg. at 32,861.

investigations."[189] One commentator has called this a "recurring pattern . . . under which [class actions] simply piggyback[] on the efforts of public agencies."[190] Indeed, in some occasions, government agencies such as the FTC have filed *amicus* briefs arguing that class counsel's fees should be reduced because the class action built off of an FTC investigation.[191]

The reason why "class action lawyers prefer to follow—rather than to lead," as one study of this issue explained, is that "those lawyers prefer 'no research' lawsuits that appear likely (from the investigation itself) to yield lucrative settlements with only a minimal investment of time and money. In contrast, government lawyers, who by definition are not driven by profits, tend to be willing to spend more time doing the factual and legal research needed to decide what kinds of cases should be brought, not simply to increase revenue, but to further the public good."[192]

The Bureau's finding that many class actions lack a corresponding public enforcement action does not undermine the overwhelming evidence showing that many class actions piggyback on prior revelations of wrongdoing. The Bureau's study ignored the relevant evidence in order to reach its conclusion.

*First*, the Bureau did not even examine how many class actions piggyback on *private* disclosures of wrongdoing, such as news reports. Once the wrongdoing is disclosed by reporters or others, the class action performs no disclosure function.

*Second*, even within the realm of government activity, the Bureau failed to examine how many class actions follow government *investigations* or other disclosures of claimed wrongdoing. The Bureau focused only on how many class actions overlapped with public enforcement actions, but there are many cases in which the government decides not to bring an enforcement action and yet has identified alleged

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[189] John H. Beisner et al., *Class Action "Cops": Public Servants or Private Entrepreneurs?*, 57 Stan. L. Rev. 1441, 1453 (2005); *see also, e.g.*, Howard M. Erichson, *Coattail Class Actions: Reflections on Microsoft, Tobacco, and the Mixing of Public and Private Lawyering in Mass Litigation,* 34 U.C. Davis L. Rev. 1, 2 (2000).
[190] John C. Coffee, *Jr., Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working,* 42 Md. L. Rev. 215, 222 (1983).
[191] Beisner et al, *supra* note 189, at 1453 (citing Brief of Amicus Curiae The Federal Trade Commission, *In re* First Databank Antitrust Litig., 209 F. Supp. 2d 96 (D.D.C. 2002) (No. 1:01CV00870), http://www.ftc.gov/os/2002/01/hearstbrief.pdf; Brief of Amicus Curiae The Federal Trade Commission, *In re* Buspirone Patent Litig., 185 F. Supp. 2d 340 (S.D.N.Y. 2002) (MDL Docket No. 1410), http://www.ftc.gov/os/2002/01/busparbrief.pdf).
[192] *Id.* at 1453-54.

wrongdoing—such as "when the discovered wrongdoing is cabined to a few individuals and the corporation has taken appropriate remedial action."[193] In those cases, too, the government's findings can be used as the basis for a copycat class action.

Indeed, "[m]any class actions . . . are filed precisely *because* a state or federal regulatory agency has investigated an alleged problem and concluded that no punishment or remedial action is called for under the circumstances."[194] Class action lawyers' incentives, after all, differ from those of government agencies: they do not have "any concern about overdeterrence."[195] Just "[t]he opposite is true: so long as the lawsuit appears likely to generate a settlement and accompanying attorneys' fees, the class action lawyer's incentive is to file it."[196] Thus, it is unsurprising that there are many cases in which no government enforcement action is filed and yet a private class action was brought.

*Third*, the Bureau's study essentially ignores the Bureau's creation, and its broad enforcement and supervisory authority, in uncovering wrongdoing. Most importantly, the study period ended in 2012, and therefore ***entirely fails to take account of the effect of the Bureau's own now fully functioning enforcement and supervision programs, which were barely underway in 2012***.[197]

The Dodd-Frank Act granted the Bureau broad enforcement and supervision authority. For example, the Bureau is authorized to combat "unfair, deceptive, or abusive act or practice[s],"[198] including by: investigating financial institutions and issuing subpoenas for information and documents[199]; conducting cease-and-desist hearings and other internal adjudications[200]; bringing civil actions in the Bureau's

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[193] *Id.* at 1454.
[194] *Id.* (emphasis added).
[195] *Id.*
[196] *Id.*
[197] The number of Bureau enforcement actions has increased from 9 enforcement actions in 2012, to 41 in 2014, to 65 in the year ending March 31, 2016. *See Semi-Annual Report of the CFPB*, March 2013, at 66, http://files.consumerfinance.gov/f/201303_CFPB_SemiAnnualReport_March2013.pdf; *Semi-Annual Report of the CFPB*, Fall 2014, at 103, http://files.consumerfinance.gov/f/201412_cfpb_semi-annual-report-fall-2014.pdf; *Semi-Annual Report of the CFPB*, Spring 2016, at 83, http://www.consumerfinance.gov/documents/535/Report.Spring_2016_SAR.06.28.16.Final.pdf.
[198] *Id.* § 5531(a).
[199] *Id.* § 5562.
[200] *Id.* § 5563.

name in state or federal courts for a variety of remedies, including refunds and restitution for consumers[201]; and referring violations of law to the Department of Justice for criminal prosecution.[202]

A recent study of the Bureau's enforcement activity through the end of 2015 found that the Bureau had brought more than 120 public enforcement actions producing ***$11.2 billion*** in consumer relief.[203] And the Bureau has used its supervisory authority to conduct hundreds of examinations.[204] The Bureau also provides a forum in which consumers can file complaints against financial institutions; it reports that financial institutions have already responded to ***more than 900,000 consumer complaints and gotten timely responses to 97% of them***.[205]

The entire reason for creating the Bureau was to increase enforcement of consumer laws: the Bureau's existence, combined with the numerous other state, local, and federal enforcement agencies, underscores that class actions have little, if any, role to play in this context—unless the Bureau does not believe that its significant resources and authority will provide consumers with additional protection. In short, the Bureau's arbitrary and capricious study methodology does nothing to demonstrate that class actions uncover misconduct that would otherwise have remained undetected. And the evidence shows that they do not. There simply is no credible evidence that class actions uncover wrongdoing.

### D. Class Actions Do Not Deter Wrongdoing.

Finally, the Bureau's explanation of its proposed rule argues that class actions protect consumers by deterring wrongful conduct by businesses. The threat of class action liability, the Bureau argues, "deters potentially illegal [business] conduct and encourages investments in compliance."[206]

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201 *Id.* § 5564.
202 *Id.* § 5566.
203 Christopher Peterson, *Consumer Financial Protection Bureau Law Enforcement: An Empirical Review* 21-22 (2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780791.
204 *CFPB Supervisory Highlights*, Spring 2014, at 5, http://files.consumerfinance.gov/f/201405_cfpb_supervisory-highlights-spring-2014.pdf ("In 2013, the CFPB conducted over one hundred supervisory activities—such as full scope reviews and subsequent follow-up examinations—and plans to conduct approximately 150 of these activities in 2014.").
205 *Id.*
206 81 Fed. Reg. at 32,862.

This deterrence argument—a familiar one made by advocates of class actions—sounds good in theory. But the reality of class actions shows that there is no credible basis for a deterrence justification.

As explained above, plaintiffs' lawyers have no interest in enforcing consumer protection laws; their interest is in maximizing their own income. Thus, they do not choose which class actions to bring based on the merits of the class claims; they look for cases in which a complaint can be written that will survive a motion to dismiss.

Defendants, meanwhile, have a strong incentive to settle any class action that is not dismissed, irrespective of the suit's merits, because gigantic defense costs coupled with massive potential liability makes going to trial too risky. The Supreme Court,[207] lower courts,[208] and commentators[209] have all acknowledged this incentive and the power it gives plaintiffs' lawyers to extort money from defendants in what Judge Henry Friendly aptly termed "blackmail settlements."[210]

Defendants also face intense pressure to settle because they bear a much greater share of the expenses of litigation and discovery. In a consumer class action, the defendant is frequently the party who possesses the bulk of the relevant, discoverable information and bears the cost of producing it to the plaintiffs. The Supreme Court has recognized that the threat of this discovery expense, which can be considerable, produces unjustified settlements.[211]

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[207] *Shady Grove Orthopedic Associates, P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 445 n.3 (2010) (Ginsburg, J., dissenting) ("Even in the mine-run case, a class action can result in potentially ruinous liability. A court's decision to certify a class accordingly places pressure on the defendant to settle even unmeritorious claims."); *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978) ("Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense.").

[208] *See, e.g.*, *In re Lorazepam & Clorazepate Antitrust Litig.*, 289 F.3d 98, 102 (D.C. Cir. 2002) ("[T]he grant of class status can put substantial pressure on the defendant to settle independent of the merits of the plaintiffs' claims."); *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293, 1298 (7th Cir. 1995) (noting that a defendant facing $25 billion in potential liability "may not wish to roll the dice. That is putting it mildly. They will be under intense pressure to settle").

[209] *See, e.g.*, Mullenix, *supra* note 113, at 416 (noting that class action defendants "may capitulate to meritless or unsubstantiated claims rather than incur substantial ongoing litigation expenses with the risk of an adverse jury decision."); Robert E. Litan, U.S. Chamber Inst. for Legal Reform, THROUGH THEIR EYES: HOW FOREIGN INVESTORS VIEW AND REACT TO THE U.S. LEGAL SYSTEM 13 (Aug. 2007) ("[S]ome defendants can feel financially pressured to settle even if they have done nothing wrong, believing it not to be worth betting their companies on a subsequent mistaken jury verdict that can be difficult to overturn on an appeal.").

[210] *See* Henry J. Friendly, FEDERAL JURISDICTION: A GENERAL VIEW 120 (1973).

[211] *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163 (2008) ("[E]xtensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent

The pressure on defendants to settle class actions is only magnified even further in cases brought under one of the many statutes that allow plaintiffs to recover a fixed dollar amount of "statutory damages" per alleged violation of the law, even if the plaintiffs suffered no actual harm from the alleged violations. Most statutory damages provisions are civil penalty provisions designed to make *individual cases* more attractive to prosecute. But as one scholar has noted, "when combined with the procedural device of the class action, aggregated statutory damages can result in absurd liability exposure in the hundreds of millions—or even billions—of dollars on behalf of a class whose actual damages are often nonexistent."[212] Thus, as Justice Ginsburg has observed, "[w]hen representative plaintiffs seek statutory damages, pressure to settle may be heightened because a class action poses the risk of massive liability unmoored to actual injury."[213]

In one Fair and Accurate Credit Transactions Act (FACTA) class action, for example, a plaintiff class sued Toys "R" Us for allegedly violating FACTA by printing sales receipts that showed more than the last four digits of a customer's credit card number. The potential statutory damages amounted to $29 billion even though, as the district court noted, the alleged violations "caused no actual harm."[214] That amount was nearly 250 times the net worth of Toys "R" Us and its parent company.[215] Unsurprisingly, it agreed to settle the case barely a month after the district court certified the class.[216]

Even more troubling is the finding of one recent study that many statutes—including the Fair Credit Reporting Act (FCRA) or Fair Debt Collection Practices Act (FDCPA)—authorize massive statutory damages, perhaps as much as $1,500 *per plaintiff*, for conduct that does not harm consumers at all, such as accidentally printing an expiration date on a credit card receipt. Given the massive damages at stake, the

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companies."); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 559 (2007) ("[T]he threat of discovery expense will push cost-conscious defendants to settle even anemic cases.").
212 Sheila B. Scheuerman, *Due Process Forgotten: The Problem of Statutory Damages and Class Actions*, 74 Mo. L. Rev. 103, 104 (2009).
213 *Shady Grove*, 559 U.S. at 445 n.3 (Ginsburg, J., dissenting).
214 *In re Toys "R" Us Delaware, Inc. Fair & Accurate Credit Transactions Act (FACTA) Litig.*, 2010 WL 5071073, at *8 (C.D. Cal. Aug. 17, 2010).
215 *Id.* at *13.
216 *See In re Toys "R" Us Delaware, Inc. Fair & Accurate Credit Transactions Act (FACTA) Litig.*, 295 F.R.D. 438, 444 (C.D. Cal. 2014).

study explains, "once class counsel obtain sufficient evidence of the failure to comply with formalities, all that remains is to agree on a settlement amount."[217] Thus, rather than deterring wrongful conduct, class actions under these statutes actually "incentivize the private pursuit of lawsuits where there is no harm to deter."[218]

In short, class actions are virtually never decided on their merits. Plaintiffs' lawyers do not choose class action cases based on their merits, and once a class is certified (and perhaps even before), the massive amount of money at stake almost always induces the defendant to settle the case irrespective of the merits.

It is accordingly highly unlikely—if not impossible—for the class action system to deter corporate wrongdoing. For class actions to have a deterrent effect, parties must believe that they can avoid class action liability by complying with the law.[219] But under the current system of class action litigation, even a law-abiding company must be prepared for the very real possibility that it will be sued in a class action and face irresistible pressure to settle the case rather than seek vindication in a risky trial. Thus, "many corporate defendants view class judgments and settlements as a cost of doing business, subsidized by insurers or passed along to consumers."[220] These companies face little reason to alter their behavior by virtue of the existence of class actions.

Businesses are far more likely to be deterred from wrongdoing by the reputational consequences of engaging in improper behavior, because reputational harm is often directly correlated to a business's success or failure. In the age of social media, consumer complaints can quickly go viral on Facebook, Twitter, and change.org (to name a few examples). That phenomenon impacts companies immediately and directly leads to changes in practices that garner consumer opposition. Class actions, by contrast, rarely, if ever, have that effect.

Companies are also likely to be deterred by the threat of government enforcement action. That is especially the case in light of the enhanced government

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[217] Johnston, *supra* note 110, at 42.
[218] *Id.*
[219] For an analogous discussion of how a failure to distinguish adequately between the culpable and the innocent dilutes the deterrent effect of sanctions in the criminal-law context, see A. Mitchell Polinsky & Steven Shavell, *The Theory of Public Enforcement of Law*, in 1 HANDBOOK OF LAW AND ECONOMICS 403, 427-29 (A. Mitchell Polinsky & Steven Shavell eds., 2007).
[220] Mullenix, *supra* note 113, at 415.

enforcement capabilities in the consumer financial protection space. Not only are the monetary penalties higher in this area, but an enforcement action brought by the government reflects the government's judgment that its limited resources should be used to combat what it considers improper activity.[221]

Of course, not all government enforcement actions are brought against covered persons who have actually engaged in wrongdoing. But while companies view class actions as a cost of doing business—rent seeking by any one of a large number of entrepreneurial plaintiffs' lawyers who are banking on the possibility that they may be able to coerce a settlement—companies are far more likely to take notice of a government enforcement action. For that reason, appropriate government enforcement plays a significant role in protecting consumers. That role is likely to increase substantially given the Bureau's robust supervision and enforcement authority—and its implementation of that authority.[222]

The Bureau is likely to focus on the precise types of alleged wrongdoing that are susceptible to class actions: misconduct that affects a large number of consumers. And the Bureau's examination authority, combined with its enforcement activities and consumer complaint database, make it highly likely that the Bureau will detect such wrongdoing—if anything, there are questions about whether the agency has gone too far. The Bureau's enforcement powers therefore provide an additional, significant factor demonstrating why the threat of class actions is irrelevant to deterring wrongful conduct in this context.

Finally, as the nonpartisan Manhattan Institute explains in a new study of this issue, companies are deterred from many forms of misconduct—such as charging improper fees—by the threat that consumers will take their business elsewhere. Indeed, the study notes, the evidence shows that when consumers complain about having been charged fees, banks forgive those fees in a large percentage of cases.[223]

The proposed rule's analysis of the deterrence issue is riddled with errors. *First*, the proposed rule claims that class certification "is not typically the force that drives

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[221] *CFPB Study* at section 9, page 12.
[222] See note 273 below and accompanying text.
[223] Jason Scott Johnston, *Class Actions and the Economics of Internal Dispute Resolution and Financial Fee Forgiveness* 4 (Manhattan Inst. Report (Preliminary) Aug. 2016), https://www.manhattan-institute.org/sites/default/files/R-JJ-0816-v1.pdf.

settlement" because the Bureau's study found that "certification almost invariably occurs coincident with a settlement."[224] But the fact that an a class action is certified and settled at the same time does not mean that the defendant was not pressured to settle by the stakes of the class action; the *in terrorem* effect of class action liability is felt at all stages of litigation, including before class certification actually occurs.

*Second*, the Bureau points to compliance bulletins and other publications as evidence that companies "monitor class litigation" so that they can change their behavior to avoid being sued.[225] But the Bureau offers little evidence that these publications actually lead to changes in corporate behavior, apart from three specific cases that offer no basis for the Bureau's sweeping generalizations.[226]

*Third*, the Bureau ignores the role of its own very substantial enforcement and supervisory actions in uncovering and deterring wrongdoing, discussed above.

In sum, the evidence shows that contrary to the proposed rule's claims, class actions do not benefit most consumers. Any benefits that that class actions do bring about, moreover, are certainly far too marginal to justify the increased costs to the business community that the Bureau acknowledges will result from the rule—and that the Bureau also acknowledges will be passed on to consumers.[227]

## IV. Eliminating Arbitration Will Harm Consumers.

Given the many advantages that arbitration's streamlined procedures offer individuals with small, individualized claims for relief, and the failed track record of class actions, the likely effect of a regulation eliminating arbitration and replacing it with class actions would be to injure, rather than promote, the interests of consumers.

[224] 81 Fed. Reg. at 32,867.
[225] *Id.* at 32,862.
[226] One of these examples, the *Overdraft* litigation, is an outlier that involved many more defendants than the average class action and a much larger settlement—$1 billion. It is unsurprising that such an action would lead to changes in industry behavior. With respect to another example—a class action against auto lenders in which the settling defendants agreed to cap interest rate markups at 2.5% and the industry followed suit—the Bureau tucks into a footnote the critical point: California passed a statute around the same time mandating a maximum of 2.5%. 81 Fed. Reg. at 32,863 n.411. As the Bureau grudgingly acknowledges, this change in law in the nation's largest state likely "influenced the adoption of [the] markup limit." *Id.* In fact, it was likely the real reason why the change was made.
[227] *See* 81 Fed. Reg. at 32,866.

But that is exactly what the Bureau proposes to do. The rule under consideration will effectively eliminate arbitration by making it economically impossible for businesses to provide it. As a result, consumers are certain to be deprived of the availability of arbitration as a simple and low-cost means for obtaining relief on small claims—and to be required to pay higher prices for financial services.

### A. The Bureau's Proposal Is Expected To Eliminate *All* Arbitration.

The proposed rule stresses that the Bureau "is not proposing to prohibit arbitration agreements entirely." According to the Bureau, providers would retain the ability to employ arbitration agreements, so long as they permitted consumers to file class actions in court.[228]

Of course the Bureau did not even try to gather data on the consequences of such a regulation—and it therefore is not surprising that these predictions based on no evidence completely ignore the inevitable real-world effect of its proposal. Prohibiting pre-dispute agreements to arbitrate all disputes on an individual basis would bring about the end of *all* consumer arbitration in the financial services sector. Even though the Bureau was repeatedly advised that this would occur, and even though companies have consistently stated that the effect of a rule such as the one proposed by the Bureau would be the elimination of arbitration,[229] the Bureau failed to assess the likely real-world consequences of its proposal—either in its study or in the analysis accompanying the proposed rule. It blithely assumes that arbitration will continue to be available.

Moreover, that assumption allowed the Bureau to avoid addressing one of the key questions relating to consumer welfare and the public interest underlying its proposal: whether class actions are so beneficial to consumers that preserving access to class actions outweighs the harm to consumers from eliminating arbitration. The Bureau proceeded on the unreasonable and inaccurate assumption that arbitration would remain available. It will not. The proposed rule therefore rests on an arbitrary and capricious premise.

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[228] 81 Fed. Reg. at 32,868.

[229] *See, e.g.*, Comment of U.S. Chamber of Commerce Ctr. for Capital Mkts. Competitiveness et al. at 39-43, Docket No. CFPB-2012-0017 (Dec. 11, 2013), http://www.instituteforlegalreform.com/uploads/sites/1/2013_12.11_CFPB_-_arbitration_cover_letter.pdf.

**1. It is economically infeasible for businesses to provide a subsidized arbitration program when they also face class action lawsuits.**

A company that sets up an arbitration program incurs significant administrative costs in connection with carrying out arbitrations—costs that the company does not incur in connection with taxpayer-funded judicial litigation. (For example, as explained above, many businesses commit to pay all filing and administrative fees associated with any arbitration that a customer files, and all businesses that designate the AAA or JAMS to administer consumer arbitrations pay the lion's share of arbitral fees under those organizations' rules).[230] Companies will be unwilling to expend these resources and set up an effective, consumer-friendly arbitration system unless they know it will save them the transaction costs of litigating in court—particularly litigating class actions, which (as discussed above) are especially costly to defend.

Thus, if a company is faced with the prospect of maintaining an arbitration system and simultaneously having to deal with judicial class action litigation, the rational response is to reduce overall transaction costs, and the only way to do that is to decide not to have an arbitration system at all. It makes no economic sense for a company to spend money on a high-quality individual dispute resolution system when it is forced to participate in class actions.

Thus, as one group of businesses represented in a brief filed in the Supreme Court, "when there is no assurance that all claims will be arbitrated in lieu of litigation, and a [company] must shoulder the additional costs of class action litigation, subsidizing the costs of individual arbitration is no longer a rational business option"; the only logical decision is to "disengage from arbitration altogether."[231]

The Bureau's proposed rule expresses skepticism that businesses would in fact eliminate their arbitration systems if the Bureau adopted the proposed ban on class waivers. It argues that businesses "must already maintain two systems" of dispute resolution and that it therefore stands to reason that banning the use of class waivers

[230] See pages 20, 28-29 above.
[231] Br. of Am. Cur. CTIA—the Wireless Association at 21, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).

would not meaningfully affect businesses' incentives to offer arbitration.[232] But the Bureau's reasoning is flawed in several respects.

*First*, the Bureau argues that because many arbitration agreements allow individuals to file in small claims court, arbitration agreements do not save businesses the burden of litigation in court.[233] But small claims courts—though less favorable and accessible to consumers than arbitration—are set up to offer parties some of the same procedural advantages of arbitration (chiefly including individualized proceedings and limits on discovery)[234]; thus, a system of arbitration and small claims court is not substantially more burdensome to businesses than a system of pure arbitration. Thus, the fact that businesses agree to both individual arbitration and litigation in small claims court does not imply that they can afford to take on the costs of class action litigation as well while subsidizing arbitration.

*Second*, the Bureau claims that its study found that "companies almost never seek to compel [individual] cases to arbitration when first filed in court"[235]—again suggesting that businesses already maintain de facto dual systems for dispute resolution. But although the study found that businesses moved to compel arbitration in only 5.7% of the individual lawsuits it examined,[236] this statistic is based on a sample of just 140 cases, because those were the only ones in which the Bureau could verify that the parties had an arbitration agreement in place.[237] And in any event, it is a misleading statistic, because there are many reasons why a business would not move to compel arbitration in a case despite preferring arbitration to individual litigation. The consumer might—as the Bureau notes in the study—have opted out of arbitration.[238] Or the business might have opted to settle the case rather than pay the costs of litigating a motion to compel. Indeed, the study found that 48.2% of the cases in a larger sample of individual lawsuits settled.[239] Finally, the plaintiff might

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232 81 Fed. Reg. at 32,867.
233 *Id.*
234 Of course, as discussed above, resource constraints prevent small claims courts from providing justice to many injured individuals. The point here is only that litigation in small claims court is less burdensome than in a court of general jurisdiction.
235 81 Fed. Reg. at 32,867.
236 *CFPB Study* at section 6, page 61.
237 *Id.*
238 *Id.* at section 6, page 60.
239 *Id.* at section 6, page 8.

have withdrawn the case or failed to prosecute it—as the Bureau found occurred in another 41.8% of cases in its larger sample.

In short, the Bureau's discussion of the rate of motions to compel arbitration in the Bureau's small sample of individual cases does not support its hypothesis that businesses would keep their arbitration systems if the Bureau were to require the availability of class actions. Instead, as our members have indicated, businesses almost certainly would eliminate the use of all arbitration in financial services contracts and refocus their dispute resolution resources on class action defense

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**2. Post-dispute arbitration agreements will not fill the void caused by the loss of pre-dispute arbitration.**

Some proponents of the Bureau's proposed rule have argued that if arbitration is beneficial for both sides of a dispute, businesses and consumers will agree to it after disputes arise and thereby circumvent the Bureau's effective ban on pre-dispute arbitration.[240] But that suggestion is mistaken: post-dispute arbitration is not a viable option, for numerous reasons.

To begin with, the Bureau's rule will cause many businesses to eliminate consumer-friendly arbitration systems—which pay consumers' costs and incentivize them to bring small claims—because they will no longer be able to justify the expense. In a "post-dispute" environment, arbitration will be less attractive to plaintiffs because the type of arbitration to which businesses would agree would not involve the massive subsidies that are a defining feature of current pre-dispute consumer arbitration agreements.

More generally, a variety of factors make parties unwilling to enter into post-dispute agreements to arbitrate. For one thing, once a dispute has arisen, the parties "often have an emotional investment in their respective positions," built up over the course of the events that led to the dispute.[241] And especially at the beginning of a

[240] Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 Ohio St. J. on Disp. Resol. 559, 567 (2001) (describing this position with respect to employment arbitration, and then explaining why it is wrong).
[241] Steven C. Bennett, *The Proposed Arbitration Fairness Act: Problems And Alternatives*, 67 Disp. Resol. J. 32, 37 (2012).

dispute, parties are "reluctan[t]…to evaluate their cases pragmatically."[242] The emotional investment in a case thus tends to skew the preferences of one party or another in favor of "refus[ing] to arbitrate"[243] and instead opting to litigate in court.

For another, litigants often feel that they "must avoid any and all actions that may signal weakness to the opposition"—which "includes desperate offers to settle, mediate, or arbitrate a dispute."[244] A "party that initially extends the offer to arbitrate runs the risk of appearing weak, especially if the other party rejects the offer."[245] Thus, parties will be loath even to *suggest* post-dispute arbitration—let alone agree to it
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The lawyers for one or both sides also have incentives to induce their clients to opt for litigation in court rather than arbitration. Litigation in court—which, as explained above, takes much longer than arbitration and involves many more procedural hurdles—offers lawyers the opportunity to earn much higher fees than they could earn in arbitration. Thus, (consciously or not) they may advise clients to choose a judicial forum that is really in the lawyers' own best interest rather than in clients'—especially in putative class actions, where named plaintiffs assert little control over the litigation and absent class members have no control whatsoever.[246]

For these reasons, post-dispute arbitration agreements "amount to nothing more than a beguiling mirage."[247] They simply do not—and would not—happen. "[P]re-dispute agreements to arbitrate," which preserve the consumer's right to an affordable forum, accordingly represent the only real-world option for addressing the very significant gap in access to justice available to consumers via the court system.[248] By effectively eliminating pre-dispute arbitration, the Bureau will completely deprive consumers of access to arbitration altogether.

[242] Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 Wm. Mitchell L. Rev. 313, 326 (2003).
[243] *Id.* at 327.
[244] David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 Berkeley J. of Emp. & Lab. L. 1, 69 (2003).
[245] *Id.*
[246] *See, e.g.*, Eric Goldman, *The Irony of Class Action Litigation*, 10 J. on Telecomm. & High Tech. L. 309, 314 (2012) ("[C]lass action lawyers often advance their own financial interests at the expense of the class members' interests.").
[247] Theodore J. St. Antoine, *Mandatory Arbitration: Why It's Better than It Looks*, 41 U. Mich. J.L. Reform 783, 790 (2008) (addressing employment arbitration).
[248] Theodore J. St. Antoine, *Mandatory Employment Arbitration: Keeping It Fair, Keeping it Lawful*, 60 Case W. Res. L. Rev. 629, 636 (2010).

### B. The Harm To Consumers From Ending Arbitration Would Be Substantial.

Eliminating arbitration would inflict serious harm on consumers. They would lose access to a valuable forum in which they can cheaply pursue the sort of disputes with businesses that they are most likely to have, and they would pay higher prices for financial services. There is no reason for the Bureau to impose a regulation that will have these counterproductive consequences.

#### 1. Without arbitration, consumers would lack meaningful options for resolving most claims.

As explained above,[249] most consumer claims involve small injuries that cannot be redressed in court through individual lawsuits because the amount at stake is too small to attract a contingency-fee lawyer. Most of these claims also cannot be brought as class actions, because they usually involve individualized facts—for example, excessive charges on a bill, deposits that have not been credited by ATMs, incorrect interest calculations, and the like—rather than the "common" "questions of law or fact" that are needed for a class action.[250]

For this huge majority of consumer claims that cannot be resolved in court, arbitration fills a gap, providing consumers with a fair, accessible forum in which to get these claims resolved swiftly and efficiently. Eliminating arbitration, however, would mean that these claims would go unaddressed—to the detriment of consumers.

#### 2. Consumers would experience higher prices and reduced access to credit.

Eliminating arbitration would also lead to an increase in the cost of credit and other financial services—a cost increase that would ultimately be borne by consumers.

One reason businesses prefer to resolve disputes in bilateral arbitration is that arbitration offers a less expensive forum for the resolution of disputes, which lowers

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[249] See pages 14-19 above.
[250] Fed. R. Civ. P. 23(a)(2).

businesses' legal costs. This, in turn, leads to cost savings that can be passed along to consumers.[251] As one scholar explains:

- "The consensus view is that businesses using adhesive arbitration agreements do so because those businesses generally find that those agreements lower their dispute resolution costs."

- "In the case of consumer arbitration agreements, this benefit to businesses is also a benefit to consumers. That is because whatever lowers costs to businesses tends over time to lower prices to consumers."

- "The extent to which cost-savings are passed on to consumers is determined by the elasticity of supply and demand in the relevant markets. Therefore, the size of the price reduction caused by enforcement of consumer arbitration agreements will vary, as will the time it takes to occur."

- "But it is inconsistent with basic economics to question the existence of the price reduction."[252]

The Bureau's proposed rule casts aside these principles of "basic economics" by largely rejecting the notion that businesses pass on the cost savings of arbitration to consumers. It cites a section of the Bureau's arbitration study that purported to examine the issue and found no "statistically significant evidence" that without arbitration, consumers would face higher prices for financial services.[253] But that analysis has been roundly criticized, and for good reason.

In the study, the Bureau examined *one* specific lawsuit (*Ross v. Bank of America*) in which some settling credit card issuers agreed not to use arbitration for a three-and-a-half year period.[254] The question the Bureau asked was whether there was

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[251] *See, e.g.*, Amy J. Schmitz, *Building Bridges to Remedies for Consumers in International eConflicts*, 34 U. Ark. L. Rev. 779, 779 (2012) ("[C]ompanies often include arbitration clauses in their contracts to cut dispute resolution costs and produce savings that they may pass on to consumers through lower prices.").
[252] *Stephen J. Ware, The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration Of Class Actions and Arbitration Fees*, 5 J. Am. Arbitration 251, 254-57 (2006) (emphasis added; footnotes omitted; citing, *inter alia*, Richard Posner, *Economic Analysis of Law* (6th ed. 2003)).
[253] 81 Fed. Reg. at 32,851.
[254] *CFPB Study* at section 10, pages 6 & n.14 (citing *Ross v. Bank of America*, No. 05-cv-7116 (S.D.N.Y.)).

"statistically significant evidence, at standard confidence level (95%), that companies that eliminated arbitration raised their prices (measured by total cost of credit) in a manner that was different from that of comparable companies that had not changed their policies regarding arbitration provisions."[255]

But as the study acknowledged (albeit in a footnote), "the result" of this analysis "has limitations."[256] That is an understatement. To begin with, while the study used the language of scientific analysis—describing the settling credit card issuers as a "treatment group" and other issuers as a "control group"—the Bureau admitted that the "control group" "may or may not have used pre-dispute arbitration provisions" at all.[257] This means that there was no control group as that term is commonly understood—a fatal flaw in the Bureau's selection of this case study.[258]

Next, the Bureau was incorrect to assume that issuers who agreed to the arbitration moratorium would be certain to raise prices if arbitration had previously produced cost savings for them that were lost due to the moratorium. As two scholars explained in a critique of the Bureau's study, it is "hardly surprising" that no price change would have occurred, given that the institutions involved in the case were large banks: "it is known that firms in the consumer services sector adjust prices much more slowly in response to cost changes than do firms in the manufacturing sector and that large firms adjust prices more slowly than do small firms."[259] The scholars also point out that "the moratorium was only temporary. There is *neither theoretical nor empirical reason* to have thought that such a temporary change in costs would change credit card pricing."[260] And they note that the Bureau only looked at the year immediately after the moratorium began—an odd choice given that "no evidence indicates that financial services prices respond so quickly even to a permanent change in costs and *no sound theoretical reason exists to think that they would*."[261]

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255 *Id.* at section 10, pages 5-6.
256 *Id.* at section 10, page 8.
257 *Id.*
258 Curiously, the report did not identify specific issuers "[f]or maximum protection of supervisory data." *Id.* at section 10, page 8 n.18. In light of the fact that the Bureau maintains an online database of credit card agreements (http://www.consumerfinance.gov/credit-cards/agreements/), this rationale for concealing information about issuers does not appear plausible.
259 Johnston & Zywicki, *supra* note 11, at 33-34.
260 *Id.* at 34 (emphasis added).
261 *Id.* at 34 (emphasis added).

Finally, and most troubling of all, ***the Bureau's study never assessed whether issuers that used arbitration agreements during the time frame studied actually had experienced any cost savings from the use of arbitration—if there were no cost savings, there would be no price increase when arbitration was eliminated.*** And when one looks at the time frame studied by the Bureau, it is unlikely that, because of the state of the law during that time, businesses were experiencing cost savings from the use of arbitration.

Specifically, the Bureau purported to examine the total cost of credit (a defined term subject to its own limitations) with a "before" period from November 2008 to October 2009 and an "after" period from January 2010 to November 2011.[262] But the problem with this time frame is that virtually all of it occurred before the Supreme Court decided *AT&T Mobility LLC v. Concepcion*[263] in late April 2011—*i.e.*, when arbitration clauses were routinely not being enforced in a number of magnet jurisdictions for consumer class actions (including California, New Jersey, Illinois, Missouri, and Washington state). When courts do not enforce arbitration agreements and allow class-action lawsuits to proceed, it is self-evident that the company that is party to an arbitration agreement will not experience reduced transaction costs from arbitration.

Economic theory (and common sense) suggest that, in the absence of reduced transaction costs to businesses, there are no cost savings to pass along to consumers. There is no doubt that, as a result of *Concepcion*, courts are today enforcing fair arbitration agreements, compelling arbitration, and dismissing class action lawsuits. As a result, credit card issuers are *now* experiencing reduced transaction costs because of arbitration, and it is reasonable to expect that some of the cost savings from arbitration will place downward pressure on the price of credit (although other types of regulation, including by the CFPB, have placed countervailing upward pressure on those prices). But the Bureau's study asked the wrong question—by focusing on a time frame when no reasonable person would contend that arbitration agreements were being enforced with the regularity needed to lead to reduced transaction costs.

Unlike the Bureau's retrospective analysis, which focused on the wrong time frame, the real questions as a matter of public policy are whether the elimination of

262 *CFPB Study* at section 10, page 9.
263 563 U.S. 333 (2011).

pre-dispute arbitration will force financial services companies to increase prices to customers, and whether the benefits of class action litigation are worth imposing the costs of a CFPB "regulatory tax." The answers are clear: "[f]orcing consumers and financial institutions to litigate class action lawsuits will impose enormous costs on what are relatively low-cost transactions," and these enormous costs will surely "make [their] way to the cost and benefits of the financial products being regulated," making consumers worse off, not better off.[264]

### C. These Harms To Consumers Are Unnecessary, Because Consumers Can Remedy Small Claims Effectively Without Class Actions.

The proposed rule attempts to make the case that these costs to consumers—reduced ability to get relief for small, individualized claims and increased costs for products and services—are justified by an offsetting benefit: consumers with shared injuries that are too small to sue over would be able to combine those claims "into a single [class action] lawsuit worth bringing."[265]

Contrary to the Bureau's assertions, however, abusive and wasteful class actions are not necessary to allow consumers with small claims to vindicate their rights. It is possible for consumers to use arbitration to do so, or to use new social media tools, which often provide quick redress without the need for a lawyer or time-consuming litigation. Finally, government enforcement agencies—most notably the CFPB itself—are available to vindicate consumers' rights.

#### 1. Arbitration allows consumers to obtain redress for small claims.

Both the majority and dissenting Justices in the Supreme Court's 2013 decision in *American Express Co. v. Italian Colors Restaurant* squarely rejected the argument that class actions are needed to enable injured parties to vindicate small claims. The dissent, written by Justice Kagan and joined by Justices Ginsburg and Breyer, identified several different ways in which consumers could effectively vindicate even small claims in arbitration without the use of class action procedures:

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[264] Berger, *supra* note 183.
[265] 81 Fed. Reg. at 32,900.

> In this case,… the [arbitration] agreement could have prohibited class arbitration without offending the effective vindication rule *if* it had provided an alternative mechanism to share, shift or reduce the necessary costs. The agreement's problem is that it bars not just class actions, but also all mechanisms…for joinder or consolidation of claims, informal coordination among individual claimants, or amelioration of arbitral expenses.[266]

As described above, consumers increasingly have access to arbitration systems that provide all of the features that Justice Kagan's dissent in *Italian Colors* identified as helpful in facilitating the individual pursuit of small claims. For example, many companies now have arbitration agreements that "shift" the "costs" of arbitration to the company and provide bonus and incentive payments to consumers who prevail.[267]

It is also easier than ever before for individual claimants to coordinate their claims by sharing the same lawyer, expert (when necessary) and information to prove a claim. For example, an enterprising lawyer can identify large numbers of clients (via the internet, social media, or other similar means), file thousands of individual arbitration demands on behalf of those clients, and distribute common costs across all those claimants, making the costs for expert witnesses and fact development negligible on a per-claimant basis.

**2. Consumers can use social media to address companies' business practices.**

Today's social media empower individuals—and consumers can and do use social media to stop unjustified business conduct, without the need to retain a lawyer or to turn to complex, lengthy and time-consuming class action procedures.

One noteworthy example is an advocacy campaign from 2011 in response to a number of large banks that had announced that they would charge consumers a $5 fee

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[266] *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2318 (2013) (Kagan, J., dissenting).

[267] *See, e.g.*, Am. Express Co., *American Express Green Card Cardmember Agreement* at 6, https://www.americanexpress.com/us/content/pdf/cardmember-agreements/green/Green_06_30_New.pdf; AT&T, *Wireless Customer Agreement*, § 2.0, https://m.att.com/shopmobile/legal/terms.wirelessCustomerAgreement.html; BMO Harris Bank N.A., *Deposit Account Agreement* at 19, https://www.bmoharris.com/pdf/global/deposit-agreement.pdf.

for using their debit cards to make purchases. After announcing the fee, one bank "received an outpouring of complaints online and at branch offices." An outraged consumer started a petition on Change.org that collected "more than 300,000 signatures opposing the fee." And other consumers started a "grass-roots effort" designating a particular day as "'Bank Transfer Day,' where customers of big banks move their accounts to community banks and credit unions." The banks ultimately abandoned plans to impose the fee.[268]

Similarly, in 2011, Verizon Wireless changed its mind about imposing a $2 fee on certain customers for paying bills, after just *one day* of consumer outrage on social media. An analyst observing the situation commented, "'The multiplication effect with things like Twitter is incredible.'"[269]

And when Capital One purchased ING Direct USA, many of ING's existing accountholders went online to express their concerns, causing "[s]ocial media sites . . . and banking blogs [to] erupt[] with customer antipathy."[270] The customer campaign attracted *New York Times* coverage, prompting Capital One to extend assurances to ING's customers that there would be no "significant changes" to their accounts.[271]

**3. Consumers also are protected by the Bureau's own enforcement powers.**

Finally, consumers are protected by the Bureau's ability to bring enforcement actions, which is one of the Bureau's "primary functions."[272] As discussed above, the Bureau has very broad enforcement authority and has exercised it vigorously, touting that its enforcement actions have, to date, led to $11.4 billion in relief for more than 25 million consumers.[273] The Bureau's website also offers consumers a portal where they can submit complaints about companies' business practices.

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268 *See* Tara Siegel Bernard, *In Retreat, Bank of America Cancels Debit Card Fee*, N.Y. Times, Nov. 2, 2011, at A1.
269 *See* Ron Lieber, *After Outcry, Verizon Abandons $2 Fee*, N.Y. Times, Dec. 31, 2011, at B1.
270 Ann Carrns, *Capital One's Response to Outrage over ING Direct Purchase*, N.Y. Times, June 22, 2011, http://bucks.blogs.nytimes.com/2011/06/22/capital-ones-response-to-outrage-over-ing-direct-purchase/.
271 *Id.*
272 12 U.S.C. § 5511(c).
273 *See* https://perma.cc/6YQS-XD2L (CFPB homepage as of August 1, 2016).

Although the business community has legitimate concerns about how broadly and aggressively the Bureau has interpreted its enforcement powers, there is no doubt that the Bureau has used them to obtain substantial relief for consumers.

Thus, even with respect to small, shared consumer injuries, there are multiple alternatives to private class action lawsuits in court brought by entrepreneurial plaintiffs' attorneys. These alternatives afford individual consumers and employees actual opportunities to pursue their disputes or otherwise vindicate their rights—in sharp contrast to the false promise of private class actions.

### D. Plaintiffs' Lawyers Will Be The Real Beneficiaries Of A Ban On Arbitration.

Consumers—the persons whom the Dodd-Frank Act requires the Bureau to "protect[]" in its arbitration regulation[274]—would be harmed by the proposed rule, but plaintiffs' lawyers will benefit tremendously.

Lawyers, as explained above, are the "true beneficiaries"[275] of most class actions. According to the Bureau's study, the fees delivered to plaintiffs' lawyers averaged 41% of the announced settlement in the class actions studied, working out to more than $1 million per case.[276] Defense counsel also earn high fees in class actions—particularly given that unlike plaintiffs' lawyers, they are paid even if the case is dismissed or withdrawn.

The arbitration system, by contrast, is set up to benefit consumers—not to enrich lawyers. Indeed, arbitration's simpler, more flexible procedures make it possible for a consumer to proceed without even being represented by a lawyer. As the scholars' critique of the Bureau's arbitration study noted, "self-represented plaintiffs were seven times more likely than represented plaintiffs to get an AAA arbitrator's decision in their favor." This finding, they explained, suggests that in arbitration, "hiring an attorney offers little value to a consumer and is often unnecessary."[277]

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[274] 12 U.S.C. § 5518(b).
[275] Shepherd, *supra* note 122, at 24.
[276] *CFPB Study* at section 8, page 33.
[277] Johnston & Zywicki, *supra* note 11, at 26.

It is no wonder, therefore, that the American Association for Justice—the primary trial lawyers' national trade association—has a form on its website inviting users to submit a comment in this very rulemaking telling the Bureau "why you oppose forced arbitration."[278] A rule that will primarily benefit lawyers plainly is not "in the public interest and for the protection of consumers."[279]

## V. The Bureau Should Consider Alternative Approaches.

The Bureau's criticisms of arbitration are unfounded, and its claimed benefits from class action lawsuits is contradicted by the evidence. These erroneous conclusions, by themselves, would be enough to show that the Bureau's proposal to eliminate arbitration in favor of class actions is arbitrary, capricious, and harms consumers rather than protects them.

But even if the Bureau's concerns were valid, the proposed rule would not be justified, because there are numerous alternatives to the effective total ban it has proposed. The Bureau has an obligation under basic principles of administrative law and Section 1028(b) of the Dodd-Frank Act to consider these options.

### A. The Bureau Could Collect More Information About Arbitration While Reserving Decision About Whether To Regulate At All.

One of the key components of the Bureau's proposed rule is a requirement that arbitration providers submit information about individual arbitrations to the Bureau, which will publish and study the data in order to "better understand arbitrations that occur now and in the future and to ensure that consumers' rights are being protected."[280] But this aspect of the proposal raises an obvious question: If the Bureau believes it would benefit from a greater understanding of arbitration, why did it not elect to collect this type of information about arbitration and wait to impose additional regulation until it could be truly confident in its conclusions—many of

[278] *See* Am. Ass'n for Justice, *What's Buried in the Fine Print?*, https://perma.cc/TQ2K-4KGX.
[279] 12 U.S.C. § 5518(b).
[280] 81 Fed. Reg. at 32,869.

which it admits are tentative or uncertain[281] and virtually all of which are contrary to the weight of evidence and informed opinion?

For example, the information reported to the Bureau could be compiled in a public database for study by the Bureau and the public. The insights gained from these assessments, in turn, would make the Bureau far better equipped to decide whether to regulate arbitration—and to what extent.

It makes no sense for the Bureau to propose, on the one hand, to collect more data about arbitration while simultaneously imposing a de facto ban on arbitration that will ensure that the Bureau obtains no useful data. The Bureau should, instead, consider collecting additional data *before* enacting any regulation, which will allow the Bureau actually to obtain useful information from its "monitoring" program.

### B. The Bureau Could Require All Arbitration Provisions To Have Consumer-Friendly Features.

The Bureau's rule proposal expresses concern about whether arbitration is fair to consumers and a viable method for bringing small claims (although nothing in the Bureau's study actually raises questions about the fairness of arbitral procedures).[282] Nevertheless, if the Bureau were genuinely concerned about arbitration's fairness, why did it not consider regulating the terms of arbitration provisions to maximize their fairness and consumers' ability to bring small claims, rather than effectively banning arbitration outright?

The wireless company AT&T, for example, uses an arbitration clause that requires the company to pay all arbitration fees and provides that customers who win more in arbitration than the company offered them in a settlement can recover a bonus incentive payment of $10,000 and *double* their attorney's fees.[283] These features make arbitration cost-free for most consumers and thus make it financially feasible to bring even the smallest claims in arbitration.

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[281] *E.g.*, *id.* at 32,855 ("The Bureau does not believe that, based on the evidence currently available to the Bureau, it can determine whether the mechanisms for the arbitration of individual disputes . . . are more or less fair or efficient in resolving these disputes than leaving these disputes to the courts.").
[282] *Id.* at 32,855-56.
[283] AT&T, *Wireless Customer Agreement*, § 2.2(3)-(4).

The Supreme Court noted in *AT&T Mobility LLC v. Concepcion* that in light of the benefits that AT&T's arbitration provision offers, consumers "were *better off* under their arbitration agreement with AT&T than they would have been as participants in a class action, which could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars."[284] And, as we mentioned above, the United States agreed with that assessment, noting that the features of AT&T's provision were "designed to ensure that consumers could bring low-value claims on an individual basis."[285]

Requiring arbitration clauses to include the same consumer-friendly features found in AT&T's arbitration agreement would benefit consumers by ensuring that they have a forum in which they can bring any claim—no matter how small—and obtain relief quickly and easily. A number of companies have similar provisions, but others do not.

But the Bureau has never considered whether requiring *all* arbitration provisions to have these features would be sufficient to advance the public interest and protect consumers. It should consider that option now, rather than imposing a de facto ban on arbitration that will take away consumers' ability to use arbitration altogether.

### C. The Bureau Could Require All Arbitration Provisions To Permit Coordination Among Individual Claimants.

The Bureau argues that class actions must be preserved so that consumers will have the opportunity to band together and aggregate their legal claims. But the Bureau never considered whether there are any *other* mechanisms, besides class actions, that allow for this type of coordination.

In fact, as noted above, Justice Kagan has observed that "non-class options abound" for allowing consumers to coordinate their claims and share the cost of litigation expenses such as attorneys' fees and expert witnesses.[286] She explained that arbitration provisions that allowed for "informal coordination among individual

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[284] 563 U.S. 333, 352 (2011) (internal quotation marks omitted).
[285] Br. of the United States as *Amicus Curiae* Supporting Respondents at 29, *Italian Colors*, No. 12-133, 2013 WL 367051.
[286] *Italian Colors*, 133 S. Ct. at 2319 (Kagan, J., dissenting).

claimants, or amelioration of arbitral expenses" would allow consumers to vindicate their rights without class actions.[287]

The Bureau and proponents of its proposed rule have argued that class actions are superior to arbitration because class actions put consumers on notice of allegedly unlawful practices in the consumer finance industry, whereas some have characterized arbitration as a secretive process in which claimants are required to agree to confidentiality. At the same time, the Bureau recognizes that this concern is of little practical weight, because only a "small minority of arbitration agreements" in the consumer finance industry require confidentiality.[288]

But if the Bureau were concerned about the risk that arbitration agreements would preclude consumers from sharing information about alleged corporate wrongdoing, why did it not consider prohibiting just confidentiality requirements in arbitration agreements, instead of banning arbitration outright?

The Bureau has failed to consider whether a rule that makes it easier for arbitration claimants to coordinate with one another—such as prohibitions on non-disclosure or confidentiality of information obtained in arbitrations—would allow consumers to obtain the benefits of acting in concert without the drawbacks of class actions. It should consider this possibility instead of doing away with arbitration entirely.

### D. The Bureau Could Require That Providers Give Consumers An Opportunity To Opt Out Of Arbitration.

The Bureau also did not consider whether its concerns about arbitration could be addressed by requiring businesses to allow consumers to choose, prior to disputes arising, whether to opt out of arbitration. If consumers have the opportunity to opt out of arbitration, they can decide for themselves whether or not litigation is a better option than arbitration—rather than having the Bureau decide for them.

The Bureau's proposed rule discounts the possibility of opt-outs, claiming that opt-out rights would be ineffective because consumers are often not aware that the

[287] *Id.* at 2318.
[288] 81 Fed. Reg. at 32,844 n.216.

financial products and services they use are subject to arbitration agreements. But as we note below, the Bureau could alleviate that problem by properly educating the public about arbitration. The Bureau should have given meaningful consideration to whether opt-out requirements would better protect consumers than a total ban on arbitration. The refusal to consider an opt-out mechanism is particularly ironic because consumers are compelled to participate in most class actions—the Bureau's preferred system of dispute resolution—and (for the overwhelming majority of class members who do not file claims) forever release their legal claims for free unless they opt out.

### E. The Bureau Could Educate The Public About Arbitration And How To Access It.

The Bureau has expressed the belief that many consumers are unaware of the fact that the products and services they use are subject to arbitration agreements. For example, the proposed rule argues that "consumers generally lack awareness regarding the effects of arbitration agreements"—citing findings in the Bureau's study that showed that most consumers whose credit card agreements contained arbitration provisions did not know that the agreements committed them to resolve disputes in arbitration and not in court.[289]

Of course, as two prominent academics explained in a critique of the Bureau's arbitration study last year, the fact that consumers may not be well informed on this subject is better explained by the likelihood that consumers do not have strong views about the particular method of dispute available to them. Most consumers prefer to take their business elsewhere, rather than litigate, when disputes are not resolved to their satisfaction.[290] But if the Bureau believes that lack of consumer awareness about arbitration agreements is a real problem, why did it not consider using its extensive resources to *educate* consumers about arbitration?

As the *Wall Street Journal* recently reported, the Bureau "is devoting a larger portion of its budget to advertising than nearly every other federal agency," with $15.3

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[289] *Id.* at 32,843.
[290] Johnston & Zywicki, *supra* note 11, at 26.

million spent on Internet advertising so far in FY2016.[291] Indeed, in many other settings, the Bureau touts its role as an educator for Americans about the financial industry, offering numerous resources on its website regarding topics from mortgages to credit cards to retirement saving.[292] But the Bureau chose not even to consider the possibility that it could educate consumers about arbitration.

Using the resources at its disposal, the Bureau could educate the public about how to pursue a claim in arbitration and how to coordinate with other individual claimants. That would likely lead to an increase in the number of arbitration filings, which the Bureau finds to be too low. The Bureau could also, if it chose, educate the public that contracts for financial products and services may contain arbitration clauses—which would enable consumers who want to retain the option to participate in lawsuits to choose financial service providers that do not use arbitration.[293] But rather than using its resources to inform the public and enable consumers to make their own choices about arbitration, the Bureau instead has decided to take the option to arbitrate away from consumers.

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The bottom line is that the Bureau's proposed rule races to effectively prohibit all arbitration in the consumer finance industry, without considering any of the many alternative regulations that would preserve, and even enhance, the benefits of arbitration for consumers while addressing a number of concerns the Bureau has raised. This approach is clearly inconsistent with the Bureau's mandate under Dodd-Frank to restrict the use of arbitration *only* if doing so would be in the public interest.

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291 Yuka Hayashi and Brody Mullins, *Consumer-Finance Agency, Under Fire, Accelerates Ad Spending*, Wall St. J. (June 12, 2016), http://www.wsj.com/articles/consumer-finance-agency-under-fire-accelerates-ad-spending-1465768902?tesla=y&mod=djemCapitalJournalDaybreak.

292 *See, e.g.*, Consumer Fin. Protection Bureau, *Your home loan toolkit: A step-by-step guide*, Aug. 2015, http://files.consumerfinance.gov/f/201503_cfpb_your-home-loan-toolkit-web.pdf (25-page guide on how to choose and obtain a mortgage).

293 As the George Mason critique of the Bureau's arbitration study found, in a number of markets, including those for checking accounts, credit cards, and prepaid cards, "consumers can quite easily avoid contracts with mandatory arbitration if they choose to do so." Indeed, "the vast majority (84%) of credit card issuers do not use . . . mandatory arbitration clauses." Johnston & Zywicki, *supra* note 11, at 20.

## VI. The Bureau Lacks Authority to Promulgate Its Proposed De Facto Ban On Arbitration.

### A. The Ban Exceeds The Bureau's Statutory Authority.

In light of the numerous substantive flaws discussed above, it is not surprising that the Bureau's proposal, if promulgated, would be invalid.

***First***, the Dodd-Frank Act states that the Bureau may prohibit or impose conditions or limitations on the use of pre-dispute arbitration in connection with the offering or providing of consumer financial products or services only if "such a prohibition or imposition of conditions or limitations" must be "in the public interest and for the protection of consumers."[294] In addition, of course, the Bureau must comply with the Administrative Procedure Act, which prohibits agency action that is "arbitrary, capricious…or otherwise not in accordance with law."[295]

As we have explained in this letter, the Bureau's proposed rule—which would amount to a de facto ban on arbitration—violates these limitations on the Bureau's authority:

- It would eliminate informal arbitral systems, which are essential for consumers to obtain redress for the vast majority of injuries that they suffer, leaving consumers without any practical means of remedying those injuries.

- The Bureau's purported justification for eliminating arbitration—the claimed benefits to consumers from the class action system—are illusory. The lion's share of benefits in these attorney-driven cases flows to lawyers, not consumers. And they do not provide any meaningful deterrence, particularly in light of the deterrent effect of the Bureau's fully-functioning enforcement and supervisory functions, which the Bureau's study failed to consider.

- Most significantly, the Bureau failed even to address whether the loss to consumers from eliminating arbitration is worth the claimed benefits of class actions—because the Bureau ignored companies' warnings that elimination of

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[294] 12 U.S.C. § 5518(b).
[295] 5 U.S.C. § 706(2).

arbitration will be the inevitable consequence of its proposed rule. Certainly the Bureau provided no rational explanation of why arbitration will continue to be available.

- The other consequence of the Bureau's proposed rule would be increased prices as businesses pass on increased transaction costs, even as it would fail to provide meaningful compensation or deterrence.

Rather than protecting consumers, the rule will harm them—and the public interest—by elevating the interests of the lawyers who benefit from class actions above those of consumers.

***Second***, The proposed rule is also invalid because the Bureau failed to comply with Section 1022 of the Dodd-Frank Act, which requires the Bureau to consider "the potential benefits and costs to consumers and [financial services providers]" whenever it issues a rule.[296] Though the Bureau purported to consider costs and benefits, this letter has shown that the benefits that the proposed rule claims would result from banning arbitration are illusory and that the rule ignores the costs that would result from funneling consumer claims into the lawyer-driven class action system. The Bureau's consideration of costs and benefits was therefore arbitrary and capricious and failed comply with the requirements of Section 1022.

***Third***, Congress specified that the findings underlying the rule must be "consistent with the study" on arbitration conducted in 2015.[297] That study, flawed as it is, provides no support for the proposition that a ban on pre-dispute individual arbitration agreements would protect consumers or serve the public interest. To the contrary, the study shows that arbitration is a fair, speedy, and useful form of consumer dispute resolution.

Moreover, the study highlights serious flaws in the ways that class actions actually function—most notably, that minuscule numbers of consumers receive compensation from class actions. Finally, the study suffers from a number of incomplete analyses and other limitations, such as its omission of any discussion of pre-arbitration settlement. These flaws prevent the Bureau from drawing any

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[296] 12 U.S.C. § 5512(b)(2)(A)(i).
[297] *Id.*

legitimate conclusions about the effectiveness of arbitration as compared to class actions.[298]

Agency action must be set aside by the courts if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[299] Under this standard, the Bureau cannot regulate arbitration without first "examin[ing] the relevant data and articulat[ing] a satisfactory explanation for its action including a rational connection between the facts found and the choices made.[300] As we have shown, the proposed rule fails this basic test. It should be set aside so the Bureau can conduct a fair, comprehensive study of arbitration and its benefits—or at a minimum revise the rule in light of the several more justifiable alternatives discussed in this letter.[301]

## VII. If The Bureau Nonetheless Decides To Promulgate A Rule, It Should Adopt Clear, Easy-To-Apply Standards For Determining When An Arbitration Agreement Is Subject To The Bureau's Restrictions.

For the reasons discussed above, the Bureau should withdraw its current proposal.

If the Bureau decides to promulgate a rule along the lines of its proposal, the Bureau should revise the proposal to ensure that any final rule: (1) does not exceed

[298] *See generally* Johnston & Zywicki, supra note 11, at 35-54.
[299] 5 U.S.C. § 706(2)(A).
[300] *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting *Motor Vehicles Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983)).
[301] The United States Court of Appeals for the District of Columbia Circuit is currently considering a constitutional challenge to the Bureau's structure on separation-of-powers grounds. *See* Pet'rs' Br. at 45-51, *PHH Corp. v. CFPB*, No. 15-1177, ECF No. 1575240 (Sept. 28, 2015). The constitutional issue was highlighted in a pre-oral argument order issued by the panel adjudicating that case and was the subject of questioning at oral argument. Per Curiam Order, *PHH Corp. v. CFPB*, No. 15-1177, ECF No. 1607052 (Apr. 4, 2016); Oral Argument Audio, *PHH Corp. v. CFPB,* https://www.cadc.uscourts.gov/recordings/recordings.nsf/DocsByRDate?OpenView&count=100; Jimmy Hoover, *DC Circ. Judge Slams Too Much Power At Top In CFPB Case*, Law360, Apr. 12, 2016, http://www.law360.com/articles/783491/dc-circ-judge-slams-too-much-power-at-top-in-cfpb-case.
A holding in *PHH* that the Bureau's structure is unconstitutional would mean that the Bureau's arbitration study was conducted without lawful authority, because of the constitutional defect, and would require the Bureau to undertake the statutorily-required study after the constitutional defect has been cured. In addition, pursuant to the terms of the Dodd-Frank Act, the Bureau would lack authority to proceed with this or any other rulemaking on arbitration until the lawfully-conducted study was completed. *See* 12 U.S.C. § 5518. A holding of unconstitutionality in *PHH* would separately mean that the Bureau lacked authority to issue the current proposed rule and request for comments, because of the Bureau's unconstitutional structure, and would require that the Bureau issue a new proposal following elimination of the constitutional defect and completion of a lawful study.

the Bureau's statutory authority; (2) draws clear, easy-to-apply lines between those arbitration agreements that are subject to the rule's restrictions and those that are not—so that the rule does not create uncertainty and produce costly and unproductive litigation over the validity of arbitration agreements; and (3) recognizes the practical realities of the commercial relationships between consumers and providers of consumer financial products and services subject to a final rule.

A number of trade associations, individual companies, and other interested parties are likely to submit comments addressing these issues. The Bureau should carefully consider all such submissions. We highlight below five issues, but emphasize that they are only a subset of the significant issues that the Bureau should address in any final rule.

### A. The Bureau Should Make Clear That Litigating Whether The Rule Applies To A Particular Arbitration Agreement Does Not Violate The Rule.

The Bureau has made clear that the intent of the proposed rule is to bar the enforcement of an arbitration agreement in connection with a putative class action, at least until class certification has been denied.[302] A court therefore would—assuming a valid rule—deny a motion to compel arbitration that would move a putative class action litigation into individual arbitration proceedings.

But the proposed rule is written so broadly that it could be read to prohibit a party from even moving to compel arbitration based on the belief that the arbitration agreement in question is not covered by the Bureau's rule. Thus, the proposal bars a company from "seek[ing] to rely in any way" on a covered arbitration agreement "with respect to any [covered] class action" including by "seek[ing] a stay or dismissal of particular claims or the entire action."[303] A company that moved to compel arbitration, only to have that motion denied by the court, thus might be alleged to have violated the rule.

This approach would have perverse consequences. Section 1036(a)(1)(A) of the CFPA makes it unlawful for any covered person to "commit any act or omission in

[302] *See* Official Interpretation 1 to Section 1040.4(a), 81 Fed. Reg. at 32928.
[303] *See* Proposed Rule § 1040.4(a).

violation of a Federal consumer financial law,"[304] which prohibition includes, by reference, "any rule…prescribed by the Bureau" under the CFPA.[305] In turn, the Bureau may obtain civil penalties of up to $1,000,000 a day for violations of a "Federal consumer financial law."[306] In other words, the Bureau may seek to impose enormous civil penalties for violations of any final arbitration rule including—at least under the current draft—for trying to compel arbitration based on a reasonable, good-faith belief that the arbitration agreement is not covered by the rule.

Consider the following example: A putative class representative alleges that he suffered injury after a financial advisor gave bad advice. The company moves to compel arbitration under its customer agreement because it believes that it provides only "financial advisory services," which are not covered by the rule. The court denies the motion, holding that the company offered "services to assist with debt management," which are covered by the proposed rule.

If the proposed rule were adopted in its final form, and interpreted to bar a party from arguing the rule's inapplicability in court, a defendant could face a crushing civil penalty for asserting what it believed to be a reasonable interpretation of the rule. That, in turn, could have the likely effect of expanding the scope of the rule beyond its bounds—because parties may be chilled from asserting legitimate rights to compel arbitration for fear that a court might rule against them and trigger an enforcement action.

The Bureau should clarify that, while a court should not enforce an arbitration agreement under the circumstances specified in the rule, a company does not violate the rule simply by good faith pursuit of its legal rights. For example, the Bureau could accomplish this goal through amendment of the operative prohibition from "shall not seek to rely" to "may not rely," and by including appropriate clarifications in the official commentary.[307]

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[304] 12 U.S.C. § 5536(a)(1)(A).
[305] *See* 12 U.S.C. § 5481(14) (defining "federal consumer financial law").
[306] *See* 12 U.S.C. § 5565(c).
[307] The Bureau may not intend to enforce the rule under such circumstances, but that provides little comfort. First, enforcement priorities change over time. Second, state attorneys general would be able to enforce the rule along with the Bureau. *See generally* 12 U.S.C. § 5552. The possible liability risk inevitably would affect company decision-making.

### B. The Bureau Should Ensure That Arbitration Remains Available For Products And Services Not Covered By Any Final Rule.

The Bureau properly has made clear that any rule will "appl[y] only to class action claims concerning the products or services covered by th[e] Rule."[308] To remain consistent with the requirements of the CFPA,[309] it is important that the Bureau not weaken that provision or the associated commentary.[310] In particular, the Bureau should be careful to preserve the ability of providers to enter into contracts involving both covered and non-covered products and services—and to include unregulated arbitration provisions with respect to the latter, as proposed Section 1040.4(a)(2)(ii) makes clear.

Failing to maintain that provision would force providers to create multiple consumer-provider contracts for a single consumer-company relationship. That, in turn, will increase costs and also create consumer confusion.

### C. The Bureau Should Clarify The Merchant Exclusion.

Congress recognized in the Dodd-Frank Act that consumers benefit when they receive interest-free credit to buy the products that they want and need. For that reason, Congress generally excluded such extensions of credit from the Bureau's authority.[311]

The proposed rule builds on this principle by providing that merely conveying an extension of credit otherwise covered by the statutory merchant exclusion does not make it subject to the arbitration rule.[312] We welcome this provision, which recognizes the practical reality that much of this interest-free merchant credit is only possible because of the securitization of the credit contracts.

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[308] *See* Proposed Rule § 1040.4(a)(2)(ii).
[309] *See* 12 U.S.C. § 5518(b) (granting rulemaking authority with respect to the use of arbitration agreements in "an agreement between a covered person and a consumer for a consumer financial product or service").
[310] *See* Comment (1) to Proposed Rule § 1040.2.
[311] *See generally* 12 U.S.C. § 5517.
[312] *See* Proposed Rule § 1040.3(b)(4).

### 1. The Need For Broader Protection For Merchants.

We are concerned, however, that the proposed rule's complex embodiment of this principle could create confusion among businesses and courts. As a general matter, the proposed rule fails to recognize the very substantial effort that will be required to understand the multi-layered exemptions, exclusions, and exceptions (and counter-exemptions, counter-exclusions, and counter-exceptions) that result from combining Section 1027(a)'s complex statutory scheme with Section 1040.3(b)(4)'s narrowly targeted expansion. The "marginal compliance costs related to particular deterrence"[313] to which the Bureau refers in the preamble, therefore, would likely be substantial. In particular, the proposed rule would impose significant legal compliance costs on merchants that would have to evaluate any final rule, and would have to consider, as to each good or service they offer or provide and on both an initial and ongoing basis, whether their goods and services are subject to any final rule. These costs would fall even more heavily on smaller merchants, for which any fixed costs would comprise a higher percentage of revenue, and on merchants without substantial pre-existing regulatory-compliance teams.

When purported class actions do materialize, any attempt to determine whether particular claims are subject to the Arbitration Rule (and thus may not be arbitrated) would require wasteful litigation of this threshold question. For many merchants, the applicability of the proposed rule's merchant exclusion (and thus of the proposed rule) would depend on complicated and non-public facts as to debt sales and inter-affiliate transfers, receivables, and operational relationships, as well as the interplay between each of these and delinquency or default. Determining the propriety of the merchant's reliance on the exclusion would thus require extensive (and expensive) discovery into corporate transactions and relationships that are not public-facing and bear no relevance to consumers.[314]

Indeed, without broader, clearer protection for merchants, the proposed rule would act as an inappropriately blunt deterrent to the use of, and reliance on, valid

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313 *See* 81 Fed. Reg. at 32,904 ("[I]t is difficult to isolate the marginal compliance costs related to particular deterrence and to quantify any additional investment that would occur in the absence of arbitration agreements. . . . [G]iven the data within its possession, the Bureau is unable to quantify these costs.").

314 Part VIII of the preamble includes an estimate of the costs of the proposed rule resulting from additional class action litigation but does not attempt to estimate (or even mention) the costs of more complex litigation to determine the validity of pre-dispute arbitration agreements arguably excluded from the proposed rule. *See id.* at 31,905–10.

pre-dispute arbitration agreements. Congress did not intend for the Bureau's arbitration rule to dissuade merchants from including pre-dispute arbitration agreements in their consumer contracts and, instead, expected the Bureau to include sufficient protections for merchants based on its findings from the Arbitration Study and comments on any proposed rule.[315] Yet preventing merchants from relying on arbitration agreements valid under the rule would likely be the result of the proposed rule, because the costs and risks that are inherent with determining whether the proposed rule would apply in any particular situation could cause merchants simply to decline to rely on valid, excluded arbitration agreements out of fear of violating that rule.

### 2. Proposed Additional Protections For Merchants.

For that reason, we recommend revising the proposal to allow the benefits of the merchant exclusion to be secured without substantial initial litigation. The Bureau should simplify the language of the proposed rule's merchant exclusion in three basic ways.

First, to make clear that all merchants and their affiliates engaged in activities related to interest-free consumer credit receive the protections of a final rule's merchant exclusion by limiting the proposed rule's applicability to incidental merchant credit to the "limited circumstances" in which the Regulatory Flexibility Act (RFA) analysis of the proposed rule states that the rule would cover merchants.[316] The Bureau has stated that it intends for the proposed rule to cover merchants that extend incidental credit only when (1) the amount of that credit significantly exceeds the market value of the goods or services sold or (2) the merchant is significantly engaged in extending credit with a finance charge.[317] Therefore, all merchants (and their affiliates) engaged in credit activities covered under Section 1040.3(a)(1) should be explicitly excluded from coverage under the proposed rule, unless they meet one of those two criteria by clear and convincing evidence.

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315 *See* 5 U.S.C. § 553(c); 12 U.S.C. § 5518(a), (b).
316 81 Fed. Reg. at 32,917.
317 *See id.*

Second, to clarify that when an extension of credit falls within the merchant exclusion, the servicing of that extension of credit also is excluded from the rule's coverage.

The proposed rule states merchants, retailers, and other sellers of nonfinancial goods or services would be excluded from the rule to the extent that they "[p]urchase or acquire an extension of consumer credit" excluded by the rule's merchant exclusion.[318] However, that exclusion does not appear to cover the acquiring merchant's subsequent servicing of that credit.[319] This limitation creates a double standard. A merchant who originally extended such credit and continued to service that credit would be excluded from the arbitration rule by the statutory merchant exclusion.[320] In contrast, a merchant who purchased the credit—for example as a result of a corporate acquisition—would be subject to the rule to the extent that it serviced the credit. There is no basis for treating those merchants differently. In both cases, the merchant would maintain a relationship with the customer and have equal incentive to continue to provide strong customer service. Indeed, the material terms would be unchanged and consumers would not even notice the transfer in many cases.

Third, the Bureau should ensure that affiliated companies benefit from the rule's merchant exclusion in the same manner as the company that extended the credit at issue. Companies often transfer contracts within a corporate family in order to take advantage of available funding streams, to manage tax implications, or for other purposes. Alternatively, companies may task an affiliate with servicing a contract even if it continues to be held by the original creditor. These internal, administrative decisions should have no effect on whether the proposed arbitration rule applies to the servicing of the credit contract subject to the rule's merchant exclusion: Intragroup transactions are, by their nature, not intended to affect consumers and do not affect consumers' access to the remedies sought to be made more readily available by the proposed rule. The Bureau thus should at minimum make clear that the rule's merchant exclusion applies both to the merchant that originally extended credit and to any affiliated merchants, including with respect to any servicing of the credit.

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[318] *See id.* § 1040.3(b)(4)(ii).

[319] *Id.*; *see also id.* § 1040.3(a)(v) (covering "servicing" of "consumer credit" covered by the rule).

[320] *See* 12 U.S.C. § 5517(a)(2)(A)(ii) (including collection of "debt arising from credit" covered by the merchant exclusion within the scope of the exclusion).

### 3. The Bureau's Dodd-Frank Act Section 1022(b)(2) and RFA Analyses for the Proposed Rule Contain Material Deficiencies.

Under Section 1022(b)(2) of the Dodd-Frank Act, the Bureau must "consider (i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule; and (ii) the impact of proposed rules on covered persons…and the impact on consumers in rural areas."[321] For rules such as the proposed rule, the RFA also generally requires certain regulatory flexibility analyses, that describe the "impact on small entities."[322] Judged by these standards, the Bureau's Dodd-Frank Act Section 1022(b)(2) and RFA analyses in Parts VIII and IX, respectively, of the preamble fall far short of the legal requirements, because they do not sufficiently take account of the costs that would be imposed by the proposed rule.

Specifically, these analyses are materially deficient because the Bureau improperly, and incorrectly, assumes that the proposed rule, as drafted, would not affect the cost of credit for merchants engaged in standard business borrowing activities. As described below, this assumption is unreasonable because of limits on the practical benefits of the proposed rule's merchant exclusion, particularly as a result of proposed Section 1040.3(b)(4).

The Bureau improperly excludes from its Part VIII and Part IX analyses any effects of the proposed rule on the cost of credit to merchants engaged in standard business borrowing activities. To the extent that the proposed rule would prohibit a provider from relying on a pre-dispute arbitration agreement "with respect to any aspect of a class action concerning any of the consumer financial products or services covered by" the proposed rule (each, a "covered class action"), the cost to the provider of defending the claim or claims underlying that class action is higher that it would be absent the proposed rule. The Bureau claims in the preamble, however, that unless the amount of credit extended by the merchant significantly exceeds the value of the good or service or the merchant engages significantly in extending credit with a finance charge, the proposed rule "would not affect the cost of credit of such merchants when they are engaged in such business borrowing activities."[323] This claim

[321] 12 U.S.C. § 5512(b)(2).
[322] 81 Fed. Reg. at 32,914 (quoting 5 U.S.C. § 603(a)).
[323] 81 Fed. Reg. at 32,883.

is contradicted by a careful analysis of how the proposed rule would limit the use of pre-dispute arbitration agreements as to various aspects of such activities.

If the Bureau properly considered the proposed rule's effects on the cost of credit to merchants engaged in standard business borrowing activities, the Bureau's analyses would attribute materially higher costs to covered persons under the proposed rule, through at least the following channels:

- ***Costs Incurred by a Non-Merchant Acquirer of an Excluded Debt***—The Bureau concedes that "an acquirer or purchaser of [incidental ECOA] consumer credit generally would be subject to proposed § 1040.4."[324] Common acquirers of such merchant credit would include banks, credit unions, finance companies, investment companies, and many others.

- ***Costs Incurred by any Person Collecting, or Otherwise Servicing, an Excluded Debt***—The proposed rule would cover the collection of debt arising from merchant credit that is sold, assigned, or otherwise conveyed, as well as *any other servicing with respect thereto*, regardless of who is collecting such debt or performing such other servicing. As explained by proposed Comment 4–2(ii), "§ 1040.4(a)(1) would . . . prohibit [a] debt collector from relying with respect to any aspect of a class action [filed against the debt collector concerning its covered debt collection products or services] on a pre-dispute arbitration agreement entered into by a merchant creditor who was excluded from coverage by § 1040.3(b)(5)."[325] Under proposed Section 1040.3(a)(10), the "debt collectors" prohibited from relying on a pre-dispute arbitration agreement in these circumstances would include essentially everyone who conceivably could collect the debt in a business borrowing arrangement.

- ***Costs Incurred as to Resale or Reconveyance Transactions***—The proposed rule would cover the resale or reconveyance of debt sold, assigned, or otherwise conveyed, under proposed Section 1040.3(b)(4)(i), by a merchant when the debt is not delinquent or in default even if such debt subsequently becomes delinquent or otherwise in default.

[324] *Id.* at 32,878.
[325] *Id.* at 32,928.

These gaps in the scope of the proposed rule's merchant exclusion would result in increases in businesses' cost of credit and illustrate the uncounted costs that merchants, as well as covered persons, would bear under the proposed rule.

In sum, the proposed rule would harm merchants by prohibiting nearly all parties involved in standard commercial borrowing and collateralized lines of credit that include the transfer of consumer credit (other than, as to certain activities, the originating merchant) from relying on a pre-dispute arbitration agreement and, therefore, increasing the costs of such borrowing options to banks, finance companies, and other acquirers, directly, and to merchants, indirectly. The proposed rule's limited merchant exclusion would be insufficient to prevent significant disruption, contract revisions, and other added costs. These additional anticipated costs, at each stage of the process of selling, collecting on, and reselling debts incurred to merchants for the purchase of their nonfinancial goods or services, would add up and affect the cost of credit of merchants engaged in business borrowing activities comparably to imposing such costs directly on the originating merchants.

### D. The Bureau Should Ensure That The Rule's Coverage Is Consistent With The Public Interest.

The Bureau should carefully consider comments addressing the need to exclude either certain providers or certain products and services from the scope of the proposed rule. In doing so, it should ensure that the final rule comports with the public interest as studied by the Bureau—products *not* studied by the Bureau (like two of the examples below) should not be subjected to the Rule. We note our strong opposition to any expansion of the categories of persons or products subject to the rule. For example, the Bureau should adopt appropriate exclusions to advance the public interest: (a) where the threat of ruinous class-action liability would distort a marketplace and injure consumers—such as with respect to credit monitoring products; and (b) where the Bureau should defer to other regulators—such as with respect to persons regulated by the SEC. The Bureau should also reconsider its position that "mobile wireless third-party billing" involves activities covered under the proposed rule.

### 1. The Bureau Should Exclude Credit Monitoring Products From Any Final Rule.

As we have explained, the history of class actions has been one of disproportionate legal fees and extremely limited consumer benefit. Often, the possible liability exposure of a company is so vast that the company has no choice but to settle, even in the absence of fault.

Heightening the distortive effect of such class actions, certain statutes are particularly unreasonable in their allocation of liability to defendant companies. One example is the Credit Repair Organizations Act ("CROA"), which not only provides for actual and punitive damages, but also permits the disgorgement of all revenues paid to the credit repair organization.[326]

The vast liability possible under CROA counsels against including claims under that statute within the scope of the arbitration rule. This is particularly true in light of the ongoing uncertainty whether courts will apply CROA to direct-to-consumer credit monitoring services. Given that uncertainty, consumer reporting agencies have used arbitration clauses to manage and price legal risk. A decision by the Bureau to eliminate that certainty will require a repricing—or, possibly, the abandonment—of credit monitoring products to account for the enormous liability risk that consumer reporting agencies would face. The Bureau should not impose higher prices on consumers in this manner, particularly because CROA is not properly interpreted to reach the delivery of credit monitoring products directly to consumers. Instead, as in other contexts where liability risk will distort the marketplace, the Bureau should exclude providers of direct-to-consumer credit monitoring products from the arbitration rule.

### 2. The Bureau Should Exclude Persons Regulated By The Securities And Exchange Commission.

Congress withheld from the Bureau any authority to enforce the Consumer Financial Protection Act (and thus any arbitration rule) against a person regulated by the Securities and Exchange Commission (SEC).[327] In addition, Congress gave the SEC authority to restrict the use of arbitration agreements by persons subject to the

[326] *See* 15 U.S.C. § 1679g(a).
[327] *See* 12 U.S.C. § 5517(i).

SEC's jurisdiction.[328] In short, Congress has made clear that it is up to the SEC—not the Bureau—to decide whether to regulate the use of arbitration by persons within the SEC's jurisdiction.

The Bureau nonetheless has chosen to create an exclusion from the proposed rule that would be triggered only if the SEC maintains or authorizes an equivalent rule regulating the use of arbitration agreements by broker dealers.[329]

This is an overreach. Even assuming that a broker dealer somehow offered or provided a consumer financial product or service, the Bureau would have no authority to enforce the CFPA with respect to such conduct, or to promulgate a rule regulating it. Congress specifically stated that "[t]he Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by the Commission."[330] That exclusion plainly bars the Bureau from subjecting broker-dealers to a rule issued by the Bureau.

Using the arbitration rule as an indirect tool to try to shape broker dealers' behavior is therefore improper and unlawful. The Bureau instead should make clear that it is leaving decisions over SEC-regulated persons' use of arbitration to the SEC—as Congress clearly intended.

### 3. The Bureau Should Exclude "Mobile Wireless Third-Party Billing" From the Proposed Rule.

In the proposed rule's preamble, the Bureau states its intent to subject "mobile wireless third-party billing" to the proposed rule.[331] Properly understood, however, mobile wireless third-party billing does not fall within the scope of the proposed rule. In addition, including mobile wireless third-party billing within the scope of the proposed rule would be contrary to the public interest. The Bureau consequently

[328] *See* 15 U.S.C. § 78o(o). Congress also required the SEC to consult with the Bureau when the SEC undertakes a potentially overlapping rulemaking. *See id.* 12 U.S.C. § 5517(i)(2).
[329] *See* Proposed Rule § 1040.3(b)(1); Comment (1) to Proposed Rule § 1040.3(b)(1).
[330] 12 U.S.C. § 5517(i)(1).
[331] The Bureau describes "mobile wireless third-party billing" as a practice whereby "a mobile wireless provider authorizes third parties to charge consumers, on their wireless bill, for services provided by the third parties." 81 Fed. Reg. at 32,841 n.157.

should clarify through an appropriate exclusion or interpretive comment that mobile wireless third-party billing is not subject to any future rule.

***First***, none of the three possible bases that the Bureau identifies for applying the rule to mobile third-party billing properly includes third-party billing services as they typically are performed in today's marketplace:

- The Bureau suggests that third-party billing involves an extension of credit under proposed Section 1040.3(a)(1). But in typical mobile wireless third-party billing transactions, wireless customers purchase the product from a third-party provider, not the mobile wireless provider. And it is the third-party provider, not the mobile wireless provider, that grants wireless customers the right to defer payment for their purchase. The third-party provider, therefore, is the only person under this arrangement that extends credit to a consumer. Indeed, the mobile wireless provider's relationships with third-party providers generally provide that the mobile wireless provider performs billing and collection services for the amounts owed by wireless customers to the third-party provider, as the provider's authorized delegate.[332] And, of course, if a mobile wireless provider is jointly engaged with the third-party provider in selling the underlying good or service, the mobile wireless provider is excluded from the Bureau's jurisdiction under Section 1027(a)(2) of the Dodd-Frank Act.

- The Bureau also suggests that mobile wireless third-party billing involves payment or financial data processing under proposed Section 1040.3(a)(8). While third-party billing services may involve payment processing of the type described in the main clause of Section 1040.3(a)(8), these services would be excluded from coverage under that provision's exception for payment processing services provided by a merchant to allow consumers to pay for nonfinancial goods and services that it markets. That is because mobile wireless providers can and do market the third-party products and services for which they process payments in a number of different ways—through third-party billing, which itself is a promotional technique because it provides a convenient

[332] The Bureau pointed out in the preamble that mobile wireless third-party billing involves an "extension of credit" provided "in connection with goods and services that the [mobile wireless] provider ***does not directly sell*** and that consumers ***do not purchase from*** the provider." 81 Fed. Reg. at 32,841 n.157 (citing 12 U.S.C. § 5517(a)(2)(A)(i)); *accord*, Complaint, *Bureau v. Sprint Corp.*, No. 14-CV-9931 (S.D.N.Y. June 30, 2015), 2014 WL 7176456, at 3; Complaint, *Bureau v. Cellco P'ship*, No. 15-CV-3268 (D.N.J. May 14, 2015), 2015 WL 3561654.

and frictionless method for wireless customers to pay for third-party goods and services that is intended to increase the third-party products' visibility to and adoption by consumers; specific promotional activities for such products and services; or distribution of the third-party products and services through retail locations or on-line distribution channels (for example, with equipment insurance). For that reason, the exclusion in Section 1040.3(a)(8) for payment processors who "market[] the non-financial good or service" would apply, putting the mobile wireless provider outside the scope of the proposed rule.[333]

- The Bureau suggests that mobile wireless third-party billing may involve transmitting or exchanging funds under proposed Section 1040.3(a)(7). But, mobile wireless providers' third-party billing services generally involve the transmission of funds solely on behalf of third-party providers of goods and services, not on behalf of consumers. As such, third-party billing by mobile wireless providers fails to satisfy the most fundamental requirement for coverage under the proposed rule—that the product or service (here, transmitting or exchanging funds) is a "consumer financial product[] or service[] as defined by [Section 1002(5) of the Dodd-Frank Act]."[334] The determinative issue for coverage under proposed Section 1040.3(a) and (a)(7) is ***for whom*** and ***for what purpose*** a mobile wireless provider transmits funds. In third-party billing arrangements, a mobile wireless provider transmits funds for the third-party provider for commercial reasons pursuant to a commercial agreement—not for the consumer to satisfy a personal, family or household need. Put another way, wireless customers have not engaged a mobile wireless provider for the purpose of transmitting funds to third-party providers on their behalf.

***Second***, the public interest weighs heavily in favor of excluding mobile wireless third-party billing from the proposed rule for at least two reasons.

[333] Indeed, the Bureau and the Federal Trade Commission ("FTC") have already recognized that many of the underlying goods and services for which mobile wireless providers offer third-party billing are not appropriately the focus of their regulatory resources. *See* Stipulated Final Judgment and Order ¶ 24, *Bureau v. Cellco P'ship*, No. 15-CV-3268 (D.N.J. June 9, 2015), ECF No. 8; Stipulated Final Judgment and Order ¶ 25, *Bureau v. Sprint Corp.*, No. 14-CV-9931 (S.D.N.Y. June 30, 2015), ECF. No. 25 (adopting similar exclusions); Stipulated Order for Permanent Injunction and Monetary Judgment ¶ 12, *FTC v. AT&T Mobility, LLC*, No. 14-CV-3227 (N.D. Ga. Oct. 8, 2014), ECF No. 2.
[334] *Id.* at 32,925 (citing 12 U.S.C. § 5481(5)).

- Determining whether the proposed rule covers a particular mobile wireless third-party billing service would require a nuanced evaluation of the business relationship between the mobile wireless provider and each of the third-party providers with which it contracts. The need to perform these evaluations on an ongoing basis would leave the application of any final rule unclear, and force mobile wireless providers to make the unacceptable choice between applying the rule more expansively than its terms or subjecting themselves to burdensome litigation challenging the scope of valid pre-dispute arbitration agreements.

- Mobile wireless third-party billing is only an incidental part of a typical wireless provider's business, the vast majority (if not all) of the rest of which is outside the Bureau's authority. Subjecting mobile wireless third-party billing to the proposed rule thus would require the wireless provider that wants to offer such third-party billing services to build a substantial compliance system and endure the risk of class action liability just for a relatively small revenue stream. Mobile wireless providers very well may decide that the resulting financial proposition simply does not make sense, causing them to reduce access to the products that consumers want. Consumers will suffer as a result, both in the short term as prices go up and product selection goes down, and in the long term, as innovative financial products offered through mobile wireless third-party billing fail in the face of stiff regulatory compliance burdens and the threat of class litigation.

For these reasons, the Bureau should expressly exclude mobile wireless third-party billing from the scope of the proposed rule. At a minimum, the Bureau should clarify in the adopting release for any final rule the particular features of third-party billing that, in the agency's view, bring the service within the coverage of the proposed rule.

**E. The Bureau Should Ensure That The Grandfather Clause Will Apply Rationally In Any Final Rule.**

Congress required that the Bureau give companies 180 days to come into compliance with any arbitration rule (measured from the rule's effective date).[335] In other words, Congress intended for arbitration agreements entered into before that date to remain enforceable even after a final arbitration rule took effect.

The Bureau has correctly recognized that Congress' intent in establishing this grandfather clause would be defeated if routine modifications of product terms and conditions eliminated its protections. The Bureau therefore has properly explained in the official commentary that a provider does not enter into an arbitration agreement for purposes of the rule when it "[m]odifies, amends, or implements the terms of a product or service that is subject to a pre-dispute arbitration agreement that was entered into before" the compliance date.[336] The Bureau should retain this provision in the final draft in order: (a) to give practical effect to Congress' intent; and (b) to avoid creating strange incentives for providers to leave product terms unchanged even as market conditions and customer preferences evolve.

Moreover, the Bureau should provide additional clarity on the distinction between a change to product terms and conditions and the offering of a new product or service (which would not be subject to the rule's grandfather clause).[337] Whether through illustrative examples or further commentary, the Bureau should explain that the grandfather clause applies to an amended agreement as long as the underlying product continues to serve the purpose for which the consumer originally entered into the agreement. For example, the grandfather clause should protect agreements that are sold or assigned given that there is no change in the product the consumer is receiving.

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[335] 12 U.S.C. § 5518(d).
[336] *See* Comment (1)(ii)(A) to Proposed Rule § 1040.4.
[337] *See* Comment (1)(i)(A) to Section 1040.4 (explaining that the arbitration rule would apply if the provider offered a new product or service).

* * * *

Thank you for your consideration of these comments. We would be happy to discuss these issues further at any time.

Sincerely,

David Hirschmann
President and CEO
Center for Capital Markets Competitiveness

Lisa Rickard
President
Institute for Legal Reform

**APPENDIX**
**Review of Information in the CFPB's Consumer Complaints Database**

## I. Introduction

The Consumer Financial Protection Bureau ("the Bureau") collects written complaints from consumers about consumer financial products and services. The complaints include basic information such as the date of submission, the company involved, whether the company made a timely response, and whether the consumer disputed the company's response. In addition, consumers are allowed to submit "consumer narratives" detailing the substance of their complaint. Last year, the Bureau collected over 271,600 complaints.[338]

According to the Bureau, these complaints provide a useful window into trends in the consumer financial marketplace. The Bureau generates biannual reports to Congress and frequent monthly complaint reports summarizing trends and statistics. Yet although the Bureau says that it "analyze[s] complaint data to help … enforce consumer financial laws" and "write better rules and regulations,"[339] the Bureau apparently did not even attempt to analyze this data in connection with its study of arbitration or subsequent proposed rule.[340]

Starting in June 2015, the Bureau made consumer narratives and the corresponding complaint data publicly available after scrubbing personal information and obtaining the consumer's consent.[341] Not all consumer complaints contain consumer narratives, and not all consumers who submit narratives consent to allow their narratives to be made public. Furthermore, narratives usually do not provide extensive detail. Nevertheless, the publication of this data makes it possible to learn more about the types of consumer financial disputes for which consumers seek resolution.

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338 Consumer Fin. Protection Bureau, *Consumer Response Annual Report, January 1 – December 31, 2015*, at 2 (Mar. 2016), http://files.consumerfinance.gov/f/201604_cfpb_consumer-response-annual-report-2015.pdf.
339 Consumer Fin. Protection Bureau, *How we use complaint data*, http://www.consumerfinance.gov/complaint/data-use.
340 The Bureau's proposed rule does not mention their collection of consumer complaints, except to note that "public enforcement agencies" and others "routinely use public databases, such as … the Bureau's complaint database , … in conducting their work." Consumer Fin. Protection Bureau, *Arbitration Agreements; Proposed Rule*, 81 Fed. Reg. 32,830, 32,870 (May 24, 2016).
341 Consumer Fin. Protection Bureau, *Disclosure of Consumer Complaint Narrative Data*, 80 Fed. Reg. 15,572 (Mar. 24, 2015).

This Review examined a sample of ten days' worth of consumer complaints from 2016. The results demonstrate that most consumer disputes are individualized, and thus highly unlikely to be compatible with class-wide resolution in traditional litigation. The Bureau should have considered this kind of data in formulating its proposed rule.

## II. Methodology

We randomly selected ten days from the Database from May to August 2016. We downloaded from the Bureau's website all consumer complaints submitted on those days that included consumer narratives. We then reviewed each narrative to determine whether the allegations were likely individualized or potentially reflective of a systemic problem, such that class treatment potentially might be appropriate. Finally, we coded the reviews and tabulated the results.

## III. Results

Our Review showed that over 90 percent of the narratives that consumers submitted to the Database described disputes that were likely individualized.

| | *Likely Individualized* | | *Potentially Classable* | | |
|---|---|---|---|---|---|
| **Date** | **Total** | **Percent** | **Total** | **Percent** | **Total** |
| 5/12/2016 | 228 | 95% | 11 | 5% | 239 |
| 5/18/2016 | 244 | 96% | 10 | 4% | 254 |
| 5/24/2016 | 247 | 91% | 23 | 9% | 270 |
| 6/6/2016 | 209 | 92% | 19 | 8% | 228 |
| 6/17/2016 | 97 | 90% | 11 | 10% | 108 |
| 6/29/2016 | 92 | 86% | 15 | 14% | 107 |
| 7/7/2016 | 116 | 86% | 19 | 14% | 135 |
| 7/11/2016 | 93 | 84% | 18 | 16% | 111 |
| 7/28/2016 | 57 | 86% | 9 | 14% | 66 |
| 8/2/2016 | 34 | 87% | 5 | 13% | 39 |
| **Total** | **1417** | **91%** | **140** | **9%** | **1557** |

These results have important implications for the Bureau's proposed rule on arbitration.

We have elsewhere explained that arbitration is the *only* practical method of dispute resolution for resolving individualized, low-value claims.[342] As Justice Stephen Breyer has recognized, without arbitration, "the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)" would be left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery."[343]

The Bureau's proposal would severely curtail, and likely eliminate, the availability of consumer arbitration, leaving aggrieved consumers with only one option for formal dispute resolution: litigation in court. But for a variety of reasons, some of which Justice Breyer sketches above, traditional litigation is no option at all for small consumer claims. Classable claims can in theory be vindicated through class actions—"in theory" because the vast majority of class actions recover precisely nothing for the class and because successful class actions tend to primarily enrich lawyers rather than class members.[344] But even that theoretical possibility is usually out of reach for the vast majority of claims that, the Bureau's own data indicates, consumers are most interested in resolving: because those claims are individualized, they cannot be vindicated in class actions.

Had the Bureau studied its own complaint data, it would have seen that depriving consumers of their best option for resolving their most common consumer claims is not worth enriching the plaintiffs' bar by doubling down on class actions. At the very least, the Bureau should have examined this readily-available information in assessing the harms and benefits to consumers of its proposed rule on consumer arbitration. Its failure to do so is one more reason why the proposed rule should be withdrawn and revisited.

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[342] See Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *Re: Notice of Proposed Rulemaking on Arbitration Agreements*, Docket No. CFPB-2016-0020 (Aug. 22, 2016).
[343] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995). *See also, e.g.*, Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 Cardozo J. Conflict Resolution 267 (2008).
[344] *See generally* Mayer Brown LLP, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 11, 2013), [http://www.mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf](http://www.mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf); Deborah R. Hensler *et al.*, CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN (2000).