The CFPB's Flawed Arbitration "Study"

Arbitration is an important means of resolving disputes that provides significant benefits to consumers and businesses. As the U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR") explained in detail in comments to the CFPB,[1] arbitration of consumer disputes has been common practice for decades; there are perhaps hundreds of millions of consumer contracts currently in force that include arbitration agreements—many of them relating to consumer financial products or services.

The Bureau's study is deeply flawed in numerous respects:

- It ignores the practical benefits of arbitration as compared to the court system for vindicating the types of injuries that consumers most often suffer (pp. 1-3, below);
- It greatly exaggerates the supposed benefits of class actions (pp. 3-8);
- It ignores the significant role of government enforcement—particularly the CFPB's own enforcement and supervision processes—in protecting consumers (pp. 8-9).
- It fails to consider the benefits that arbitration provides to injured parties in a variety of contexts—including in consumer arbitrations, when consumers are not discouraged by plaintiffs' lawyers and others from invoking arbitration (pp. 9-14); and
- It wrongly denies the reduced transaction costs resulting from arbitration, which produce lower prices for consumers (pp. 14-18).

A. *As the Bureau's study of individual lawsuits confirms, for most injured consumers, the judicial system is not a realistic means for obtaining redress.*

Arbitration provides consumers, employees, and other injured parties with accessible and fair procedures for obtaining redress for claims that cannot be vindicated in court.

Many criticisms of arbitration are based on a flawed premise that the alternative system—litigation in court—gives individuals a meaningful and realistic option for resolving their disputes. That premise would make sense only if the judicial system were free of transaction costs, if every legitimate claimant could obtain legal representation, and if lawsuits were resolved expeditiously. But today's judicial system falls far short of that ideal: litigation in court is costly and prone to intolerably long delays, and claimants often have difficulty finding a lawyer to take their case.[2]

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1 Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *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), *available at* http://www.instituteforlegalreform.com/uploads/sites/1/2013_12.11_CFPB_-_arbitration_cover_letter.pdf ("*Chamber Comment II*"); Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *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), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0051 ("*Chamber Comment I*").

2 *See Chamber Comment II* at 6-9.

Most wrongs suffered by consumers are relatively small and individualized—excess charges on a bill, a defective piece of merchandise, and the like—and are simply too small to justify paying a lawyer to handle the matter. Such claims do not—and could not—attract lawyers willing to work on a contingency fee basis, because the claim promises no substantial recovery (and therefore no substantial legal fee).[3] And because these claims are individualized, they do not share the common factual basis required for a class action to be certified.

Even when a claim is large enough to justify paying an attorney's fees—or to attract a contingency-fee lawyer—the complexity of the litigation system makes litigation costly and inconvenient. In addition, every participant in the legal system faces a significant access-to-justice problem in our overcrowded and underfunded courts: docket backlogs have skyrocketed, courthouses have been closed due to budget cuts, and trials are delayed. In California, for example, repeated budget cuts have forced 52 courthouses and 202 courtrooms to close, prompting the state judiciary to warn that funding for the state's courts is no longer "enough to sustain a healthy [judicial system]."[4] Los Angeles County, the state's largest, reported this year that its remaining courts are facing "unmanageably high" workloads, which is producing "intolerable delay" in civil cases.[5]

As a result of these structural problems, it is extremely difficult, if not impossible, for individual consumers to litigate their claims in court as a practical matter. The Bureau's study results reflect this reality and demonstrate that litigation in court on an individual basis is not a realistic prospect for most people.

The Bureau examined individual (*i.e.*, non-class) cases brought in federal court by individual plaintiffs. Only in a miniscule percentage of the cases studied—5.6%—did plaintiffs pursue their claims *pro se*, confirming that litigation in court without the assistance of an attorney is infeasible for most consumers. The vast majority—90%—of federal-court individual cases the Bureau studied resulted in a known or potential settlement of the individual's claims. But the Bureau found very little data about the settlements; in the few cases where it did, the "amounts of the settlements ranged from $250 to $15,000." Individual arbitration settlements and awards reflect similar or better successes: where data was available, "the average and median [debt] forbearance amounts were $ 6,968 and $4,900."

Consumers obtained judgments in only 6.8% of the court cases studied, but most of those judgments involved a default judgment against the company. And for all the emphasis

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3 One study reported that a claim must be worth at least $60,000. 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 10 (Nov. 23, 2011), http://www.mnbar.org/sections/outstate-practice/11-23-11%20Civil%20Justice%20Reform.pdf.

4 Judicial Council of Cal., *InFocus: Judicial Branch Budget Crisis*, *available at* http://www.courts.ca.gov/partners/courtsbudget.htm.

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

that critics of arbitration place on the importance of a jury trial, only *one* judgment for a consumer "was the result of a trial."[6]

The Bureau's review of small claims courts—and "what use parties made of" these courts "with respect to consumer financial disputes"[7]—provides little reason to believe that consumers can effectively pursue relief in those forums, either. The Bureau undertook a limited examination of small claims court, cabining its review to "potential credit card cases involving a set of ten large credit card issuers."[8] It appears that the Bureau simply counted the number of consumer credit card disputes, and did not address other categories of disputes that consumers may have. The report does not make a qualitative assessment of how small claims court operates in practice.

In fact, while small-claims courts were developed to make it easier for individuals to proceed without representation, they do not provide a realistic alternative because those courts are overcrowded and underfunded—as numerous media investigations have demonstrated.[9] For individuals unable to pursue their claims in arbitration, the outlook in small claims court is grim. The Bureau failed to assess the practical reality for these consumers.

B. *The Bureau's study paints an unjustifiably positive and one-sided picture of class actions, which provide virtually no benefits to the vast majority of consumers.*

The principal attack on arbitration—strongly touted by the plaintiffs' bar—stems from the fact that arbitration agreements typically require that arbitration proceed on an individual basis and bar class procedures in arbitration and in court. This argument rests on a dubious assumption: that the elimination of class actions deprives consumers of a procedural mechanism that supposedly provides enormous benefits by allowing the vindication of small claims that (according to the argument) would be too expensive for plaintiffs to arbitrate individually. The Bureau's proposal rests entirely on this argument, claiming that consumers are "significantly better protected from harm" when they are able to bring class action lawsuits and that class actions must be preserved.

But even the Bureau's own gerrymandered study does not support this idealized view of the class action system. Although the language of the study report is carefully crafted to avoid criticizing class actions, the study's underlying data actually establish that class actions are, on the whole, not effective for the kinds of claims that most individuals are likely to have. These details—buried in the Bureau's study among the more conspicuous statements implying

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6 Consumer Fin. Protection Bureau, *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* at section 6, pages 48-49 (Mar. 1, 2015) ("*CFPB Study*").

7 *Id*. at section 7, pages 2-3.

8 *Id*. at section 7, page 6.

9 *Chamber Comment II* at 9-13; *see also* William Glaberson, *Despite Cutbacks, Night Court's Small Dramas Go On*, N.Y. TIMES, June 2, 2011, *available at* http://www.nytimes.com/2011/06/03/nyregion/despite-cutbacks-new-york-small-claims-courts-trudge-on.html; Emily Green, *Budget Woes Mean Big Delays For Small Claims Courts*, Nat. Pub. Radio, May 15, 2013, *available at* http://www.npr.org/2013/05/17/182640434/budget-woes-mean-big-delays-for-small-claims-courts.

that class actions are beneficial—in fact offer further proof that most class actions provide no benefit to consumers.

First, most cases filed as purported class actions are not resolved in a manner that provides any benefit to absent class members. According to the Bureau's data, 87% of resolved class actions (excluding claims affected by arbitration agreements) resulted in no benefit to absent class members. Instead, most were dismissed by or settled with the named plaintiff only. The Bureau found that only 13% of putative class actions were finally approved for classwide settlement during the study period.[10]

That is an even smaller than the proportion observed in another study conducted in 2013 by Mayer Brown LLP on behalf of the Chamber of Commerce.[11] That study found that ***the overwhelming majority of class actions result in no recovery at all*** for members of the putative class. Approximately two-thirds of cases studied were dismissed on the merits by the court, or dismissed voluntarily by the plaintiff.

The Bureau's report fails to acknowledge it, but the plain fact is that absent class members receive nothing unless a class action is settled on a class-wide basis, or there is a class-wide judgment for plaintiffs (something that almost never happens).

Second, even in those cases that do result in class settlements, most class members still receive nothing. The Bureau's report attempts to tout the purportedly large number of class members "eligible for relief," but the only relevant metric is the rates at which "eligible" class members actually received relief, typically after submitting claims. In sharp contrast with the flood of statistics provided on other topics—including the numbers of class members eligible for relief when cases settle—the Bureau's report seemed designed to obscure the proportion of eligible class members who actually submitted claims. Where statistics were available, the Bureau's study reported a "weighted average claims rate" of just 4%.[12] That 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 miniscule: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.[13]

The Bureau's own study thus shows that even in the 13% of class actions that did settle on a classwide basis, approximately 96% of class members received no benefit. The Bureau could have—and should have—provided a precise calculation of the overall likelihood that a class member will receive a benefit in a class action, but even a back-of-the-envelope estimate suggests that 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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10 *Id.* at section 6, page 37.

11 Mayer Brown LLP, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 11, 2013) ("*Chamber Study*"), *available at* http://www.mayerbrown.com/files/uploads/-Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf.

12 *Id.* at section 8, page 30.

13 *Chamber Study* at 7 & n.20.

Why do the low claims rates in most class actions matter? In determining who benefits, it makes no difference how many people are "eligible" to make claims; all that matters is who follows through and actually receives compensation. As the Chamber's study explained, there are many reasons why a class member might not submit a claim, such as because he or she believes the modest award is not worth their while, or the process is burdensome, or they do not believe they have been injured in the first place.[14] But whatever their reasons, it is clear that most class members do not submit claims and thus are not made better off by class actions.

The Bureau's study also reveals other data about how class actions provide little value to individuals (although, again, one has to dig beneath the surface). For example, the study carefully avoids any mention of the ***average*** amount of payments to class members, instead trumpeting "a total of $1.1 billion in 251 settlements." It elsewhere says that 236 settlements involved 34 million class members "who received, or will receive, a cash payment." Even if one gives the Bureau the benefit of the doubt and 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.[15]

What is more, claimants had to wait significantly longer in class actions than in arbitration to obtain relief. According to the Bureau, class actions that settled on a classwide basis—and for which it was thus even *possible* that a class action could provide benefits to absent class members—took an average of two years to resolve. (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).[16] 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. In contrast to the interminable length of most class actions, meanwhile, arbitrations resolved by an arbitrator took between four and eight months to resolve, and those arbitrations that were settled took a mere two to five months.[17]

In sum, the Bureau's own data reveal that class members in the vast majority of class actions receive no more than a pittance—and then only after a long wait while the lawsuit drags on.

Third, the Bureau's data also shows that while class members receive little, ***the lawyers who bring these class actions do very well for themselves***. Based on the Bureau's report, 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%. 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***.[18] It is telling that the Bureau did not attempt to compare this staggering amount paid to by plaintiffs' lawyers with the meager amount that class members ***actually*** received.

14 *Id*.

15 *CFPB Study* at section 8, pages 27-28.

16 *Chamber Study* at 1.

17 *Id.* at section 5, page 72; *id*. at section 8, page 37.

18 *Id.* at section 8, page 33.

These massive attorneys' fees are but one part of the equation: They do not include the other very large transaction costs associated with litigating class actions—the defense costs that companies must pay in all cases, and the cost to the courts of handling these cases. ***The Bureau does not even attempt to determine whether the class action system justifies these enormous costs.***

Perhaps the Bureau chose not to try to answer that question because it knew it would not like the answer: our class action system is *not* worth its high costs, because it produces only paltry benefits to consumers. Again, the Bureau found that the average settlement payment in a class action is just $32. And in many class actions, class members receive far less. Indeed, some class actions result in settlements where class members receive only small coupons; in these coupon cases, as one commentator puts it, "[t]he lawyers ha[ve] a nice payday and most of the class members pitch[] the coupons into the trash."[19] Professor Martin Redish has decried this phenomenon of "faux class actions," in which "as a practical matter [class members] will receive no damages" and "[t]he real parties in interest" are "the plaintiffs' lawyers, who are the ones primarily responsible for bringing th[e] proceeding."[20]

In some class actions, moreover, plaintiffs receive ***literally nothing at all***, because the only relief awarded in the settlement is injunctive relief or *cy pres* relief, which requires the defendant to pay money to a charitable organization. Chief Justice John Roberts has raised concerns about the "fairness" of *cy pres* settlements,[21] and scholars have suggested that they violate absent class members' due process rights.[22] But despite the fact that injunctive and *cy pres* relief do almost nothing to benefit class members, plaintiffs' attorneys eagerly pursue both, because "class counsel's interest in maximizing its fees is satisfied regardless of whether the settlement funds are paid to class members or distributed *cy pres*."[23]

Fourth, contrary to the Bureau's assertions, our abusive and wasteful class action system is not necessary to allow consumers with small claims to vindicate their rights effectively. Indeed, in the Supreme Court's recent decision in *American Express Co. v. Italian Colors Restaurant*, both the majority *and* the dissent rejected that notion. 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:

> In this case, . . . the [arbitration] agreement could have prohibited class arbitration without offending the effective vindication rule *if* it had provided an

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19 Rob Berger, *The CFPB Declares War on Arbitration*, Forbes, Oct. 18, 2015, *available at* http://www.forbes.com/sites/robertberger/2015/10/18/the-cfpb-declares-war-on-arbitration.

20 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), available at http://judiciary.house.gov/_files/hearings/Hearings%202012/Redish%2006012012.pdf.

21 *See Marek v. Lane*, 134 S. Ct. 8, 9 (2013) (Roberts, C.J., respecting the denial of certiorari) (noting the many "fundamental concerns surrounding the use of [*cy pres*] remedies in class action litigation").

22 Martin H. Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action*, 62 Fla. L. Rev. 617, 650 (2010).

23 Rhonda Wasserman, *Cy Pres in Class Action Settlements*, 88 S. Cal. L. Rev. 97, 123 (2014).

> 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.[24]

Consumers increasingly have access to arbitration systems that provide all of the features that the *Italian Colors* dissent identified as necessary to allow for effective, individual vindication 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.[25] It is also easier than ever before for individual claimants to coordinate their claims by sharing the same lawyer, expert, and other elements required to prove a claim. For example, an entrepreneurial plaintiffs' lawyer can recruit 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 over all those claimants, making the costs for expert witnesses and fact development negligible on a per-claimant basis.

There are thus 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.***

Fifth, in an attempt to sidestep the facts that class actions often provide no benefit to class members and are unnecessary to vindicate small consumer claims, the Bureau contends in its October 2015 rulemaking announcement that class actions also serve the broader social purpose of deterring wrongdoing. By threatening companies that violate the law with huge liability, the Bureau claims, class actions "strengthen[] incentives for [companies] to engage in robust compliance."[26] But this deterrence argument doesn't hold water.

In order for class actions to deter wrongdoing, parties must fear that they will be subject to class action liability if they act wrongfully. But plaintiffs' lawyers don't choose which class actions to bring based on the merits of the underlying claims; rather, they simply look for *any* claims that can withstand a motion to dismiss and satisfy the standards for class certification. These lawyers know that, as Justice Ruth Bader Ginsburg has observed, once a class is certified, the "potentially ruinous liability" facing a defendant "places pressure on the defendant to settle even unmeritorious claims."[27] In any case where class certification is granted, the rational thing for a defendant to do is settle rather than risk going to trial, even if it has done nothing wrong; as one appellate judge has put it, class certification "is, in effect, the whole case."[28] The Bureau's

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

25 *See Chamber Comment II* at 31-36 (collecting arbitration agreements).

26 CFPB Proposal at 15.

27 *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 445 n.3 (2010) (Ginsburg, J., dissenting) (internal quotation marks omitted).

28 Hon. Diane Wood, Circuit Judge, Remarks at the FTC Workshop: Protecting Consumer Interests in Class Actions (Sept. 13–14, 2004), in *Panel 2: Tools for Ensuring that Settlements are "Fair, Reasonable, and Adequate,"* 18 Geo. J. Legal Ethics 1197, 1213 (2005).

own findings back up this analysis: the Bureau found that classwide judgments for plaintiffs on the merits after a trial are virtually unheard of, occurring in "less than 1% of cases."[29]

Because the threat of class action liability is a function of who plaintiffs' lawyers sue, rather than of whether a business who has engaged in actual wrongdoing, class actions cannot—and do not—generally deter wrongful conduct. On the contrary, even law-abiding businesses must treat class actions as an inevitable cost of doing business.

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.

C. *Government enforcement plays a significant role in protecting consumers.*

Companies *are* likely, however, to be deterred by the threat of government enforcement action. That is especially the case in light of the enhanced government enforcement capabilities in the consumer financial protection space. Not only are the monetary penalties higher, 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.[30]

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, government enforcement plays a significant role in protecting consumers. That role is likely to increase substantially given the Bureau's supervision and enforcement authority.

The Bureau's study provides zero support for class action proponents' common claim that class actions play an important role in supplementing government enforcement efforts. The Bureau found, for example, that most government enforcement is independent of private lawsuits. Less than 9% of government enforcement actions were preceded by a private class action.[31]

For cases in which there was no government enforcement action (6%), the study does not indicate how much consumers actually received under class action settlements. (It only provides "gross" numbers.) It is therefore impossible to determine whether these settlements actually provided meaningful consumer benefits. It is also impossible to determine what amount of these settlements companies actually paid out – the amount that would be relevant if, contrary to the evidence, companies were deterred by the prospect of settling class actions brought by entrepreneurial plaintiffs' lawyers.

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[29] *CFPB Study* at section 6, page 37.

[30] *Id.* at section 9, page 12.

[31] *Id.* at section 9, page 14.

Most importantly, the study period ended in 2012, and therefore ***entirely fails to take account of the effect of the Bureau's own fully functioning enforcement and supervision programs***. In the year ending December 31, 2012, the Bureau was a party to 9 enforcement actions.[32] In the year ending September 30, 2014, there were 41 public enforcement actions.[33] And the Bureau has used its supervisory authority to conduct hundreds of examinations.[34] 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 450,000 of these complaints, with 98% of consumers receiving a timely response***.[35]

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.

Moreover, the Bureau is likely to focus on the precise types of 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. The Bureau's enforcement powers therefore provide an additional, significant factor why the threat of class actions is irrelevant to deterring wrongful conduct in this context.

D. *The Bureau's study does little to evaluate—or even describe—the procedures available in arbitration that afford consumers with fair, faster, and less expensive dispute resolution compared with litigation.*

The Bureau's own study reveals that—especially in contrast to class action litigation—arbitration provides consumers with effective procedures that enable them to obtain relief on claims that would be impractical to pursue in court.

The reasons that consumers cannot pursue most of their potential claims in court are (1) the claims are too small to attract a lawyer (typically more than $50,000 must be at issue in order to do so), and (2) the claims are too individualized to be addressed in a class action.

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32 *Semi-Annual Report of the CFPB*, March 2013, at 66, *available at* http://files.consumerfinance.gov/f/201303_CFPB_SemiAnnualReport_March2013.pdf.

33 *Semi-Annual Report of the CFPB*, Fall 2014, at 103, *available at* http://files.consumerfinance.gov/f/201412_cfpb_semi-annual-report-fall-2014.pdf.

34 *CFPB Supervisory Highlights*, Spring 2014, at 5, *available at* 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.").

35 Berger, *supra* note 19.

Consumers who use arbitration get decisions on the merits more frequently and more quickly than they would in court. Consumers win at least as often, if not more often, than they do in court.[36] And companies pay most of the fees associated with arbitration.[37]

The Bureau made no serious effort to examine the benefits of arbitration because it did not make any qualitative effort to assess how arbitration's procedures work and whether those procedures would facilitate the ability of consumers to bring claims.

But even the narrow examination of arbitration that the Bureau *did* undertake confirms arbitration's advantages:

- ***More of consumers' affirmative claims were decided on the merits***: 24% in arbitrations, compared to less than 8% in litigation (and all but three of those were default judgments).[38] The success rate for consumers was even higher—27.2%—in the subset of arbitrations where the consumer brought affirmative claims but did not dispute any alleged debts.[39]

- In arbitrations resolved by arbitrators involving affirmative claims by consumers where data on the amount of the award was available, consumers received relief on 32 claims on the merits; the average payment to consumers was $5,389, and the median amount was $2,682.[40] Those awards are ***significantly greater than the relief to claimants in class action settlements***.

- The one reported court award was $4,925; the average settlement was $2,128; and the median amount was $1,001. Those consumers who were able to use arbitration to obtain a merits decision did much better.

- ***Consumers did better <u>without</u> a lawyer than with one***: as two prominent scholars at George Mason University explain in a critique of the Bureau's study, the Bureau's data showed that "self-represented plaintiffs were seven times more likely than represented plaintiffs to get an AAA arbitrator's decision in their favor." That finding, they conclude,

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36 *Compare* Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 898 (2010) (studying claims filed with the American Arbitration Association and concluding that consumers win relief 53.3% of the time), *with* 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).

37 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, 802 (2003) (finding that lower-income employees "paid no forum fees" in 61% of the cases studied; employees also paid no attorney's fees in 32% of the cases).

38 *See id.* at section 6, pages 48-49.

39 *Id.* at section 5, page 39.

40 *Id.* at section 5, page 41.

suggests that in arbitration, "hiring an attorney offers little value to a consumer and is often unnecessary."[41]

To the extent the Bureau does discuss the terms of arbitration agreements, it presents a false and misleading picture of the arbitral process.

The Bureau recites various provisions of certain arbitration agreements—for example, provisions that bar punitive or consequential damages, limit the time period for filing claims, or require hearings in particular locations, or permit a company to recovery attorneys' fees whenever it prevails.[42] But the Bureau fails to explain that courts have routinely and consistently invalidated such provisions on state-law unconscionability grounds—a point that the Chamber has made fully clear to the Bureau.[43] That omission is an obvious attempt by the Bureau to create the patently erroneous impression that such provisions are being applied in practice simply because they are included in the terms of some arbitration agreements.

Even more troubling, the Bureau simply failed even to mention—much less analyze—the extent to which arbitration creates incentives for companies to settle individual claims or disputes even before the filing of a formal arbitration proceeding. Because businesses subsidize most or all of the costs of arbitration—under AAA consumer rules, for example, a business must cover at least $1500 in filing fees[44]—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 lacking in court, where the cost burden falls on the consumer.

In addition, many arbitration agreements create significant incentives to settle claims before arbitration begins, such as through arbitration provisions that—like the provision at issue in *AT&T Mobility v. Concepcion*—contain potential 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 of less than the bonus figure—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.

The Supreme Court explained in *Concepcion* that the consumers' claim in that case was "most unlikely to go unresolved" because the arbitration 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."[45] And this self-imposed incentive to settle occurs not just at the stages of a formally commenced arbitration or the pre-

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41 Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique* 26 (Mercatus Ctr., George Mason Univ., Working Paper, Aug. 2015), *available at* http://www.law.gmu.edu/assets/files/publications/working_papers/LS1507.pdf.

42 *Id.* at section 2, pages 45-64.

43 *Chamber Comment II* at 23-28.

44 AAA Consumer Arbitration Rules at 34, *available at* https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&.

45 *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, 1753 (2011).

arbitration negotiation period. Instead, large numbers of AT&T customers have their concerns resolved at a much earlier point by calling or e-mailing AT&T's customer care department, which is remarkably effective: the record in *Concepcion* indicated that AT&T representatives awarded more than $1.3 billion in compensation to customers during a single twelve-month period in response to customer concerns and complaints.

The Supreme Court, and other courts, have found that provisions like these give companies a very significant incentive to settle even marginally meritorious claims on terms favorable to claimants—in order to avoid the downside risk of losing and having to pay the bonus amount.[46] That confers an important benefit not available in litigation, and one that cannot be quantified by looking at the results of arbitration proceedings. But the Bureau failed to examine the issue.

The Bureau also failed to examine how a well-functioning arbitration system works in practice. For example, the Bureau could have—but did not—study the arbitration system for the Kaiser Foundation Health Plan in California, which has more than seven million members. The Kaiser arbitration system gets high marks from health plan 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.[47] It also could have studied the use of arbitration in the securities industry.[48] ***It did neither.***

The CFPB's December 2013 preliminary results of its arbitration study—attached as the Appendix A to the CFPB's report—suggest that few individuals bring small dollar claims in arbitration.[49] But for several reasons, the number of formal claims filed by consumers in arbitration and in court says nothing about the accessibility and fairness of the two methods of dispute resolution.

First, consumers' claims are often resolved before the filing of a formal arbitration proceeding. 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

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46 *See id.*; *see also Coneff v. AT&T Corp.*, 673 F.3d 1155, 1159 (9th Cir. 2012) (noting that 'the *Concepcion* Court [had] examined this very arbitration agreement' and concluded 'that aggrieved customers who filed claims would be essentially guaranteed to be made whole'" because "the arbitration agreement [at issue] has a number of fee-shifting and otherwise pro-consumer provisions") (quoting *Cruz v. Cingular Wireless*, 648 F.3d 1205, 1215 (11th Cir. 2011) (citing *Concepcion*, 131 S. Ct. at 1753)).

47 *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, *available at* http://www.oia-kaiserarb.com/pdfs/2014-Annual-Report.pdf.

48 Fin. Indus. Regulatory Auth., *Dispute Resolution Statistics* (April 2015), *available at* https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics (noting that customer was awarded damages in 39 to 47 percent of customer claimant cases decided in arbitration over last five years, and that in 2013 "approximately 77 percent of customer claimant [arbitration] cases resulted, through settlements or awards, in monetary or non-monetary recovery for the investor").

49 *CFPB Study* at Appendix A, pages 76-82.

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. As the George Mason professors 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."[50]

Indeed, the George Mason scholars found that at one bank they examined, consumers who sought voluntary refunds from the bank successfully obtained them 68% of the time.[51] 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."[52]

Even when internal dispute resolution mechanisms fail and consumers do file for arbitration, there are significant incentives for businesses to settle claims before arbitration begins. As explained above (at pages 11-12), businesses subsidize most or all of the costs of arbitration, and many have adopted arbitration agreements that provide for potential bonus payments to customers who do better in arbitration than a company's last settlement offer. Significantly, a great many arbitration provisions require the company involved to pay all or nearly all of the arbitration costs, and many of the provisions include bonus provisions. Those agreements provide a very powerful incentive for pre-arbitration settlement of any non-frivolous consumer claim of $5,000 or less.

Second, a concerted campaign to invalidate arbitration agreements was underway for the period studied by the Bureau. Plaintiffs' lawyers vigorously resisted arbitration (with success in certain "magnet" jurisdictions for class actions) before *Concepcion*. And after the Supreme Court held in *Concepcion* that class waivers in arbitration agreements are enforceable, the plaintiffs' bar has 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.

Third, the Bureau examined the records of just one arbitration provider, the American Arbitration Association (AAA), ignoring the other arbitral forums open to consumers. In particular, 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***.[53] By focusing solely on the AAA, the Bureau failed to capture a significant portion of the arbitrations that happen today.

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50 Johnston & Zywicki, *supra* note 41, at 30.

51 *Id.* at 38.

52 *Id.*

53 *See* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0019 (Modria comment submitted to CFPB June 19, 2012).

Finally, the focus on "small-value" claims presents a misleading picture of arbitration. The Bureau arbitrarily reported the incidence of claims involving $1,000 or less and then concludes that few consumers arbitrate small claims.[54] But that definition is odd, given that—based on information compiled by the CFPB's own December 2013 preliminary results—most state small-claims courts permit the assertion of claims of up to $10,000.[55]

Hopefully, the Bureau did not adopt this overly narrow definition in order to be able to assert, erroneously, that consumers do not use arbitration for small claims. In addition, of course, this analysis ignores entirely the fact, discussed above, that the terms of a growing number of arbitration agreements provide a very substantial incentive for the pre-arbitration settlement of such claims.

In sum, the Bureau's examination of how arbitration works is patently inadequate, and will undermine the validity of any regulations that the Bureau might attempt to promulgate.

E. *The Bureau's survey of consumers reveals only that consumers do not focus on dispute resolution when choosing among consumer financial products and services.*

The Bureau's study 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 regulation of arbitration is "in the public interest and for the protection of consumers."[56]

That is because the Bureau refused to obtain information about consumers' baseline level of knowledge of other key provisions of their card agreements.[57] Without that comparative baseline, the Bureau cannot determine whether consumers pay greater, less, or the

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54 *CFPB Study* at Appendix A, page 14.

55 *Id.* at Appendix A, pages 160-61.

56 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 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, and Yuxiang Liu, *"Whimsy Little Contracts" With Unexpected Consequences: An Empirical Analysis of Respondent Understanding of Arbitration Agreements* (Oct. 29, 2014), *available at* http://ssrn.com/abstract=2516432).

57 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), *available at* 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.

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.

Indeed, the approach taken by the Bureau in constructing the survey unfortunately suggests that the Bureau's analysis is results-oriented. Any neutral evaluation of credit card agreements would have not just inquired about dispute resolution provisions but also about other provisions as comparators (such as whether consumers recalled the interest rate or credit limit). Why didn't the Bureau ask such a basic question? In the absence of an explanation from the Bureau, observers are left to conclude that obtaining such information would not serve the Bureau's pre-ordained goals. If consumers do recall their interest rates and credit limits, that result would confirm that dispute resolution is not as salient as other terms (like the price of credit); and if they did not, that response would indicate that consumers simply don't recall any of the elements of the credit card deal once they have entered into it, even those that are undoubtedly important to their decision. Either way, the irrelevance of the Bureau's survey approach would have been confirmed.

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 a list of nine elements, dispute resolution was the least-selected choice.

That finding is entirely unsurprising. As we have seen, businesses have a strong incentive to resolve consumer disputes internally in order to keep consumers' business. Thus, as the 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 *need* to know anything about" whether their agreement with a company provides for arbitration or litigation.[58]

F. *Arbitration clauses lead to lower prices for consumers.*

It cannot be debated that litigation in court—especially class-action litigation—imposes substantial transaction costs on businesses. Because arbitration offers a less-expensive forum for the resolution of disputes, it should reduce the transaction costs that businesses bear in the judicial system, and basic economic principles teach that some portion of those cost savings will be passed along to consumers.[59]

Here's how Professor Stephen Ware explains this phenomenon:

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[58] Johnston & Zywicki, *supra* note 41, at 30, 32.

[59] *See Chamber Comment II* at 37-38, 54-55.

- "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."[60]

The Bureau's analysis of whether consumers experience cost savings from arbitration is "inconsistent with basic economics," because it claims that cost savings are absent.

The report does include caveats that would allow a careful reader to understand that, in fact, the Bureau's analysis is of little value. Unfortunately, the Bureau failed to highlight those cautions. That said, the Bureau acknowledges that:

- "[t]he assertion that pre-dispute arbitration clauses generate cost savings, in itself, is difficult to test and has not been established or disproved";

- "[w]hether such savings, to the extent they exist, are passed along to consumers is even more difficult to establish or disprove";

- "[i]mportantly, even a correlation between the use of pre-dispute arbitration clauses and price levels should not be construed as a casual relationship between the two, absent additional information." [61]

Despite these acknowledgments—which should have caused the Bureau to undertake a robust analysis rather than a rushed one—the Bureau proceeded to focus on the implications of one particular lawsuit (*Ross v. Bank of America*) in which some settling credit card issuers agreed not to use arbitration for a 3-½ year period.[62] The question the Bureau asked is "whether it can find 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."[63]

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60 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)).

61 *CFPB Study* at section 10, page 5.

62 *Id.* at section 10, pages 6 & n.14 (citing *Ross v. Bank of America*, No. 05-cv-7116 (S.D.N.Y.)).

63 *Id.* at section 10, pages 5-6.

But as the Bureau acknowledges (in a footnote), "the result" of its analysis "has limitations."[64] That is a serious understatement. To begin with, while the study uses the language of scientific analysis—describing the settling credit card issuers as a "treatment group" and other issuers as a "control group"—the Bureau states that the "control group" "may or may not have used pre-dispute arbitration provisions" at all.[65] To be blunt, the Bureau is saying "there was no control group."[66]

Next, the Bureau was incorrect to assume that issuers who agreed to the arbitration moratorium would definitely raise prices if arbitration had produced cost savings for them. As the George Mason scholars explained in their critique of the Bureau's study, "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."[67]

Finally, and most troubling of all, the Bureau's report never assesses 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 apparent that there were virtually no cost savings to be had because of the state of the law during that time. 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.[68] 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*[69] in late April 2011—*i.e.*, when arbitration clauses were routinely not being enforced in magnet jurisdictions for consumer class actions (including California, New Jersey, Illinois, 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 place downward pressure on the price of credit (although other types of regulation, including by the CFPB, have placed upward pressure on those prices). But the Bureau's study asks the wrong question by focusing on a time frame

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64 *Id.* at section 10, page 8.

65 *Id.* at section 10, page 8.

66 Bizarrely, the report does 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 seems doubtful.

67 Johnston & Zywicki, *supra* note 41, at 34 (emphasis added).

68 *CFPB Study* at section 10, page 9.

69 131 S. Ct. 1740 (2011).

when no reasonable person would contend that arbitration agreements were being enforced with the regularity needed to lead to reduced transaction costs.

Unlike the retrospective analysis the Bureau undertook focusing on the wrong time frame, the real question, as a matter of public policy, is whether the elimination of pre-dispute arbitration in consumer financial service contracts 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 answer to that question seems 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*, rather than better off.[70]

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70 Berger, *supra* note 19.