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BUSINESS LAW TODAY

# The CFPB Proposed Arbitration Ban, the Rule, the Data, and Some Considerations for Change

By Ramona L. Lampley

Predispute consumer arbitration has sparked energetic debate and sharp divides over the utility of the class action versus the utility of individual arbitration. Thus far, the U.S. Supreme Court's jurisprudence has given a "thumbs up" approach to predispute consumer arbitration waivers, which almost always include a class waiver agreement. In *AT&T Mobility LLC v. Concepcion*, 563 U. S. 333, 347–48 (2011), the Supreme Court implicitly approved predispute class-action waivers, when it held that the Federal Arbitration Act (FAA) preempted California state law, which tended to hold such agreements unconscionable in consumer cases. Then in *American Express Company v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2309 (2013), the Court rejected the argument that aggregate, or class litigation, is necessary to preserve the opportunity to vindicate low-value, statutory claims. Congress showed little interest in amending the FAA, even for consumer cases. It seemed that consumer arbitration was the "wild west" of the law, in that it was largely unregulated and could direct claims to the black hole of private dispute resolution.

### The CFPB Proposes an Arbitration Prohibition

But then entered the Consumer Financial Protection Bureau (CFPB). In May 2016, the CFPB issued a proposed rule prohibiting predispute arbitration agreements in providing consumer financial services products. This rule would prohibit mandatory predispute arbitration agreements in consumer agreements for items such as checking or savings accounts, credit cards, student loans, payday loans, automobile leases, debt management services, some payment processing services, other types of consumer loans, prepaid cards, and consumer debt collection. The rule would also prohibit predispute arbitration agreements in connection with providing a consumer report or credit score to a consumer or referring applicants to creditors to whom requests for credit may be made.

Ironically, the CFPB chose to exclude the federal government, its affiliates, and state governments when providing consumer financial products or services, permitting the government to enter into private arbitration class waivers, whereas private industry cannot. The rule includes other exclusions, such as for brokers under the Securities and Exchange Commission (SEC).

The proposed rule prohibits covered providers from "rely[ing] in any way on a predispute arbitration agreement" in connection with "any aspect of a class action that is related to any of the consumer financial services or products" covered by the rule after the final rule's effective date. The prohibition does not apply if the presiding court has ruled that the case may not proceed as a class action and the time for interlocutory appellate review has passed.

For consumer arbitration agreements entered into after the effective date, the proposed rule requires the following arbitration agreement language: "We agree that neither we nor anyone else will use this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action even if you do not file it."

The effective compliance date will be 211 days after publication of the final rule in the Federal Register. The Dodd-Frank Act requires that any proposed rule apply only to agreements entered into 180 days

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after the rule's effective date, which is proposed as 30 days.

The proposed rule also provides for certain reporting requirements of arbitration results to the CFPB for any consumer arbitration that does occur, presumably when the consumer elects to choose arbitration over class actions. The provider must report the initial claim and counterclaim, the arbitration agreement, the judgment or award, if any, and any communication received from an arbitrator or arbitral service regarding a provider's failure to pay required fees or a finding that the arbitration agreement is out of compliance with the arbitral service's fairness principles or due process rules.

In support of the rule, CFPB Director Cordray touted the benefits of the class action for consumers, claiming that consumer financial services "group lawsuits delivered, on average, about $220 million in payments to 6.8 million consumers per year." But the CFPB's decision to require class resolution as superior dispute resolution vehicle to individual arbitration is not necessarily supported by the findings of the CFPB's empirical arbitration study. Why are the study results so important? The Dodd-Frank Act delegates rulemaking authority on arbitration in consumer financial products and services to the CFPB, but any rules promulgated "*must be consistent with the* [arbitration] *study*." 12 U.S.C. § 5518(b) (emphasis added).

### The CFPB Ban on Class Arbitration Waivers—What's Happening Now

As noted above, the CFPB published the proposed rule banning the use of class arbitration waivers in May 2016. The notice-and-comment period ended August 22, 2016. The CFPB was flooded with nearly 13,000 comments on the proposed rule, both in favor of the rule and against it. A number of consumer financial services representatives stated that the CFPB's rule will effectively end the viability of consumer arbitration. Put simply, without the "carrot" of a class arbitration waiver, a company has no incentive to offer, much less to cover the costs of, individual consumer arbitration.

Prior to the presidential election, most folks thought the CFPB would publish the proposed rule rather quickly. Even after the election, many predicted that the CFPB would publish the final rule banning class waivers in consumer arbitration agreements before President Trump's inauguration. As of the date of this article, the CFPB's fall 2016 regulatory agenda identifies February 2017 as the target date for publication of the final arbitration rule. But surprisingly, the CFPB has not published a final rule yet.

There are a number of reasons the CFPB may delay publishing the final rule. First, one might expect any rule so blatantly antibusiness to draw the attention of President Trump, which could cause a flutter of tweets or other social media ire.

Second, the CFPB's previously impervious structure is now in question. In October 2016, the U.S. Court of Appeals for the District of Columbia in *PHH Corp. v. Consumer Financial Protection Bureau*, 839 F.3d 1, 8–9 (D.C. Cir. Oct. 11, 2016), declared the directorship of the CFPB, set up to be unaccountable to the executive, unconstitutional. The D.C. Circuit analyzed the enormous power this single-director structure gave the CFPB:

> The CFPB's concentration of enormous executive power in a single, unaccountable, unchecked Director not only departs from settled historical practice, but also poses a far greater risk of arbitrary decision-making and abuse of power, and a far greater threat to individual liberty, than does a multi-member independent agency.
>
> . . .
>
> This new agency, the CFPB, lacks that critical check and structural constitutional protection, yet wields vast power over the U.S. economy. So "this wolf comes as a wolf."

*Id.* at *4 (quoting *Morrison v. Olson*, 487 U.S. 654, 699 (1988) (Scalia, J. dissenting)). The D.C. Circuit chose to remedy the CFPB's structural flaw not by shutting down the CFPB, but by electing the narrower remedy of severing the "for-cause" director removal provision, making the CFPB director removable at the will of the president. The ramifications of this decision certainly affect the CFPB's unwieldy power, but the extent of that weakening remains to be seen.

The D.C. Circuit granted the CFPB's petition for rehearing en banc and vacated the panel's opinion on February 16, 2017. The en banc court hearing will be held on May 24, 2017. This opinion will likely have a large effect on the scope of the CFPB, and current Director Cordray's authority under this new administration. Even if the CFPB goes forward with the final rule, it is likely that it will face a slew of litigation from industry advocates who support consumer arbitration, which may deteriorate the effectiveness of the rule.

In the interim, to the extent the CFPB is reconsidering the effectiveness of this watershed anti-arbitration rule, it could revise the rule to still permit consumer arbitration to develop, but under a regulatory regime that is more pro-consumer. The CFPB arbitration study shows some defects in consumer arbitration in its current form, but it also highlights some major deficits in consumer class actions.

### The CFPB Arbitration Study: What is Working In Consumer Arbitration, What is Not

In 2015, the CFPB finished its multiyear study of consumer financial arbitration before the American Arbitration Association (AAA) and of class actions based on consumer financial services. Although the CFPB states that the study shows "that class actions provide a more effective means for consumers to challenge problematic practices" by financial services companies, the results are not quite so conclusive. The Arbitration Report showed:

- Over the three-year period of 2010–2012, consumers filed an average of 411 claims for arbitration in consumer financial services products. This is abysmally low.
- Of the 1,060 arbitration filings studied, about 60 percent settled or ended in a manner consistent with settlement. Only

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32 percent were resolved on the merits. This settlement figure suggests that some sort of resolution is being achieved prior to a merits decision in consumer arbitration.

- Consumers had access to attorneys. Counsel represented consumers in nearly 60 percent of the cases. Companies, of course, nearly always had counsel.
- It appears that attorneys with arbitration experience are representing these consumers. Repeat player attorneys represented consumers in 50 percent of filings across all consumer financial services product markets. Forty-five percent of those filings were by "heavy" consumer repeat players, meaning the attorney appeared in four of more arbitration disputes in the three-year study period. For student loan disputes, heavy repeat player law firms represented 93 percent of consumers.
- Dispute resolution is not a primary concern for consumer choice. When asked about factors that are important in selecting a credit card, no consumer raised dispute resolution. When asked, in a telephone survey, what one would do if a credit card company charged an improper fee, most respondents commonsensically answered he or she would cancel the credit card. Less than 2 percent mentioned seeking legal advice or suing, but 10 percent said they would refer the issue to a governmental agency.

What does this information tell us about consumer arbitration? Well, first it tells us that consumers are not pursuing consumer arbitration at all, which is troubling. Are consumers scared of arbitration? Unwary of the procedure? Cynical of recovery? Or are the arbitration fees still too high to make it worth pursuing? The AAA currently caps a consumer's fees in consumer arbitration at $200. The business portion of a consumer arbitration, regardless of who initiates it, is $1,700, plus an additional $750 arbitrator compensation fee. Some businesses agree to fully pay the costs of consumer arbitration in the arbitration agreement, and some "consumer-friendly" agreements even offer to pay a premium and/or attorneys' fees if the consumer receives an arbitral award that is greater than the business's last settlement offer. The Arbitration Study did not report on how often an arbitrator awards such "incentivizing premiums," but one would think their very presence encourages settlements.

The Arbitration Study also tells us that for the few consumer cases being pursued, consumers have access to attorney representation. The attorneys who tend to represent consumers in this dispute have developed a cottage niche, no doubt because they are familiar with the AAA Consumer Arbitration Rules and procedure. Finally, the settlement figures tell us that something useful is occurring in consumer arbitration. In some way, perhaps due to the business-side costs of consumer arbitration or incentivizing premiums, parties are likely reaching a settlement resolution prior to a merits decision.

The study also reported "win" rates for affirmative consumer claims and for business claims. Remember that only 32 percent of the cases filed resulted in an arbitrator decision on the merits, thus the sample size is very low. For claims brought by consumers that resulted in a decision on the merits, consumers "won" some kind of relief in about 20 percent of the cases (32/158). Businesses "won" relief in over 90 percent of the business-brought cases (227/244) that went to a merits decision, although some of the decisions were similar to a default judgment.

But one cannot make an assessment of arbitration by simply comparing consumer win rates to business win rates. As stated above, the sample size of merits decision was very small. More importantly, the study shows that most arbitration disputes resolved in a manner consistent with settlement. Additionally, differing incentives to assert claims can explain some of the difference in outcomes. If a business funds all or most of the dispute resolution process, consumers are incentivized to bring claims of questionable merit. Yet for the business which must pay all or most of the upfront costs ($1,700 per consumer claim under AAA rules), the incentive is to not bring (1) low value claims or (2) claims of questionable merit. Any comparative "win" rate of consumers to businesses would need to be compared to how consumers fare in *litigation*, not just how consumers fare compared to businesses, a point the Arbitration Study made.

### The CFPB Arbitration Study: What It Tells Us About Individual Consumer Recovery in Class Actions

The CFPB Consumer Arbitration Study also examined class action recovery in consumer financial class actions. Although the CFPB concluded, in proposing its arbitration class-waiver ban, that consumers are better off preserving the class action than waiving it, the study results do not support this conclusion. For example, the CFPB Arbitration Study found that approximately 60 percent of the consumer financial products class actions filed ended in a *non-class settlement* or *potential non-class settlement* (i.e., withdrawal or dismissal by the plaintiff). Only *12 percent* (69 cases) reached an approved class-action settlement. This means that only a very small portion of class actions filed resulted in any damages to the class-member consumer. Yet those class actions filed do result in a societal drain on judicial resources and corporate class action defense costs (which we would assume are passed on in one form or other to the consumer). Attorneys' fees awarded to counsel in class action settlements during the relevant time frame were $424 million, which is estimated at about 24 percent of total class payments and 16 percent of gross relief (proposed cash relief and in kind relief).

Second, the average claims rate (claims made as a percentage of eligible class members) was low, 21 percent, with an 8 percent median. Thus, even when consumers obtain a settlement through the class device, they usually do not take the administrative steps to obtain the payout. Finally, the CFPB study did not attempt to provide data on the average class member recovery for those 69 cases that reached class settlement or the difficulty of obtaining settlement proceeds. But even taking Directory Cor-

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dray's slogan of an average of "about $220 million in payments to 6.8 million consumers per year in consumer financial services cases," one could estimate this results in about $32.35 in recovery to the individual per year, that is, if he or she takes the time to read and fill out the cumbersome forms required for claims-made recovery. These statistics cause one to at least question the effectiveness of the class action for providing individual relief to the class members.

### The CFPB Could Take a More Moderate Approach to Facilitate Transparent and Free Consumer Arbitration

What should we make of the data provided above? First, it is premature to conclude that the class action is a more effective dispute resolution platform than individual arbitration. When only 12 percent of cases filed results in any class settlement, it suggests that there is a significant waste in the system. Second, we know arbitration is chilling consumer activity. The CFPB could confront this by providing more consumer education on arbitration and requiring more transparency. The CFPB could implement data-reporting requirements (similar, but more extensive than, those in the proposed rule for essentially post-dispute arbitration) that require reporting of the types of claims made, demand amounts, counterclaims and amounts, case resolutions, product types, and information about consumer representation.

The CFPB should require any consumer arbitration to be fully business-funded at no cost to the consumer. When a business faces transaction costs of nearly $2,000 per arbitration filed, repeat consumer filings will attract its attention. In addition, the CFPB could consider requiring that any consumer arbitration which results in a favorable consumer award on the merits should be awarded treble damages and attorneys' fees. This provision would include a sort of "built in" incentivizing provision. The goal of this provision is to encourage organically what we already see occurring, increased settlement of consumer disputes. Still further, the CFPB should require that any consumer arbitration award must result in a written statement of decision, which permits other consumers to know how the arbitrator applied the law to the facts of that case. This will facilitate consumer knowledge of potential corporate overreach (and encourage more recovery), and will also help aid the consumer in arbitrator selection. The CFPB has a number of measures it could take to regulate consumer arbitration to the benefit of the consumer, short of removing a potentially viable dispute resolution platform that could benefit the individual consumer.

### Conclusion

The CFPB's proposed anti-arbitration rule will have a wide effect on consumer financial services, and even potentially on other consumer arbitration agreements. But the CFPB's arbitration class-waiver ban is essentially an election of the class action to the expense of individual arbitration. This policy choice is premature and is not yet supported by the data. The abysmally low number of consumer arbitration filings is too low to make generic assessments regarding the efficacy of consumer arbitration. But it tells us consumers need to know more and have confidence to pursue their own low-value claims, or be aware that attorney assistance may be available. Even still, the image the Arbitration Study paints of class actions show that this vehicle is not providing satisfactory recovery to the individual class members. But requiring businesses to fully fund and incentivize consumer arbitration in a fair and transparent way could provide a vehicle for individualized low-cost consumer relief. Will there still be some *de minimis* claims that are not pursued on the individual level? Yes. But this tradeoff may be rational in the eyes of *the consumer* to preserve an essentially free dispute resolution platform for economically rational claims. The CFPB should take the time pending issuance of its final rule, under a new Executive Branch, to issue regulations that will make consumer arbitration more susceptible to empirical study, more transparent, and cost free for the consumer.

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