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CFPB's Proposed Arbitration Rule Benefits Class-Action Lawyers at the Expense of Consumers

by Alan S. Kaplinsky and Mark J. Levin

The Consumer Financial Protection Bureau (CFPB) is on the verge of setting a new legal standard for class-action waivers in consumer-arbitration agreements that directly contradicts US Supreme Court precedents.[1] CFPB's recently announced proposed rule on consumer-arbitration agreements[2] would prohibit financial-services providers from including such waivers in their account contracts. Although CFPB asserts that the proposed rule is necessary because class actions promote consumer welfare and the public good, CFPB's own empirical study of consumer-arbitration agreements that it completed just last year eviscerates those lofty contentions.[3]

Moreover, as CFPB itself admits, if the proposed rule becomes final, enormous financial burdens will be imposed on financial-services providers that presently utilize arbitration agreements, as well as on consumers themselves—the very group CFPB is charged with protecting. The only people who will benefit are the plaintiffs' class-action lawyers, who will garner hundreds of millions if not billions of dollars in additional attorneys' fees.

Background of the Proposed Arbitration Rule

In § 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Congress directed CFPB to study pre-dispute arbitration.[4] Section 1028 of the Dodd-Frank Act also authorized CFPB, after completing its study, to issue regulations restricting or prohibiting the use of arbitration agreements only if CFPB found that such rules would be "in the public interest and for the protection of consumers."[5] In addition, Congress required that the findings in any such rule be consistent with the results of CFPB's study.

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[1] *See American Express Co., Inc. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013); *AT&T Mobility, LLC v. Concepcion*, 131 S. Ct. 1740, 1753 (2011).

[2] *See* Consumer Financial Protection Bureau, Arbitration Agreements, Proposed Rule, 81 Fed. Reg. 32,830 (proposed May 24, 2016) (to be codified at 12 C.F.R. pt. 1040).

[3] *See* Consumer Financial Protection Bureau, Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) (Mar. 10, 2015), *available at* http://www.consumerfinance.gov/data-research/research-reports/arbitration-study-report-to-congress-2015/.

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.).

[5] *Ibid.*

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On March 10, 2015, CFPB published the study, and on May 24, 2016 it published the proposed arbitration rule in the Federal Register with a comment deadline of August 22, 2016.[6] If it becomes final, the proposed rule's requirements would apply beginning on the 211th day after publication of the final rule in the Federal Register.[7]

Overview of the Proposed Rule

The proposed rule would generally prohibit companies that offer consumer financial-services products from including arbitration clauses that block class-action lawsuits in their consumer financial-services contracts.[8] It would also require companies that choose to use arbitration clauses for individual disputes to submit the claims filed and awards issued to CFPB so that it can monitor the fairness of the arbitral process.[9]

The proposed rule would apply to any pre-dispute arbitration agreement "entered into" after the compliance date. The term "entered into" includes any circumstance in which a person agrees to undertake obligations or gains rights in an agreement.[10] If the contract containing the arbitration agreement was entered into before the compliance date, it would be grandfathered and may continue to be enforced after the compliance date. Grandfathered contracts, and the arbitration agreements within them, can be amended after the compliance date without triggering application of the proposed rule.[11] However, if the contract is amended to add a new covered product or service after the compliance date, disputes concerning the new product or service will be subject to the proposed rule.[12]

Financial Impacts of the Proposed Arbitration Rule on Consumers and the Public

The proposed arbitration rule is not in the public interest or for the protection of consumers because it would inflict extreme financial harm on financial-services providers, federal and state court systems, and consumers themselves. CFPB estimates that the proposed rule will cause 53,000 providers who currently utilize arbitration agreements to incur between *$2.62 billion and $5.23 billion* over a five-year period to deal with 6,042 additional federal and state court class actions that will be filed due to the proposed rule's elimination of class waivers.[13] Presumably, these statistics at a minimum will be repeated every five years, and the volume of class-action litigation is likely to increase even more over time as the effects of grandfathering dissipate. If the proposed rule becomes final, the public will be harmed by these additional class actions because the state and federal courts are already chronically underfunded and seriously overwhelmed with the existing case load.

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[6] Messrs. Kaplinsky and Levin assisted the American Bankers Association, the Consumer Bankers Association, and the Financial Services Roundtable in submitting comments, *available at* http://www.regulations.gov/document?D=CFPB-2016-0020-4294. [Ed. Note: Washington Legal Foundation also submitted comments to CFPB on the proposed rule, *available at* http://www.wlf.org/upload/litigation/misc/CFPBComments-ArbitrationofConsumerFinanceDisputes.pdf.]

[7] Section 1028(d) of the Dodd-Frank Act states that any arbitration regulation shall apply to agreements between a consumer and a covered person entered into after the end of the 180-day period beginning on the effective date of the regulation, as established by CFPB. CFPB proposes that the proposed rule establish an effective date of 30 days after publication of a final rule in the Federal Register. *See* 81 Fed. Reg. 32,831.

[8] *Id*. at 32,888-89.

[9] *Id.* at 32,893.

[10] *Id.* at 32,885.

[11] *Id.* at 32,928.

[12] *Id.* at 32,885.

[13] *Id.* at 32,907-09.

Moreover, consumers will be harmed substantially in at least three other ways. First, most of the putative class members in the 6,042 additional class actions will not benefit in any manner. CFPB's study found that 87% of the 562 class actions studied produced no benefits to the putative class members. Most class actions settle individually, leaving the putative class members to fend for themselves.[14] The plaintiffs' class-action lawyers alone benefitted in those cases from hundreds of millions of dollars in attorneys' fees.[15]

Even the 13% of class actions that settled on a class-wide basis produced only miniscule benefits to the settlement-class members. The average settlement-class member received a paltry $32.35 after waiting for two or more years.[16] In the class settlements that required the putative class members to submit a claim form, the weighted average claims rate was only 4%, meaning that 96% of the potentially eligible members failed to obtain any benefits because they did not submit claims.[17]

Second, the proposed rule will likely cause consumers with small claims that are not amenable to class-action treatment to abandon their claims altogether. Few consumers will be able to find a lawyer to handle a small non-classable claim, even small claims courts are a hassle, and many if not most companies will likely cease offering even individual arbitration programs if class-action waivers are prohibited. That is because the cost of defending class actions, when combined with the cost of subsidizing individual arbitrations, may lead companies to conclude that the cost of arbitration outweighs the benefits to be gained from providing consumers with an alternative-dispute-resolution forum.[18]

Third, if, as anticipated, most companies abandon their arbitration programs altogether due to the prohibition on class-action waivers, consumers will be deprived of the many proven benefits of individual arbitration. CFPB itself acknowledges that arbitrations "proceed relatively expeditiously [and] the cost to consumers of this mechanism is modest."

Moreover, consumers who prevail in arbitration may obtain "substantial individual awards" as "the average recovery … [in the arbitrations CFPB studied] was nearly $5,400."[19] CFPB's study showed that the average award to a prevailing consumer in arbitration was more than 166 times what individual class members recover on average in class settlements.[20] They received that award in 2-5 months,[21] instead of more than two years.[22] And, the costs to the consumer were minimal.[23]

Furthermore, none of the 562 class actions CFPB studied went to trial.[24] By contrast, the study found that of 341 cases resolved by an arbitrator, in-person hearings were held in 34% of the cases, and an arbitrator issued an award on the merits in about one-third of the cases.[25] Prior studies showed that consumers prefer

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[14] Study, § 1, pp. 13-14; § 6, p. 37.
[15] *Id.* at § 8, p. 33.
[16] *See id*. at § 5, pp. 13, 41; 81 Fed. Reg. 32,849 n. 305.
[17] Study, § 1, p. 17, § 8, p. 30.
[18] Under the American Arbitration Association (AAA) and JAMS consumer arbitration rules, companies pay the lion's share of the filing, administrative and arbitrator costs, which in an individual arbitration can exceed $3,000.00. The consumer's share of the costs is capped at $200.00 (AAA) or $250.00 (JAMS). Many companies, in their arbitration agreements, also agree to pay the consumer's share of the costs.
[19] 81 Fed. Reg. 32,855.
[20] Study, § 5, pp. 13, 41.
[21] *Id*. at § 1, p. 13.
[22] *Id.* at § 6, pp. 9, 43.
[23] *Id.* at § 1, p. 13; § 4, pp. 10-11; *see also* note 18 *supra*.
[24] Study, § 6, pp. 7, 38.
[25] *Id.* at § 5, pp. 11-12.

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arbitration to court litigation,[26] but CFPB (perhaps to avoid a similar outcome) refused to survey consumers who actually participated in an arbitration about their experiences with and attitudes toward arbitration.[27] Notably, CFPB urges its own employees to arbitrate their workplace disputes because it provides "faster and less contentious results" and preserves "confidentiality."[28]

CFPB's Policy Goals Do Not Require Class-Action Lawsuits

CFPB contends that class actions are necessary to provide a procedure for resolving small-dollar consumer claims, to address harms about which consumers are unaware, and to modify and regulate corporate behavior. However, CFPB's own data convincingly demonstrates that CFPB itself is far more effective and efficient than class actions in addressing such matters. Through 2015, CFPB has ordered companies to pay more than $11.4 billion to more than 25 million consumers.[29] Thus, CFPB's enforcement efforts have resulted in an average payment of $440 to each consumer, approximately 14 times the $32.35 cash payment received by the average putative class member. And, none of that consumer relief was siphoned off to pay attorneys' fees.

Conclusion

The proposed rule should not become final because it is not in the public interest, nor does it protect consumers. It is also inconsistent with CFPB's own empirical study of consumer arbitration. If the proposed rule does become final, the supposed beneficiaries of that rule—consumers—will be seriously and irrevocably harmed.

[26] *See, e.g.*, Harris Interactive, *Survey of Arbitration Participant*s (Apr. 2005), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf.
[27] Study, § 3, pp. 4-5 ("[w]e opted not to explore consumer satisfaction with arbitration (or litigation) proceedings.").
[28] *See* U.S. Government Accountability Office, Report to Congressional Requestors, *Consumer Financial Protection Bureau Additional Actions Needed to Support a Fair and Inclusive Workplace* ("GAO Report"), pp. 48-49 (May 2016).
[29] *See* http://www.consumerfinance.gov/.

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