FINAL REPORT

of the

Small Business Review Panel on the CFPB's Potential Rulemaking on Pre-Dispute Arbitration Agreements

December 11, 2015

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1. Introduction

Under the Regulatory Flexibility Act (RFA), the Consumer Financial Protection Bureau (Bureau) must convene and chair a Small Business Review Panel (Panel) when it is considering a proposed rule unless it has determined to exercise its discretion to certify that the rule would not have a significant economic impact on a substantial number of small entities.[1] The Panel considers the impact of the proposals under consideration by the Bureau and obtains feedback from representatives of small entities that would be subject to the rule. The Panel includes representatives from the Bureau, the Small Business Administration's (SBA) Office of Advocacy, and the Office of Information and Regulatory Affairs in the Office of Management and Budget (OMB).

This Panel Report addresses the Bureau's potential rulemaking on the use of mandatory pre-dispute arbitration agreements relating to consumer financial products and services. "Mandatory pre-dispute arbitration agreements" refers to agreements, or parts of agreements, that require future disputes between the parties to the agreement to be resolved by an arbitrator. (In this Report, we refer to such agreements more simply as "arbitration agreements.") The Bureau is not considering regulations that would apply to agreements to arbitrate after a dispute arises. *See* 12 U.S.C. 5518(c). The Bureau is considering a rulemaking because it is concerned that consumers cannot obtain remedies when they are harmed by providers of consumer financial products and services, because arbitration agreements effectively block consumers, in many situations, from participating in class proceedings. The Bureau is also concerned that by blocking class actions, arbitration agreements do not allow consumers to benefit from the deterrent effect of class actions. Finally, the Bureau is concerned about the potential for consumer harm if arbitration agreements were to be administered in biased or unfair ways. Accordingly, the Bureau is considering proposals that would (1) prohibit the application of arbitration agreements as to class litigation and (2) require submission of arbitral claims and awards to the Bureau and, potentially, also provide for publication of those disputes and awards on the Bureau's website. A rulemaking concerning arbitration agreements would be pursuant to the Bureau's authority under section 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which directs the Bureau to study arbitration agreements in connection with the offering or providing of consumer financial products or services and authorizes the Bureau to regulate their use if the Bureau finds that certain conditions are met.[2]

In accordance with the RFA, the Panel conducted its review at a preliminary stage of the Bureau's rulemaking process. The Panel's findings and discussion here are based on information available at the time this Panel Report was prepared and therefore may not reflect the final findings of the Bureau to the extent that it decides to produce a proposed rule. To the extent that the Bureau proceeds in the rulemaking process, including taking actions responsive to the feedback received from small entity representatives (SERs) and the findings of this Panel, the agency may conduct additional analyses and obtain additional information.

[1] 5 U.S.C. 609(b).

[2] 12 U.S.C. 5518(b).

This Panel Report reflects feedback provided by the SERs and identifies potential ways for the Bureau to shape the proposals under consideration to minimize the burden of the rule on small entities while achieving the purpose of the rulemaking. Options identified by the Panel for reducing the regulatory impact on small entities of the present rulemaking may require further consideration, information collection, and analysis by the Bureau to ensure that the options are practicable, enforceable, and consistent with the Dodd-Frank Act.

The Bureau will consider the Panel's findings when preparing any Notice of Proposed Rulemaking. This Panel Report will be included in the public record for any Bureau rulemaking on pre-dispute arbitration agreements in contracts for consumer financial products and services. This report includes the following:

a. A description of the proposals that are being considered by the Bureau and that were reviewed by the Panel;
b. Background information on small entities that would be subject to those proposals and on the particular SERs selected to advise the Panel;
c. A discussion of the comments and recommendations made by the SERs; and
d. A discussion of the findings of the Panel.

In particular, the Panel's findings address the following:

a. A description of and, where feasible, an estimate of the number of small entities impacted by the proposals under consideration;
b. A description of projected compliance requirements of all aspects of the proposals under consideration;
c. A description of alternatives to the proposals under consideration which may accomplish the stated objectives of the Bureau's rulemaking and which may minimize any significant economic impact on small entities of the proposals under consideration; and
d. A list, to the extent practicable, of all relevant Federal rules which may duplicate, overlap or conflict with the proposals under consideration.

2. Background

2.1 Background on the Use of Arbitration to Resolve Consumer Disputes

Arbitration agreements were originally used primarily between companies that bargained with each other to create tailored contracts. Early on, courts were often hostile to such arrangements. As a result, in 1925 Congress passed what is now known as the Federal Arbitration Act (FAA) to require that, subject to limited exceptions, courts enforce parties' agreements to arbitrate disputes that may arise between them.[3] Today, arbitration agreements are often used in standard-form contracts where both parties do not have equal bargaining power, such as in contracts between companies and their employees, investors, or consumers. These agreements have spread rapidly in the last few decades, and their use has become a contentious legal and policy issue.

[3] 9 U.S.C. 1 through 16.

In recent years, courts have focused on various legal issues raised by the use of arbitration agreements in standard-form contracts. One issue is whether arbitration agreements that ban class proceedings in arbitration should be enforced given that they effectively allow companies to shield themselves from all class proceedings. Such arbitration agreements do so because companies sued in a class case in court can use an arbitration agreement to seek dismissal of the court case in favor of an arbitration in which no class proceedings are permitted. Before 2011, lower courts were divided on whether arbitration agreements that bar class proceedings were unenforceable because they violated some states' laws. In 2011, in *AT&T Mobility LLC v. Concepcion*, the Supreme Court held that the FAA preempted California state law that would have prohibited the enforcement of an arbitration agreement barring class proceedings in a consumer case.[4]

2.2 Statutory Authority

Section 1028(a) of the Dodd-Frank Act required the Bureau to study "the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services." Section 1028(b) gives the Bureau the authority to regulate their use provided that certain conditions are met:

> The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).

Section 1028(d) of the Dodd-Frank Act further provides that "any regulation prescribed by the Bureau under subsection (b) shall apply, consistent with the terms of the regulation, to any agreement 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 the Bureau."

Having completed the Study required by section 1028(a), the Bureau is considering regulatory proposals to limit the use of arbitration agreements in certain contracts for consumer financial products or services.

2.3 The Bureau's Study of Arbitration Agreements

As noted above, section 1028(a) of the Dodd-Frank Act required the Bureau to study the use of arbitration agreements in connection with consumer financial products or services. The Bureau released Preliminary Results of its study on December 12, 2013.[5] After completing additional work and analysis, the Bureau released its *Arbitration Study: Report to Congress*,

[4] 131 S. Ct. 1740 (2011).

[5] Consumer Financial Protection Bureau, *Arbitration Study Preliminary Results* (Dec. 12, 2013) ("Preliminary Results"), *available at* http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf.

pursuant to section 1028(a) of the Dodd-Frank Act (Study) on March 10, 2015.[6] Among other things, the Study used a detailed analysis of empirical evidence, including consumer contracts and court data, to describe how individual and aggregated disputes between consumers and consumer finance companies have been resolved both in arbitration and in the courts. The comprehensive Study was comprised of nine separate sections addressing:

- The prevalence of arbitration agreements in certain consumer financial product markets;
- Consumers' knowledge and understanding of arbitration and other dispute resolution mechanisms as reflected by a national survey of credit card users;
- The different procedural rules applicable in consumer arbitration and select courts;
- A review of consumer financial disputes filed with the American Arbitration Association by consumers and/or companies;
- A review of individual consumer financial claims filed in federal court and of class consumer financial claims filed in federal and certain state courts;
- A review of filings in small claims courts by consumers and companies in the credit card marketplace;
- A review of the terms of consumer financial class settlements in federal court;
- A review of data on how public enforcement actions and private class actions overlap with respect to disputes about consumer and consumer financial products; and
- A review of data on the relationship between pre-dispute arbitration clauses in consumer credit card contracts and the price and availability of consumer credit card products.

The Outline of Proposals Under Consideration (Outline), included as Appendix C to this Report, describes the Study's key findings as they relate to the proposals under consideration for the SBREFA Panel. In brief, those findings include that tens of millions of consumers use financial products that are subject to arbitration agreements and that few consumers file formal claims against providers of consumer financial products or services, whether in small claims court, arbitration, or federal court. In contrast to the relatively few individually-filed claims and resulting small aggregate relief for consumers, the Study found evidence that class litigation provides a potential means of securing relief for a much larger number of consumers.

Based in part on these findings, the primary proposal under consideration would prohibit the use of arbitration agreements that block consumers' participation in class litigation. The other proposal under consideration would allow the Bureau to monitor individual consumer financial arbitration going forward because the Study was inconclusive as to the results of individual arbitration, in part because very few occur.

2.4 Related Federal Rules

Several other federal laws and regulations address the use of arbitration agreements. Notwithstanding the FAA, several federal rules limit the use of arbitration agreements in certain contracts. For example, since 1976, commodities merchants have been permitted to use arbitration agreements only when customers voluntarily agree to arbitrate disputes before they arise. These merchants must offer their products to consumers even when the consumer does not

[6] *Available at* http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

agree to pre-dispute arbitration.[7] Arbitration agreements that apply to class litigation have been prohibited in securities contracts between broker dealers and their customers since 1992.[8] The Military Lending Act and its implementing regulations, which were recently expanded by the Department of Defense to reach most forms of credit accessed by servicemembers and their families, prohibit arbitration agreements in consumer credit contracts with certain covered servicemembers or their dependents.[9]

In addition to providing the Bureau the authority to regulate the use of arbitration agreements in consumer financial contracts, the Dodd-Frank Act prohibited all arbitration agreements in consumer mortgages[10] and also authorized the Securities and Exchange Commission to regulate arbitration agreements in contracts between consumers and securities broker-dealers or investment advisers.[11] The Department of Health and Human Services also recently proposed regulations that would regulate the use of arbitration agreements in long-term care contracts with consumers.[12] Finally, the Federal Trade Commission also interprets federal law as prohibiting arbitration agreements in warranties for consumer products.[13]

3. Overview of Proposals and Alternatives under Consideration

The Bureau is considering two distinct proposals – one regarding class litigation and another regarding individual arbitration, as described more fully in the Outline.

3.1 Proposal to Prohibit the Use of Pre-Dispute Arbitration Agreements in Class Litigation

Under the proposals being considered by the Bureau, any arbitration agreement included in a contract for a consumer financial product or service offered by an entity subject to the proposals would be required to provide explicitly that it is inapplicable to cases filed in court on behalf of a class unless and until class certification is denied or the class claims are dismissed. As noted in the Outline, the Bureau expects that this proposal would include model or mandatory language that covered entities could include in their contracts to comply with a rule. The Bureau believes that this approach would prevent companies from using an arbitration agreement to support a motion to compel arbitration in a class case, at least until class certification is denied or the class claims are dismissed. This proposal seeks to address consumer harm that occurs when arbitration agreements block consumers from filing or participating in class litigation, which

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[7] 17 CFR 166.5(b)–(c), implementing 7 U.S.C. 21(b)(10)(A).

[8] Financial Industry Regulatory Authority (FINRA) Rule 2268(f).

[9] 10 U.S.C. 987, as implemented by 32 CFR 232.8(c).

[10] Dodd-Frank Act section 1414(a). That prohibition was implemented in Regulation Z by the Bureau's Loan Originator Compensation Rule. 12 CFR 1026.36(h).

[11] Dodd-Frank Act section 921.

[12] Centers for Medicare & Medicaid Services, Medicare and Medicaid Programs; Reform of Requirements for Long-Term Care Facilities; Proposed Rule, 80 FR 42168, 42264–65 (July 16, 2015) (proposing to require that arbitration agreements be explained in understandable language, acknowledged by the resident, provide for a convenient venue and a neutral arbiter, entered into on a voluntary basis, not be made a condition of admission, and not restrict or discourage communication with government authorities).

[13] 16 CFR 703.5(j); FTC Final Revised Interpretations, 80 FR 42710, 42718-20 (July 20, 2015).

decreases monetary and behavioral relief potentially available to consumers and reduces deterrent effects from class cases.

The Bureau evaluated an alternative approach that would afford providers of consumer financial services the discretion to use arbitration agreements preserving the consumer's access to class arbitration—*i.e.*, class proceedings conducted in arbitration instead of court—in lieu of class litigation, provided that such class arbitration proceedings satisfied minimum fairness standards. The Bureau did not present this as a proposal under consideration, however, because it is not confident that class arbitration is a reliable setting for aggregated resolution of consumer finance disputes, given that class arbitration has rarely been used to resolve such disputes. Further, the Bureau also believes that few, if any, companies would choose to adopt arbitration agreements that permit class arbitration rather than class litigation. The Bureau's belief is based on statements by industry groups that class litigation is preferable to class arbitration, as well as the prevalence in arbitration agreements of "anti-severability" provisions, which state that if a court concludes that the no-class arbitration provision is not enforceable, the entire arbitration agreement also should be deemed unenforceable to prevent a court or arbitrator from mandating class arbitration. Notwithstanding these concerns, the Bureau notes that the proposals under consideration would permit an arbitration agreement that allows for class arbitration, provided a consumer could not be forced to participate in class arbitration instead of class litigation.

3.2 Proposal to Impose Conditions on the Use of Arbitration Agreements By Requiring Submission of Arbitral Claims and Awards

The Bureau is also considering a proposal to require covered entities that use arbitration agreements in their agreements with consumers to submit initial claim filings and written awards in consumer finance arbitration proceedings to the Bureau. The Bureau is further considering whether to publish the claims or awards to its website, making them available to the public. Before collecting or publishing any arbitral claims or awards, the Bureau would ensure that these activities comply with privacy considerations. The Bureau does not believe that this aspect of the proposal under consideration would require changes to be made to the text of companies' arbitration agreements, alter the conduct of arbitration proceedings, or impose requirements on the content of written awards. As described in the Outline, this proposal seeks to address the potential for consumer harm if arbitration agreements were to be administered by biased administrators or individual arbitrations were otherwise conducted in an unfair manner. Monitoring claims and awards (and potentially allowing for public review) will help the Bureau detect indicia of unfairness before widespread consumer harm occurs.

The Bureau also considered other alternatives, including an outright ban on the use of arbitration agreements for individual disputes and a requirement that arbitration agreements specify use of arbitration administrators that have procedures to ensure that individual arbitrations are administered in accordance with principles of fundamental fairness. The Bureau did not include these options as proposals under consideration at this time, however, because the evidence obtained thus far, including evidence analyzed in the Study, is inconclusive, due in part to the low number of claims resolved in arbitration. Further, the proposal to require submission of claims and awards which the Bureau would consider publishing may be sufficient to protect consumers from the risk of harm that may occur.

3.3 Coverage

Under the proposals being considered by the Bureau and as described in the Outline, the requirements described above in parts 3.1 and 3.2 would apply to entities that provide the following financial products or services for consumer purposes, as defined in Dodd-Frank Act section 1002 and subject to the limitations in Dodd-Frank Act sections 1027 and 1029:

- extensions of credit by a creditor or credit card issuer under the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the Bureau's Regulation Z (12 CFR Part 1026), or by a creditor under the Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.) and the Bureau's Regulation B (12 CFR Part 1002), or the brokering, servicing, acquiring, or purchasing of any such credit, extending or brokering automobile leases as defined in Bureau regulations (to be codified at 12 CFR 1090.108), or providing debt relief services for such credit or automobile leases under the Telemarketing Sales Rule (16 CFR Part 310); and
- accounts with depository institutions under the Truth in Savings Act (12 U.S.C. 4301) and the Bureau's Regulation DD (12 CFR Part 1030) and the National Credit Union Administration's implementing regulations (12 CFR Part 707); and
- products or services subject to the Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) and the Bureau's Regulation E (12 CFR Part 1005), transmitting or exchanging funds under Dodd-Frank Act section 1002(15)(A)(iv), or check cashing under Dodd-Frank Act section 1002(15)(A)(vi); and
- obtaining information from a credit reporting agency as defined in the Fair Credit Reporting Act (15 U.S.C. 1681 et seq.) for the purposes of monitoring, on behalf of the consumer, the consumer's credit; and
- collecting debt related to any of these consumer financial products or services.

This coverage formula includes, but is not limited to, the following types of entities: banks, credit unions, credit card issuers, certain auto lenders, small-dollar or payday lenders, auto title lenders, installment and open-end lenders, private student lenders, providers of other credit in certain other contexts, loan originators that are not creditors, providers of credit in the form of deferred third-party billing services, providers of certain auto leases for at least 90 days, servicers of covered credit and auto leases, remittance transfer providers, providers of domestic money transfer services or currency exchange, general-purpose reloadable prepaid card issuers, certain providers of virtual currency products and services, check cashing providers, credit service/repair organizations, debt settlement firms, providers of credit monitoring services, and debt buyers. The Bureau is also considering whether to cover additional consumer financial products and services; for example, payment processing.

The Bureau noted in its Outline that it is considering excluding from its proposed regulation products or services that are in any of the following categories: (1) already subject to arbitration rules issued by the Securities and Exchange Commission or the Commodity Futures Trading Commission;[14] (2) provided by persons when not regularly engaged in business activity (*e.g.*, an individual who may loan money to a friend); (3) provided by the federal government;

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[14] *See generally* FINRA Code of Arbitration Procedure (subject to review and approval by the SEC); *see also* 17 CFR 166.5(b) (CFTC regulations implementing Commodity Exchange Act and requiring that arbitration agreements be voluntary).

(4) provided by state, local, and tribal governments and government entities to persons in their jurisdiction, or to persons outside their jurisdiction if not credit that is subject to the Truth in Lending Act or Regulation Z; and (5) credit a business extends for the consumer's purchase of its own nonfinancial goods or services when covered by Dodd-Frank Act section 1027(a)(2)(B)(i).[15] The Bureau indicated in its Outline that it is still evaluating whether regulatory action is warranted in these categories of activity, but does not want to delay action with regard to the operation of arbitration agreements in contracts for other types of consumer financial products or services in the meantime.

3.4 Effective Date

As directed by the Dodd-Frank Act, the Bureau indicated that it anticipates that the proposals, if adopted, would become operative no earlier than 180 days after the effective date of a final rule.[16] The Bureau stated that it currently contemplates setting an effective date of 30 days after the rule is published.

4. Applicable Small Entity Definitions

A "small entity" may be a small business, small nonprofit organization, or small government jurisdiction. The North American Industry Classification System (NAICS) classifies business types and the SBA Office of Size Standards establishes size standards for a "small business." To assess the impacts of the proposals under consideration, the Panel meets with small entities that may be impacted by those proposals and so, in this instance, sought feedback from several different types of entities, including banks; credit unions; debt buyers and debt collectors; marketplace consumer lenders; nonbank auto lenders; payment processors; remittance and other money transfer providers; and short-term, small-dollar lenders and other providers of personal loans.

5. Small Entities That May Be Subject to the Proposals Under Consideration

The Panel identified 22 categories of small entities that may be subject to the proposals under consideration. The NAICS industry and SBA small entity thresholds for those categories are the following:

NAICS description	NAICS #	SBA Small business threshold
All Other Nondepository Credit Intermediation	522298	$38.5m in revenue
All Other Professional, Scientific, and	541990	$15m in revenue

[15] The Outline (n.75) explained that this exemption related to activities such as factoring, and recited the terms used in section 1027(a)(2)(B)(i) of the Dodd-Frank Act. The references in the Outline to section 1027(a)(2)(B)(ii) were typographical errors and were intended to refer to section 1027(a)(2)(B)(i) of the Dodd-Frank Act.

[16] 12 U.S.C. 5518(d) ("Notwithstanding any other provision of law, any regulation prescribed by the Bureau under subsection (b) shall apply, consistent with the terms of the regulation, to any agreement 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 the Bureau.").

Technical Services		
Collection Agencies	561440	$15m in revenue
Commercial Banking	522110	$550m in assets
Commodity Contracts Dealing	523130	$38.5m in revenue
Consumer Lending	522291	$38.5m in revenue
Credit Bureaus	561450	$15m in revenue
Credit Card Issuing	522210	$550m in assets
Direct Life Insurance Carriers	524113	$38.5m in revenue
Direct Property and Casualty Insurance Carriers	524126	1500 employees
Financial Transactions Processing, Reserve, and Clearinghouse Activities	522320	$38.5m in revenue
Mortgage and Nonmortgage Loan Brokers	522310	$7.5m in revenue
Other Activities Related to Credit Intermediation	522390	$20.5m in revenue
Other Depository Credit Intermediation	522190	$550m in assets
Passenger Car Leasing	532112	$38.5m in revenue
Real Estate Credit	522292	$38.5m in revenue
Sales Financing	522220	$38.5m in revenue
Truck, Utility Trailer, and RV (Recreational Vehicle) Rental and Leasing	532120	$38.5m in revenue
Used Car Dealers	441120	$25m in revenue
Utilities (including Electric Power Generation, Transmission, and Distribution of Electric Power, Natural Gas, Water / Sewage, and other systems)	221	between $15–$27.5m in revenue, or 250–1000 employees
Wired Telecommunications Carriers	517110	1500 employees
Wireless Telecommunications Carriers (except Satellite)	517210	1500 employees

6. Summary of Small Entity Outreach

6.1 Summary of Panel's Outreach Meeting with Small Entity Representatives

The Bureau convened the Panel on October 20, 2015. The Panel held a full-day outreach meeting (Panel Outreach Meeting) with SERs on October 28, 2015, in Washington, D.C., with access by telephone for SERs that did not travel. In preparation for the Panel Outreach Meeting and to facilitate an informed and detailed discussion of the proposals under consideration, the Bureau provided each of the SERs with the materials listed in Appendix B. The Bureau also confirmed the services and products offered or provided by the SERs' businesses, their use of arbitration agreements in these products, and whether the businesses had faced a class action. In advance of the Panel Outreach Meeting, the Bureau, SBA Office of Advocacy, and OMB held two conference calls with SERs to describe the Small Business Review Process, to discuss the proposals under consideration, and to answer any preliminary questions from the SERs.

Representatives from 18 small businesses that offer multiple different consumer financial products and services (described in more detail in part 7 below) were selected as SERs for this SBREFA process and participated in the Panel Outreach Meeting, either in person or by phone. Representatives from the Bureau, SBA Office of Advocacy, and OMB provided introductory remarks. The meeting was then organized around a discussion led by the Bureau's Office of Regulations and its Office of Research about the proposals under consideration and the potential impact on small businesses. The PowerPoint slides framing this discussion are attached at Appendix E.

The Bureau also provided the SERs with an opportunity to submit written feedback by November 9, 2015. Nine of the SERs provided written comments. Copies of these written comments are attached at Appendix A.

6.2 Other Outreach Efforts, Including to Small Entities

In addition to the SBREFA process, the Bureau has conducted extensive outreach efforts to industry and consumer groups as well as some entities that would be covered by the Bureau's proposals were they to be adopted. The Bureau has also conducted three public field hearings on issues related to pre-dispute arbitration agreements in contracts for consumer financial products and services. The most recent of these public fora—held in Denver, Colorado on October 7, 2015—coincided with the release of the Outline of Proposals under Consideration and Alternatives Considered. The Bureau has met numerous times to discuss arbitration with trade associations that represent small entities that would be affected by the proposals under consideration and has informed the Panel that it will continue to be receptive to such meetings.

7. List of Small Entity Representatives

The following 18 SERs were selected to participate in the Panel's Small Business Review process:

NAME & TITLE	BUSINESS NAME	HEADQUARTERS STATE[17]	ENTITY TYPE
Sylvia Aparicio, Senior Vice President, Chief Legal Officer, Fair Lending Officer	First Community Bank	Texas	Bank
Davida Barker, CEO/Manager	Resource Federal Credit Union	Tennessee	Credit Union
Jim Bennett, CEO	U.S. Payments, LLC	Oklahoma	Payment Processor
S. Glenn Bryan, Senior Vice President	Legacy Community Federal Credit Union	Alabama	Credit Union
Thomas Conner, President	Third Union Finance	Mississippi	Nonbank Auto Lender
Kelly Knepper-Stephens, General	Stoneleigh Recovery Associates, LLC	Illinois	Debt Collector/Debt Buyer

[17] Some of the SERs operate in multiple states.

Counsel			
Phillip Lathrop, President	VP Motors, Inc. d/b/a V P Auto Sales	Texas	Nonbank Auto Lender
Kevin M. Lutkins, Corporate Counsel/ Compliance Officer	MEMO Financial Services, Inc., and Subsidiaries	Pennsylvania	Payment Processor
John Meldon, President	J.J. Best Banc & Co.	Massachusetts	Nonbank Auto Lender
Sean Miller, Assistant Vice President, Compliance	Meadows Credit Union	Illinois	Credit Union
Alison Nicoll, General Counsel	Upstart Network, Inc.	California	Marketplace Consumer Lender
Tonya Randolph, General Counsel and Comptroller	Whitestone Financial, Inc.	North Carolina	Nonbank Auto Lender
Lauren Rosenfeld, General Counsel	FMA Alliance, Ltd.	Texas	Debt Collector/Debt Buyer
Trent Sorbe, President, Central Payments Division	Central Bank of Kansas City	Missouri	Bank
Andrew Twyman, President	ATG Credit, LLC	Illinois	Debt Collector/Debt Buyer
Claudia Urjel, Chief Compliance Officer	Pronto Money Transfer, Inc.	California	Remittance Provider
Craig Wells, CEO and President	Spectrum Franchise Group Inc. / Cash Plus, Inc.	California	Short-Term, Small-Dollar Lender
Nathan D. Willner, Manager, Legislative Affairs	Lyons, Doughty & Veldhius, P.C.	Maryland	Debt Collector/Debt Buyer

When selecting SERs for this SBREFA process, the Bureau sought participation both by entities that used arbitration agreements and those that did not, although, as noted in footnote 17, the Bureau prioritized inclusion as SERs entities that use arbitration agreements. The Bureau also actively sought participation by small entities that have faced class actions. As the chart below indicates, 14 of the 18 SERs use arbitration agreements, and 10 have faced class actions (including three of the four entities that did not use arbitration agreements).[18]

[18] Neither the prevalence of arbitration agreements nor class actions among SERs is necessarily representative of the prevalence of arbitration agreements or class actions in consumer financial products or services more broadly.

ENTITY TYPE	NO. OF SERS	SERS USING ARB. AGREEMENTS	SERS THAT HAVE FACED CLASS ACTION(S)
Nonbank Auto Lender	4	3	1
Bank	2	2	1
Credit Union	3	1	3
Debt Collector/Debt Buyer[19]	4	4	4
Marketplace Consumer Lender	1	1	0
Short-Term, Small-Dollar Lender	1	1	1
Payment Processor	2	1	0
Remittance Provider	1	1	0
Total	**18**	**14**	**10**

Many of the SERs offer more than one consumer financial product or service that would be covered by the proposals under consideration. The chart below sets forth the range of consumer financial products and services that are offered by the SERs selected by the Bureau.

PRODUCT OR SERVICE	KNOWN SERS OFFERING PRODUCT/SERVICE	USE ARB. AGREEMENT
Auto Loans	9	4
Check Cashing	1	0
Credit Cards[20]	5	0
Third-Party Debt Collection	4	4
Deposit Accounts[21]	5	1
Domestic Money Transfer	1	1
General-Purpose Prepaid Cards[22]	6	4
International Money Transfer	1	1
Other Personal Loans	8	4
Payment Processing	2	1
Private Student Loans	2	2
Short-Term, Small-Dollar Loans	2	1

[19] Because third-party debt collectors can collect on debts containing arbitration clauses and debt buyers can acquire debts containing the clauses and courts in some jurisdictions allow third parties to invoke the underlying arbitration agreements, we count them here and in the chart below as users of arbitration agreements.

[20] The total number of entities offering the product or service includes two banks that partner with third-party issuers (and therefore do not set the terms of the contract even though the card is branded with their name). Some of the SERs that issue credit cards were nominated by their trade associations.

[21] The total number of entities offering the product or service includes five deposit accounts that include check cashing services, domestic money transfer services, or international money transfer services.

[22] The total number of entities offering the product or service includes at least one bank or credit union that partners with third-party issuers and acts as a program manager/broker with respect to their prepaid card program.

8. Summary of Small Entity Representative Comments

Through the SBREFA process, the Panel solicits feedback from small businesses early in a rulemaking proceeding and prior to the Bureau's development of a proposed rule. To obtain specific information about the costs of complying with a potential rulemaking, the Bureau provided SERs with a list of questions to consider about the impact of the proposals under consideration. These discussion questions, included at Appendix D, along with the Outline of Proposals under Consideration (Appendix C), formed the basis of the Panel Outreach Meeting and the subsequent written comments.

During the October 28th Panel Outreach Meeting, as well as during the associated telephone conferences and in written materials submitted to the Bureau following the Panel Outreach Meeting, the SERs provided feedback on all aspects of the proposals under consideration. The SERs provided a substantial amount of information to the Panel about how the SERs conduct their businesses and how the proposals could impact their businesses. The Panel appreciates the effort made by the SERs to provide meaningful comments and data and for their time spent assisting the Panel.

8.1 Comments Related to the Bureau's Proposal to Prohibit Arbitration Agreements that Block Class Actions

Reason for SERs' Companies' Adoption of Arbitration Agreements

The majority of the SERs' companies that included arbitration agreements in their consumer contracts stated that they did so primarily to defend against class action litigation. A few SERs noted that their companies had adopted arbitration agreements in the late 1990s or early 2000s when, in their view, class action litigation became more common. Several SERs' companies had adopted an arbitration agreement after being sued in a class action but a few had done so after observing competitors be sued in class actions without themselves being named in such a suit. A few SERs mentioned that their companies operated in multiple states and that exposure to both federal and multiple state law regimes made defense from class actions through arbitration agreements more desirable. Two SERs' companies had faced a class action but did not add an arbitration agreement to the company's contracts as a result.

A few SERs' companies that included arbitration agreements in their consumer contracts indicated that they did so for certain products but not for others. Those that selectively included arbitration agreements indicated that they did so where they perceived a greater exposure to class action litigation for particular products, for instance because the products are more highly regulated or subject to multiple states' laws. For example, one credit union SER included arbitration agreements for his company's prepaid cards and private student loans but not for the bank's other products. Another SER that included arbitration agreements for some products but not for others stated that the regulations affecting products for which his company did not have an arbitration agreement— mailbox rental and prepaid telephone cards—were straightforward and thus his company did not see a need to adopt arbitration agreements in the contracts for those products.

A few SERs stated that their companies did not include arbitration agreements in their consumer contracts. These SERs indicated that their companies attempt to resolve disputes with their customers directly and that they were not typically subject to litigation. Two of these SERs indicated that their companies did not currently use arbitration agreements but that they might consider doing so in the future. One SER indicated that her company had not adopted arbitration agreements despite having been advised to do so.

The SERs in the debt-collection industry noted that they did not have contractual relationships with consumers but that they sometimes relied on the arbitration agreements in the underlying contracts on which they collected as a defense against class action litigation.[23] One debt collector SER estimated that approximately 30% of his company's clients' contracts contain arbitration agreements. All of the debt-collection SERs stated that the existence of an arbitration agreement in the underlying debt did not affect their companies' decisions to undertake the collection of the debt or the prices paid or charged for debt collection activities.

One SER's company had an arbitration agreement that required arbitration only of disputes of less than $10,000. Thus, the agreement would not apply to class actions filed in court over that amount.

Cost of Adopting Arbitration Agreement[24]

The SERs' companies that include arbitration agreements in their contracts reported several different processes for adopting those agreements. Several SERs indicated that their companies obtained the contracts with arbitration agreements from third parties, either from form providers or other companies involved in the offering of their products. For example, one SER whose company originates auto loans used contracts provided by the auto dealers on whose vehicles the company offered financing. None of these SERs provided specific information on the cost of adopting an arbitration agreement through these third parties but generally they indicated that modifications to their form contracts would not be a major source of burden.

One SER representing a depository institution indicated that his company had hired outside counsel to draft and adopt an arbitration agreement and estimated a cost of about $60,000. That cost included the legal fees for several outside law firms' review of the contract and drafting of the arbitration agreement, as well as for ongoing monitoring of case law and continual revisions of the arbitration agreement language to ensure that it remained enforceable.

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[23] Debt collectors seek to collect debt from a consumer based on the consumer's agreement with another company. Consumers do not enter into a contractual agreement with the debt collectors. According to SERs in the debt collection industry, if the underlying credit agreement between the consumer and the company has an arbitration agreement, debt collectors may be able to rely upon that arbitration agreement to compel arbitration in court, depending on the case law in the relevant jurisdiction.

[24] As stated in the Outline of Proposals Under Consideration, the Bureau believes that affected entities generally could face three types of costs from the proposals with respect to class litigation: (1) administrative costs due to a requirement that covered entities update their contracts to revise arbitration agreement language that otherwise would not comply with the Bureau's proposal (*i.e.*, to include language in new agreements providing that arbitration agreements do not apply to cases filed on a class basis), (2) costs related to additional potential liability due to class litigation exposure (including defense costs, court costs, substantive settlement and damages exposure), and (3) increased cost of compliance with existing consumer finance and other laws and other costs due to entities attempting to minimize any such additional class litigation exposure in the future.

One SER without an arbitration agreement indicated that his company decided not to adopt one after a form provider the company uses had quoted a high price for adding one to the SER's existing contract.

SERs' Companies' Costs to Defend Class Action Litigation

Many SERs' companies had been sued in a class action case.[25] The number of times companies had faced a class action varied. The debt collector SERs indicated that they were sued on a putative class basis approximately one to five times per year.[26] The non-debt collector SERs that had faced a class action had each faced only one class action lawsuit, with the exception of a credit union that had faced two, filed more than ten years apart. Several SERs had adopted arbitration agreements after facing one class action lawsuit and had never been sued in a class action again. A few SERs had never faced a class action lawsuit.

Most of the SERs' companies that had faced class actions stated that the legal defense costs were the primary expense to them of class action litigation and that those costs bore no relationship to whether the suit was, in their view, meritorious. Several SERs noted that their legal costs to defend a putative class action are higher than those incurred in defending an individual case. One SER estimated the legal costs of defending a class action to her company at $15,000 to $50,000. One debt collector SER whose company faces multiple class actions per year stated that defense costs for class actions were typically three times that of an individual case because settlement negotiations take much longer in putative class cases. That SER estimated the legal defense costs of a class action case at approximately $16,000 to $18,000. A different debt collector SER estimated the cost to defend a class action as twice that of an individual case. That SER further stated that her company typically spent $120,000 per year defending class actions. A few SERs indicated that the cost to a small entity of defending a class action to a decision by a court, whether on a dispositive motion or a trial, could put a small entity out of business.[27] For this reason, two SERs asserted that they would consider closing their businesses if the Bureau's proposal were enacted and that they could no longer use arbitration agreements to block class action litigation, although they did not explain how they reached these conclusions.

For the SERs that had defended a class action, rather than attempt to settle it quickly, the costs varied with the higher end being $50,000 to $60,000 to defend the case to a dispositive motion. One SER contacted law firms in different regions of the country to collect data on

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[25] The Bureau actively sought participation by small entities that have faced class actions. The prevalence of class actions among SERs' companies is not necessarily representative of the prevalence of class actions in consumer financial products or services more broadly. *See generally* CFPB Arbitration Study Section 8. Specifically, the Bureau identified three class action settlements involving SERs using data from the Study's survey of class action settlements in federal court, and an additional class action complaint involving a SER using data from the Study's survey of federal and state court complaints. *See* Study Sections 6 and 8. See also the chart at Page 12 indicating that 10 SERs have faced class actions.

[26] The debt collector SERs expressed their belief that the existence of an arbitration agreement in the underlying contracts on which they collected did not deter the filing of class action lawsuits against them. This may be because only certain jurisdictions allow debt collectors to rely upon an arbitration agreement in the underlying contract to compel arbitration. *See supra* n.22.

[27] No SERs indicated that they had litigated a class action to a verdict.

typical defense costs to defend a class action to a decision and received estimates of $107,800 to $204,500 depending on the region. One SER spent in excess of $50,000 to defend and resolve a class action filed in the 1990s related to an alleged violation of law by a franchisee. Another SER discussed a class action against a group of approximately 60 similarly situated companies, many of whom joined together to hire an attorney to defend them. This SER stated that the legal defense costs to the group were over $600,000. The SER did not state the costs to his company individually.

Most SERs that had faced class actions indicated that their companies had resolved the cases with an individual settlement with the named or lead plaintiff. Several debt collection SERs indicated that because legal defense costs are so high, they preferred to settle putative class action cases on a non-class basis with the plaintiffs, rather than litigate the cases, even when they believed the allegations were unfounded. Two SERs estimated that settlements with putative class plaintiffs were at least twice as large as those with plaintiffs in individual cases. Several SERs estimated the costs of non-class settlement with putative class plaintiffs as between $5,000 and $20,000. One SER stated that these settlement amounts were often more than the individual plaintiffs' alleged damages because plaintiffs often refused to settle putative class cases even when they were offered their full damages. That SER stated her belief that the named plaintiffs are unjustly enriched by the filing of putative class cases. A few SERs asserted that the bulk of the non-class settlement payments typically went to the plaintiff's attorney rather than to the plaintiff and argued that this was an indication that class action litigation did not benefit individual consumers.

Only one SER who stated that his company had been involved in a class action lawsuit described how that case had culminated in a class-wide settlement. The SER estimated the amount of the settlement at $3 million plus attorney's fees estimated at 25% of the settlement amount. The SER acknowledged his company had violated a provision of state law in partnering with a third party, leading to the lawsuit and eventual settlement. The SER reported that his company had to lay off numerous staff as a result of the settlement and that the lawsuit almost put the company out of business. The SER's company nevertheless did not add an arbitration agreement to its consumer contracts.[28]

Several SERs noted that defending class actions diverted employee time from core business activities such as customer service and compliance to managing litigation, collecting documents, and discussing the litigation with outside counsel. One debt collector SER estimated the staff time to manage defense of a class action at 100 hours. One SER, however, stated that her company had resolved a few putative class actions for no cost by notifying the plaintiff's counsel that the allegations were inaccurate and that the claims were therefore meritless.

A few SERs stated that class actions also imposed reputational costs on their companies. One debt collector SER noted that potential clients asked how often the SER had been sued in class action litigation. Other SERs noted that potential customers may not want to do business with their companies after learning the company was sued in a class action. SERs generally

[28] The SER stated that it had investigated with its form provider adopting an arbitration agreement but decided against it because the form provider quoted a price that the SER's company found too expensive.

stated that class actions brought against them often alleged what were, in their view, "hyper-technical" violations of law.

Effect of Arbitration Agreements on Class Action Litigation

Many SERs indicated their belief that the presence of an arbitration agreement deterred the filing of class actions against their companies or reported that their companies had not been sued in a class case since adopting an arbitration agreement. At least one SER had adopted an arbitration agreement as a direct result of being sued in a class action lawsuit and had never faced another class suit. One SER had adopted an arbitration agreement after seeing many competitors sued in class action litigation although his company had never been sued. Two SERs reported being sued in class action litigation and still had not adopted an arbitration agreement. Only two SERs stated that they their companies had relied on an arbitration agreement to move to compel arbitration in a class case. One of these, a debt collector, settled the case on an individual basis before the arbitration motion was decided. In the other case, the trial court granted the company's motion to compel arbitration and dismissed the class action case. The plaintiff subsequently appealed the decision and the SER's company ultimately settled the case on an individual basis with the plaintiff before the appeal was decided.

The debt collector SERs, however, did not believe that the presence of an arbitration agreement in the underlying debt they collected deterred the filing of class actions against them (likely because debt collectors can successfully assert an arbitration agreement as a defense to a suit in court in some jurisdictions but not others). These SERs stated that the existence of arbitration agreements in the underlying contracts on which they collected were useful primarily in negotiating lower individual settlements in putative class cases. One SER estimated that her company was able to negotiate a 40% lower settlement in a putative class case where an arbitration agreement existed than if there had been no arbitration agreement in the underlying contract.

General Criticisms of Class Action Litigation as Unnecessary or Overly Burdensome

Several SERs argued that class action lawsuits are often brought for "hyper-technical" violations of law that they did not believe actually harmed consumers. The examples given by these SERs were cases against them or their competitors for inadequate disclosures or small fees that were improperly charged that resulted in the prospect of large statutory damages and therefore costly legal defense or settlements. One SER described a lawsuit arising from the font size for legally-required contract language being smaller than required by law and therefore costing the company significant expense to settle a class action lawsuit. Similarly, SERs noted that the regulatory landscape for consumer financial products was particularly complex and rapidly changing, especially for SERs that operated in multiple states, and that the SERs were therefore subject to potential class action lawsuits for technical violations of many complex state and federal laws.

Several of the SERs criticized particular statutes that gave rise to class actions against them. These SERs, most of whom were involved in debt collection, noted that lawsuits under the Telephone Consumer Protection Act (TCPA), Fair Debt Collection Practices Act (FDCPA), and Fair Credit Reporting Act (FCRA) were particularly common and threatening to their businesses. The TCPA in particular troubled these SERs because damages available under that statute are not limited in a class action case and thus the SERs believe there is a risk of going out of business every time they are sued under the TCPA.[29] One SER referred to these as “annihilation damages” because they could force a company out of business.

A few SERs argued that because certain relevant statutes provide for statutory damages and attorney’s fee awards for a winning plaintiff, individual plaintiffs were incentivized to bring suit under those statutes and there was no need for consumers to group their claims through a class action. These SERs particularly cited the FDCPA as an example of one such statute. One SER pointed out that the recovery in an individual suit under certain statutes would be significantly greater than the average recovery for consumers as shown in Section 8 of the Bureau’s Arbitration Study, which reviewed class action settlements in federal consumer finance cases over a five-year period. The SER also noted that there is a cap on class damages in FDCPA cases.

Several SERs stated their belief that class actions primarily benefit plaintiff’s attorneys rather than consumers. Several SERs reported dealing with plaintiff’s attorneys whom they believed to be out to benefit themselves primarily and not their consumer clients. Two debt collection SERs stated that they were often sued in putative class action cases in which they did not believe the plaintiff’s attorney ever intended to move to certify the class action and instead believed that the case was filed as a putative class case only to obtain a higher settlement amount from the SER defendant. These debt collection SERs did pay more to settle these cases.

A few SERs noted their companies’ experience being sued in a class action suit where the plaintiff had never contacted the company to complain about the alleged violation before filing suit. These SERs indicated frustration with these suits based on the belief that they would have resolved the plaintiff’s alleged harm through their customer service process and obviated the need for a class action suit had they had that opportunity.

Several SERs noted that the threat of class action litigation can constrict the market for their products. One SER whose company had faced a class action in the 1990s noted that the company’s franchisee went out of business as a result, thereby causing constriction in the market. A debt collector SER noted that one large client that does not include arbitration agreements in its contracts is extremely careful in its oversight of the SER’s company in its debt collection activities. The SER estimated the cost of oversight by this client as more than double the cost for oversight from other clients. This client also requires more staff time than other clients and the SER believes this is due to class action exposure that the company’s other clients do not have. This SER has questioned whether to continue to do business with this client given how costly it is to do so, which would then leave fewer collectors to collect that client’s debts. This SER expressed her belief that the debt collection market would constrict if more debt collectors decide to exit the market because of the enhanced oversight by clients and threat of class actions. However, the SER noted that her business could not pass these costs on to its large client due to strong competition in the debt collection market.

One debt collector SER believed that media, including television news, websites, and social media serve to inform consumers of potential harms by consumer finance companies and

[29] 47 U.S.C. § 227(b)(3)(B) (providing for greater of actual damages or $500–1,500 per violation depending on whether willful or knowing, without any limit on damages in class case).

therefore render class actions unnecessary. In his view, consumers can learn through media of potential harms and then seek redress directly from the company or sue the company in an individual lawsuit or arbitration.

Cost of Changing Customer Agreements to Comply with the Bureau's Proposal

Most SERs indicated that the cost to change their agreements to comply with the Bureau's proposal would be minimal. SERs indicated that they would consider retaining outside counsel to do so but they did not expect that expense to be significant. One SER indicated that because her business operates mostly online, updating language of the company's contract for prospective consumers would be simple, particularly given that the Bureau said it would provide model or mandatory language. Another SER, a prepaid card provider, stated that his business would consider updating contracts for existing customers as well. That SER stated that updating contracts for existing customers would be difficult and potentially costly, however, because in the SER's estimation, 80% of cardholder addresses become inaccurate one to three years after the customer acquires the product.

Relationship Between Arbitration Agreements and Compliance Efforts

The majority of the SERs stated that they would not alter their spending on compliance activities whether or not their consumer contracts include an arbitration agreement. These SERs noted their belief that their companies complied fully with all relevant laws and would do so regardless of class action exposure. A few SERs indicated that class action exposure (and particularly the costs of defending and settling spurious class actions) may reduce their compliance budget. According to these SERs, the existence of arbitration agreements that block class actions allows them to spend more on compliance than they would be able to if they could not use arbitration agreements to block class actions. Another SER, a debt collector, predicted that the proposals under consideration would cause the level of compliance across the debt collection industry to decline, because firms that make relatively greater investments in compliance will be relatively more likely to go out of business. One debt collection SER stated that, in her view, individual lawsuits deter non-compliance with the law as much as class action lawsuits and thus there was no need for the Bureau's proposal to prohibit the use of arbitration agreements as to class action lawsuits.

One SER stated that her company might invest more in compliance if the Bureau's proposal were enacted and the company could not use arbitration agreements to block class actions. According to this SER, the increased exposure to class actions might cause her company to hire additional staff for its compliance department and increase spending on outside legal counsel.

Most SERs stated that, regardless of whether they used an arbitration clause that could block class actions, they invested in customer service and attempted to resolve consumers' complaints in order to retain customers and would continue to do so. Several of these SERs emphasized that as small entities, customer relationships were particularly important to them and thus they had even greater incentive to resolve customers' disputes through their customer service departments.

Whether Entities Would Retain or Drop Arbitration Agreements

The SERs expressed a range of views on whether the proposal to make arbitration agreements inapplicable to class litigation would cause them to drop their arbitration agreements entirely rather than insert the model or mandatory language that the Bureau has said it would propose. One SER stated that he expected that his business would keep its arbitration agreements because individual arbitration would continue to be a cost-effective way of resolving consumers' disputes. One SER stated that she was not sure, but that her business would likely keep its agreements, because the agreements would continue to reduce the business's costs. Two SERs noted that they were not sure but would likely drop their agreements because the agreements could no longer be used to block class actions. One SER stated her business would drop their agreements because the agreements would no longer "equalize the benefits for both sides."

Availability and Cost of Insurance/Indemnification for Potential Class Action Liability

The SERs that had faced class litigation described a variety of experiences with insurance coverage for costs related to defending those cases. Two SERs, each representing a credit union, reported that they successfully recovered litigation expenses from their insurance companies when they were sued in class actions. Two other SERs stated that they did not have insurance, or were not covered for class actions, when they faced class action lawsuits.

With respect to whether the SERs were presently insured for litigation costs related to class actions, three SERs noted that their business has litigation insurance, but that class actions are covered on a case-by-case basis under their policy, making coverage for a particular class action unpredictable (much as coverage for any individual litigation would similarly be unpredictable).

Two other SERs, both debt collectors, provided detailed information on the cost of general litigation insurance that would cover class action liability. The cost of such insurance for one SER's company increased from $8,314 with a $25,000 deductible in 2011 to $47,573 with a $50,000 deductible in 2015, although the SER's company had also negotiated an increase in the liability limit for class action defense costs from $100,000 in 2014 to $500,000 in 2015. The cost for such insurance for another debt collector SER's company increased from $38,580 with a $50,000 deductible in 2009 to $67,460 with a $100,000 deductible in 2015. One of these SERs stated that her company has general litigation insurance (and one of the two SERs also has a class action rider), but the usefulness of the coverage is limited by the high deductible. One of those SERs stated, generally, that she believed the increase in insurance costs is due to an increased number of TCPA class actions in the SER's industry. The other debt collector SER noted that her insurance company did not ask whether the SER had an arbitration agreement when it applied for the policy. This SER also stated that her business has indemnification provisions in its contracts, but that the indemnification process is difficult to negotiate with clients. One of these SERs also noted that his company spent an additional $5,000 in attorney's fees to dispute coverage with the insurance company.

Three of the SERs indicated that they did not have applicable insurance coverage at the time of the Panel. One of these SERs stated that his business has litigation insurance, but he does not believe the insurance would cover class actions (although the SER was unsure). The other two of these SERs stated that they are not insured against class actions; one of the SERs, a debt collector, stated that insurance is difficult to obtain in his industry, and the other SER—a short-term, small-dollar lender—stated that insurance against class actions is not available from his provider.

Two SERs predicted that their insurance premiums would increase if the proposal to make arbitration agreements inapplicable to class litigation is adopted although they had not asked their insurers. One of these SERs—a short-term, small-dollar lender—asserted that, according to its insurance carrier, the class proposal under consideration would cause its annual insurance premium to increase by 30% to 40%.

The SER who described his company's entering into a class action settlement and laying off personnel indicated that he would check on whether it was covered by insurance. This SER did not provide further information on this after the Panel Outreach Meeting.

Class Arbitration as Alternative to Class Litigation

A few SERs noted that their arbitration agreements were silent as to class arbitration. Those SERs indicated that they had not made a conscious decision to allow class arbitration. One SER indicated that he might consider arbitration claims on a class basis if the option ever arose and a plaintiff's attorney wanted to pursue that avenue. Two SERs stated that class arbitration is not a viable option because class arbitrations lack the informality of individual arbitration; they make the process slower and more costly due to increased procedural complexity.

8.2 Comments Related to the Proposal to Require Submission to the Bureau of Arbitral Claims and Written Awards

Personal Experience with Individual Arbitration, Including Post-Dispute

Most SERs had no direct experience with individual arbitration. Two SERs did, however, describe their experiences with individual arbitration. One of these SERs stated that his business voluntarily agreed to arbitrate a dispute with a consumer, after the dispute arose. In that arbitration, the consumer won. The other SER stated that his business participated in a court-ordered arbitration. This SER stated that this arbitration likely reduced the costs of resolving the dispute, but also decreased the probability that the SER would be totally vindicated on the claim by increasing the probability of settlement. A third SER, a debt collector, stated that some consumers—advised by lawyers, in the SER's view—invoke arbitration strategically in litigation. According to the SER, because these consumers appear to be represented by counsel in connection with the invocation, this serves to effectively block companies from communicating directly with consumers toward an efficient resolution of the debt. The SER also stated that, when motions to compel arbitration are granted, some consumers never file in arbitration, leaving cases in limbo. In the SER's view, the ability to use arbitration agreements strategically in this manner is helpful to consumers and would not be available to consumers if, as the SER predicts, creditors drop their arbitration agreements in response to the proposals under consideration by the Bureau.

Costs/Risks of Submission Requirement

In general, the SERs stated that they were not concerned about the costs of submitting claims and awards to the Bureau, as they expected such costs to be minimal. One SER, however, stated that the submission requirement would require a "significant amount" of her business's counsel's time—specifically, two to six hours on each individual filing—due to the need to redact documents, although the Bureau did not specify requirements for such redacting in its proposal under consideration. Another SER expressed concern about penalties for inadvertent violations of the submission requirement, noting that it may be easy for small entities to forget this obligation, given that individual arbitrations rarely occur. That SER indicated that his concern would be mitigated were the Bureau to require arbitration administrators, instead of financial institutions, to submit the materials. Another SER expressed concern that requiring arbitration administrators to perform redactions and file documents with the Bureau could increase administrators' costs, which they could pass on to businesses.

Concerns About Individual Arbitration Data

While the SERs stated that they were not concerned about the costs of submission, two SERs did express concern about what conclusions the Bureau would draw from the submitted claims and awards. Several SERs stated that consumer claims resulting in awards may represent a skewed sample of results in arbitration because most cases settle and details of the settlements would not be submitted to the Bureau. For example, two SERs argued that this set of claims would reflect what consumers recover when arbitrators decide in their favor, but not what consumers recover when arbitrations settle, the latter being significantly more common than an actual award on the merits by an arbitrator. Another SER, a debt collector, asserted that consumers who have submitted complaints to the Bureau have attributed errors made by creditors to debt collectors, and the SER expressed concern that a similar issue could arise with the submitted claims and awards.

8.3 Comments Related to the Proposal's Potential Effect on the Cost of Credit to SERs or Consumers

The SERs expressed concerns about how the proposals under consideration would affect their borrowing costs. One SER believed his business would lose its business line of credit if it could not use arbitration agreements to block class actions. Another SER stated that the class proposal under consideration would increase her business's borrowing costs, and also that drawing on its credit to pay litigation costs related to a class action would "raise warning signs" for her business's lender. Another SER stated that mere exposure to class action liability would cause his business's lender to "raise an eyebrow." One debt collector SER stated that his company's bank had closed its line of credit in recent years due to concerns over the industry but that the company was able to obtain a line of credit at another bank relatively quickly. None of these SERs reported that they actually had spoken with their lender or that, when they sought credit in the past, their lender inquired as to whether they used arbitration agreements in their consumer contracts.

In general, SERs in the business of extending credit stated that the proposal under consideration regarding class actions might cause them to increase the cost of credit they offer to their consumers. One of these SERs stated that the proposal may increase his business's expenses overall—such as insurance premiums, compliance investment, and exposure to class actions for which his business is uninsured—and, due to that SER's thin margins, such increases may require his business to increase the cost of consumer credit. However, another SER—a short-term, small-dollar lender—stated that he would be unable to increase the cost of his business's loans due to limitations imposed by state law. Another SER, a buy-here-pay-here auto dealer, stated that, in addition to potentially raising the cost of credit, his business could recoup costs by increasing its debt collection and collateral recovery efforts.

Three SERs predicted that, if the class proposal under consideration goes into effect, some small entities would reduce their product offerings. One of these SERs speculated that products designed for underserved groups may be especially vulnerable because cases involving such products are more attractive to plaintiff's attorneys.

8.4 Comments Related to Potential Alternatives Suggested by SERs

The Panel asked the SERs to suggest alternative approaches for the Bureau to consider in lieu of, or in addition to, either or both of the proposals under consideration. Two SERs recommended that the Bureau consider exempting small businesses from the proposals under consideration. One of these SERs suggested that the Bureau also consider "staying" the rule with respect to small businesses and, in the meantime, study how the proposal would affect the volume of class litigation. Two SERs, however, expressed concern that if the class proposal is adopted with a small business exemption, arbitration systems for resolving consumer financial disputes may disappear, because such systems would no longer be used by larger entities and thus maintaining a consumer arbitration system would become cost-prohibitive for arbitration administrators.

In addition to an exemption for small businesses, the SERs also suggested other limitations to the Bureau's proposal. Two SERs recommended limiting the proposal under consideration regarding class actions to specific statutes. For example, one of these SERs suggested limiting the class proposal to statutes that cap class recovery. Another SER suggested that the proposal to make arbitration agreements inapplicable to class actions apply only where the plaintiff's attorneys represent that they will limit their attorney fee award to ten percent of the class award, or less, if successful. Another SER proposed exemptions for consumer products that "have a track record of being responsive to the needs of their consumers."

Numerous SERs recommended that the Bureau consider other regulatory interventions in lieu of the class proposal. Two SERs proposed that the Bureau explore making individual arbitration more consumer-friendly. One of these SERs suggested that the Bureau require, for example, that arbitrations be held in a location convenient for the consumer; that the costs of arbitration to the consumer be reduced or borne by the company; or that consumers be permitted to opt-out of arbitration agreements. Other recommendations offered by the SERs include that the Bureau consider increasing consumer education regarding arbitration; publicize information about trends and patterns of illegal behavior; require businesses to pay consumers' costs of filing in small claims court; prescribe standardized language for arbitration agreements and associated disclosures including an opt-out option; develop a specialized arbitration forum for consumer disputes that would provide a panel of arbitrators for a single dispute and allow consumer input on the arbitrators chosen; create a Bureau-approved list of approved arbitrators for consumer arbitrations; require companies that use arbitration agreements that block class actions to pay the filing fees for any individual arbitration or pay into a fund administered by the Bureau that would pay filing fees for individual arbitrations over small dollar claims.

Two SERs stated that new technologies have obviated the need for the class proposal under consideration. One of these SERs argued that consumers who are harmed by providers of consumer financial products and services can resolve their disputes with those providers by submitting complaints to the Bureau.[30] The other SER, a debt collector, argued that class actions are no longer needed to inform harmed consumers because mobile apps, blogs, message boards, podcasts, and other means through which consumers can learn about trends in consumer protection litigation have proliferated.

8.5 Comments Related to Further Research by the Bureau

Several of the SERs advised the Bureau to conduct additional research on various topics, including consumer satisfaction with the arbitration process; the impact of the proposals the Bureau is considering on "cost of and access to quality consumer financial products"; the effect of the class proposal on the volume of litigation, including class litigation; and the availability of insurance that covers class action litigation costs, including any ambiguity or uncertainty about coverage. One SER questioned the Bureau's authority under section 1028 of the Dodd-Frank Act to adopt the proposals under consideration in a rulemaking because he believed the Bureau's Study showed that arbitration agreements benefit consumers and thus a rulemaking was inappropriate. Another SER suggested that the Bureau request various data from defendants in consumer protection actions that have been adjudicated or resolved, including the statute(s) under which the suit was filed, whether either party moved to compel arbitration, the outcome of any such motion, and the outcome of the litigation. The SER maintained that this data would show that defendants rarely invoke arbitration agreements with class waivers but that such agreements are a useful litigation tool.

9. Panel Findings and Recommendations

9.1 Number of Entities Affected

For purposes of assessing the impacts of the proposals under consideration on small entities, "small entities" are defined in the RFA to include small businesses, small nonprofit organizations, and small government jurisdictions that would be subject to the proposals under consideration. A "small business" is defined by the SBA Office of Size Standards for all industries through the NAICS.

SBREFA Pre-Dispute Arbitration Agreement Firm Count Methodology

To arrive at the number of entities affected, the Bureau began by creating a list of markets that would be covered if the proposals under consideration were to be adopted. The Bureau assigned at least one but often several NAICS codes to each market. For example, while payday and other installment loans are provided by storefront payday stores (NAICS 522390),

[30] The Bureau's consumer complaint system permits consumers to submit complaints to the Bureau. The complaints are forwarded to the company that is the subject of the complaint for response. Complaint data is shared with state and federal agencies that oversee financial products and services, and some de-identified complaint data is posted publicly on the Bureau's website. In addition, consumers' descriptions of what happened are included if consumers consent to their publication and after the CFPB takes steps to remove personal information. Companies' public-facing responses to complaints are included if companies choose to publish one.

they are also provided by other small businesses, such as credit unions (NAICS 522120). The Bureau estimated the number of small firms in each market-NAICS combination (for example, storefront payday stores in NAICS 522390 would be such a market-NAICS combination), and then the Bureau adds together all the markets within a NAICS code if there is more than one market within a NAICS code, accounting for the potential overlaps between the markets (probably all banks that provide payday-like loans also provide checking accounts, and we do not double-count them). The Bureau first attempted to estimate the number of firms in each market-NAICS combination by using administrative data (for example, Call Reports that credit unions have to file with the NCUA). When administrative data was not available, the Bureau attempted to estimate the numbers using public sources, including the Bureau's previous rulemakings and impact analyses. When neither administrative nor other public data was available, the Bureau utilized Census's NAICS numbers. The Bureau estimated the number of small businesses according to the SBA's size standards for NAICS codes (when such data was available).[31] When the data was insufficient to precisely estimate the number of businesses under the SBA threshold, the Bureau based its estimate for the number of small businesses on the SBA's estimate that 95% of firms in finance and insurance are small.[32]

Although the Bureau attempted to account for overlaps wherever possible, a firm could be counted several times if it participates in different industries and was counted separately in each data source. While this analysis removes firms that were counted twice using the NAICS numbers, some double counting may remain due to overlap in non NAICS estimates. For the NAICS codes that encompass several markets, the Bureau summed the numbers for each of the markets-NAICS combinations to produce the table of affected firms.

For each market, the Bureau attempted to estimate the percentage of firms that use pre-dispute arbitration agreements. The Bureau relied on figures from the Study, other publications and resources, including trade associations, and attempted to develop a methodology for sampling contracts on the Internet. The methodology involved attempting to sample the contracts of 20 businesses from randomly-selected states and different levels of web search relevance (to alleviate selection biases). However, service providers in most affected markets generally do not provide their contracts or terms and conditions online. Even when some contracts are available online in a specific market, the businesses that provided such information are usually large, national corporations that operated in multiple states. The lack of revenue and employment information on firms also makes it hard to determine which of the sampled businesses are small according to the SBA threshold. After attempting this methodology for several markets,[33] the Bureau decided to contact trade associations to obtain supplemental data including for the markets that were not covered in Section 2 of the Study.

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[31] The Bureau also used data from the Census Bureau, including Statistics of U.S. Businesses.

[32] *See* SBA Office of Size Standards, *SBA's Size Standards Analysis: An Overview on Methodology and Comprehensive Size Standards Review*, Presentation of Sharma R. Khem (2011), *available at* http://www.gtscoalition.com/wp-content/uploads/2011/07/Size-Stds-Presentation_Dr.-Sharma-SBA.pdf at 4.

[33] The Bureau attempted the sampling method for the following markets: Currency Exchange, Other Money Transmitters / Remittances, Telephone (Landline) Services, Cable Television. The Bureau also started work on a few other markets before determining that the results are unlikely to be sufficiently representative for the purposes of this report.

A Note on NAICS Counts and Other Industry Size Estimates

NAICS numbers were taken from the 2012 NAICS Manual, the most recent version available from the Census Bureau. The data provided employment, average size, and an estimate of the number of firms for each industry, which are disaggregated by a six-digit ID. Other industry counts were taken from a variety of sources, including other Bureau rulemakings, internal Bureau data, public data and statistics, including published reports and trade association materials, and in some cases from aggregation websites. For a select number of industries, usually NAICS codes that encompass both covered and not covered markets, we estimated the covered market in this NAICS code using data from a web aggregator. The reason the Bureau relied on this estimate instead of the NAICS estimate is that NAICS estimates are sometimes too broad. For example, the NAICS code associated with virtual wallets includes dozens of other small industries, and would overestimate the actual number of firms affected by an order of magnitude or more.

Finally, the table below sets forth potentially affected markets (and the associated NAICS codes) in which it appears reasonably likely that more than a few small entities use arbitration agreements. Some affected markets (and associated NAICS codes) are not listed because the number of small entities in the market using arbitration agreements is likely to be insignificant. For example, the Bureau did not list convenience stores (NAICS 445120). While consumers can cash a check at some grocery or convenience stores, the Bureau does not believe that consumers generally sign contracts that contain pre-dispute arbitration agreements with grocery or convenience stores when cashing checks. For the same reason, currency exchange providers (NAICS 523130) are not listed on the table. Other notable exceptions were Other Depository Credit Intermediation (NAICS 522190) and attorneys who collect debt (NAICS 541110). The Bureau believes that for these codes virtually all providers that are engaged in these activities are already reporting under other NAICS codes (for example, Commercial Banking, NAICS 52211). In addition, the proposal under consideration would apply to brokering, extending, and servicing of mortgages. For example, the Bureau estimates that there are 7,007 entities classified as mortgage and nonmortgage brokers (NAICS 522310), 6,657 of which are small. However, the Bureau believes that arbitration agreements are not prevalent in the consumer mortgage market. Further, the proposal would apply to extensions of credit by providers of whole life insurance policies (NAICS 524113) to the extent that activity is not the “business of insurance” under the Dodd-Frank Act section 1002(15)(C)(i) and 1002(3) and arbitration agreements are used for such policy loans; however, it is unlikely that a significant number of such providers would be affected because a number of state laws restrict the use of arbitration agreements in insurance products and, in any event, it is possible that the loan feature of the whole life policy could be part of the “business of insurance” depending on the facts and applicable law. Finally, the Bureau does not believe that a significant number of new car dealers offer or provide consumer financial products or services that renders these dealers subject to the Bureau’s regulatory jurisdiction; as a result, passenger car leasing companies (NAICS 532112) are not included in the table below; rather, the table covers dealer portfolio leasing and lending with the used car dealer category (NAICS 441120) and indirect auto lenders with the sales financing category (NAICS 522220).

Description	NAICS	Markets affected in this NAICS	Businesses	SBREFA Small Businesses	SBA Small Business Threshold	% Est'd to use PDAAs[34]	Midpoint Est of Businesses using PDAAs
All Other Nondepository Credit Intermediation	522298	Other Personal Loans, Pawnshops[35]	10,300	10,086	$38.5m in revenue	0-20%	1,009
All Other Professional, Scientific, and Technical Services	541990	Credit Counseling	726	715	$15m in revenue	50-80%	465
Collection Agencies	561440	Debt Collectors	4,500	4,356	$15m in revenue	100%	4,356
Commercial Banking	522110	Depository Institutions, Student Loan Servicing	13,303	11,608	$550 million in assets	0-20%	1,161
Consumer Lending	522291	P2P Lending, Other Personal Loans, Student Loan Issuance - Private, Third Party Payment Processing, Consumer Lending, Commercial Banking	6,620	6,416	$38.5m in revenue	80-100%	5,775
Credit Bureaus	561450	Credit Reporting Agencies[36], Credit Monitoring	410	390	$550m in assets	0-20%	39
Credit Card Issuing	522210	Credit Cards, Consumer Lending	444	422	$550m in assets	0-20%	42
Direct Property and Casualty	524126	Homeowners Insurance[37]	2,269	2,156	1500 employees	0-20%	216

[34] The percentage is reported for SBREFA Small Businesses only, where such estimate was available.
[35] Pawnshops would be potentially affected insofar as they provide consumer loans.
[36] Credit bureaus would be potentially affected insofar as they provide credit monitoring services.

Insurance Carriers							
Financial Transactions Processing, Reserve, and Clearinghouse Activities	522320	Other Personal Loans, Other Money Transmitters / Remittances, Prepaid Cards, Payment Processing/Transfers, ACH Systems, Third Party Financial Service Providers, Mobile Payments	7,380	6,880	$38.5m in revenue	20-50%	2,408
Other Activities Related to Credit Intermediation	522390	Payday Loan, Tribal Lending, Refund Anticipation Check, Deposit Advance, Servicing (non-mortgage), Virtual Currency, Money Order, Traveler's Checks, Mobile Wallets, Debt Settlement/Relief, Marketplace Loans, Tax Lending, Lump Sum Payment Company (payment advance)	11,023	10,812	$20.5m in revenue	80-100%	9,731
Sales Financing	522220	Installment Lending, Auto Title Lending, Auto Finance, Truck/Boat/RV Finance	9,058	8,523	$38.5m in revenue	80-100%	7,671

[37] This only includes businesses that provide credit monitoring services. Such entities are counted here. To the extent those activities are determined to be the "business of insurance" under applicable law for any given insurance entity, this estimate is overinclusive insofar as the proposals under consideration would not apply to activities that are the "business of insurance."

Truck, Utility Trailer, and RV (Recreational Vehicle) Rental and Leasing	532120	Truck/Boat/RV Finance	1,645	1,533	$38.5m in revenue	80-100%	1,380
Used Car Dealers	441120	Buy-Here Pay-Here Auto Dealers[38]	9,156	8,966	$550m in assets	80-100%	8,069
Utilities	221	All Types of Utilities[39]	5,973	5,973	between $15-$27.5m in revenue, or 250-1000 employees	0-20%	597
Wired Telecommunications Carriers	517110	Telephone - landline, Cable Television, Cable Providers (First Party)[40]	3,520	3,421	1500 employees	80-100%	3,079
Wireless Telecommunications Carriers (except Satellite)	517210	Cell Phones[41]	716	686	1500 employees	80-100%	617

In Section 8 of the Study, the Bureau documented approximately 420 class litigation settlements in Federal courts over 5 years. The data on class settlements from Section 6 of the Study, adjusting for the population represented by the selected jurisdictions, suggests that there were fewer class litigation settlements in state courts than in federal courts.[42] The Bureau conservatively assumes a rate of 800 class settlements between federal and state courts over five

[38] The exemption in the proposal under consideration for merchants engaged in transactions falling within section 1027(a)(2)(B)(i) of the Dodd-Frank Act is not contemplated to apply to merchants engaged in transactions that are subject to section 1027(a)(2)(B)(ii) or (iii) of the Dodd-Frank Act.

[39] The proposal under consideration would generally not apply to governmental entities, and would only apply to private utilities that engage in third party billing. However, the estimates here do not exclude governmental entities, or non-governmental entities not doing third-party billing, and therefore may be overinclusive.

[40] *Id.*

[41] *Id.*

[42] On p. 37 of Section 6 of the Study, for cases filed over the same time period, the Bureau reports 61 class settlements in federal courts, compared to 8 class settlements in state courts representing 18.2% of the population.

years, or 160 class settlements a year. The Bureau is still analyzing how many of these settlements involved smaller entities.

From the table above, the Bureau estimates that approximately 40,000 small entities in affected markets do not use PDAAs. Even assuming that only entities without PDAAs (including debt collectors) are parties to class litigation settlements, that all of the 160 class settlements a year involved smaller entities, and that no entity was subject to more than one settlement, this estimate still results in approximately 0.4% chance of a small entity being involved in a class litigation settlement in a given year.

9.2 Related Federal Rules

As noted in part 2.4 above, several other federal laws and regulations address the use of arbitration agreements in both consumer finance products or services and other types of products or services. There are several federal laws and regulations that may apply. First, the Military Lending Act and its regulations, implemented by the Department of Defense, prohibit arbitration agreements in consumer credit contracts with certain covered servicemembers or their dependents.[43] Second, the Dodd-Frank Act prohibits arbitration agreements in mortgage contracts. This statutory provision is implemented in regulations by the Bureau.[44] There are also arbitration rules issued by the Securities and Exchange Commission and the Commodity Futures Trading Commission that apply to entities subject to the authority of those agencies.[45] As is discussed above, the proposals under consideration would not disturb these two laws and related regulations.

9.3 Compliance Burden and Potential Alternatives

9.3.1. Proposal to Prohibit Arbitration Agreements that Block Class Actions

Costs of Defending Class Actions

The SERs expressed their beliefs that arbitration agreements either reduced their companies' exposure to class action lawsuits or, for the debt collectors, provided increased leverage to negotiate favorable settlements of class action lawsuits. The SERs argued that the Bureau's proposal under consideration to prohibit arbitration agreements that block class actions would increase the likelihood of their being sued in a class action or reduce their ability to settle all cases, including class actions, favorably. Many of the SERs expressed concern about the significant costs to their companies of defending class actions, including legal defense costs, costs of settlement, and employee time diverted from regular business activity. Some expressed concern that a small entity could reduce its product offerings or incur legal defense costs so high as to put it out of business.

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[43] 10 U.S.C. 987, as implemented by 32 CFR 232.8(c).

[44] Dodd-Frank Act section 1414(a), as implemented by 12 CFR 1026.36(h).

[45] *See generally* FINRA Code of Arbitration Procedure (subject to review and approval by the SEC); *see also* 17 CFR 166.5(b) (CFTC regulations implementing Commodity Exchange Act and requiring that arbitration agreements be voluntary).

The Panel recommends that the Bureau continue to evaluate the costs to small entities of defending class actions and how such costs may differ from the costs to larger entities.[46]

Availability and Cost of Insurance or Indemnification

The SERs expressed concern about how the Bureau's class proposal would affect the availability and cost of insurance coverage for class action litigation defense costs. SERs in certain markets stated that the cost of insurance was already high and that the premiums have been increasing rapidly in recent years. The SERs further noted that whether an insurer would cover class action legal costs under relevant policies was unpredictable and thus that the SERs were uncertain whether their companies could rely on insurance to protect them in the event they were sued in a class action lawsuit. In general, the SERs stated that insurance would be insufficient protection against the potentially large costs of a class action lawsuit.

The Panel recommends that the Bureau further assess the availability and costs of insurance for small entities (including impacts on insurance premiums and deductibles and any costs related to pursuing unpaid claims against an insurer), particularly whether and how insurance covers class action defense costs and whether exposure to class actions will impact the cost and availability of this insurance.

The Panel further recommends that the Bureau seek comment on or conduct additional outreach to better understand when small entities may be indemnified by third parties for their behavior and related expenditures they could incur in class actions.

Compliance/Deterrence

Most of the SERs rejected the Bureau's reasoning in its proposals under consideration that the potential for class action litigation encourages companies to comply with relevant consumer finance laws and deters companies from practices that may harm consumers. Instead, most of the SERs stated that they believed that they fully complied with all relevant consumer protection laws and that they intended to continue such full compliance in the future. Some of these SERs believed that smaller entities had greater incentives to comply with the law than larger ones in order to retain customers. These SERs further stated that the cost of defending hyper-technical class actions diverted companies' resources that might otherwise be spent on compliance.

The Panel recommends that the Bureau seek comment on whether small entities engage in different compliance practices than large entities. The Panel further recommends that the Bureau analyze the impact of class actions on small entities' conduct.

9.3.2. Proposal to Require Submission to the Bureau of Arbitral Claims and Written Awards to the Bureau

[46] "Costs" includes attorneys' fees, settlement amounts, and the small entities' employees' time and other costs related to the class action (including time spent on investigation and discovery, in-house counsel defense efforts, and time diverted from other activities).

Although the SERs did not believe that the direct costs of submitting arbitral claims and awards to the Bureau would be significant, they expressed some concern about the indirect costs of this proposal under consideration, such as whether it might cause the cost of arbitration administration to increase and whether it might require the SERs' companies to devote employee resources to redacting customers' confidential information before submission. Apart from the potential costs of the submission proposal under consideration, the SERs expressed concerns about the possibility that the Bureau would publish arbitral claims and awards, including concerns that the privacy of customer information could be compromised, that SERs' companies reputations could be harmed, and that publication of awards and not settlement information would not present a representative picture of the arbitration process given that most arbitrations result in settlements.

The Panel recommends that the Bureau seek comment on whether the publication of claims and awards would present a representative picture of arbitration. The Panel further recommends that the Bureau continue to assess whether and by how much its proposal under consideration regarding submission and publication of arbitration materials would increase the costs of arbitration, including administrative fees or covered entities' time. In addition, the Panel recommends that the Bureau consider the privacy and reputational impacts of publishing claims and awards (for both the businesses and consumers involved in the dispute).

9.3.3. Impact on Cost of Credit for Small Entities

Some SERs expressed concern that the Bureau's class proposal would expose their businesses to more class litigation, which could, in turn, increase their companies' legal defense costs and therefore increase the cost of credit to those entities.

The Panel recommends that the Bureau consider whether there are alternatives to provide relief to consumers for harms and encourage compliance with relevant consumer financial laws that would not increase small entities' exposure to class action lawsuits that could increase their cost of credit.

9.3.4. Alternative Approaches to Regulation

The SERs indicated that the proposal under consideration for class actions could subject them to substantial additional costs, primarily through increased exposure to class action litigation which can be costly to defend. To reduce this burden, some SERs suggested that the Bureau consider alternative approaches that could, in their view, accomplish the goals of the proposal under consideration for class actions, which include deterring such companies from violating the law or harming consumers and providing relief to consumers harmed by companies that provide consumer finance products or services.

Small Entities

The SERs stated that small businesses have a greater need to retain customers than their larger counterparts and thus are less likely to violate consumer protection laws or harm their customers. Moreover, SERs stated that, in the instances where customers may be harmed, small entities have significant incentives to resolve any disputes through customer service channels and other informal means in order to retain the customer and avoid potential litigation. SERs also stated that they may be impacted by class actions even when they have, in their view, done nothing wrong.

The Panel recommends that the Bureau continue to evaluate the impact of its proposals under consideration on small entities and whether the Bureau should consider exempting small entities from some or all of the requirements for any proposed rule it might issue or delaying implementation for small entities.

Consumer Education and Improved Disclosure

Some of the SERs stated their belief that consumer harms could be addressed on a large scale by individual consumers without class action litigation if consumers were made aware of their dispute resolution rights (*i.e.*, a consumer's possible options of bringing a claim in a small claims court or an individual arbitration proceeding) through changes to disclosure requirements or Bureau-led consumer education initiatives. These SERs suggested that the Bureau could assist in educating consumers about these dispute resolution rights in order to promote these fora as viable means of resolving disputes and redressing consumer harms.

The Panel recommends that the Bureau consider whether, through improved disclosure requirements and consumer education initiatives, the Bureau could increase consumers' awareness and understanding of their dispute resolution rights and use of these fora to resolve disputes and redress consumer harms.

Improvements to Individual Arbitration

Several of the SERs stated their belief that consumer harms could be addressed through individual arbitration if that forum were made more consumer-friendly. This would, in these SERs' view, reduce the need for class action litigation to remedy consumer harms.

The Panel recommends that the Bureau continue to evaluate whether it can improve consumer access to and the efficacy of individual arbitrations and whether these improvements would be sufficient to provide the same benefits the Bureau believes would be provided by the class proposal. Specifically, the Panel recommends that the Bureau consider the following improvements to individual arbitration: requiring that arbitration agreements contain consumer-friendly provisions for individual arbitration and whether these improvements could provide these benefits (*e.g.*, provisions requiring that companies pay a greater share of consumers' costs in arbitration/small claims court, provisions requiring opt-out mechanisms, or provisions encouraging fair arbitrators for individual arbitrations (including the creation of a specialized arbitration forum for consumer disputes that would provide a panel of arbitrators for a single dispute and allow consumer input on the arbitrators chosen), create a Bureau-approved list of arbitrators for consumer arbitrations, that arbitration agreements be permitted to block class actions if the company also agrees to pay consumer's filing fees for individual arbitration or that companies be required to pay into a fund that would pay the arbitration costs of small-dollar claims).

Concerns About Specific Causes of Action

The debt collection SERs expressed particular concern about exposure to class action litigation based on certain statutory causes of actions that have no limit on statutory damages in a class action, such as the TCPA. These SERs indicated that class actions under the TCPA were increasingly common and that the threat of such lawsuits was enormous given their unlimited damages potential, particular to small entities that may be unable to absorb a very large class action award or settlement. These SERs further noted that many statutes provide for attorneys' fee recovery and argued that such provisions create a sufficient incentive for both consumers and plaintiff's attorneys to bring individual claims under those statutes.

The Panel recommends that the Bureau evaluate and seek comment on whether specific features of particular causes of action affect the availability of consumer relief, the deterrent effect of class actions, and consequences to small entities arising from settlement or recovery for those causes of action. The statutory features to consider include the availability of attorney's fees, the presence and absence of limits to class recovery, and the amount of damages and whether these features counsel in favor of exempting certain causes of action from the requirement that class actions be available in a proposed rule.

List of Appendices

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Appendix A

Written Comments from Small Entity Representatives

1st Community Bank
MEMBER FDIC

November 9, 2015

By electronic deliver to:
nathaniel.balk@consumerfinance.gov.

Re: Comment of Small Entity Representative Sylvia to the small business review panel for potential rulemaking on arbitration agreements

Mr. Nathaniel Balk
1275 First Street, NE
Washington, DC.

Dear Mr. Balk,

I appreciate the opportunity to participate in the October 28, 2015 convening meeting of the Consumer Financial Protection Bureau's Small Business Regulatory Review Panel (Panel) to provide the small bank perspective with regard to potential rulemaking on arbitration agreements. Below are additional comments to highlight and elaborate on topics that arose at the meeting regarding the Bureau's "Outline of Proposals Under Consideration and Alternatives Considered" (Outline).

First Community Bank, asset size $392M, has utilized an Arbitration Agreement for approximately twenty years for consumer and commercial transactions including deposit and loan products. Our agreement is highly visible and explained to customers in detail upon opening an account.

Pre-dispute arbitration and waivers of class action suits are defensive measure intended to avoid costly and potentially devastating litigation costs, settlement pay-outs, and reputational damages, consequences the bank cannot avoid even if it wins a suit or has done nothing wrong. One case could wipe out or seriously harm the economic well-being of the bank, as well as its reputation. As one member of the Panel put, it, "You don't have to be wrong to be put out of business." Even if a class action has not yet been filed against our bank, it is the *realistic risk of a lawsuit,* based on reported lawsuits and their costs, including litigation against small banks and other small businesses, against which the bank must protect itself.

The risk of litigation is heightened by the constantly changing and ever-increasing volume and complexity and technical nature of consumer credit and bank account regulations. While government agencies, including the Bureau of Consumer Financial Protection (Bureau), endeavor to make regulations clear and unambiguous, they often are not. In addition, technical, harmless violations can spawn class action suits. For example, as noted at the meeting, the Regulation E (Electronic Fund Transfer Act) requirement that ATM owners post a sign about potential ATM fees on ATMS ignited a wave of litigation on the basis that notices were not posted. However, though difficult to prove, many believed (and in some cases had proof) that signs had been damaged or removed by plaintiff's before using the ATM. Regulation E was also the basis for a rash of lawsuits related to a requirement that ATMs owners post notices that ATM fees "will" be imposed. The lawsuits claimed the notices were inaccurate because customers of the ATM owners, in fact, did not have to pay. While the regulation was ultimately amended in both cases, it was only after the filing and settlement of numerous lawsuits.

These are only a few examples. As discussed at the meeting, other regulations, such as the Telephone Consumer Protection Act, pose significant risk because the liability is not capped. That the Bureau does not control all the regulations that may be the basis for lawsuits, including those that are frivolous or based on technical violations, does not relieve it of the responsibility to consider their impact on the litigation risk and cost to small banks and other small financial service businesses. Similarly, the Bureau should not disregard the shortcomings of the judicial system simply because the Bureau does not control it. Rather, the Bureau should consider both the impact of the class action on regulations the Bureau does not promulgate and the shortcomings of the judicial system, as both are relevant to the "public interest" which the Bureau must consider before regulating pre-dispute arbitration agreements.

The Bureau also inquired at the meeting whether a potential means of reducing litigation costs and risks is through insurance. Insurance only goes so far in reducing the risks, costs, and harm to small banks.

First, insurance does not cover all potential lawsuits. As discussed at the meeting, there may be riders and exceptions to policies. In addition, there are many uncertainties about whether insurance will cover a particular claim. When asked whether the insurance company would cover litigation costs for compliance violations, the response of our insurance company was, "It depends," and that it is a case-by-case determination based on the specific merits of the claim in question. As an example, one bank reported that its insurance company recently challenged a claim on the basis that the bank could have prevented the compliance violation. Insurance companies will also deny coverage if it is found that there were intentional violations or bad faith. Such subjective terms and uncertainty about coverage increase the risk that the bank must manage.[1] Class action waivers reduce the risk of a devastating lawsuit that insurance does not cover. I am not an insurance expert, but I urge the Bureau to study and provide data on the extent to which insurance policies cover claims and any ambiguity or uncertainty about coverage.

Second, and often overlooked, there are bank costs beyond what the insurance company pays. This includes not only the deductible and possibly penalties, but also the business disruption costs, such as the time and involvement of bank staff across the board, including upper management, accountants, and frontline and back office staff. Bank staff have to set aside regular work serving customers in order to respond to subpoenas, research, sort, and produce documents, answer interrogatories, and prepare for and attend depositions and court meetings and proceedings. Even a case that is dismissed with summary judgement involves time and costs. While our litigation experience so far has been limited to commercial cases it has involved at times key upper management of the Bank to spend an extended amount of time on unsupported claims. When confronted with litigation, a small community bank is best represented by upper management resulting in time spent on matters that are not our primary objective to serve our community. We are forced to divert our attention to claims rather than focusing on the needs of small businesses and consumer.

Third, as discussed at the meeting, premiums can increase and insurance may be cancelled as a result of a lawsuit. Indeed, insurance companies may inquire about a bank's specific practices based on recent insurance claims made by other banks, lawsuits, and regulatory enforcement actions. Ultimately, it is our customers who pay that price. Increased insurance premiums may seem inconsequential because they can be absorbed by incremental price increases paid by all consumer customers. However, it is the never-ending "incremental costs" that ultimately raise the prices of consumer bank accounts and consumer credit. The Bureau should not under-estimate how the additional risk, including the

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1 An additional potential hardship is that the bank may have to fund defense costs initially because questions of coverage may not be determined until late into or even after the litigation process.

uncertainty of insurance coverage in the event of a lawsuit, is built into what consumers pay for banking services.

Beyond the cost of defending a lawsuit, which may or may not be covered by insurance, is the reputational risk a small bank suffers from a single class action suit. A bank suffers damage to its reputation even if the case is dismissed in summary judgement, the bank ultimately wins the case, or the bank simply settles a meritless case as a matter of expediency and cost-effectiveness. As a small bank, my bank prides itself in its commitment and investment in our community. Reputation, especially for a small bank, is critical. A single headline can undercut a lifetime building of community trust and reputation. Class action waivers and arbitration help to minimize the potential unfair damage to our reputation.

The Bureau has asked whether arbitration causes small entities to be more lax about compliance. As a small bank that is subject to routine examination for compliance with all consumer regulations, I can answer emphatically that the arbitration provision has no impact on our compliance efforts. The arbitration clause impacts our *legal* costs, but not our compliance costs. In addition, while the arbitration agreement does not impact our commitment to compliance, its removal may impact our ability to serve our community. For example, some products designed for vulnerable or underserved groups may be less attractive to offer because they are more likely to draw the attention of plaintiffs' attorneys due to the emotional appeal.

I understand the objective of ensuring consumers' harms, including those involving small amounts that might not merit pursuit. However, the Bureau is better able than class action suits to address complaints that involve small amounts. It is able to address them more efficiently and in a manner where consumers, rather than lawyers, receive a meaningful award.

In addition to the prohibition against class action waivers, the Bureau is considering a requirement that arbitration claims and awards be submitted to the Bureau and potentially published. I appreciate the Bureau's interest in understanding the arbitration process and experience, but publication of claims and awards will create a false picture, much as the publication of consumer complaints do. The data will be skewed and potentially inaccurate and misleading. Accordingly, any such provision will serve as an effective deterrent.

Rather than prohibiting class action waivers, the Bureau could ensure effective, convenient, and quick resolution of small dollar claims through an improved arbitration system coupled with consumer education of the arbitration option. Arbitration already provides a quicker, more convenient, and less daunting and expensive alternative to going to court. An improved arbitration process -- as an alternative to a prohibition of class action waivers -- would impose minimal if any costs on consumers and ensure convenient access through a variety of channels. Consumers would thus be more likely to have small dollar disputes resolved and also be more likely to receive compensation than they would in class action suits. The Bureau could further the effectiveness of the improved arbitration by increasing consumer awareness of the arbitration option. The Bureau could fund such efforts through its Consumer Financial Civil Penalty Fund. This fund, which is funded from civil penalties, may be used for the purpose of consumer education and financial literacy programs under Section 1017(d)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This approach would allow the Bureau to achieve the goal of ensuring small dollar claims are addressed and addressed in a manner that is easy and convenient for consumers, but avoid the risks, inefficiencies, costs, and often unfairness of class actions suits that I have described above.

Again, I appreciate the opportunity to provide suggestions on the impact of potential restrictions on pre-dispute arbitration agreements as described in the Bureau's Outline. As noted, such arbitration agreements help my small bank to manage risk and avoid potentially devastating class action suits that involve not only significant costs, but damage to our reputation. I stress that our arbitration provision and class action waiver have no impact on our level of compliance with consumer protection provisions. As a regulated bank, we are regularly examined to ensure compliance with consumer protection regulations. Moreover, the Bureau is in a better position than class action lawyers to resolve disputes involving small amounts in an effective and efficient manner. Finally, improving the arbitration process and encouraging its use is a more effective and fair way to address concerns about resolution of small-dollar claims.

Please feel free to contact me at 361-888-9310 for further insight on the impact of this proposed rulemaking on small businesses. The effect on our small community bank would lead to an impact on the small businesses and consumers we strive to serve.

Respectfully submitted,

Sylvia S. Aparicio
Senior Vice President
Chief Lending Officer
Fair Lending Officer

FMA Alliance, Ltd's Response to the CFPB's Discussion Questions Regarding the Potential Arbitration Rulemaking

1. If your buisness includes arbitration agreements in any of its contracts for consumer financial products or services, please answer the questions a-f below. (if not, proceed to question 3, or if your buisness is a debt collector or debt buyer, proceed to question 2.)

FMA is a third party collection agency that does not purchase debt or contract with consumers for financial products or services.

2.If your buisness is a debt collector or debt buyer: Does the presence (or absence) of an arbitration agreement in a consumer credit agreement affect which accounts you collect or purchase or how you structure your services? Does it affect your charge for collecting, or the price of purchasing accounts? If so, why not?

FMA is a compliance-oriented agency and does not differentiate accounts based on the presence or absence of an arbitration agreement. All accounts are worked pursuant to the highest compliance standards. However, the inability of one of FMA's clients to utilize arbitration agreements has materially and adversely affected the profitability of the client relationship. Because the client cannot use arbitration agreements, the risk of vicarious liability via the agency has resulted in increased client oversight that is expensive and requires significant amounts of agency time and money.

The reluctance of agencies to continue working with the effected creditors will result in substantial consumer harm. The working paper by Viktar Fedaseyeu via the Federal Reserve of Philadelphia has unequivocally determined that for each new restriction codified in state debt collection regulations, there is a 2.2 % decrease in the number of new revolving lines of credit.[1] The sweeping change proposed by the CFPB would impact the marketplace in a far more systemic way, but would not decrease the threat of consumer harm as agencies are very focused on compliance practices due to regulatory oversight.

Please see the attached appendix for more information.

3. If your business does not include arbitration agreements in any of its contracts for consumer financial products or services, has this been a deliberate choice? If so, please explain why it does not do so, including any benefits or costs from not doing so.

FMA is a third party collection agency that does not purchase debt or contract with consumers regarding financial services or products.

[1] See appendix for further data.

4. Would the proposals under consideration on class actions or individual arbitration change your business's decision to include (or not include) arbitration agreements in contracts for consumer financial products or services? Why/why not? If so, how

FMA is a third party collection agency that does not purchase debt or contract with consumers regarding financial services or products.

5. Do you have views or data on how often your competitors include arbitration agreements in the types of consumer financial products or services that your business provides? If so, please elaborate, and note the products or services for which you have views or data.

FMA and its competitors are third party collection agencies that do not purchase debt or contract with consumers regarding financial services or products. However, most financial services clients do include arbitration agreements.

6. How often does your business review or update terms and conditions in its contracts generally, and terms and conditions of any arbitration agreements specifically? Please describe the process and cost involved. Do you use employees, outside counsel, or standard contract language? How do you distribute these changes to consumers?

FMA is a third party collection agency that does not purchase debt or contract with consumers regarding financial services or products.

7. Has your business ever agreed to arbitrate a dispute with a consumer afterthe dispute arose, when there was no arbitration agreement in place before the dispute arose?

FMA was referred to arbitration by a Judge in the Eastern District of New York in 2000. The parties had entered into settlement negotiations prior to the referral and the case settled before arbitration. FMA has never been approached by a consumer who wished to resolve their claims via arbitration. FMA would agree to proceed via arbitration if asked.

However, FMA would prefer to resolve any issues or concerns with consumers without litigation or arbitration. FMA has a very robust internal complaint process and has found that early and non-legal resolution is always the best method of resolving consumer complaints. FMA employs personnel in the Compliance Department whose only job duties are to track, resolve, and provide feedback regarding consumer complaints. As such, most issues are quickly remediated without the need for attorney involvement. The cases that are filed are based on highly technical and novel alleged statutory violations, and in virtually all cases FMA never spoke to the filing consumer.

8. As far as you are aware, has your business brought a claim against a consumer in arbitration or been named as a respondent in an arbitration filed by a consumer, relating to any consumer financial products or services you provide?

FMA does bring any affirmative claims against consumers or participate in collections via litigation. Further we have not been named as a Defendant. Thus, none.

9. If you answered yes to the above question, please discuss how many arbitrations there have been and provide more information about these proceedings, such as whether the case began in court, the arbitration administrator(s) used, the fees your business was asked to pay, the fees it actually paid, any other expenses incurred, how long the arbitration took (from filing through conclusion), whether the arbitrator rendered an award on the merits, and whether the award was filed publicly in a court proceeding (such as to enforce or review the award) or otherwise made public.

None.

10. If your buisness has been named as a defendant in any class actions filed or settled with consumers related to the products or services provided to consumers, please identify each such case of which you are aware and note the product or service involved.

FMA has been named as a Defendant in the following purported class action cases since 2010:

1. Astolin v. FMA Alliance, Ltd., U.S. District Court, Southern District of New York.
2. Rubin v. FMA Alliance, Ltd., U.S. District Court, Southern District of New York.
3. Dzidzovic v. FMA Alliance, Ltd., U.S, District Court, Eastern District of New York.
4. Irving v. FMA Alliance, Ltd., U.S. District Court, Middle District of Pennsylvania.
5. Robertson v. FMA Alliance, Ltd., In the County Court Thirteenth Judicial Circuit of the State of Florida.

Each case was premised on FDCPA violations. The *Robertson* matter contained both FDCPA and state claims. Plaintiffs did not move for class certification in any of the above-referenced cases. All cases were settled on an individual basis. More specific information is provided in the appendix.

As evidenced above, consumers and attorneys prefer to litigate FDCPA claims on an individual basis rather than in a class context. This is in large part due to (1) the class cap which limits recovery to 1% of the collector's net worth, and (2) the requirement that attorney's fees be approved in a class settlement.

Thus, this data squarely contradicts the CFPB's conclusion that (1) consumers are unable to obtain relief for smaller claims filed on individual basis, and (2) cannot find representation for their claims.

As discussed in question 16, the practice of filing class complaints without the intent to move forward with class certification is harmful to consumers, the credit market, and substantially affects small businesses due to the increased cost of managing these claims.

Please see the attached appendix for more information.

11. Do you believe that any of these class actions lacked any basis in fact or law or otherwise should not have been brought? Why?

Please see the attached appendix.

12. Did your buisness file a motion with the court, based on an arbitration agreement, to compel arbitration of any of these cases? Why or why not?

Please see the attached appendix.

13. If the product or service in these cases did not have an arbitration agreement at the time of the case, did you adopt one later? If so, why?

FMA is a third party collection agency that does not purchase debt or contract with consumers for financial products or services.

14. In recent years, has your business at any point been threatened with a class action over its consumer financial products or services? If so, please describe your experience. Did your buisness refer to an arbitration agreement in response to a letter threatening suit?

It is common practice for attorney demands to include a class action threat, regardless of the viability of their claim. FMA will refer to arbitration agreements in settlement negotiations, but only if Plaintiff's counsel is refusing to negotiate reasonably.

Please see attached appendix for more information.

15. If you know, has the presence/absence of an arbitration agreement affected whether your buisness has faced class actions or a threat of class actions?

Discussing arbitration agreements is a critical tool for FMA as set forth in Question 12 above. There have been several instances where Plaintiff's counsel is unwilling to accept a proposed settlement, despite the fact that the consumer was offered more than two times their claimed damages plus attorney's fees. Plaintiffs rationalize their rejection on the basis that proceeding with a class will be far more expensive for the Defendant while Plaintiff's will continue accruing statutory attorney's fees. Because the case is being settled on an individual basis, discussing arbitration provides FMA counsel an opportunity to restructure the negotiation and focus on the actual allegations of the named consumer rather than a fictitious class.

This is critical in all of FMA's FDCPA cases, because Plaintiff's counsel is incented to bring a class claim without any intent to file a motion for class certification.

16. What were the impacts to your buisness in dealing with such litigation or the threat of it, including staff and managerial time, discussing the threat and any third-party expenses? Do you believe the presence or absence of an arbitration agreement affected this? Why?

As set forth herein, the class actions filed against FMA resulted in considerable expenses. The impacts are broken down by category below. Insurance costs are discussed separately in FMA's response to Question 17. 16 (b-d) are provided in the appendix.

a. Consumer harm.

Class action cases filed without intent to certify a class harms consumers. As set forth above, the individual Plaintiff receives a reward higher than the total cost of the alleged violations or harms set forth in their Complaint. As such, they are unjustly enriched and receive an undue windfall because no non-named potential plaintiffs receive any settlement or awarded damages. Thus, in practice FDCPA class actions adversely affect the credit market without any real benefits of a class action.

Additionally, the CFPB believes one of the main benefits of a class is the notice process. However, in all of the class action complaints filed against FMA, no non-named consumers received notice of the class.

The CFPB's position that class actions benefit consumers is potentially valid in theory, but in practice they are non-existent because Plaintiff attorneys often do not attempt to certify a class.

17. Do you have any data you wish to provide on the cost your buisness pays, or has been quoted for insuring against defense costs or legal liabilities involving claims that might be brought by your consumers? This could be general commercial liability insurance or specialized insurance that may cover some costs incurred in litigation.

Please see attached appendix.

18. In your experience, has the price of any insurance your business has obtained, or been quoted, varied based on whether you have an arbitration agreement?

FMA does not contract with consumers, therefore arbitration is not a direct factor considered by our insurer. However, the same issue is analyzed by reviewing our cost claims. For example, if FMA was named in a TCPA class action based on the ambiguous FCC 2015 Declaratory Ruling, the claim would be exorbitant and the use of an arbitration agreement would affect the overall outcome. The risk of a meritless case precluding FMA from obtaining insurance is very real as further outlined in FMA's response to Question 19 below.

19. Do you have any observations on our preliminary analyses of the legal costs discussion in the Outline (at pp. 27-29)?

Because the TCPA does not place a cap on damages, there are risks that were not fully considered. A review of *In Re TCPA litigation* provides an important sample case for analysis and consideration herein.

In 2014, Capital One paid the largest TCPA settlement on record of $74 million, and two defendant debt collection agencies paid settlement amounts of $1.4 million and $1 million toward the class fund. In these cases, the class members will receive between $20 and $40. However, all parties vehemently deny any wrongdoing, and made a buisness decision to settle based on the cost of litigation. Even if the Defendants won the initial case, they would have been forced to incur the costs of an appeal.

Capital One and the associated agencies were precluded from utilizing an arbitration agreement in this case due to a settlement the *Ross* case. If the settlement in *Ross* did not apply, the outcome could have been starkly different. The costs to the marketplace of this case were not meaningfully evaluated in the study in concluding the *Ross* case had no adverse effects. Further, the effects may take years to actualize as credit decisions are not instantaneous.

In closing, the $35 settlements obtained by class members did not justify the expense of this case. The attorney received $15,668,265.00 which equates to an hourly rate of $3,671.00, while the claimants received nuisance settlements. The issue of attorney’s fees is being further appealed in the Seventh Circuit as the class members are furious over the amounts received in settlement. This contradicts the CFPB’s findings that smaller claims are best obtained via class relief or that consumers are content to receive monetary relief that wouldn’t cover the cost of a tank of gas.

Another factor to be evaluated by the CFPB is the cost of oversight for third party vendors, including debt collection agencies as fully analyzed in FMA’s response to Question 2 above.

Please see the attached appendix for more information.

<u>20. If your contracts for consumer financial products or services include arbitration agreements, please compare, if possible, your business’s investment in compliance with consumer protection laws now with its investment in compliance before it used arbitration agreements.</u>

FMA is a third party collection agency that does not purchase debt or contract with consumers regarding financial services or products

<u>21. Would the proposal under consideration change your business’s investments in compliance? If so, why and how? When answering this question, please keep in mind all types of potential investment in compliance, such as additional staff time, additional managerial time, additional training time, time for additional rounds of review of documents or products, and any monetary expenses for third-party services.</u>

The CFPB's proposals would not result in increased compliance costs in relation to internal processes, internal controls or additional staff that focus on FMA's internal compliance measures. As a large market participant, FMA is heavily invested in compliance for reasons wholly unassociated with litigation risks, including regulatory oversight. For example, FMA (1) has invested over $1,000,000.00 in call analytics software, (2) does not credit report, and (3) has invested significant IT personnel time in creating a program that systemically closes any account that goes out of statute while at FMA and returns it to the creditor.

However, due to FMA's analysis as set forth in response to Question 2, FMA would incur substantial costs in relation to unnecessary third party oversight. Due to the decreased margins associated with additional client oversight, FMA would actually have to divert funds invested in internal compliance controls to counter the oversight costs. As such, the proposals would have the unintended consequence of creating additional opportunities for unintended consumer harm.

<u>22. As noted in the Outline (at p. 15), one of the goals of the class proposal is to ensure compliance with consumer protection laws. Do you have views on alternatives for the Bureau to achieve this goal, such as prohibiting arbitration agreements, allowing a business to block class litigation with an arbitration agreement that makes class arbitration available (discussed in the Outline at pp. 17-18), or any other alternatives?</u>

Rather than prohibit arbitration agreements for class actions on a per-se basis, the CFPB should analyze piecemeal prohibitions that specifically target the harm they are seeking to prevent. Congress took a similar statutory approach when prohibiting arbitration clauses in mortgage agreements due to the specific types of harm they were trying to prohibit. The per-se ban as proposed is not narrowly tailored, and therefore may result in arbitrary and capricious results.

For example, the TCPA is not one of the statutes governed by the CFPB and should not be covered by the rules. Additionally, because the FDCPA provides for statutory damages of $1,000.00 and attorney's fees, there is no benefit to class certification because there are no "small claims." Data regarding same has been set forth in this response.

However, the CFPB may identify certain statutes whose harms are so specific that prohibiting arbitration agreements is necessary. This approach would mirror Congress's intent in enacting Dodd-Frank.

<u>23. As noted in the Outline (at pp. 14-15), one of the goals of the class proposal is to ensure consumers have a way to group together to seek relief for smaller claims that typically are not pursued individually. Do you have views on alternatives for the Bureau to achieve this goal, such as prohibiting arbitration agreements, allowing a business to block class litigation with an arbitration agreement that makes class arbitration available (discussed in the Outline at pp. 17-18), or any other alternatives?</u>

FMA's experience as well as external data on FDCPA class actions does not support the conclusion that consumers are only able to obtain relief via class settlement. The FDCPA and other statutes governed by the CFPB provide for statutory damages of $1,000.00 which is why arbitration claims for less than "small value" amounts were not identified. The $1,000.00 statutory damages provision is an important cofounding variable that must be reviewed when analyzing the CFPB's study. Further, because the FDCPA provides for attorney's fees, consumers have no issue retaining counsel to file cases on their behalf. This is fully supported by real litigation data.

Pursuant to WebRecon, a common industry service provider, the following lawsuits were filed in September 2015:

- 870 FDCPA, 141 Class Action (16.2%)
- 242 TCPA, 68 Class Action (28.1%)
- 332 FCRA, 29 Class Action (8.7%)

The following data is for lawsuits filed in September 2014:

- 783 FDCPA, 73 Class Action (9.3%)
- 193 TCPA, 12 Class Action (6.2%)
- 177 FCRA, 24 Class Action (13.6%)

Pursuant to the data in relation to actual cases filed, consumers are far more likely to seek redress individually rather than on a case basis. Further, as demonstrated by FMA's analysis in Section B, virtually all of the filed class actions will be settled on an individual basis and were brought without any intent to seek class certification.

Until there is actual data evidencing individual claims are not pursued, the threshold issue regarding the nature of class actions has not been established by the study.

<u>24. Do you have any observations about the alternative the Bureau has considered, as described in the Outline (at pp. 17-18 and pp.21-22), such as prohibiting arbitration agreements in individual cases or adopting procedural rules for individual arbitration?</u>

The CFPB's complaint portal meets all of the intended goals of class actions. First, the complaint is submitted to a regulator for review and oversight. Second, it is an effective way to illicit small damages. Third, the narrative option allows other consumers to be made aware of similar issues and meets similar goals of the notice requirement.

The effectiveness of the CFPB portal is established by looking at the data. September 2014 litigation information is delineated above. In September 2014, consumers elected to file 2640 CFPB Complaints against debt collectors which more than double the amount of FDCPA cases filed. In the CFPB's study of complaints from July 2011-July 2014, the CFPB found that

11% of all complaints were closed with monetary relief and an additional 11% were closed with non-monetary relief. [2] As such, the CFPB complaint portal is meeting the same goals.

The procedural rules for arbitration are equally concerning. The CFPB found that consumers succeeded in arbitration on 20% of their claims as compared to 6.8% of individual federal filings. As such, there is no need to expend any funds to further review these cases. Additionally, there is a statistically critical confounding variable that would skew the data. When there is any liability, most Defendants will elect to settle. Thus the cases in where an arbitrator rules, the Defendant likely has already determined they do not face any liability. Therefore, the cases that are reported and not settled will only reflect a specific liability group and cannot be deemed accurate for the purpose of the CFPB's proposals.

<u>25. When your business borrows money, does it use consumer products as a source of financing? For example, do personnel use a personal credit card for business expenses? Do personnel take out other types of consumer loans for business expenses? If so, please describe the types of credit used, the types of expenses funded by these loans, and generally the amount of your business's expenses that is funded by consumer loans.</u>

FMA personnel use corporate credit cards for buisness expenses. Currently, FMA has no debt but maintains a line of credit with a major bank.

<u>26. If your business sells consumer goods or services that are not financial in nature, what amount and proportion of these sales allow the consumer to defer payment? What amount and proportion of the consumer debts in these transactions are pledged as collateral for a business loan or sold to a third party (e.g., factoring)?</u>

FMA does not sell consumer goods or services.

<u>27. Is your business subject to any other regulations that may overlap, duplicate, or conflict with the proposals under consideration? For example, are any of your financial products or services subject to Military Lending Act regulations that prohibit arbitration agreements in certain credit products provided to service members, or to Dodd-Frank Act regulations that prohibit arbitration agreements in mortgage credit agreements</u>?

Because FMA works in several lines of buisness, including home loans, we are affected by several different regulations. However, a majority of FMA's buisness is in the post charge-off credit card market which is not currently subject to arbitration restrictions.

Please see attached appendix for more information.

<u>28. What would it cost your business to submit arbitration claims and awards to the Bureau, as described in the Outline (at p. 25)? Would you expect to rely on an arbitration administrator to</u>

[2] http://files.consumerfinance.gov/f/201407_cfpb_report_consumer-complaint-snapshot.pdf

provide this service for you? What costs would your business incur if it were required to redact consumers' personal information from arbitration filings and awards before sending them to the Bureau?

Due to the privacy concerns inherent in debt collection, FMA would not rely on a third party to redact any documents. Further, it is likely that the creditors will require that FMA redact the data, submit the redacted documents to the creditors for review and approval and then submit the documents. As such, the proposals would require a significant amount of FMA Counsel's time. At minimum, FMA estimates two (2)-six (6) hours would be spent on each individual filing depending on the nature of the claim.

LYONS, DOUGHTY & VELDHUIS, P.C.
10461 Mill Run Circle, Suite 825
Owings Mills, Maryland 21117

November 9, 2015

Eric I. Goldberg
Senior Counsel
Office of Regulations
Consumer Financial Protection Bureau

Sent Via E-Mail Only: nathaniel.balk@consumerfinance.gov

Re: Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements

Dear Mr. Goldberg:

Thank you again for giving us the opportunity to provide you with additional information and feedback regarding the presence, use and effect of class action waivers in arbitration provisions. We truly appreciate the Bureau's interest in our perspective and look forward to having a continued dialog on this issue.

As I mentioned briefly during the October 28, 2015 meeting, Lyons, Doughty & Veldhuis, P.C. occupies a unique niche on the continuum of the consumer-creditor relationship. We are neither creditors nor creditors' assignees; we do not prepare credit agreements, nor are we parties to those agreements. We are attorneys who represent creditors and creditors' assignees.

For that reason, we wanted to take this opportunity to provide you with a more in-depth explanation of why we, as creditors' rights attorneys, implore the Bureau to gather the data it recognizes it lacks – data regarding the impact of class action waivers on the rights of consumers – before implementing rules that would strip small businesses like ours of this essential legal strategy.

The Bureau proceeds on the assumption that class actions are an essential element of consumer protection for two reasons: first, the Bureau submits that in the absence of a class action, injured consumers won't realize that they too have been harmed. Second, the Bureau submits that class actions force industry change. The Bureau thus concludes that consumer contracts containing class waivers are harmful to consumers because, when class actions are referred for individual arbitration, the harm to consumers remains unpublicized and unaddressed.

The Bureau's concerns are legitimate. We take pride in practicing law not only in accordance with the obligations imposed upon us as attorneys, in a manner conducive to allowing the consumer to make informed choices about his or her account. We, too, are consumer advocates because we, too are consumers: we represent our clients in such a way that those consumers who legitimately owe delinquent accounts are encouraged to repay their debt, while taking into account individual hardships and other circumstances impacting their ability to do so. This aim is only accomplished by acting within the bounds of the law – where consumers are harmed, and where harmful practices are not curbed, all consumers are affected. Thus, we feel it is imperative that the Bureau understand that in this regard, we share the same goal.

However, while the Bureau observes this process from a distance, we constantly engage in litigation, collection activities, and other consumer interaction. Thus, what the Bureau hoped to learn through research, we experience on a daily basis. For this reason, we felt it important to describe why the removal of class waivers from arbitration provisions would not only lend no protection to consumers, but would instead cause irreparable harm to legitimate market participants who share the Bureau's goal of recovering legitimate consumer debt in a manner consistent with the law.

A. CLASS ACTIONS AND CONSUMER EDUCATION

The Bureau takes the position that class actions are necessary to educate other consumers who have been harmed by an abusive act or practice, but who are unaware that they have been harmed. The Bureau is concerned that where class actions are referred for individual arbitration, consumer education is stifled. As a small creditors' rights law firm, our experience is that consumers are particularly well-informed about consumer protection litigation trends, and that other means of education are far more effective than class notices.

Our lives have become increasingly digital. The volume of information readily available online through a simple Google or Yahoo search is limitless. This easy access to information has yielded message boards and other forums for individuals sharing a variety of interests, as well as a means for service providers to market their services to those groups. In the context of consumers' rights under federal and state laws, there are literally hundreds[1] of such message boards and listservs. Some openly advertise themselves as ways for consumers

[1] A Google search for "debt collection message boards" yields over 1.1 million results.

to prevail in claims against their creditors[2]; others serve as a question-and-answer forum for consumers – and, in some circumstances, attorneys – to inquire about the legality of certain debt collection practices and seek informal advice about how to communicate – or avoid communicating – with creditors and collectors[3].

Media regularly reports on such websites and the individuals who use them, publishing profiles of consumers who routinely file lawsuits for violations of federal and state law. An April 23, 2010 article in The New York Times profiled Steven Katz, an accountant who created the Steven Katz School of Bill Collector Education. Significantly, the article also discussed the proliferation of websites dedicated to providing consumers with strategies for suing debt collectors:

> Mr. Katz can also claim some credit for the increase in [FDCPA] lawsuits. For six years, he has run a free Web site called Debtorboards.com, where people share tips on topics like keeping a paper trail and recording calls from collectors. He said the site received two million hits in 2009, a 60 percent increase over the previous year[4].... Mr. Katz said his Web site was not intended to help people avoid paying legitimate debts. But if they do so, so be it – he feels no need to apologize.

As this open dialog among consumers has increased, so too have the advertising efforts of consumers' rights attorneys. YouTube reports 884 available videos by Lemberg Law, many of which make specific mention of creditors' rights law firms[5]. Similarly, YouTube reports 69 videos by attorney Vicki Piontek. Four of the first five video titles specifically mention creditors' rights law firms: the Law Offices of Ed Overcash, LLC; Frederick J. Hanna and Associates; Fulton,

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[2] *See, e.g.,* www.debtorboards.com, "Debtorboards – Sue Your Creditor and Win!"

[3] *See, e.g.,* http://boards.straightdope.com/sdmb/showthread.php?t=616175, "The Straight Dope, Debt Collectors: A$$holes or Honest Shlubs" (last visited November 6, 2015).

[4] "Learning How to Fight the Collector," The New York Times, April 23, 2010, http://www.nytimes.com/2010/04/24/business/24collection.html (last visited November 6, 2010).

[5] *See, e.g.,* https://www.youtube.com/watch?v=c8FRgwgsnOM ("Fulton, Friedman & Gullace Harassment? Sue and Get Up to $1,500 Per Call"); https://www.youtube.com/watch?v=U3vQ8cxj-Pc ("Forster and Garbus Harassment? Sue Forster & Garbus Get up to $1,50 Per Call"); https://www.youtube.com/watch?v=WzaZXz-JpYg ("Weltman, Weinberg & Reis Harassment? Sue and get up to $1,500 Per Call") (last visited November 6,2015).

Freidman & Gullace, LLP; and Blatt, Hasenmiller, Liebsker and Moore, LLC[6]. Attorneys representing consumers maintain blogs, record podcasts, and develop apps designed to keep consumers apprised of recent litigation trends, victories, and strategies for consumers interested in pursuing claims against creditors or service providers.

These messages reach *all* consumers, not just those interested in obtaining information regarding consumer protection laws and litigation. Newspapers and television stations regularly report on a variety of consumer protection issues: indeed, in October and November 2015 alone, there have been a plethora of articles in local and national publications, addressing a wide variety of consumer protection issues including student debt, "robocalls," and bank settlements, and utility bills[7].

In simple terms, the days of consumers learning about their injuries by receiving notice of a class action passed long ago. The manners by which consumers obtain and exchange information have changed and, as a consequence, so too have the manners by which consumers learn of and respond to harm (or potential harm) by creditors, debt buyers and debt collectors. In our experience, the danger that a potentially harmed consumer will be kept in the dark is nearly non-existent: in Maryland, pro bono and law school clinics are actively involved in the small claim docket, and readily volunteer their services

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[6] https://www.youtube.com/results?search_query=Vicki+Piontek (last visited November 6, 2015).

[7] http://www.nbcnews.com/business/consumer/budget-deal-gives-debt-collectors-authority-robocall-cellphones-n458101, Budget Deal Gives Debt Collectors Authority to 'Robocall' Cellphones, November 5, 2015; http://www.cbsnews.com/news/debt-collectors-shut-down-for-abusive-practices/, Debt Collectors Shut Down for Abusive Practices, November 4, 2015; http://consumerist.com/2015/11/02/jpmorgan-to-pay-100m-to-settle-unlawful-debt-collection-allegations-in-california/, "JPMorgan to Pay $100M to Settle Unlawful Debt Collection Allegations in California," November 2, 2015; http://setexasrecord.com/stories/510644835-woman-sues-oxford-law-alleging-violations-of-fair-debt-collection-practices-act, "Woman Sues Oxford Law, Alleging Violations of Fair Debt Collection Practices Act," October 26, 2015; http://www.local12.com/news/features/top-stories/stories/Howard-Ain-Troubleshooter-Debt-collection-scam-alert-223205.shtml, "Howard Aid, Troubleshooter: Debt Collection Scam Alert," October 23, 2015; http://savannahnow.com/effingham-now/2015-10-21/consumer-ed, "Consumer Ed," October 20, 2015; http://journalstar.com/business/local/banking-department-warns-of-debt-collection-scam/article_1bd5a3ae-3b00-5722-ae79-2517bf0de8ff.html, "Banking Department Warns of Debt Collection Scam," October 9, 2015; http://time.com/money/4066283/debt-collector-pizza-delivery-guy/, "When the Debt Collector Poses as a Pizza Delivery Guy, October 8, 2015.

to consumers named as defendants in collection matters. Many Maryland firms wear two hats in this regard: they will volunteer their services in a collection matter, and subsequently represent the same consumer in an FDCPA matter (in which any settlement or verdict in favor of the consumer necessarily includes the payment of counsel fees). In Pennsylvania, bankruptcy attorneys will counsel their clients to bring in every item of correspondence received, and will review all such correspondence for any potential adversary claims against collectors and creditors. During depositions, consumers often testify that filing suit against the collector, creditor or attorney was not the consumer's idea, but was instead his or her counsel's idea.

In our experience, consumers are better informed about their rights now than they have ever been. When this is combined with the increased regulation governing creditors' rights litigation, we find that the real-world risk of a harmed consumer remaining uninformed is largely non-existent.

B. CLASS ACTIONS AND INDUSTRY CHANGE

The Bureau is concerned that the absence of class action litigation stifles industry change. The Bureau believes that debt collectors revise their practices in response to class actions, and thus that the inclusion of class waivers in arbitration provisions contributes to the risk that bad practices will go unaddressed.

As we stated briefly during the October 28, 2015 hearing, as attorneys who collect debt, we answer to many masters. We must conduct ourselves in accordance with the rules of ethics; with each state's procedural and practice requirements; with each state's debt collection laws and regulations; with federal debt collection laws and regulations; and in accordance with our client's instructions. In simplest terms, compliance is paramount. Consequentially, we devote a significant portion of our time, as well as our finances, to ensuring that we practice law in a manner consistent with the requirements and expectations of the many entities overseeing our business.

The Bureau believes that class actions encourage industry participants to change bad practices. We submit to you that *any* adverse action, without regard to who files it or where it is filed, causes us to examine the practice or procedure at issue and, if necessary, to make changes.

In Maryland, where our firm maintains a robust practice, the most recent significant state and federal cases regarding consumers' rights have been individual claims. *Bartlett v. Portfolio Recovery Associates, LLC* and *Townsend v. Midland Funding, LLC*, 91 A.3d 1127 (Md. 2014) caused us to examine our complaints and the documents we utilize when trying our cases. After the Fourth Circuit remanded *Powell v. Palisades Acquisition XVI, et. al.*, 782 F.3d 119 (2014) for further proceedings, we examined the processes associated with assignments of judgment. Following the Maryland Court of Special Appeals' opinion in *Finch and Dorsey v. LVNV Funding, LLC, et. al.*, 71 A.3d 193 (2013), we scoured our files for any judgments that might be deemed "void" pursuant to the Court of Special Appeals' opinion, and addressed them accordingly.

Litigation is not the only trigger for change. News of consent orders involving debt buyers and banks prompts us to revisit our compliance management systems and tighten our processes. News of enforcement actions by the FTC and the CFPB yields the same action. Indeed, even something as small as a casual conversation with a colleague often generates an examination of some aspect of our practice. Because our industry changes so quickly, and because judicial and regulatory action generates a nationwide response, our practice must keep pace if we are to remain competitive.

To that end, we find it important to point out that class certification does not equal liability. The Bureau's concern assumes that class actions are *de facto* successful when, in fact, this is not the case. Even certified classes fail as a matter of law due to plaintiffs' failure to meet their evidentiary burden, and certified class may also be decertified where appropriate. We find it of equal importance to emphasize that where classes are certified and subsequently settled, or where class actions are settled on a class-wide basis pre-certification, such settlements invariably contain a provision clearly stating that the settlement is not an admission of liability by the defendant. The Bureau's concern assumes that class settlements are similarly indicative of liability, when in fact there has been no such finding.

Finally, and along similar lines, we find it important to note that seeking to avail ourselves of class action waivers is not itself indicative that we believe we are liable for the allegations at issue. We do not move to compel arbitration to cover up wrongdoing. We move to compel individual arbitration because, in circumstances such as those described during the October 28, 2015 hearing, one class action can spell bankruptcy for our business.

Removal of class action waivers from arbitration provisions will not encourage change, nor will it increase visibility of alleged wrongdoing within the industry. Because our industry is a competitive one in which only the most compliant will succeed, we *must*, out of necessity, stay constantly attuned to best practices, whether they are revealed by a client audit, a lawsuit from across the country, a CID, a casual inquiry, or simple intuition. To the extent the Bureau believes that class actions are the most powerful tools for encouraging change, we submit that from the perspective of a small business, the opposite is true: no lawsuit, regardless of the amount in controversy, is too small to ignore.

C. *RECOMMENDED ALTERNATIVES TO REMOVAL OF CLASS WAIVERS*

The Bureau has requested suggestions from the panel participants regarding alternatives to its proposed rulemaking. The Bureau suggests two rules: the first would prohibit class waivers from arbitration provisions in all consumer contracts moving forward, while the second would require industry participants to report to the Bureau regarding any claims referred to arbitration.

We believe the Bureau should proceed with the latter, in order to determine the necessity of the former. We suggest, however, that the Bureau gather more specific data *before* taking other action, so that the Bureau can better determine whether wholesale prohibition of class waivers is warranted. In simplest terms, the Bureau has an incomplete picture of how litigation truly unfolds, because it relied on that which it could obtain using public filings. As we hope the October 28, 2015 hearing revealed, the Bureau's data does not actually reflect the nature and impact of consumer protection litigation, nor does it truly demonstrate that consumers sustain actual harm due to the inclusion of class waivers in consumer goods contracts.

We encourage the Bureau to request data from defendants in consumer protection actions that have already been filed and adjudicated or resolved – regardless of where such actions were filed – the Bureau should look at the following information; the statute(s) pursuant to which suit was filed; a copy of the terms and conditions applicable to the contract at issue, where available; whether the terms and conditions contained an arbitration provision; whether either party moved to compel individual arbitration; the outcome of any such motion; and the outcome of the litigation (i.e., settled prior to trial)[8]. This will not only allow the Bureau to determine whether consumers are in fact harmed by the presence of class action waivers, but it will allow the Bureau to truly appreciate the fact that such waivers are a rarely used but essential litigation tool necessary for small law firms, such as ours, to resolve consumer disputes without becoming insolvent.

During the October 28, 2015 hearing, the Bureau reiterated its displeasure with creditors' use of "captive" arbitration companies, such as NAF, who were rendering arbitration awards skewed in favor of creditors. To address this, we would welcome further dialog regarding the formation and implementation of an arbitration program designed specifically for consumer disputes. Much like certain private arbitration programs, such a program would allow claims to be arbitrated before a panel of three arbitrators: one selected by the consumer and one selected by the creditor, who will then jointly select a third neutral arbitrator. To address the Bureau's concern regarding unrepresented parties, we propose

[8] The overwhelming majority of settlement agreements contain confidentiality provisions prohibiting the parties from disclosing the amount of settlement absent an Order of Court.

that where a consumer proceeds to arbitration *pro se*, the Bureau may select the arbitrator on the consumer's behalf or, alternatively, the Bureau may train an available panel of Bureau-approved arbitrators and select one such individual for proceedings involving *pro se* litigants. Such a process would ensure that (1) consumers' claims are heard before panel members educated about consumer protection statutes; (2) consumers' claims are heard before a truly level panel; and (3) the Bureau would be poised to monitor arbitration proceedings in a manner that allows it to glean real-time data regarding the frequency and outcome of arbitration proceedings.

Once again, we thank the Bureau for this opportunity and for its consideration of our position.

Very truly yours,

Nathan D. Willner, Esquire
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Statement for the Record

Consumer Financial Protection Bureau's
Small Business Regulatory Enforcement Fairness Act panel on Arbitration

November 9, 2015

Submitted by: Trent Sorbe

President, Central Payments Division

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CFPB's Actions are Inconsistent with the Study's Findings

On October 28, 2015, Central Bank of Kansas City ("the Bank") participated in the Consumer Financial Protection Bureau's ("CFPB") Small Business Regulatory Enforcement Fairness Act ("SBREFA") panel on Arbitration. As a SBREFA panelist, Central Bank of Kansas City very much appreciates the opportunity to submit written comments which supplement the oral statements we made during the October 28, 2015 SBREFA panel meeting with the CFPB.

Section 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") gives the CFPB the authority to issue regulations that would "prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties."[1] Additionally, Section 1028 requires the Bureau to study the use of arbitration agreements in connection with consumer financial products or services.[2] However, Section 1028 also states that the CFPB may only regulate arbitration agreements if the study finds that such regulation is "in the public interest and [necessary] for the protection of consumers"[3] and the findings of any regulation are to be consistent with the Study performed by the CFPB.[4]

On March 10, 2015, the CFPB publicly released its more than 700 page Study on Consumer Arbitration ("Study"). Later, on October 7, 2015, the CFPB held a public hearing in Denver, Colorado on mandatory pre-dispute arbitration clauses. During the public hearing, Director Cordray made several statements regarding arbitration that are inconsistent with the Study, including the following:

- Companies *"thus provide themselves with a free pass from being held accountable by their customers. That free pass is secured by making sure their customers cannot group together to seek relief for wrongdoing."*
- *"So the essence of the proposals we have under consideration is that they would get rid of this free pass that prevents consumers from holding their financial providers directly accountable for the harm they cause when they violate the law."*
- *"Arbitration clauses that bar group lawsuits protect these ill-gotten gains by enabling companies to avoid being held accountable for their misdeeds. Thus, companies are likely to take less care to ensure that their conduct complies with the law than they would have taken if they did not have a free pass from group lawsuits. Indeed, some companies may even feel emboldened that they can safely engage in conduct that could violate consumer protection laws or even their own contracts with customers."*
- *"Companies should not be able to place themselves above the law and evade public accountability by inserting the magic word "arbitration" in a document and dictating*

[1] Dodd-Frank Act section 1028
[2] Dodd-Frank Act section 1028
[3] Dodd-Frank Act section 1028
[4] Dodd-Frank Act section 1028

> *the favorable consequences. Consumers should be able to join together to assert and vindicate their established legal rights."*

The Bank applauds the CFPB for taking the time to extensively research arbitration clauses pursuant to the agency's statutory mandate. Although we believe the CFPB conducted its research in a thoughtful and earnest manner, the report was not comprehensive and as a result the conclusions reached by the CFPB are woefully incomplete. Accordingly, the Bank respectfully disagrees with the conclusions reached by the CFPB in the Study and believes the agency's conclusions are not aligned with the Study's data and underlying facts. Based on the limited data in the Study, the Bank believes that there is only one logical conclusion that can be drawn from any reasonable reading of the Study: arbitration agreements benefit consumers. The Study's results do not grant Director Cordray with the mandate he appears to believe exists to take affirmative steps to regulate pre-dispute arbitration agreements, and/or restrict the inclusion of class action waivers in customer agreements, as the Study shows those restrictions to not harm consumers.

Since its public release, the Study has served as the foundation for the CFPB's efforts to begin regulating the use of arbitration clauses in consumer agreements despite the fact that the Study makes it clear that arbitration results in obvious benefits to the consumer. Simply put, arbitration is quicker, less expensive, and more effective for the consumer than lengthy, cumbersome, and expensive litigation. The Bank believes that the results of the Study fail to meet the statutory threshold for regulation in this area. Namely, the imposition of conditions or limitations on mandatory pre-dispute arbitration clauses is not in the public interest nor is it needed for the protection of consumers. Therefore, the Bank fails to understand the legal or rational basis by which the CFPB believes that it must move forward with preparing and releasing a Notice of Proposed Rulemaking to regulate pre-dispute arbitration agreements.

The Benefits of Arbitration

A proper analysis of the data in the Study reveals the wide variety of ways arbitration benefits consumers, especially when compared to litigation. According to the Study, the CFPB researched 562 class actions and the results included the following:

- No class actions were tried on the merits.
- None of the 562 class actions studied by the CFPB went to trial. By contrast, in arbitrations studied by the CFPB, of 341 cases resolved by arbitrator, in-person hearings were held in 34% of the cases, and the arbitrators reached the merits of the claims in 146 cases.
- In 60% of those class actions studied, there were no benefits whatsoever to the plaintiff.
- Only 15% of the class actions received final class settlement approval.
- The average class action consumer cash settlement was $32.35.
- The average amount received by consumers who prevailed in arbitration $5,389.
- The average arbitration lasts approximately 2-7 months, while class action litigation takes two or more years.
- The average arbitration costs the consumer a total of $200, but a federal court complaint costs $400 to file.

If the CFPB promulgates a proposed rule seeking to limit the scope and reach of pre-dispute arbitration agreements, it will be acting in direct conflict with the results of the Study, specifically the bullet points highlighted above. If the CPFB were to regulate pre-dispute arbitration agreements in a way that contradicts the statistics detailed above, or in a fashion that is not "consistent with the Study," the outcome will ultimately harm consumers and therefore would not be in the public interest or for the "protection of consumers."

Additional Study is Needed

It is our belief that the CFPB would benefit greatly from additional research into arbitration agreements, including research that focuses on consumer satisfaction with the arbitration process. It is apparent that the most fundamental flaw of the Study is the CFPB did not actively pursue the fundamental question of how consumers view arbitration. This is a glaring omission. For example, if the CFPB had just simply asked consumers their opinions about arbitration, the CFPB would have likely received feedback similar to the findings of a 2005 Harris Interactive poll in which 609 consumers participating in arbitration were surveyed and reported that arbitration was: a) faster (74%), simpler (63%), and cheaper (51%) than going to court; and b) a form of redress that they were likely to use again (66%).

An additional area of study discussed during the SBREFA panel was the impact such regulation would have on the cost of and access to quality consumer financial products, particularly for low- and moderate-income consumers. SBREFA panelists overwhelmingly felt that both cost and access would suffer. Yet, the Study fails to adequately consider these potential ramifications.

Prohibiting Class-Action Clauses from Arbitration Agreements Only Benefits Lawyers

According to the Study, attorney's fees awarded to class counsel in settlements was an astronomical $424,495,451. Once you begin to compare the individual award amounts of consumers who recovered in arbitration ($5,389) to the award amount given to consumers who participated in class action litigation ($32.35) there is only one logical conclusion a reasonable person can arrive at – the clear winners in class action litigation is plaintiff's counsel. If, as discussed above, there are no benefits to the general public or consumers individually to filing a class-action lawsuit, it is not clear why the CFPB intends to release a proposal that in its current form will inevitably lead to lower consumer awards and unjustly enrich class-action lawyers who will have an incentive to continuously seek out potential plaintiffs in an effort to file lawsuits (legitimate or frivolous) that will never go to trial, but have the potential to generate millions in attorney's fees. Such an unfair and unjust result must be avoided. The plaintiff's bar is an inappropriate group to rely upon for consumer protection - their motives are seldom protecting the impacted class - but rather to maximize the fees they can generate from unsuspecting plaintiffs.

Ultimate Impact on Small Financial Institutions

By law the CFPB must convene a panel when it is considering promulgating a proposed rule that could have a significant economic impact on small entities. Once it convenes a SBREFA panel, the CFPB is required to collect the advice and recommendations of the panelist regarding the potential increased cost the proposal under consideration may impose on small businesses. Per CFPB's day-long October 28th SBREFA session, the consensus of the attendees was that a proposed rule would have a significant impact on the small entities in the room. Although it is nearly impossible to quantify the increased risk and cost of potential frivolous lawsuits without knowing the precise details of the proposal the CFPB is preparing to release early next year, one thing is for certain, frivolous litigation (or just the threat thereof) will result in higher costs, a concentration of financial services products, and fewer product choices for consumers.

Recommendations

If and when the CFPB releases a proposed rule seeking to regulate pre-dispute arbitration agreements, below are two recommendations that we respectfully request that the CFPB should consider including in any proposal that is published for public notice and comment.

a. Safe Harbor for Small Entities

The Bank recommends that when the CFPB releases its upcoming proposed rule on arbitration, that the agency, per its SBREFA mandate[5], should be mindful of the impact of any proposal that restricts the use of pre-dispute arbitration agreements may have on small providers of financial services. More specifically, the CFPB should include in its proposal a "safe harbor" for small institutions so that the mere threat of litigation alone does not have the ability to force a small business from the market or scare small businesses from entering the market in the first place.

b. Exempt Certain Products and Industries from the Proposed Rule

The Bank believes that the CFPB's upcoming proposed rules should develop specific criteria or a checklist that would exempt qualifying products from the proposed rule. For instance, according to the CFPB's Monthly Consumer Complaint October 2015 report, the CFPB has received a total of 2733 prepaid related complaints from consumers.[6] This is the lowest of number of complaints that the CFPB has published. The Bank asserts that products and industries, specifically small industries, such as the prepaid card industry, which have a track record of being responsive to the needs of their consumers should have the ability to continue to serve those consumers without the threat of class action litigation undermining their ability to stay in business.

Conclusion

As a member of the CFPB's SBREFA panel on Arbitration, the Bank appreciates the opportunity to share its thoughts about the CFPB's plans to develop a proposed rule seeking to regulate the use of pre-dispute arbitration agreements. We believe a more thorough discussion should take place on this issue before the CFPB issues a Notice of Proposed Rulemaking regarding pre-dispute arbitration agreements. It is essential that the CFPB continue to gather facts and seek a cross-section of opinions from consumers, legal experts, and the financial

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[5] 36 5 U.S.C. 609(b), available at https://www.sba.gov/advocacy/regulatory-flexibility-act.

[6] CFPB Monthly Complaint Report for October 2015:
http://files.consumerfinance.gov/f/201510_cfpb_monthly-complaint-report-vol-4.pdf

services industry in order to try to reach the appropriate balance between protecting the integrity of the legal system and associated costs with resolving legitimate consumer claims.

Respectfully Submitted:

CASH PLUS

November 9, 2015

Mr. Nathaniel Balk
Director's Financial Analyst,
Office of Regulations
Consumer Financial Protection Bureau
1275 First Street NE
Washington, DC 20002

VIA ELECTRONIC MAIL
(nathaniel.balk@cfpb.gov)

RE: SBREFA Written Submission

Dear Nate:

Thank you for allowing me to participate as a Small Entity Representative on the Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements. I appreciated your attention to my comments during the panel discussions and hope you will provide the same consideration to the points I raise in this letter. My comments will focus solely on your proposal to prohibit the use of class action waivers in arbitration agreements.

1. Background

I am the President and CEO of Cash Plus, Inc., a financial service center with operations and franchised locations in eight states. Founded in 1984, with one location, we have since grown through franchising to forty locations. Currently, Cash Plus has fifteen employees, and its franchisees have 160 employees. Through this structure, I am able to relate to you the experiences of Cash Plus as a small business as well as the experience of its forty franchisees, each of which is independently owned and operated.

We offer a wide variety products and services to our customers, from check cashing and small-dollar loans to mailbox and bill payment services. Our small-dollar loans are all less than $500 and typically average $400. We are proud of our outstanding record of "Kings and Queens" customer service and that we offer beneficial products to our customers on fair and reasonable terms.

I view Cash Plus as a relationship lender, and we strive to address complaints about our products or services at their inception with full disclosure. Our commitment to customer satisfaction has prevented the need to resort to litigation, arbitration, or any other type of formal legal relief. Our jobs, livelihoods, and capital investments depend on keeping Cash Plus's customers happy. We do so through our commitment to a culture of compliance and through proactively resolving consumer complaints early.

Cash Plus and its franchisees provide critical financial services to thousands of hard-working Americans every day. Our customers come from many difference walks of life but share the need to conduct their financial transactions in a safe, regulated environment. As I will explain in more detail below, a class action litigation is a death knell for a small business. A single class action can cause a small operator to close down, resulting in the loss of jobs, investment and, more importantly, our locations as a source of credit and other types of financial services. As has been found in multiple research papers from reputable sources, communities fare worse when credit products such as payday loans are eliminated. (See, e.g., "Payday Holiday: How Households Fare Under Payday Bans," by Federal Reserve Bank of New York Research Officer Donald P. Morgan and Cornell University graduate student Michael R. Strain, www.cfsa.net/FedReserve.html; "Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap," by Dartmouth College Professor Jonathan Zinman, www.dartmouth.edu/~jzinman/Papers/Zinman_RestrictingAccess_oct08.pdf).

2. **Cash Plus adopted an arbitration agreement that included a class waiver due to its own negative experience with class litigation.**

Since 1998, Cash Plus has used an arbitration agreement that includes a class action waiver in its small-dollar loan contract. We began including the arbitration agreement after a class action caused one our franchisees to close four stores and cost Cash Plus, Inc. thousands of dollars.

In the late 1990s, prior to implementing arbitration language in its contracts, one of Cash Plus's franchisees in San Diego, California was the victim of a very costly class action suit. This small business owner offered a 15% discount to all of his small loan customers off state mandated capped prices. Despite including all required federal and state disclosures in the loan agreement, immediately prior to the suit, California mandated that certain disclosures occur in ½-inch high letters. In a strategy that was clearly a set-up, a close friend of a class-action lawyer's son visited the San Diego store, receiving a $50 loan and paying a $7.50 fee. This person had never been a customer before and never returned. In addition, the customer never even complained about the transaction causing him any harm. Nevertheless, about two months later the customer initiated a class-action lawsuit.

Upon learning that the franchisee only owned four stores and had limited ability to pay, class counsel filed suit against Cash Plus, Inc. (the franchise company) hoping to find deeper pockets. Over the next approximately nine months the franchisee spent in excess of $50,000 on his defense. Rather than spending another $75,000 to $100,000 in legal fees, the business owner decided to lay off his eighteen employees and close all four stores. This setup over the font size of a disclosure caused the franchisee to forfeit his life's savings in the form of his capital investment and to file for bankruptcy. In addition, customers lost access to a convenient financial service center that offered small dollar loans below state maximums. For its part, Cash Plus, Inc. spent in excess of $100,000 to defend and resolve the case stemming from a $7.50 fee and a technical violation of state law. While we believe the CFPB would prefer to see only significant, meaningful class actions filed, once plaintiffs class action attorneys are uninhibited by class waivers, there would be no way for CFPB to control the types of suits that would be filed. Once again, it is most often not the merits of a case that determine the costs of defense and settlement, it is simply the filing of a class action that causes the harm to a small business. It is hard to imagine that the public was benefitted in any way in this instance.

Following the resolution of the lawsuit, Cash Plus, Inc. adopted its arbitration agreement and so did all of its franchisees, nationwide. Currently, the Cash Plus arbitration agreement permits customers to file individual arbitration actions. If a customer chooses to pursue arbitration, <u>our agreement provides that Cash Plus will pay for the customer's filing costs</u>. Customers also have a right to file suit in small claims court. Our agreements also provide consumers with all of the rights and remedies that they would be able to obtain through a judicial proceeding. Other than the ability to file a class action, no substantive right is eliminated.

3. If adopted in its current form, the proposal would have a disproportionate effect on Cash Plus and other small businesses.

The proposal to prohibit class action waivers in arbitration agreements would disproportionately affect small businesses such as Cash Plus franchisees. Like many other small businesses, Cash Plus stores operate on thin profit margins. On average, our stores generate less than $100,000 in annual net income. In comparison, the Bureau's arbitration study indicates that a consumer class action lawsuit would, on average, include:

- A mean monetary award of $391,500; and
- A mean award of legal fees of $82,200.

Adding these mean amounts to our own potential defense costs illustrates that a single consumer class action could cost a Cash Plus and its operator more than $500,000, a terminal event for us and other small businesses. In fact, just the *filing* of a meritless class action claim could lead to increased and often unbearable costs. When a consumer files a class action lawsuit, we incur attorney's fees. In the rare event that our insurance policy covers the claim, we would still incur the costs of an insurance deductable and, in the immediate future, increased premiums or a canceled policy. The Bureau should also be mindful of other indirect costs and potential harms to small businesses such as the loss of banking services and an increased cost of credit due to increased reputational and compliance risk. The cost to any business to assign personnel to manage a lawsuit, much less a class action, has a significant impact, one that is disproportionate to small businesses. A class action lawsuit need not be legitimate to be financially catastrophic.

The proposal to eliminate class action waivers would exponentially increase our risk of a lawsuit that would cause Cash Plus, Inc. or any one of its franchise locations to close. Unfortunately, I know from personal experience that it only takes only one class action lawsuit from an enterprising plaintiff (or more likely a plaintiffs class action attorney) to cause this undesirable result. While larger businesses may be able to recover from the $500,000 loss incurred by an average class action lawsuit, Cash Plus owners and other small lenders will have no choice but to close.

4. **Cash Plus cannot protect itself against increased class litigation risk through purchasing additional insurance coverage or through increased prices.**

Several of your questions were designed to address whether small businesses could purchase insurance to protect against increased class action risk. For Cash Plus, the answer is no. In our own experience, Cash Plus's insurer did not cover the class action that caused our franchisee's operations to close. Further, many insurers include class action riders in their contracts that absolve the insurer of any responsibility for class relief. Consequently, Cash Plus cannot realistically defray the potentially catastrophic risk of a class action through its insurance coverage. However, even though we cannot insure against consumer class actions, our own insurer will still increase our annual premiums to account for the risk of class action litigation. According to our insurance carrier, prohibiting class action waivers in arbitration agreements could cause our annual premiums to increase by 30% to 40%. Moreover, to suggest that businesses carry insurance to defray the cost of class action litigation would likely incent even more frivolous litigation, as plaintiffs would know that a fund exists from which to recover.

Other questions during our panel appeared to suggest that Cash Plus could simply increase the costs of its loans to account for the increased risk. This is also not a viable option. As a small-dollar lender, we operate in a highly-regulated environment where state law caps the permissible fees that we may charge. Cash Plus, Inc. and its franchisees offer loans at or near those caps because of the high-risk nature of our loan portfolio and employee and facility overhead expenses. State caps prohibit us from passing any of our increased litigation costs to consumers.

Cash Plus and other small businesses do not have the option to shift our increased risk to insurers or to pass along increased costs of doing business to consumers. We bear the full weight of the increased risk caused by the elimination of class action waivers.

5. **The CFPB could adopt several alternatives that would better accomplish its goal of allowing consumers to preserve small claims without unduly harming small business.**

The proposal to eliminate class action waivers rests on the notion that consumers benefit from aggregating claims, particularly in cases where consumers are unlikely or unable to bring an individual claim. We understand this concern, but submit that there are better alternatives to accomplish your goal without causing disproportionate harm to small business. There are several other less-harmful alternatives to consider, including:

a. *Requiring covered parties who use an arbitration agreement with a class action waiver to pay the filing fees of any individual action.*

The proposal suggests that consumers may need to aggregate claims involving small dollar amounts due to the costs of an arbitration filing. As an alternative to eliminating class action waivers, the Bureau should consider requiring covered parties using a class action waiver in an arbitration agreement to either pay the filing costs of consumers who wish to arbitrate disputes or pay into a fund administered by the Bureau that would pay the arbitration costs of small dollar claims. This alternative would allow consumers to pursue individual claims for small dollar amounts without concern for the costs of arbitration, while still allowing small entities protection against devastating class damages.

b. *Limit the prohibition on class action waivers to laws that contain caps on class recovery.*

Many consumer protection statutes include caps to class relief. For example, the Truth in Lending Act caps class damages at the lesser of 1% of a creditor's net worth or $1 million.[1] Other consumer protection statutes such as the Telephone Consumer Protection Act provide for statutory damages without any limitation on class relief.[2] The Bureau could, at least in some way, limit the harm to small business by permitting class action waivers for any statute that does not limit class relief. While Cash Plus and others would still be under threat from class action litigation, we would at least have the option to require individual arbitration in cases where there is the potential for ruinous damages.

c. *Provide a stay period for small businesses and conduct additional study.*

As I explained above, small businesses like Cash Plus franchisees would suffer disproportionately under the proposal. Cash Plus, Inc. and its counterparts operate on thin margins and cannot absorb the costs that even a single class action can impose. Despite the devastating effects of even a single class action, the Bureau has not collected any data on the impact that its proposal would have on the volume of consumer class action litigation. Therefore, the Bureau should include a stay or moratorium in its final rule that protects small businesses while allowing additional time to study the impact that the proposal will have on class litigation.

d. *Include in the rules an exemption that allows businesses with less than a reasonable level of sales annually to include arbitration in lieu of class action.*

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[1] *See* 15 U.S.C. § 1640.
[2] *See* 47 U.S.C. § 227.

As was explored at the panel, class action litigation impacts small businesses disproportionately. The cost to defend a class action can be the same for a small business as a larger, more substantial business. Counsel fees are counsel fees. Therefore, the same amount of counsel fees that might be sustainable for a larger business will ruin a small business. I would urge the Bureau to create a revenue floor under which a financial service provider could still utilize a class action waiver in its loan and other documents. In addition to this exemption, the CFPB could also include a study provision that would require small businesses to report claims filed against them. This type of mechanism would give small businesses a fighting chance to survive. Furthermore, this exemption would be justified because the number of transactions conducted by these small businesses is lower that larger companies, as reflected in lower revenues.

6. Conclusion

I sincerely thank you for the opportunity to participate as a Small Entity Representative. As a policy-maker, I know that you have difficult decisions that often balance competing interests. As a consumer protection regulator, you typically seek to balance the interests of consumers and business. However, the proposal as currently written favors class action lawyers' interest above all others. It is a telling statistic that the average consumer in the Bureau's study collected only $16.87 in relief, while class counsel collected $97 million.[3] Consumers will suffer by losing access to credit and other services when financial service centers such as Cash Plus shut down due to inevitable class litigation costs.

Sincerely,

Craig Wells,
President and CEO
Cash Plus, Inc.

Cc: Eric Goldberg, CFPB
Ed D'Alessio, FiSCA
Allen Denson, FiSCA

[3] Outline of Proposals Under Consideration and Alternative Considered at 10.

STONELEIGH
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November 9, 2015

Eric Goldberg
Senior Counsel
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Consumer Financial Protection Bureau
1700 G Street, N.W.
Washington, D.C. 20552

Sent via email to Nathaniel Balk Nathaniel.balk@cfpb.gov.

RE: **Small Entity Representative Stoneleigh Recovery Associates' Response to CFPB Potential Rulemaking on Arbitration Agreements**

Dear Mr. Goldberg:

Thank you for the opportunity to serve as a Small Entity Representative in connection with the Small Business Review Panel convened in relation to the CFPB potential rulemaking on pre-dispute arbitration agreements in contracts for consumer financial products and services. Stoneleigh Recovery Associates (SRA) is grateful to have been chosen as a representative of the debt collection/debt buying industry.

Please find SRA's written comments attached for your consideration. If you have additional questions, or need additional information, please let me know.

Best Regards,

Kelly Knepper-Stephens
General Counsel and Chief Compliance Officer
kstephens@stoneleigh.biz
630-396-8087

cc: Jennifer Smith, Esq., Assistant Chief Counsel for Economic Regulation and Banking, Office of Advocacy, Small Business Administration
Shagufta Ahmed, Policy Analyst, Office of Management & Budget

SMALL ENTITY REPRESENTATIVE STONELEIGH RECOVERY ASSOCIATES' RESPONSE TO CFPB POTENTIAL RULEMAKING ON ARBITRATION AGREEMENTS

Stoneleigh Recovery Associates, LLC (SRA) is a compliant, forward thinking, and customer-centric third party collection agency, located in Lombard, Illinois. Currently we service in excess of a billion dollars in outstanding receivables. This inventory includes major automotive financial service lenders, the medical industry, bankcard receivable companies, and many others. We are a licensed and bonded agency, carrying a five million dollar errors and omissions insurance policy. We are a Certified Professional Receivables Company by the Debt Buyers Association (DBA International), we have an A rating with the Better Business Bureau (BBB), and are an active member of DBA International, the American Collection Association (ACA International) and InsideARM Compliance Professionals. SRA greatly appreciates the opportunity to participate in the Small Business Review Panel convened in relation to the CFPB potential rulemaking on pre-dispute arbitration agreements in contracts for consumer financial products and services.

SRA opposes any rule banning pre-dispute arbitration agreements for class action law suits (PDAA). As a small business with limited resources, SRA does not have the financial ability to fight lawsuits based on merit. SRA must rely on PDAAs as a tool to minimize excessive risk and provide a framework for more reasonable settlement negotiations. SRA is not a party to any PDAA and must rely on the issuing creditor having included broad enough language to encompass SRA as an entity eligible to invoke the agreement. If a PDAA exists, SRA will argue our eligibility to enforce the clause. Depending on the jurisdiction, it is possible for a party who was not a part of the original contract to enforce a PDAA.

The first portion of the proposed rule banning PDAA will effectively eliminate the issuing creditor from including arbitration clauses in their consumer contracts.[1] Without the ability to use arbitration clauses for both class action and other negotiations, SRA's litigation costs will increase. More critically, the inability to settle just one class action lawsuit could put us out of business; causing us to close our doors, leaving our 75 employees without a job, and leaving their 106 dependants without support.

SRA represents just one of the many small debt collection companies[2] and debt buyer[3] companies operating in local communities around the United States. One class action law

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[1] *See, for example,* Andrew Pincus, *The Plaintiffs' Lawyer Protection Bureau*, U.S. Chamber Institute for Legal Reform (October 7, 2015), http://www.instituteforlegalreform.com/resource/the-plaintiffs-lawyer-protection-bureau (last visited November 9, 2015) ("no company is going to take on the extra costs of an arbitration system while also facing the huge costs associated with class action lawsuits.").

[2] "The majority of debt collection companies are small businesses, with over 59 percent maintaining nine or fewer employees, and over 74 percent maintaining fewer than 20 employees." Ernst & Young, The Impact of Third-Party Debt Collection on the U.S. National and State Economies in 2013

suit can shut any one of these companies down.[4] SRA, on behalf of our entire industry, urges the CFPB to consider a less restrictive proposal. As written the ban on mandatory pre-dispute arbitration clauses for class action cases is the most drastic remedy possible to resolve what may not actually be a problem.

The assumption that there are a significant consumers harmed by these clauses is unfounded. First, most consumers resolve disputes in the initial stages directly with the business. SRA makes around 200,000 phone calls a month and in that same time frame resolves hundreds of consumer complaints in house.[5] It is not a sound business practice to allow consumer complaints to go unresolved. Our customers expect that SRA will treat all consumers with fairness and respect, upholding the local, state and federal laws that regulate our industry. If we did not implement industry best practices our customers would fire us and we would go out of business.

Second, those consumers who do not reach out to SRA to resolve a dispute often reach out to the CFPB, the various states attorney general, and/or the BBB. SRA resolves between 50-100 complaints filed with outside agencies every year. Additionally, the CFPB publishes information regarding the number of complaints filed and resolved through its complaint portal. As of November 9, 2015, there have been 474,489 company responses to consumer complaints and, critically, 98 percent of consumers receive timely responses from companies.[6] In its Spring 2015 Semi-Annual Report the CFPB states that financial service companies responded to approximately 95 percent of complaints sent to them and reported having closed 92 percent of the complaints.[7] In terms of relief, the CFPB indicates that debt collection companies have closed a substantial majority (82 percent) either with just an explanation (66 percent) or some form of non-monetary relief (16 percent).[8]

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at 18 (July 2014). According to the American Collector Association International (ACA), they have over 3,000 small business member companies.

[3] According to the Debt Buyer's Association International (DBA) over eighty percent of their membership is comprised of small businesses.

[4] An informal DBA International member survey, conducted as part of SRA's preparation for SBREFA participation, found that seventy eight percent of respondents do not believe that their business can survive a class action law suit.

[5] On average, SRA places 200,000 phone calls each month. SRA speaks with approximately 9,500 of those consumers. SRA sends, on average, 60,000 letters to consumers a month.

[6] *Consumer Complaint Database*, Consumer Financial Protection Bureau, http://www.consumerfinance.gov/complaintdatabase/ (last visited Nov. 9, 2015).

[7] CONSUMER FINANCIAL PROTECTION BUREAU, Semi-Annual Report (Spring 2015) at 49, available at http://files.consumerfinance.gov/f/201506_cfpb_semi-annual-report-spring-2015.pdf (last visited November 9, 2015)

[8] Semi-Annual Report, *supra*, at 50 (Table 12).

Finally, as explained in further detail herein, many consumers chose to file a law suit without ever reaching out to resolve the issue informally. SRA receives, on average, 30 demands and/or law suits each year—a handful of which are class action law suits. SRA spends, on average, 120,000 dollars per year resolving these suits, including meritless claims.

To reach those consumers whose harm is not resolved when a class action law suit is dismissed and sent to arbitration on an individual basis, the CFPB should continue to monitor trends and patterns of bad behavior through their enforcement, supervision, and legal divisions. The CFPB should continue to publicize information about these trends and disfavored conduct. Publication, similar to the CFPB complaint database, Consent Orders, and Amicus Briefs, will alert and notify other companies about bad behavior, deter companies from engaging in such practices in the future, and inform consumers that they may have been harmed. The CFPB should also educate consumers about arbitration so that they understand its usefulness as a tool to address claims against companies.

All three of these steps—monitoring, publicizing, and educating—will deter bad behavior and notify consumers of potential harm without causing significant financial injury to the small businesses who work hard to comply with the law. "Small business[es] inherently provide greater consumer protection and less risk by their very size and the manner in which they operate. Nowhere is the need for the active participation of small businesses greater than in the consumer credit market, especially for those consumers that are the most vulnerable in the credit cycle."[9] Unfortunately, the proposed rule harms small business without providing true protections for consumers.

I. CLASS ACTIONS PROVIDE LITTLE BENEFIT TO CONSUMERS AND CAN DESTROY SMALL BUSINESS

A. Consumers Recover More Proceeding on an Individual Basis than as a Class

The CFPB Arbitration Study, the most comprehensive study on the subject, found in the class cases surveyed that $540 million in gross relief went to at least 32 million consumers per year on average over a five year period—this means each consumer recovered less than fifteen dollars (because attorney cost and fee awards are included in the $540 million figure). (CFPB Proposal at 10). The Arbitration Study further "showed that 87 percent of the class actions examined resulted in no consumer benefit. The 12 percent that were settled provided benefits on average to only four percent of consumers."[10]

[9] Brian Fair, *Keep Small Business in the Credit Cycle*, The Hill Congress Blog, May 20, 2015, available at http://thehill.com/blogs/congress-blog/economy-budget/242594-keep-small-business-in-the-credit-cycle#disqus_thread (last visited November 9, 2015).

[10] Pincus, *The Plaintiffs' Lawyer Protection Bureau*, supra.

The CFPB Outline of Proposals Under Consideration and Alternatives Considered (CFPB Proposal) assumes consumers do not bring law suits because the injury to consumers may be too small to make pursuing relief through a law suit worth a consumer's time and effort. (CFPB Proposal at 3). This assumption is incorrect; the statutory schemes of the three main federal statutes that regulate SRA and the debt collection industry allow for consumer recovery on an individual basis that is greater than their average recovery reported in the CFPB Arbitration Study. The three main statutes are the Fair Debt Collection Practices Act (FDCPA), 15 USC §§1692 *et seq*., the Telephone Consumer Protection Act (TCPA), 47 USC §227, and the Fair Credit Reporting Act (FCRA), 15 USC §§1681 *et seq*..

Fair Debt Collection Practices Act

The FDCPA provides for statutory damages in the amount of one thousand dollars ($1,000). 15 USC §1692k(a)(2)(A) (2010). This is not a small dollar amount for a consumer. Conversely, any class action brought under the FDCPA is capped at one percent of a company's net worth or five hundred thousand dollars, whichever is less. 15 USC §1692k(a)(2)(B). Proceeding on a class basis will most always result in a consumer recovering less than if the consumer had chosen to pursue their claim on an individual basis. One percent of a small company's net worth divided evenly been a class of consumers is almost always going to be less than one thousand dollars.

Telephone Consumer Protection Act

The TCPA provides for five hundred dollars in damages for each violation (e.g., for every phone call to a cell phone using an autodialer without prior express consent). 47 USC §227(3)(B) (2010). A court may treble these damages if it finds willful or knowing violations. 47 USC §227(3)(C). SRA makes on average 200,000 calls per month. While not all of these calls are to cell phones, the majority of consumers no longer have land lines. This growing reliance on mobile devices, coupled with the TCPA's statutory scheme and FCC's amorphous regulations allow consumers to recover a substantial amount of money depending on the number of calls and intent of the caller that far exceeds the recovery on a class basis. [11]

Fair Credit Reporting Act

The FCRA provides for between one hundred and one thousand dollars in damages plus punitive damages for willfully failing to abide by the requirements set out in the statute. 15

[1111] On June 18, 2015, the Federal Communications Commission (FCC) adopted its Declaratory Ruling and Order concerning the rules and regulations implementing the TCPA. The FCC attempted to clarify the definition of an autodialer to include equipment that does not presently have the ability "to store or produce number and dial those numbers at random in sequential order or from a database of numbers." Most modern phone technology is software controlled equipment that can be programmed through software changes or updates to "store or produce number and dial those numbers at random in sequential order or from a database of numbers." The FCC Order can be found at: https://www.fcc.gov/document/tcpa-omnibus-declaratory-ruling-and-order (last visited November 8, 2015).

USC 1681n(1). There is no cap provided for negligent violations of the law although punitive damages are not recoverable if the conduct is only negligent. 15 USC 1681o(a).

While there is no cap for class action damages under the FCRA and TCPA, consumers still fair better on an individual claim basis. This is most likely due to the size of the class, although in some instances it could relate to the fees demanded by plaintiff's attorneys. *See Grok Lines, Inc. v. Paschall Truck Lines, Inc.,* 2015 U.S. Dist. LEXIS 124812 (N.D. Il. September 18, 2015) (rejecting TCPA class settlement where named plaintiff would recover 1,500 dollars, plaintiff's attorneys would receive 98,000 dollars for costs and fees, and other members of the class would receive promise not to send faxes). As the Seventh Circuit explained "[c]lass action attorneys have an 'inherent motivation' to enrich themselves at the expense of the class." *Thorogood v. Sears, Roebuck& Co.*, 627 F.3d 289, 293 (7th Cir. 2010) (listing other cases and scholarly research concerning the "unfortunate reality"[12] of class action plaintiff's bar).

An indirect consequence of the proposed rule is the empowerment and enrichment of class action attorneys to the detriment of consumers who benefit from the "low-cost, easy-to-use dispute resolution system" that is arbitration.[13]

Additionally, small injuries do not make it difficult for consumers to find an attorney to handle their cases. Fee shifting provisions in the FDCPA[14] and FCRA,[15] plus the unlimited TCPA damages, results in a plethora of attorneys specializing in debt collection litigation willing to represent consumers for "free." If you google "Stoneleigh Recovery Associates" you will see at least two attorney advertisements offering a free consultation, free representation, and the chance to recover money.[16] Similarly, if you search "Stoneleigh Recovery Associates" on YouTube you will find attorney advertisements offering the same free consultation, free representation and the chance to recover money.[17]

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[12] *Grok Lines,* 2015 U.S. Dist. LEXIS 124812 at 6.

[13] Pincus, *supra.* For information concerning the consumer benefits to arbitration, see *Dog Bite Man: New York Times Prefers Lawyer-Controlled Class Actions over Fair Arbitration that Enables Individuals to Protect Themselves*, US Chamber of Commerce Institute for Legal Reform, November 2, 2015, available at: http://www.instituteforlegalreform.com/resource/dog-bites-man-new-york-times-prefers-lawyer-controlled-class-actions-over-fair-arbitration-that-enables-individuals-to-protect-themselves (last visited November 9, 2015).

[14] 15 USC §1692k(a)(3).

[15] 15 USC §1681n(1)(3) and 15 USC §1681o(a)(2).

[16]https://www.google.com/?gws_rd=ssl#q=stoneleigh+recovery+associates (last visited November 8, 0215).

[17] https://www.youtube.com/results?search_query=stoneleigh+recovery+associates (last visited November 8, 2015).

SRA informally polled our outside counsel that serve as defense attorneys in the debt collection/debt buyer space concerning the number of plaintiff's attorneys they could name off the top of their heads without searching. These attorneys on average practice in four states each. They can list up to twenty frequent filers of consumer litigation under the FDCPA, FCRA and TCPA.

B. SRA and Similarly Situated Small Businesses Cannot Afford a Class Action Suit

The costs associated with class action law suits are so expensive that there is no room in a small business's budget for class action defense. Small businesses, like SRA, are forced to settle class action and other law suits regardless of merit. Additionally, the no-cap TCPA and FCRA open SRA and other small business to annihilation damages that support the class action attorney with little recovery for the class members as discussed above.

Apart from the attorney's fees and possible settlement amount, class action law suits have other internal costs related to discovery and production of information that take time and energy of company employees away from their job responsibilities. This cost is difficult to measure and crosses outside of a company's internal legal team. Time away from everyday responsibilities also prohibits the ability to focus on other more important functions such as operations, compliance, improvement, marketing, etc.

Over the past few years SRA has gained experience with a handful of class action law suits and demands, as shown in Table 1.

TABLE 1: SRA ATTORNEY DEMANDS AND LAW SUITS BY YEAR

	2011	2012	2013	2014	2015
Demands	38	38	22	29	16
Class Action Demands				1	1
Individual Lawsuits	8	10	14	10	11
Class Action Law Suits	0	0	1	3	6

SRA has never settled a case on a class basis. For the class cases that settle prior to SRA filing any response, SRA spends more settling a class action than in settling individual law suits. On average, SRA spends more than twice as much to settle a class action (prior to filing any response) then an individual law suit or demand.

SRA filed a motion to dismiss and compel arbitration in one class action. We reached a settlement prior to the motion being heard. However, the motion contributed to reaching a lower settlement amount than in our other class action cases where we could not move to compel arbitration. **This case cost 40 percent less than the class actions cases—without a PDAA—in which SRA filed a response.**

Since 2013, SRA has filed a response and begun litigation in one class action case per year.[18] Over these three years, these cases comprised roughly 18 to 32 percent of the litigation expenditures for year in which they were filed. **The one-time SRA filed a motion to compel arbitration resulted in a 14 percent savings to our litigation budget that year.**

Defense Attorney Costs

SRA contacted outside counsel in several regions across the US and asked for an estimation of attorneys fees for representation in a class action law suit. Their response is found in Table 2. In so responding one attorney commented on the varying and excessive nature of defense costs for class action representation, reflecting that class size and issue complexity can vary the fees significantly. For example her office has been representing a company on a class action since 2011 where the fees so far total $298,000 (averaging $75,000 per year). In another matter where they reached a class settlement, her office billed $150,000 in fees for the year long representation.

TABLE 2: ESTIMATED DEFENSE ATTORNEY COSTS

Work	Midwest[19]	South[20]	Central	West Coast
Receipt of Claim, Review, Discuss with Client, Analysis and Answer	$2,000	$2,000	$1,500	$800-$1,200
Preliminary Motions (to dismiss on pleadings, stay proceedings, etc.)	$12,000	$10,000 - $25,000	$5,000	$1,200 (routine motions)
Initial disclosures, scheduling report, initial conference.	$1,000			$6,400 (court conferences)
Mediation			$3,000	$16,000 (court ordered ADR)
Discovery	$20,000	$30,000-$50,000	$10,000-30,000	$24,000
Class Certification (add additional costs if in person hearings—oral argument, fairness, etc.	$10,000 $2,000	$7,500	$15,000	$24,000
Summary Judgment	$10,000	$10,000	$15,000	$16,000
Research, Witness Interview, Case Development, Pre-Trial Filings and Prep			$30,000	

18 All other class actions were settled prior to filing any response.

19 The Midwestern attorney indicated that these numbers can increase by fifty thousand dollars just depending on the class size, the type of case, and the particular plaintiff's attorneys. This attorney also indicated that the discovery costs are often driven up by Plaintiff's counsel request for harassing information and multiple depositions.

20 The Southern attorney reported that fighting the issue of arbitration in the first instance would cost $25,000 plus. This attorney also indicated that the cost of notification and mailing awards averages to ten dollars per class member, taking into consideration the cost of class administration.

Trial (average 4 days plus preparations)	$44,800	$50,000	$40,000	$32,000
Class Notification Cost (depends on class size can been 35-13,000)	$1,000 - $3,000	$350- $30,000		
Calls and Emails with Opposing Counsel and Client, Miscellaneous Planning	$3,000		$5,000	
Class Award Mailing Cost (depends on if the class is opt-in, opt-out, and how many elect to stay in the class)	$1,000- $3,000	$350- $30,000		$21.00-$7,800
CAFA Compliance and Notification to States	$1,000			
TOTAL ESTIMATED CLASS ACTION DEFENSE COSTS	**$107,800 to $110,800**	**$108,000 to $204,500**	**$124,500 to $144,500**	**$120.421 to $128,600**

Errors & Omissions Insurance

The errors and omissions insurance coverage does not provide complete coverage in the event of a class action law suit. Often, the exclusion and riders limit the coverage on class action claims that ultimately result in no coverage. For example, our two policies with Catlin had a TCPA rider, which limited the coverage on any TCPA law suit to $100,000.00 in defense costs only. We have a $50,000 deductible so in effect our insurance only covers $50,000 in defense fees on TCPA cases. As described above, $100,000 will not even cover the entirety of defense costs.

This year during the renewal process, we indicated that we did not want a TCPA exclusion from coverage. The insurance provider agreed to eliminate a TCPA exclusion but substituted a class action sublimit rider. Their first proposed rider would have limited coverage on class action law suits to $100,000 (this would not even cover the defense attorney cost). After negotiating for a larger sublimit on class action cases, the insurance company raised the coverage on class action law suits to $500,000 but then increased the premium by five percent to the amount shown in Table 3.

The cost of SRA's errors and omissions insurance costs has more than doubled since 2011 as shown in Table 3.

TABLE 3: SRA'S ERRORS & OMISSIONS INSURANCE COVERAGE

Policy Period	Insurance Company	Premium	Limits of Liability	Deductible
2011	National Union Fire Insurance Co.	$8,314.00	$1,000,000.00	$25,000.00
2012	National Union Fire Insurance Co.	$12,396.00	$1,000,000.00	$25,000.00
2013	Catlin Specialty	$22,447.00	$1,000,000.00	$50,000.00
2014	Catlin Specialty	$21,007.00	$1,000,000.00	$50,000.00
2015	AmTrust	$47,572.85	$5,000,000.00	$50,000.00

An additional cost related to fighting a class action involves hiring outside insurance counsel to fight with the insurance provider to ensure that the insurance company is providing insurance and defense as required under the policy. To date we have spent: $6,303.90 fighting our errors and omissions insurance providers. In all the cases that SRA has submitted to insurance for coverage, we have received a reservation of rights letter where the insurance company explains that they will represent us but reserve all rights to not provide coverage in the event that the matter is not covered under the policy.

As part of a 2012 class action, SRA had a dispute with National Union over the defense counsel the insurance company wanted to appoint. We hired outside counsel to fight our National Union to ensure that they would cover the claim with the attorney of SRA's choice providing representation. We paid the outside counsel $5,070.90 to dispute with National Union. In the end, the National Union allowed the attorney SRA chose to defend the class action and provided coverage under the policy; however, they did not renew our policy after that situation.

Having competent attorneys experienced in debt collection litigation appointed by the insurance company is crucial to resolving the matter quickly and resourcefully with the minimum expense possible. In 2015 we again had to hire the same outside counsel to fight with Catlin concerning the appointment of counsel. In this instance, SRA paid the outside firm $1,233.00 to have Catlin approve SRA's chosen counsel as defense counsel in the class action.

In 2015, we needed to increase our limit of liability for one of our customer requirements to five million dollars. The premiums we were quoted based on the limit of liability desired are shown in Table 4.

TABLE 4: 2015 PREMIUMS BY LIMITATION OF LIABILITY

AmTrust 2015 Premium (not including surplus lines taxes and fees)	AmTrust 2015 Limit of Liability
$22,310.00	$1,000,000
$28,900.00	$2,000,000
$31,500.00	$3,000,000
$41,900.00	$5,000,000 ($500,000 sublimit on class actions)
$43,565.00	$5,000,000 ($1,000,000 sublimit on class actions)

<u>Plaintiff's Attorney Costs and Fees</u>

Often plaintiff's attorney's fees are astronomical in comparison to the settlement amount received by the class members. There is a body of case law discussing the fees received by the plaintiff's attorneys.[21] In our experience we have settled all class action cases on individual basis. In those settlements, SRA rarely learns the breakdown of the settlement amount between the consumer and his or her representative. In the instances where we have been privy to that information, the attorney usually recovered substantially more than the consumer –two times the amount. When the one instance where the attorney recovered less than the consumer is removed, the attorneys recovered as much as six times more than the consumers.

Perhaps a solution to the ability of the attorney to recover significantly more than the class members, would be to adopt a rule that PDAAs are effective except when the class attorneys represent and warrant in the class filing that they will limit their attorney fee award to ten percent or less than the class award if successful. Their failure to do so would make the PDAA effective and allow the financial institution to contest class certification on that basis and move to compel arbitration.

II. SRA's Investment in Compliance is Part of Our Operating Philosophy

The cost of compliance has no relation to whether or not the accounts in our office have arbitration agreements in the original contract or terms and conditions. SRA does not know at the time of placement whether or not any given account has an arbitration agreement. The only time that we check for a PDAA is after we have received service in a law suit or notice of an attorney demand. Therefore the assumption that consumers and or their attorneys will not pursue a law suit due to a PDAA is incorrect.

Our business model, along with the business model of most small businesses, is to set high compliance standards in line with the local, state and federal laws regulating our business. SRA continues to invest in and grow our compliance management system as demonstrated by the estimated yearly compliance expenditures in Table 5. This commitment to high standards is a part of our operating philosophy and the ethical principals upon which SRA was founded. Without this philosophy we would not be successful and it would be difficult to attract customers.

The presence of a PDAA in a consumers account does not change our investment in compliance with consumer protection laws. Nor will the proposal under consideration change our investment in compliance. The one time SRA availed itself of a PDAA and filed a motion to compel arbitration we had a 14 percent savings to our litigation budget that year.

TABLE 5: SRA'S ESTIMATED COST OF COMPLIANCE

Item	One Time Fixed Costs	Additional Yearly Costs
Compliance Department		
Employees		$196,400.00
Training and Education		$6,133.00

[21] See *Grok Lines, Inc. v. Paschall Truck Lines, Inc.*, 2015 U.S. Dist. LEXIS 124812 (N.D. Il. September 18, 2015); *Thorogood v. Sears, Roebuck& Co.*, 627 F.3d 289, 293 (7th Cir. 2010) page 5, *supra.*

Conferences		$15,279.32
Membership & Materials		$9,480.00
Licensing & Bonds		$70,422.96
Compliance Systems		
First Communication Platform	$81,179.33	
Second Communication Platform	$102,000.00	96,000.00
Voice Analytics	$135,000.00	
Scrubs (BK, Litigious)		$11,095
Cell Phone Scrubs		$1,188.00
Third Party Auditor		$30,109.28
IT Protections		
Firewall	$5,000.00	$2,000.00
Antivirus Software		$2,000.00
Content Filter	$15,000.00	$4,000.00
Data Backup		$15,000.00
Disaster Recovery Facility		$12,000.00
Fire Suppression System	$16,000.00	$1,000.00
Generator	$35,000.00	
Log Monitoring Service		$15,000.00
Encryption at Rest Testing		$33,000.00
Internal Penetration Testing		$10,000.00
External Penetration Testing		$5,500.00
Vulnerability Scanning		$8,600.00
Cyber Insurance		$8,500.00
Video Cameras	$4,000.00	
Building Alarm		$1,000.00
Electronic Key Locks	$5,000.00	
Legal Costs		
Average Total For Settlements		$75,000.00
Average Outside Counsel Expenditure		$45,000.00
Registered Agent		$4,975.40
Errors & Omissions		$47,572.85
General Liability Insurance		$5,829.00

Third Union Finance, Inc.

and

Whitestone Financial, Inc.'s

Written Comments

for the

Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements

Submitted

November 9, 2015

Third Union Finance, Inc. and Whitestone Financial, Inc. (collectively, the "Companies") ask that the Consumer Financial Protection Bureau ("CFPB") not proceed with the rulemaking on arbitration agreements. This rulemaking has the potential to put the Companies, and other small businesses, out of business. This will not only hurt the Companies' employees, but will prevent thousands of customers from having access to affordable credit.

Arbitration is beneficial for both businesses, consumers, and the U.S. Court system. If the CFPB prohibits the application of arbitration agreements as to class cases in court, arbitration in the consumer finance space will go away. It will be replaced by class action litigation which provides great benefits to plaintiffs' attorneys, but very few benefits to borrowers. Even the risk of class action litigation can harm businesses and their customers. Banning pre-dispute arbitration agreements in class litigation will not increase compliance, as the CFPB believes. It has no relation to compliance. The Companies object not only to the prohibition on pre-dispute arbitration agreements, but also to the requirement to submit arbitral claims and awards to the CFPB.

I. Benefits of Arbitration

Pre-dispute arbitration agreements are the most effective and efficient way to resolve disputes with consumers that are not settled during the average complaint resolution process. Pre-dispute arbitration agreements are not a way for companies to avoid the consequences of their actions, but are an efficient way for both companies and customers to quickly work out a resolution that serves the customer. In an arbitration, the customer gets an opportunity to have her case heard on the merits, at a time and a place (even over the phone) that is convenient for her. And the company has a chance to provide a fair resolution that restores the relationship between the lender and the company. The survival of a small business is based on strong, positive customer relationships.

Numerous studies show that arbitration is beneficial because: (1) consumers prevail more often than businesses in cases that go to arbitration; (2) the majority of consumer arbitrations result in monetary or nonmonetary recovery for the consumer; (3) consumers win some relief in arbitration cases as often, or more often, than in court cases; (4) arbitration is quicker than bringing a lawsuit in the crowded and overburdened federal and state court systems; and (5) consumers may file and pursue arbitration at a minimal cost. The studies describing these conclusions include:

- The Financial Industry Regulatory Authority's ("FINRA") dispute resolution statistics;[1]
- *Creditor Claims in Arbitration and in Court,* The Searle Civil Justice Institute's ("SCJI") Preliminary Report (March 2009) and Interim Report No. 1 (November 2009) on consumer arbitration;[2]

[1] www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/ which demonstrate that in 2011, approximately 74 percent of customer claimant cases resulted, through settlements or awards, in monetary or non-monetary recovery for the consumer.

[2] The study concluded that consumers won some relief in arbitration cases as often, or more often, than in court cases, even after controlling for differences among the types of cases and the venue in which they were brought. The

- Sarah R. Cole's and Kristen M. Blankley's study, *Empirical Research on Consumer Arbitration: What the Data Reveals (2009)*;[3]

- Ernest & Young's 2004 study, *Outcomes of Arbitration, an Empirical Study of Consumer Lending Cases*;[4]

- The American Arbitration Association's Consumer-Related Disputes Supplementary Procedures;[5]

- Elizabeth Hill's *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*;[6]

- Harris Interactive's *Arbitration: Simpler, Cheaper and Faster Than Litigation*;[7]

- Lewis L. Maltby's *Private Justice: Employment Arbitration and Civil Rights*;[8]

- Lisa B. Bingham's *Is There a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Active Cases and Outcomes*;[9]

- *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure*;[10]

- Michael Delikat & Morris M. Kleiner's *An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintifs Better Vindicate Their Rights?*;[11]

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study also concluded that prevailing consumers were awarded as high a percentage, or a higher percentage, of what they sought in arbitration, rather than in court cases. Moreover, the study found that arbitration was cheaper and faster for consumers.

[3] http://pennstatelawreview.org/articles/113%20Penn%20St.%20L.%20Rev.%201051.pdf

[4] The study concluded that consumers prevailed more often than businesses in cases that went to an arbitration hearing. The study also showed that consumers obtained favorable results in close to 80 percent of the cases that were reviewed.

[5] www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CGIQFjAA&url=http%3A%2F%2Fwww.adr.org%2Fcs%2Fidcplg%3FIdcService%3DGET_FILE%26dDocName%3DADRSTG_005021%26RevisionSelectionMethod%3DLatestReleased&ei=F42qT8b_Gqbs6gHYstH1BA&usg=AFQjCNGTzLjDCrelZ_CmX0yjZSK6NZ1Akg&sig2=d9tIZI1cFo5pxz-KX6sxDw

[6] 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 (2003).

[7] http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf (Apr. 2005) This study demonstrates strong satisfaction with arbitration results and process, including speed and simplicity.

[8] 30 Colum. Hum. Rts. L. Rev. 29, 48, 63 (1998). The director of ACLU's National Task Force on Civil Liberties in the Workplace concludes that employees collectively receive 10.4% of their demand in litigation, compared with 18% in arbitration, and "arbitration holds the potential to make workplace justice truly available to rank-and-file employees for the first time in our history."

[9] 6 INT'L J. CONFLICT MGMT. 369, 378 (1995). Employees won 73% of the arbitrations they initiated and 64% of all employment arbitrations, including those initiated by employers, in AAA employment arbitrations.

[10] CAL. DISP. RESOL. INST. 25 (Aug. 2004), www. mediate.com/cdri/cdri_print_Aug_6.pdf. Consumers prevailed 71% of the time in arbitrations.

- Christopher R. Drahozal and Samantha Zyontz's *An Empirical Study of AAA Consumer Arbitration*;[12] and

- Christopher R. Drahozal and Samantha Zyontz's *Creditor Claims in Arbitration and in Court*.[13]

Even the CFPB's own arbitration study[14] shows that arbitration is beneficial. For a detailed review of the study, please see the Appendix, which is a Summary and Critique of the CFPB's study by the Mercatus Center at George Mason University. While the CFPB's press release announcing the study claims that arbitration agreements are detrimental to consumers, a careful reading of the 728-page study shows that arbitration *benefits* consumers. For example, arbitration is quicker and more cost-effective for consumers than litigation. Unlike in civil litigation where a consumer faces uncertain attorney fees, arbitration fees are modest and disclosed. Consumers paid an average of $206 in fees in arbitration cases reviewed by the CFPB. In some of those cases, consumers' final fees were modified by the arbitrator's decision. In addition, needy consumers may seek a waiver of fees.

Furthermore, the CFPB's study shows that arbitration is a convenient option for consumers. Most arbitration clauses reviewed by the CFPB required hearings to take place close to the consumer's residence. The study estimated that consumers traveled an average of 15 miles to attend in-person hearings. The study also notes that an arbitration can be resolved either on the basis of the parties' submission of documents, by a telephone hearing, or by an in-person hearing.

In addition, the study demonstrates that arbitration provides consumers with fairly quick resolutions to their disputes. According to the CFPB study, telephone arbitrations were resolved in a median five months, and in-person hearings were resolved in a median seven months. By contrast, class action settlements received final court approval after an average of 690 days, or close to two years.

And lastly, according to the study, arbitration leads to higher monetary relief for consumers than lawsuits. Comparing cases where the CFPB could determine the award amount and excluding an outlier award, the average consumer relief in arbitrations was $5,389, compared to an average award in individual federal court claims of $5,245. In terms of award dollars, consumers fared a little better in arbitration – receiving nearly $150 more in relief – than in court. The CFPB's study lacks comparable statistics for individual class members. The award amounts are highlighted in the aggregate, without revealing the dollar amount each class member received.

[11] DISP. RESOL. J., Nov. 2003 – Jan. 2004, at 56, 57. Employees prevailed 33.6% of the time in court versus 46% of the time in arbitration in employment discrimination cases, received higher median damages awards, and took less time.

[12] 25 Ohio St. J. on Disp. Resol. 843 (2010). This article concludes that arbitration is inexpensive and expeditious. It also found that there was no statistically significant repeat-player effect.

[13] 7 Hastings Bus. L.J. 77 (2011). This article found that consumers prevailed more often in arbitrations than in court.

[14] CFPB's Arbitration Study: Report to Congress 2015. http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf

While the CFPB study touted that "some 34 million class members had received or were scheduled to receive cash relief as a result of the filing of a claim or receiving an automatic distribution of relief," simple calculations from the numbers presented in the study show that class members only receive around $32.

The U.S. Supreme Court and the U.S. Department of Labor also support arbitration. As noted by the Court in a 1995 decision upholding arbitration: "The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices…"[15] The Department of Labor encourages "the creative potential of alternatives to standard court litigation," as long as the "legal needs and priorities of a diverse American workforce are fairly satisfied."[16]

II. Problems with Class Action Litigation

If the CFPB proceeds with its proposal and prohibits the application of arbitration agreements as to class cases in court, arbitration will cease to be a way to resolve disputes between lenders and their customers. As a small entity representative ("SER") explained during the Small Business Advisory Review Panel ("Panel"), a pre-dispute arbitration clause without a class action waiver is like buying car insurance only for the small dings on the car. Arbitration will be replaced by class action litigation; a single one of which could wipe out a small business. Class action litigation does not benefit consumers or businesses. Only the plaintiffs' attorneys benefit. If the CFPB is trying to protect consumers, it should not force them into class actions.

Class action litigation provides little benefit for the consumer. Consumers receive pittances, $32 per class member according to the CFPB's study, while class action lawyers reap financial windfalls. The Department of Labor acknowledges that, "…court litigation has become a less-than-ideal method of resolving employees' public law claims. As spelled out in the Fact Finding Report, employees bringing public law claims in court must endure long waiting periods as governing agencies and the overburdened court system struggle to find time to properly investigate and hear the complaint."[17] The Department of Labor continues, "Moreover, the average profile of employee litigants – detailed in the Fact Finding Report – indicates that lower-wage workers may not fare as well as higher-wage professionals in the litigation system; lower-wage workers are less able to afford the time required to pursue a court complaint, and are less likely to receive large monetary relief from juries."[18]

Even if class members are entitled to an award, they frequently fail to obtain them. The CFPB's own study found that in class action settlements, the unweighted average claims rate was 21 percent. The median was only 8 percent.

[15] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995)
[16] U.S. Dept. of Labor. "Employment and Dispute Resolution."
http://www.dol.gov/_sec/media/reports/dunlop/section4.htm
[17] *Ibid.*
[18] *Ibid.*

Class action litigation also harms consumers because it drives up prices and limits competition. In order to settle large class actions, companies need money, necessitating a rise in prices. If the settlement is too high, it will drive small business out of business, thus limiting competition. Class actions are expensive. Defending a class action claim will typically be hundreds of thousands of dollars. Merely addressing a demand letter, even just to get the case to go away, costs between $15,000 - $50,000. Even if a company is right on the merits of the case, class action discovery is too expensive to pursue, so a company will settle. In a Supreme Court opinion, Justice Scalia wrote, "Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims."[19] This will encourage the same attorney, or other attorneys, to file additional lawsuits. During the Panel, a small bank from Texas said that it might have to stop offering consumer credit products. A competitor in vehicle finance has already stopped. Class actions are not just expensive, they take time. In a small company, top executives will have to spend a significant amount of time responding to the lawsuit – time that is not spent serving their customers.

As the CFPB study indirectly points out, class action attorneys are the real winners, raking in $424,495,451 in fees awarded in settlements during the period studied. Plaintiffs' attorneys can get thousands of dollars just in response to a demand letter on behalf of the class, even if the case does not go forward and the attorneys do not actually file for class certification or discovery. During the Panel, a SER mentioned an attorney who had filed over three hundred cases, none of which actually moved forward. In another example, there have been numerous times when companies offer individual rewards to end a class action, but those individual rewards are turned down by plaintiffs' attorneys. An individual reward would help the consumer, but not the attorney.

Eliminating pre-dispute arbitration agreements substantially increases the risk of class action litigation, which in turn devastates the relationship between customers and small businesses. This is extremely problematic for small businesses since small businesses rely on good customer relations to survive. Satisfied customers tell their friends and family members about their good experience and send those friends and family members to that small business for needed services. This will not happen if small businesses no longer have an opportunity to work one on one with its customers. Class action litigation cuts off the opportunity for businesses to work with their customers. It also creates a serious entry barrier for new small businesses. If the CFPB's ban goes into effect up and coming small business entrepreneurs will be forced to weigh the decision to enter the consumer financial products market against the probability of being the subject of a class action suit, even a frivolous suit, and the unsustainable cost associated with such an action. This will have the unwelcomed effect of deterring competition in this market, ultimately driving up costs to consumers.

Class actions will increase after the CFPB's ban goes into effect. The CFPB believes that increased compliance may stave off litigation. This is not the case. First, if the CFPB really thought that class action litigation would not increase, there would be no reason for them to initiate this rulemaking. Second, plaintiffs' attorneys will likely file lawsuits just because they can. Just look at the increase in the number of Telephone Consumer Protection Act ("TCPA") lawsuits. In 2013, there was a 70 percent uptick in TCPA litigation. There was an additional 25

[19] *AT&T Mobility v. Concepcion*, 563 U.S. 333 (2011)

percent increase in 2014.[20] Another example is the flood of class actions that occurred in Mississippi in the 1990's.

This increase in class action litigation will further encumber already overburdened courts. The immense transfer of cases currently handled by private arbitrators has the very real potential of "crashing" the judicial system, an impact the CFPB has yet to examine. Not only will the courts be overburdened by the number of cases, they will be fiscally overwhelmed as well. The CFPB's proposal is basically an unfunded mandate. District, state, and federal courts will have to pick up the costs of an increased case load.

As far back as 1995, the Judicial Conference of the U.S. was concerned with the increase in litigation. "Today, a number of the federal court's core values are in jeopardy, largely for reasons beyond the courts' control. The increasing atomization of society, its stubborn litigiousness, the breakdown of other institutions, and paradoxically, the very popularity and success of the federal courts, have combined to strain the courts' ability to perform their mission."[21] The Conference's report continues, "Huge burdens are now being placed on the federal courts. An historical overview of cases commenced in the federal district and appeals courts since 1904 reveals remarkable growth."[22] The report specifies, "The U.S. population has increased slightly more than 200% since 1904. In the same period, however, while federal criminal cases commenced annually in the district courts have increased a relatively modest 157%, civil case filings have increased 1,424%, with most of that growth in the period since 1960."[23]

In Sept. 2015, the Judicial Conference issued a strategic plan. The plan mentions issues such as delays and backlogged cases, budget constraints, insufficient number of judges, limited juror resources, as well as overburdened and congested courts.[24] Interesting, the Judicial Conference specifically mentions alternative dispute resolution:

> "To improve access, rules of practice and procedure undergo regular review and revision to reflect changes in law, to simplify and clarify procedures, and to enhance uniformity across districts. Rule changes have also been made to help reduce cost and delay in the civil discovery process, to address the growing role of electronic discovery, and to take widespread advantage of technology in court proceedings. National mechanisms to consolidate and coordinate multidistrict litigation avoid duplication of discovery, prevent inconsistent pretrial rulings, and conserve the resources of the parties, their counsel, and the judiciary. In addition, many courts provide settlement conferences, mediation programs, and other forms of alternative dispute resolution to parties interested in resolving their claims prior to a judicial decision. Despite these and other efforts, some lawyers, litigants, and members of the public continue to find litigating in the federal courts challenging.

[20] Lunsford, Patrick. "FDCPA Lawsuits Decline for Third Straight Year, But TCPA Suits Up 25%." Inside Arm. Jan. 23, 2015. http://www.insidearm.com/daily/fdcpa-lawsuits-decline-for-third-straight-year-but-tcpa-suits-up-25/
[21] Judicial Conference of the United States. "Long Range Plan for the Federal Courts." December 1995. http://www.uscourts.gov/file/2826/download. pp. 9 -10
[22] *Ibid.*
[23] *Ibid.*
[24] Judicial Conference of the United States. "Strategic Plan for the Federal Courts. Sept. 2015. http://www.uscourts.gov/file/18424/download

> Court operations and processes vary across districts and chambers, and *pursuing federal litigation can be time consuming and expensive*."[25] [emphasis added]

At the very least, the CFPB should not proceed with this rulemaking until it investigates the effect the rulemaking will have on the U.S. judicial system.

III. Consequences of Increased Litigation Risk

In addition to harming the small business-customer relationship, and the expense of facing class action litigation, the mere risk of class action can harm small businesses. For example, small businesses may not be able to get insurance to cover class action lawsuits. It is almost impossible to determine ahead of time if an insurance company would actually cover a claim. If an insurance company did offer clear, class action insurance, the premiums would be staggering. It would be akin to getting hurricane coverage. Not only would the premiums increase, but when the plaintiffs' attorneys discover that the company has insurance, the demands increase.

The risk of litigation may also result in banks choosing to end relationships with small consumer finance businesses. Already, some of these businesses have faced increased scrutiny from banks as a result of Operation Choke Point. If the banks decide that small consumer finance businesses may face large class action settlements, they may deem them even riskier. This is happening even now as a result of the increased TCPA litigation. Some banks are already freezing their business customers' accounts.

IV. Prohibiting Arbitration Agreements Has No Relation to Compliance.

The CFPB mistakenly believes that prohibiting the use of pre-dispute arbitration agreements in class litigation strengthens incentives for consumer financial service providers to engage in robust compliance and customer service on an ongoing basis. In reality, there is no relationship between the existence of an arbitration agreement and a small businesses compliance management system or customer service. The Companies maintain a high level of compliance. They have done so successfully for years. The Companies also maintain a high level of customer service. Stellar customer service is the cornerstone of any small business, and without it, a small business would fail.

In fact, prohibiting the use of pre-dispute arbitration agreements will have the opposite effect on compliance and customer service than the one the CFPB is anticipating. Using an example that one of the SERs explained during the Panel – if compliance and litigation are a pie, small consumer finance businesses spend about a quarter of that pie on litigation and about three quarters on compliance. Pre-dispute arbitration agreements are crucial to keeping litigation costs low. Without those agreements, small consumer finance businesses will likely spend at least half of that pie on litigation, resulting in less money being spent on compliance. If litigation costs rise even further, there will not be enough money for small businesses to comply with federal and state laws and they will be forced out of business.

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[25] *Ibid.*, p. 13

V. Requirement to Submit Arbitral Claims and Awards to the CFPB

The CFPB is considering a proposal to require covered entities that use arbitration agreements in their contracts with consumers to submit initial claim filings and written awards in consumer finance arbitration proceedings to the CFPB. The Companies believe that reporting this information would present a biased picture of arbitral awards. By presenting data on what consumers recover when arbitrators make a judgment in their favor, but no data on what consumer recover when arbitrations settle (the likely outcome in a majority of arbitrations), the CFPB would present a biased view of what consumer recover in arbitrations.

VI. Alternatives

In light of the CFPB's broadly employed restitution powers – powers granted by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") – class action lawsuits are not necessary as a mechanism to recompense injured consumers or to ensure compliance by regulated industries. Consumers compensated by CFPB enforcement and consent orders do not share their compensation with lawyers, and those consumers who are not fully compensated through CFPB enforcement and consent orders are better off with speedy and effective resolutions of their cases through arbitration. The Dodd-Frank Act also gives state attorneys general additional enforcement authority. While attorneys general receive notice of class action settlements that are subject to the Class Action Fairness Act, this is hardly the most potent weapon in a state attorney general's consumer protection arsenal. Attorneys general can use their authority under the Dodd-Frank Act to bring civil actions for unfair, deceptive or abusive acts or practices. The CFPB should let its own enforcement attorneys and state attorneys general protect consumers, not plaintiffs' attorneys who are looking to help themselves.

The CFPB believes that possible class-wide arbitrations could be a solution. However class-wide arbitrations are untenable. As the U.S. Supreme Court has recognized, arbitration is unsuitable for class-wide claims because a "switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment." [26] Moreover, unlike individual claims, class-wide claims are not initiated by putative class members – aside from named plaintiffs – and have regularly been criticized as more for the benefit of counsel than the putative class. [27]

It is possible that the SBA could recommend exempting small businesses from the rule. The Companies caution against that approach because without the support from the larger players, the consumer finance arbitration system could go away and the small businesses would be left without arbitrators to use.

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[26] *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1751 (2011).
[27] Hensler, *Class Counsel, Self-Interest and Other People's Money*, 35 U. Mem. L. Rev. 53, (2004).

VII. Acknowledgement

On behalf of Third Union Finance and Whitestone Financial, we thank the CFPB, SBA, and OMB for the opportunity to participate in the Small Business Advisory Review Panel for Potential Rulemaking on arbitration agreements. We appreciate the option to submit these comments and recommendations in addition to the verbal comments made during the hearing. And we hope that the CFPB reconsiders its proposal. A proposal in which it is impossible to calculate the cost to businesses and consumers is not one that will serve either constituency.

Respectfully Submitted,

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APPENDIX

The Consumer Financial Protection Bureau's Arbitration Study

A Summary and Critique

Jason Scott Johnston
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August 2015

MERCATUS WORKING PAPER

MERCATUS CENTER
George Mason University
3434 Washington Blvd., 4th Floor, Arlington, Virginia 22201
www.mercatus.org

Jason Scott Johnston and Todd Zywicki. "The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique." Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, August 2015.

Abstract

The Consumer Financial Protection Bureau's *Arbitration Study: Report to Congress 2015* does not support the case for ex ante regulation of mandatory consumer arbitration clauses. It contains no data on the typical arbitration outcome—a settlement—and it is these arbitral settlements, and not arbitral awards, that should be compared to class action settlements. It does not address the public policy question of whether, by resolving disputes more accurately on the merits, arbitration may prevent class action settlements induced solely by defendants' incentive to avoid massive discovery costs. It shows that in arbitration consumers often get settlements or awards, are typically represented by counsel, and achieve good results even when they are unrepresented. In class action settlements, the Consumer Financial Protection Bureau reports surprisingly high payout rates to class members and low attorneys' fees relative to total class payout. These aggregated average numbers reflect the results in a very small number of massive class action settlements. Many class action settlements have much lower payout rates and higher attorneys' fees.

JEL codes: K2, G2, K23, K41

Keywords: consumer financial regulation, arbitration, class action litigation, attorneys' fees

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Acknowledgments

The authors would like to thank the Mercatus Center for financial support and IBC Bank for generously sharing with us the data described in the article regarding internal resolution of complaints by consumers.

The Consumer Financial Protection Bureau's Arbitration Study

A Summary and Critique

Jason Scott Johnston and Todd Zywicki

I. Introduction

For decades, legal commentators have debated the normative desirability of clauses in consumer contracts that require consumers to arbitrate rather than litigate claims against providers of consumer products and services.[1] Consumer advocates have been especially concerned that, by precluding consumer class actions, such mandatory arbitration clauses will leave consumers without any effective remedy for violations of consumer contracts and allow even more egregious corporate misconduct that violates state and federal consumer protection statutes.[2] However, although many consumer contracts clearly include clauses requiring consumers to arbitrate claims, there is relatively little systematic empirical evidence about how consumers fare in either arbitration or consumer class actions. With dozens of state and federal consumer protection statutes aimed at both compensating consumers and deterring corporate misconduct, empirical evidence on the effectiveness of arbitration versus consumer class action has been needed badly.

In enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act,[3] Congress finally joined the debate over arbitration versus class action relief in consumer financial contracts. Under Dodd-Frank, pre-dispute mandatory arbitration clauses are unconditionally banned in contracts for residential mortgages and home equity loans.[4] For most other types of consumer financial contracts, however, Dodd-Frank delegates to federal agencies

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[1] *See* sources cited in Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SW. U. L. REV. 87, 87 n.1 (2012).
[2] For examples of this view, *see* David S. Schwartz, *Claim-Suppressive Arbitration: The New Rules*, 87 IND. L.J. 239 (2012); Maureen Weston, *The Death of the Class Action After* Concepcion*?*, 60 U. Kan. L. REV. 767 (2012).
[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[4] *Id.* § 1414.

the job of gathering more systematic evidence about arbitration. Section 1028(a) of Dodd-Frank requires the newly created Consumer Financial Protection Bureau (CFPB) to provide Congress with a report on "the use of agreements providing for arbitration of any future dispute between covered persons and consumers."[5] As for what the CFPB is to do after it issues such a report, section 1028(b) grants the CFPB the authority to "prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers." For arbitration clauses in broker–customer contracts, Dodd-Frank commands that the Securities and Exchange Commission (SEC) conduct a similar study.[6]

Although nothing indicates that the SEC will be reporting anytime soon on arbitration clauses in broker–customer contracts,[7] the CFPB has now issued two reports on arbitration in consumer financial contracts: the December 2013 *Preliminary Results* study (hereafter preliminary results)[8] and the March 2015 *Arbitration Study: Report to Congress 2015* (hereafter Report).[9] The CFPB substantially added to the Report while incorporating the earlier preliminary results. Although the tone and conclusions of the Report are measured and cautious, many commentators have interpreted it as a prelude to aggressive regulation of arbitration agreements

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[5] *Id.* § 1028(a).
[6] Section 921 of Dodd-Frank also requires the Securities and Exchange Commission to study and report on the use of mandatory arbitration clauses in broker–customer contracts.
[7] As noted by George H. Friedman, *What's a Regulator to Do? Mandatory Consumer Arbitration, Dodd-Frank, and the Consumer Financial Protection Bureau*, 20 DISP. RESOL. MAG. (2014) (citation omitted) *available at* http://www.americanbar.org/publications/dispute_resolution_magazine/2014/summer/what-s-a-regulator-to-do--mandatory-consumer-arbitration--dodd-f.html ("Given the more than 90 mandatory study and rulemaking requirements the SEC has under Dodd-Frank, it is not at all surprising that arbitration is not high on the agency's priority list.")
[8] CONSUMER FIN. PROT. BUREAU (CFPB), ARBITRATION STUDY: PRELIMINARY REPORT (2013).
[9] CFPB, ARBITRATION STUDY: REPORT TO CONGRESS 2015 (2015).

in consumer credit contracts[10] or perhaps even as an outright ban on mandatory arbitration clauses. Deepak Gupta, who acted as senior counsel for enforcement strategy at the CFPB during the new federal agency's founding in 2011–2012, has told the press that prohibiting or restricting mandatory arbitration would be "the single most transformative thing the bureau can do" for consumers.[11] In May 2015, 58 members of Congress wrote to CFPB Director Richard Cordray, pointing to the findings of the study and "urg[ing] the CFPB swiftly to undertake a rulemaking to eliminate the use of forced arbitration clauses in these contracts."[12]

Proponents of that view particularly point to the Report's apparent enthusiasm for the use of class action litigation to resolve disputes involving consumer credit products instead of arbitration. Although the Report draws no firm conclusions, it may seem to suggest that arbitration is often an ineffective means for compensating consumers in disputes involving consumer credit products and that class action cases are an attractive alternative. If that is the implied message, then the CFPB may attempt to point to its Report as providing a foundation for banning or restricting the use of mandatory arbitration clauses in consumer credit contracts such as contracts for credit cards, prepaid cards, checking accounts, and payday loans, just as Dodd-Frank itself prohibits arbitration in mortgage and other contracts.

The CFPB's Report, however, provides no foundation for imposing new restrictions or prohibitions on mandatory arbitration clauses in consumer contracts. Although the Report provides some useful new information about the use of arbitration clauses in contracts involving

[10] As we note later, the Report is not limited to products that constitute "consumer credit," such as credit cards; it also includes a variety of consumer financial products, such as checking accounts, prepaid cards, and even cell phone contracts. Nevertheless, in this paper, we will frequently use the term *consumer credit contracts* as a shorthand for this range of contracts involving consumer financial products.
[11] Carter Dougherty, *CFPB Finds Arbitration Harms Consumers, Presaging New Rules*, BLOOMBERG BUS., March 20, 2015, *available at* http://www.bloomberg.com/news/articles/2015-03-10/cfpb-finds-arbitration-harms-consumers-in-study-presaging-rules.
[12] Letter from Sen. Al Franken et al. to Richard Cordray, Director, Consumer Financial Protection Bureau (May 21, 2015), *available at* http://www.cfpbmonitor.com/files/2015/05/150521CFPBarbitrationLetter.pdf.

consumer financial services, its findings fail to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class action litigation would be beneficial to consumers and the economy. Most importantly for public policy purposes, the CFPB's data do not allow for meaningful comparison between arbitration and class actions. The CFPB's Report sheds no light on what is perhaps the key public policy question: whether class action settlements often represent a deal struck by defendants to avoid massive discovery costs threatened in lawsuits of questionable substantive merit, whereas arbitration may resolve individual claims more accurately in terms of the substantive merits of the dispute.

Instead, the CFPB's Report presents mountains of data on outcomes in arbitration and in class action lawsuits. These data suffer from a number of shortcomings. The CFPB is to be lauded for looking at thousands of actual case files and docket sheets for details on class action settlements. But by presenting data on what consumers recover when arbitrators make a judgment in their favor but no data on what consumers recover when arbitrations settle—the likely outcome in a majority of arbitrations that the CFPB studies—the CFPB invites a false apples-to-oranges comparison between class action *settlements* and arbitral *awards*. The CFPB did not have access to data on the amount of arbitral settlements, but it should have clearly cautioned against drawing a comparison between arbitral awards and class action settlements.

As for the CFPB's data on class action settlements, its sample of class action settlements likely includes many settlements in lawsuits against debt collection agencies. Because debt collectors are not parties to an arbitration clause between the consumer and the creditor, a debt collector cannot avail itself of an arbitration clause in the contract between the consumer and creditor. The CFPB said that it only included class settlements involving disputes to which an arbitration clause might have applied. As the debt collector settlements were not such disputes, if the CFPB had consistently applied its own rule for determining which class settlements to include in the sample it studied, then the CFPB would have excluded the large number of debt collector class action settlements.

More seriously, the CFPB's data on two measures—on the fraction of consumers actually receiving a payment under a class action settlement (the claims rate) and on attorneys' fees as a fraction of the total amount paid to class members—are aggregate averages. To construct these aggregate averages, the CFPB counts the number of class members paid, and the total amount paid in attorneys' fees, and divides those numbers by, respectively, the total number of class members and the class payment. The problem with that approach is that it tends to overweight data from only half a dozen huge class action settlements. The outcomes in this very small number of class action settlements dominate the CFPB's reported data. Were the CFPB to have broken down claims rates and attorneys' fees by case type—for example, settlements under the Telephone Consumer Protection Act (TCPA)—then its data would likely have revealed not only that substantial variation exists across case types in both the claims rate and the size of attorneys' fees, but also that for some case types, such as TCPA settlements, only about 5% of consumers ever receive a payout in typical class action settlements, whereas attorneys' fees are on average almost as large as the total amount paid to the class.

As for the CFPB's arbitration data, the CFPB discovered that for most financial products, some providers require arbitration of disputes, but others do not. When arbitration is required, the CFPB found that a majority of consumers are represented by counsel in arbitration, with an even higher fraction represented when there is an issue regarding a disputed debt. At the same time, the CFPB found that arbitration is such a simple and cheap process (now requiring only a $200 filing fee) that consumers achieve good outcomes even when they are not represented by counsel.

Finally, we find the CFPB's data from consumer surveys very significant. When consumers were asked what they would do if a credit card company failed to remove a fee that the consumer complained had been wrongly assessed, very few said that they would resort to calling a lawyer. Instead, the vast majority of consumers said that they would simply cancel their accounts and take their business elsewhere. Our data indicate that this consumer market response is credible and real: as economic theory predicts, financial institutions seem to respond to the threat of losing a consumer's business by waiving various fees and charges on a case-by-case basis. For the vast majority of consumer disputes involving small claims, the market creates incentives for firms to resolve such disputes internally.

Our conclusion, therefore, is that although the CFPB Report has some new information about both arbitration and class action litigation as alternative devices for resolving consumer financial disputes, the Report does not provide much of the key information necessary to fully evaluate the relative roles of arbitration and class actions as ex post dispute resolution mechanisms for consumer cases. Substantially more and different evidence would be necessary to conclude that consumers are harmed by arbitration or that they would benefit from unleashing class action litigation more routinely. The propriety of caution in moving to restrict arbitration agreements on the basis of the CFPB's findings is especially appropriate in light of the well-established public policy favoring the use of alternative dispute resolution techniques. As the Supreme Court has repeatedly emphasized in opinions upholding mandatory arbitration clauses, when in the Federal Arbitration Act, the U.S. Congress made pre-dispute mandatory arbitration clauses "valid, irrevocable and enforceable,"[13] it expressed both a "liberal federal policy favoring

[13] The statute, Federal Arbitration Act, 9 U.S.C. § 2 (1925), continues to say ". . . save upon such grounds as exist in law or equity for the revocation of any contract."

arbitration" and the "fundamental principle that arbitration is a matter of contract."[14] Before regulation overrides such a well-established policy, substantial and rigorous evidence must show that arbitration is significantly worse for consumers than are the existing institutional alternatives.

In this paper, we will analyze the Report's methodology and conclusions and identify the Report's limitations as a basis for aggressive regulation of arbitration provisions in consumer credit contracts.

II. Well-Established Public Policy That Favors Arbitration over Litigation

In recent years, the Supreme Court has made it crystal clear that the policy favoring arbitration expressed in the Federal Arbitration Act preempts efforts by state courts, in particular, to declare that arbitration clauses are unenforceable on public policy grounds. More precisely, in *AT&T Mobility v. Concepcion*, the Supreme Court squarely addressed holdings by a number of state courts that arbitration clauses waiving class action litigation were unenforceable on grounds of unconscionability or public policy. Those courts[15] had reasoned that class action relief was necessary to secure an important goal underlying state consumer protection statutes—that of deterring firms from misbehavior that inflicts harm on consumers that is so small that individual claims are not viable but that is large in the aggregate. Relying solely on affidavit evidence from trial attorneys, these courts had held that individual arbitration could not effectuate this goal

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[14] AT&T Mobility v. Concepcion, 563 U.S. 321, 131 S. Ct. 1740, 1745 (2011), quoting Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 67 (2010).

[15] Perhaps the most prominent example is the California Supreme Court in Discover Bank v. Superior Court, 36 Cal. 4th 148, 113 P.3d 1100 (2005), the case relied on by the California Supreme Court in declaring unenforceable the arbitration clause at issue in *Concepcion*. Under the narrow reading of the *Discover Bank* holding put forward by *Concepcion*, the court's rule striking down class action waivers was limited to such waivers in adhesion contracts in which the consumer alleged that small damages were incurred because of the defendant's scheme to "cheat" consumers. But other state supreme courts had relied on essentially identical reasoning without similar doctrinal limits. *See*, e.g., Scott v. Cingular Wireless, 161 P.3d 1000 (Wash. 2007).

because attorneys would not undertake such representation on an individual basis, even in arbitration. With class action relief waived, these courts had found that small consumer claims would not be effectively pursued, thus leaving consumers uncompensated and firms undeterred from misbehavior that generated such small, nonviable consumer claims.[16]

Concepcion was precisely the kind of small stakes consumer contract dispute for which state courts had claimed that individual arbitration could not substitute for class action–style relief. The plaintiffs in *Concepcion* alleged that that AT&T had engaged in false advertising and fraud by charging them a $30.22 sales tax on a phone that it had advertised as being free. Under AT&T's arbitration clause, for claims less than $10,000, a consumer wishing to pursue a claim in arbitration could do so over the phone, via written submissions, or in person. If the consumer received an arbitration award larger than AT&T's last settlement offer, then under the clause, AT&T promised to pay a minimum of $7,500 plus the claimant's attorney fees.[17] The District Court in *Concepcion* thought highly of this arbitration mechanism, finding that it was "quick, easy to use" and likely to "promp[t] full or . . . even excess payment to the customer without the need to arbitrate or litigate" and that the $7,500 premium functioned as "a substantial inducement for the consumer to pursue the claim in arbitration."[18] Still, it found that under California law, AT&T's clause was unenforceable because AT&T had failed to show that arbitration under its clause could adequately substitute for the deterrent effect of class action relief.

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[16] Some courts, such as the California Supreme Court in *Discover Bank*, tried to be careful to say that they were ruling arbitration clauses unconscionable so that their decisions would be protected from preemption by language in section 2 of the Federal Arbitration Act, which says that arbitration clauses are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2006). Other courts, such as the Washington Supreme Court in *Scott v. Cingular Wireless*, were willing to simply say that mandatory arbitration clauses in consumer contracts were void as against state public policy. As discussed later in this paper, the Supreme Court did not find at all persuasive the idea that *Discover Bank* represented just a routine (or case-specific) finding of unconscionability.
[17] This summary of the clause is taken from the Court's opinion in *Concepcion.*
[18] AT&T Mobility v. Concepcion, 131 S. Ct. 1740, 1745 (citing Laster v. T-Mobile USA, Inc., 2008 WL 5216255, *11–*12) (S.D. Cal., Aug. 11, 2008).

In reversing the Ninth Circuit affirmance in *Concepcion*, the Supreme Court ruled that by effectively requiring that consumers be given the choice between individual versus classwide relief ex post, the California Supreme Court's approach to mandatory arbitration in consumer contracts would create an inevitable incentive for such classwide dispute resolution. This incentive, the Court held, struck at the heart of the federal policy favoring arbitration, for "the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment."[19]

Since *Concepcion,* the Supreme Court has continued to reject challenges to the enforceability of arbitration clauses that are based on the supposed loss of deterrence entailed by mandatory arbitration. In 2013, in *American Express v. Italian Colors Restaurant*[20] (*Amex II*), the Court ruled enforceable a clause mandating arbitration and waiving classwide relief even for claims alleging violations of federal antitrust law. The plaintiff in *Amex II* had argued that no plaintiff's attorney would incur the enormous cost of hiring the experts necessary to have a chance of winning such a case unless individual claims were aggregated to allow classwide damages. The Supreme Court saw no merit in this argument, responding to it by commenting simply that in *Concepcion*, "we specifically rejected the argument that class arbitration was necessary to prosecute claims 'that might otherwise slip through the legal system.'"[21]

The Supreme Court's conclusion in *Amex II* is particularly informative about the Court's attitude toward arbitration and its potential. The affidavit evidence in that case—that the expert witnesses that are necessary to pursue such cases are a large expense that can be justified only by

[19] *Id.* at 1751.
[20] 470 U.S. 213, 133 S. Ct. 2304 (2013).
[21] *Id.* at 2312 (citing *Concepcion*, 131 S. Ct. at 1753).

the prospect of aggregate recovery—likely struck many antitrust litigators as accurate. However, the conclusion that such aggregate recovery can be achieved only through class actions is not one the Court was ready to accept. Class action law firms already have begun to file mass arbitrations for antitrust violations, and an online consumer organization even helps consumers join such mass arbitrations.[22] The Court's broad interpretation of the Federal Arbitration Act reflects its view that Congress wants arbitration to be given every chance to succeed. The Supreme Court's now quite extensive jurisprudence on arbitration has made clear that the strong presumption in federal law in support of arbitration rests in large part on the idea that consumers benefit from the speed, simplicity, and low costs of arbitration. An often-repeated argument is that much of this benefit comes in the form of lower consumer prices.[23] As we explain later in this paper, the decreased consumer prices may result from the lower litigation costs, but the magnitude of the decrease may be difficult to estimate. However, as we also stress, arbitration may benefit consumers further by improving firm incentives to invest in accurate internal dispute resolution systems that pretermit external dispute resolution in whatever form. And, of course, consumers may benefit from being able to participate directly in a cheap, quick, and informal method of dispute resolution.

Whatever the range of benefits to consumers from arbitration may be, the Supreme Court is clearly of the view that Congress may well have understood there to be many benefits. At the same time, the chorus of criticism regarding class action litigation has grown in recent years. As a result of those criticisms, initiatives at both the state and the federal levels have attempted to

[22] *See* Sternlight, *supra* note 1, at 92.
[23] *See* Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 1 J. DISP. RESOL. 89, 90–93 (2001); Stephen J. Ware, *The Case for Enforcing Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251 (2006); Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. & PUB. POL'Y 549, 575–76 (2008).

pare back class actions and to ensure that class actions truly further the cause of justice and result in compensation to consumers for real harms suffered, rather than simply providing an outsized payment to class action lawyers to resolve nuisance litigation.

Those efforts have been met by a campaign by class action attorneys, law professors, and consumer advocates to delegitimize arbitration while supporting class actions for disputes involving consumer products and services.[24] Given the hostility of those interests to arbitration, it was not unexpected that they would celebrate the tone of the CFPB's Report as signaling a move toward restrictions on arbitration agreements. For example, in the letter from Democratic members of Congress, the signatories asserted,

> In total, the study conducted by the CFPB at Congress's request roundly confirms that individuals unknowingly sign away their rights through forced arbitration agreements, which do not reduce consumer costs for financial services.… Based on this substantial bedrock of evidence, we urge the CFPB to move forward quickly to use its authority under the Dodd-Frank Act to issue strong rules to prohibit the use of forced arbitration clauses in financial contracts and give consumers a meaningful choice after disputes arise.[25]

Critics of arbitration agreements make a number of stylized, oft-repeated criticisms of arbitration.[26] Some critics, such as the California Supreme Court,[27] object to arbitration clauses contained in what they call *adhesion contracts*, by which they mean contracts whose terms (including arbitration terms) were not and probably could not be subject to consumer bargaining. Other critics argue that arbitration proceedings are unfair and tilted against consumers and that

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[24] For works by one especially dedicated scholar, *see* Myriam Gilles, *Killing Them with Kindness: Examining Consumer-Friendly Arbitration Clauses after* AT&T Mobility v. Concepcion, 88 NOTRE DAME L. REV. 825 (2013); Myriam Gilles, *Opting out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373 (2005).
[25] Letter from Franken et al., *supra* note 12, at 2.
[26] Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 163 (2005); Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871 (2007–2008); Miles B. Farmer, *Mandatory and Fair: A Better System of Mandatory Arbitration*, 121 YALE L.J. 2346 (2011–2012).
[27] Discover Bank v. Superior Court, 36 Cal. 4th 148, 162–163, 113 P. 3d 1100, 1110 (2005).

arbitration effectively annihilates many consumer claims.[28] Still others argue that given the small size of the claims at stake in many disputes, it is not financially feasible for consumers to bring arbitration actions to vindicate their rights.[29] Finally, critics of consumer arbitration often point to class action litigation as their preferred method for resolution of consumer disputes.

III. The CFPB Report: Summary and Critique

In December 2013, the CFPB produced the preliminary results of its study of arbitration in consumer financial products contracts. More than a year later, in March 2015, the CFPB released its final arbitration study, *Arbitration Study: Report to Congress 2015*. The Report expands on the findings in the preliminary results. More generally, it presents entirely new material, so that the preliminary results (which according to the CFPB stand "as presented there") and the Report together constitute the CFPB's report to Congress on arbitration.[30] Hence, in this paper, we discuss components.[31]

For both versions of its arbitration study, the CFPB was given access to actual American Arbitration Association (AAA) consumer arbitration files. According to the CFPB, it was given access to the AAA consumer arbitration files only under a confidentiality restriction. Although the AAA makes data about its consumer arbitrations available publicly online, the publicly available data do not include all of the information that is contained in the actual arbitration case

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[28] *See* Sternlight, *supra* note 1; Jean R. Sternlight, *Tsunami*: AT&T Mobility LLC v. Concepcion *Impedes Access to Justice*, 90 OR. L. REV. 703 (2012).
[29] David Korn & David Rosenberg, Concepcion's *Pro-defendant Biasing of the Arbitration Process: The Class Counsel Solution*, 46 U. MICH. J.L. REFORM 1151 (2013).
[30] The CFPB's explanation of the relationship between the Report and the preliminary results appears at page 9 of section 1 of the Report.
[31] When we refer simply to the CFPB's Report or the Report, we are referring to the final arbitration study: CONSUMER FIN. PROT. BUREAU (CFPB), ARBITRATION STUDY: REPORT TO CONGRESS 2015 (2015). We will by contrast refer to the preliminary results study of December, 2013, as just that: the preliminary results report, CFPB ARBITRATION STUDY: PRELIMINARY REPORT (2013).

files. Thus, in its arbitration study, the CFPB had a unique opportunity to expand what is known about consumer arbitration.

In its 2015 Report, the CFPB reported on what it had learned about AAA arbitrations involving credit cards, checking accounts, payday loans, prepaid cards, auto purchase loans, and private student loans. After releasing the 2013 preliminary results, the CFPB added private student loan and automobile loans to its 2010–2012 arbitration dataset. This addition was not trivial: student and auto loan arbitrations make up 31% of the arbitrations covered by the 2015 Report.[32]

One of the most interesting general findings in the CFPB's research into AAA arbitration of disputes involving these six products is that arbitrations involving some of the products typically concern a dispute as to the debt amount, but those involving other products rarely concern such a dispute. With its access to actual AAA arbitration files, the CFPB was able to discern that in arbitrations with affirmative consumer claims for relief, the consumer is typically disputing the amount of a debt that is being collected outside arbitration.[33] The CFPB further found that consumers often dispute the debt amount by way of defense in an arbitration action.

[32] CFPB (2015), *supra* note 9, section 5, at 20.

[33] In the body of the preliminary results report, the CFPB explained that it "counted mutual submissions and consumer filed disputes as debt collection arbitrations when the case included a substantive debt dispute and the arbitration record shows that there was a prior court proceeding as to which the consumer invoked arbitration." CFPB (2013), *supra* note 8, at 66. The CFPB further explained that "there were a number of pleading formats in consumer-filed and mutually submitted AAA arbitrations . . . that persuaded us that the debt collection category needs to be broadened in this way. In some cases, for example, the consumer may affirmatively state that he or she has no claims but wants the arbitrator to resolve the merits of the company's underlying debt collection claim. In others, the consumer states that he or she is filing the arbitration demand instead of filing an answer to a collection claim in court, or the consumer may file an arbitration for declaratory judgment that he or she does not owe the amount claimed by the company. . . . In some respects, however, we may have undercounted debt collection arbitrations in our total pool of cases. Our definition relies on an indication in the arbitration record of prior court proceedings. The arbitration record may not contain that indication, even when there was, in fact, a prior collection action in court. In addition, even when a company has not yet sued in court to collect debt, it is possible that some consumers are preemptively filing arbitrations to challenge the company's pre-judicial assertion of a debt. In fact, a substantial number of the 'non-debt collection' credit card arbitrations in our review appeared to involve only a substantive debt dispute and no non-debt claims at all, even though the arbitration may be filed by a consumer. . . . [W]e opted to use objective rules to define debt collection arbitrations, rather than trying to assess whether the weight of the arbitration record indicated that collection activity was already underway before a substantive dispute reached arbitration. But it is important to bear in mind that our 'non-debt collection category' included a large number of cases in which debt was at issue." CFPB (2013), *supra* note 8, at 67–68.

The fraction of arbitrations in the CFPB's dataset involving a dispute over the debt amount varies from 98% of student loan arbitrations and 87% of credit card arbitrations to 11% of payday loan arbitrations and 3% of checking account arbitrations.[34] The variation in the frequency with which different types of arbitrations involve disputed debt amounts does not seem to be explained by whether the company initiated arbitration—debts were very often disputed for both credit card and student loan arbitrations, but companies initiated 54% of credit arbitrations and only 2.8% of student loan arbitrations.

As the CFPB explained in its 2013 preliminary results, in 2009 the AAA self-imposed a moratorium on debt collection actions filed by businesses.[35] That moratorium remains in place in 2015. However, the AAA will arbitrate a debt collection issue raised by either the consumer or the business in an arbitration filed by a consumer (or when the consumer consents in writing to arbitration of a debt collection) and will arbitrate a debt collection action in a case that the court has ordered to be arbitrated.[36]

One thing that the CFPB Report may help explain is why the AAA seemed more than happy to self-impose its moratorium on hearing AAA debt collection arbitrations filed by businesses. Even under the CFPB's rather broad definition of a *debt collection arbitration*, the CFPB found only 522 debt collection actions over the 2010–2012 period, and all but 4 of these actions involved credit card disputes.[37] By contrast, in 2012 alone, the small claims court in Philadelphia County, Pennsylvania, had more than 2,200 debt collection cases.[38] That the number of debt collection actions pursued in court is almost an order of magnitude greater than

[34] CFPB (2015), *supra* note 9, section 5, at 26. The report does not provide frequencies; those are computed here.
[35] CFPB (2013), *supra* note 8, at 65.
[36] *Id.* at 66.
[37] CFPB (2015), *supra* note 9, section 4, at 92.
[38] *Id.*

the number pursued by arbitration makes clear that AAA arbitration is a relatively insignificant institution of consumer debt collection.

In its 2013 preliminary results, the CFPB presented data on three main aspects of consumer arbitration: (a) the claimed amount, (b) the frequency with which consumer claimants have legal representation, and (c) the substantive legal basis of consumer claims. To this list, the 2015 Report added two main types of data on arbitrations: (a) outcomes in cases that reached final resolution by an arbitrator, as well as basic statistics on how outcomes varied depending on what the substantive basis of the consumer's claim was and whether the consumer had representation, and (b) some data on the arbitration process, such as how long it took to get a final arbitrator decision, and data on consumers who changed the amount claimed during the arbitral process. Perhaps the most important part of the 2013 preliminary results report was its comparison of the number of small claims consumer arbitrations with the results of a selected sample of consumer class action litigations. The 2015 Report significantly adds to the CFPB's comparison of arbitration cases to class action cases by presenting extensive data on what kinds of claims are brought as consumer class actions and on the settlements in such cases. It also provides some data allowing comparison of the kinds of cases brought as class actions with those brought as individual actions. Thus, in many ways, the heart of the CFPB's combined 2013 preliminary results and 2015 Report is a quite detailed comparison of the results in consumer class actions with the results in consumer AAA arbitrations. We argue in this paper that, for a number of reasons, this comparison cannot be taken as indicating the superiority of either class actions or consumer arbitrations, although the CFPB's comparison of the two approaches is clearly the most detailed yet produced.

Three other aspects of the CFPB's Report deserve mention. Two of those elements are directly related to the general comparison of class actions and arbitration: a survey of consumers that seeks to identify what consumers know about arbitration, class actions, and other methods of dispute resolution and an econometric study of whether arbitration leads to lower prices for consumers. We comment on these aspects in detail later in this paper.

Furthermore, although the CFPB focused mainly on comparing different methods of ex post dispute resolution, it also reported on the frequency with which consumer contracts in various product markets contain mandatory arbitration clauses and on the various features of such mandatory arbitration clauses, such as whether the clauses waive class relief. We also comment in some detail on this aspect of the Report.

We do not comment on some relatively short sections of the Report that examine the role of small claims courts in consumer dispute resolution and the relationship between public enforcement actions and consumer class actions. Looking at online small claims court databases for which states offered free or low-cost access to case information, the CFPB was able to obtain systematic case document information for only two state small claims courts, those in Alameda County, California, and Philadelphia County, Pennsylvania. The CFPB found essentially what other researchers have found previously:[39] that there is considerable variation across states in small claims courts procedures, with some states adopting procedures that tend to discourage businesses from using small claims courts to pursue cases against consumers and other states having procedures (such as venue rules) that have encouraged business to pursue debt collection and other actions against consumers in small claims court. As for public enforcement actions, the CFPB addressed the question of the extent to which private class actions merely piggyback off

[39] *See* Richard Hynes, *Broke but Not Bankrupt: Consumer Debt Collection Actions in State Court*, 60 FLA. L. REV. 1 (2008).

previously adjudicated public enforcement actions. Looking at all large-dollar ($10 million or more) class action settlements plus a sample of other class action settlements, the CFPB found that only a relatively small fraction, 12%, of private consumer class actions were filed after public enforcement actions dealing with the same issues. Because there is no widespread perception that consumer class actions merely duplicate and piggyback public enforcement, this finding is essentially a null result in terms of the larger policy debate.

IV. CFPB Findings That Undercut Arguments That Arbitration Is Unfair to Consumers

The CFPB Report is useful in providing data—much of it for the first time—with respect to many of the claims typically made about arbitration. Somewhat surprisingly, however, some of the CFPB's findings tend to *rebut* the hypotheses of arbitration's critics. Moreover, where the data do not undermine arguments for restricting arbitration, they are subject to serious drawbacks that limit the usefulness of the data for supporting restrictions on consumer arbitration.

A. Do Consumers Have Meaningful Choice Regarding Whether to Enter into Contracts That Contain Arbitration Clauses?

One criticism of arbitration clauses in consumer credit contracts is that such contracts are "contracts of adhesion," such that consumers have no meaningful choice but to accept the terms.[40] It is implied that with respect to most so-called contracts of adhesion, the terms of the contracts offered by virtually every financial institution are identical on this point; thus, the consumer cannot avoid the clause by dealing with a different financial institution.

Yet one of the most important contributions of the CFPB Report is to demonstrate that such an assumption may be untrue when it comes to consumer credit. For example, the CFPB

[40] *See* CFPB (2015), *supra* note 9, section 1, at 4, n.4.

data show that although there has been a slight increase in use since the Supreme Court made clear that state courts may not invalidate mandatory arbitration clauses in consumer contracts on public policy grounds,[41] the vast majority (84%) of credit card issuers do not use such mandatory arbitration clauses. Arbitration clauses are used more often by larger card issuers.[42] With respect to checking accounts, mandatory arbitration clauses are even less common; the CFPB found that only 8% of banks include arbitration clauses in their checking account contracts. Thus, for checking and credit card accounts, consumers can quite easily avoid contracts with mandatory arbitration if they choose to do so.

Even in contracts in which arbitration clauses are most common—prepaid cards, where 92% of the contracts studied included mandatory arbitration clauses—providers accounting for about 17% of the market do not contractually require arbitration.[43] That statistic suggests that consumers who dislike arbitration can find prepaid card providers that do not require that form of dispute resolution.[44]

The only market in which the CFPB found that virtually all (99.9%) consumers are bound by mandatory arbitration was the market for mobile wireless service. Mobile wireless contracts were not studied by the CFPB in its 2013 preliminary results, and their inclusion in the 2015 Report is puzzling. The CFPB says that it included mobile wireless contracts in its 2015 Report because the major wireless providers allow consumers to charge payments for goods and

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[41] AT&T Mobility v. Concepcion, 563 U.S. 321 (2011).
[42] CFPB (2015), *supra* note 9, section 2, at 7, 9–12. One possible explanation for the distinction between larger and smaller credit card issuers is that larger issuers may be especially prone to large nuisance class actions simply because of their size; thus, to avoid such litigation, they may find arbitration especially valuable.
[43] *Id.*, section 2, at 8.
[44] Indeed, in light of the relative ease with which consumers of prepaid cards (as opposed to credit cards and bank accounts) can and do switch from one prepaid card to another, if consumers valued an arbitration-free contract, they could likely adopt such a card without difficulty. *See* Todd J. Zywicki, *The Economics and Regulation of Network-Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013).

services to their wireless bills, a practice known as *mobile wireless third-party billing*.[45] In the developing world, where many consumers have neither credit cards nor bank accounts, mobile wireless third-party billing is apparently a rapidly growing market.[46] In the United States, mobile wireless third-party billing has been a tiny share of the market, and even in the future it will likely be used only to pay for smartphone apps.[47] The actual market significance of mandatory arbitration for mobile wireless billing depends on the future importance of mobile wireless billing and may not be indicated by the share of the wireless market taken by wireless firms that require arbitration. Disputes under mobile phone contracts appear to have little more to do with financial services than does the purchase of any other ordinary goods or services; thus, the findings with respect to mobile wireless service cannot easily be generalized to other consumer financial services.

As we discuss later in this paper, the CFPB also found that most consumers do not pay much attention to whether their credit card contract has a mandatory arbitration clause. This finding might be taken to imply that even if consumers could, in theory, shop among card providers on the basis of whether they require arbitration, in practice, firms would not be influenced by consumer shopping in determining whether to require arbitration. Not only is that implication unjustified, but so too is the entire premise—made not just by the CFPB Report but by the literature preceding it—that for arbitration to benefit consumers, consumers must observe and shop among contract clauses that specify the method by which ex post disputes with the firm will be resolved.

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45 CFPB (2015), *supra* note 9, section 2, at 25–26.

46 Mondato, *The Re-emergence of Carrier Billing*, LATEST INSIGHT BLOG (Sept. 24, 2014), http://mondato.com/blog/carrier-billing/.

47 FED. TRADE COMM'N, MOBILE CRAMMING: A FTC STAFF REPORT 4–5 (July 2014), *available at* https://www.ftc.gov/system/files/documents/reports/mobile-cramming-federal-trade-commission-staff-report-july-2014/140728mobilecramming.pdf.

To understand why that impression is mistaken, note that as we also discuss later, the CFPB found that consumers do consider terms such as what interest rate is offered and whether firms fairly resolve consumer complaints. Indeed, the CFPB reports that the vast majority of consumers respond to firms that do not fairly resolve complaints by canceling their cards with the firms. A firm's required method of ex post dispute resolution is not something that consumers specifically consider while shopping, but the matters that consumers do consider—prices and how firms resolve complaints—are likely directly influenced by whether a firm can require arbitration. If by requiring arbitration a firm reduces its expected costs of ex post dispute resolution and increases the benefits of accuracy in internal dispute resolution (meaning, it grants consumers a refund when the firm really has made a mistake and denies refunds when no mistake has been made), then arbitration reduces the firm's costs while increasing its payoff to investing in internal dispute resolution. Arbitration's likely influence is under the hood, as it were, but potentially it is just as great as if consumers did shop directly considering arbitration clauses.

B. Is Arbitration Fair to Consumers?

A second criticism of arbitration is that it is unfair to consumers. The unfairness is allegedly both substantive, in that consumers fare worse in arbitration than they do in litigation, and procedural, in that consumers lack legal counsel when they pursue arbitration claims. The CFPB arbitration study casts significant doubt on the validity of both criticisms.

1. The CFPB arbitration study reports surprisingly high rates of legal representation in consumer AAA arbitrations. The CFPB arbitration study clearly shows that representation is not a problem for consumers in most types of AAA consumer arbitrations. For all product markets combined, consumers were represented by counsel in 63% of arbitration cases.[48] For payday and student loan arbitrations, consumers have counsel in 95% of the cases, and for checking account disputes, 56% of the cases. Even in credit card arbitrations—the only important type of AAA consumer arbitration in which consumers did not have counsel in the majority of cases—consumers still were represented by counsel in 47% of the cases. Importantly, in credit card cases in which consumers disputed the debt amount, they were represented by counsel 70% of the time.[49]

In section 6 of the Report, the CFPB implicitly compares the representation rates in arbitration with representation rates in individual and class action litigation filed in federal court. Unsurprisingly, class counsel were present in all class actions studied by the CFPB (except, apparently, one), and individual plaintiffs had representation in about 94% of the individual federal actions.[50]

2. The CFPB report also shows that unrepresented consumers have relatively high success rates in AAA arbitration, so that legal representation is not as important in AAA arbitration as in state and federal court litigation. The problem with the CFPB's implicit comparison is that it does not in any way control for the relative value of representation to a plaintiff in federal court versus a claimant in consumer arbitration proceedings. Representation is valuable in federal court because civil procedure is complicated and the costs of pursuing a claim are high. Pro se—or as they are now called, self-represented—plaintiffs in civil federal lawsuits of all types are only 4% in the CFPB's large sample of cases. For a federal plaintiff to reach the point at which settlement is even on the table, let alone to get to a substantive trial on the merits, he or she has to successfully

[48] CFPB (2015), *supra* note 9, section 5, at 29.
[49] *Id.*, section 5, at 30.
[50] *Id.*, section 6, at 22–23.

serve process, manage to file a complaint that can withstand increasingly tough pleading standards and the inevitable failure to state a claim motion, and then do enough discovery to get past a summary judgment motion. Few self-represented plaintiffs succeed in overcoming those federal court hurdles.

Oddly, the CFPB reports both on the AAA arbitration procedures that apply to the cases it actually studies and on the JAMS procedures, which are irrelevant to AAA arbitrations. However, under the AAA consumer arbitration procedures that actually apply to the cases studied by the CFPB, all consumers have to do to initiate an arbitration is to file a claim describing the dispute and the business that they are disputing against, specify where they would like the arbitration hearing to happen if they want a hearing, and attach a copy of any arbitration agreement. Since 2013, the consumer has had to pay only a $200 fee administrative fee to the AAA, with all remaining fees paid by the company and the $200 fee waived for any consumer whose income is less than two times the federal poverty level. The AAA chooses the arbitrator from its National List of Arbitrators, and then the arbitrator makes a decision. Essentially, none of the complex procedural motions found in federal court are permitted in arbitration, and for claims under $10,000, the arbitrator's decision is by default based only on the documents submitted or, in some cases, on a telephone hearing held. Only for claims above $10,000 is an actual hearing before an arbitrator the default way of resolving the dispute. If a hearing is held, it must be in a location convenient for the consumer.

At 26 pages, section 4 of the Report, on how arbitration procedures differ from procedures in court, is one of the shortest sections in the entire study. Importantly, the CFPB makes no attempt in the section to estimate the actual transaction costs that a consumer would face in pursuing an individual claim in federal court rather than in arbitration. Nor does it attempt to estimate the actual ability of a consumer to pursue a self-represented claim in federal court. However, it is worth noting that what is essentially the entire procedural requirement for an arbitration consumer—filing a claim with the arbitration agreement attached that states the basic facts of the claim—is just the first step in federal court. That first step itself has detailed legal requirements attached to it—requirements than can cause dismissal with prejudice if not followed. It would seem that even if representation is valuable to consumers in arbitration, the AAA arbitration procedures at least allow for the possibility that an unrepresented consumer claimant may succeed. Without considering both the costs and the benefits of litigation proceedings, of course, it is impossible to say whether consumers would be better off being forced to litigate instead of arbitrate.[51]

That the AAA consumer arbitration procedure is much simpler and less costly than federal court litigation is strongly suggested by CFPB findings showing that arbitrations are resolved very quickly. The Report finds that even when telephone hearings were conducted, most arbitrations were resolved in less than five months, and even with a hearing, most were resolved in less than seven months. When there was a known settlement, it usually was achieved in about five months.[52]

Moreover, the CFPB also found that hiring an attorney is far from crucial to consumers in AAA arbitration. On the one hand, at relative frequencies of 40% versus 34%, consumers with representation more often got settlements than those without attorneys. On the other hand, at relative rates of 2% versus 14%, consumers with attorneys did much worse in cases that actually

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[51] We follow the standard conclusion of arbitration experts that for arbitration to be viable, it must be a mandatory pre-dispute clause. Otherwise, the use of arbitration would unravel because of standard forum-shopping problems as consumers decided whether to sue or to arbitrate on the basis of the forum that they thought most advantageous for their claim.
[52] CFPB (2015), *supra* note 9, section 5, at 72.

ended in a decision by the arbitrator.[53] Thus, the arbitration study shows that self-represented plaintiffs were seven times more likely than represented plaintiffs to get an AAA arbitrator's decision in their favor. That finding is consistent with arbitration's being a process set up so that hiring an attorney offers little value to a consumer and is often unnecessary.

As noted earlier, the CFPB arbitration study reports that 94% of individual plaintiffs in its sample of federal and state court consumer lawsuits were represented by attorneys. By far the most important type of individual suit pursued on a self-represented basis involved a checking account or debit card. In such suits, 68% of plaintiffs were self-represented.[54] Surprisingly, given the finding that self-representation is actually the rule rather than the exception in individual lawsuits involving checking accounts and debit cards, the CFPB study fails to report on how outcomes in individual consumer lawsuits varied between those brought by consumers with counsel and those brought by consumers who were self-represented.

The CFPB reports that consumers who *did* have counsel in individual consumer lawsuits obtained judgments in their favor about 7% of the time, with settlements occurring somewhere in the range of 42% to 48% of all cases filed, depending on whether one counts known or "potential" settlements.[55] The CFPB reports that over the entire set of 668 arbitrations in which it coded consumers as making an affirmative claim for relief, consumers received awards in 20% of the 158 arbitrations that the CFPB determined to have ended in an arbitral award, or 6% of the total number of such arbitrations.[56] Yet the CFPB also reports that of all 1,060 arbitrations in its sample (not just those in which consumers made affirmative claims for relief), 57% either were

[53] *Id.*, section 5, at 55. The rates in the text are derived from figures 11 and 12.
[54] *Id.*, section 6, at 32.
[55] *Id.*, section 6, at 48.
[56] *Id.*, section 5, at 41.

known to have settled or were "consistent with settlement."[57] Thus, with 57% of all arbitrations resulting in settlement and 6% in an award for a consumer claimant, arbitration seems to generate *comparable or even slightly better results* for individual claimants than do individual consumer lawsuits (where up to 48% result in settlements and 7% in consumer judgments).

Note that the CFPB found a much lower rate of consumer success in AAA arbitrations than previously reported in the pathbreaking study of AAA arbitration by Christopher Drahozal and Samantha Zyontz. Drahozal and Zyontz studied 301 AAA consumer arbitration cases heard in 2007 and found that consumers won some relief in 53.3% of arbitrations.[58] Moreover, consumers recovered attorneys' fees in 63% of cases in which they sought fees.[59] The CFPB finding that unrepresented consumers in AAA arbitration are much more likely to prevail on the merits than are represented consumers in lawsuits filed in court is consistent with the earlier finding by Drahozal and Zyontz that, at least in some types of cases, consumers win *more* frequently in arbitration than in court.[60]

The large disparity between the consumer AAA arbitration success rates reported by the CFPB (20% for consumers making affirmative claims) and by Drahozal and Zyontz (53%) suggests that further work needs to be done with AAA consumer arbitration files. In any event, the data that the CFPB has reported in its 2015 study is not consistent with the claim that arbitration yields worse outcomes for consumers. As it stands in its now presumably final form, the CFPB Report suggests, to the contrary, that AAA arbitration may be the *only* forum in which unrepresented consumers have a chance to obtain a decision in their favor.

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[57] *Id.*, section 5, at 32.
[58] Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 OHIO ST. J. DISP. RESOL. 843 (2010).
[59] *Id.*
[60] Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 HASTINGS BUS. L.J. 77 (2011).

V. Understanding the Effect of Arbitration Clauses: The Irrelevance of the CFPB's Findings

In the 2015 Report, the CFPB expanded the scope of its inquiry into the effect of arbitration clauses for consumers. One new section (section 10) purports to be a statistical (or econometric) analysis of whether mandatory arbitration clauses lower prices for consumers. Another new section (section 3) presents the results of a survey that probed whether consumers know whether they are bound by mandatory arbitration clauses. Neither set of results can be taken as disconfirming the benefits of arbitration to consumers. The CFPB's finding that a temporary moratorium on the use of arbitration clauses by some credit card issuers did not significantly affect pricing relative to that of issuers without such a moratorium just confirms that financial products providers, like firms generally, do not change prices in response to temporary cost changes, nor does the CFPB provide any explanation as to why it thinks otherwise. The Report shows nothing that indicates whether arbitration benefits consumers by lowering prices. The CFPB's survey of consumers found that consumers know little about ex post dispute resolution mechanisms—whether arbitration or class actions. However, the CFPB's survey also revealed why such relative ignorance is perfectly rational: when they feel that a credit card firm has wrongfully imposed a fee or charge that it refuses to reverse, consumers overwhelmingly prefer the market response of canceling their cards over litigating or arbitrating the dispute.[61]

A. Why Consumers Don't Need to Know Much about Arbitration Clauses

In section 3 of the Report, the CFPB provides the results from a survey that asked about a thousand credit card owners a number of questions about their choice of a credit card and about

[61] As discussed later in the next subsection, the CFPB reports that faced with a situation in which a credit card company was imposing a charge that the consumer had not signed up for, 57% of the survey respondents said they would cancel their card (the market response), whereas only 1% said they would seek legal advice or sue using an attorney. *See* CFPB (2015), *supra* note 9, section 3, at 18.

whether they would pursue a complaint against a credit card company through an external dispute resolution mechanisms such as litigation or arbitration if the company failed to resolve their claim internally. In answering an open-ended question of the form, "Why did you choose the card you did?," a relatively small fraction of respondents came up with a particular reason. The most frequently given responses to this open-ended question were the interest rate on the card and the card's rewards program. When various credit card features were asked about specifically (the closed-end format), most respondents indicated that the interest rate, customer service, rewards, fees, issuer's reputation, and card acceptance all were factors that entered into their decision to get a particular card.[62]

As for knowledge about and willingness to pursue external dispute resolution, the CFPB survey found that even if consumers were charged a fee that they knew the company had incorrectly assessed, only 1.4% of respondents said they would seek legal advice and an even smaller 0.7% said they would consider initiating legal proceedings. A similarly small percentage of consumer respondents, 1.7%, said that they would simply pay the fee. As for arbitration clauses, consumers seemed to have little understanding of whether their credit card contract contained such a clause and whether the clause prevented them from taking a dispute to court. Regardless of what the contract actually said, about 20% of consumers thought that their contract included such a clause and about 7% of consumers thought that they could not sue in court, regardless of whether their contract had a mandatory arbitration clause. Most consumers with a mandatory arbitration clause (57%) still thought that they could participate in a class action lawsuit.[63]

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[62] *Id.*, section 3, at 14.
[63] *Id.*, section 3, at 3.

The CFPB highlights its final set of findings by placing it in the first paragraph summarizing the results of its survey: the relative ignorance of consumers regarding whether their credit card contract has a mandatory arbitration clause and the effect of such a clause on their right to file suit. However, the CFPB's survey clearly shows that consumers do care about many features of their cards, such as the interest rate and whether the card has a rewards program. It also shows that consumers care intensely about whether credit card companies remove incorrectly assessed fees and charges. As noted previously, the survey found that 57% of respondents said that they would cancel their cards if a company incorrectly assessed a fee and failed to remove it in response to a consumer complaint. Only 1% would seek legal advice or sue using an attorney. The survey thus found that consumers prefer the market to the legal response for perceived service failures by a credit card company. When a company does not resolve a dispute internally to the customers' satisfaction, consumers take their credit card business elsewhere.

The CFPB's survey provides strong evidence of the credibility of the threat posed by consumers to take their business elsewhere if a credit card company does not reverse mistaken fees and charges. Savvy consumers know that if they have a long and profitable relationship with a financial services provider, the provider is very likely to waive various fees to keep them happy and to keep their business. A classic example of such business-motivated forgiveness of fees occurs when a credit card issuer waives the late fee and interest payment imposed when a credit cardholder with a good record of making payments on time happens to be a bit late once in making a payment. Another example is when a provider waives a fee that it has indeed mistakenly assessed. The provider may have inadvertently placed individual social security number information in a location on a document where it is visible to third parties or had a malfunctioning ATM terminal. In such cases, the provider may itself take corrective action, such as providing free credit monitoring (in the social security number case) or reversing charges for disputed transactions (in the ATM malfunction case).

The assumption by consumers that firms will work to retain their business turns out to be reasonable. To understand the propensity of financial institutions to resolve customer disputes internally, we were able to examine data provided by a mid-sized regional bank in Texas with respect to its internal processes for resolving disputes. According to this bank, a consumer complaint about a fee that was charged initiated an internal review process within the bank that analyzed refund requests on a case-by-case basis. During 2014, the process undertaken by the bank resulted in its refunding 94% of wire transfer fees that customers complained about at its San Antonio office and 75% of wire transfer fees that customers complained about at its Brownsville office. During that same period, the bank responded to complaints about inactive account fees by making refunds 74% of the time in San Antonio but only 56% of the time in Houston. Refunds varied among products as well: the bank rarely granted refunds of ATM fees but routinely granted refunds of overdraft fees, inactive account fees, and others.

The variation in bank refund rates by location and product strongly suggests that customer value maximization and not minimization of the risk of class action litigation was the driving force behind this bank's refund decisions. Especially in the largest class actions, such as the bank overdraft fee settlements discussed later in this paper, class litigation is typically premised on a firmwide practice. If fear of such litigation were driving bank refund practices, one would not expect to see wide variation across products and branch locations. Variation is precisely what one would expect to see if refunds were based on individualized determinations of the validity of the consumer's complaint and on the value of keeping a consumer's business.[64]

Overall, the bank offered refunds in about 68% of cases in which a consumer complained, resulting in refunds of over $2.275 million in 2014. Such a high refund rate explains what the CFPB leaves unexplained: why consumers do not know much about external dispute resolution mechanisms such as class actions and arbitration but do know that they will take their business elsewhere if a credit card issuer fails to internally resolve a valid complaint. There is evidence that credit card issuers, like the Texas bank, reverse fees and charges on an individualized basis, depending on a particular cardholder's history with and value to the issuer.[65] Credit card issuers have every incentive to respond to valid complaints brought by their cardholders precisely because consumers do what they told the CFPB they would do: terminate a card when the issuer does not respond. Given the effectiveness of this market response, consumers do not need to know anything about the details of the potential legal response they might have available when a company declines to refund charges and fees, and they have no reason to assume that being required to arbitrate rather than litigate would be an important reason to select one card over another.

B. Why the CFPB's Econometrics Are Flawed and Not So Harmless

One of the traditional arguments in favor of mandatory arbitration clauses in consumer contracts is that if arbitration lowers costs for financial product providers, consumers will benefit, because the lower costs are passed on to consumers in the form of lower prices. In section 10 of its

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[64] That such determinations may sometimes involve the exercise of discretion by middle-level managers does not make them any less motivated by the firm's incentive to retain valuable customers. Indeed, such discretion may allow for more accurate determination of customer-specific value.

[65] *See* Jason Scott Johnston, *The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation between Businesses and Consumers*, 104 MICH. L. REV. 857 (2006).

Report, the CFPB took the settlement in an antitrust case, *Ross v. Bank of America*,[66] as a natural experiment shedding light on whether, in fact, arbitration clauses do lead to lower prices for consumers. Under the settlement in *Ross*, a subset of four defendants agreed to stop using arbitration clauses for at least three and a half years. The CFPB looked at whether the change in the total cost of credit charged to consumers after the imposition of the settlement terms differed between the credit card issuers who stopped using arbitration clauses under the settlement and a large (although not precisely identified) set of issuers not subject to the settlement. The CFPB found no statistically significant difference in the change in the cost of credit across the two groups after one group stopped using arbitration clauses.[67]

Basic economic theory predicts that competition forces firms to pass on to consumers at least a portion of any cost decrease. As an empirical matter, evidence shows that financial products firms do pass on changes in their costs, as, for example, when debit card issuers passed on price controls on debit card interchange fees in the form of higher bank fees for consumers.[68] However, financial economists have long known that banks do not adjust their deposit and loan rates quickly or fully to temporary changes in market interest rates. Recent work indicates clearly that to explain bank pricing, one needs to take account not only of current and recent values of factors such as money market rates but also of expected future rates.[69] More generally, it is known that firms in the consumer services sector adjust prices much more slowly in response to

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[66] No. 05-Civ. 7116 (S.D. N.Y.).
[67] CFPB (2015), *supra* note 9, section 10, at 15.
[68] David S. Evans, Howard Chang & Steven Joyce, *The Impact of the U.S. Debit Card Fee Regulation on Consumer Welfare: An Event Study Analysis* (U. CHI. COASE-SANDOR INST., Research Paper No. 658, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2342593; Todd Zywicki, Geoffrey Manne & Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (ICLE FIN. REG. RES. PROGRAM, White Paper 2014-2, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.
[69] *See* Kenneth J. Kopecky & David D. Van Hoose, *Imperfect Competition in Bank Retail Markets, Deposit and Loan Rate Dynamics, and Incomplete Pass Through*, 44 J. MONEY, CREDIT & BANKING. 1185 (2012).

cost changes than do firms in the manufacturing sector and that large firms adjust prices more slowly than do small firms.[70]

In light of what economists have learned about how firms adjust prices to cost changes, it is hardly surprising that the CFPB found that the four credit card issuers that agreed to remove arbitration clauses for three and half years did not change their credit card prices in a way that significantly differed from the practices of other issuers. Even if the arbitration clause moratorium increased the costs to the subject firms, 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. Moreover, the CFPB looked at whether prices changed differentially during the year after the arbitration moratorium was imposed. Again, no evidence indicates that financial services prices respond so quickly even to a permanent change in costs and no sound theoretical reason exists to think that they would.

In addition to these theoretical problems, there are technical failures with the CFPB's econometric study of whether credit card firms that removed arbitration clauses changed prices at a different rate than firms that did not. Perhaps most importantly, the Report fails to indicate whether the CFPB checked to ensure the validity of the econometric technique it used. The technique—which compares the change in prices in the treatment group (the companies subject to the arbitration clause moratorium) to the change in prices in the control group (the companies still using arbitration clauses)—is valid only if prices in the two groups of companies had been changing at the same rate before the imposition of the moratorium. Only if this were true (so-called parallel paths) could one say that any change in prices among the companies not subject to

[70] *See* Daniel A. Dias, Carlos Robalo Marques, Fernando Martins & J.M.C. Santos Silva, *Understanding Price Stickiness: Firm-Level Evidence on Price Adjustment Lags and Their Asymmetries*, OXFORD BULL. ECON. & STAT. (2014).

the moratorium would be a good proxy for how prices would hypothetically have changed among companies subject to the moratorium.[71] Nothing in the report indicates that the CFPB checked for parallel paths.

In contrast, concrete case study evidence shows at least one example in which consumers who were willing to accept a contract that included an arbitration clause were offered a lower interest rate than those who insisted on the right to litigate disagreements.[72] Especially in light of this evidence and the theoretical and econometric problems with the CFPB's study of arbitration clauses and credit card prices, it is clear that much more careful empirical work needs to be done before conclusions can be made about the potential pass-through to consumers of cost savings from arbitration.

VI. Arbitration and Class Actions Compared

As we have explained, the major concern that courts have had with mandatory arbitration clauses in consumer contracts is that such clauses typically preclude class action lawsuits. Courts that have invalidated such arbitration clauses on public policy grounds have found that class actions are necessary for consumers to be adequately compensated and for firms to be deterred from practices causing widespread but small consumer harm. The CFPB's arbitration study attempts to inform this debate by providing some evidence on the outcomes that consumers receive under arbitration versus recoveries in class action suits. Unfortunately, although the CFPB's arbitration reports do provide new data on both class actions and arbitration, they do little to inform the public policy debate. Although the CFPB finds that few arbitration cases involve claim amounts

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[71] Actually there are other assumptions implicitly made by the difference-in-difference approach, but this one is the most basic to the validity of the estimates. See Ricardo Mora & Iliana Reggio, *Treatment Effect Identification Using Alternative Parallel Assumptions* (UNIVERSIDAD CARLOS III MADRID, Economic Series Working Paper No. 12-33, Dec. 2012).

[72] *See* Christopher Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV 695 (2001), discussing Stiles v. Home Cable Concepts, Inc., 994 F. Supp. 1401 (M.D. Ala. 2004).

less than $1,000 per claimant, it fails to note that class actions against financial services providers also seem to seldom involve claims of less than $1,000 per claimant. The CFPB is to be lauded for looking at a large number of actual case files for data on class action outcomes and settlements. However, its summary data on the fraction of class members who receive compensation (claims rates) and on attorney's fees as a fraction of class recovery are aggregated averages that conceal substantial variation across case types in both claims rates and the relative size of attorneys' fee awards—variation that includes many class settlements with very low claims rates and attorneys' fees that are very large compared to the aggregate payout to the class. Finally, in several respects—as by presenting data on arbitration awards but none on arbitration settlements, while presenting data only on class action settlements—the CFPB invites misleading comparisons that tend to bias rather than illuminate the public policy debate.

A. The Paucity of Small-Dollar Arbitrations

Perhaps the most emphasized finding in the CFPB's preliminary results is the discovery that "almost no AAA arbitration filings for these three product markets had under $1,000 at issue."[73]

More precisely, the preliminary results report states,

> [D]uring the period 2010 through 2012, there were an annual average of seven arbitrations per year filed with the AAA that concerned disputed debt amounts that were at or below $1,000, and … an annual average of under eight AAA arbitrations in which there was no disputed debt amount identified and the affirmative claim amount was at or below $1,000.[74]

The preliminary results report later states that only 23 consumer claims were for less than $1,000, with some 14 being for exactly $1,000.[75]

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[73] CFPB (2013), *supra* note 8, at 14.
[74] *Id.*
[75] *Id.* at 81.

In the particular arbitration type that the CFPB calls *debt disputes*,[76] the agency invokes both the Chamber of Commerce and Justice Stephen Breyer to define a *small-dollar claim* as one in which the consumer claims no more than $1,224.[77] For such claims, the CFPB reports that "there were under 19 cases on average each year in which there was a 'small dollar' debt dispute. Looking only at cases without disputed debt amounts, but only affirmative claim amounts, there were just over 8 cases each year on average that were 'small dollar.'"[78]

Noting the relatively small number of arbitration claims of under $1,000, the CFPB implies that the absence of these small-dollar claims from the dataset suggests that arbitration is not a feasible dispute resolution procedure for many consumers. Moreover, in the preliminary results, the CFPB compares the relative absence of small-dollar claims by consumers in arbitration unfavorably with certain class action cases in which the constituent consumers have recovered positive albeit modest amounts. This comparison might suggest that class actions are a more feasible means for aggregating smaller claims than is requiring disputes to be resolved by individual arbitration. The next section of this paper will examine the claims regarding the comparative efficiency of arbitration versus class litigation; this section will discuss briefly why the apparent absence of small-dollar claims from the CFPB's data cannot necessarily be read to suggest that arbitration is not a feasible means for consumers to recover monetary amounts in small-dollar disputes.

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[76] The following numbers refer to the 326 cases for which the CFPB could identify a claim form amount but could not identify a disputed debt amount. Of those cases, 146 involved credit cards, with a median claim of $8,945; 61 involved checking accounts, with a median claim of $15,000; and 119 involved payday loans, with a median claim of $42,500. *Id.* at 80.

[77] Here is how the CFPB gets the $1,224 threshold for a "small-dollar claim": First, it uses Justice Breyer's example, from Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995) of a small-dollar claim being one that involves the "value of only a refrigerator or television set." *Id*. at 82. Then the CFPB uses *Time* magazine's report that the average price of a new TV in the second quarter of 2012 was $1,224.

[78] *Id.* at 82.

One obvious possible explanation for the relative absence of small-dollar disputes in arbitration procedures is that many disputes are resolved without arbitration *or* litigation. In particular, as we have explained, financial institutions routinely provide refunds and other adjustments to fees and the like in an effort to preserve customer goodwill and relationships. The example of bank refund practices discussed previously suggests that one plausible explanation for a relative paucity of small-dollar arbitration disputes is that many complaints (especially valid complaints) that might otherwise lead to arbitration or litigation are instead resolved internally with relief to the consumer. Indeed, if refunds are more likely to be granted for meritorious complaints than for frivolous complaints, then the overwhelming number of meritorious complaints may be resolved consensually rather than by conflict. Perhaps one reason that those denied a refund do not arbitrate is that their complaints lack merit.[79]

The likelihood that many financial institutions internally refund or adjust many charges incurred by consumers indicates that the CFPB cannot assume that arbitration is not a viable resolution system because of the relative paucity of small-dollar disputes found in the dataset. In fact, at the one bank for which we have data, consumers prevailed 68% of the time in obtaining refunds.[80] To suggest otherwise would perversely imply that, rather than handling disputes internally and issuing refunds, financial institutions should force consumers to arbitrate. More important, several alternative explanations can account for the apparent paucity of small-dollar arbitrations involving financial institutions; before the CFPB can assume that the apparent lack of such cases means that arbitration is not financially feasible, it must first consider those other explanations.

[79] Indeed, given the value of goodwill with consumers and the relative cost of the dispute process to the amount typically at stake, the bank seems likely to err on the side of being overly generous in granting refunds in many cases.
[80] We are unaware of any comparable data from any other bank, but we have no reason to believe that the internal dispute resolution and account adjustment patterns of this particular bank are particularly unique or unrepresentative.

B. The Selective Class Action Data in the Preliminary Results

Perhaps the most striking rhetorical feature of the CFPB's preliminary results was that immediately after highlighting that there were only 23 AAA consumer arbitrations over the period 2010–2012 involving what it called "small-dollar claims," the CFPB report went on to "compare the benefits to consumers from arbitration to the benefits from class action litigation."[81] This exercise, however, involved comparing all consumer arbitrations before the AAA over the period 2010–2012 to a very small sample of settlements in consumer class actions. The CFPB discussed only eight such settlements because, for unexplained reasons, it studied only settlements reached after the latter half of 2009 in cases involving a contract between consumers and providers that dealt with one the agency's three product areas and that contained an arbitration clause. The eight settlements were found by looking at "electronic databases, as well as blogs and websites that track class action settlements."[82] Of the eight settlements described by the CFPB, three cases alleged violations of state payday loan laws, three involved allegedly fraudulent checking account overdraft fees, one was a credit card case, and one involved currency. In all the settlements described by the CFPB, a large number of members of the class actually received small payouts:

- Of the 10 million consumers who submitted claims in *In re Currency Conversion Fee Antitrust Litigation*, 7 million received a flat fee of $17 while the other 3 million "submitted more detailed claim materials, which entitled them to a significantly larger recovery."[83]

[81] CFPB (2013), *supra* note 8, at 102.
[82] *Id.* at 103.
[83] *Id.* at 105.

- *Hoffman v. Citibank*, a case challenging Citibank's actions in retroactively increasing the interest rates on some customers' outstanding credit card balances in alleged violation of California laws, resulted in interim payments of $18 each to 12,500 claimants.[84]
- In *Hooper v. Advance America*, a payday loan case alleging violations of Missouri's payday loan statute and Merchandising Practices Act, 10,400 consumers submitted claims and shared $520,000 in cash payments and $9 million in debt forgiveness.[85]
- In *Kucan v. Advance America*, another payday loan case alleging violations of North Carolina's payday lending statute, 135,000 members shared via automatic payments in a settlement fund of $11.5 million, or about $85 per class member.[86]
- In a third payday loan case, *Hager v. Check into Cash*, which also alleged violations of North Carolina's payday lender statute, automatic payments totaling $7.6 million were made to 104,000 class members, or $73 per class member.[87]
- *In re Checking Account Overdraft Litigation*, a multidistrict action in which class actions from across the country were consolidated in the Southern District of Florida, alleged that the banks processed debit transactions in such a way as to create overdrafts and thus generate overdraft fees. The bank defendants and the settlements identified by the CFPB were (a) Chase, which settled in 2012 with 5 million class members, who each received $61 and agreed to restrictions on fees for transactions under $5 (the court valued this additional relief at $52 million); (b) M&I, which paid $2.7 million, or $14 each, to 190,000 class members with no claim form required; and (c) Compass Bank,

[84] *Id.* at 106.
[85] *Id.*
[86] *Id.* at 107.
[87] *Id.* at 107–8.

which sent a notice to 826,000 class members that they shared $8 million in case relief, or $9 each.[88]

It is noteworthy that the CFPB preliminary results identified per claimant payouts only for the larger payouts, such as Chase (we computed the per claimant payout for M&I and Compass). Also, in describing all the class action settlements, the CFPB takes great pains to count the number of consumers who opted out of each settlement and then pressed the same claim against the same defendant in arbitration. The CFPB then stresses that there were "three arbitrations in which an opt-out from one of these cases *may* have made the same claim in AAA arbitration against a party within the scope of the applicable settlement."[89] It continues,

> No other opt-out from one of these cases appears to have filed the same dispute before the AAA. A total of 3,605 individuals opted out of these settlements. More than 13 million class members made claims or received payments under these settlements. Total payments or debt relief to the classes are in excess of $350 million, exclusive of attorneys fees and the value of injunctive relief.[90]

C. The More General Class Action Filing and Settlement Data in the Final Report

An obvious problem with the presentation of this class action settlement data in the 2013 preliminary results is that only eight large and potentially unrepresentative class action settlements are discussed. In the 2015 Report, the CFPB attempted to remedy the lack of representation by gathering data on a much larger set of class actions. The CFPB reported on all federal court class action filings and on filings in selected state courts that involved six types of financial products: credit cards, checking and debit accounts, payday loans, prepaid cards, private student loans, and automobile loans. For these six products over the period 2010–2012,

[88] *Id.* at 109.
[89] *Id.* at 104.
[90] *Id.*

the CFPB found 470 federal court filings and 92 state court filings.[91] Quite differently, the CFPB also reported on all class action settlements in federal court over a period twice as long—covering 2008–2012—involving five of these products (automobile loans, student loans, credit cards, checking and savings accounts, and prepaid cards) plus settlements involving credit reporting, debt collection, debt settlement, mortgages, and privacy.[92]

From these data, the CFPB reported three important statistics about class actions. First, it reported aggregated data showing that for the class action settlements it found over the 2008–2012 period, more than 11 million consumer class members received $1.1 billion in compensation.[93] By comparison, the CFPB reported that for arbitrations it studied over the period 2011–2012, it could verify arbitral awards to only 32 consumers (or 20% of consumers making affirmative claims for relief) for a total of $172,433.[94] Second, for the 105 class action settlements for which the CFPB was able to calculate a rate at which consumer class members actually received compensation, it found that the unweighted average claims rate was 21%, with an average weighted claims rate of 11%.[95] Third, the CFPB reported that attorneys' fees averaged 21% of the cash relief (and 16% of the total relief, including in-kind) received by class members.[96] Because the final two findings—on the fraction of class members receiving compensation and attorneys' fees as a fraction of what class members receive—are strikingly at odds with what has previously been reported, we begin by discussing those.

1. The CFPB's class action claims rate data presents a misleading picture of claims rates in class action settlements and obscures evidence that for many and perhaps most class actions,

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[91] CFPB (2015), *supra* note 9, section 6, at 17.
[92] *Id.*, section 8, at 12.
[93] *Id.*, section 8, at 27–28.
[94] *Id.*, section 5, at 41.
[95] *Id.*, section 8, at 30.
[96] *Id.*, section 8, at 33.

fewer than 10% of the class actually receive compensation. The CFPB reports that on (unweighted) average 21% of consumer class members received some kind of compensation under class settlements. This report paints a relatively rosy picture of class action settlements. When it comes to consumer compensation under class action settlements, previous research has found wide variation in the fraction of the class that actually receives compensation (the payout or claims rate), with claims rates often below 5% in large class actions where consumers have to fill out forms to receive compensation.[97] As the CFPB Report correctly points out, the defect in this research is that it does not work from case files themselves.[98] Instead, previous researchers have looked for reports of class action settlements in places such as the *BNA Class Action Reporter*[99] or, at best, have studied actual settlements but only in a very small number of class actions.[100]

In the Report, the CFPB got information about class action settlements from the docket sheet case records and through selective interviews with settlement administration companies (the organizations that actually manage the process of notifying and paying class members). Because every class action settlement requires the court to make a fairness determination, the federal court PACER (Public Access to Court Electronic Records) docket sheet data typically includes several documents from which one can discern a good deal about class action settlement

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[97] *See*, for example, DEBORAH HENSLER ET AL., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAINS (Rand, 2000); NICHOLAS PACE ET AL., INSURANCE CLASS ACTIONS IN THE UNITED STATES (Rand, 2007); MAYER BROWN LLP, DO CLASS ACTIONS BENEFIT CLASS MEMBERS? AN EMPIRICAL ANALYSIS OF CLASS ACTIONS (2013).

[98] CFPB (2015), *supra* note 9, section 8, at 6–7, 29–30.

[99] For an example of a study that looks to such reporters for data on class action settlements, *see* Mayer Brown LLP, *supra* note 97.

[100] Brian T. Fitzpatrick & Robert C. Gilbert, *An Empirical Look at Compensation in Consumer Class Actions*, (VAND. U. L. SCHOOL, Law and Economic Working Paper No. 15-6, March 2015). The paper looks at actual settlement terms for 15 consumer class actions, but 13 of them come from the consolidated *In Re Checking Account Overdraft Litigation*, the CFPB's major case study, which as we discuss *infra* is highly unrepresentative of the typical consumer class action settlement.

terms. For its 2015 Report, the CFPB looked at the largest sample of class action settlements ever studied, all settlements for selected types of class actions over the 2008–2012 period.

a. The CFPB failed to consistently adhere to its own stated methodology for determining what sorts of class action settlements to include in its study sample. There are several problems with the CFPB's reported numbers on class action claims rates. First, the CFPB did not consistently apply its own stated criterion for determining what kinds of class action settlements it would include in its sample. The CFPB stated that it did not study consumer class actions involving what was obviously a financial service—class actions alleging that ATM machines did not have a notice of fees "on or at" the machine, as the Electronic Funds Transfer Act (EFTA) then required—because ATM plaintiffs might not be customers of the ATM provider and therefore potentially would not be covered by the defendant's arbitration clause.[101]

If the CFPB had applied the same rationale that it applied to exclude ATM notice failure cases, then it would have excluded many and perhaps most of the class settlements in its study. According to the CFPB, 55% of the class action settlements it studied involved debt collection.[102] Debt collection class actions in federal court are typically brought under the Fair Debt Collection Practices Act (FDCPA) or the Telephone Consumer Protection Act (TCPA). The FDCPA protects consumers against a variety of harassing debt collection practices and also requires debt collectors to make certain disclosures, whereas the TCPA protects consumers against autodialed phone calls and text messages (typically made for debt collection or mass marketing and advertising). Both statutes apply to debt collection actions taken by the creditor (e.g., a subprime auto lender) or a debt collection company hired by the creditor (e.g., a law firm

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[101] CFPB (2015), *supra* note 9, appendix L, at 74.
[102] *Id.*, section 8, table 8, at 25.

doing debt collection). Debt collection companies are not in a contractual relationship with consumers; they are independent contractors hired by debt holders to collect debts. Hence, the majority of the courts that have decided the issue have said that such independent contractors are not parties to the contract between the consumer and the original creditor and, therefore, may not avail themselves of any mandatory arbitration provision in that contract.[103] Thus, because many of its debt collection settlements likely involved claims against debt collection companies, the CFPB should have excluded many and perhaps most of the settlements in its sample according its own stated criterion for sample construction.

b. The CFPB's aggregate average class claims rate obscures evidence of enormous variation in claims rates across different case types. The CFPB might well counter by arguing that because most debt collection class settlements are quite small,[104] both in terms of the size of the class and the size of the aggregate payout to the class, its inclusion of so many debt collection settlements is unlikely to have had a major effect on its reported claims rate. The kind of claims rate reported by the CFPB, however, is likely to obscure what the bulk of class action settlements actually bring for class members.

The reason for this lack of clarity is that the CFPB's reported claims rate is an aggregate average. The CFPB's claims rate is equal to its estimate of the total number of class members receiving payments in its sample divided by its estimate of the total number of class members in that same sample.[105] Thus, the CFPB's claims rate lumps all types of class action settlements together, simply reporting an aggregated average claims rate.

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[103] Richard M. Alderman, *The Fair Debt Collection Practices Act Meets Arbitration: Non-parties and Arbitration*, 24 LOY. CONSUMER L. REV. 586 (2012).
[104] From CFPB (2015), *supra* note 9, section 8, table 8, at 25, one can see that the total relief in debt collection settlements was only about 4% of the total cash relief across all product categories.
[105] *Id.*, section 8, at 26–27.

The Report shows that the total or aggregate cash payouts to class members for checking account and credit card class actions is about $1.4 billion.[106] This amount is 67% of the total cash relief in all class settlements studied by the CFPB, even though these cases make up a small portion of the total number of class settlements. Some of these cases are among the class settlements that the CFPB covered in its selective report on class action settlements in its 2013 preliminary resullts. Referring to the preliminary results, one sees that in the checking account overdraft litigation (consolidated in the Southern District of Florida) alone, the settlements discussed by the CFPB compensated about 6 million class members.[107] Thus, a very small number of large cases involving huge plaintiff classes are driving the results, even though those cases are likely not typical of most class action cases.

2. The CFPB's Report on attorneys' fees relative to class payouts is also an aggregate average that conceals variation across case types and enormously high attorneys' fees relative to the class payout for some types of consumer class actions. The CFPB reports that attorneys' fees in class settlements are a surprisingly low 21% of the total cash compensation paid to class members (and an even lower 16% of what it calls "total gross relief"). But the CFPB's number for attorneys' fees as a fraction of class payout is generated by the same sort of aggregate average method used to compute class payout rates. The CFPB divided total attorneys' fees paid in all its class settlements by the total amount paid to class members in those settlements.[108] However, the CFPB did apply this method for each case type, so that one may see the fraction of total attorneys' fees paid relative to the total cash relief in class settlements in, for example, settlements that the CFPB categorized as involving credit cards or checking accounts. The CFPB

[106] *Id.*, section 8, table 8, at 25.
[107] CFPB (2013), *supra* note 8, at 105–8.
[108] CFPB(2015), *supra* note 9, section 8, at 33.

also broke down attorneys' fees relative to the amount paid to the class for different categories of total class payments. These data reveal that although attorneys' fees are a relatively small percentage of class payments for the largest class settlements (averaging only 9% for settlements larger than $100 million), they constitute a much higher fraction of the class award for smaller total class payments (averaging 57% for class awards less than or equal to $100,000).[109]

After reporting these relatively disaggregated numbers on attorneys' fees as fraction of class payouts, the CFPB states that "[o]ver 90% of individual class members in consumer financial settlements . . . are in settlements where the fee rate is under 40% . . . [and] the vast majority of class members are in settlements where the fee rates, . . . are less than 20%."[110] Similarly, the CFPB defends its method of presenting a ratio of attorneys' fees to class payouts by aggregating payouts and fees across all cases within a given category (either financial product category or payout amount) as an approach that reflects the fact that attorneys' fees tend to be a lower fraction of the class payout when payouts are bigger.[111]

An obvious consequence of this approach is that the CFPB's reported number for attorneys' fees as fraction of total class payout for both all settlements and any given type of settlement (e.g., credit card or checking account) will reflect the relatively low attorneys' fees in settlements with the biggest class payouts. Thus, it is possible—and perhaps likely—that attorneys' fees for most cases (both overall and for a particular case type) are much higher than the number reported by the CFPB, *even exceeding the class recovery*, but this problem would be completely hidden by the CFPB's methodology.

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[109] *Id.*, section 8, tables 10 and 11, at 33–34.
[110] *Id.*, section 8, at 34.
[111] *Id.*, section 8, at 33–34.

3. The CFPB's aggregative data on class settlements does not really illuminate the choice between arbitration and class actions. Perhaps the biggest problem with the aggregate averages that the CFPB reports for both class action claims rates and attorneys' fees as a fraction of total class payout is that such averages are swamped by numbers from settlements in a mere *six* class actions that account for only 2% of the CFPB's class action settlements with cash payouts. The total cash payout to class members of about $812 million in these six settlements makes up 83% of total cash payouts in the 241 settlements studied by the CFPB.[112] Although the CFPB does not report the number of class members paid in these six monster class actions, it seems clear that that the classes were huge. When the CFPB reports that attorneys' fees are relatively low and class claims (payout) rates relatively high, it is really saying that for these six settlements attorneys fees are relatively low and payout rates are relatively high.

This information could have some relevance to the design of public policy regarding arbitration as a substitute for class actions. But that relevance is likely less than it might first appear. Such information might seem to be directly applicable, thereby implying that class actions are a cost-effective method of consumer compensation and deterrence in cases with enormous numbers of consumers and aggregate damages but small harm to the consumers individually. But this reasoning presumes that the defendant's conduct underlying the biggest class action settlements was actually wrongful. Because such settlements do not involve an adjudication of wrongfulness—and, indeed, are virtually always justified by class counsel on the ground that they might not succeed on the merits—they may arise in cases where there is no actual wrong to be compensated or deterred but massive discovery costs to be avoided. Hence, even when the settlements reported by the CFPB have seemingly good outcomes, it is not clear

[112] *Id.*, section 8, at 28–29.

that those settlements were socially desirable. The CFPB's data on class settlements, though somewhat informative, do not shed light on the crucial questions that must be answered to make a relative evaluation of class actions and arbitration.

D. The Misleading Comparison of Class Action Settlement Payouts to Arbitral Awards

Indeed, read as a whole, the CFPB's study does more to mislead the comparison of arbitration and class actions than it does to inform and guide that comparison. Recall that the CFPB reported aggregated data showing that, for the class action settlements it found over the 2008–2012 period, more than 11 million consumer class member received $1.1 billion in compensation,[113] whereas for arbitrations it studied over the period 2011–2012, it could verify arbitral awards to only 32 consumers (or 20% of consumers making affirmative claims for relief) for a total of $172,433.[114] This comparison of aggregate payouts from class actions and arbitration surely could be taken to show that arbitration is the weaker instrument of compensation. The CFPB's presentation, however, is a misleading conflation of two different types of data.

In presenting data on arbitral awards for consumers, the CFPB is careful to note that, in the 20% of AAA arbitrations over the 2011–2012 period in which consumers making affirmative claims received such an award (32 of 158 such claims), they received on average only 57% of what they claimed (or as the CFPB puts it, an average of 57 cents for every dollar that they claimed).[115] Although the CFPB reports on aggregate class action settlement amounts (and amounts per class member) for different types of class actions, nowhere does the CFPB Report present comparable information on how the actual settlement payout to individual class members compares with the per plaintiff damages claimed.

[113] *Id.*, section 8, at 3–5.
[114] *Id.*, section 5, at 41.
[115] *Id.*

This does not mean that class settlements for less than statutory damages are somehow suspect. To the contrary, basic economic theory predicts that settlement amounts will typically be less than the maximum amount recoverable in litigation. The same dynamic may be at work in arbitration, but the CFPB presents no data on AAA consumer arbitration settlements because it did not have access to such data. Still, the CFPB did present data showing that 23% of AAA consumer arbitrations were known to have settled, with another 34% likely to have settled.[116] Thus 57%, or the vast majority of AAA consumer arbitrations studied by the CFPB, were likely or known to have settled. Without data on the settlement amounts in those cases, it is highly misleading for the CFPD to present data on consumer arbitral awards. Had the CFPB made a proper apples-to-apples data comparison, it would have compared consumer recovery in successful consumer arbitrations not to class action settlements but to the 2% of consumer class actions in which consumers got an individual or classwide judgment.[117] Instead, the numbers that the CFPB does report invite a misleading comparison of class settlements to arbitral awards.

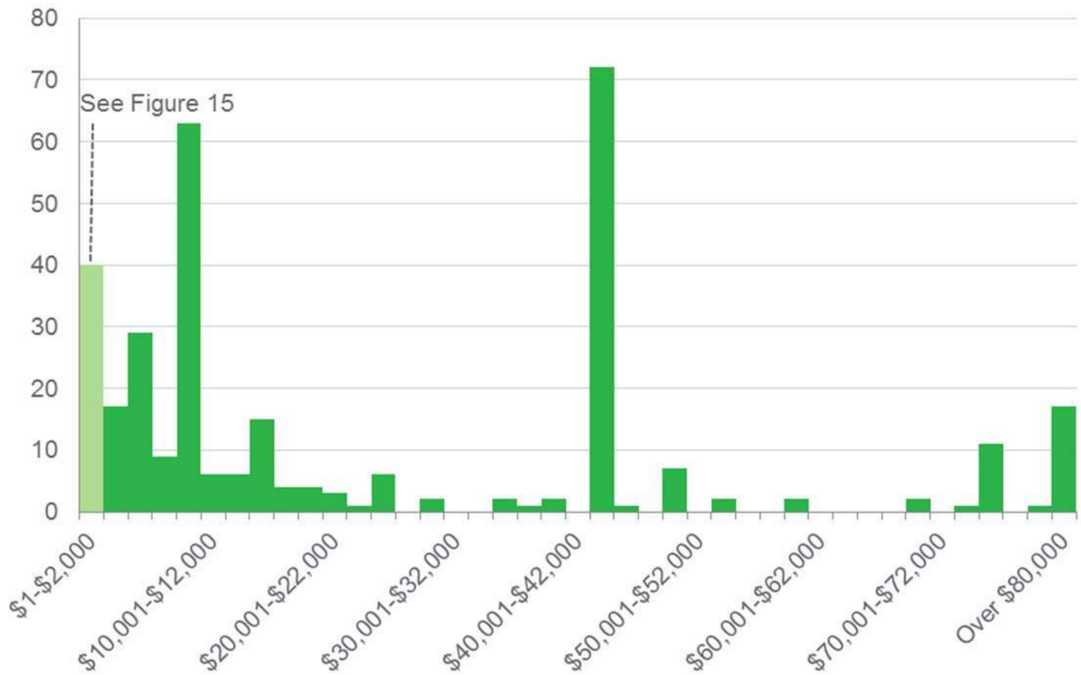
E. Claims Less Than $1,000 against Financial Products and Services Providers Are Relatively Rare—Regardless of Whether They Are Arbitrated or Litigated

In its preliminary results study, the CFPB reported finding "almost no" AAA arbitration filings in the three product markets it studied that involved claims of less than $1,000. Although the CFPB did not give numbers for the fractions of claims falling within different ranges, it did present figure 14, reprinted here as figure 1,[118] which shows the overall distribution of claims. The figure does not indicate that the actual number of claims less than $1,000 found by the

[116] *Id.*, section 5, at 33.
[117] *Id.*, section 6, at 39.
[118] CFPB (2013), *supra* note 8, at 81.

CFPB, 23, is especially unusual; indeed, very small claims appear to be more likely than, say, claims in the $50,000–$70,000 range.

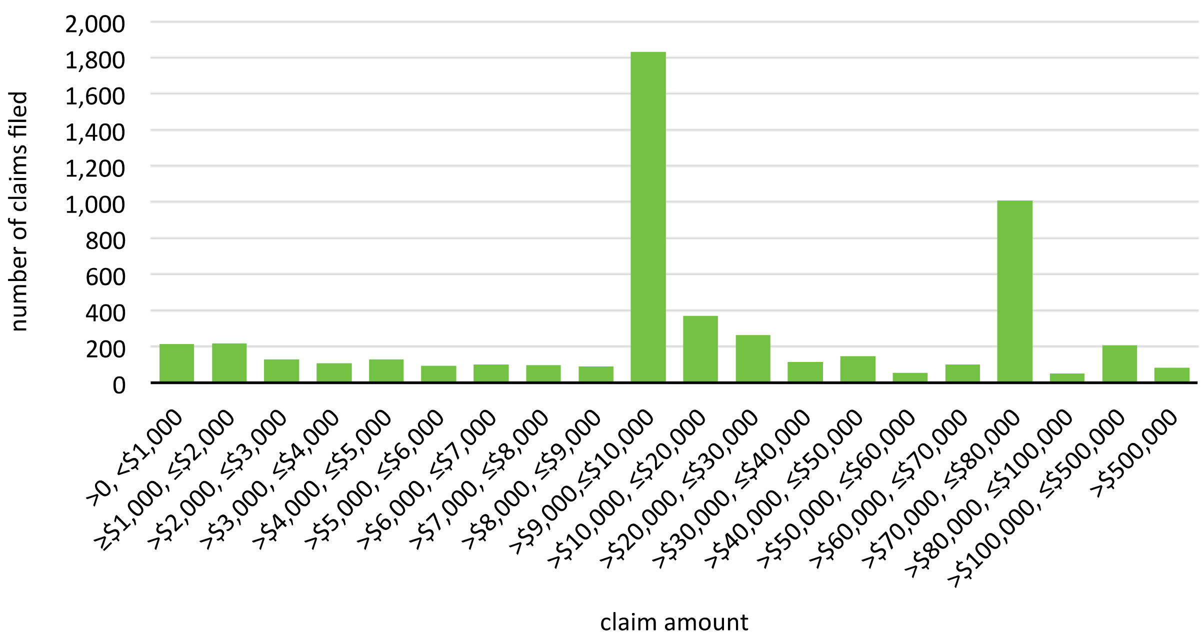
Figure 1. Distribution of Claim Amounts in AAA Arbitrations Studied in the Consumer Financial Protection Bureau Preliminary Results



Source: Consumer Financial Protection Bureau, *Arbitration Study: Preliminary Report*, 81, figure 14 (2013). "See Figure 15" in the chart refers to a figure in the source publication.

Still, clearly CFPB's sample did not include a large number of arbitrations with claim amounts less than $1,000. But it would be wrong to infer from this finding—restricted as it is to arbitrations involving particular product markets—that consumer arbitrations for less than $1,000 are rare among all AAA consumer arbitrations. Figure 2 shows the distribution of claim amounts (in filings with nonzero claims) for all AAA consumer arbitrations filed over the period 2009–2014, the most recent period for which publicly available AAA data exist online. A quick glance at figure 2 indicates that in this dataset, too, few claims for less than $1,000 were filed. But in fact, the 219 claims that were less than $1,000 make up 3.5% of all claims, and claims less than or equal to $2,000 make up 7% of all claims. By comparison, in the CFPB's AAA financial products arbitrations, claims for less than $1,000 make up only 2% of all claims.[119] In other words, small claims were 75% more likely in the overall AAA consumer filing dataset than in the CFPB's financial products AAA consumer dataset. The fact that a nontrivial number of small-dollar AAA arbitrations are brought for other products, suggests that small-dollar arbitrations actually are feasible. In turn, the finding suggests that the relative scarcity of small-dollar consumer arbitrations against financial institutions may reflect something other than the economic feasibility of arbitrations and some factor unique to financial services, such as more robust internal dispute resolution practices.

Figure 2. Frequency of Claim Amounts, All AAA Consumer Arbitrations, 2009–2014



Source: Data compiled from AAA consumer arbitration statistics, available at https://www.adr.org/aaa/faces/aoe/gc/consumer/consumerarbstat?_afrLoop=209719868901203&_afrWindowMode=0&_afrWindowId=8ok8435fw_1#%40%3F_afrWindowId%3D8ok8435fw_1%26_afrLoop%3D209719868901203%26_afrWindowMode%3D0%26_adf.ctrl-state%3D8ok8435fw_51.

[119] This number results from dividing the 23 small arbitrations that the CFPB identified by 1,060, the total number of arbitrations in its sample.

The evidence about both class actions and arbitrations suggests that further work is needed to investigate precisely why one sees a relatively low number of small-dollar claims both in consumer class actions and consumer arbitrations. Such work should recognize, however, that the $1,000 threshold appears to be a poor indicator of whether a claim against a financial products provider is a "small-dollar" claim. One reason that $1,000 is a poor way to define small claims against financial products and servicers providers is that many (and probably most) class actions against financial product suppliers are brought under federal consumer protection statutes that authorize statutory damages up to either $1,000 or $1,500 per claimant without proof of injury. Therefore, those amounts are the effective minimum amounts claimed by a class member in such class actions, regardless of how small the actual individual harm may be.

One of the new pieces of information provided by CFPB concerns the substantive legal basis for AAA consumer arbitrations. The CFPB found that virtually all the arbitrations it studied involve a federal or state statutory claim or both. For example, the preliminary results indicate that for noncollection credit card arbitrations, federal statutory claims make up 59% and state statutory claims another 21%.[120] The federal and state consumer protection statutes that consumers invoke in AAA arbitration are essentially the same (although appearing in different proportions) as those that provide the basis for consumer class actions against financial product providers.[121]

Because AAA consumer financial products arbitrations proceed under the same kinds of federal (and state) consumer protection statutes as do consumer class actions involving these products, it would be surprising to find that many AAA consumer arbitrations claimed less

[120] CFPB (2013), *supra* note 8, at 86–87.
[121] The CFPB preliminary results find that in the credit card arbitrations, 39% of claims rely on the Fair Debt Collection Practices Act, 22% on the Fair Credit Reporting Act, and 16% on the Fair Credit Billing Act. *Id.* at 86.

than $1,000 (or sometimes $1,500). The CFPB's study, referring as it does to a 1995 opinion by Justice Breyer as its benchmark for a small-dollar consumer claim, seems to ignore the fact that virtually all consumer claims are brought under federal or state consumer protection statutes that entitle consumers to at least $1,000. In such cases, Breyer's $1,000 figure is no longer a useful threshold.

VII. What CFPB Should Do before It Considers Prohibiting Arbitration

The CFPB's Report provides some useful new information about both consumer class actions and arbitrations involving selected financial products and services, but it does not provide data on key measures of the performance of either class actions or arbitrations. Most notably, the Report contains no information on the size of arbitral settlements, and it does not provide data on class action settlements that are sufficiently fine-grained to allow one to see how class payout rates and attorneys' fees vary with case type. Some of the CFPB's findings actually undermine several key arguments that are often asserted to justify restrictions on arbitration, such as the supposed unfairness of arbitration procedures. The Report shows not only that most AAA consumer claimants have counsel but also that they usually do not need it: the CFPB's Report provides evidence that AAA arbitration may be the only way for consumers to successfully seek outside redress without resort to hiring costly legal counsel.

Although the relative absence of small-dollar disputes between consumers and financial institutions in the AAA data might suggest that arbitration is ineffective for dealing with such disputes, the absence of such observations alone cannot sustain the conclusion that the disputes are not economically feasible to arbitrate. First, in an era when virtually all consumer legal actions—whether adjudicated before the AAA or in federal court—are brought under federal consumer protection statutes authorizing statutory damages (often without proof of injury to the consumer), it is difficult even to identify what constitutes such a claim. Second and more importantly, the CFPB's Report provides no evidence for why disputes involving very small claim amounts are not typically arbitrated. However, as we noted, data provided by one financial institution indicates that it grants refunds to 68% of customers who complain, suggesting that the bank has a well-established internal system for resolving meritorious small-dollar consumer claims, pretermitting either arbitration or litigation. Together with the CFPB's survey evidence showing that consumers do, indeed, punish firms that try to attach unreasonable charges and fees by taking their business elsewhere, it may well be that truly small-dollar claims are increasingly being eliminated by the market itself.

Public policy in the United States has long supported the use of arbitration and other means of dispute resolution as an alternative to litigation. Indeed, in at least some areas (such as securities litigation), Congress has acted in recent years to pare back the scope of class action lawsuits. It is generally recognized that reckless and irresponsible class action cases can be harmful to consumers, businesses, and the economy as a whole. Frivolous class action cases impose both direct and indirect costs on businesses that inevitably are passed on to consumers in the form of higher prices, reduced quality, or reduced innovation and consumer choice. In the context of consumer financial products, such lawsuits drive up the cost of doing business, and those costs are passed on to consumers in the form of higher interest rates and restricted credit availability. In perhaps its most glaring omission, however, the CFPB Report makes no attempt to assess the merit of consumer class actions that end in the class action settlements it reports. It does not present any data that even illuminate which firms tend to settle and which do not and how key measures of class action performance (claims rates and attorneys' fees relative to the class payout) vary with the statutory basis of the claim settled. After reading the voluminous Report, one knows no more about whether the settlement of frivolous consumer class actions is a real social problem than one did before reading it. Likewise, one knows no more about whether arbitration realizes its promise of achieving more accurate determination of consumer disputes on the legal merits.

Although the point is largely ignored in the Report, over time courts have developed a robust and evolving jurisprudence to protect consumers in cases involving unfair arbitration clauses.[122] The CFPB's Report does not provide anywhere near the kind of information that would be necessary for the CFPB to craft ex ante regulation of consumer arbitration clauses that would do a better job of weeding out unfair arbitration clauses than what courts have done through ex post adjudication. Indeed, broad regulatory action by the CFPB that might nullify or discourage consumer arbitration could preempt what has become quite precise judicial supervision and fine-tuning of consumer arbitration clauses. Such ex post judicial supervision seems already to have changed that way that companies such as AT&T draft arbitration clauses, leading to arbitration procedures that are cheap and easy for consumers to pursue and that offer consumers large payments (in AT&T's case, $10,000) when the consumer wins. Consumer arbitration is only in its infancy. It has tremendous promise. The CFPB's Report provides no evidence for this promise to be aborted by expansive new CFPB regulation.

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[122] And as argued by Drahozal, *supra* note 72, judicial policing is not the only mechanism for ensuring substantively fair terms in mandatory arbitration clauses. Firm reputation and other market sanctions also play a role.

CFPB

Small Business Review Panel on Arbitration Agreements October 28th 2015

SER-Phillip Lathrop VP Motors Inc. Garland Texas

Also current President of the Texas Independent Automobile Dealers Association and 5 year tenure as Legislative Chair of the TIADA

VP Motors Inc. dba VP Auto Sales was incorporated in 1988. We operate what is referred to as Buy Here Pay Here dealership, financing in house the vehicles we sell. Our customers are typically unable to acquire bank financing due to negative credit ratings. Our yearly revenue will typically be between 10 and 15 million.

Included

1. Article written by Texas Independent Automobile Dealer Association Legal Counsel Mike Dunagan describing the potential class action suit Texas dealers were involved in in 2002. This suit initiated the use of arbitration agreements by hundreds and perhaps thousands of Texas dealers.
2. Expense of the suit.
3. A copy of the Arbitration agreement with class action waiver I use at VP Auto Sales.
4. A summary of my input in defense of our use of arbitration agreements.
5. Suggestion for alternative action concerning small businesses to CFPB.

I thank the CFPB and SBA for giving us an opportunity to give our input prior to any final rulemaking on this issue.

Phillip Lathrop

Rather Case Victory Shows

Value of Dealer Unity

By Michael W. Dunagan

Dealer Gary Sayre was one of many Dallas-area dealers who were paid visits by a private process server in March of 2002. Sixty-one dealers were named as defendants in the initial class action suit filed by a group of plaintiff's attorneys who had targeted Texas buy-here-pay-here dealers. Despite every effort that he and his fellow dealers had made to comply with the admittedly complex federal and state laws and regulations, Sayre was accused of misleading and defrauding his customers by charging interest on deferred sales tax and by generally over-charging on his contracts.

The case of Rather vs. Dallas Automotive (the case was named for the first plaintiff and the first defendant listed in the suit) is a classic demonstration of the danger that lurks out there for every car dealer. As a class-action suit with multiple plaintiffs, it held the potential to bankrupt honest, law-abiding businessmen who had built successful businesses from the ground up.

But, more importantly, Rather vs. Dallas Automotive has served as a shining example of what a group of smart, unified dealers can achieve when they are organized, focused, and intent on standing their ground in the face of adversity. The Dealer Class-Action Defense Task Force's efforts came to fruition when the last dealer-defendant was dropped in February, officially bringing an end to Rather vs. Dallas Automotive. (All of the dealer-defendants who were part of the group has also been dropped from the related Fort Worth case, although the Fort Worth case and the related San Antonio case are still on-going as this is written.)

The two-year journey through the class-action litigation minefield began in January of 2002 when dealers were notified by some of their customers that letters had been sent accusing the dealers of over-charging. The letters, which were addressed to persons who had purchased vehicles from buy-here-pay-here dealers in the previous years, invited the recipients to sign and return the letters to the plaintiff's attorneys who would sue the dealers and obtain refunds, all at no cost to the consumer.

Rumors had been spreading for months about a planned class-action suit against dealers who were actually charging interest on deferred sales tax, but most of the dealers clearly did not charge interest on deferred sales tax. When those dealers called the law firm that sent the solicitation letters, they were informed that it could be proved that the dealers were making illegal charges and they should make arrangements to pay up.

Most of these dealers were using software that had been approved by the Office of Consumer Credit Commissioner and were using approved contract forms that clearly showed that deferred sales tax was subtracted from the amount financed before finance charge was calculated. By March, the private process server began making his rounds, delivering suit papers to confused and disbelieving dealers.

It became clear immediately that the suit weren't just targeted toward a few renegade dealers who were trying to pick up some extra bucks. Some very knowledgeable and compliance-conscious dealers were included as defendants. Many dealers who weren't named in the suit knew they were vulnerable because they used the same software and forms as the defendants.

By the time Sayre called me for advice, I was aware of the scope and the nature of the claims. I was also as befuddled as the dealers were. But one thing seemed clear. Either the plaintiff's attorneys knew something we didn't know or they were just wrong. The other thing that was crystal clear to me and was my first recommendation to Sayre: Hire the best and most powerful defense counsel you can whether you can afford it or not. After we had interviewed two prominent law firms, and gotten retainer quotes and estimates, Sayre started crunching the numbers. While each dealer would be hard-pressed to afford the high-dollar and long-term cost of defense, a large group of dealers could pool their resources and take advantages of economies of scale. For a relatively small monthly payment, dealer defendants could be part of major defense effort that was coordinated and competent.

Sayre enlisted Robert Milligan, Blake Ingram, and Phil Lathrop to help coordinate the group. The committee members put up the initial money to fund the group and gave countless hours of time away from their businesses to spread the gospel. The Dallas County Automobile Dealers Association, under president Hal Hammond, helped set up a meeting to which all dealers were invited. Almost 200 dealers and some attorneys attended and heard Sayre's and the committee's pitch: "United, we can defeat this thing. Divided, they'll pick us off one at a time." A majority of the dealer defendants signed on and the law firm of Locke, Liddell & Sapp was retained. The firm had been representing new car dealers in class-action litigation over vehicle inventory tax and had successfully represented dealers and auctions in challenging the $225 import fee the legislature had passed.

Within weeks, suits were filed in Fort Worth, San Antonio, Austin, Beaumont, and Houston (although the Austin, Beaumont and Houston suits were filed as individual suits, not class actions). Over 250 dealers state-wide were now defendants. Many of the defendants in the Fort Worth suit jointed the Task Force. Appeals were made at meetings set up by TIADA in the affected cities, and many dealers who weren't named in any suit contributed to the cause.

The first order of business in the Dallas suit was to fight the plaintiffs' demand that all contracts and sales files for the past several years be produced. We were successful in having discovery limited to records on the named plaintiffs. Next, the defense pushed the plaintiffs to explain how a dealer who wasn't charging interest on deferred sales tax could be accused of doing so. The plaintiffs' focus would eventually change from interest on deferred sales tax to a series of technical contract violations. It had become apparent that the plaintiffs were backing off their original central theme and the threat of a certified class was diminishing.

Initially, dealers were dropped from the suit in groups. Then, toward the end, our attorneys convinced the plaintiffs to drop the rest, one at a time.

Many things happened during the two-year life span of the Rather case, and not all were good. For one, two of the group's initial members died. There's little doubt that many dealers and their families experienced accelerated aging and lost sleep over the threat of financial devastation. For some, plans for expansion and renewal of credit lines were impaired by the legal cloud.

But as the dust settles and we are able to put things back into perspective, one silver lining shines through with undisputed brilliance. When a dedicated group of dealers brings its collective skills and abilities to a task, no matter how daunting, let no man or beast get in the way. I'm just glad I was on the right side.

Expense of the Suit

As this suit was dated 2002, the actual invoices have been archived.

I reached out to what is now Locke-Lord to the lead attorney on our case. Rob Mowrey responded by e-mail and indicated his electronic record showed a billing of $665,000 to our group. Mr. Dunagan estimated his fee at $30,000.

The court denied the certification of the class. I can only imagine what this could have grown to had the class been certified. If we had not banded together and were forced to fight this as individual businesses, I fear many of us would be out of business or settling when not guilty.

Summary of My Input

1. My experience with class action attorneys is very negative. The efforts to afford legal defense were astounding as my involvement running my own business was greatly reduced to deal with the potential suit. If I had not joined with a group of other dealers to cover the expense, I would have been forced to settle despite the fact the allegations were unfounded and the suit was eventually dropped.

2. The plaintiffs were solicited and didn't know what they were suing me for. At the plaintiff deposition, a women when asked by our attorneys why she was suing VP Auto Sales said "I got a letter in the mail that said I might get some money, so I signed up." When asked why she bought another vehicle from us after she sued us (a timing issue for us, as my sales manager didn't realize she was suing us) she claimed we had always done right by her in the past and liked doing business at the dealership. Needless to say the plaintiffs' attorneys wished they had put up a different plaintiff, or coached the one they had better.

3. When the original alleged accusation started losing steam, the plaintiffs' attorneys started looking for other issues such as the notification letters we send, after a loan has gone into default and the vehicle has been repossessed, late fees and any other issue they hoped they could turn into a class. Usually defined as a fishing expedition.

4. Class Actions are a business model to enrich the firms that can get a certification while giving consumers very little pay back. The CFPB handout show between 2008 and 2012 only 419 class actions were certified in Federal court. 220 million was paid out to 6.8 million defendants. The math being $32 per plaintiff. The law firms received between 16 and 21 % or between 35 and 46 million dollars. Forbes Magazine in a Dec. 11th article by Daniel Fisher states of 5 large cases in 2009 (the sixth being the Madoff case, excluded as an outlier) paid plaintiffs a high of 12% to a low of .000006 of the settlements.

5. CAFA is better than nothing, but class action attorneys can still wreak havoc at little risk to themselves. Again quoting Daniel Fisher in 2009 excluding labor and security cases of 148 class action cases, 28 settled, 27 were dismissed, 30% voluntarily dismissed and settled on an individual basis, 14 cases left pending and none went to trial. The bottom line to me is innocent or guilty, settle is the name of the game for these type suits.

6. Other disturbing facts that support my concept that class action is a business model with little interest in consumer justice can be seen everywhere. As I told the panel, the class action attorney that filed the suit on me, sold books, videos and gave lectures at the local college instructing other attorneys and would be attorneys on how to file these suits. The American Bar Association website includes Class Action 101: A Primer on Finding Plaintiffs for Your Class Action. The Ohio Advisory Opinion of 2013 allows mass text advertising. There are rules against solicitation of clients but Rule 7.3 allows banner ads as not solicitation. In most states you can pay for client leads. If plaintiffs are so wronged and injured, why do they have to be sought out under every nook and cranny?

Appendix B

List of Materials Provided to Small Entity Representatives

In advance of the Panel's Outreach Meeting with SERs, the Bureau provided each of the SERs with the materials listed below. Each of these items was also made available on the Bureau's website at www.consumerfinance.gov.

1. Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Outline of Proposals under Consideration and Alternatives Considered (*See Appendix C*)

2. Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Discussion Issues for Small Entity Representatives (*See Appendix D*)

3. Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Presentation Materials (*See Appendix E*)

4. Fact Sheet: Small Business Review Panel Process

5. Arbitration Study: Introduction and Executive Summary

Appendix C

Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Outline of Proposals under Consideration and Alternatives Considered

FINAL
10-6-15

OCTOBER 7, 2015

SMALL BUSINESS ADVISORY REVIEW PANEL FOR POTENTIAL RULEMAKING ON ARBITRATION AGREEMENTS

OUTLINE OF PROPOSALS UNDER CONSIDERATION AND ALTERNATIVES CONSIDERED

CONTENTS

I. Introduction

As part of the Consumer Financial Protection Bureau's efforts to make consumer finance markets work for consumers, and in accordance with specific authority from Congress, the Bureau is examining the role of arbitration agreements in the resolution of consumers' disputes with providers of consumer financial products and services. Consumers and providers (*i.e.* the parties) may agree to arbitrate in two ways: they may agree to arbitrate a dispute after it has arisen or they may agree to arbitrate through contracts or clauses in contracts that require the parties to submit any future disputes between them to an arbitrator, rather than to a court.[1] The former are sometimes called "post-dispute arbitration agreements" and the latter are sometimes called "mandatory pre-dispute arbitration agreements" because they commit the parties to arbitration before there is a dispute between them. The proposals under consideration concern mandatory pre-dispute arbitration agreements only, which are typically referred to in this outline more simply as "arbitration agreements." Arbitration agreements were originally used primarily in contracts between businesses, but in recent decades have become increasingly common in consumers' contracts with businesses for everyday consumer products, including financial products and services.

Congress directed the Bureau to study arbitration agreements in consumer financial contracts and authorized the Bureau to regulate their use if the Bureau finds that certain conditions are met. In March 2015, the Bureau completed its comprehensive three-year study of arbitration agreements and other methods for dispute resolution in markets for consumer financial products and services (the Study).[2] Among other things, the Study found that contracts for consumer financial products and services frequently contain arbitration agreements mandating that future disputes between the parties be resolved in arbitration instead of in court, if either party so chooses. The Study also found that most of these arbitration agreements contain provisions stating that arbitration may not proceed on a class basis. Together, these provisions can effectively preclude all class proceedings, in court or in arbitration. The Study further found that few consumers bring formal individual disputes against their financial service providers, either in court or arbitration.[3]

The Bureau does not believe, based on available data, that the reason consumers take relatively few individual complaints to court or arbitration is that consumers do not have disputes with their consumer financial service providers. Instead, the relative dearth of individual court or arbitration filings may be explained by the fact that, where consumers know they are harmed, their individual injury may be too small to make it worth their time and effort to pursue a remedy for the harm, especially through a formal filing in court or arbitration. These small injuries may also make it more difficult for consumers to find an attorney to handle their cases. In addition, the Bureau believes, based on available data, that in some cases consumers may not know that they have suffered harm because some harms are not apparent to people who are not

[1] In practice, under the latter type of arbitration agreement, a party sued in court may ask the court dismiss or stay the lawsuit so that the dispute can instead be decided by an arbitrator.

[2] Bureau of Cons. Fin Prot. *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* (Mar. 2015) ("Study"), *available at* http://www.consumerfinance.gov/reports/arbitration-study-report-to-congress-2015/.

[3] However, financial services providers filed hundreds of thousands of individual arbitration proceedings against consumers in periods before those covered by the Study.

experts in the law or because the harms are caused by practices that are not detectable by individuals.

Given that few consumer harms appear to be resolved through the filing of formal individual disputes against their financial services providers, the Bureau believes that it is important that the other methods that exist to remedy consumer harms remain available. While the Bureau and other government enforcement agencies can remedy some of these harms through public enforcement actions and supervisory oversight, these agencies have limited resources. Therefore, the Bureau believes that consumers are better protected and the market is fairer for those companies that comply with the law when consumers also are able to obtain relief by grouping their own disputes against providers of consumer financial products or services in private proceedings, including litigation. Indeed, the Study shows that these aggregated actions – typically class action litigation – have provided significant benefits to consumers, through cash settlements and other benefits made available to them and from agreements by companies to stop harmful behavior. Class litigation may also benefit consumers through the deterrent impact of those settlement agreements on other companies' conduct.

For these and other reasons, the Bureau is concerned that arbitration agreements effectively prohibit class proceedings, including litigation, and that they prevent many consumers from obtaining remedies when they are harmed by their providers of consumer financial products or services. The Bureau is further concerned that the contractual prohibitions on class proceedings reduce the deterrent effect of such proceedings and deprive consumers of positive changes companies may make to avoid liability or to remediate harm. They also may facilitate the adoption by companies of business practices that could harm consumers by reducing the risks associated with unlawful behavior.

In accordance with its authority under section 1028(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Bureau has preliminary determined that a regulation that would prohibit the application of pre-dispute arbitration agreements to class litigation in court would protect consumers, serve the public interest, and be consistent with the Study. This proposal would not prevent consumers and providers of covered consumer financial products and services from agreeing to arbitrate disputes on a class basis, as long as class litigation remains an option. The Bureau believes that consumers and the broader consumer finance market will benefit by allowing consumers to pursue relief for violations of law through class proceedings against providers of covered consumer financial products or services without the impediment of arbitration agreements. Through such proceedings, the Bureau expects that consumers will receive monetary relief when companies violate the law and that companies will change their practices to comply with the law, which will benefit consumers.

The Bureau is not proposing for consideration a ban on all pre-dispute arbitration agreements or other conditions or limitations on the use of such agreements at this time. The Bureau's present assessment based on the evidence obtained thus far is that arbitration agreements that compel arbitration of individual consumer financial disputes do not necessarily lead to systemic case outcomes that harm consumers. The Bureau is concerned, however, that pre-dispute arbitration agreements that require arbitration of individual claims may have in the recent past led to harms to many consumers and is further concerned that these types of harms may recur. Specifically, in the early 2000s, companies filed hundreds of thousands of arbitrations seeking to collect debts from consumers before a single arbitration administrator that was alleged by

Minnesota's attorney general to have institutional conflicts of interest.[4] Cognizant of this recent history, the Bureau wants to prevent harm to consumers in individual consumer arbitrations.

To better understand arbitrations that occur now and in the future, the Bureau is therefore considering proposals that would facilitate ongoing Bureau as well as public monitoring of consumer financial arbitrations. Specifically, the Bureau is considering a proposal that would require companies that use arbitration agreements with consumers for certain types of consumer financial products or services to submit claims filed and awards issued in any arbitration proceedings to the Bureau. The Bureau is further considering periodically publishing the claims or awards on its website.

To begin the rulemaking process, the Bureau along with the Office of Management and Budget (OMB) and the Small Business Administration Office of Advocacy (SBA) will convene a Small Business Review Panel (Panel) to consider the potential impact of the proposals the Bureau is considering on small businesses. Following completion of the Panel process, consideration of the Panel's recommendations, and other stakeholder outreach, the Bureau expects to commence a rulemaking.

II. Background

Companies often provide consumer financial products and services under the terms of a standard-form, written contract. In addition to being governed by such contracts, the relationship between a consumer and a financial service provider is generally governed by consumer protection laws at the state level, federal level, or both. These laws create legal rights for consumers and impose responsibilities on covered providers of financial products and services. Some of these laws can be enforced directly by consumers by bringing private lawsuits against the financial service provider, while others are subject to enforcement only by government actors.

Absent an agreement to the contrary, if a dispute arises between a consumer and a company as to whether one party or the other has violated the contract or a privately enforceable law, the party who believes that a violation has occurred has the right to seek resolution of the dispute in a court of law, either by filing an individual lawsuit or by filing or participating in a class lawsuit. A class lawsuit is one in which, in defined circumstances, one or more plaintiffs may file suit on behalf of similarly situated individuals. If the class is certified by the court, members of a class — for example, customers of a company who have been affected by a particular practice — may be eligible to obtain relief without initiating their own lawsuits. Conversely, if the defendant prevails in a class case after the class is certified, members of the class may be bound by the decision and thereby precluded from initiating their own lawsuits with respect to the issues in the class case. Filings and decisions in both class cases and individual cases filed in court are generally a matter of public record.

The parties to a contract can also agree to alternative means of resolving disputes that arise between them. A common form of alternative dispute resolution provided for in contracts is final and binding arbitration in which one or more privately-chosen arbitrators are empowered to resolve the dispute. These arbitration agreements generally give each party to the contract

[4] Without admitting to the allegations, this administrator agreed to permanently cease administering consumer arbitrations pursuant to a consent decree resolving litigation against it. *See* Consent Decree entered in *Minnesota v. Nat'l Arb. Forum, Inc., et al.*, No. 27-CV-09-18550 (July 17, 2009).

two distinct rights. First, either side can file disputes against the other in arbitration and obtain a decision from the arbitrator. The arbitrator's decisions are generally not appealable in court, meaning a party who disagrees with a decision has very limited options to have that decision reconsidered or reversed, and that party cannot ignore the arbitrator's decision and pursue the dispute again in court. Second, if one side sues the other in court, the party that has been sued in court can use the arbitration agreement to require that the dispute proceed, if at all, in arbitration instead.[5]

Arbitration agreements were originally used primarily between companies that bargained with each other to create tailored contracts. Early on, courts were often hostile to such arrangements, and Congress in 1925 passed the Federal Arbitration Act to require that, subject to a few exceptions, courts enforce arbitration agreements.[6] Arbitration agreements are now often used in standard-form contracts where both parties do not have equal bargaining power, such as in contracts between companies and their employees, investors, or consumers. These agreements have spread rapidly in the last few decades, and their use has become a contentious legal and policy issue. Courts have focused on various issues raised by the use of arbitration agreements and the application of laws governing contracts and the Federal Arbitration Act in such standard-form contracts. One issue is whether arbitration agreements that ban class proceedings in arbitration should be enforced given that they effectively allow companies to shield themselves from all class proceedings. They do so because companies sued in a class case in court can use an arbitration agreement to seek dismissal of the court case in favor of an arbitration in which no class proceedings are permitted. Before 2011, lower courts were divided on whether arbitration agreements that bar class proceedings were unenforceable because they violated some states' laws. In 2011, in *AT&T Mobility LLC v. Concepcion*,[7] the Supreme Court resolved this divide by holding that the Federal Arbitration Act preempted California state law that would have prohibited the enforcement of an arbitration agreement barring class proceedings in a consumer case.

As is mentioned above, arbitration agreements in consumer contracts have been the subject of legislation and regulation. For example, since 1976, commodities merchants have been permitted to use arbitration agreements only when customers voluntarily agree to arbitrate disputes before they arise. These merchants must offer their products to consumers even when a customer does not agree to pre-dispute arbitration.[8] As another example, arbitration agreements that apply to class litigation have been prohibited in securities broker dealer contracts since 1992.[9] The Military Lending Act and its implementing regulations, which were recently expanded by the Department of Defense to reach most forms of credit accessed by servicemembers and their families, prohibit arbitration agreements in consumer credit contracts with certain covered servicemembers or their dependents.[10] In addition to providing the Bureau the authority to regulate the use of arbitration agreements in consumer financial contracts, the

[5] These arbitration agreements typically do not apply to lawsuits in small claims court, however, where disputes under a specified dollar amount often can be resolved quickly and without an attorney.

[6] 9 U.S.C. 1 through 16.

[7] 131 S. Ct. 1740 (2011).

[8] 17 CFR 166.5(b)-(c), implementing 7 U.S.C. 21(b)(10)(A).

[9] Financial Industry Regulatory Authority (FINRA) Rule 2268(f).

[10] 10 U.S.C. 987, as implemented by 32 CFR 232.8(c).

Dodd-Frank Act prohibited all arbitration agreements in consumer mortgages[11] and included authority for the Securities and Exchange Commission to regulate arbitration agreements in contracts between consumers and securities broker-dealers or investment advisers.[12] The Department of Health and Human Services also recently proposed regulations that would regulate the use of arbitration agreements in long-term care contracts with consumers.[13] Finally, the Federal Trade Commission also interprets federal law as prohibiting arbitration agreements in warranties for consumer products.[14]

A. The Bureau's Study of Arbitration Agreements

The Dodd-Frank Act required the Bureau to study the use of arbitration agreements in connection with consumer financial products or services.[15] As a preliminary step toward such a study, the Bureau published a Request for Information in 2012 that sought comments on the appropriate scope, methods, and data sources that the Bureau should consider in its study of arbitration agreements.[16] The Bureau received 60 comments in response to the request and met with numerous commenters and other stakeholders to discuss their concerns as it considered how to construct its study. The Bureau released Preliminary Results of its study on December 12, 2013.[17] Following the public release of the Preliminary Results, the Bureau again met with numerous stakeholders to seek additional feedback before the Bureau prepared the final Study. After completing additional work and analysis, the Bureau released the Study on March 10, 2015. Among other things, the Study used a detailed analysis of empirical evidence, including consumer contracts and court data, to describe how individual and aggregated disputes between consumers and consumer finance companies have been resolved both in arbitration and in the courts.

The Bureau believes that its Study is the most comprehensive empirical study of consumer financial arbitration ever conducted. Specifically, the Study analyzed over 850 consumer

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[11] Dodd-Frank Act section 1414(a). That prohibition was implemented in Regulation Z by the Bureau's Loan Originator Compensation Rule. 12 CFR 1026.36(h).

[12] Dodd-Frank Act section 921.

[13] Centers for Medicare & Medicaid Services, Medicare and Medicaid Programs; Reform of Requirements for Long-Term Care Facilities; Proposed Rule (July 16, 2015), 80 FR 42168, 42264 (proposing to require that arbitration agreements be explained in understandable language, acknowledged by the resident, provide for a convenient venue and a neutral arbiter, entered into on a voluntary basis, not be made a condition of admission, and not restrict or discourage communication with government authorities).

[14] 16 CFR 703.5(j); FTC Final Revised Interpretations, 80 FR 42710, 42718-20 (Jul. 20, 2015).

[15] Dodd-Frank Act section 1028(a) ("The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.").

[16] Consumer Financial Protection Bureau, Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements 4 (Apr. 27, 2012) (Docket No. CFPB-2012-0017). The Bureau subsequently received and considered additional feedback from interested persons in connection with its survey of credit card customers. Agency Information Collection Activities; Comment Request (Jun. 7, 2013) (Docket No. CFPB-2013-0016).

[17] Consumer Financial Protection Bureau, *Arbitration Study Preliminary Results* (Dec. 12, 2013) ("Preliminary Results"), *available at* http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf.

finance agreements between companies and consumers, over 1,800 consumer finance arbitration disputes filed over a period of three years, a sample of the nearly 3,500 individual consumer finance cases filed in federal court over the same time frame, all of the 562 consumer finance class cases filed in federal court and in selected state courts during the same time period, 40,000 small claims filings over the course of a single year, more than 400 consumer financial class settlements in federal courts over a period of five years, and more than 1,100 state and federal public enforcement actions relating to consumer finance. The Study further included a national survey of over 1,000 credit card consumers to learn more about their knowledge and understanding of arbitration and other dispute resolution mechanisms.

The Study made a number of important findings, including that tens of millions of consumers use consumer financial products that are subject to arbitration agreements.[18] For example, the share of contracts that include arbitration agreements is 53% of the credit card market,[19] 44% of insured deposits in the checking account market, 92% for a sample of prepaid card agreements obtained by the Bureau, 99% for a sample of storefront payday loan agreements from California and Texas agreements, and 99% of the mobile wireless market. The Study also found that in the credit card, checking account, and payday loan markets, arbitration agreements are more prevalent in contracts involving larger providers of financial services than smaller providers.[20] In the credit card market, 75% of the largest issuers used arbitration agreements, while 42% of the smaller and mid-sized bank issuers did so. In the checking account market, 46% of the largest banks used arbitration agreements, as compared to 7% of the small and mid-sized banks studied. In the payday market, all of the 11 large lenders studied had arbitration agreements, as compared to 84% of a sample of smaller lenders.

Section 2 of the Study also provided data on the use of arbitration agreements by entities of different sizes. Entities generally qualify as “small” under SBA standards if their assets, revenues, or employee count fall below thresholds established by SBA, which are assigned by industry classifications in the Census.[21] The table below summarizes the data on the use of arbitration agreements from the Study for selected markets, and breaks out this data further to identify prevalence of these agreements for small entities for which data on size is generally publicly available (banks and credit unions) in certain markets (checking/debit cards, credit cards, private student loans, and prepaid GPR cards):

Market/product	Prevalence of Arbitration Clause Data for Small Entities and Observations
Checking/debit cards	Of a random sample of banks not among the largest 100, 7% used arbitration agreements for their accounts (section 2.3.2). Over half of the banks in this 7% appear small.
Credit cards	24 credit card agreements reported to the Bureau by banks

[18] Study, *supra* note 2**,** section 1.4.1.

[19] But for a settlement of an antitrust lawsuit involving four large credit card issuers, the market share of credit card consumers whose contracts would include arbitration agreement would have been 94%. Study, *supra* note 22, section 2.3.1.

[20] The Study did not delineate small providers in the three other markets studied.

[21] *See* U.S. Small Business Administration, “Table of Small Business Size Standards Matched to North American Industry Classification System Codes,” available at https://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf.

	not among the largest 50 issuers had arbitration agreements (section 2.3.1). Eight of these 24 banks that appear to be small.
Prepaid GPR cards	Among the banks issuing the 52 prepaid GPR card agreements sampled (section 2.3.3), we found that only one bank was small, and that card agreement included an arbitration agreement. Outside of that sample, we have also found 4 other small banks whose prepaid GPR cards were reviewed in the Bureau's 2014 Study of Prepaid Account Agreements; it appears that 3 of these banks include arbitration agreements in their prepaid GPR cards.[22]
Private student loans	A widely offered student loan product (section 2.3.5) includes an arbitration agreement and appears to be used by over 150 small credit unions.[23]

With respect to the market for short-term smaller-dollar loans, the Bureau notes that size standards for this market are generally tied to firm revenue. However, nonbank firms are a significant portion of this market, and information concerning their revenues does not appear to be consistently available. Nonetheless, the Bureau notes that 84% of storefront payday lenders (not among the 11 largest participants) in a sample of such lenders in California and Texas used arbitration agreements (section 2.3.4).

As noted, arbitration agreements provide that, at the election of either party, claims must be decided in arbitration rather than in court. The Study showed that less than 2% of consumers surveyed said that they would seek out a lawyer in response to a dispute with their credit card company and less than 1% said that they would initiate legal proceedings without mention of an attorney.

Consistent with the findings in the survey, consumers in fact initiated a relatively small number of individual cases against their financial service providers either in arbitration or in court. Between 2010 and 2012, across six different consumer finance markets, 1,847 arbitration disputes were filed with the American Arbitration Association (AAA), the largest administrator of arbitration agreements within the consumer finance field. An unknown number of these

[22] The Bureau's study of prepaid account agreements is available at http://files.consumerfinance.gov/f/201411_cfpb_study-of-prepaid-account-agreements.pdf. In addition to the account agreements reviewed in the arbitration study and in the prepaid account agreement study, the Bureau also has identified an additional small bank issuer whose GPR prepaid card includes an arbitration agreement. Finally, other entities, such as nonbank program managers, participate in delivering prepaid GPR card services to consumers. It may be likely that some program managers for cards in the sample were small. *See* CFPB, Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z); Proposed Rule (Dec. 23, 2014), 79 FR 77102, 77283-77285 (Bureau's 2014 proposal to regulate prepaid accounts finding over 100 entities that are small or potentially small participating in the prepaid account market). Nonetheless, data concerning the revenues of such program managers does not appear to be consistently publicly available.

[23] Credit unions offering this product are listed at http://www.studentchoice.org/. Credit unions and banks across the country, including a number of small entities, also partner with Sallie Mae to originate private student loans with arbitration agreements (the Smart Option Student Loan).

cases were filed by companies, rather than consumers. Most of the claims filed in arbitration were for large dollar amounts. Only about 25 arbitration disputes per year involved affirmative consumer claims for $1,000 or less.[24] The average and median affirmative consumer claim amounts were $27,000 and $11,500, respectively.

The Study similarly found that few consumers file individual cases in federal court. Across five markets, between 2010 and 2012, the Study found an average of just over 1,150 individual consumer financial cases per year filed in federal court.[25] When looking at cases filed against credit card issuers in small claims court, the numbers were similarly low. In 2012, consumers in jurisdictions with a combined total population of around 85 million filed fewer than 870 small claims court credit card claims against issuers representing 80% of credit card loans outstanding. These low numbers of formal claims may be due to the fact that consumers are able to resolve harms with their consumer financial service providers informally through contacting the company's customer service representatives. The Study showed, however, that at least for disputes concerning banks' checking account overdraft policies, informal dispute resolution provided relief to few consumers who were harmed.[26]

In contrast to the relatively few individually-filed claims, the Study found evidence that class litigation provides a potential means of securing relief for a much larger number of consumers. Across substantially all consumer finance markets, the Study showed that at least 32 million class members per year were eligible for relief pursuant to class settlements approved by federal courts between 2008 and 2012. The settlements totaled $540 million per year in cash, in-kind relief, and attorneys' fees and expenses, with roughly 18% of that going to expenses and attorneys' fees. Further, these figures do not include the value to consumers of class settlements requiring companies to change their behavior, although this value is potentially substantial since the Bureau did not quantify it.

The Study further provided evidence that arbitration agreements provide a substantial barrier to pursuing claims on an aggregated (*i.e.* class) basis. Almost all of the arbitration agreements studied prohibit arbitration from proceeding on a classwide basis. Indeed, the Study found only two class arbitration cases filed with the AAA in six markets studied over a period of three years.

Further, arbitration agreements are more likely to be used to stop cases filed on behalf of a class than in cases filed on an individual basis. Among the 1,205 individual federal court cases studied, companies moved to compel arbitration in only 12 cases or less than 1%. In contrast, out of 562 class cases filed over three years in federal court and selected state courts, the Study found that arbitration agreements were cited as the basis for a motion to dismiss or stay the case in 94 cases (about 17% of the class cases) and courts dismissed or stayed about half of those cases.[27] Outside of those 562 cases analyzed, the Study further identified more than 60 other class consumer finance cases dismissed or stayed on the basis of arbitration agreements since 2011, for a total of over 100 class cases identified in the Study as blocked by arbitration

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[24] See the Study for an explanation of "affirmative" consumer claims. Study, *supra* note 22, section 5.2.1. In general, the Study treated claims under federal or state statute as an affirmative consumer claim, as distinguished from a claim involving disputed debt.

[25] Other than the small claims filing discussed in this paragraph, the Study did not review other individual cases filed in state court.

[26] Study, *supra* note 2, section 8.3.8.

[27] In the other half, the court either did not rule on the motion relying on the arbitration agreement or denied it. Study, *supra* note 2, section 6.7.1.

agreements. For most of the cases analyzed in the Study, information was not available as to whether the relevant contracts contained arbitration agreements. In the 40 class cases where the Study was able to ascertain that the case was subject to an arbitration agreement (in a subset of cases involving credit card issuers), motions to compel arbitration were filed 65% of the time.

Government actors, including the Bureau, are also able to file lawsuits to remedy aggregate harms to consumers. The Study showed, however, that private class lawsuits pursued claims that government actors typically did not. In reviewing 114 identified private consumer finance settlements in class cases, the Study was unable to identify an overlapping public enforcement proceeding in 66% of these 114 filings. With regard to the relationship between state and federal enforcement actions and private class litigation, the Study identified 740 enforcement actions filed between 2008 and 2012 by regulators in 20 states and four municipalities and counties, and another 410 cases that were filed by federal regulators. In 88% of these, the Study did not find an overlapping private class complaint. The Study also did not find that arbitration agreements led to lower prices for consumers, at least in the credit card market, subject to limitations noted in the Study.[28] The Study did not find a statistically significant difference in the differences in total cost of credit to consumers between four large credit card issuers that agreed to remove arbitration agreements from their consumer financial contracts as a requirement in the settlement of an antitrust lawsuit and issuers that did not agree to do so.

With respect to the few individual arbitrations that were filed with AAA, the Study found differences as compared to individual court cases with regard to filing fees, attorney representation rates, and time to completion. Filing fees for arbitrations were slightly lower than in court. In the time range covered by the Study, AAA charged $125 to file a claim under $10,000 and $375 to file a claim up to $75,000 compared to $400 to file any claim in federal court.[29] The Study also found that nearly 37% of consumers proceeded without attorney representation in the arbitration cases studied, compared to about 6% of cases filed on an individual basis in federal court.[30]

With respect to the time it takes for a consumer to resolve a dispute in arbitration as compared to court, the Study found that arbitration cases were resolved in a median of 150 days (although cases may have proceeded in court before being sent to arbitration) as compared to a median of 127 days for individual cases filed in federal court.[31]

As to outcomes in individual arbitration, the Study found that less than one third of the claims filed were resolved by arbitrators; the majority of cases ended in what may have been a settlement between the parties, rather than an arbitrator's decision.[32] In litigation, over half of the individual cases filed in federal court ended in a known settlement and another 40% resulted

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[28] Study, *supra* note 2, section 10.

[29] AAA now charges a $200 flat fee for filing all claims.

[30] The Study further showed that companies were represented by counsel in the majority of arbitration disputes. Study, *supra* note 2, section 5.5.3.

[31] The time to resolve class cases filed in court was longer than for either individual arbitration disputes or court cases, likely because class cases are more complex than individual cases. For class cases filed in federal court, the time to close was a median of just over 200 days. For class cases filed in selected state court, the time to closure was a median of 255 days for one of the years studied and 407 for the other year studied.

[32] Study, *supra* note 2, section 5.6.6.

in what may have been a settlement.[33] Of the cases resolved by arbitrators, consumers prevailed in about 20% of affirmative claims they asserted, whereas companies prevailed in about 93% of affirmative claims they asserted.[34] In federal individual litigation, consumers won a judgment against a company in 6.8% of all of the cases studied (none of the individual cases were filed by companies against consumers).[35] The Study was careful to point out, however, that these differences in outcomes could be attributable to "selection bias," the differences in the types of claims submitted for arbitral decision by consumers and companies.

Since the Study was released, the Bureau has invited feedback from and engaged with key stakeholders including through roundtable discussions with both industry and consumer groups. The Bureau continues to be receptive to input and anticipates that the SBREFA and rulemaking processes will provide further opportunities for comment from interested stakeholders.

B. Regulatory Authority

The Dodd-Frank Act gives the Bureau the authority to issue regulations that would "prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties," if doing so is "in the public interest and for the protection of consumers." Section 1028(b) also requires that "[t]he findings in such rule shall be consistent with the Study."

The Bureau believes that the proposals under consideration are consistent with the Study and meet the standards for exercise of the Bureau's rulemaking authority under section 1028(b). The Bureau seeks input regarding all aspects of the proposals, including whether they are the most effective means of furthering consumer and public interests in light of the Study and other evidence regarding use of arbitration agreements in connection with contracts for consumer financial products and services.

The Bureau anticipates that the impact of the proposals under consideration, if adopted, would vary in type and magnitude for the different types of entities covered by the proposals. The differential impact of the proposals under consideration likely would result from, among other things, variation in existing practices with regard to consumer financial contracts generally and the use of arbitration agreements specifically, as well as varying levels of exposure to consumer financial litigation and arbitration.

III. The SBREFA Process

Pursuant to the consultation process prescribed in the Small Business Regulatory Enforcement Fairness Act (SBREFA),[36] the Bureau is seeking input about the rulemaking proposals it is considering. The SBREFA consultation process provides a mechanism for the Bureau to obtain input directly from small financial services providers early in the rulemaking process about new

[33] Study, *supra* note 2, section.2.2.

[34] Study, *supra* note 32.

[35] Study, *supra* note 33.

[36] 5 U.S.C. 609(b), *available at* https://www.sba.gov/advocacy/regulatory-flexibility-act.

regulatory requirements it is contemplating. SBREFA directs the Bureau to convene a Panel when it is considering a proposed rule that could have a significant economic impact on a substantial number of small entities. The Panel includes representatives from the Bureau, SBA, and OMB. SBREFA requires the Panel to meet with a selected group of individuals who are representative of small entities that are likely to be subject to the rules that the Bureau may issue. The industries that would be covered by the proposal the Bureau is considering will be discussed in part IV.C.

During the Panel outreach meeting, small entity representatives (SERs) will provide the Panel with important feedback on the potential economic impacts of complying with proposed regulations. They may also provide feedback on regulatory options under consideration and regulatory alternatives to minimize these impacts. In addition, the Dodd-Frank Act directs the Bureau to collect the advice and recommendations of the SERs concerning whether the proposals under consideration might increase the cost of credit for small businesses and not-for-profits and concerning alternatives to minimize any such increase.[37]

Within 60 days of convening, the Panel is required to complete a report on the input received from the SERs during the Panel process. The Bureau will consider the SERs' feedback and the Panel's report as it prepares the proposed rule. Once the proposed rule is published, the Panel's final report will be placed in the public rulemaking record. The Bureau welcomes further feedback from the SERs during the public comment period on the proposed rule.

The Bureau is convening a Panel to obtain input from the selected SERs on proposals under consideration for arbitration agreements. The Bureau has prepared this Outline for the SERs in order to provide the necessary background and facilitate the Panel process. The Bureau also recommends that SERs review the Study. However, the Panel process is only one step in the full rulemaking process. No providers of consumer financial products or services will be required to comply with new regulatory requirements before a proposed rule is published, public comment is received and reviewed by the Bureau, a final rule is issued, and 180 days passes from the effective date of the regulation, as required by Dodd-Frank Act section 1028(d). One of the specific questions on which the Bureau will seek input during the SBREFA process is how long small entities would need to implement the proposals under consideration.

The Bureau is also conferring with other federal agencies, as well as tribal and possibly other governments, and is seeking feedback from a wide range of other stakeholders on the proposals under consideration.

IV. Proposals Under Consideration to Limit the Use of Pre-Dispute Arbitration Agreements

As reflected in the Study, while consumers do not typically take individual disputes concerning their agreements for consumer financial products or services to arbitration or to court, the Bureau is concerned that arbitration agreements limit aggregate relief to consumers, principally by preventing consumers from filing and participating in consumer finance class proceedings. As to the few consumer financial arbitrations that do occur, the Bureau is concerned that there is a potential for significant consumer harm if arbitration agreements were to be administered in biased or unfair ways.

[37] 5 U.S.C. 603(d).

The proposals below cover: (1) prohibiting the application of arbitration agreements as to class cases in court; and (2) requiring submission to the Bureau of arbitral disputes (*i.e.*, claims in arbitration) and awards and potentially also publication of those disputes and awards on the Bureau's website. Both of these proposals would apply to pre-dispute arbitration agreements "between a covered person and a consumer for a consumer financial product or service" as identified in part IV.C, subject to certain limited exceptions described in more detail at part IV.C.[38] The Bureau is not considering at this time a proposal that would prohibit entirely the use of pre-dispute arbitration agreements. The proposals being considered would not affect the ability of consumers and companies to agree to arbitrate disputes after they arise. The Bureau seeks feedback on all aspects of the proposals under consideration.

A. Proposals to prohibit the use of pre-dispute arbitration agreements in class litigation

1. Why is the Bureau considering proposals to prohibit the use of pre-dispute arbitration agreements in class litigation?

As noted above, the Study shows that individual consumers rarely file disputes against their consumer financial service providers, either in court or in arbitration. Survey results reported in the Study similarly show that only around 2% of consumers surveyed would consult an attorney or pursue an individual lawsuit as a means of resolving a small-dollar dispute.[39] While the Study does not address the question of *why* consumers do not file individual disputes in either forum, it may be because the amounts at stake are too small to make it rational for either the consumer or attorneys who may represent the consumer to pursue on an individual basis.[40] It may also be the case that individual, unrepresented consumers are unable to detect that their financial services provider has acted in a manner that may give rise to a legal claim.[41]

The Bureau recognizes that informal dispute resolution systems exist at companies to address some individual disputes about which consumers are aware.[42] However, companies' informal systems are voluntary and are primarily designed to benefit those consumers who pursue them. Many more consumers may be harmed by the same wrongful practice without realizing it or

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[38] Covered financial products and services are defined in Dodd-Frank Act section 1002(15)(A), subject to limitations and exceptions set forth in sections 1002(15)(B)-(C), 1027, and 1029 of the Act.

[39] Study, *supra* note 2, section 3.4.2.

[40] *See, e.g.*, *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) ("The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.") (Emphasis in original.)

[41] For example, most consumers lack expertise to identify violations of antitrust law or to detect systemic widespread discrimination that might violate federal or state law.

[42] Consumers can also opt to submit a complaint to the Bureau about certain consumer financial goods and services. Complaints benefit the public and the financial marketplace by informing the Bureau's work; however, the Bureau's informal complaint system is not a substitute for consumers' rights to bring formal disputes. Consumer Financial Protection Bureau, *Submit a Complaint*, at http://www.consumerfinance.gov/complaint/.

without filing their own disputes. An obvious drawback of such an approach for consumer protection is that companies can choose not to resolve disputes raised by customers who complain or can resolve disputes with those customers while maintaining practices that violate the law or harm consumers who never complain. Indeed, the Study showed that at least for the class case settlements concerning banks' checking account overdraft policies, informal dispute resolution did not provide relief to many consumers harmed by the overdraft policies.

Given the relatively few disputes filed by individual consumers and the inherent limits of informal dispute resolution, the Bureau believes that existing avenues of aggregate legal relief should be available to consumers who may be harmed by their consumer financial service providers. The Bureau believes that the availability of such avenues for consumers not only facilitates relief in specific cases, but also strengthens incentives for consumer financial service providers to engage in robust compliance and customer service on an ongoing basis. While the Bureau and other government actors can and do file lawsuits against companies that cause harm to large numbers of consumers, government resources to pursue such lawsuits are limited.

A common form of aggregate relief for consumers is private class litigation. Class litigation procedures were developed in part because "the amounts at stake for individuals may be so small that separate suits would be impracticable."[43] Indeed,

> [t]he policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her own rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.[44]

For this reason, class cases are particularly relevant in consumer financial markets where it is less likely for any individual consumer to incur large losses as a result of a particular common practice even though, in aggregate, losses may be substantial.[45] Indeed, a number of the federal consumer financial protection laws administered and enforced by the Bureau explicitly acknowledge the relevance of private enforcement under class litigation by including these remedies in their statutory scheme.[46] Most class cases also provide finality to companies because settlements or judgments that occur in class cases bind consumers who have not opted out. This, in turn, can, for example, reduce the likelihood of a public enforcement action or the magnitude of relief paid in any such actions that are brought.

Class cases can provide significant relief to consumers who have been harmed by their consumer financial service providers. Conservatively, the Study found settlements in class cases provided,

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[43] 1966 Adv. Comm. Notes, 28 U.S.C. App., p.698.

[44] *Amchem Prod., Inc. v. Windsor*, 521 U.S. 591, 617 (1997) (*citing Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)).

[45] *See, e.g.*, *In Re Checking Account Overdraft Litig.*, MDL 2036 (consolidated class claims against financial institutions for posting transactions from highest-to-lowest transaction size the banks thereby causing consumers to pay more in overdraft fees than they would have had the transactions been posted in a more neutral order).

[46] *See, e.g.*, the Electronic Fund Transfer Act, 15 U.S.C. 1693f(e); the Fair Debt Collection Practices Act, 15 U.S.C. 1692k(a)(2)(B); the Truth in Lending Act (including the Consumer Leasing Act and the Fair Credit Billing Act), 15 U.S.C. 1640(a)(2)(B); and the Equal Credit Opportunity Act, 15 U.S.C. 1691e(b).

in federal courts alone, $540 million in gross relief to at least 34 million consumers per year on average over a five-year period.[47] Class litigation settlements sometimes also require behavior changes on the part of defendants (*i.e.* agreements to stop the allegedly harmful conduct at issue) and, through public attention on these cases, arguably affect or influence the business practices of companies more broadly. The Bureau believes that class cases may improve industry compliance with the law to the extent the threat of class litigation deters companies from engaging in conduct that could violate consumer protection laws or their contracts with consumers.

Arbitration agreements can be and are used to dismiss class cases that consumers file in court. As noted, the Study shows that at least tens of millions of consumers have consumer finance contracts that contain arbitration agreements. The Study further shows that most arbitration agreements can be used to move class lawsuits from court to arbitration, where class proceedings are typically prohibited under the arbitration agreement.[48] Companies often successfully use arbitration agreements in consumer financial class litigation cases filed in court to block access to any form of class proceeding (and thus class relief) for those claims.[49] For example, in cases involving credit card issuers with arbitration agreements, the Study found that credit card issuers known to have arbitration agreements used them to move for stay or dismissal of the case in 65% of the class litigation cases.[50] The Study found over 100 examples of federal court consumer finance class cases dismissed or stayed on the basis of an arbitration agreement since 2010 alone – preventing virtually all of the consumers who may have been part of those classes from pursuing classwide relief to which they may have been entitled under the law or the terms of their contracts. In addition, it is likely that some class cases were never filed in the first instance because attorneys aware of arbitration agreements and the existing case law knew that they had little chance of being allowed to pursue the case. Moreover, as the Study showed, consumers rarely choose to file individual arbitrations instead.

The Bureau understands that class lawsuits have been subject to significant criticism that regards them as an imperfect tool that can be expensive and cumbersome for all parties. However, the Bureau notes that Congress, state legislatures, and the courts have mechanisms for managing and improving class procedures over time. On balance, the Bureau believes that consumers are significantly better protected from harm by consumer financial service providers when they are able to aggregate claims. Accordingly, the Bureau believes that ensuring that consumers can pursue class litigation related to covered consumer financial products or services without being curtailed by arbitration agreements protects consumers, furthers the public interest, and is consistent with the Study.

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[47] This total is a conservative estimate because it does not include the value of companies' agreements to change their behavior.

[48] Specifically, the Study reports that 93.9% of the credit card arbitration agreements, 88.5% of the checking account arbitration agreements, 97.9% of the prepaid card arbitration agreements, 88.7% of the storefront payday loan arbitration agreements, 100.0% of the private student loan arbitration agreements, and 85.7% of the mobile wireless arbitration agreements in our sample contained terms that expressly prohibit arbitration from proceeding on a class basis. Study, *supra* note 2, section 2.5.5.

[49] *See, e.g.*, Study, *supra* note 2, section 6.7.2. Except for the analysis of cases against credit card issuers, the Study was not able to determine what percentage of cases involved a claim in which an arbitration agreement existed and which could have been relied upon in a motion to compel arbitration. Nevertheless, such motions to compel arbitration are filed in far greater proportion of class litigation cases (16.7%) than federal individual cases (less than 1%).

[50] *Id*.

2. Requirement that pre-dispute arbitration agreements provide they are inapplicable to class litigation

To address the concerns discussed above, the Bureau is considering a proposal to require any arbitration agreement included in a contract for a consumer financial product or service offered by an entity subject to the proposals to provide explicitly that the arbitration agreement is inapplicable to cases filed in court on behalf of a class unless and until class certification is denied or the class claims are dismissed. As specified by the Dodd-Frank Act and discussed in more detail in part IV.C below, this requirement would apply to arbitration agreements entered into at least 180 days from the effective date of any regulation.[51] The Bureau expects that such a proposal would include model or mandatory language that companies can include in arbitration agreements to comply with a rule. The Bureau believes that this approach would prevent companies from using an arbitration agreement to support a motion to compel arbitration in a class case, at least until class certification is denied or the class claims are dismissed.

This proposal seeks to address consumer harm caused by arbitration agreements that block consumers from filing or participating in class litigation, thereby reducing monetary and behavioral relief potentially available to consumers as well as reducing the deterrent effects from class cases.[52] As noted above, there is precedent in securities law for a rule that precludes arbitration agreements from blocking class litigation. Since 1992, the Financial Industry Regulatory Authority (FINRA), a self-regulatory organization overseen by the Securities and Exchange Commission, has required arbitration agreements adopted by broker-dealers to include language disclaiming the application of the arbitration agreement to class cases.[53]

3. Alternatives considered

As noted in part IV.B.3 below, the Bureau considered prohibiting arbitration agreements entirely. That alternative, like the proposal discussed above, would ensure consumer access to class proceedings. However, for the reasons discussed below, the Bureau is not considering that proposal.

The Bureau considered an alternative proposal to address consumers' access to class proceedings. That alternative would have given consumer financial services providers discretion to use arbitration agreements that required that class proceedings be conducted in arbitration instead of court, provided those arbitration proceedings satisfied minimum standards of fairness. Put another way, the alternative proposal would have prohibited companies from using their arbitration agreements to block class proceedings altogether, but would have allowed them unilaterally to choose whether such proceedings were conducted in court or administered in arbitration.

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[51] The effective date is discussed in greater detail below in part III.C.

[52] As discussed in more detail in part IV.A.3 below, this proposal would not prohibit an arbitration agreement from allowing class arbitration in addition to class litigation.

[53] FINRA Rule 2268(f). FINRA, formerly the National Association of Securities Dealers, also serves as an arbitral administrator for disputes concerning broker-dealers and its rules further prohibit broker-dealers from enforcing an arbitration agreement against a member of a certified or putative class case. FINRA Rule 12204(d). *See also* S.E.C. Release No. 31371 (1992) (approving FINRA Rule 2268(f)).

For reference, the rules of arbitration administrators such as AAA and JAMS (another large arbitration administrator) include procedures, derived from class action litigation procedures, for administering class arbitrations. These class arbitration procedures, discussed in the Study (Section 4.8), set out a three-step process: first, the arbitrator determines whether the arbitration agreement authorizes class arbitration; second, if the arbitration agreement authorizes class arbitration, the arbitrator determines whether a class should be certified, applying similar standards to those used in class litigation in court; third, if a class is certified (and the case does not settle), the arbitrator proceeds to resolve the case on the merits, resulting in a binding arbitration award.[54] A court may review decisions of the arbitrator only on limited grounds, as described in the Study.

There is little evidence, however, that these class arbitration rules have been widely applied in the resolution of consumer finance disputes. The Study found only two class arbitrations filed in AAA between 2010 and 2012 relating to the credit card, checking account/debit card, payday loan, prepaid card, private student loan, and auto loan markets. For this and other reasons, the Bureau rejected consideration of such an alternative proposal allowing companies to require class arbitrations for consumer finance claims because it is not confident that class arbitration is a reliable setting for aggregated resolution of consumer finance claims. The Bureau has reason to believe that few, if any, companies would choose to adopt arbitration agreements that permit class arbitration, rather than class litigation were the Bureau to adopt this option. Indeed, the Study noted that most arbitration agreements with class arbitration prohibitions also contain an "anti-severability" provision stating that if a court concludes that the no-class arbitration provision is not enforceable, the entire arbitration agreement also should be deemed to be unenforceable to prevent a court or arbitrator from mandating class arbitration, thereby demonstrating that companies have effectively chosen class litigation in court over class arbitration. Relatedly, industry groups have expressly stated that class litigation is preferable to class arbitration. For example, in response to the Bureau's 2012 Request for Information, an industry trade association contended that, if forced to submit to class arbitration, industry uniformly would abandon arbitration agreements – thereby risking exposure to class litigation instead.[55]

Notwithstanding these concerns about class arbitration, the Bureau notes that the proposal being considered would permit an arbitration agreement that allows for class arbitration provided a consumer could not be forced to participate in class arbitration instead of class litigation. In other words, an arbitration agreement that allowed a consumer to choose whether the claim is filed in a class case in court or in arbitration would be permissible under the proposal (but one that permitted the claim to only be filed in arbitration would not be permissible).

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[54] Under the AAA procedures, the party filing the class arbitration pays a preliminary filing fee of $3,350 for the first step of the case. If the case proceeds past the first step (determination as to whether the arbitration agreement permits class arbitration), the party filing the case also pays a supplemental filing fee. If the case proceeds to the third stage (following class certification), the arbitrator can allocate administrative fees for the arbitration based on the law and the arbitration agreement.

[55] *See also* Brief for Chamber of Commerce of the United States of America as Amicus Curiae in Support of Plaintiff-Appellants, *Marriott Ownership Resorts, Inc. v. Sterman*, No. 15-10627 at 9 (11th Cir. Apr. 1, 2015) ("Class arbitration is a worst-of-all-worlds Frankenstein's monster: It combines the enormous stakes, formality and expense of litigation ... with exceedingly limited judicial review of the arbitrators' decisions.").

B. Proposals to impose conditions on the use of pre-dispute arbitration agreements by requiring submission of arbitral claims and awards

1. Why is the Bureau considering proposals to condition the use of pre-dispute arbitration agreements by requiring submission of arbitral claims and awards?

The benefits and drawbacks of arbitration in individual proceedings, as well as the frequency of individual arbitration, have long been contested. The Bureau believes that the Study provides the most comprehensive data on individual consumer financial arbitration frequency and outcomes to date.

The Study found that filing an arbitration case is slightly less costly than initiating a case in federal court and that the time to resolution in arbitration is similar to the time to resolution of an individual case filed in federal court.[56] As to outcomes, the Study found that consumers prevailed on affirmative claims significantly less often than companies in arbitration, although the Study does not establish whether this is because of the types or relative merits of claims brought in arbitration by both consumers and companies.

It is important to note that the Study was limited to cases handled by AAA between 2010 and 2012; the Study did not review arbitrations administered by other firms during other periods. For example, the Study noted but did not review individual arbitrations administered by the National Arbitration Forum (NAF), which for a number of years prior to the period covered by the Study was the predominant administrator of consumer finance arbitrations. NAF primarily handled debt collection disputes, including 214,000 consumer arbitrations in 2006 alone. The Minnesota Attorney General filed suit against NAF in 2009 alleging state law fraud and other claims arising from allegations that NAF shared common ownership with a number of firms that filed debt collection claims before it. As is noted above, NAF agreed to permanently stop handling consumer arbitrations to resolve this litigation. Afterwards, both AAA and JAMS voluntarily stopped accepting debt collection disputes unless the consumer agreed to arbitration after the debt collection dispute arose. However, AAA and JAMS could end their voluntary moratoria at any time or entities could choose other providers.

The Bureau believes that there is a potential for consumer harm if arbitration agreements were to be administered by biased administrators (as was alleged in the case of NAF) or individual arbitrations were otherwise conducted in an unfair manner. Thus, the Bureau is considering a limited intervention that would serve to deter the emergence of such unfair arbitrations and also to shed sunlight on any unfairness that might emerge, while at the same time would impose minimal regulatory burdens on current arbitration activity.

[56] The time to close for class court cases, though, is longer than for both individual arbitrations and individual court cases.

With respect to claims, the Bureau is considering collecting them, as well as potentially publishing them on its website. The collection of claims would permit the Bureau (and the public, if the Bureau chose to publish them) to monitor arbitrations on an ongoing basis and to identify trends in arbitration proceedings (such as changes in the frequency with which claims are filed or to the subject matter of the claims filed). The monitoring and publication of claims further could assist the Bureau and the public in identifying potentially problematic business practices that harm consumers, particularly since many claims settle before an award is rendered.

As to submission of awards, the Bureau is similarly considering publishing them on its website . The Bureau believes that the submission requirement under consideration would prevent the types of harm outlined above and that publication would provide transparency as to how different arbitrators decide cases, signaling to attorneys for consumers and companies which sorts of cases favor and do not favor consumers, in order that better pre-arbitration case assessment can take place.[57] Making awards public may also generate public confidence in the arbitrators selected for a specific case as well as the arbitration system, at least for administrators whose awards tend to demonstrate fairness and impartiality. While the Bureau does not expect that arbitral awards would be deemed precedential in a court or arbitration, publication may help develop understanding of the facts and law at issue in those disputes. Consumers, public enforcers, and plaintiffs' attorneys could review the published information for trends that warrant further action.

2. Requirement to submit arbitral claims and awards to the Bureau

The Bureau is considering a proposal to require covered entities that use arbitration agreements in their contracts with consumers to submit initial claim filings and written awards in consumer finance arbitration proceedings to the Bureau through a process the Bureau would expect to establish as part of this rulemaking. The Bureau is also considering whether to publish the claims or awards to its website, making them available to the public. Before collecting or publishing any arbitral claims or awards, the Bureau would ensure that these activities comply with privacy considerations. This aspect of the proposal under consideration would not require changes to be made to the text of companies' arbitration agreements, alter the conduct of arbitration proceedings, or impose requirements on the content of written awards and, as discussed below in part V, would impose minimal costs on covered entities.

Currently, the two main administrators of consumer financial arbitrations do not require publication of claims or awards in matters between consumers and providers of financial services. Specifically, AAA does not currently require publication of consumer claims or awards although it "may choose to publish an award."[58] JAMS also does not publish its claims or

[57] The Bureau already publishes narratives and outcomes data concerning consumer complaints filed with the Bureau. The Bureau has stated that it "believes that greater transparency of information does tend to improve customer service and identify patterns in the treatment of consumers, leading to stronger compliance mechanisms and customer service. . . . In addition, disclosure of consumer narratives will provide companies with greater insight into issues and challenges occurring across their markets, which can supplement their own company-specific perspectives and lend more insight into appropriate practices." Consumer Financial Protection Bureau, Disclosure of Consumer Complaint Narrative Data, Docket No. CFPB-2014-0016, at 14 (Mar. 12, 2015). Similarly, the Bureau understands that state law data requirements generated information used to identify certain problematic practices in NAF.

[58] AAA Rule R-43(c).

awards. (NAF also did not publish these items when it administered consumer arbitrations.) Arbitration administrators are, however, currently required to publish data about certain consumer finance arbitrations (although not the awards themselves) pursuant to California law.[59]

Some arbitration providers already require publication of awards for disputes concerning matters other than consumer finance. A self-regulatory organization, FINRA, requires publication of all awards in disputes between customers and broker-dealers and publishes them on its public website.[60] In addition, AAA requires the publication of awards in all employment arbitrations and awards and dockets for all class arbitration proceedings before it.

It is important to note that the proposal under consideration would apply equally to individual arbitration proceedings and any arbitration that could proceed on an aggregated basis. Consumer financial class arbitrations may occur, whether because the parties agree to them post-dispute or because an arbitration agreement that allows a consumer to choose whether to file a class case in court or in arbitration would be permissible under the proposal, as is discussed in part IV.A. Particularly in light of the concerns raised about class arbitration, this data would also be helpful to the Bureau, consumers, companies, and possibly to other regulatory entities and academics who study consumer finance.

3. Alternatives considered

The Bureau considered alternative proposals to address individual arbitrations, including prohibiting the use of arbitration agreements in individual cases outright or requiring arbitration agreements to specify use of arbitration administrators that have procedures to ensure that individual arbitrations are administered in accordance with principles of fundamental fairness. The Bureau is not considering a proposal to prohibit arbitration agreements or to require safeguards for fundamental fairness for individual disputes at this time. The Bureau is not doing so because the evidence obtained thus far, including evidence analyzed in the Study, shows that few individual consumer finance claims are administered now and is inconclusive due in part to the low number of claims resolved in arbitration.[61] Further, the proposal to require submission of claims and awards which the Bureau would consider publishing may be sufficient to protect consumers from the risk of harm that may occur without mandated safeguards.

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[59] Cal. Civ. Proc. Code § 1281.96 (requiring administrators of consumer arbitrations in California to publish at least quarterly 12 data points on each arbitration). A recent study indicated that many arbitration administrators in California did not comply with the requirement or only partially complied. David J. Jung, *et al*., Reporting Consumer Arbitration Data in California: An Analysis of Compliance with California Code of Civil Procedure Section 1281.96 (Dec. 2013), *available at* http://gov.uchastings.edu/docs/arbitration-report/2014-arbitration-update.

[60] FINRA Code of Arb. Proc. for Customer Disputes, Rule 12904(e) (requiring publication of the parties' names); Rule 12904(h) ("All awards shall be made publicly available."). All FINRA arbitrations are on a searchable database. FINRA Arbitration Awards Online at http://finraawardsonline.finra.org/.

[61] With respect to the alternative of prohibiting the use of arbitration agreements in individual cases, the Bureau believes that the cost of such an alternative to small entities would be comparable to the cost of the proposals under consideration or less, because the effect of both would be the same as to class proceedings and there are relatively few individual consumer finance cases in either arbitration or litigation.

In rejecting these alternative proposals at this time, the Bureau notes that further interventions, up to and including prohibiting the use of arbitration agreements in all cases, may become appropriate. One benefit among others of the submission requirement being considered is that the Bureau can more effectively monitor arbitrations to determine if such regulation is needed in the future.

C. Effective Date and Coverage

1. Effective Date

As directed by the Dodd-Frank Act, the Bureau anticipates that the proposals, if adopted, would become operative no earlier than 180 days after the effective date of a final rule.[62] The Bureau currently contemplates setting an effective date of 30 days after the rule is published. Thus, the Bureau anticipates that such a rule would not apply to arbitration agreements entered into before 210 days after a rule is published by the Bureau. The Bureau seeks input from the SERs on the feasibility of complying with the proposals under consideration in that timeframe. Specifically, the Bureau seeks input on how and when contracts containing arbitration agreements are created and distributed and whether such practices might make compliance by the proposed effective date difficult. This input would then determine whether the Bureau should consider an alternative (*i.e.*, longer) compliance date for all entities or for some or all small entities in particular that would be covered by the proposal under consideration.

2. Coverage

Small entities that might be affected by this rulemaking within the meaning of SBREFA include those that provide the following financial products or services for consumer purposes, as defined in Dodd-Frank section 1002 and subject to the limitations in Dodd-Frank sections 1027 and 1029,:

- extensions of credit by a creditor or credit card issuer under the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the Bureau's Regulation Z (12 CFR Part 1026), or by a creditor under the Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.) and the Bureau's Regulation B (12 CFR Part 1002), or the brokering, servicing, acquiring, or purchasing of any such credit, extending or brokering automobile leases as defined in Bureau regulations (to be codified at 12 CFR 1090.108), or providing debt relief services for such credit or automobile leases under the Telemarketing Sales Rule (16 CFR Part 310); and
- accounts with depository institutions under the Truth in Savings Act (12 U.S.C. 4301) and the Bureau's Regulation DD (12 CFR Part 1030) and the National Credit Union Administration's implementing regulations (12 CFR Part 707); and
- products or services subject to the Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) and the Bureau's Regulation E (12 CFR Part 1005), transmitting or exchanging funds under Dodd-Frank Act section 1002(15)(A)(iv), or check cashing under Dodd-Frank Act section 1002(15)(A)(vi); and

[62] Dodd-Frank Act section 1028(d) ("Notwithstanding any other provision of law, any regulation prescribed by the Bureau under subsection (b) shall apply, consistent with the terms of the regulation, to any agreement 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 the Bureau.").

- obtaining information from a credit reporting agency as defined in the Fair Credit Reporting Act (15 U.S.C. 1681 et seq.) for the purposes of monitoring, on behalf of the consumer, the consumer's credit; and
- collecting debt related to any of these consumer financial products or services.

This includes but is not limited to banks, credit unions, credit card issuers, certain auto lenders, small-dollar or payday lenders, auto title lenders, installment and open-end lenders, private student lenders, providers of other credit in certain other contexts, loan originators that are not creditors, providers of credit in the form of deferred third-party billing services, providers of certain auto leases for at least 90 days, servicers of covered credit and auto leases, remittance transfer providers, providers of domestic money transfer services or currency exchange, general-purpose reloadable prepaid card issuers, certain providers of virtual currency products and services, check cashing providers, credit service/repair organizations, debt settlement firms, providers of credit monitoring services, and debt buyers.

The Bureau is also considering whether to cover additional consumer financial products and services; for example, payment processing. The Bureau is considering excluding from its proposed regulation products or services that are in any of the following categories: (1) already subject to arbitration rules issued by the Securities and Exchange Commission or the Commodity Futures Trading Commission,[63] (2) provided by persons when not regularly engaged in business activity (*e.g.*, an individual who may loan money to a friend), (3) provided by the federal government; (4) provided by state, local, and tribal governments and government entities to persons in their jurisdiction, or to persons outside their jurisdiction if not credit that is subject to the Truth in Lending Act or Regulation Z; and (5) credit a business extends for the consumer's purchase of its own nonfinancial goods or services when covered by Dodd-Frank Act section 1027(a)(2)(B)(ii). The Bureau is still evaluating whether regulatory action is warranted in these categories of activity, but does not want to delay action with regard to the operation of arbitration agreements in contracts for other types of consumer financial products or services in the meantime.

The Bureau seeks input on whether it should cover consumer financial products or services that are subject to other consumer laws and regulations or activities under a broader set of laws over which the Bureau has some authority. The Bureau further seeks input on each of these exclusions under consideration and also on whether additional consumer financial products or services should be excluded from the proposals under consideration.

V. Potential Impacts on Small Entities

A. Overview

The Regulatory Flexibility Act (RFA) generally requires an agency to carefully consider the economic impacts rules will have on small entities.[64] For purposes of the RFA analysis, the proposal the Bureau is considering may apply to those covered persons providing the consumer financial products or services outlined in part IV.C.2 above.

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[63] *See generally* FINRA Code of Arbitration Procedure (subject to review and approval by the SEC); *see also* 17 CFR 166.5(b) (CFTC regulations implementing Commodity Exchange Act and requiring that arbitration agreements be voluntary).
[64] 5 U.S.C. 601.

In order to estimate the potential impacts on small entities the Bureau needs to both ascertain the number of covered entities that are small entities and the percentage of these entities that have arbitration agreements, realizing that these percentages might vary across markets.[65] The entities to which the proposals under consideration might apply can be roughly subdivided into two categories. The first category is comprised of entities that primarily provide consumer financial products or services. For example, a bank that issues credit cards and provides checking accounts or an entity that provides payday loans would generally fall into this category because providing that product or service is the entity's primary business. The second category is comprised of entities that provide consumer financial products or services ancillary or incidental to the provision of nonfinancial goods or services. For example, a college that provides financial advice to its students or a seller of nonfinancial goods or services providing deferred third-party billing services would generally fall into this category.

The Study provided the proportion of entities that currently have arbitration agreements in their contracts in a subset of the markets that have covered entities: credit cards, checking accounts, general purpose reloadable prepaid cards, payday loans, private student loans, and mobile wireless third-party billing. In terms of the categorization described above, five are primary consumer financial product and service providers and one provides financial products or services ancillary or incidental to nonfinancial services. For other markets, anecdotal data that the Bureau has obtained suggests that at least some of these covered persons use arbitration agreements. The Bureau continues to analyze public data sources and other publicly available information, but has not arrived at an estimate of the percentage of entities that use arbitration agreements in these other markets. In connection with this SBREFA process, the Bureau seeks data from market participants on the prevalence of arbitration agreements in contracts for these products or services among small entities and on whether these arbitration agreements contain provisions that effectively prohibit class proceedings.

As noted above, the Dodd-Frank Act prohibits arbitration agreements in mortgage lending credit agreements. The prevalence of arbitration agreements in mortgage agreements was small for at least a decade prior to the passage of the Dodd-Frank Act, partially stemming from the Government Sponsored Entities' policies to not purchase residential mortgage contracts that contained arbitration agreements. Thus, although the Bureau is not considering an explicit exemption for residential mortgage lending, the Bureau does not expect this market to be impacted, except with respect to participants in the market who are not party to the credit agreement.

The Bureau believes that affected entities generally could face three types of costs from the proposals under consideration with respect to class arbitrations: (1) administrative costs due to a requirement that covered entities update their contracts to revise arbitration agreement language that otherwise would not comply with the Bureau's proposal (*i.e.* to include language in new agreements providing that arbitration agreements do not apply to cases filed on a class basis), (2) costs related to additional potential liability due to class litigation exposure (including defense costs, court costs, substantive settlement and damages exposure), and (3) increased cost of compliance with existing consumer finance and other laws and other costs due to entities attempting to minimize any such additional class litigation exposure in the future. The three types of costs are described in more detail below. The Bureau seeks SERs' input on each cost, as well as any other costs that affected entities might face.

[65] See Section 2 of the Study, *supra* note 2, where the Bureau analyzed the prevalence of use of arbitration agreements in several markets.

The Bureau is also considering a proposal that would require covered entities to submit to the Bureau arbitral awards and initial claim filings for any arbitration in connection with consumer financial products or services in which the covered entity is involved. The Bureau would then consider publishing information regarding the awards and the claims on its website. Given the current low prevalence of individual arbitrations as noted in the Study, the Bureau believes that this requirement imposes a negligible cost on each entity that includes arbitration agreements in its contracts. The vast majority of the entities covered are unlikely to face this cost at all – the Bureau counted individual arbitrations administered yearly in major markets in the major administrator (AAA) to be in the hundreds in total. This number included individual arbitrations involving entities above the SBA thresholds that delineate small entities for the purpose of the RFA and SBREFA. For the few small entities that would be directly affected because they participate in an arbitration proceeding, they likely would be required to send the Bureau an electronic file with documents that the entity already possesses. The Bureau seeks input on this cost, but believes that it is less than $100 per individual arbitration and that most small entities will not be participating in any consumer finance arbitrations in a given year. The Bureau further seeks input on whether a redaction requirement would materially impact this cost.

In theory, some of the costs of this rule might be passed from covered entities through to their customers. For example, credit card issuers might increase their interest rates or fees in response to the costs identified above. However, the Bureau's detailed analysis of data regarding credit card issuers in the Study did not find statistically significant evidence of that occurring. The Bureau nonetheless seeks input, particularly any empirical evidence, on the proportion of the costs the entities expect to pass through to consumers, either in terms of higher prices or in other ways (for example, lower quality products).

Entities that do not currently use arbitration agreements in their consumer financial products or services might benefit from this rulemaking. Such entities may tend to prioritize compliance and customer service investments to manage their litigation risk, but find that the costs of that approach put them at a competitive disadvantage relative to companies that simply rely on the clauses as a shield. The rule could create a more level playing field that would tend to encourage their competitors to make similar investments. Furthermore, certain statutes actually limit liability for companies that fail to comply with the statute notwithstanding valid efforts to comply, thus rewarding companies that invest more in compliance.[66]

B. Administrative cost of including new language in future contracts between covered persons and consumers

[66] *E.g.*, Truth in Lending Act, 15 U.S.C. § 1640(c) ("A creditor or assignee may not be held liable in any action brought under this section or section 1635 of this title for a violation of this subchapter if the creditor or assignee shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error."); Fair Debt Collection Practices Act, 15 U.S.C. § 1692k(b) (requiring a court to consider whether a debt collector's noncompliance was "intentional" in determining liability).

As is noted above, arbitration agreements are typically included in contracts between covered persons and consumers for consumer financial products or services. In many cases, these contracts are provided in writing to consumers either in paper or online, but in some cases are posted in a storefront when consumers contract for a new product or service. If the Bureau adopts the proposals being considered, affected small entities would be required to include new language in the standard-form contracts used starting at a certain point in the future – *i.e.*, those contracts with arbitration agreements entered into after approximately 210 days after any rule is published. (Arbitration agreements already entered into would not need to be changed or amended.) This model or Bureau-mandated language would provide that the arbitration agreements cannot be applied to class litigation. For the reasons listed below, the administrative cost of including this new language in the affected form contract is difficult to ascertain in the abstract, without asking small entities for relevant data. Accordingly, the Bureau seeks input on the administrative cost of including this new language in the affected form contracts that a given small entity would use in the future for covered consumer financial services or products. In addition, whether entities choose to maintain arbitration agreements under the rule may vary significantly. For example, some entities may use arbitration agreements strictly to manage class proceeding risk and may remove them if the Bureau were to adopt the proposal under consideration, while others may also value the ability to use them in individual disputes and thus will continue to use them. The Bureau therefore also seeks input on the extent to which entities would choose to remove arbitration agreements from their contracts entirely as opposed to including new language in arbitration agreements they use in the future, and the cost of doing so.

There may be a number of different factors affecting this administrative cost. One factor is what type of labor the small entity deploys to add new language to such contracts. For example, an employee could simply insert the Bureau's model language into a version stored on a computer system. The small entity may use an in-house or outside vendor in this process, such as a lawyer, form provider, or other type of vendor. These services may be provided as part of a larger suite of services provided by the vendor (and thus the small entity may incur no charge to implement this contract change). Overall, the Bureau believes that there will be cost differences depending on whether, for a given product, the entity is using its own (customized and internally developed) contracts or arbitration agreements or whether the entity is using a form provider's contracts or arbitration agreement.

The Bureau seeks further input on the extent to which form providers are used. Because the Bureau anticipates providing model contract language, and form providers generally serve many entities, the Bureau anticipates the form provider's cost per entity for providing a new form contract would be minimal. Nevertheless, the Bureau seeks input on what costs, if any, are involved for entities that use contracts provided by a form provider, and in particular how much additional review the entity would typically engage in after receiving an updated form contract from a provider. The affected entities might also use the language of model agreements from AAA or other arbitral administrators. The Bureau seeks input on the costs of covered persons' updating contracts that are based on such models and input on why an entity might deviate from using model language provided by the Bureau.

Additionally, an entity might have several product lines, each product line with its own contract that the entity would need to update. The entities might need to update posted terms, whether they are physically posted, or posted on a website, or made available in a mobile application. Again, costs could be impacted, as described above, by whether an entity uses its own forms or those created by a form provider.

Finally, the Bureau expects that entities will be able to use existing inventory of preprinted contracts they have, if any, before the rule is in effect. However, for some affected entities this length of time might be too short to allow it to clear out the existing inventory of contracts and other materials that would need to be updated. The Bureau seeks input on the existence and the magnitude of such costs.

C. Legal cost due to possible additional class litigation exposure

If affected entities are no longer able to use arbitration agreements to effectively terminate class litigation, those entities would likely be exposed to the possibility of additional class litigation or threats of class litigation.

In its Study, the Bureau found on average 187 class actions per year in the credit card, checking/debit card, prepaid card, payday loan, auto loan, and private student loan markets (including cases against debt collectors in these markets) filed in federal courts and a sample of state courts representing about a fifth of the U.S. population. Some companies – particularly larger firms over SBA size limits for small entities – faced multiple class actions. These cases were filed against companies that used arbitration agreements as well as companies that did not. The Study did not disaggregate the number of these cases that were filed against small entities. As a point of comparison, however, a very preliminary estimate is that there are over 40,000 small entities in these six markets.

To the extent that the adoption of the proposal under consideration would increase exposure of small entities using arbitration agreements to class litigation, these entities might incur the following directly related cost increases: legal defense costs (including attorneys' fees, court costs and expert witness fees), settlement costs, and the costs attributable to the time that management and staff of the affected entity would have to spend dealing with related matters. In the Study, the Bureau documented the incidence of class litigation in particular markets, both in federal courts as well as in a sample of state courts. The Bureau is seeking input on: (1) the prevalence of actual filed or threatened class cases against affected small entities and whether the proposals under consideration would alter that prevalence, (2) costs related to defending against a class case, and (3) other possible costs associated with a potential increase in the incidence of class cases. This last category of costs could include, for example, expenditures that occur before a case is filed. While the Study documented the settlement amounts in federal class litigation settlements, such settlements typically do not reflect both the defendants' own legal defense and court costs and the opportunity costs of the defendants' employees' time spent on class litigation.

The Bureau continues to seek input and data on these costs.[67] Specifically, wages for in-house lawyers and support staff and, where used, outside defense lawyers vary widely by geography,

[67] In response to the Bureau's 2012 Request for Information, several industry trade associations noted that calculating defense costs may be difficult, if not impossible, because most businesses do not track such costs separately. Another industry trade association did, however, point to an annual survey of firms relating to class action defense costs. *See* Carlton Fields Jorden Burt 2015 Class Action Survey, available at http://classactionsurvey.com. That survey states that it covers "350 companies of all sizes," and it did not break out defense costs for small entities. The survey also covered cases of varying types (consumer fraud and other types, such as securities class actions), and did not contain data on the cost of retaining

skill level, practice area, and size of firm, among other variables. According to a survey by a legal consultancy, small companies (with revenue up to $25 million) pay in-house attorneys a salary between $81,500 and $181,000 and paralegals/legal assistants between $41,250 and $75,250 depending on experience.[68] Outside law firms may utilize paralegals/legal assistants, associate attorneys, partner attorneys, or some combination of these on a given matter. One recent survey found that during 2014 the average hourly rate charged by a law firm partner in a general litigation practice was $350, and the average hourly rate charged by a law firm partner practicing in the area of finance, loans, and investments was $450.[69] Another survey found that associates charge average rates between $274 and $400 depending on the size of the firm.[70] Another survey found that paralegal/legal assistant hourly rates ranged between $60 and $170.[71] Use of alternative fee arrangements, as well as fee caps, also may be increasing and may further vary costs incurred in defending class proceedings.

As to how long class cases take to defend, the Study reported data at Table 7 of Section 6, finding the median time to closure for closed class cases analyzed in the Study was 218 days. Class cases closed after a non-class settlement or potential non-class settlement (68% of the closed class cases cases) took a median of less than 200 days. Cases resulting in final approval of class settlements closed in a median of 670 days.

The Bureau is further interested in the breakdown of settlement costs in class litigation. In particular, the proportion of costs that goes to pay the class members themselves. The Study sheds some light on this topic, showing that in 419 class litigations concerning consumer finance, the plaintiffs' attorney's fees were on average 21% of cash relief to the class at the time the Bureau was able to assess cash relief. The Bureau seeks further input on these costs.

To be able to measure these costs accurately, the Bureau encourages SERs to consider similar costs that the SERs presumably faced before they adopted arbitration agreements. This information will aid the Bureau in evaluating the impact of arbitration agreements on the SERs' litigation costs.

On the one hand, the proposal under consideration would prohibit an entity from blocking a class proceeding using an arbitration agreement. This may increase the incentive for consumers to file such cases. However, due to the increased potential for these cases, as discussed in part D

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outside counsel on a per-year per-case basis for the sorts of cases that affected entities might be defending.

[68] *See* Robert Half, Legal 2015 Salary Guide at 13, available at http://www.roberthalf.com/legal/the-2015-legal-salary-guide (also noting that medium size companies (annual revenue between $25 million and $250 million) pay in-house attorneys between $97,500 and $225,000). Relatedly, the Bureau of Labor Statistics reports that the median annual wage for a lawyer in the finance industry in 2012 was $134,940. *See* Bureau of Labor Statistics, U.S. Department of Labor, Occupational Outlook Handbook, 2014-15 Edition, Lawyers, available at http://www.bls.gov/ooh/legal/lawyers.htm. The mean annual wage for paralegals and legal assistants was $49,680. *See* Bureau of Labor Statistics, U.S. Department of Labor, Occupational Employment and Wages, May 2014 – 23-2011 Paralegals and Legal Assistants, available at http://www.bls.gov/oes/current/oes232011.htm.

[69] LexisNexis, 2014 CounselLink Enterprise Legal Management Trends Report at 26.

[70] ABA Journal, "A lawyer's value, hour by hour," Sept. 1, 2014, available at http://www.abajournal.com/magazine/article/a_lawyers_value_hour_by_hour/.

[71] National Association of Legal Assistants 2015 National Utilization and Compensation Survey Report, Section 3 Billing Rates, at 7-8, available at http://www.nala.org/Upload/file/PDF-Files/News-Articles/15SEC3.pdf.

below, companies may invest more in compliance to limit their exposure to class proceedings. As a result, this increased compliance may, in turn, decrease the incentive to file such cases. For these reasons, it is difficult to project frequency of future class litigation based on historical data. For reference, the Bureau believes that the expected cost of facing class litigation historically has been small for any given entity; that is, considering the low frequency of class litigation, the likelihood that any given small entity would be sued has been low. The Bureau identified fewer than 100 consumer finance class litigation settlements per year in federal court in its Study, many of which involved entities above the SBA small entity thresholds. In total, the Bureau could only find fewer than 160 class litigations filed per year in federal courts in six markets. While the Bureau could not analyze all cases filed on the state level, it did review cases filed in a set of states accounting for roughly one fifth of the U.S. population. There, the Bureau found roughly 30 cases filed per year in six markets. Also, note that the Bureau found that while 15% of the cases result in a final class settlement and an additional 2% had a class settlement pending approval as of August 31, 2014 (the latest date such outcomes were analyzed in the Study), the rest did not (at least in the time frame analyzed in the Study). For example, the most common outcome in class cases that were filed and analyzed in the Study was for a settlement or a potential settlement with the plaintiff consumer before the case was certified as a class case. The Bureau requests comments on costs related to both the cases that result in a final class settlement and to the other cases as well. These numbers include filings that involved entities above the SBA small entity thresholds; however, the numbers of small entities affected might increase to the extent that more cases are filed due to the inability of defendants to invoke arbitration agreements to effectively terminate class litigation.

Furthermore, the Bureau expects that private class litigation attorneys may have fewer incentives to file class litigation against a smaller entity than a larger entity. For example, several consumer finance statutes feature explicit damages caps which may be related to an entity's revenue, and smaller entities generally have fewer consumers, which also may limit what can be recovered.[72]

D. Possible cost due to managing any perceived risk of increased exposure to class litigation

One of the possible effects of a prohibition on the use of arbitration agreements in class litigation is that entities might take steps to decrease the risk of class litigation exposure in the future (to the extent they perceive that the proposals under consideration would create increased exposure). These adjustments could come in several forms, such as increased investments in compliance, changes to product design, increased purchase of insurance (or increased insurance premiums). The potential for a given entity to engage in some or all of these adjustments will depend upon, among other things, their existing practices and level of compliance with laws that have private remedies. These practices and compliance levels vary both within and across markets and jurisdictions.

It is difficult to quantify these costs for the proposal, in part because covered entities may each respond differently to it. Even for existing regulations, it is difficult to quantify such costs. In

[72] *See, e.g.*, Fair Debt Collection Practices Act, 15 U.S.C. 1692k(a)(2)(B) (limiting statutory damages in class actions to "the lesser of $500,000 or 1 per centum of the net worth of the debt collector."); Truth in Lending Act, 15 U.S.C. 1640(a)(2)(B) (limiting damages class actions to "the lesser of $1,000,000 or 1 per centum of the net worth of the creditor").

2013, the Bureau published a report seeking to understand the effects of compliance with parts of Regulations DD, E, P, and V on bank operations (the 2013 Report).[73] In the 2013 Report, the Bureau conducted a detailed analysis of operations at seven banks and, among other findings, analyzed how compliance with aforementioned regulations is spread across the banks' business functions depending on regulatory requirements.[74] While working on the 2013 Report, the Bureau did not find any other relevant data sources providing similar information. The 2013 Report outlined the difficulties involved in measuring the incremental cost of such compliance activities, including that financial institutions do not generally keep such statistics requiring that the data be collected through detailed personnel interviews at the financial institution that required a significant investment of time from both Bureau and institution personnel. These same difficulties arise in quantifying the cost of compliance for the proposal under consideration across the various markets that would be covered.

With respect to the potential for increased investment in compliance, there might be a one-time component of this effect, such as reviewing existing products, policies and procedures in response to a rule from the Bureau. For example, an entity might decide to go through a one-time review of its policies and procedures and staff training materials to ensure that the risks of a future class litigation exposure are minimized. This review might result in revisions to policies and related additional staff training. There might also be an ongoing component of systematic policies, reviews of procedures, and staff training to ensure a consistently low level of conduct of the type that companies perceive can create exposure to class litigation. There might also be additional expense to the extent that laws change, court decisions interpreting those laws are publicized, or new products are developed. The ongoing component could also include additional periodic personnel time spent on review of policies and procedures, additional periodic training that employees and third-party service providers must receive, as well as any outside audits or legal reviews that the entity might perform.

Another example of an ongoing component is entities' purchase of insurance that would cover some or all of the costs of class litigation. Insurance policies can vary widely in their scope, exclusions, and levels of coverage. Pricing also depends on underwriting the risk specific to the entity. Anecdotal reports suggest that general commercial liability policies may cover defense costs in some class cases, and that larger companies may seek specialized class action insurance. However, the Bureau has not found data indicating the incremental cost of insuring against consumer financial class action defense and liability costs, availability of such policies, and whether they would cover all potential class claims and related attorney's fees. The Bureau believes that while there would be some one-time upfront costs of selecting the right insurance provider, most of the cost would stem from the ongoing insurance premium payments once a company selected a policy. The Bureau seeks input on the extent that affected small entities would seek such insurance if they do not have it already and what the entities believe the payments would be if such insurance is available.

The ongoing component could also include costs due to changes in product and services. For example, an entity might decide that a particular feature of a product makes the entity more susceptible to class litigation, and therefore the entity would decide to remove that feature from the product, possibly resulting in decreased revenue. For example, lenders may abandon an

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[73] CFPB Report, "Understanding the Effects of Certain Deposit Regulations on Financial Institutions' Operations: Findings on Relative Costs for Systems, Personnel, and Processes at Seven Institutions" (Nov. 2013) (the 2013 Report), available at http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

[74] *See* the 2013 Report at 65, Table 5.

aggressive business practice for the fear that it will violate laws with private remedies. Similarly, an entity might update its product features based on external information, such as actions by either regulators or private actors against the entity's competitors. The ongoing component could also include changes to the product design process. Product design could consume more time due to additional rounds of legal and compliance review. The prohibition on the use of the arbitration agreements in class litigation could result in some products not being developed and marketed primarily due to the risk associated with class litigation. The Bureau encourages the SERs to provide specific examples of products that might not have been developed absent the ability to include arbitration agreements in their terms.

Finally, the ongoing component could also include entities investing additional resources into informal dispute resolution. Similarly, the entities could invest more in customer service in order to minimize the number of disputes arising.

E. Cost of credit to small entities

Pursuant to the RFA, the Bureau considers the impact of the proposals under consideration on the cost of credit to small entities. For several reasons, the Bureau believes that the proposals under consideration would have a minimal impact on the cost of credit to small entities. As noted in part IV.C.2 above, the Bureau is considering an exemption for credit a business extends for the consumer's purchase of the business's own nonfinancial goods or services that are covered by Dodd-Frank Act section 1027(a)(2)(B)(ii).[75] Absent such an exemption, merchants granting credit to consumers would be covered by the scope proposed above if the merchant sells, assigns, or otherwise conveys that consumer credit to a third party. Such sale, assignment, or conveyance could occur, for example, in certain types of commercial borrowing engaged in by merchants. However, due to the exemption under consideration, such merchants would not be covered on this basis. Thus the proposal would not affect the cost of credit of such merchants when they are engaged in such borrowing activities.

In addition, there is a potential for an indirect impact on the cost of credit for at least some of those small entities that would be covered by the proposal under consideration. In particular, this impact could occur for small entities that use credit cards and other financial products or services that are primarily used by consumers. However, the Bureau believes this impact would only occur to the extent any costs of the proposals under consideration are passed through to consumers. Such a pass through of costs to consumers could also affect small entities using these financial products or services because covered persons, such as credit card issuers, might not be able to perfectly price discriminate between consumers and small entities. The Bureau does not believe that this increase, even if it were to occur, would significantly impact small entities or their access to credit, but the Bureau seeks input on this question and more generally on any impact on the cost of credit to small entities.

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[75] Under the Dodd-Frank Act, the Bureau generally does not have authority to regulate credit that merchants, retailers, or other persons provide to consumers to purchase their own goods or services that are not financial in nature. However, if such merchants, retailers, or other persons sell, convey, or otherwise assign this consumer credit to a third-party (when the credit is not in default or delinquent), the Bureau does have authority to regulate such credit. *See* Dodd-Frank Act section 1027(a)(2)(B)(ii). The Bureau understands that it may be common for merchants, retailers, and other persons to make such sales, assignment, or conveyances of consumer credit as part of their business commercial borrowing arrangements. One example is through "factoring," in which a business sells its accounts receivable at a discount, in order to generate cash flow.

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The Bureau seeks input on the costs outlined above and on any related costs. Many of these costs are opportunity costs (*e.g.* management time involved and extra time spent on product design and development in additional rounds of legal and compliance review) that may be difficult to quantify. Nonetheless, the Bureau encourages SERs to attempt quantification to the extent possible and also to provide specific examples. To be able to measure these costs more accurately, the Bureau encourages SERs to consider similar costs that the SERs presumably faced before they adopted their arbitration agreements.

Appendix A: Legal Authority

Dodd-Frank Wall Street Reform and Consumer Protection Act,
Pub. L. 111-2013, 124 Stat. 1376 (approved July 21, 2010)

Sec. 1028. Authority to Restrict Mandatory Pre-Dispute Arbitration.

(a) STUDY AND REPORT.—The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.

(b) FURTHER AUTHORITY.—The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).

(c) LIMITATION.—The authority described in subsection (b) may not be construed to prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person after a dispute has arisen.

(d) EFFECTIVE DATE.—Notwithstanding any other provision of law, any regulation prescribed by the Bureau under subsection (b) shall apply, consistent with the terms of the regulation, to any agreement 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 the Bureau.

Appendix B: Glossary

Arbitration means a form of alternative dispute resolution in which a privately-appointed individual — an arbitrator — is empowered to resolve disputes that arise between the parties, including both contractual disputes and disputes under state or federal law.

Class Arbitration means a class case that proceeds in arbitration. Like other forms of arbitration, a privately-appointed individual — an arbitrator — is empowered to resolve the dispute. The arbitrator (or arbitrators) will typically first decide whether a class can be certified and then will decide the merits of the underlying dispute.

Class Proceeding or Class Case means a lawsuit that allows a large number of people with a common interest in a matter to sue or be sued as a group. In federal courts, such actions are brought in accordance with Rule 23 of the Federal Rules of Civil Procedure, which requires the party seeking class certification to demonstrate that (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class. Similar rules exist in the states that permit class cases.

Dodd-Frank Act means the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (July 21, 2010), section 1028 of which provide the Bureau with the authority to promulgate rules related to the proposals under consideration.

Pre-Dispute Arbitration Agreement means an agreement or part of an agreement that requires future disputes between the parties to the agreement to be resolved by an arbitrator. (Often referred to as an **Arbitration Agreement** in this document.)

Small Business Regulatory Enforcement Fairness Act of 1996 or **SBREFA**, Pub. L. No. 104-121 (Mar. 29, 1996), refers to the statute that establishes the Small Business Review Panel process for certain Bureau, Environmental Protection Agency, and Occupational Health and Safety Administration rulemakings.

Small Business Review Panel or **Panel** means a panel formed of representatives from the Bureau, the Chief Counsel for Advocacy of the Small Business Administration, and the Office of Information and Regulatory Affairs in the Office of Management and Budget. A Panel is convened in accordance with SBREFA when a rule under development may have a significant economic impact on a substantial number of small entities. The Panel for the Bureau's rulemaking on arbitration agreements will prepare a report of its recommendations after discussing with small entity representatives the Outline of Proposals Under Consideration and Alternatives Considered.

Small Entity means a small business, small organization, or a small government as defined by the Regulatory Flexibility Act. The size standards for classifying a business as small vary by industry and are established by the Small Business Administration.

Small Entity Representative or **SER** means a representative of a small entity who participates in the SBREFA process to provide input on costs and benefits of the proposals under consideration in a rulemaking.

Appendix D

Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Discussion Questions for Small Entity Representatives

OCTOBER 7, 2015

SMALL BUSINESS ADVISORY REVIEW PANEL FOR POTENTIAL RULEMAKING ON ARBITRATION AGREEMENTS

DISCUSSION ISSUES FOR SMALL ENTITY REPRESENTATIVES

To help frame discussion of issues and cost of credit matters in the upcoming Small Business Review Panel (Panel) meeting, we are providing this list of questions on which the Consumer Financial Protection Bureau (Bureau) seeks your advice, input, and recommendations. As you think about these questions, it would be helpful to refer to the "Outline of Proposals Under Consideration and Alternatives Considered" (Outline) enclosed with this document.[1]

The questions are designed identify the type of information that may help you to participate effectively in the discussion with the Panel and other small entity representatives. Some questions may not apply to you or your business. When a topic is relevant to you, please be prepared to discuss it based on your experience or knowledge of the experience of other small entities in your line(s) of business. It would also be useful to the discussion to provide specific examples of issues that have arisen in your business activities.

The Panel would like to understand the potential economic impacts of the proposals under consideration discussed in the Outline. The Panel's understanding would be enhanced if you provide a sense of the type and amount of any costs of complying with existing requirements, if any, as well as estimates of costs for the proposals under consideration. Some of the questions suggest ways in which you might want to consider these costs as you prepare for the general discussion. The Bureau welcomes any quantitative information you may choose to provide in response to these questions, but these questions should not be treated as data requests. While company-specific information can help the discussion, we understand that you may wish to frame your response in a manner that protects your company's proprietary information, as your responses may be included in a public report. Please note that when we ask about costs or other quantitative information, we are only looking for approximations, to the best of your knowledge; we do not need you to send us documentation. We also understand that some potentially relevant events may have occurred too long ago for you to recall, or to recall details.

A. Experience using arbitration agreements[2] and in arbitration proceedings

1. If your business includes arbitration agreements in any of its contracts for consumer financial products or services, please answer the questions a-f below. (If not, proceed to question 3, or if your business is a debt collector or debt buyer, proceed to question 2.):

    a. Which product(s) or service(s) first included an arbitration agreement and when?

[1] For background on the SBREFA process, visit http://content.consumerfinance.gov/f/201510_cfpb_fact-sheet-small-business-review-panel-process.pdf.

[2] Unless otherwise noted, we use the phrase "arbitration agreement" to refer agreements entered into with a consumer before a dispute arises.

b. For what reasons did your business begin including arbitration agreements in its contracts for consumer financial products or services. Do any reasons no longer apply? Are there other reasons for continuing to include arbitration agreements?

c. Do any of your arbitration agreements allow for class arbitration (as described in the Outline)? If any of your arbitration agreements do not, or is silent on the topic of class arbitration, please explain the reason for this.

d. For each product or service with an arbitration agreement, please indicate each method of drafting these agreements and, if known, the cost of drafting.
    i. Used employees (a lawyer or a non-lawyer or both)
    ii. Consulted outside counsel such as a law firm
    iii. Obtained standard contract language from one or more of the following (please identify each source): (1) a search on the Internet; (2) a form provider; (3) a trade association; or (4) another source.

e. Do you sell consumer accounts to third parties or use third parties to collect debts? If so, do any third parties ask that these accounts include arbitration agreements or seek to only buy debts on accounts with arbitration agreements?

f. Do you provide products or services to consumers that are not financial in nature? If so, what are these products or services, and do you provide them under the same contract that you use to provide financial products or services?

2. If your business is a debt collector or a debt buyer: Does the presence (or absence) of an arbitration agreement in a consumer credit agreement affect which accounts you collect or purchase or how you structure your services? Does it affect your charge for collecting, or the price for purchasing, accounts? If so, how? If not, why not?

3. If your business does not include arbitration agreements in any of its contracts for consumer financial products or services, has this been a deliberate choice? If so, please explain why it does not do so, including any benefits or costs from not doing so.

4. Would the proposals under consideration on class actions or individual arbitration change your business's decision to include (or not include) arbitration agreements in contracts for consumer financial products or services? Why/why not? If so, how?

5. Do you have views or data on how often your competitors include arbitration agreements in the types of consumer financial products or services that your business provides? If so, please elaborate, and note the products or services for which you have views or data.

6. How often does your business review or update terms and conditions in its contracts generally, and terms and conditions of any arbitration agreements specifically? Please describe the process and cost involved. Do you use employees, outside counsel, or standard contract language? How do you distribute these changes to consumers?

7. Has your business ever agreed to arbitrate a dispute with a consumer after the dispute arose, when there was no arbitration agreement in place before the dispute arose?

8. As far as you are aware, has your business brought a claim against a consumer in arbitration or been named as a respondent in an arbitration filed by a consumer, relating to any consumer financial products or services you provide?

9. If you answered yes to the above question, please discuss how many arbitrations there have been and provide more information about these proceedings, such as whether the case began in court, the arbitration administrator(s) used, the fees your business was asked to pay, the fees it actually paid, any other expenses incurred, how long the arbitration took (from filing through conclusion), whether the arbitrator rendered an award on the merits, and whether the award was filed publicly in a court proceeding (such as to enforce or review the award) or otherwise made public.

B. Experience with class litigation

The questions in this section ask about your business's class action lawsuit experience.

10. If your business has been named as a defendant in any class actions filed by or settled with consumers related to the products or services provided to consumers, please identify each such case of which you are aware and note the product or service involved.

11. Do you believe that any of these class actions lacked any basis in fact or law or otherwise should not have been brought? If so, please explain why.

12. Did your business file a motion with the court, based on an arbitration agreement, to compel arbitration of any of these cases? Why or why not?

13. If the product or service in these cases did not have an arbitration agreement at the time of the case, did you adopt one later? If so, why?

14. In recent years, has your business at any point been *threatened* with a class action over its consumer financial products or services? If so, please describe your experience. Did your business refer to an arbitration agreement in response to a letter threatening suit?

15. If you know, has the presence/absence of an arbitration agreement affected whether your business has faced class actions or a threat of class actions?

16. What were the impacts to your business in dealing with such litigation or the threat of it, including staff and managerial time discussing the threat and any third-party expenses (*e.g.*, attorney's fees, court costs, expert witness fees, discovery costs, etc.)? Do you believe the presence or absence of an arbitration agreement affected this? Why?

17. Do you have any data you wish to provide on the cost your business pays, or has been quoted, for insuring against defense costs or legal liabilities involving claims that might be brought by your customers? This could be general commercial liability insurance or specialized insurance that may cover some costs incurred in class actions.

18. In your experience, has the price of any insurance your business has obtained, or been quoted, varied based on whether you have an arbitration agreement?

19. Do you have any observations on our preliminary analyses of the legal costs discussion in the Outline (at pp. 27-29)?

C. Investment in compliance with consumer protection laws

The questions in this section ask about your business's costs to ensure compliance with consumer protection laws. By "consumer protection laws," we mean statutes and regulations administered by the Bureau and other federal and state laws, whether they are specific to the financial products or services your business provides, or generally applicable to consumer financial products or services such as laws on unfair and deceptive practices, fraud, torts, and contracts. By "compliance investments," we are referring broadly to the operating costs your business incurs in performing activities reasonably necessary to comply and demonstrate compliance with consumer protection laws. These costs may come in a variety of forms, such as preparing policies, procedures, and forms for consumers or personnel; researching legal requirements; consulting or hiring compliance professionals; assigning compliance duties to existing personnel; training personnel; establishing a complaint procedure and responding to consumer complaints; conducting compliance audits or reviews; or other activities.[3]

20. If your contracts for consumer financial products or services include arbitration agreements, please compare, if possible, your business's investment in compliance with consumer protection laws now with its investment in compliance before it used arbitration agreements.

    a. Did including an arbitration agreement change your business's investment in compliance with consumer protection laws?

    b. Does the arbitration agreement save your business money? If so, how? Does it affect your investment in compliance? If so, how?

21. Would the proposal under consideration change your business's investments in compliance? If so, why and how? When answering this question, please keep in mind all types of potential investment in compliance, such as additional staff time, additional managerial time, additional training time, time for additional rounds of review of documents or products, and any monetary expenses for third-party services.

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[3] For other examples, you may wish to consult the discussion of compliance costs in the Outline (at pp. 29-31) or the Bureau's 2013 study on cost of compliance with certain Bureau regulations of deposit products, available at http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

D. Alternatives considered

22. As noted in the Outline (at p. 15), one of the goals of the class proposal is to ensure compliance with consumer protection laws. Do you have views on alternatives for the Bureau to achieve this goal, such as prohibiting arbitration agreements, allowing a business to block class litigation with an arbitration agreement that makes class arbitration available (discussed in the Outline at pp. 17-18), or any other alternatives?

23. As noted in the Outline (at pp. 14-15), one of the goals of the class proposal is to ensure consumers have a way to group together to seek relief for smaller claims that typically are not pursued individually. Do you have views on alternatives for the Bureau to achieve this goal, such as prohibiting arbitration agreements, allowing a business to block class litigation with an arbitration agreement that makes class arbitration available (discussed in the Outline at pp. 17-18), or any other alternatives?

24. Do you have any observations about the alternative the Bureau has considered, as described in the Outline (at pp. 17-18 and pp. 21-22), such as prohibiting arbitration agreements in individual cases or adopting procedural rules for individual arbitration.

E. Cost of credit to small entities

25. When your business borrows money, does it use consumer products as a source of financing? For example, do personnel use a personal credit card for business expenses? Do personnel take out other types of consumer loans for business expenses? If so, please describe the types of credit used, the types of expenses funded by these loans, and generally the amount of your business's expenses that is funded by consumer loans.

26. If your business sells consumer goods or services that are not financial in nature, what amount and proportion of these sales allow the consumer to defer payment? What amount and proportion of the consumer debts in these transactions are pledged as collateral for a business loan or sold to a third party (*e.g.*, factoring)?

F. Other issues for discussion

27. Is your business subject to any other regulations that may overlap, duplicate, or conflict with the proposals under consideration? For example, are any of your financial products or services subject to Military Lending Act regulations that prohibit arbitration agreements in certain credit products provided to service members, or to Dodd-Frank Act regulations that prohibit arbitration agreements in mortgage credit agreements?

28. What would it cost your business to submit arbitration claims and awards to the Bureau, as described in the Outline (at p. 25)? Would you expect to rely on an arbitration administrator to provide this service for you? What costs would your business incur if it were required to redact consumers' personal information from arbitration filings and awards before sending them to the Bureau?

Appendix E

Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Presentation Materials

Small Entity Representative Meeting

Small Business Review Panel on Pre-dispute Arbitration Agreements | October 28, 2015

Consumer Financial Protection Bureau

Schedule

8:30–9:30 a.m.	Welcome, Introductions, and Overview
9:30—10:30 a.m.	Topic A: Proposal to Prohibit Application of Arbitration Agreements to Class Litigation Brief Overview of Proposal Discussion: Changing Agreements
10:30—10:45 a.m.	Break
10:45 a.m.—Noon	Topic A (continued) Discussion: Experience with Class Litigation and Related Defense Costs
Noon—12:45 p.m.	Working Lunch
12:45—1:30 p.m.	Topic A (continued) Discussion: Investments in Compliance with Consumer Protection Laws Discussion: Alternatives
1:30—2:30 p.m.	Topic B: Proposal to Require Submission of Arbitration Claims or Awards and Remaining Issues Brief Overview of Proposal Discussion: Experience with Arbitration Discussion: Submission Proposal Discussion: Alternatives to Submission Proposal Discussion: Cost of Credit and Other Relevant Laws
2:30—3:30 p.m.	Closing

Welcome, Introductions, and Overview

8:30—9:30a.m.

Consumer Financia
Protection Bureau

Welcome and Introductions

- Consumer Financial Protection Bureau (CFPB) Welcome and Opening Remarks
  - Meredith Fuchs, Acting Deputy Director
- Small Business Administration (SBA) Office of Advocacy Welcome and Opening Remarks
  - Claudia Rodgers, Acting Chief Counsel for Advocacy
- Introduction of SBREFA Panel
  - Dan Sokolov, CFPB (Panel Chair)
  - Jennifer Smith, SBA Office of Advocacy
  - Shagufta Ahmed, Office of Management and Budget (OMB), Office of Information and Regulatory Affairs
- Introduction of Small Entity Representatives and Agency Staff

Overview: What is SBREFA?

- The Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”) requires the CFPB to form a Small Business Review Panel to obtain advice and recommendations from small entities for proposed rules that may have a significant economic impact on a substantial number of small entities.
- A Small Business Review Panel consists of
  - the CFPB;
  - the Chief Counsel for Advocacy of SBA; and
  - the Office of Information and Regulatory Affairs of OMB.

Overview: Your Role in the Process

- At today's meeting, we seek your advice, input, and recommendations regarding the issues raised in the Discussion Questions.
- Some questions may not apply to you or your business. When a topic is relevant to you, please be prepared to discuss it based on your experience or knowledge of the experience of other small entities in your line(s) of business.
- You are not required to submit any written materials to the CFPB. Should you wish to do so, you may provide them to us today or e-mail them to nathaniel.balk@cfpb.gov no later than Monday, November 9.
- Your responses may be included in a public report, so you may wish to frame your responses in a manner that protects your company's proprietary information.

Overview: Background on the SBREFA Proposals Under Consideration

1. Require PDAAs included in contracts for consumer financial products or services offered by entities subject to the proposals to provide explicitly that they are inapplicable to class litigation.
2. Require covered entities that use PDAAs in their contracts with consumers to submit initial claim filings and written awards in consumer finance arbitration proceedings to the Bureau. The Bureau is also considering publishing claims or awards on the Bureau's website.

Topic A
Proposal to Prohibit Application of Arbitration Agreements to Class Litigation

9:30—10:30 a.m.

- Brief Overview of Proposal
- Changing Agreements (Questionnaire, Part A)

Topic A: Proposal Regarding Class Litigation

Brief Overview of Proposal

- We are considering a proposal to require any PDAA included in a contract for a consumer financial product or service offered by an entity subject to the proposals to *provide explicitly that the arbitration agreement is inapplicable to cases filed in court on behalf of a class* unless and until class certification is denied or the class claims are dismissed.
- We expect that such a proposal should include model or mandatory language that companies can or must include in PDAAs to comply with the rule.
- We believe that this approach would prevent companies from using a PDAA to support a motion to compel arbitration in a class case, at least until class certification is denied or the class claims are dismissed.

Topic A: Proposal Regarding Class Litigation

Brief Overview of Proposal

- We believe consumers are better protected, and the market is fairer for companies that comply with the law, when consumers are able to participate in group adjudications against providers of consumer financial products and services.
- The Study shows that these aggregated actions have provided significant benefits to consumers, through cash settlements and agreements by companies to stop harmful behavior. They also benefit consumers through the deterrent impact of the threat of suit, as well as settlement agreements on other companies' conduct.
- The Bureau is concerned that consumers' ability to participate in class proceedings is cut off by PDAAs, preventing many consumers from obtaining remedies when they are harmed by providers of consumer financial products or services.

Topic A
Proposal to Prohibit Application of Arbitration Agreements to Class Litigation

9:30—10:30 a.m.

- Brief Overview of Proposal
- Changing Agreements (Questionnaire, Part A)

Consumer Financia Protection Bureau

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 1

For SERs with arbitration agreements:

a. Which product(s) or service(s) first included an arbitration agreement and when?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 1

For SERs with arbitration agreements:

a. Which product(s) or service(s) first included an arbitration agreement and when?

b. For what reasons did your business begin including arbitration agreements in its contracts for consumer financial products or services? Any no longer apply? Other reasons to include?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 1

For SERs with arbitration agreements:

a. Which product(s) or service(s) first included an arbitration agreement and when?

b. For what reasons did your business begin including arbitration agreements in its contracts for consumer financial products or services? Any no longer apply? Other reasons to include?

c. Do any of your agreements allow for class arbitration? If not, why?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 1

For SERs with arbitration agreements:

a. Which product(s) or service(s) first included an arbitration agreement and when?

b. For what reasons did your business begin including arbitration agreements in its contracts for consumer financial products or services? Any no longer apply? Other reasons to include?

c. Do any of your agreements allow for class arbitration? If not, why?

d. For each product or service with an arbitration agreement, please indicate each method of drafting these agreements and, if known, the cost of drafting. (Used employees? Outside counsel? Form provider?)

Question 1

For SERs with arbitration agreements:

e. Do you sell consumer accounts to third parties or use third parties to collect debts? If so, do any third parties ask that these accounts include arbitration agreements or seek to only buy debts on accounts with arbitration agreements

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 1

For SERs with arbitration agreements:

e. Do you sell consumer accounts to third parties or use third parties to collect debts? If so, do any third parties ask that these accounts include arbitration agreements or seek to only buy debts on accounts with arbitration agreements?

f. Do you provide products or services to consumers that are not financial in nature? If so, what are these products or services, and do you provide them under the same contract that you use to provide financial products or services?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 2

<u>For debt collectors/debt buyers:</u>

a. Does the presence (or absence) of an arbitration agreement in a consumer credit agreement affect which accounts or collect or purchase or how you structure your services?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 2

For debt collectors/debt buyers:

a. Does the presence (or absence) of an arbitration agreement in a consumer credit agreement affect which accounts or collect or purchase or how you structure your services?

b. Does it affect your charge for collecting, or the price for purchasing, accounts?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 2

<u>For debt collectors/debt buyers:</u>

a. Does the presence (or absence) of an arbitration agreement in a consumer credit agreement affect which accounts or collect or purchase or how you structure your services?

b. Does it affect your charge for collecting, or the price for purchasing, accounts?

c. If so, how? If not, why not?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 3

<u>For SERs without arbitration agreements:</u>

Is not having an arbitration agreement a deliberate choice?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 4

Would the proposals under consideration on class actions or individual arbitration change your business's decision to include or not include arbitration agreements in contracts for consumer financial products or services? Why/why not? If so, how?

(a) In terms of the costs your business would face if an individual arbitration case is filed against it, do you expect these would be greater, lower, or about the same on average as the costs your business would face if an individual lawsuit is filed against it in court? Why?

- For example, we are aware that businesses must pay administrative and arbitrator fees in arbitration that are not paid in court cases (and under our proposals, a business would be required to e-mail claims and any awards to the Bureau). On the other hand, the risk of burdensome discovery (or protracted appeals) is generally understood to be lower in arbitration than in a court case.

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 4

Would the proposals under consideration on class actions or individual arbitration change your business's decision to include or not include arbitration agreements in contracts for consumer financial products or services? Why/why not? If so, how?

(b) Apart from the costs your business may incur if a case is filed against you in arbitration, are there any costs associated with maintaining the arbitration agreement you have? If so, what are these costs? How much are they and how often are they incurred?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 4

Would the proposals under consideration on class actions or individual arbitration change your business's decision to include or not include arbitration agreements in contracts for consumer financial products or services? Why/why not? If so, how?

(b) Apart from the costs your business may incur if a case is filed against you in arbitration, are there any costs associated with maintaining the arbitration agreement you have? If so, what are these costs? How much are they and how often are they incurred?

(c) In light of your answers to the above questions, do you expect you would keep your arbitration agreement if the Bureau were to adopt the proposals under consideration? Why? Why not?

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 5

Do you have views or data on how often your competitors include arbitration agreements in the types of consumer financial products or services that your business provides?

If so, please elaborate, and note the products or services for which you have views or data.

Topic A: Proposal Regarding Class Litigation

Changing Agreements (Questionnaire, Part A)

Question 6

How often does your business review or update terms and conditions in its contracts generally, and terms and conditions of any arbitration agreements specifically?

(a) Please describe the process and cost involved. Do you use employees, outside counsel, or standard contract language?

(b) How do you distribute these changes to consumers?

Break

10:30—10:45 a.m.

Topic A

Proposal to Prohibit Application of Arbitration Agreements to Class Litigation

10:45 a.m.—Noon

- Experience with Class Litigation and Related Defense Costs (Questionnaire, Part B)

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 10

If your business has been named as a defendant in any class actions filed by or settled with consumers related to the products or services provided to consumers, please identify each such case of which you are aware and note the product or service involved.

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 11

Do you believe that any of these class actions lacked any basis in fact or law or otherwise should not have been brought?

Why or why not?

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 12

Did your business file a motion with the court, based on an arbitration agreement, to compel arbitration of any such cases?

Why or why not?

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 13

If the product or service in these cases did not have an arbitration agreement at the time of the case, did you adopt one later?

If so, why?

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 14

In recent years, has your business at any point been *threatened* with a class action over its consumer financial products or services? If so, please describe your experience.

Did your business refer to an arbitration agreement in response to a letter threatening suit?

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 15

If you know, has the presence/absence of an arbitration agreement affected whether your business has faced class actions or a threat of class actions?

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 16

What were the impacts to your business in dealing with such litigation or the threat of it, including staff and managerial time discussing the threat and any third-party expenses (*e.g.*, attorney's fees, court costs, expert witness fees, discovery costs, etc.)?

Do you believe the presence or absence of an arbitration agreement affected this? Why?

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 17

Do you have any data you wish to provide on the cost your business pays, or has been quoted, for insuring against defense costs or legal liabilities involving claims that might be brought by your customers?

This could be general commercial liability insurance or specialized insurance that may cover some costs incurred in class actions.

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 18

In your experience, has the price of any insurance your business has obtained, or been quoted, varied based on whether you have an arbitration agreement?

Topic A: Proposal Regarding Class Litigation

Experience with Class Litigation and Related Defense Costs (Part B)

Question 19

Do you have any observations on our preliminary analyses of the legal costs related to the possibility of additional class litigation or threats of class litigation (Outline pp. 27-29)?

Working Lunch

Informal Discussions Between SERs and Panel Members

Noon—12:45 p.m.

Topic A

Proposal to Prohibit Application of Arbitration Agreements to Class Litigation

12:45—1:30 p.m.

- Investments in Compliance with Consumer Protection Laws (Questionnaire, Part C)

- Alternatives (Questionnaire, Part D)

Consumer Financia
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Topic A: Proposal Regarding Class Litigation

Investments in Compliance with Consumer Protection Laws (Part C)

Question 20

If your contracts for consumer financial products or services include arbitration agreements, please compare, if possible, your business's investment in compliance with consumer protection laws now with its investment in compliance before it used arbitration agreements.

a. Did including an arbitration agreement change your business's investment in compliance with consumer protection laws?

b. Does the arbitration agreement save your business money? If so, how? Does it affect your investment in compliance? If so, how?

Topic A: Proposal Regarding Class Litigation

Investments in Compliance with Consumer Protection Laws (Part C)

Question 21

Would the proposal under consideration change your business's investments in compliance?

If so, why and how?

Consider additional staff time, additional managerial time, additional training time, time for additional rounds of review of documents or products, and any monetary expenses for third-party services.

Topic A

Proposal to Prohibit Application of Arbitration Agreements to Class Litigation

<u>12:45—1:30 p.m.</u>

- Investments in Compliance with Consumer Protection Laws (Questionnaire, Part C)
- Alternatives (Questionnaire, Part D)

Question 22

One of the goals of the class proposal is to ensure compliance with consumer protection laws.

Do you have views on alternatives for the Bureau to achieve this goal, such as prohibiting arbitration agreements, allowing a business to block class litigation with an arbitration agreement that makes class arbitration available, or any other alternatives?

a. Did including an arbitration agreement change your business's investment in compliance with consumer protection laws?

b. Does the arbitration agreement save your business money? If so, how? Does it affect your investment in compliance? If so, how?

Topic A: Proposal Regarding Class Litigation

Alternatives (Questionnaire, Part D)

Question 23

One of the goals of the class proposal is to ensure consumers have a way to group together to seek relief for smaller claims that typically are not pursued individually.

Do you have views on alternatives for the Bureau to achieve this goal, such as prohibiting arbitration agreements, allowing a business to block class litigation with an arbitration agreement that makes class arbitration available or any other alternatives?

Topic B
Proposal to Require Submission of Arbitration Claims or Awards and Remaining Issues

1:30—2:30 p.m.

- Brief Overview of Proposal
- Discussion: Experience with Arbitration
- Discussion: Costs of Submission Proposal
- Discussion: Alternatives to Submission Proposal
- Discussion: Cost of Credit and Other Relevant Laws

Topic B: Proposal Regarding Submission of Claims/Awards
Brief Overview of Proposal

- We are not proposing for consideration a ban on all PDAAs.
- We are concerned, however, that PDAAs requiring arbitration of individual claims have in the recent past led to harms to many consumers and are further concerned that these types of harms may recur.
- Thus, we are considering a limited intervention that would serve to deter the emergence of unfair arbitrations and also shed sunlight on any unfairness that might emerge, while simultaneously imposing minimal regulatory burdens on current arbitration activity.

Topic B: Proposal Regarding Submission of Claims/Awards

Brief Overview of Proposal

- We are considering a proposal to require covered entities that use PDAAs in their contracts with consumers to *submit initial claim filings and written awards in consumer finance arbitration proceedings to the Bureau*.
- We are also considering whether to publish the claims or awards on our website, making them available to the public.
- Before collecting or publishing any arbitral claims or awards, we would ensure that these activities comply with privacy considerations.

Topic B

Proposal to Require Submission of Arbitration Claims or Awards and Remaining Issues

<u>1:30—2:30 p.m.</u>

- Brief Overview of Proposal
- Discussion: Experience with Arbitration
- Discussion: Costs of Submission Proposal
- Discussion: Alternatives to Submission Proposal
- Discussion: Cost of Credit and Other Relevant Laws

Question 7

Has your business ever agreed to arbitrate a dispute with a consumer after the dispute arose, when there was no arbitration agreement in place before the dispute arose?

Question 8

As far as you are aware, has your business brought a claim against a consumer in arbitration or been named as a respondent in an arbitration filed by a consumer, relating to any consumer financial products or services you provide?

Question 9

If you answered yes to the above question, please discuss how many arbitrations there have been and provide more information about these proceedings.

Topic B

Proposal to Require Submission of Arbitration Claims or Awards and Remaining Issues

1:30—2:30 p.m.

- Brief Overview of Proposal
- Discussion: Experience with Arbitration
- Discussion: Costs of Submission Proposal
- Discussion: Alternatives to Submission Proposal
- Discussion: Cost of Credit and Other Relevant Laws

Topic B: Proposal Regarding Submission of Claims/Awards

Costs of Submission Proposal (Questionnaire, Part F)

Question 28

What would it cost your business to submit arbitration claims and awards to the Bureau, as described in the Outline?

a. Would you expect to rely on an arbitration administrator to provide this service for you?

b. What costs would your business incur if it were required to redact consumers' personal information from arbitration filings and awards before sending them to the Bureau?

Topic B

Proposal to Require Submission of Arbitration Claims or Awards and Remaining Issues

<u>1:30—2:30 p.m.</u>

- Brief Overview of Proposal
- Discussion: Experience with Arbitration
- Discussion: Costs of Submission Proposal
- Discussion: Alternatives to Submission Proposal
- Discussion: Cost of Credit and Other Relevant Laws

Topic B: Proposal Regarding Submission of Claims/Awards

Alternatives to Submission Proposal (Questionnaire, Part D)

Question 24

Do you have any observations about the alternatives the Bureau considered, such as prohibiting arbitration in individual agreements or adopting procedural rules for individual arbitration?

Topic B

Proposal to Require Submission of Arbitration Claims or Awards and Remaining Issues

1:30—2:30 p.m.

- Brief Overview of Proposal
- Discussion: Experience with Arbitration
- Discussion: Costs of Submission Proposal
- Discussion: Alternatives to Submission Proposal
- Discussion: Cost of Credit and Other Relevant Laws

Question 25

When your business borrows money, does it use consumer products as a source of financing?

For example, do personnel use a personal credit card for business expenses? Do personnel take out other types of consumer loans for business expenses?

If so, please describe the types of credit used, the types of expenses funded by these loans, and generally the amount of your business's expenses that is funded by consumer loans.

Question 26

If your business sells consumer goods or services that are not financial in nature, what amount and proportion of these sales allow the consumer to defer payment?

What amount and proportion of the consumer debts in these transactions are pledged as collateral for a business loan or sold to a third party (*e.g.*, factoring)?

Question 27

Is your business subject to any other regulations that may overlap, duplicate, or conflict with the proposals under consideration?

For example, are any of your financial products or services subject to Military Lending Act regulations that prohibit arbitration agreements in certain credit products provided to service members, or to Dodd-Frank Act regulations that prohibit arbitration agreements in mortgage credit agreements?

Other Questions from SERS?

Closing

2:30—3:30 p.m.

Closing

- Remarks
  - Richard Cordray, Director, CFPB
- Closing Remarks by SERs
- Closing Remarks by CFPB, SBA, and OMB