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ARBITRATION

The Other Shoe Has Dropped: CFPB Releases Report on Arbitration

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The Consumer Financial Protection Bureau (CFPB) recently released its long awaited Report to Congress on arbitration agreements in consumer financial contracts. The Report's conclusion, and Director Richard Cordray's remarks, were as expected: consumers are better served by litigation—and particularly, class action litigation—than by agreements to arbitrate disputes. But after spending almost three years analyzing the issue, the 700-page Report does not appear to back up that conclusion. Rather, the evaluation of arbitration agreements, including class action waivers, requires complex value judgments that are not suited to the Bureau's data-driven approach. Here's our summary and analysis of the CFPB's findings, along with a roadmap of what comes next (104 BBR 524, 3/17/15).

What Did the Bureau Find?

In its Report, the CFPB evaluated: (1) the prevalence and features of arbitration agreements; (2) consumer understanding of arbitration agreements; (3) how arbitration procedures differ from judicial procedures; (4) the types and resolutions of claims in arbitration; (5) the types and resolutions of claims in litigation; (6) suits brought in small claims courts; (7) the value of class action settlements; (8) the relationship between public enforcement and class actions; and (9) whether arbitration clauses lower prices for consumers.

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The analysis focuses on six consumer financial product markets: (a) credit cards; (b) deposit accounts; (c) general purpose reloadable prepaid cards ("prepaid cards"); (d) private student loans; (e) storefront payday loans; and (f) mobile wireless contracts. The Bureau also looked at auto loans in some of its analysis.

Prevalence of Arbitration Agreements

Overall, the Bureau found that about half of all accounts in five of the six product markets include an arbitration agreement. The CFPB found that credit card account holders maintaining about 44 percent of credit card debt have arbitration agreements. The Bureau notes that credit card account holders with credit cards issued by the four biggest issuers do not have arbitration agreements. So, assuming there is some relationship between the amount of credit card debt and the number of credit card customers, fewer than half of all credit card customers have arbitration agreements with their credit card issuer.

The numbers are about the same for deposit accounts. The Bureau reports that about 44 percent of insured deposits are maintained by financial institutions whose deposit agreements have arbitration clauses.

Prepaid card data reflects about the same percentage. The Bureau looked only at general purpose reloadable prepaid cards offered by the three largest prepaid card companies. These companies account for over 68 percent of dollar amounts loaded onto prepaid cards, and about 83 percent of those cards had arbitration agreements. Even if we were to extrapolate from these percentages to prepaid card agreements as a whole, about

56 percent of prepaid card balances are on prepaid cards governed by arbitration agreements.[1]

On payday loans, the CFPB's conclusion that a very high percentage of payday loan contracts include an arbitration clause is based primarily on information provided by the largest lenders in three of the largest states (California, Florida, and Texas). The Bureau attempted to obtain agreements from other (presumably smaller) lenders, but reported a very low response rate.[2] As the Bureau noted in the context of other product types, agreements for smaller lenders are less likely to include arbitration agreements than agreements for larger lenders.[3] Accordingly, the Bureau's admittedly incomplete data set does not allow for sound, evidence-based extrapolation to payday lending contracts as a whole.

For student loans, the CFPB explains that loans made by six of the seven largest student lenders are governed by arbitration clauses. But the vast majority of student loans are federal and not private. The Bureau did not determine the percentage of student loan agreements as a whole that include arbitration agreements.

Accordingly, the Bureau's admittedly incomplete data set does not allow for sound, evidence-based extrapolation to payday lending contracts as a whole.

It is interesting that the Bureau included mobile wireless providers as the last of the six product markets it evaluated. The CFPB takes the view that mobile payment subscribers are Covered Persons under the Dodd-Frank Act and therefore subject to the CFPB's authority because mobile payment contracts ''authorize third parties to charge consumers for services on their mobile phone bills.''[4] We can't help but wonder if the prevalence of arbitration agreements in mobile wireless contracts played a role in the Bureau's decision to include them. It is not an accident that the game-changing Supreme Court arbitration ruling, *AT&T v. Concepcion*, 131 S. Ct. 1740 (2011), involved a mobile wireless contract. In fact, these companies, much more than providers of traditional financial products, have led the charge on arbitration. Customers of mobile wireless providers are also more likely to have so-called Gold Standard arbitration agreements that provide for a minimum flat recovery amount for prevailing consumers, which is many times greater than the average claim and recovery of their attorneys' fees. The Bureau mentions these types of agreements in passing, but does not otherwise distinguish between mobile wireless products and consumer financial products.

The bottom line, then, is that consumers of traditional financial services products have a choice of whether or not they want disputes to be resolved in arbitration. Only about half of the credit card, deposit account, and prepaid card agreements, and far less than half of the student loan agreements, include arbitration agreements. To the extent that ''tens of millions of consumers use consumer financial products or services that are subject to pre-dispute arbitration clauses'',[5] tens of millions of other consumers use consumer financial products or services that are *not* subject to pre-dispute arbitration clauses.

Arbitration Agreement Features; Comparison of Procedures— Arbitration and Court

Echoing the findings on prevalence, the Bureau found that a significant percentage of arbitration agreements in all but the mobile wireless product market allowed consumers to opt out of arbitration or to bring their claims in small claims court. The percentage of the product market allowing consumers to reject the arbitration agreement ranged from 17 percent for prepaid card contracts to 83 percent for payday loan contracts. Almost all of the arbitration agreements across all product markets (ranging from 85 percent for prepaid cards to 99.9 percent for payday loans) allow consumers to bring claims in small claims court.

The Bureau's findings debunked several conventional myths regarding arbitration agreements, because:

- ''[m]ost contracts with arbitration clauses did not include damages limitations;''[6]
- ''[f]ew credit card, prepaid card, and payday loan contracts with arbitration clauses in [the] sample set time limits for consumers to file claims.'' Although a higher percentage of checking account agreements included time limits, the average time allowed to file a claim under those agreements was over a year;[7] and
- ''most arbitration clauses in the sample were silent on confidentiality and did not impose any nondisclosure obligation on the parties.''[8]

The Bureau's findings on cost provisions in the arbitration agreements it reviewed confirm the widely understood view that arbitration is a relatively inexpensive method of dispute resolution. The Bureau reports that under American Arbitration Association (AAA) rules, the consumer pays a flat $200 filing fee for claims under $10,000 and, under JAMS rules, the consumer pays a flat $250 fee. These fees are much lower than the $400 filing fees in federal court.[9] Arbitration agreements governing more than 43 percent of the outstanding credit card loans and more than 40 percent of the insured deposits require or allow the financial products or service providers to pay some or all of the consumer's filing fee under certain circumstances. Contracts governing some portion of the other product markets contained similar provisions.

As the Report explains, since March 2014, AAA rules have prohibited any reallocation of fees regardless of

[1] Note, though, that this likely over-states the percentage of prepaid cards governed by arbitration agreements because it is based on the use of arbitration agreements by the three largest providers. As the Bureau found with respect to other product types, agreements with smaller lenders are less likely to include arbitration clauses. *See, e.g.*, Report Section 2 at 10, 14.

[2] Report Section 2.3.4 n.67.

[3] *See, e.g.*, Report Section 2 at 10, 14.

[4] Report Section 2 at 25-26.

[5] Report Section 1.4.1 at 9.

[6] Report Section 2.5.6 at 47.

[7] Report Section 2.5.7 at 50.

[8] Report Section 2.5.8 at 52.

[9] Report Section 4 at 10-12.

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the contractual authority to do so.[10] JAMS rules allow the arbitrator to reallocate fees, although they do not require it. Fewer than 25 percent of each of the product markets governed by arbitration agreements allow for reallocation of fees to the consumer, while a much higher percentage allow the arbitrator to reallocate fees to the company.

The Bureau's discussion of the differences between arbitration proceedings and judicial proceedings indicates that there are no material differences. Although the Bureau asserts that discovery may be more limited in arbitration, the AAA rule it quotes does not support this statement. The rule provides that the arbitrator has discretion to control discovery with a view toward achieving an efficient result ''while at the same time promoting equality of treatment and safeguarding each party's opportunity to fairly present its claims and defenses.''[11] It is hard to see how this standard could possibly prejudice either party. Rather, it reflects Rule 1 of the Federal Rules of Civil Procedure, which requires ''the just, speedy, and inexpensive determination of every action,'' as well as the proportionality considerations that have increasingly been incorporated into the discovery rules.

Takeaways from this section are that arbitration agreements provide most consumers with the choice to resolve their disputes in small claims court, the costs of arbitration are less than the costs of filing in court, and most of the agreements replicate the potential recovery, time to bring suit, and other rights provided in judicial proceedings.

[T]ens of millions of other consumers use consumer financial products or services that are *not* subject to pre-dispute arbitration clauses.

Consumer Understanding

Although the Bureau purports to determine what consumers understand about dispute resolution systems in the next section of the Report, in fact, its analysis is limited to whether consumers weigh dispute resolution provisions in acquiring credit cards and consumers' understanding of the dispute resolution rights in credit card agreements. The Bureau ignored five of the six product markets in its analysis of this issue because credit card agreements are on file at the Bureau so it could study consumers' awareness of their contract terms and because credit cards offer ''strong market penetration with consumers across the nation.''[12] But the Bureau obtained copies of hundreds of arbitration agreements in all of the product areas and certainly other product markets, such as deposit accounts, have strong nationwide market penetration as well.

The Bureau based its analysis on the responses of 1,007 consumers who had credit cards and who completed surveys sent by the Bureau and on responses by two focus group panels. The response rate on the surveys was less than 25 percent. The Bureau recognizes that the margin of error increases as the number of respondents decreases, and most of the Bureau's analysis is based on much smaller subsets of the total number of consumers who responded to the survey.

The Bureau started by evaluating whether and how consumers consider dispute resolution provisions in deciding whether to enter into a credit card agreement. One-third of the respondents did not shop around at all in deciding to enter into a credit card agreement, and another 6 percent of the respondents were not involved in the decision to enter into the agreement. Of the remaining 60 percent, not surprisingly, consumers ranked interest rate, fees, convenience, and card acceptance as the most influential factors in their decision to open a particular credit card account. They did not identify dispute resolution. That may be because, as the Bureau found, respondents were many times more likely to respond that they would close their credit card account or attempt to escalate to a manager in response to a dispute than they were to seek legal advice or initiate legal proceedings.

Only 570 of the 1,007 respondents who completed the survey identified their credit card issuers clearly enough for the Bureau to determine whether their credit card agreements included an arbitration agreement. Consistent with the prevalence findings discussed above, fewer than half of this sub-set of respondents had credit cards with an arbitration agreement. Of those, about half did not know whether they could sue their issuer in court. Of the rest, only a few of the respondents knew their credit card agreements included an arbitration agreement. Similarly, about 41 percent of the respondents who could explain what a class action is and whose agreement included a class waiver did not know whether they could participate in a class action against their credit card issuer, and most of the rest thought they could participate in a class action.

Given the small samples of sizes on which most of the Bureau's analysis is based, it is unclear whether the Bureau obtained data from a sufficient number of people to extrapolate from the responses to consumers who have credit card accounts more generally, much less consumers in other product markets. The Bureau's findings regarding consumers' understanding of their dispute resolution provisions would seem to flow directly from its finding that consumers are not interested in using any form of dispute resolution process for disputes with their credit card issuers. This lack of interest is reflected in the miniscule number of cases filed in arbitration or court against providers of the products in the markets analyzed by the Bureau.

That consumers believed they have the right to sue in court is not surprising. After all, there are no television shows or news reports about arbitration proceedings, nor do we learn about arbitration in school. Does this indicate consumers prefer one dispute resolution method over another? No. It indicates they do not anticipate invoking their dispute resolution rights and so do not devote the time and effort required to educate themselves about them.

Claims Brought in Arbitration

In analyzing arbitration proceedings for disputes involving the six product markets, the Bureau only considered claims filed with AAA. The Bureau found that

[10] The Bureau notes elsewhere in the Report that ''most consumer financial arbitration disputes are administered by AAA.'' Report Section 4 at 2.

[11] Report Section 4 at 17 (quoting AAA Commercial Rules).

[12] Report Section 3 at 2.

the ''vast majority of consumer financial disputes filed with the AAA'' are not resolved on the merits.[13] Rather, they settle or ''reach other procedural outcomes,'' including abandonment and dismissal.[14] The Bureau did not have access to settlement data and so cannot report on or evaluate settlement outcomes.

The Bureau also recognized that it cannot evaluate whether arbitration favors consumers or companies for a number of reasons. First, as the Bureau explained, arbitration results reflect strategic decisions to settle or abandon claims, which impact the types of claims that are resolved on the merits. As a result, ''[c]onsumers (or companies) may appear to do poorly [on claims decided on the merits]—or to bring only weak claims—but that may result from settlement decisions as much as (or more than) from the arbitration process itself.''[15]

Second, the claims consumers bring in arbitration are different from the claims brought by companies. That companies or consumers appear to do better or worse in arbitration may reflect the differences in the types of claims brought rather than anything about the arbitration proceedings.

Third, disputes filed in arbitration differ from disputes filed in court. Because ''[d]isputes are not randomly assigned to the two different fora,'' the outcomes may reflect strategic decisions about where the parties decided to pursue their claims.[16]

There is no way to separate out the impact of these strategic decisions, both within particular disputes in arbitration versus litigation in court and in comparing resolutions in arbitration to resolutions in court. Accordingly, there is no way to draw conclusions about the relative merits or downsides to either type of dispute resolution. The Bureau spends about 150 pages of its 700-page Report cataloguing the types of claims and resolutions in arbitration and in court. But the shortcomings the Bureau itself recognized leave it without any comparison data that could support any proposed rulemaking to limit or prohibit arbitration agreements.

The most interesting piece of data in the Bureau's extensive catalogue of arbitration proceedings is the Bureau's finding that for the three-year period from 2010 to 2012, only 1,847 disputes were filed with AAA involving products in the six product markets. That figure is astounding given the tens of millions of consumers who have at least one and probably more than one consumer financial contracts, and the Bureau's finding that about half of these contracts include an arbitration agreement. This figure makes clear that consumers who responded to the Bureau's survey acted rationally in not factoring dispute resolution terms into their decision to open a particular account or obtain a particular loan. They also acted rationally in not knowing whether their account is governed by an arbitration agreement. How can the Bureau possibly draw conclusions on whether arbitration benefits or harms consumers given the miniscule number of disputes filed each year?

The other takeaway from the Bureau's arbitration proceedings catalogue is that only about one-third of the disputes filed from 2010-2011 were resolved by the arbitrator on the merits. Over half settled or were characterized by the Bureau as having been resolved consistent with settlement. The remaining 10.5 percent of the disputes were resolved in a manner the Bureau characterized as inconsistent with settlement.

A few other interesting points:

- Attorneys' fees were awarded about equally to consumers and to companies;
- In-person hearings took place very close to consumers' homes (median distance of 15 miles);
- The median time to settlement was 155 days from filing; and
- Consumer fees reflect the amounts stated in the AAA rules (median cost $125).

The Bureau also reports on the relative ''win'' rates for consumers and companies. The Bureau itself recognized, though, that the fact that consumers or companies prevail more often or that consumers or companies recover, on average, more or less than the opposing party does not allow us to draw any conclusions as to the relative merits of either side's claims or the impact of arbitration on the result. That said, there is nothing in the Bureau's findings that indicates or reflects any bias against either party. Both consumers and companies prevailed in a significant percentage of the small number of cases decided by arbitrators on their merits.

Individual Claims Brought in Court

As with claims filed in arbitration, the headlines on the Bureau's analysis of individual claims filed in court are the significant limitations in the information analyzed and the inability to draw any conclusions from that information. The Bureau only looked at complaints filed in federal court. This limitation means the Bureau's sample only included claims for which federal courts have jurisdiction—either cases involving alleged violations of federal statutes or regulations or claims in which the parties reside different states and the amount at issue is more than $75,000. There is no reason to believe cases filed in state court share these characteristics.

Moreover, as with claims brought in arbitration, the vast majority of claims filed in court are resolved by settlements. The Bureau does not have access to the terms of those settlements and so has very little data about the outcomes of the disputes. Unlike in arbitration, complaints filed in court rarely include an amount claimed. Without this information, the Bureau cannot evaluate recovery rates even for the very few claims decided on the merits.

Finally, as with arbitration, ''[c]omparing frequency, processes, or outcomes across litigation and arbitration is especially treacherous'' because differences in the data likely reflect strategic decisions made by consumers and companies.[17] It is difficult to understand how the Bureau can possibly promulgate rules based on costs and benefits as required by Dodd-Frank given these limitations in the Bureau's approach.

As was the case with arbitration, the number of individual actions filed in federal court is very small. The Bureau identified only 3,462 individual actions filed in federal court regarding the product markets from 2010-2012. Although this number is approximately double the number of arbitrations filed during the same time

[13] Report Section 5 at 5.
[14] *Id.* at 6.
[15] Report Section 5 at 6.
[16] Report Section 5 at 7.
[17] Report Section 6 at 4.

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period, the Bureau reports that companies rarely moved to compel arbitration of individual actions.[18] This means all consumers, regardless of whether their contract includes an arbitration agreement, can file suit in court. However, only those consumers who have arbitration agreements can file arbitrations. As discussed above, on average, about half of the consumer contracts in the six product markets include arbitration agreements. Therefore, only about half of all consumers in the six product markets can file arbitrations. Put another way, twice as many consumers can bring claims in court than can bring claims in arbitration. The number of claims per consumer, therefore, is the same for arbitration as it is for actions filed in court.

The Bureau only analyzed the outcomes of 1,205 individual actions.[19] The distribution of resolution methods for these cases was similar to the distribution for arbitration: very few of the cases were resolved on the merits and 90 percent of the cases were resolved by settlements or potential settlements. About 4 percent of the cases were dismissed when the court granted the company's dispositive motion. Only 0.5 percent of the cases were dismissed or stayed in favor of arbitration. Although the Bureau reports that 82 of the cases were resolved in favor of the consumer, 78 of these cases were the result of a default judgment.

The bottom line, then, is that only four of the individual actions filed during 2010-2012 were resolved on the merits. Three were resolved on summary judgment, and only one was resolved at trial. Accordingly, the Bureau's determination that most of the consumers in these cases requested a jury trial is irrelevant—only one of the individual actions analyzed by the Bureau made it to trial.

It is difficult to understand how the Bureau can possibly promulgate rules based on costs and benefits as required by Dodd-Frank given these limitations in the Bureau's approach.

Timing from filing to completion in the individual cases filed in court was comparable to the timing in arbitration. The Bureau found median time to closure for individual cases that were not transferred to multidistrict litigation (MDL) was 127 days, and the average was 171 days (suggesting a few outlier cases that skew the average). Median time from filing to settlement was 120 days and median time from filing to judgment was 184 days.

Class Proceedings

The Bureau's analysis of class proceedings does not seem to support its ultimate conclusion, trumpeted in the first sentence of the press release accompanying the Report that ''arbitration agreements restrict consumers' relief for disputes with financial service providers by limiting class actions.'' The press release further claims that it is ''common for arbitration clauses to be invoked to block class actions.'' In fact, what the Report shows is that arbitration is rarely invoked and even more rarely granted. Far and away the most ''common'' response to a putative class action is settlement.

The Bureau studied a total of 562 putative class actions filed in state and federal courts concerning the six products between 2010 and 2012. In only 94, or 16.7 percent, of those cases did a defendant even file an arbitration-based motion. And, of those, only 46, or 8 percent, were granted in whole or in part. Perhaps in the Bureau's view of class action litigation, 8 percent is too ''common,'' but it seems like a stretch to us. By contrast, a more likely outcome is settlement: a whopping 78 percent of the 562 cases had settled on a class or individual basis without any adjudication on the merits. In other words, being compelled to comply with an agreement to arbitrate was among the rarest of outcomes.

What Happens Next?

By its Report, the CFPB has fulfilled its statutory mandate to study the use of pre-dispute arbitration clauses in connection with consumer financial products and services.

The Bureau is now statutorily authorized, if it so chooses, to promulgate regulations that ''prohibit or impose conditions or limitations on the use of'' such agreements subject to certain conditions:

- The Bureau must find that any such prohibition or limitation is in the public interest and for the protection of consumers.
- The Bureau's regulation must be supported by findings that are consistent with the Report.
- The Bureau may not regulate post-dispute arbitration agreements.
- The Bureau's regulation will have only a prospective effect on agreements entered into 180 days after the effective date of any regulation.

While the Report and Director Cordray's remarks indicate that the Bureau is likely to issue anti-arbitration regulations, these hurdles are not insignificant. It is not, for example, beyond dispute that a regulation prohibiting an arbitration provision in a consumer contract is both ''in the public interest'' and ''for the protection of consumers'' or that such a regulation would be consistent with the Report's findings.

We do not believe that the Bureau will be issuing proposed regulations in the near future. Indeed, in prepared remarks accompanying the Report's release, Richard Cordray noted that ''people are right to be interested in digesting these results and considering how we intend to fulfill the objectives established by Congress. We will be meeting with stakeholders after they have had a chance to read our report . . . .''[20]

[18] Report Section 6 at 8 [noting companies filed motions to compel arbitration in only 1 percent of the individual actions filed in court].

[19] Report Section 6 at 8.

[20] Prepared Remarks of CFPB Director Richard Cordray at the Arbitration Field Hearing March 10, 2015.