"Preliminary Results" of the Consumer Financial Protection Bureau's Ongoing Study of Arbitration Reveal Much More Work To Do

Agency Acknowledges That It Has Not Yet Studied Key Issues

Before the Consumer Financial Protection Bureau may regulate or prohibit the use of arbitration agreements by the businesses it oversees, the Bureau must first conduct a study of arbitration agreements entered into "in connection with the offering or providing of consumer financial products or services" to consumers.[1] Any regulation that the Bureau might subsequently propose must be consistent with the results of the study and justified by the public interest; the Bureau also "shall" consider "the potential benefits and costs to consumers and [businesses], including the potential reduction of access by consumers to consumer financial products or services resulting from" any such rule.[2]

On December 11, 2013, the CFPB issued its "study results to date." The Bureau stated:

- "Readers should not interpret this presentation as our assessment, preliminary or otherwise, of the relative importance of different areas to be covered in the statutory report to Congress. Rather, the subjects addressed here are those as to which we already have been able to obtain and analyze sufficient data in order to make some preliminary findings."

- "Because the Bureau's work on this study is ongoing, any of the findings presented here may be refined or modified when we issue our report to Congress."

- "This presentation focuses on the 'front-end' of formal disputes involving consumers"—the nature of formal filings; "[i]n later work, we intend to address the 'back-end' of formal disputes: what happens, in how long, and at what cost."

The Bureau also identified a variety of areas not yet addressed, such as "the disposition of cases across arbitration and litigation (including class litigation), both in terms of substantive outcome and in terms of procedural variable like speed to resolution"; "consumer benefits and transaction costs in consumer class actions involving consumer financial services" including "whether class actions exert improper pressure on defendants to settle meritless claims"; and "the possible impact of arbitration clauses on the price of consumer financial products."

These disclaimers are important, because ***the "preliminary results" provide little information that is relevant to the central questions that the Bureau must address***: For the kinds of injuries that most consumers can suffer, what is the real-world accessibility, cost, fairness, and efficiency of arbitration as compared to suing in court? And how will consumers be harmed if arbitration is prohibited or subjected to regulation that eliminates arbitration's availability?

- **The number of formal claims filed by consumers in arbitration and in court—the principal focus of the Bureau's attention—says nothing about the relative accessibility and fairness of the two methods of dispute resolution.**

  Most of the CFPB's preliminary results relate to the numbers of cases filed in arbitration

and in court. The Bureau compares the number of complaints filed in arbitration to a larger total number of potential customers, and seems to view the disparity as possible evidence that arbitration is not useful to consumers. That conclusion would be wrong, for several reasons:

- ***First*, consumers' claims often are resolved before the filing of a formal arbitration proceeding**. Individuals who file arbitration demands—just like those who file small claims court cases or lawsuits in court—are almost always a very small group of consumers whose concerns were not resolved through less-formal customer service mechanisms. When companies have millions of customers, it is likely that thousands—perhaps tens of thousands—of customers will at some point in their relationship have concerns that may or may not develop into full-fledged disputes. But the vast majority of those customer concerns are resolved through informal channels, such as customer service processes, negotiation, or mediation, before a concern ripens into a dispute and a formal arbitration demand is filed.

    - Because businesses subsidize most or all of the costs of arbitration—under AAA consumer rules, for example, a business must cover at least $1500 in filing fees—it is economically rational for every business to settle disputes of less than $2,000-5,000 before an arbitration is commenced. But ***that same incentive is lacking in court, where the cost burden falls on the consumer***.

    - What is more, many arbitration agreements create even greater incentives to settle claims before arbitration begins, such as through arbitration provisions that—like the provision at issue in *AT&T Mobility v. Concepcion*—contain potential bonus payments to customers who do better in arbitration than a company's last settlement offer (providing, for example, that the customer will be awarded a minimum amount, often $5,000-10,000, plus attorneys' fees and, often, other costs). It is thus a straightforward matter of economics that, if a consumer has a dispute with a company of less than the bonus figure—and the claim is not frivolous or abusive—the company has every reason to settle by offering a payment (often for the full amount of the claim plus an amount for attorneys' fees) that satisfies the customer.

        - Thus, as the Supreme Court explained in *Concepcion*, the consumers' claim in that case was "most unlikely to go unresolved" because the arbitration provision at issue provided that the company would pay the Concepcions a minimum of $7,500 and twice their attorneys fees if they obtained an award "greater than AT&T's last settlement offer." And this self-imposed incentive to settle occurs not just at the stages of a formally commenced arbitration or the pre-arbitration negotiation period. Instead, large numbers of AT&T customers have their concerns resolved at a much earlier point by calling or e-mailing AT&T's customer care department, which is remarkably effective: the record in *Concepcion* indicated that AT&T representatives awarded more than $1.3 billion in compensation to customers during a single twelve-month period in response to customer concerns and complaints.

- Significantly, the Bureau's own preliminary results recognize that virtually all of the arbitration provisions studied require the company involved to pay all or nearly all of the arbitration costs and that many of the provisions include bonus provisions. Those agreements provide a very weighty incentive for pre-arbitration settlement of any non-frivolous consumer claim of $5,000 or less.

- ***Second*, a concerted campaign to invalidate arbitration agreements was underway for the entire period studied by the Bureau**. Plaintiffs' lawyers vigorously resisted arbitration (with success in certain "magnet" jurisdictions for class actions) before *Concepcion*. And after the Supreme Court held in *Concepcion* that class waivers in arbitration agreements are enforceable, the plaintiffs' bar has continued to search for ways to avoid their clients' agreements to resolve their disputes in arbitration. The unfortunate effect of these widespread efforts is that lawyers who represent consumers and their allies in consumer advocacy organizations have discouraged consumers from pursuing their disputes in simplified, often cost-free arbitration.

- ***Third*, the number of individuals who opt out of class action settlements shows nothing about the relative utility of arbitration and judicial litigation**. The Bureau identified eight class actions in which the class members could choose to reject the benefits of the proposed settlement and instead file an individual arbitration claim. The failure of class members to do that, the Bureau seems to say, provides some evidence of the relative utility of arbitration and class actions. Put simply, any such contention is ludicrous.

  - A large number of consumers in these cases did nothing: they neither opted out, nor filed the forms required (in all but two of the cases) to obtain a share of the settlement. The most logical conclusion is that these consumers viewed the claim as spurious and/or the litigation process as a waste of their time.

  - The fact that some consumers took advantage of a settlement offer says nothing about their view of the judicial litigation process—they may simply have concluded that it was worth obtaining what was offered—and absolutely nothing about their view of arbitration as an alternative.

  - Finally, that some consumers opted out but did not pursue arbitration claims similarly offers no illumination about their views of arbitration as compared to litigation. Class members opt out of class actions for multiple reasons, as practitioners know well. True, some opt-outs may wish to pursue their own claim separately, either by arbitration or small claims court. But other opt-outs may believe that the case is meritless and so they do not want to be part of the settlement class, and still others may object to class actions or to litigation in general. If (as is common) the class member who opted out has no quarrel with the company, then there is no reason that he or she would have chosen to initiate an arbitration. By suggesting otherwise, the Bureau appears to be assuming that (a) the claims at issue in the class action have merit; and (b) that the class members who opted out feel the same way. That thinking defies common sense and real-world experience.

- ***Fourth*, the Bureau's definition of "small-value" claims presents a misleading picture of arbitration**. The Bureau defines small-value claims as those involving $1,000 or less and then concludes that few consumers arbitrate small claims. But that definition is odd, given that—based on information compiled in Appendix E of the CFPB's own document—most state small-claims courts permit the assertion of claims of up to $10,000. Hopefully, the Bureau did not adopt this overly narrow definition in order to be able to assert, erroneously, that consumers do not use arbitration for small claims. In addition, of course, this analysis ignores entirely the fact, discussed above, that the terms of a growing number of arbitration agreements provide a very substantial incentive for the pre-arbitration settlement of such claims.

- ***Fifth*, the Bureau has not yet addressed the critical question of how the resolution of consumers' claims in arbitration compares to the outcomes obtained in court**. As the Bureau acknowledges, it has not yet compared the results that consumers obtain in arbitration and in court. But ***existing empirical research shows that consumers do at least as well – if not better – in arbitration than in court.***

  - Professor Christopher Drahozal, along with Samantha Zyontz, concluded that consumers who file claims with the American Arbitration Association win relief ***53.3% of the time.***[3] By contrast, empirical studies that have sampled wide ranges of claims have similarly reported that ***plaintiffs win in state and federal court approximately 50% of the time.***[4] The most recent statistics provided by the American Arbitration Association show that approximately 60 percent of its consumer arbitrations settle or are withdrawn from administration, and consumers prevail in almost half (48 percent) of the remaining consumer-initiated arbitrations.[5]

- **The Bureau's brief discussion of class actions provides no basis for any conclusion regarding their value to consumers – as the Bureau itself acknowledges.**

  - The CFPB observes that most arbitration agreements preclude class actions and class arbitrations. That is not surprising because, as the Supreme Court explained in great detail in *Concepcion*, **class actions are incompatible with arbitration, which traditionally has taken place on an individual (one-on-one) basis.**

  - **Critics of arbitration contend that small claims cannot be** pursued on an individual basis, because the cost of proving the claim will far surpass any recovery. Only through classwide proceedings, they say, can plaintiffs attain the economies of scale necessary to pursue these small claims by spreading the costs of proof across an entire class. They then contend that settlements of such class actions will deliver significant benefits to class members. But these arguments are based on theoretical opinions of how class actions function; as it turns out, the theory is diametrically opposed to how class actions work in practice.

  - Any legitimate study of dispute resolution—and certainly any regulation based on such a study—cannot rest on theoretical assumptions about the value of the class action device; instead, the study should examine the reality of how that procedure

works. Thus, the question for the Bureau is whether the value of class actions outweighs the value that arbitration provides individual consumers by increasing their ability to pursue their claims and obtain *meaningful* recoveries—not just through the formal arbitration process but also through informal resolutions that result from the greater incentives to settle that are generated by arbitration agreements).

- The U.S. Chamber of Commerce has recently commissioned an empirical study of consumer and employment class actions that seeks to address the reality of class actions. The new study examined a sample of 148 cases filed in or removed to federal court in 2009. The study reveals that the overwhelming majority of class actions result in ***no recovery at all for members of the putative class***—even though in a number of those cases the lawyers who sought to represent the class often enriched themselves in the process (and the lawyers representing the defendants always did).[6] The study found: (1) No cases resulted in a trial or judgment on the merits for the class; (2) The overwhelming majority of cases are dismissed voluntarily by named plaintiffs or dismissed by courts as legally unsustainable; (3) The remaining minority of class members that are settled on a classwide basis provide little, if any, tangible benefit. In the cases where claims information was available, few class members—often fewer than 10 percent, and sometimes less than 1 percent—even bothered to submit claims.

- While it is true that some class actions result in settlements where the parties agree to an "automatic distribution" of benefits to class members, such distributions are the exception rather than the rule. The Bureau's unrepresentative sample pointed to two automatic distributions out of eight possible settlements. While the Chamber's broader study identified thirteen automatic distributions out of forty settlements studied, ***only one of the thirteen was a consumer case***; ten involved claims by retirement plan participants in ERISA class actions where damages and eligibility could be ascertained easily from the plan's records. Thus, contrary to the implication in the Bureau's study, such settlements are exceptionally rare in the consumer context.

- And the Bureau itself has acknowledged that it intends to study—among other areas that it has not yet addressed—"the disposition of cases across arbitration and litigation (including class litigation), both in terms of substantive outcomes and in terms of procedural variables like speed to resolution." It must do so by looking at a sample set that is greater than (a statistically insignificant) eight cases, and one that is selected on the basis of neutral factors rather than selected because class members obtained relief.

- **The Bureau's analysis provides strong evidence of the fairness of the arbitration process**. The CFPB's review reveals:

  - By far the leading choice of arbitration provider is the non-profit American Arbitration Association, which has long been recognized as the gold standard among arbitration

administrators.

- Under most of the arbitration provisions studied, the business has agreed to pay all (or nearly all) of the costs of arbitration.

- All but one of the arbitration provisions studied ensured that the arbitration provider's rules would govern the selection of arbitrators using neutral criteria, and therefore did not create even an arguable risk of biased arbitrators.

- The Bureau states that arbitration clauses are "more complex than the rest of the contract." But there are many reasons for that.

    - First, arbitration provisions define procedures that will govern dispute resolution, and (by necessity) must be comprehensive because they apply in *every* dispute.

    - Second, even simplified legal procedures are likely to be more complicated than the "business" terms of consumer financial contracts. If companies were required to attach to their contracts the rules for dispute resolution in court, such as the Federal Rules of Civil Procedure, there is no doubt that those rules would be at least as hard to read—perhaps even harder—than the typical arbitration provision. (Indeed, the Federal Rules of Civil Procedure were so hard to read that they were substantially revised in 2007 solely to make them more comprehensible.)

    - Third, arbitration agreements have become longer and more complex over time in response to a wide variety of novel challenges raised by lawyers seeking to avoid those agreements. And courts that are hostile to arbitration have accepted some of those challenges, forcing the drafters of arbitration agreements to respond by adding further explanations (and, unfortunately, more length).

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[1] 12 U.S.C. § 1028(a).

[2] *Id*. §§ 1028(b) & 1022(b)(2)(A)(i).

[3] Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 898 (2010).

[4] *See, e.g.*, Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991-92, plaintiffs won 51% of jury trials in state court and 56% of jury trials in federal court, while in 1979-1993 plaintiffs won 50% of jury trials).

[5] AAA, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload*, http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_004325.

[6] The study is available here: http://www.instituteforlegalreform.com/uploads/sites/1/-Class_Action_Study.pdf.