WOODSTOCK INSTITUTE

Advancing Economic Security and Community Prosperity

August 18, 2016

<u>Via Online Submission & E-Mail</u>

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Re: <u>Docket No. CFPB– 2016–0020 or RIN 3170–AA51</u>

Dear CFPB:

I am writing on behalf of Woodstock Institute concerning the Consumer Financial Protection Bureau's (CFPB's) Notice of Proposed Rulemaking governing agreements that provide for the arbitration of disputes between consumers and providers of certain consumer financial products and services. The proposed rule would prohibit class action waivers and would require regulated parties that use pre-dispute arbitration agreements to submit certain records relating to arbitral proceedings to the CFPB. Woodstock strongly supports the proposed rule, but urges the CFPB to modify the rule as follows:

- prohibit altogether the use of pre-dispute arbitration agreements,
- require companies to report on all uses of arbitration, not just cases that result in an arbitration proceeding,
- require all entities that fall within the CFPB's regulatory authority to comply with the rule,[i]
- require providers of credit cards and bank accounts to comply with the rule if they amend their agreements after the effective date of the rule.

The Legal Standard

Section 1028(a) of the Dodd-Frank Act requires the CFPB to conduct a study concerning the use of pre-dispute arbitration agreements between covered persons and consumers in connection with the offering or providing of consumer financial products or services. That study is cited herein as the CFPB Arbitration Study. Section 1028(b) of the Dodd-Frank Act provides that the CFPB "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." Further, the Act requires that the rule be consistent with the CFPB Arbitration Study. As explained below, the CFPB's proposed rule satisfies both requirements. It is in the public interest and for the protection of consumers, and it is consistent with the CFPB Arbitration Study.

Incorporation By Reference

Woodstock would like to incorporate into this letter the comments already submitted to the CFPB by certain commenters. These comments include (1) comments dated May 23, 2016, submitted by 210 law professors and scholars (the "Professors' Letter"), (2) comments dated August 3, 2016, submitted by certain U.S. Senators and Members of Congress, and (3) comments dated August 11, 2016, submitted by certain Attorneys General.

About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of equitable lending and investments; wealth creation and preservation; and safe financial products, services, and systems. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. Our key tools include: applied research; policy development; coalition building; and technical assistance. Woodstock Institute has been a recognized economic justice leader and bridge-builder between communities and policymakers in this field since it was founded in 1973 near Woodstock, Illinois.

Class actions enable consumers to hold companies accountable for their behavior.

The CFPB Arbitration Study presents solid evidence that class actions have been effective in enabling consumers to vindicate their rights. Consumers have obtained both monetary and "behavioral relief" through class action litigation. The CFPB Arbitration Study analyzed 419 consumer financial class action settlements in federal court from November 1, 2008, through December 31, 2012.[ii] Data on class size was available for 329 of those cases. In those 329 cases, there was a total of 350 million class members.[iii] In terms of relief to the class, for the 419 cases, the total amount of relief offered was $2.7 billion, which included cash relief, debt forbearance, in-kind relief, fees, and expenses.[iv] Fifty-six of the settlements had behavioral relief – commitments by the company "to alter its behavior prospectively, for example by promising to change business practices in the future or implementing new compliance programs."[v] Data on the size of payments actually made or scheduled to be made to the class was available for 251 of the 419 cases. For those 251 cases, $1.1 billion had been or was scheduled to be paid to class members in cash or debt forbearance.[vi] Data on the number of individual payments was available for 236 of the 419 cases. For those 236 cases, 34 million consumers were guaranteed recovery.

The average payment per individual that was made or scheduled to be made in the 251 cases referenced above was less than $33. If the 34 million consumers referenced above had been prevented from participating in a class action, it is likely that the vast majority (if not all) of them would have received nothing because the size of each individual claim was too small to warrant a lawsuit or an arbitration. The Professors' Letter quotes Judge Richard Posner, who stated: "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."[vii] Indeed, the CFPB Arbitration Study found that, for six product markets, there were only 3,462 individual consumer cases filed in federal court during a three year period.[viii] As for individual arbitrations, the CFPB Arbitration Study found that, for six product markets, there were only 1,409 claims filed by consumers or filed mutually by companies and consumers with the American Arbitration Association for the period of 2010 to 2012.[ix] These data strongly suggest that a class action waiver does not simply deprive a consumer of the class action mechanism, it effectively deprives the consumer of any practical remedy and enables companies to get away with behavior that costs consumers hundreds of millions of dollars. Class actions are necessary to ensure that consumers can hold companies accountable for their behavior.

Class actions deter corporate wrongdoing.

Preserving the right of consumers to band together in class actions helps deter bad behavior by corporations. Academics have found empirical evidence that class action litigation has a deterrent effect on "potential miscreants."[x] The Professors' Letter states that "[c]ompanies engage in risk management calculations and are less likely to risk violating consumer laws if they know they may be sued in class actions for such violations."[xi] This argument is common sense. Assuming that corporations are rational actors, they are less likely to rip off or otherwise harm their customers if they know that it may result in protracted and costly litigation. The deterrent effect of class actions is a compelling reason to prohibit class action waivers.

The arbitration process tilts in favor of corporations.

The data on arbitration outcomes contained in the CFPB Arbitration Study show that arbitration is not friendly territory for consumers. The CFPB identified 158 cases brought by consumers in which the arbitrator rendered a decision on the merits. In those cases, arbitrators provided some kind of relief in favor of consumers' affirmative claims in only 32 disputes (20.3 percent).[xii] By contrast, of 244 cases brought by companies in which the arbitrator rendered a decision on the merits, arbitrators provided some kind of relief in favor of the company in 227 or 93.0 percent of those disputes.[xiii] For consumers, these are not good odds.

The "repeat player" effect may skew arbitrations in companies' favor. That is, a party who makes repeat appearances before an arbitrator is more likely to prevail. Professor Lisa Blomgren Amsler (formerly Bingham) conducted a study that identified the existence of the repeat-player effect in employment arbitrations.[xiv] Her findings were as follows:

> In repeat player cases, employees won something only 16% of the time. Employees dealing with non-repeat player employers recovered on average 48% of what they demanded, while employees dealing with repeat player employers recovered only 11% of what they demanded.[xv]

It is much more likely for a company, as opposed to an individual, to be a party to multiple arbitrations. This may benefit a company in two ways. First, the company, due to its experience with arbitration, is better able to use the system to its advantage. Second, the hope for repeat business gives arbitrators a financial incentive to rule in favor of the company. Surely, a ruling in the company's favor increases the likelihood that the company will continue to use the firm's arbitrators. This is not paranoia; it is common sense. It is only rational that a company would favor an arbitrator who has ruled in its favor in the past.

Arbitrator bias – whether real or apparent -- is reinforced by the fact that consumers can rarely appeal arbitration decisions. Knowing that his or her decision will not be reviewed may embolden a potentially biased arbitrator. From 2010 to 2012, out of 1,847 arbitration cases filed, the CFPB identified only four consumer appeals, none of which resulted in a reversal of the original award.[xvi] The data regarding arbitration outcomes, the possible "repeat player" effect, and the non-appealability of arbitration decisions all support banning arbitration agreements altogether.

Consumers do not knowingly and voluntarily enter into arbitration agreements.

Consumers are not able to negotiate the terms of their contracts with financial product and service providers. (Imagine a consumer trying to haggle over the fine print of his credit card agreement!) Thus, an arbitration "agreement" in a consumer financial contract is not an agreement at all, but rather, is a "take it or leave" provision that is forced on the consumer. Moreover, in the vast majority of instances, consumers are unaware that they are "agreeing" to sign away their rights. The CFPB conducted a nationwide telephonic study of credit card users to measure their awareness of the dispute resolution provisions in their credit card agreements. Less than 7% of consumers whose credit card agreements included pre-dispute arbitration clauses stated that they could not sue their credit card issuers in court.[xvii] As noted by the CFPB, "[e]ven this 7% share may not, in fact, have knowledge of the clause. A statistically similar proportion of consumers without a clause in their agreement reported that they could not sue their issuers in court. (7.7% compared to 6.8%.)."

The fact that these waivers of rights are neither knowing nor voluntary should render them invalid. If not invalid as a legal matter, they are contrary to basic principles of justice. In the employment context, "[a] waiver in a severance agreement generally is valid when an employee *knowingly and voluntarily* consents to the waiver (emphasis in original)."[xviii] Similarly, in the consumer financial product and service context, because arbitration agreements are neither knowing nor voluntary, the CFPB ought to expand its proposed rule to do away with pre-dispute arbitration agreements altogether.

The proposed rule's reporting requirement would promote transparency and accountability.

As observed in the Professors' Letter, arbitration is mostly a private and confidential process.[xix] An arbitrator who might choose to insert bias in his or her decision would be encouraged by this veil of secrecy. By contrast, openness and transparency promote accountability. Justice Louis Brandeis famously said, "Sunlight is said to be the best of disinfectants." Arbitrators are more likely to adhere to standards of justice and fairness if they know that their decisions are being reported to federal authorities and being published on the internet (even in a redacted form). In this way, the proposed rule's reporting requirement is in the public interest and for the protection of consumers.

The information that would be collected under the proposed rule would benefit policymakers, industry, consumer advocates, and the general public.

The information that would be collected under the proposed rule would be useful to many parties. For policymakers, the information would help them tailor laws and regulations that promote good public policy. For industry, the information would make them aware of practices that might run afoul of existing laws and regulations. For consumer advocates, the information would enable us to better target our advocacy efforts. And, for members the general public, the information would alert consumers to possible injuries to themselves of which they might be unaware.

Conclusion

Class actions play an important role in enabling consumers to hold corporations accountable for wrongdoing. This is good for both consumers who are harmed by corporate wrongdoing and – because of the deterrent effect of class actions – for the general public. Thus, permitting corporations to force consumers to waive their right to participate in class actions runs contrary to the public interest. Correspondingly, the CFPB's proposed rule prohibiting class action waivers is in the public interest and for the protection of consumers.

The same is true for the proposed rule's requirement that regulated companies provide the CFPB with information regarding the use of arbitration in the consumer financial context. This requirement promises to increase arbitrator accountability and to inform future policy-making in the area of arbitration.

Finally, as explained in the foregoing, Woodstock believes that ample evidence exists to support a blanket prohibition on pre-dispute arbitration clauses in the consumer financial context. It would be difficult to credibly argue that arbitration agreements in the consumer financial context represent a "meeting of the minds." Because these agreements are not voluntary and because they are usually not entered into knowingly, they should not be allowed to deprive consumers of their constitutional rights.

Thank you for your thoughtful consideration of our comments.

Very truly yours,

Dory Rand

Dory Rand
President
Woodstock Institute

[i] The final rule should specifically delineate the entities that are covered. Woodstock also concurs with the National Consumer Law Center's comments regarding the entities that should be covered by the rule.
[ii] CFPB Arbitration Study at 8.1.
[iii] *Id.*
[iv] *Id.*
[v] *Id.* at Section 8.1. n.7.
[vi] *Id.*
[vii] The Professors' Letter at 5 (citing *Carnegie v. Household Int'l Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).
[viii] CFPB Arbitration Study at 6.2.1.
[ix] *Id.* at 5.5.1.
[x] Jennings, Jared; Simi Kedia; and Shivaram Rajgopal. "The Deterrence Effects of SEC Enforcement and Class Action Litigation," at 1. August 10, 2011. https://www.researchgate.net/profile/Shiva_Rajgopal/publication/265524471_The_Deterrence_Effects_of_SEC_Enforcement_and_Class_Action_Litigation/links/53fe2d710cf23bb019be43bd.pdf.
[xi] The Professors' Letter at 4.
[xii] CFPB Arbitration Study 5.2.2. at 13.
[xiii] *Id.* at 14.
[xiv] Lisa Bingham, "Employment Arbitration : The Repeat Player Effect," Employee Rights and Employment Policy Journal (1999). http://www.kentlaw.edu/ilw/erepj/abstracts/v1n1/Bingham.html#Name_1_.
[xv] *Id.*
[xvi] CFPB Arbitration Study at 5.2.1, 5.2.2.
[xvii] *Id.* at 3.1.
[xviii] EEOC, "Understanding Waivers of Claims in Employee Severance Agreements," accessed Aug. 16, 2016. https://www.eeoc.gov/policy/docs/qanda_severance-agreements.html.
[xix] The Professors' Letter at 7.