CFPB's Report to Congress: To Arbitrate Consumer Financial Services Claims or Not

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The Consumer Financial Protection Bureau published its "Arbitration Study, Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act §1028(a)" and a "Fact Sheet" about the Report in March. The Report follows and updates the CFPB's "Arbitration Study Preliminary Results" issued in December 2013. The CFPB characterizes its Report as "the most comprehensive empirical study of consumer financial arbitration carried out to date." Consumer financial services companies should consider the Report's approach, possible rulemaking and actions by the CFPB, and steps that can be taken to anticipate those actions.

The backdrop for the Consumer Financial Protection Bureau's (CFPB) *Arbitration Study, Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act §1028(a)*[1] is characterized by the CFPB in a somewhat negative context. The CFPB introduces its report by stating that the use of pre-dispute arbitration provisions by the financial industry in agreements governing consumer financial products and services is fraught with "contentious legal and policy issues." It further characterizes "the advantages and disadvantages of pre-dispute arbitration provisions in connection with consumer financial products or services" as being "fiercely contested." It goes on, however, to cite as an "important development" in this ongoing controversy the US Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*,[2] a decision that, among other things, resolved a division between the courts on state law challenges to the enforceability of no-class provisions in arbitration clauses.

Concepcion established that the Federal Arbitration Act of 1925 (FAA)[3] preempts state laws that "stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in enacting the FAA, including those laws that prohibit enforcing arbitration clauses that do not allow class action arbitration. *Concepcion* concluded that "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[4] The CFPB notes that there has been a "slight increase in arbitration clause use between year-end 2012 and year-end 2013 [and] continues the slight upward trend since the Supreme Court's 2011 decision in *Concepcion*."

It does not otherwise address the Supreme Court's views expressed in *Concepcion* on the enforceability of arbitration provisions and no-class provisions in consumer contracts.

The CFPB report states that it is only reporting the results of data gathering and analysis. Yet, in what is referred to as its "Facts Sheet" about the report,[5] it summarizes the results by concluding "that arbitration agreements restrict consumers' relief by limiting class actions." It contrasts the number of consumers who filed individual claims with the number of consumers eligible for relief through class action settlements, implying that requiring individual arbitration is not an effective means of addressing consumer disputes. It further concludes that there is "[n]o evidence of arbitration clauses leading to lower prices for consumers." It cautions that its figures do not include the "potential value to consumers of companies changing their behavior," potentially reflecting its willingness to accept consumer advocates' criticism of arbitration clauses premised on the theory that arbitration clauses "may undermine deterrence and leave widespread wrongdoing against consumers unaddressed."

Given the apparent contrasting positions between consumer advocates and the consumer financial services industry, understanding the data and the limits of the report is important. Consumer financial services companies should consider reviewing their current arbitration agreements to anticipate action by the CFPB, which could include prohibiting arbitration provisions in consumer financial services contracts altogether or imposing conditions and limitations on their use.

The Report Required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd- Frank Act) directs the CFPB to "conduct a study of, and...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." After the report is submitted to Congress, the CFPB can issue regulations designed to prohibit or impose conditions or limitations on the use of an arbitration agreement by a consumer financial services provider—a "covered person"[6]—if it finds "that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers."

In mid-December 2013, the CFPB issued its 168-page "Arbitration Study Preliminary Results."[7] The study has been subject to much criticism by industry participants because, although its research was incomplete, it nevertheless signaled the antipathy the CFPB has for the use of arbitration agreements in contracts between financial services providers and consumers. For example, although couched as a factual presentation, the study's initial "conclusions" raised serious concerns about whether the subsequent report would be balanced when it analyzed the complex issues that would need to be addressed. A number of reviewers of the study concluded that, in most instances, the tone of the study, and the CFPB's preliminary findings, could be read as justifying the CFPB's eventual conclusion that arbitration provisions in consumer financial services contracts are detrimental to consumers and should be regulated. An objective reading of the limited research in the study, however, shows that the current conflict resolution system that has been developed is working well to promptly resolve small dollar amount claims—an area that is important to both consumers and those who offer consumer financial products and services. For example, the carve-out in many arbitration provisions permitting claims to be brought in small claims courts appears to work fairly and efficiently and, for larger claims, the amounts rarely exceed $20,000 to $30,000. Those claims are generally handled expeditiously in an arbitral forum.[8] The study is now Appendix A to the report.

Analysis of the Report

The criticisms of the study and, ultimately, of the report, may result from the long-held opinion and characterization by consumer advocates that the interests of consumers and the financial services industry are adverse. As an example, the CFPB generalizes that "[c]onsumer advocates generally see pre-dispute arbitration as unfairly restricting consumer rights and remedies" whereas, "[i]ndustry representatives, by contrast, generally argue that pre-dispute arbitration represents a better, more cost-effective means of resolving disputes that serves consumers well."[9]

The CFPB shows its bias when it notes that class actions are the preferred and only effective method for seeking to change the behavior of companies even though arbitrators can award remedies to address

consumer claims, including granting injunctive relief. The CFPB does not pursue that issue, perhaps because the relief that can be awarded depends, in part, on federal and state statutes that provide procedures and requirements for private contractual arbitration.[10]

An arbitration is conducted according to the specific terms of the arbitration provision, the rules of the arbitral forum, and the federal or state law that applies to the arbitration. That important analysis is missing and appears to have been considered beyond the scope of the report. Arbitrators also do not make their awards in a vacuum. Even though private arbitration is confidential, an award must be confirmed by a court in order to be enforceable. If an arbitration case is settled, dismissed, or abandoned for other reasons, the results may not be available at all.

The CFPB provides data in its report about class action recovery. However, that data is limited and does not isolate the actual recovery received by a consumer (who makes a claim in the class settlement). The number of consumer plaintiffs in a settlement class who actually submit a timely and meritorious claim and receive settlement funds or benefits is generally a small percentage of the members of the proposed settlement class. The amounts recovered in the class settlements included in the report also include attorneys' fees for plaintiffs' counsel and other costs of administration. There is simply insufficient data in the report to understand the benefits obtained by consumers in a class action or to conclude that a class action is a superior method for resolving consumer claims. It appears that the emphasis of the CFPB lies, not in the recovery by an individual in a consumer claim or dispute, but rather, in the perceived non-monetary aspects of consumer class actions: the ability to seek a change in the behavior or practices of the defendant by requesting injunctive or other remedial relief. It ignores that, in many cases, defendants may capitulate to class claims because there is no cost-effective way to resolve the dispute on the merits because of the rules governing class actions generally.

Consumer advocates often characterize the use of arbitration provisions in consumer contracts as tilting the playing field against consumers in favor of the financial services industry. This supposition disregards the indisputable national public policy that strongly favors arbitration and the fact that the Supreme Court dispelled the myth that permitting classwide resolution of disputes is required. The evidence is the FAA itself and the Supreme Court's and other courts' recent endorsements of the enforceability of arbitration provisions in consumer contracts. Contrary laws and rules are preempted.

Although it is not possible to predict with certainty what regulatory actions the CFPB may take to address arbitration provisions, opponents of arbitration in consumer contracts will likely push the CFPB to require that arbitration provisions in contracts between consumers and financial services providers permit the arbitration of class claims or require certain provisions deemed to "level the playing field" or hybridize arbitration. In contrast, the consumer financial services industry will likely insist that the CFPB be required to justify any action it takes to limit the use of arbitration provisions in consumer financial contracts. The CFPB may be required to demonstrate actual consumer harm (*i.e.*, that prohibiting, conditioning, or limiting the use of arbitration agreements "is in the public interest and for the protection of consumers") as it faces challenges under the Administrative Procedures Act (APA).[11] The evidence of harm will require more than the two years of data, limited scope, and limited analysis of the report.

The Empirical Data

The CFPB reports that "[t]ens of millions of consumers use consumer financial products or services that are subject to pre-dispute arbitration clauses."[12] In its analysis of the nine core sections in the report, the CFPB relies on the following empirical data:

- Section 2, *How prevalent are pre-dispute arbitration clauses and what are their main features?*, is based on a number of data sets the CFPB assembled consisting of a total of approximately 850 consumer financial agreements, of which slightly under half are credit card agreements;
- Section 3, *What do consumers understand about dispute resolution systems?*, reports on the results of a national survey of 1,007 credit card holders concerning their knowledge and understanding of arbitration and other dispute resolution mechanisms;
- Section 5, *What types of claims are brought in arbitration and how are they resolved?*, is based on a data set consisting of 1,847 arbitration cases filed with the American Arbitration Association (AAA) by consumers or companies from 2010 to 2012,

for six consumer financial product markets: credit cards, checking accounts/debit cards, payday loans, prepaid cards, private student loans, and auto loans.

- Section 6, *What types of claims are brought in litigation and how are they resolved?*, is based on a data set consisting of 562 state and federal consumer financial class actions and 3,462 individual actions in federal court, filed between 2010 and 2012, assembled through a computer-assisted search methodology coupled with extensive manual review; one in seven federal credit card cases chosen as a random sample was included in the analyses;
- Section 7, *Do consumers sue companies in small claims courts?*, repeats the CFPB's small claims court analysis presented in the study and is based on a review of more than 42,000 filings in small claims courts by consumers and companies in the credit card marketplace;
- Section 8, *What is the value of class action settlements?*, is based on a data set consisting of 419 consumer financial class action settlements subject to final approval between 2008 and 2012 assembled through a computer-assisted search methodology coupled with extensive manual review; this review also includes a case study of one multidistrict litigation (MDL) proceeding involving consumer financial issues and combines class actions against approximately two dozen financial institutions;
- Section 9, *What is the relationship between public enforcement and consumer financial class actions?*, is based on a data set consisting of 1,150 consumer financial public enforcement actions identified through a search of selected Web sites of state and federal regulatory and enforcement agencies; through computer-assisted searching and extensive manual review, the CFPB identified a matching private class action for 133 of the public enforcement cases and 33 overlapping consumer class actions; and
- Section 10, *Do arbitration clauses lead to lower prices for consumers?*, uses the CFPB's Consumer Credit Card Database, which contains de-identified, account-level data with respect to credit card accounts covering an estimated 85–90 percent of the credit card marketplace.

Recommendations

Anticipating possible adverse regulatory action by the CFPB, it may be in the consumer financial services industry's best interests to continue developing research and issuing its own studies that support the continued and unabated use of arbitration provisions in consumer financial products and services contracts.[13] Elements of the report may be useful to consumer financial services industry participants when they review their current arbitration provisions to anticipate adverse CFPB action by reviewing, updating, or adopting arbitration provisions for their various consumer contracts. This is particularly important because it is not at all clear whether a regulation adopted by the CFPB limiting consumer arbitration provisions would be applied retroactively or would otherwise nullify an existing provision in a consumer financial contract on a going-forward basis.[14]

Even if future regulations or restrictions on arbitration in consumer contracts are not applied retroactively or do not prohibit enforcement of existing contract provisions, the CFPB has the ability to challenge their use. The CFPB can act under its authority to challenge any consumer practices as unfair, deceptive, or abusive acts and practices (UDAAP).[15] There is some guidance in analogous statutes as to what practices may be considered unfair or deceptive, and thus subject to UDAAP actions, but it must be noted that it is only guidance. It is not binding on the CFPB.[16] Recent UDAAP actions by the CFPB and state attorneys general provide some limited guidance, but are by no means definitive.

The report identifies several features in the arbitration provisions that were reviewed by the CFPB, and in each case it provides statistics about the categories of contracts for consumer financial products and services contracts that include them. These categories provide some insight into the aspects of arbitration that most concern the CFPB.

The features discussed in the report include arbitration provisions that:[17]

- Allow the consumer to opt-out or reject the arbitration clause within a specified time period (generally either 30 or 60 days);
- Permit claims to be brought in small claims actions in lieu of an arbitral forum;
- Identify an entity(ies) (*e.g.*, AAA, JAMS, or the National Arbitration Forum) that may administer the arbitration, including procedures governing how the arbitrator(s) are to be selected;

- Delegate enforceability decisions to the arbitrator, reducing the role of courts in applying, for example, the unconscionability doctrine to assess the enforceability of arbitration clauses;
- Limit the availability of claims proceedings and representative actions;
- Limit the recovery of damages, including, but not limited to, punitive and consequential damages;
- Limit the time period a consumer can file a claim in arbitration;
- Impose confidentiality and nondisclosure obligations on the parties;
- Mandate the location of the hearing;
- Allocate the costs of arbitration between the parties;
- Include a contingent minimum recovery;
- Address various core characteristics of the arbitration process, including, but not limited to, waiver of a jury, inability to participate as a class member in a class action filed in a court, discovery limitations, and appeal rights; and
- Include an arbitral appeals process.

Many of the arbitration provisions reviewed by the CFPB in its report reflect an evolving process by financial services companies to draft arbitration provisions that will withstand enforceability challenges and respond to *Concepcion* and its progeny. Enforceability challenges continue following the Supreme Court's ruling. One of the remaining arguments used to defeat arbitration is that the provision is unconscionable. Many courts have sharply limited using state law-based theories of unconscionability to deny arbitration. Others are still reluctant to do so.

The need for injunctive relief has been the basis for another challenge to enforcing arbitration. The argument has been that some statutory claims are not subject to arbitration because they seek injunctive relief, which is not available in arbitration. That argument has recently been significantly eroded. For example, several California courts have confirmed that claims for injunctive relief brought under California's unfair competition law, false advertising law, and Consumers Legal Remedies Act are arbitrable.[18] Nonetheless, the challenges to the enforceability of arbitration provisions continue and the CFPB has signaled its intentions. There may be no sure way to avoid a challenge to an arbitration provision in a consumer contract, but taking a balanced, even-handed approach when drafting and enforcing consumer arbitration provisions will be a necessary step.

Endnotes

1 A copy of the report can be found at *http://www.consumerfinance.gov/reports/arbitration-study-report-to-congress-2015/*, last accessed June 1, 2015.

2 131 S. Ct. 1740, 563 U.S. 321 (2011).

3 9 U.S.C. §§ 1-16.

4 *Concepcion, supra* n.2 at 1748.

5 A copy of the Fact Sheet can be found at *http://files.consumerfinance.gov/f/201503_cfpb_factsheet_arbitration-study.pdf*, last accessed June 1, 2015.

6 "Consumer Financial Product or Service" is defined as one that is offered or provided for use by consumers primarily for personal, family, or household purposes, or that is offered or provided in connection with such products. 12 U.S.C § 5481(5).

7 A copy of the study can be found at *http://files.consumerfinance.gov/f/2013_cfpb_arbitration-study-preliminary-results.pdf*.

8 Except as otherwise noted, the study is incorporated by reference into the CFPB's 410-page the report (not including Appendix A (the study) and Other Appendices (Appendices B through V). The report is the study, and report to Congress, required by Section 1028(a).

9 *See* report at p. 2.

10 *See*, for example, *California Code of Civil Procedure Sections* 1281–1281.96.

11 The statutory standard in Section 1028(a) of the Dodd-Frank Act (*i.e.*, that the imposing limitations on arbitration must be in the public interest and for the protection of consumers) appears to be significantly higher than the general standard required to support and justify agency actions under the APA. *See* 5 U.S.C. §§ 511–599.

12 *See* report at p. 9.

13 Section 1414(e) of the Dodd-Frank Act completely prohibits pre-dispute arbitration provisions for most residential mortgage loans, whereas the terms of Section 1028(a) impliedly confirm that the use of arbitration for other categories of consumer financial contracts is valid (but subject to an adverse determination by the CFPB after study and reporting).

14 Any regulation prescribed by the CFPB will apply 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 CFPB.

15 *See* Dodd-Frank Act, §§ 1002, 1031, & 1036(a), codified at 12 U.S.C. §§ 5481, 5531, & 5536(a).

16 Guidance is provided under Section 5 of the Federal Trade Commission Act.The CFPB is not bound to the FTC's interpretation of what is "unfair" or "deceptive."

17 The CFPB includes statistical data about the clauses included by the consumer financial services industry in their arbitration clauses in various tables. *See* Report, Section 2.5.1, Table 2: Arbitration Clauses Permitting Opt-Outs from Arbitration; Section 2.5.2, Table 3: Arbitration Clauses With Small Claims Court Carve-Outs; Section 2.5.3,Table 4: Sole Administrator Specified In Arbitration Clauses, and Table 5: Administrator Specified In Arbitration Clauses, Sole Or Otherwise; Section 2.5.4, Table 6: Delegation Provisions In Arbitration Clauses; Section 2.5.5, Table 7: Arbitration Clauses With No-Class-Arbitration Provisions; Section 2.5.6, Table 8: Damages Limitations In Contracts With Arbitration Clauses; Section 2.5.7,Table 9:Arbitration Clauses With Time Limits For Filing Claims; Section 2.5.8, Table 10: Arbitration Clauses With Confidentiality Provisions; Section 2.5.9, Table 11: Hearing Locations Specified In Arbitration Clauses; Section 2.5.12, Table 16: Disclosure Of Differences Between Arbitration And Litigation In Arbitration Clauses; Section 2.5.13, Table 17: Arbitration Appeals Process In Arbitration Clauses.

18 The FAA preempts the "*Broughton-Cruz* rule" the California Supreme Court established in *Broughton v. Cigna Healthplans*, 21 Cal.4th 1066 (1999), and *Cruz v. PacifiCare Health Systems, Inc.*, 30 Cal.4th 303 (2003). *See Kilgore v. KeyBank, N.A.*, 718 F.3d 1052 (9th Cir. 2013).

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