GT GreenbergTraurig

CFPB Observer

April 2015

CFPB Releases its Consumer Arbitration Study

The CFPB released its long-awaited study on the use of pre-dispute arbitration clauses in consumer contracts for financial products and services on March 10, 2015. The 410-page Arbitration Study (Study) (728 pages when including the 2013 Preliminary CBPB Study) is the CFPB's report to Congress, as required under Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Congress has also authorized the CFPB, under Section 1028(b) of the Act, to promulgate regulations "prohibiting or limiting" the use of pre-dispute arbitration clauses to the extent consistent with the CFPB's research, findings, the public interest, and the interests of consumers. The Study is a likely prelude to further regulations aimed at eroding the traditional use of arbitration as a remedy for resolving financial disputes. The Study's analytics and findings are limited to "pre-dispute" arbitration clauses, meaning those that are part of consumer contracts entered into before a dispute arises.

The CFPB set the foundation for the Study by characterizing as "fiercely contested" the debate between consumer advocates and industry representatives over the advantages and disadvantages of arbitration for resolving consumer financial disputes. In contrast with past efforts at studying consumer arbitration clauses, the CFPB claimed that the Study is "empirical, not evaluative," thus presumably more definitive and backed by further analytics and data. According to the CFPB, the Study is also distinguished from prior studies as bearing a more "consumer financial focus", with the findings based on a "careful analysis of empirical evidence." The Study follows three years of research and analysis that caps the CFPB's 2013 Preliminary Study. While certainly more consumer focused than many other studies, the CFPB fails to address or produce evidence that creditors' preferences for arbitration as the favored means for resolving consumer financial disputes has changed. As well, the Study does little to mask its support for class claims as providing the best benefit for consumers, notwithstanding the significant portion of recoveries devoted to class counsels' attorneys' fees and the costs of administration.

CFPB Director Richard Cordray, in remarks made at a field hearing coinciding with the March 10 release of the report, emphasized the comprehensive nature of the endeavor, citing a review of:

- 852 consumer finance agreements;
- 1,800 consumer finance arbitration disputes filed over the prior three years;
- 3,500 individual consumer finance cases filed in federal court;
- 562 consumer class action lawsuits filed in federal and "selected" state courts;
- Over 40,000 small claims filings in a single year;
- Over 400 consumer financial class action settlements reached in federal courts over a five-year period; and,
- Over 1,100 state and federal public enforcement actions in the consumer finance arena.

Additionally, the CFPB conducted a national telephone survey of over 1,000 credit card holders to "learn about their knowledge and understanding of arbitration and other dispute resolution mechanisms." As the Study shows, arbitration clauses bind as many as 80 million consumers through their credit card agreements.

Director Cordray's reference to the pre-Depression 1925 Federal Arbitration Act (FAA) during his remarks presages the belief that changes in the manner in which consumer financial arbitrations are handled are appropriate and overdue. This despite the Supreme Court's relatively recent decision in A*T&T Mobility LLC v. Concepcion*, 563 U.S. 321 (2011), affirming the FAA's goal of encouraging arbitration by requiring courts to honor arbitration agreements in accordance with the contracting parties' expectations.

Among other significant findings, the Survey found that only 2 percent of consumers surveyed said they would consider bringing formal legal proceedings against their credit card issuer if they were unable to obtain relief through the company's own channels. Three out of four of the consumers surveyed did not know whether they were subject to an arbitration clause.

As Director Cordray stated, the CFPB is committed to "data-driven decision-making," as distinguished from the lack of empirical evidence that informed this exercise in years past. The Director celebrated the "depth and richness" of the Study, which presents a challenge to the Congress as to whether it will agree. Industry advocates have suggested that the Study was not structured to fully measure consumer sentiments when it comes to the benefits of litigation versus arbitration.

The underlying data were assembled to analyze consumer pre-dispute arbitration clauses in contracts for credit cards, prepaid cards, payday loans, and checking accounts, focusing on the particular characteristics and features of these clauses, and the frequency and circumstances in which consumers actually avail themselves of the arbitration process to resolve disputes.

The likely direction and immediate results following Congress's digestion of the Study will be CFPB regulations on pre-dispute consumer finance arbitration clauses. The Study's conclusion that class and collective action waivers, which are found in more than 90 percent of the contracts reviewed, are problematic and should be limited will likely be in the CFPB's regulation. Therefore, the CFPB may be positioning to mount a regulatory challenge under Section 1028(b) of the Dodd-Frank Act to the Supreme Court's validation of "no class" provisions in pre-dispute consumer financial arbitration clauses in *Concepcion*, where the FAA was held to preempt California's prohibition as unconscionable any pre-dispute arbitration clause through which consumers waived their right to pursue class actions.

As highlighted by Director Cordray, companies invoke arbitration clauses to block class actions more commonly (in nearly two-thirds of cases studied) than to force an individual lawsuit into arbitration. As well, even though the American Arbitration Association (AAA) – the largest national organization devoted to arbitration – has a procedure to handle class-wide disputes in arbitration, AAA's rules only permit such a proceeding if not barred under the parties' contract. The Study concludes that only two class action arbitrations were filed with the AAA between 2010 and 2012, neither of which was concluded as of the Directors' recent remarks (one was dropped, and the other is pending dismissal).

Further, as to results from class action settlements compared with results from arbitrations, the Study considered federal district court and selected state court actions – which included the same "product markets" analyzed for arbitrations (i.e., credit card; checking account/debit cards; payday loans; prepaid cards; private student loan; and, auto loans), but found that the areas providing the most cash in settlement were checking/savings products, credit reporting, credit cards and auto loans. The CFPB

sought to address the benefits to consumers from individual arbitration as compared to the results from participating in class action settlements. The data set covered 419 class action settlements during 2008 through 2012, and consisted of a total of $2.7 billion recovered ($2.0 million cash and $700,000 in-kind relief) in gross settlements, which, after litigation costs of 18 percent (attorney's fees, costs, administrator fees totaling $490 million), resulted in net relief available to class members of $2.2 billion.

The actual comparison to arbitration outcomes in the Study are limited and contain many qualifiers, including that limited data are available because of non-reporting of arbitration awards and the fact that arbitrators do not resolve the majority of consumer financial disputes. The Study concludes that it is "quite challenging to attempt to answer even the simple question of how well do consumers (or companies) fare in arbitration." The Study's set-up of a much-sought real comparison of the results and benefits to consumers and companies between arbitration and class litigation will leave one without any real satisfaction or questions answered. Again, this may be by design as the CFPB is clearly trumpeting the resurgence of class claims as the best leveling agent for consumers (or, more likely, consumer advocates) against industry for resolving disputes involving consumer finance products and services.

Also, the Study includes a somewhat irrelevant finding as to whether arbitration clauses lead to lower prices for consumers. The CFPB found the theory of arbitration saving money, compared to litigation costs, which can be passed on to consumers is not supported by the data. The Study used "real-world" comparisons from a 2010 antitrust settlement where three credit card companies dropped their use of consumer financial arbitration for 3½ years (and thus were exposed to class action litigation). These three companies' experiences were compared to the non-settling companies that retained mandatory arbitration provisions in their contracts. The Bureau performed a "total cost of consumer credit" comparison between the issuers without arbitration clauses to those that retained the clauses. The Study found that there was no statistically significant evidence of any price increases to consumers without mandatory arbitration clauses, compared with those that retained their arbitration clauses in their contracts, which appears to be CFPB-speak for the proposition that mandatory consumer arbitration clauses do not lead to lower prices for consumers.

The upcoming months will provide the real results of the Study and likely future regulatory action as supposedly benefiting consumers justified by the mandate from Section 1028(b) that the CFPB act "in the public interest and for the protection of consumers" with regard to arbitration clauses involving consumer financial products and services provides a certainty that things will change dramatically. The "smart money" appears to be watching the potential interplay between the federal courts' actions involving consumer arbitration clauses as a potential preview of how legal challenges to rule-making may fare. The potential for some insight from the courts may occur relatively soon. On March 23, 2015 the Supreme Court accepted certiorari from the Ninth Circuit in *DirectTV v. Imburgia*, which has been set for oral argument during the Court's October 2015 term, and revisits a mandatory arbitration clause invoking the FAA. Although the narrow issue presented is whether a reference to state law in an arbitration agreement is somehow immune from the preemptive force of federal law, the Supreme Court's acceptance may signal an effort to provide further clarification to its 2011 decision in *Concepcion*. *[See this previous GT Alert on this subject, as well.]*

This *GT Alert* was prepared by **Murray B. Silverstein**, **Gil Rudolph, Brett Kitt,** and **Peter Cockrell.** Questions about this information can be directed to any member of Greenberg Traurig's **Consumer Financial Protection Bureau (CFPB)** team of professionals:

- Gil Rudolph | Co-Chair, Financial Regulatory & Compliance | +1 202.530.8575 | rudolphg@gtlaw.com
- Murray B. Silverstein | Financial Regulatory & Compliance | +1 813.318.5741 | silversteinmb@gtlaw.com
- Brett Kitt | Financial Regulatory & Compliance | +1 202.533.2359 | kittb@gtlaw.com
- Scott Sheehan | Financial Regulatory & Compliance | + 1 713.374.3543 | sheehans@gtlaw.com
- Michael Sklaire | Financial Services Litigation & Regulation | +1 703.749.1308 | sklairem@gtlaw.com
- Andy Berg | Financial Services Litigation & Regulation | +1 202.331.3181 | berga@gtlaw.com
- Michele Stocker | National Chair, Financial Services Litigation | +1 954.768.8271 | stockerm@gtlaw.com
- Jennifer Gray | Financial Services Litigation & Regulation | +1 310.586.7730 | grayjen@gtlaw.com
- Brian Schulman | Financial Services Litigation & Regulation | +1 602.445.8407 | schulmanb@gtlaw.com
- Jacob Bundick | Financial Services Litigation & Regulation | +1 702.792.3773 | bundickj@gtlaw.com
- Alan Slomowitz | Government Law & Policy| +1 202.533.2318 | slomowitza@gtlaw.com
- Albert Wynn | Government Law & Policy| +1 202.530.8531 | wynna@gtlaw.com
- Patrick Anderson | Government Law & Policy | +1 202.331.3100 | andersonp@gtlaw.com
- Thomas McKee | Litigation | +1 703.749.1300 | mckeet@gtlaw.com
- Peter Cockrell | Financial Regulatory & Compliance | +1 202.530.8517| cockrellp@gtlaw.com

Albany
+1 518.689.1400

Amsterdam
+31 (0) 20 301 7300

Atlanta
+1 678.553.2100

Austin
+1 512.320.7200

Boca Raton
+1 561.955.7600

Boston
+1 617.310.6000

Chicago
+1 312.456.8400

Dallas
+1 214.665.3600

Delaware
+1 302.661.7000

Denver
+1 303.572.6500

Fort Lauderdale
+1 954.765.0500

Houston
+1 713.374.3500

Las Vegas
+1 702.792.3773

London*
+44 (0) 203 349 8700

Los Angeles
+1 310.586.7700

Mexico City+
+52 (1) 55 5029 0000

Miami
+1 305.579.0500

New Jersey
+1 973.360.7900

New York
+1 212.801.9200

Northern Virginia
+1 703.749.1300

Orange County
+1 949.732.6500

Orlando
+1 407.420.1000

Philadelphia
+1 215.988.7800

Phoenix
+1 602.445.8000

Sacramento
+1 916.442.1111

San Francisco
+1 415.655.1300

Seoul∞
+82 (0) 2 369 1000

Shanghai
+86 (21) 6391.6633

Silicon Valley
+1 650.328.8500

Tallahassee
+1 850.222.6891

Tampa
+1 813.318.5700

Tel Aviv^
+972 (0) 3 636 6000

Tokyo¤
+81 (0)3 3216 7211

Warsaw~
+48 22 690 6100

Washington, D.C.
+1 202.331.3100

Westchester County
+1 914.286.2900

West Palm Beach
+1 561.650.7900