The Consumer Financial Protection Bureau's Arbitration Study

A Summary and Critique

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August 2015

MERCATUS WORKING PAPER

MERCATUS CENTER
George Mason University
3434 Washington Blvd., 4th Floor, Arlington, Virginia 22201
www.mercatus.org

Jason Scott Johnston and Todd Zywicki. "The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique." Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, August 2015.

Abstract

The Consumer Financial Protection Bureau's *Arbitration Study: Report to Congress 2015* does not support the case for ex ante regulation of mandatory consumer arbitration clauses. It contains no data on the typical arbitration outcome—a settlement—and it is these arbitral settlements, and not arbitral awards, that should be compared to class action settlements. It does not address the public policy question of whether, by resolving disputes more accurately on the merits, arbitration may prevent class action settlements induced solely by defendants' incentive to avoid massive discovery costs. It shows that in arbitration consumers often get settlements or awards, are typically represented by counsel, and achieve good results even when they are unrepresented. In class action settlements, the Consumer Financial Protection Bureau reports surprisingly high payout rates to class members and low attorneys' fees relative to total class payout. These aggregated average numbers reflect the results in a very small number of massive class action settlements. Many class action settlements have much lower payout rates and higher attorneys' fees.

JEL codes: K2, G2, K23, K41

Keywords: consumer financial regulation, arbitration, class action litigation, attorneys' fees

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Acknowledgments

The authors would like to thank the Mercatus Center for financial support and IBC Bank for generously sharing with us the data described in the article regarding internal resolution of complaints by consumers.

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I. Introduction

For decades, legal commentators have debated the normative desirability of clauses in consumer contracts that require consumers to arbitrate rather than litigate claims against providers of consumer products and services.[1] Consumer advocates have been especially concerned that, by precluding consumer class actions, such mandatory arbitration clauses will leave consumers without any effective remedy for violations of consumer contracts and allow even more egregious corporate misconduct that violates state and federal consumer protection statutes.[2] However, although many consumer contracts clearly include clauses requiring consumers to arbitrate claims, there is relatively little systematic empirical evidence about how consumers fare in either arbitration or consumer class actions. With dozens of state and federal consumer protection statutes aimed at both compensating consumers and deterring corporate misconduct, empirical evidence on the effectiveness of arbitration versus consumer class action has been needed badly.

In enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act,[3] Congress finally joined the debate over arbitration versus class action relief in consumer financial contracts. Under Dodd-Frank, pre-dispute mandatory arbitration clauses are unconditionally banned in contracts for residential mortgages and home equity loans.[4] For most other types of consumer financial contracts, however, Dodd-Frank delegates to federal agencies

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[1] *See* sources cited in Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SW. U. L. REV. 87, 87 n.1 (2012).
[2] For examples of this view, *see* David S. Schwartz, *Claim-Suppressive Arbitration: The New Rules*, 87 IND. L.J. 239 (2012); Maureen Weston, *The Death of the Class Action After* Concepcion*?*, 60 U. Kan. L. REV. 767 (2012).
[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[4] *Id.* § 1414.

the job of gathering more systematic evidence about arbitration. Section 1028(a) of Dodd-Frank requires the newly created Consumer Financial Protection Bureau (CFPB) to provide Congress with a report on "the use of agreements providing for arbitration of any future dispute between covered persons and consumers."[5] As for what the CFPB is to do after it issues such a report, section 1028(b) grants the CFPB the authority to "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." For arbitration clauses in broker–customer contracts, Dodd-Frank commands that the Securities and Exchange Commission (SEC) conduct a similar study.[6]

Although nothing indicates that the SEC will be reporting anytime soon on arbitration clauses in broker–customer contracts,[7] the CFPB has now issued two reports on arbitration in consumer financial contracts: the December 2013 *Preliminary Results* study (hereafter preliminary results)[8] and the March 2015 *Arbitration Study: Report to Congress 2015* (hereafter Report).[9] The CFPB substantially added to the Report while incorporating the earlier preliminary results. Although the tone and conclusions of the Report are measured and cautious, many commentators have interpreted it as a prelude to aggressive regulation of arbitration agreements

[5] *Id.* § 1028(a).
[6] Section 921 of Dodd-Frank also requires the Securities and Exchange Commission to study and report on the use of mandatory arbitration clauses in broker–customer contracts.
[7] As noted by George H. Friedman, *What's a Regulator to Do? Mandatory Consumer Arbitration, Dodd-Frank, and the Consumer Financial Protection Bureau*, 20 DISP. RESOL. MAG. (2014) (citation omitted) *available at* http://www.americanbar.org/publications/dispute_resolution_magazine/2014/summer/what-s-a-regulator-to-do--mandatory-consumer-arbitration--dodd-f.html ("Given the more than 90 mandatory study and rulemaking requirements the SEC has under Dodd-Frank, it is not at all surprising that arbitration is not high on the agency's priority list.")
[8] CONSUMER FIN. PROT. BUREAU (CFPB), ARBITRATION STUDY: PRELIMINARY REPORT (2013).
[9] CFPB, ARBITRATION STUDY: REPORT TO CONGRESS 2015 (2015).

in consumer credit contracts[10] or perhaps even as an outright ban on mandatory arbitration clauses. Deepak Gupta, who acted as senior counsel for enforcement strategy at the CFPB during the new federal agency's founding in 2011–2012, has told the press that prohibiting or restricting mandatory arbitration would be "the single most transformative thing the bureau can do" for consumers.[11] In May 2015, 58 members of Congress wrote to CFPB Director Richard Cordray, pointing to the findings of the study and "urg[ing] the CFPB swiftly to undertake a rulemaking to eliminate the use of forced arbitration clauses in these contracts."[12]

Proponents of that view particularly point to the Report's apparent enthusiasm for the use of class action litigation to resolve disputes involving consumer credit products instead of arbitration. Although the Report draws no firm conclusions, it may seem to suggest that arbitration is often an ineffective means for compensating consumers in disputes involving consumer credit products and that class action cases are an attractive alternative. If that is the implied message, then the CFPB may attempt to point to its Report as providing a foundation for banning or restricting the use of mandatory arbitration clauses in consumer credit contracts such as contracts for credit cards, prepaid cards, checking accounts, and payday loans, just as Dodd-Frank itself prohibits arbitration in mortgage and other contracts.

The CFPB's Report, however, provides no foundation for imposing new restrictions or prohibitions on mandatory arbitration clauses in consumer contracts. Although the Report provides some useful new information about the use of arbitration clauses in contracts involving

[10] As we note later, the Report is not limited to products that constitute "consumer credit," such as credit cards; it also includes a variety of consumer financial products, such as checking accounts, prepaid cards, and even cell phone contracts. Nevertheless, in this paper, we will frequently use the term *consumer credit contracts* as a shorthand for this range of contracts involving consumer financial products.

[11] Carter Dougherty, *CFPB Finds Arbitration Harms Consumers, Presaging New Rules*, BLOOMBERG BUS., March 20, 2015, *available at* http://www.bloomberg.com/news/articles/2015-03-10/cfpb-finds-arbitration-harms-consumers-in-study-presaging-rules.

[12] Letter from Sen. Al Franken et al. to Richard Cordray, Director, Consumer Financial Protection Bureau (May 21, 2015), *available at* http://www.cfpbmonitor.com/files/2015/05/150521CFPBarbitrationLetter.pdf.

consumer financial services, its findings fail to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class action litigation would be beneficial to consumers and the economy. Most importantly for public policy purposes, the CFPB's data do not allow for meaningful comparison between arbitration and class actions. The CFPB's Report sheds no light on what is perhaps the key public policy question: whether class action settlements often represent a deal struck by defendants to avoid massive discovery costs threatened in lawsuits of questionable substantive merit, whereas arbitration may resolve individual claims more accurately in terms of the substantive merits of the dispute.

Instead, the CFPB's Report presents mountains of data on outcomes in arbitration and in class action lawsuits. These data suffer from a number of shortcomings. The CFPB is to be lauded for looking at thousands of actual case files and docket sheets for details on class action settlements. But by presenting data on what consumers recover when arbitrators make a judgment in their favor but no data on what consumers recover when arbitrations settle—the likely outcome in a majority of arbitrations that the CFPB studies—the CFPB invites a false apples-to-oranges comparison between class action *settlements* and arbitral *awards*. The CFPB did not have access to data on the amount of arbitral settlements, but it should have clearly cautioned against drawing a comparison between arbitral awards and class action settlements.

As for the CFPB's data on class action settlements, its sample of class action settlements likely includes many settlements in lawsuits against debt collection agencies. Because debt collectors are not parties to an arbitration clause between the consumer and the creditor, a debt collector cannot avail itself of an arbitration clause in the contract between the consumer and creditor. The CFPB said that it only included class settlements involving disputes to which an arbitration clause might have applied. As the debt collector settlements were not such disputes, if the CFPB had consistently applied its own rule for determining which class settlements to include in the sample it studied, then the CFPB would have excluded the large number of debt collector class action settlements.

More seriously, the CFPB's data on two measures—on the fraction of consumers actually receiving a payment under a class action settlement (the claims rate) and on attorneys' fees as a fraction of the total amount paid to class members—are aggregate averages. To construct these aggregate averages, the CFPB counts the number of class members paid, and the total amount paid in attorneys' fees, and divides those numbers by, respectively, the total number of class members and the class payment. The problem with that approach is that it tends to overweight data from only half a dozen huge class action settlements. The outcomes in this very small number of class action settlements dominate the CFPB's reported data. Were the CFPB to have broken down claims rates and attorneys' fees by case type—for example, settlements under the Telephone Consumer Protection Act (TCPA)—then its data would likely have revealed not only that substantial variation exists across case types in both the claims rate and the size of attorneys' fees, but also that for some case types, such as TCPA settlements, only about 5% of consumers ever receive a payout in typical class action settlements, whereas attorneys' fees are on average almost as large as the total amount paid to the class.

As for the CFPB's arbitration data, the CFPB discovered that for most financial products, some providers require arbitration of disputes, but others do not. When arbitration is required, the CFPB found that a majority of consumers are represented by counsel in arbitration, with an even higher fraction represented when there is an issue regarding a disputed debt. At the same time, the CFPB found that arbitration is such a simple and cheap process (now requiring only a $200 filing fee) that consumers achieve good outcomes even when they are not represented by counsel.

Finally, we find the CFPB's data from consumer surveys very significant. When consumers were asked what they would do if a credit card company failed to remove a fee that the consumer complained had been wrongly assessed, very few said that they would resort to calling a lawyer. Instead, the vast majority of consumers said that they would simply cancel their accounts and take their business elsewhere. Our data indicate that this consumer market response is credible and real: as economic theory predicts, financial institutions seem to respond to the threat of losing a consumer's business by waiving various fees and charges on a case-by-case basis. For the vast majority of consumer disputes involving small claims, the market creates incentives for firms to resolve such disputes internally.

Our conclusion, therefore, is that although the CFPB Report has some new information about both arbitration and class action litigation as alternative devices for resolving consumer financial disputes, the Report does not provide much of the key information necessary to fully evaluate the relative roles of arbitration and class actions as ex post dispute resolution mechanisms for consumer cases. Substantially more and different evidence would be necessary to conclude that consumers are harmed by arbitration or that they would benefit from unleashing class action litigation more routinely. The propriety of caution in moving to restrict arbitration agreements on the basis of the CFPB's findings is especially appropriate in light of the well-established public policy favoring the use of alternative dispute resolution techniques. As the Supreme Court has repeatedly emphasized in opinions upholding mandatory arbitration clauses, when in the Federal Arbitration Act, the U.S. Congress made pre-dispute mandatory arbitration clauses "valid, irrevocable and enforceable,"[13] it expressed both a "liberal federal policy favoring

[13] The statute, Federal Arbitration Act, 9 U.S.C. § 2 (1925), continues to say ". . . save upon such grounds as exist in law or equity for the revocation of any contract."

arbitration" and the "fundamental principle that arbitration is a matter of contract."[14] Before regulation overrides such a well-established policy, substantial and rigorous evidence must show that arbitration is significantly worse for consumers than are the existing institutional alternatives.

In this paper, we will analyze the Report's methodology and conclusions and identify the Report's limitations as a basis for aggressive regulation of arbitration provisions in consumer credit contracts.

II. Well-Established Public Policy That Favors Arbitration over Litigation

In recent years, the Supreme Court has made it crystal clear that the policy favoring arbitration expressed in the Federal Arbitration Act preempts efforts by state courts, in particular, to declare that arbitration clauses are unenforceable on public policy grounds. More precisely, in *AT&T Mobility v. Concepcion*, the Supreme Court squarely addressed holdings by a number of state courts that arbitration clauses waiving class action litigation were unenforceable on grounds of unconscionability or public policy. Those courts[15] had reasoned that class action relief was necessary to secure an important goal underlying state consumer protection statutes—that of deterring firms from misbehavior that inflicts harm on consumers that is so small that individual claims are not viable but that is large in the aggregate. Relying solely on affidavit evidence from trial attorneys, these courts had held that individual arbitration could not effectuate this goal

[14] AT&T Mobility v. Concepcion, 563 U.S. 321, 131 S. Ct. 1740, 1745 (2011), quoting Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 67 (2010).

[15] Perhaps the most prominent example is the California Supreme Court in Discover Bank v. Superior Court, 36 Cal. 4th 148, 113 P.3d 1100 (2005), the case relied on by the California Supreme Court in declaring unenforceable the arbitration clause at issue in *Concepcion*. Under the narrow reading of the *Discover Bank* holding put forward by *Concepcion*, the court's rule striking down class action waivers was limited to such waivers in adhesion contracts in which the consumer alleged that small damages were incurred because of the defendant's scheme to "cheat" consumers. But other state supreme courts had relied on essentially identical reasoning without similar doctrinal limits. *See*, e.g., Scott v. Cingular Wireless, 161 P.3d 1000 (Wash. 2007).

because attorneys would not undertake such representation on an individual basis, even in arbitration. With class action relief waived, these courts had found that small consumer claims would not be effectively pursued, thus leaving consumers uncompensated and firms undeterred from misbehavior that generated such small, nonviable consumer claims.[16]

Concepcion was precisely the kind of small stakes consumer contract dispute for which state courts had claimed that individual arbitration could not substitute for class action–style relief. The plaintiffs in *Concepcion* alleged that that AT&T had engaged in false advertising and fraud by charging them a $30.22 sales tax on a phone that it had advertised as being free. Under AT&T's arbitration clause, for claims less than $10,000, a consumer wishing to pursue a claim in arbitration could do so over the phone, via written submissions, or in person. If the consumer received an arbitration award larger than AT&T's last settlement offer, then under the clause, AT&T promised to pay a minimum of $7,500 plus the claimant's attorney fees.[17] The District Court in *Concepcion* thought highly of this arbitration mechanism, finding that it was "quick, easy to use" and likely to "promp[t] full or . . . even excess payment to the customer without the need to arbitrate or litigate" and that the $7,500 premium functioned as "a substantial inducement for the consumer to pursue the claim in arbitration."[18] Still, it found that under California law, AT&T's clause was unenforceable because AT&T had failed to show that arbitration under its clause could adequately substitute for the deterrent effect of class action relief.

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[16] Some courts, such as the California Supreme Court in *Discover Bank*, tried to be careful to say that they were ruling arbitration clauses unconscionable so that their decisions would be protected from preemption by language in section 2 of the Federal Arbitration Act, which says that arbitration clauses are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2006). Other courts, such as the Washington Supreme Court in *Scott v. Cingular Wireless*, were willing to simply say that mandatory arbitration clauses in consumer contracts were void as against state public policy. As discussed later in this paper, the Supreme Court did not find at all persuasive the idea that *Discover Bank* represented just a routine (or case-specific) finding of unconscionability.

[17] This summary of the clause is taken from the Court's opinion in *Concepcion.*

[18] AT&T Mobility v. Concepcion, 131 S. Ct. 1740, 1745 (citing Laster v. T-Mobile USA, Inc., 2008 WL 5216255, *11–*12) (S.D. Cal., Aug. 11, 2008).

In reversing the Ninth Circuit affirmance in *Concepcion*, the Supreme Court ruled that by effectively requiring that consumers be given the choice between individual versus classwide relief ex post, the California Supreme Court's approach to mandatory arbitration in consumer contracts would create an inevitable incentive for such classwide dispute resolution. This incentive, the Court held, struck at the heart of the federal policy favoring arbitration, for "the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment."[19]

Since *Concepcion,* the Supreme Court has continued to reject challenges to the enforceability of arbitration clauses that are based on the supposed loss of deterrence entailed by mandatory arbitration. In 2013, in *American Express v. Italian Colors Restaurant*[20] (*Amex II*), the Court ruled enforceable a clause mandating arbitration and waiving classwide relief even for claims alleging violations of federal antitrust law. The plaintiff in *Amex II* had argued that no plaintiff's attorney would incur the enormous cost of hiring the experts necessary to have a chance of winning such a case unless individual claims were aggregated to allow classwide damages. The Supreme Court saw no merit in this argument, responding to it by commenting simply that in *Concepcion*, "we specifically rejected the argument that class arbitration was necessary to prosecute claims 'that might otherwise slip through the legal system.'"[21]

The Supreme Court's conclusion in *Amex II* is particularly informative about the Court's attitude toward arbitration and its potential. The affidavit evidence in that case—that the expert witnesses that are necessary to pursue such cases are a large expense that can be justified only by

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[19] *Id.* at 1751.
[20] 470 U.S. 213, 133 S. Ct. 2304 (2013).
[21] *Id.* at 2312 (citing *Concepcion*, 131 S. Ct. at 1753).

the prospect of aggregate recovery—likely struck many antitrust litigators as accurate. However, the conclusion that such aggregate recovery can be achieved only through class actions is not one the Court was ready to accept. Class action law firms already have begun to file mass arbitrations for antitrust violations, and an online consumer organization even helps consumers join such mass arbitrations.[22] The Court's broad interpretation of the Federal Arbitration Act reflects its view that Congress wants arbitration to be given every chance to succeed. The Supreme Court's now quite extensive jurisprudence on arbitration has made clear that the strong presumption in federal law in support of arbitration rests in large part on the idea that consumers benefit from the speed, simplicity, and low costs of arbitration. An often-repeated argument is that much of this benefit comes in the form of lower consumer prices.[23] As we explain later in this paper, the decreased consumer prices may result from the lower litigation costs, but the magnitude of the decrease may be difficult to estimate. However, as we also stress, arbitration may benefit consumers further by improving firm incentives to invest in accurate internal dispute resolution systems that pretermit external dispute resolution in whatever form. And, of course, consumers may benefit from being able to participate directly in a cheap, quick, and informal method of dispute resolution.

Whatever the range of benefits to consumers from arbitration may be, the Supreme Court is clearly of the view that Congress may well have understood there to be many benefits. At the same time, the chorus of criticism regarding class action litigation has grown in recent years. As a result of those criticisms, initiatives at both the state and the federal levels have attempted to

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[22] *See* Sternlight, *supra* note 1, at 92.

[23] *See* Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 1 J. DISP. RESOL. 89, 90–93 (2001); Stephen J. Ware, *The Case for Enforcing Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251 (2006); Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. & PUB. POL'Y 549, 575–76 (2008).

pare back class actions and to ensure that class actions truly further the cause of justice and result in compensation to consumers for real harms suffered, rather than simply providing an outsized payment to class action lawyers to resolve nuisance litigation.

Those efforts have been met by a campaign by class action attorneys, law professors, and consumer advocates to delegitimize arbitration while supporting class actions for disputes involving consumer products and services.[24] Given the hostility of those interests to arbitration, it was not unexpected that they would celebrate the tone of the CFPB's Report as signaling a move toward restrictions on arbitration agreements. For example, in the letter from Democratic members of Congress, the signatories asserted,

> In total, the study conducted by the CFPB at Congress's request roundly confirms that individuals unknowingly sign away their rights through forced arbitration agreements, which do not reduce consumer costs for financial services. . . . Based on this substantial bedrock of evidence, we urge the CFPB to move forward quickly to use its authority under the Dodd-Frank Act to issue strong rules to prohibit the use of forced arbitration clauses in financial contracts and give consumers a meaningful choice after disputes arise.[25]

Critics of arbitration agreements make a number of stylized, oft-repeated criticisms of arbitration.[26] Some critics, such as the California Supreme Court,[27] object to arbitration clauses contained in what they call *adhesion contracts*, by which they mean contracts whose terms (including arbitration terms) were not and probably could not be subject to consumer bargaining. Other critics argue that arbitration proceedings are unfair and tilted against consumers and that

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[24] For works by one especially dedicated scholar, *see* Myriam Gilles, *Killing Them with Kindness: Examining Consumer-Friendly Arbitration Clauses after* AT&T Mobility v. Concepcion, 88 NOTRE DAME L. REV. 825 (2013); Myriam Gilles, *Opting out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373 (2005).
[25] Letter from Franken et al., *supra* note 12, at 2.
[26] Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 163 (2005); Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871 (2007–2008); Miles B. Farmer, *Mandatory and Fair: A Better System of Mandatory Arbitration*, 121 YALE L.J. 2346 (2011–2012).
[27] Discover Bank v. Superior Court, 36 Cal. 4th 148, 162–163, 113 P. 3d 1100, 1110 (2005).

arbitration effectively annihilates many consumer claims.[28] Still others argue that given the small size of the claims at stake in many disputes, it is not financially feasible for consumers to bring arbitration actions to vindicate their rights.[29] Finally, critics of consumer arbitration often point to class action litigation as their preferred method for resolution of consumer disputes.

III. The CFPB Report: Summary and Critique

In December 2013, the CFPB produced the preliminary results of its study of arbitration in consumer financial products contracts. More than a year later, in March 2015, the CFPB released its final arbitration study, *Arbitration Study: Report to Congress 2015*. The Report expands on the findings in the preliminary results. More generally, it presents entirely new material, so that the preliminary results (which according to the CFPB stand "as presented there") and the Report together constitute the CFPB's report to Congress on arbitration.[30] Hence, in this paper, we discuss components.[31]

For both versions of its arbitration study, the CFPB was given access to actual American Arbitration Association (AAA) consumer arbitration files. According to the CFPB, it was given access to the AAA consumer arbitration files only under a confidentiality restriction. Although the AAA makes data about its consumer arbitrations available publicly online, the publicly available data do not include all of the information that is contained in the actual arbitration case

[28] *See* Sternlight, *supra* note 1; Jean R. Sternlight, *Tsunami*: AT&T Mobility LLC v. Concepcion *Impedes Access to Justice*, 90 OR. L. REV. 703 (2012).
[29] David Korn & David Rosenberg, Concepcion's *Pro-defendant Biasing of the Arbitration Process: The Class Counsel Solution*, 46 U. MICH. J.L. REFORM 1151 (2013).
[30] The CFPB's explanation of the relationship between the Report and the preliminary results appears at page 9 of section 1 of the Report.
[31] When we refer simply to the CFPB's Report or the Report, we are referring to the final arbitration study: CONSUMER FIN. PROT. BUREAU (CFPB), ARBITRATION STUDY: REPORT TO CONGRESS 2015 (2015). We will by contrast refer to the preliminary results study of December, 2013, as just that: the preliminary results report, CFPB ARBITRATION STUDY: PRELIMINARY REPORT (2013).

files. Thus, in its arbitration study, the CFPB had a unique opportunity to expand what is known about consumer arbitration.

In its 2015 Report, the CFPB reported on what it had learned about AAA arbitrations involving credit cards, checking accounts, payday loans, prepaid cards, auto purchase loans, and private student loans. After releasing the 2013 preliminary results, the CFPB added private student loan and automobile loans to its 2010–2012 arbitration dataset. This addition was not trivial: student and auto loan arbitrations make up 31% of the arbitrations covered by the 2015 Report.[32]

One of the most interesting general findings in the CFPB's research into AAA arbitration of disputes involving these six products is that arbitrations involving some of the products typically concern a dispute as to the debt amount, but those involving other products rarely concern such a dispute. With its access to actual AAA arbitration files, the CFPB was able to discern that in arbitrations with affirmative consumer claims for relief, the consumer is typically disputing the amount of a debt that is being collected outside arbitration.[33] The CFPB further found that consumers often dispute the debt amount by way of defense in an arbitration action.

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[32] CFPB (2015), *supra* note 9, section 5, at 20.

[33] In the body of the preliminary results report, the CFPB explained that it "counted mutual submissions and consumer filed disputes as debt collection arbitrations when the case included a substantive debt dispute and the arbitration record shows that there was a prior court proceeding as to which the consumer invoked arbitration." CFPB (2013), *supra* note 8, at 66. The CFPB further explained that "there were a number of pleading formats in consumer-filed and mutually submitted AAA arbitrations . . . that persuaded us that the debt collection category needs to be broadened in this way. In some cases, for example, the consumer may affirmatively state that he or she has no claims but wants the arbitrator to resolve the merits of the company's underlying debt collection claim. In others, the consumer states that he or she is filing the arbitration demand instead of filing an answer to a collection claim in court, or the consumer may file an arbitration for declaratory judgment that he or she does not owe the amount claimed by the company. . . . In some respects, however, we may have undercounted debt collection arbitrations in our total pool of cases. Our definition relies on an indication in the arbitration record of prior court proceedings. The arbitration record may not contain that indication, even when there was, in fact, a prior collection action in court. In addition, even when a company has not yet sued in court to collect debt, it is possible that some consumers are preemptively filing arbitrations to challenge the company's pre-judicial assertion of a debt. In fact, a substantial number of the 'non-debt collection' credit card arbitrations in our review appeared to involve only a substantive debt dispute and no non-debt claims at all, even though the arbitration may be filed by a consumer. . . . [W]e opted to use objective rules to define debt collection arbitrations, rather than trying to assess whether the weight of the arbitration record indicated that collection activity was already underway before a substantive dispute reached arbitration. But it is important to bear in mind that our 'non-debt collection category' included a large number of cases in which debt was at issue." CFPB (2013), *supra* note 8, at 67–68.

The fraction of arbitrations in the CFPB's dataset involving a dispute over the debt amount varies from 98% of student loan arbitrations and 87% of credit card arbitrations to 11% of payday loan arbitrations and 3% of checking account arbitrations.[34] The variation in the frequency with which different types of arbitrations involve disputed debt amounts does not seem to be explained by whether the company initiated arbitration—debts were very often disputed for both credit card and student loan arbitrations, but companies initiated 54% of credit arbitrations and only 2.8% of student loan arbitrations.

As the CFPB explained in its 2013 preliminary results, in 2009 the AAA self-imposed a moratorium on debt collection actions filed by businesses.[35] That moratorium remains in place in 2015. However, the AAA will arbitrate a debt collection issue raised by either the consumer or the business in an arbitration filed by a consumer (or when the consumer consents in writing to arbitration of a debt collection) and will arbitrate a debt collection action in a case that the court has ordered to be arbitrated.[36]

One thing that the CFPB Report may help explain is why the AAA seemed more than happy to self-impose its moratorium on hearing AAA debt collection arbitrations filed by businesses. Even under the CFPB's rather broad definition of a *debt collection arbitration*, the CFPB found only 522 debt collection actions over the 2010–2012 period, and all but 4 of these actions involved credit card disputes.[37] By contrast, in 2012 alone, the small claims court in Philadelphia County, Pennsylvania, had more than 2,200 debt collection cases.[38] That the number of debt collection actions pursued in court is almost an order of magnitude greater than

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[34] CFPB (2015), *supra* note 9, section 5, at 26. The report does not provide frequencies; those are computed here.
[35] CFPB (2013), *supra* note 8, at 65.
[36] *Id.* at 66.
[37] CFPB (2015), *supra* note 9, section 4, at 92.
[38] *Id.*

the number pursued by arbitration makes clear that AAA arbitration is a relatively insignificant institution of consumer debt collection.

In its 2013 preliminary results, the CFPB presented data on three main aspects of consumer arbitration: (a) the claimed amount, (b) the frequency with which consumer claimants have legal representation, and (c) the substantive legal basis of consumer claims. To this list, the 2015 Report added two main types of data on arbitrations: (a) outcomes in cases that reached final resolution by an arbitrator, as well as basic statistics on how outcomes varied depending on what the substantive basis of the consumer's claim was and whether the consumer had representation, and (b) some data on the arbitration process, such as how long it took to get a final arbitrator decision, and data on consumers who changed the amount claimed during the arbitral process. Perhaps the most important part of the 2013 preliminary results report was its comparison of the number of small claims consumer arbitrations with the results of a selected sample of consumer class action litigations. The 2015 Report significantly adds to the CFPB's comparison of arbitration cases to class action cases by presenting extensive data on what kinds of claims are brought as consumer class actions and on the settlements in such cases. It also provides some data allowing comparison of the kinds of cases brought as class actions with those brought as individual actions. Thus, in many ways, the heart of the CFPB's combined 2013 preliminary results and 2015 Report is a quite detailed comparison of the results in consumer class actions with the results in consumer AAA arbitrations. We argue in this paper that, for a number of reasons, this comparison cannot be taken as indicating the superiority of either class actions or consumer arbitrations, although the CFPB's comparison of the two approaches is clearly the most detailed yet produced.

Three other aspects of the CFPB's Report deserve mention. Two of those elements are directly related to the general comparison of class actions and arbitration: a survey of consumers that seeks to identify what consumers know about arbitration, class actions, and other methods of dispute resolution and an econometric study of whether arbitration leads to lower prices for consumers. We comment on these aspects in detail later in this paper.

Furthermore, although the CFPB focused mainly on comparing different methods of ex post dispute resolution, it also reported on the frequency with which consumer contracts in various product markets contain mandatory arbitration clauses and on the various features of such mandatory arbitration clauses, such as whether the clauses waive class relief. We also comment in some detail on this aspect of the Report.

We do not comment on some relatively short sections of the Report that examine the role of small claims courts in consumer dispute resolution and the relationship between public enforcement actions and consumer class actions. Looking at online small claims court databases for which states offered free or low-cost access to case information, the CFPB was able to obtain systematic case document information for only two state small claims courts, those in Alameda County, California, and Philadelphia County, Pennsylvania. The CFPB found essentially what other researchers have found previously:[39] that there is considerable variation across states in small claims courts procedures, with some states adopting procedures that tend to discourage businesses from using small claims courts to pursue cases against consumers and other states having procedures (such as venue rules) that have encouraged business to pursue debt collection and other actions against consumers in small claims court. As for public enforcement actions, the CFPB addressed the question of the extent to which private class actions merely piggyback off

[39] *See* Richard Hynes, *Broke but Not Bankrupt: Consumer Debt Collection Actions in State Court*, 60 FLA. L. REV. 1 (2008).

previously adjudicated public enforcement actions. Looking at all large-dollar ($10 million or more) class action settlements plus a sample of other class action settlements, the CFPB found that only a relatively small fraction, 12%, of private consumer class actions were filed after public enforcement actions dealing with the same issues. Because there is no widespread perception that consumer class actions merely duplicate and piggyback public enforcement, this finding is essentially a null result in terms of the larger policy debate.

IV. CFPB Findings That Undercut Arguments That Arbitration Is Unfair to Consumers

The CFPB Report is useful in providing data—much of it for the first time—with respect to many of the claims typically made about arbitration. Somewhat surprisingly, however, some of the CFPB's findings tend to *rebut* the hypotheses of arbitration's critics. Moreover, where the data do not undermine arguments for restricting arbitration, they are subject to serious drawbacks that limit the usefulness of the data for supporting restrictions on consumer arbitration.

A. Do Consumers Have Meaningful Choice Regarding Whether to Enter into Contracts That Contain Arbitration Clauses?

One criticism of arbitration clauses in consumer credit contracts is that such contracts are "contracts of adhesion," such that consumers have no meaningful choice but to accept the terms.[40] It is implied that with respect to most so-called contracts of adhesion, the terms of the contracts offered by virtually every financial institution are identical on this point; thus, the consumer cannot avoid the clause by dealing with a different financial institution.

Yet one of the most important contributions of the CFPB Report is to demonstrate that such an assumption may be untrue when it comes to consumer credit. For example, the CFPB

[40] *See* CFPB (2015), *supra* note 9, section 1, at 4, n.4.

data show that although there has been a slight increase in use since the Supreme Court made clear that state courts may not invalidate mandatory arbitration clauses in consumer contracts on public policy grounds,[41] the vast majority (84%) of credit card issuers do not use such mandatory arbitration clauses. Arbitration clauses are used more often by larger card issuers.[42] With respect to checking accounts, mandatory arbitration clauses are even less common; the CFPB found that only 8% of banks include arbitration clauses in their checking account contracts. Thus, for checking and credit card accounts, consumers can quite easily avoid contracts with mandatory arbitration if they choose to do so.

Even in contracts in which arbitration clauses are most common—prepaid cards, where 92% of the contracts studied included mandatory arbitration clauses—providers accounting for about 17% of the market do not contractually require arbitration.[43] That statistic suggests that consumers who dislike arbitration can find prepaid card providers that do not require that form of dispute resolution.[44]

The only market in which the CFPB found that virtually all (99.9%) consumers are bound by mandatory arbitration was the market for mobile wireless service. Mobile wireless contracts were not studied by the CFPB in its 2013 preliminary results, and their inclusion in the 2015 Report is puzzling. The CFPB says that it included mobile wireless contracts in its 2015 Report because the major wireless providers allow consumers to charge payments for goods and

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[41] AT&T Mobility v. Concepcion, 563 U.S. 321 (2011).

[42] CFPB (2015), *supra* note 9, section 2, at 7, 9–12. One possible explanation for the distinction between larger and smaller credit card issuers is that larger issuers may be especially prone to large nuisance class actions simply because of their size; thus, to avoid such litigation, they may find arbitration especially valuable.

[43] *Id.*, section 2, at 8.

[44] Indeed, in light of the relative ease with which consumers of prepaid cards (as opposed to credit cards and bank accounts) can and do switch from one prepaid card to another, if consumers valued an arbitration-free contract, they could likely adopt such a card without difficulty. *See* Todd J. Zywicki, *The Economics and Regulation of Network-Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013).

services to their wireless bills, a practice known as *mobile wireless third-party billing*.[45] In the developing world, where many consumers have neither credit cards nor bank accounts, mobile wireless third-party billing is apparently a rapidly growing market.[46] In the United States, mobile wireless third-party billing has been a tiny share of the market, and even in the future it will likely be used only to pay for smartphone apps.[47] The actual market significance of mandatory arbitration for mobile wireless billing depends on the future importance of mobile wireless billing and may not be indicated by the share of the wireless market taken by wireless firms that require arbitration. Disputes under mobile phone contracts appear to have little more to do with financial services than does the purchase of any other ordinary goods or services; thus, the findings with respect to mobile wireless service cannot easily be generalized to other consumer financial services.

As we discuss later in this paper, the CFPB also found that most consumers do not pay much attention to whether their credit card contract has a mandatory arbitration clause. This finding might be taken to imply that even if consumers could, in theory, shop among card providers on the basis of whether they require arbitration, in practice, firms would not be influenced by consumer shopping in determining whether to require arbitration. Not only is that implication unjustified, but so too is the entire premise—made not just by the CFPB Report but by the literature preceding it—that for arbitration to benefit consumers, consumers must observe and shop among contract clauses that specify the method by which ex post disputes with the firm will be resolved.

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[45] CFPB (2015), *supra* note 9, section 2, at 25–26.
[46] Mondato, *The Re-emergence of Carrier Billing*, LATEST INSIGHT BLOG (Sept. 24, 2014), http://mondato.com/blog/carrier-billing/.
[47] FED. TRADE COMM'N, MOBILE CRAMMING: A FTC STAFF REPORT 4–5 (July 2014), *available at* https://www.ftc.gov/system/files/documents/reports/mobile-cramming-federal-trade-commission-staff-report-july-2014/140728mobilecramming.pdf.

To understand why that impression is mistaken, note that as we also discuss later, the CFPB found that consumers do consider terms such as what interest rate is offered and whether firms fairly resolve consumer complaints. Indeed, the CFPB reports that the vast majority of consumers respond to firms that do not fairly resolve complaints by canceling their cards with the firms. A firm's required method of ex post dispute resolution is not something that consumers specifically consider while shopping, but the matters that consumers do consider—prices and how firms resolve complaints—are likely directly influenced by whether a firm can require arbitration. If by requiring arbitration a firm reduces its expected costs of ex post dispute resolution and increases the benefits of accuracy in internal dispute resolution (meaning, it grants consumers a refund when the firm really has made a mistake and denies refunds when no mistake has been made), then arbitration reduces the firm's costs while increasing its payoff to investing in internal dispute resolution. Arbitration's likely influence is under the hood, as it were, but potentially it is just as great as if consumers did shop directly considering arbitration clauses.

B. Is Arbitration Fair to Consumers?

A second criticism of arbitration is that it is unfair to consumers. The unfairness is allegedly both substantive, in that consumers fare worse in arbitration than they do in litigation, and procedural, in that consumers lack legal counsel when they pursue arbitration claims. The CFPB arbitration study casts significant doubt on the validity of both criticisms.

1. The CFPB arbitration study reports surprisingly high rates of legal representation in consumer AAA arbitrations. The CFPB arbitration study clearly shows that representation is not a problem for consumers in most types of AAA consumer arbitrations. For all product markets combined, consumers were represented by counsel in 63% of arbitration cases.[48] For payday and student loan arbitrations, consumers have counsel in 95% of the cases, and for checking account disputes, 56% of the cases. Even in credit card arbitrations—the only important type of AAA consumer arbitration in which consumers did not have counsel in the majority of cases—consumers still were represented by counsel in 47% of the cases. Importantly, in credit card cases in which consumers disputed the debt amount, they were represented by counsel 70% of the time.[49]

In section 6 of the Report, the CFPB implicitly compares the representation rates in arbitration with representation rates in individual and class action litigation filed in federal court. Unsurprisingly, class counsel were present in all class actions studied by the CFPB (except, apparently, one), and individual plaintiffs had representation in about 94% of the individual federal actions.[50]

2. The CFPB report also shows that unrepresented consumers have relatively high success rates in AAA arbitration, so that legal representation is not as important in AAA arbitration as in state and federal court litigation. The problem with the CFPB's implicit comparison is that it does not in any way control for the relative value of representation to a plaintiff in federal court versus a claimant in consumer arbitration proceedings. Representation is valuable in federal court because civil procedure is complicated and the costs of pursuing a claim are high. Pro se—or as they are now called, self-represented—plaintiffs in civil federal lawsuits of all types are only 4% in the CFPB's large sample of cases. For a federal plaintiff to reach the point at which settlement is even on the table, let alone to get to a substantive trial on the merits, he or she has to successfully

[48] CFPB (2015), *supra* note 9, section 5, at 29.
[49] *Id.*, section 5, at 30.
[50] *Id.*, section 6, at 22–23.

serve process, manage to file a complaint that can withstand increasingly tough pleading standards and the inevitable failure to state a claim motion, and then do enough discovery to get past a summary judgment motion. Few self-represented plaintiffs succeed in overcoming those federal court hurdles.

Oddly, the CFPB reports both on the AAA arbitration procedures that apply to the cases it actually studies and on the JAMS procedures, which are irrelevant to AAA arbitrations. However, under the AAA consumer arbitration procedures that actually apply to the cases studied by the CFPB, all consumers have to do to initiate an arbitration is to file a claim describing the dispute and the business that they are disputing against, specify where they would like the arbitration hearing to happen if they want a hearing, and attach a copy of any arbitration agreement. Since 2013, the consumer has had to pay only a $200 fee administrative fee to the AAA, with all remaining fees paid by the company and the $200 fee waived for any consumer whose income is less than two times the federal poverty level. The AAA chooses the arbitrator from its National List of Arbitrators, and then the arbitrator makes a decision. Essentially, none of the complex procedural motions found in federal court are permitted in arbitration, and for claims under $10,000, the arbitrator's decision is by default based only on the documents submitted or, in some cases, on a telephone hearing held. Only for claims above $10,000 is an actual hearing before an arbitrator the default way of resolving the dispute. If a hearing is held, it must be in a location convenient for the consumer.

At 26 pages, section 4 of the Report, on how arbitration procedures differ from procedures in court, is one of the shortest sections in the entire study. Importantly, the CFPB makes no attempt in the section to estimate the actual transaction costs that a consumer would face in pursuing an individual claim in federal court rather than in arbitration. Nor does it attempt to estimate the actual ability of a consumer to pursue a self-represented claim in federal court. However, it is worth noting that what is essentially the entire procedural requirement for an arbitration consumer—filing a claim with the arbitration agreement attached that states the basic facts of the claim—is just the first step in federal court. That first step itself has detailed legal requirements attached to it—requirements than can cause dismissal with prejudice if not followed. It would seem that even if representation is valuable to consumers in arbitration, the AAA arbitration procedures at least allow for the possibility that an unrepresented consumer claimant may succeed. Without considering both the costs and the benefits of litigation proceedings, of course, it is impossible to say whether consumers would be better off being forced to litigate instead of arbitrate.[51]

That the AAA consumer arbitration procedure is much simpler and less costly than federal court litigation is strongly suggested by CFPB findings showing that arbitrations are resolved very quickly. The Report finds that even when telephone hearings were conducted, most arbitrations were resolved in less than five months, and even with a hearing, most were resolved in less than seven months. When there was a known settlement, it usually was achieved in about five months.[52]

Moreover, the CFPB also found that hiring an attorney is far from crucial to consumers in AAA arbitration. On the one hand, at relative frequencies of 40% versus 34%, consumers with representation more often got settlements than those without attorneys. On the other hand, at relative rates of 2% versus 14%, consumers with attorneys did much worse in cases that actually

[51] We follow the standard conclusion of arbitration experts that for arbitration to be viable, it must be a mandatory pre-dispute clause. Otherwise, the use of arbitration would unravel because of standard forum-shopping problems as consumers decided whether to sue or to arbitrate on the basis of the forum that they thought most advantageous for their claim.
[52] CFPB (2015), *supra* note 9, section 5, at 72.

ended in a decision by the arbitrator.[53] Thus, the arbitration study shows that self-represented plaintiffs were seven times more likely than represented plaintiffs to get an AAA arbitrator's decision in their favor. That finding is consistent with arbitration's being a process set up so that hiring an attorney offers little value to a consumer and is often unnecessary.

As noted earlier, the CFPB arbitration study reports that 94% of individual plaintiffs in its sample of federal and state court consumer lawsuits were represented by attorneys. By far the most important type of individual suit pursued on a self-represented basis involved a checking account or debit card. In such suits, 68% of plaintiffs were self-represented.[54] Surprisingly, given the finding that self-representation is actually the rule rather than the exception in individual lawsuits involving checking accounts and debit cards, the CFPB study fails to report on how outcomes in individual consumer lawsuits varied between those brought by consumers with counsel and those brought by consumers who were self-represented.

The CFPB reports that consumers who *did* have counsel in individual consumer lawsuits obtained judgments in their favor about 7% of the time, with settlements occurring somewhere in the range of 42% to 48% of all cases filed, depending on whether one counts known or "potential" settlements.[55] The CFPB reports that over the entire set of 668 arbitrations in which it coded consumers as making an affirmative claim for relief, consumers received awards in 20% of the 158 arbitrations that the CFPB determined to have ended in an arbitral award, or 6% of the total number of such arbitrations.[56] Yet the CFPB also reports that of all 1,060 arbitrations in its sample (not just those in which consumers made affirmative claims for relief), 57% either were

[53] *Id.*, section 5, at 55. The rates in the text are derived from figures 11 and 12.
[54] *Id.*, section 6, at 32.
[55] *Id.*, section 6, at 48.
[56] *Id.*, section 5, at 41.

known to have settled or were "consistent with settlement."[57] Thus, with 57% of all arbitrations resulting in settlement and 6% in an award for a consumer claimant, arbitration seems to generate *comparable or even slightly better results* for individual claimants than do individual consumer lawsuits (where up to 48% result in settlements and 7% in consumer judgments).

Note that the CFPB found a much lower rate of consumer success in AAA arbitrations than previously reported in the pathbreaking study of AAA arbitration by Christopher Drahozal and Samantha Zyontz. Drahozal and Zyontz studied 301 AAA consumer arbitration cases heard in 2007 and found that consumers won some relief in 53.3% of arbitrations.[58] Moreover, consumers recovered attorneys' fees in 63% of cases in which they sought fees.[59] The CFPB finding that unrepresented consumers in AAA arbitration are much more likely to prevail on the merits than are represented consumers in lawsuits filed in court is consistent with the earlier finding by Drahozal and Zyontz that, at least in some types of cases, consumers win *more* frequently in arbitration than in court.[60]

The large disparity between the consumer AAA arbitration success rates reported by the CFPB (20% for consumers making affirmative claims) and by Drahozal and Zyontz (53%) suggests that further work needs to be done with AAA consumer arbitration files. In any event, the data that the CFPB has reported in its 2015 study is not consistent with the claim that arbitration yields worse outcomes for consumers. As it stands in its now presumably final form, the CFPB Report suggests, to the contrary, that AAA arbitration may be the *only* forum in which unrepresented consumers have a chance to obtain a decision in their favor.

[57] *Id.*, section 5, at 32.
[58] Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 OHIO ST. J. DISP. RESOL. 843 (2010).
[59] *Id.*
[60] Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 HASTINGS BUS. L.J. 77 (2011).

V. Understanding the Effect of Arbitration Clauses: The Irrelevance of the CFPB's Findings

In the 2015 Report, the CFPB expanded the scope of its inquiry into the effect of arbitration clauses for consumers. One new section (section 10) purports to be a statistical (or econometric) analysis of whether mandatory arbitration clauses lower prices for consumers. Another new section (section 3) presents the results of a survey that probed whether consumers know whether they are bound by mandatory arbitration clauses. Neither set of results can be taken as disconfirming the benefits of arbitration to consumers. The CFPB's finding that a temporary moratorium on the use of arbitration clauses by some credit card issuers did not significantly affect pricing relative to that of issuers without such a moratorium just confirms that financial products providers, like firms generally, do not change prices in response to temporary cost changes, nor does the CFPB provide any explanation as to why it thinks otherwise. The Report shows nothing that indicates whether arbitration benefits consumers by lowering prices. The CFPB's survey of consumers found that consumers know little about ex post dispute resolution mechanisms—whether arbitration or class actions. However, the CFPB's survey also revealed why such relative ignorance is perfectly rational: when they feel that a credit card firm has wrongfully imposed a fee or charge that it refuses to reverse, consumers overwhelmingly prefer the market response of canceling their cards over litigating or arbitrating the dispute.[61]

A. Why Consumers Don't Need to Know Much about Arbitration Clauses

In section 3 of the Report, the CFPB provides the results from a survey that asked about a thousand credit card owners a number of questions about their choice of a credit card and about

[61] As discussed later in the next subsection, the CFPB reports that faced with a situation in which a credit card company was imposing a charge that the consumer had not signed up for, 57% of the survey respondents said they would cancel their card (the market response), whereas only 1% said they would seek legal advice or sue using an attorney. *See* CFPB (2015), *supra* note 9, section 3, at 18.

whether they would pursue a complaint against a credit card company through an external dispute resolution mechanisms such as litigation or arbitration if the company failed to resolve their claim internally. In answering an open-ended question of the form, "Why did you choose the card you did?," a relatively small fraction of respondents came up with a particular reason. The most frequently given responses to this open-ended question were the interest rate on the card and the card's rewards program. When various credit card features were asked about specifically (the closed-end format), most respondents indicated that the interest rate, customer service, rewards, fees, issuer's reputation, and card acceptance all were factors that entered into their decision to get a particular card.[62]

As for knowledge about and willingness to pursue external dispute resolution, the CFPB survey found that even if consumers were charged a fee that they knew the company had incorrectly assessed, only 1.4% of respondents said they would seek legal advice and an even smaller 0.7% said they would consider initiating legal proceedings. A similarly small percentage of consumer respondents, 1.7%, said that they would simply pay the fee. As for arbitration clauses, consumers seemed to have little understanding of whether their credit card contract contained such a clause and whether the clause prevented them from taking a dispute to court. Regardless of what the contract actually said, about 20% of consumers thought that their contract included such a clause and about 7% of consumers thought that they could not sue in court, regardless of whether their contract had a mandatory arbitration clause. Most consumers with a mandatory arbitration clause (57%) still thought that they could participate in a class action lawsuit.[63]

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[62] *Id.*, section 3, at 14.
[63] *Id.*, section 3, at 3.

The CFPB highlights its final set of findings by placing it in the first paragraph summarizing the results of its survey: the relative ignorance of consumers regarding whether their credit card contract has a mandatory arbitration clause and the effect of such a clause on their right to file suit. However, the CFPB's survey clearly shows that consumers do care about many features of their cards, such as the interest rate and whether the card has a rewards program. It also shows that consumers care intensely about whether credit card companies remove incorrectly assessed fees and charges. As noted previously, the survey found that 57% of respondents said that they would cancel their cards if a company incorrectly assessed a fee and failed to remove it in response to a consumer complaint. Only 1% would seek legal advice or sue using an attorney. The survey thus found that consumers prefer the market to the legal response for perceived service failures by a credit card company. When a company does not resolve a dispute internally to the customers' satisfaction, consumers take their credit card business elsewhere.

The CFPB's survey provides strong evidence of the credibility of the threat posed by consumers to take their business elsewhere if a credit card company does not reverse mistaken fees and charges. Savvy consumers know that if they have a long and profitable relationship with a financial services provider, the provider is very likely to waive various fees to keep them happy and to keep their business. A classic example of such business-motivated forgiveness of fees occurs when a credit card issuer waives the late fee and interest payment imposed when a credit cardholder with a good record of making payments on time happens to be a bit late once in making a payment. Another example is when a provider waives a fee that it has indeed mistakenly assessed. The provider may have inadvertently placed individual social security number information in a location on a document where it is visible to third parties or had a malfunctioning ATM terminal. In such cases, the provider may itself take corrective action, such as providing free credit monitoring (in the social security number case) or reversing charges for disputed transactions (in the ATM malfunction case).

The assumption by consumers that firms will work to retain their business turns out to be reasonable. To understand the propensity of financial institutions to resolve customer disputes internally, we were able to examine data provided by a mid-sized regional bank in Texas with respect to its internal processes for resolving disputes. According to this bank, a consumer complaint about a fee that was charged initiated an internal review process within the bank that analyzed refund requests on a case-by-case basis. During 2014, the process undertaken by the bank resulted in its refunding 94% of wire transfer fees that customers complained about at its San Antonio office and 75% of wire transfer fees that customers complained about at its Brownsville office. During that same period, the bank responded to complaints about inactive account fees by making refunds 74% of the time in San Antonio but only 56% of the time in Houston. Refunds varied among products as well: the bank rarely granted refunds of ATM fees but routinely granted refunds of overdraft fees, inactive account fees, and others.

The variation in bank refund rates by location and product strongly suggests that customer value maximization and not minimization of the risk of class action litigation was the driving force behind this bank's refund decisions. Especially in the largest class actions, such as the bank overdraft fee settlements discussed later in this paper, class litigation is typically premised on a firmwide practice. If fear of such litigation were driving bank refund practices, one would not expect to see wide variation across products and branch locations. Variation is precisely what one would expect to see if refunds were based on individualized determinations of the validity of the consumer's complaint and on the value of keeping a consumer's business.[64]

Overall, the bank offered refunds in about 68% of cases in which a consumer complained, resulting in refunds of over $2.275 million in 2014. Such a high refund rate explains what the CFPB leaves unexplained: why consumers do not know much about external dispute resolution mechanisms such as class actions and arbitration but do know that they will take their business elsewhere if a credit card issuer fails to internally resolve a valid complaint. There is evidence that credit card issuers, like the Texas bank, reverse fees and charges on an individualized basis, depending on a particular cardholder's history with and value to the issuer.[65] Credit card issuers have every incentive to respond to valid complaints brought by their cardholders precisely because consumers do what they told the CFPB they would do: terminate a card when the issuer does not respond. Given the effectiveness of this market response, consumers do not need to know anything about the details of the potential legal response they might have available when a company declines to refund charges and fees, and they have no reason to assume that being required to arbitrate rather than litigate would be an important reason to select one card over another.

B. Why the CFPB's Econometrics Are Flawed and Not So Harmless

One of the traditional arguments in favor of mandatory arbitration clauses in consumer contracts is that if arbitration lowers costs for financial product providers, consumers will benefit, because the lower costs are passed on to consumers in the form of lower prices. In section 10 of its

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[64] That such determinations may sometimes involve the exercise of discretion by middle-level managers does not make them any less motivated by the firm's incentive to retain valuable customers. Indeed, such discretion may allow for more accurate determination of customer-specific value.

[65] *See* Jason Scott Johnston, *The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation between Businesses and Consumers*, 104 MICH. L. REV. 857 (2006).

Report, the CFPB took the settlement in an antitrust case, *Ross v. Bank of America*,[66] as a natural experiment shedding light on whether, in fact, arbitration clauses do lead to lower prices for consumers. Under the settlement in *Ross*, a subset of four defendants agreed to stop using arbitration clauses for at least three and a half years. The CFPB looked at whether the change in the total cost of credit charged to consumers after the imposition of the settlement terms differed between the credit card issuers who stopped using arbitration clauses under the settlement and a large (although not precisely identified) set of issuers not subject to the settlement. The CFPB found no statistically significant difference in the change in the cost of credit across the two groups after one group stopped using arbitration clauses.[67]

Basic economic theory predicts that competition forces firms to pass on to consumers at least a portion of any cost decrease. As an empirical matter, evidence shows that financial products firms do pass on changes in their costs, as, for example, when debit card issuers passed on price controls on debit card interchange fees in the form of higher bank fees for consumers.[68] However, financial economists have long known that banks do not adjust their deposit and loan rates quickly or fully to temporary changes in market interest rates. Recent work indicates clearly that to explain bank pricing, one needs to take account not only of current and recent values of factors such as money market rates but also of expected future rates.[69] More generally, it is known that firms in the consumer services sector adjust prices much more slowly in response to

[66] No. 05-Civ. 7116 (S.D. N.Y.).
[67] CFPB (2015), *supra* note 9, section 10, at 15.
[68] David S. Evans, Howard Chang & Steven Joyce, *The Impact of the U.S. Debit Card Fee Regulation on Consumer Welfare: An Event Study Analysis* (U. CHI. COASE-SANDOR INST., Research Paper No. 658, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2342593; Todd Zywicki, Geoffrey Manne & Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (ICLE FIN. REG. RES. PROGRAM, White Paper 2014-2, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.
[69] *See* Kenneth J. Kopecky & David D. Van Hoose, *Imperfect Competition in Bank Retail Markets, Deposit and Loan Rate Dynamics, and Incomplete Pass Through*, 44 J. MONEY, CREDIT & BANKING. 1185 (2012).

cost changes than do firms in the manufacturing sector and that large firms adjust prices more slowly than do small firms.[70]

In light of what economists have learned about how firms adjust prices to cost changes, it is hardly surprising that the CFPB found that the four credit card issuers that agreed to remove arbitration clauses for three and half years did not change their credit card prices in a way that significantly differed from the practices of other issuers. Even if the arbitration clause moratorium increased the costs to the subject firms, the moratorium was only temporary. There is neither theoretical nor empirical reason to have thought that such a temporary change in costs would change credit card pricing. Moreover, the CFPB looked at whether prices changed differentially during the year after the arbitration moratorium was imposed. Again, no evidence indicates that financial services prices respond so quickly even to a permanent change in costs and no sound theoretical reason exists to think that they would.

In addition to these theoretical problems, there are technical failures with the CFPB's econometric study of whether credit card firms that removed arbitration clauses changed prices at a different rate than firms that did not. Perhaps most importantly, the Report fails to indicate whether the CFPB checked to ensure the validity of the econometric technique it used. The technique—which compares the change in prices in the treatment group (the companies subject to the arbitration clause moratorium) to the change in prices in the control group (the companies still using arbitration clauses)—is valid only if prices in the two groups of companies had been changing at the same rate before the imposition of the moratorium. Only if this were true (so-called parallel paths) could one say that any change in prices among the companies not subject to

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[70] *See* Daniel A. Dias, Carlos Robalo Marques, Fernando Martins & J.M.C. Santos Silva, *Understanding Price Stickiness: Firm-Level Evidence on Price Adjustment Lags and Their Asymmetries*, OXFORD BULL. ECON. & STAT. (2014).

the moratorium would be a good proxy for how prices would hypothetically have changed among companies subject to the moratorium.[71] Nothing in the report indicates that the CFPB checked for parallel paths.

In contrast, concrete case study evidence shows at least one example in which consumers who were willing to accept a contract that included an arbitration clause were offered a lower interest rate than those who insisted on the right to litigate disagreements.[72] Especially in light of this evidence and the theoretical and econometric problems with the CFPB's study of arbitration clauses and credit card prices, it is clear that much more careful empirical work needs to be done before conclusions can be made about the potential pass-through to consumers of cost savings from arbitration.

VI. Arbitration and Class Actions Compared

As we have explained, the major concern that courts have had with mandatory arbitration clauses in consumer contracts is that such clauses typically preclude class action lawsuits. Courts that have invalidated such arbitration clauses on public policy grounds have found that class actions are necessary for consumers to be adequately compensated and for firms to be deterred from practices causing widespread but small consumer harm. The CFPB's arbitration study attempts to inform this debate by providing some evidence on the outcomes that consumers receive under arbitration versus recoveries in class action suits. Unfortunately, although the CFPB's arbitration reports do provide new data on both class actions and arbitration, they do little to inform the public policy debate. Although the CFPB finds that few arbitration cases involve claim amounts

[71] Actually there are other assumptions implicitly made by the difference-in-difference approach, but this one is the most basic to the validity of the estimates. See Ricardo Mora & Iliana Reggio, *Treatment Effect Identification Using Alternative Parallel Assumptions* (UNIVERSIDAD CARLOS III MADRID, Economic Series Working Paper No. 12-33, Dec. 2012).

[72] *See* Christopher Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV 695 (2001), discussing Stiles v. Home Cable Concepts, Inc., 994 F. Supp. 1401 (M.D. Ala. 2004).

less than $1,000 per claimant, it fails to note that class actions against financial services providers also seem to seldom involve claims of less than $1,000 per claimant. The CFPB is to be lauded for looking at a large number of actual case files for data on class action outcomes and settlements. However, its summary data on the fraction of class members who receive compensation (claims rates) and on attorney's fees as a fraction of class recovery are aggregated averages that conceal substantial variation across case types in both claims rates and the relative size of attorneys' fee awards—variation that includes many class settlements with very low claims rates and attorneys' fees that are very large compared to the aggregate payout to the class. Finally, in several respects—as by presenting data on arbitration awards but none on arbitration settlements, while presenting data only on class action settlements—the CFPB invites misleading comparisons that tend to bias rather than illuminate the public policy debate.

A. The Paucity of Small-Dollar Arbitrations

Perhaps the most emphasized finding in the CFPB's preliminary results is the discovery that "almost no AAA arbitration filings for these three product markets had under $1,000 at issue."[73]

More precisely, the preliminary results report states,

> [D]uring the period 2010 through 2012, there were an annual average of seven arbitrations per year filed with the AAA that concerned disputed debt amounts that were at or below $1,000, and . . . an annual average of under eight AAA arbitrations in which there was no disputed debt amount identified and the affirmative claim amount was at or below $1,000.[74]

The preliminary results report later states that only 23 consumer claims were for less than $1,000, with some 14 being for exactly $1,000.[75]

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[73] CFPB (2013), *supra* note 8, at 14.
[74] *Id.*
[75] *Id.* at 81.

In the particular arbitration type that the CFPB calls *debt disputes*,[76] the agency invokes both the Chamber of Commerce and Justice Stephen Breyer to define a *small-dollar claim* as one in which the consumer claims no more than $1,224.[77] For such claims, the CFPB reports that "there were under 19 cases on average each year in which there was a 'small dollar' debt dispute. Looking only at cases without disputed debt amounts, but only affirmative claim amounts, there were just over 8 cases each year on average that were 'small dollar.'"[78]

Noting the relatively small number of arbitration claims of under $1,000, the CFPB implies that the absence of these small-dollar claims from the dataset suggests that arbitration is not a feasible dispute resolution procedure for many consumers. Moreover, in the preliminary results, the CFPB compares the relative absence of small-dollar claims by consumers in arbitration unfavorably with certain class action cases in which the constituent consumers have recovered positive albeit modest amounts. This comparison might suggest that class actions are a more feasible means for aggregating smaller claims than is requiring disputes to be resolved by individual arbitration. The next section of this paper will examine the claims regarding the comparative efficiency of arbitration versus class litigation; this section will discuss briefly why the apparent absence of small-dollar claims from the CFPB's data cannot necessarily be read to suggest that arbitration is not a feasible means for consumers to recover monetary amounts in small-dollar disputes.

[76] The following numbers refer to the 326 cases for which the CFPB could identify a claim form amount but could not identify a disputed debt amount. Of those cases, 146 involved credit cards, with a median claim of $8,945; 61 involved checking accounts, with a median claim of $15,000; and 119 involved payday loans, with a median claim of $42,500. *Id.* at 80.

[77] Here is how the CFPB gets the $1,224 threshold for a "small-dollar claim": First, it uses Justice Breyer's example, from Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995) of a small-dollar claim being one that involves the "value of only a refrigerator or television set." *Id*. at 82. Then the CFPB uses *Time* magazine's report that the average price of a new TV in the second quarter of 2012 was $1,224.

[78] *Id.* at 82.

One obvious possible explanation for the relative absence of small-dollar disputes in arbitration procedures is that many disputes are resolved without arbitration *or* litigation. In particular, as we have explained, financial institutions routinely provide refunds and other adjustments to fees and the like in an effort to preserve customer goodwill and relationships. The example of bank refund practices discussed previously suggests that one plausible explanation for a relative paucity of small-dollar arbitration disputes is that many complaints (especially valid complaints) that might otherwise lead to arbitration or litigation are instead resolved internally with relief to the consumer. Indeed, if refunds are more likely to be granted for meritorious complaints than for frivolous complaints, then the overwhelming number of meritorious complaints may be resolved consensually rather than by conflict. Perhaps one reason that those denied a refund do not arbitrate is that their complaints lack merit.[79]

The likelihood that many financial institutions internally refund or adjust many charges incurred by consumers indicates that the CFPB cannot assume that arbitration is not a viable resolution system because of the relative paucity of small-dollar disputes found in the dataset. In fact, at the one bank for which we have data, consumers prevailed 68% of the time in obtaining refunds.[80] To suggest otherwise would perversely imply that, rather than handling disputes internally and issuing refunds, financial institutions should force consumers to arbitrate. More important, several alternative explanations can account for the apparent paucity of small-dollar arbitrations involving financial institutions; before the CFPB can assume that the apparent lack of such cases means that arbitration is not financially feasible, it must first consider those other explanations.

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[79] Indeed, given the value of goodwill with consumers and the relative cost of the dispute process to the amount typically at stake, the bank seems likely to err on the side of being overly generous in granting refunds in many cases.
[80] We are unaware of any comparable data from any other bank, but we have no reason to believe that the internal dispute resolution and account adjustment patterns of this particular bank are particularly unique or unrepresentative.

B. The Selective Class Action Data in the Preliminary Results

Perhaps the most striking rhetorical feature of the CFPB's preliminary results was that immediately after highlighting that there were only 23 AAA consumer arbitrations over the period 2010–2012 involving what it called "small-dollar claims," the CFPB report went on to "compare the benefits to consumers from arbitration to the benefits from class action litigation."[81] This exercise, however, involved comparing all consumer arbitrations before the AAA over the period 2010–2012 to a very small sample of settlements in consumer class actions. The CFPB discussed only eight such settlements because, for unexplained reasons, it studied only settlements reached after the latter half of 2009 in cases involving a contract between consumers and providers that dealt with one the agency's three product areas and that contained an arbitration clause. The eight settlements were found by looking at "electronic databases, as well as blogs and websites that track class action settlements."[82] Of the eight settlements described by the CFPB, three cases alleged violations of state payday loan laws, three involved allegedly fraudulent checking account overdraft fees, one was a credit card case, and one involved currency. In all the settlements described by the CFPB, a large number of members of the class actually received small payouts:

- Of the 10 million consumers who submitted claims in *In re Currency Conversion Fee Antitrust Litigation*, 7 million received a flat fee of $17 while the other 3 million "submitted more detailed claim materials, which entitled them to a significantly larger recovery."[83]

[81] CFPB (2013), *supra* note 8, at 102.
[82] *Id.* at 103.
[83] *Id.* at 105.

- *Hoffman v. Citibank*, a case challenging Citibank's actions in retroactively increasing the interest rates on some customers' outstanding credit card balances in alleged violation of California laws, resulted in interim payments of $18 each to 12,500 claimants.[84]
- In *Hooper v. Advance America*, a payday loan case alleging violations of Missouri's payday loan statute and Merchandising Practices Act, 10,400 consumers submitted claims and shared $520,000 in cash payments and $9 million in debt forgiveness.[85]
- In *Kucan v. Advance America*, another payday loan case alleging violations of North Carolina's payday lending statute, 135,000 members shared via automatic payments in a settlement fund of $11.5 million, or about $85 per class member.[86]
- In a third payday loan case, *Hager v. Check into Cash*, which also alleged violations of North Carolina's payday lender statute, automatic payments totaling $7.6 million were made to 104,000 class members, or $73 per class member.[87]
- *In re Checking Account Overdraft Litigation*, a multidistrict action in which class actions from across the country were consolidated in the Southern District of Florida, alleged that the banks processed debit transactions in such a way as to create overdrafts and thus generate overdraft fees. The bank defendants and the settlements identified by the CFPB were (a) Chase, which settled in 2012 with 5 million class members, who each received $61 and agreed to restrictions on fees for transactions under $5 (the court valued this additional relief at $52 million); (b) M&I, which paid $2.7 million, or $14 each, to 190,000 class members with no claim form required; and (c) Compass Bank,

[84] *Id.* at 106.
[85] *Id.*
[86] *Id.* at 107.
[87] *Id.* at 107–8.

which sent a notice to 826,000 class members that they shared $8 million in case relief, or $9 each.[88]

It is noteworthy that the CFPB preliminary results identified per claimant payouts only for the larger payouts, such as Chase (we computed the per claimant payout for M&I and Compass). Also, in describing all the class action settlements, the CFPB takes great pains to count the number of consumers who opted out of each settlement and then pressed the same claim against the same defendant in arbitration. The CFPB then stresses that there were "three arbitrations in which an opt-out from one of these cases *may* have made the same claim in AAA arbitration against a party within the scope of the applicable settlement."[89] It continues,

> No other opt-out from one of these cases appears to have filed the same dispute before the AAA. A total of 3,605 individuals opted out of these settlements. More than 13 million class members made claims or received payments under these settlements. Total payments or debt relief to the classes are in excess of $350 million, exclusive of attorneys fees and the value of injunctive relief.[90]

C. The More General Class Action Filing and Settlement Data in the Final Report

An obvious problem with the presentation of this class action settlement data in the 2013 preliminary results is that only eight large and potentially unrepresentative class action settlements are discussed. In the 2015 Report, the CFPB attempted to remedy the lack of representation by gathering data on a much larger set of class actions. The CFPB reported on all federal court class action filings and on filings in selected state courts that involved six types of financial products: credit cards, checking and debit accounts, payday loans, prepaid cards, private student loans, and automobile loans. For these six products over the period 2010–2012,

[88] *Id.* at 109.
[89] *Id.* at 104.
[90] *Id.*

the CFPB found 470 federal court filings and 92 state court filings.[91] Quite differently, the CFPB also reported on all class action settlements in federal court over a period twice as long—covering 2008–2012—involving five of these products (automobile loans, student loans, credit cards, checking and savings accounts, and prepaid cards) plus settlements involving credit reporting, debt collection, debt settlement, mortgages, and privacy.[92]

From these data, the CFPB reported three important statistics about class actions. First, it reported aggregated data showing that for the class action settlements it found over the 2008–2012 period, more than 11 million consumer class members received $1.1 billion in compensation.[93] By comparison, the CFPB reported that for arbitrations it studied over the period 2011–2012, it could verify arbitral awards to only 32 consumers (or 20% of consumers making affirmative claims for relief) for a total of $172,433.[94] Second, for the 105 class action settlements for which the CFPB was able to calculate a rate at which consumer class members actually received compensation, it found that the unweighted average claims rate was 21%, with an average weighted claims rate of 11%.[95] Third, the CFPB reported that attorneys' fees averaged 21% of the cash relief (and 16% of the total relief, including in-kind) received by class members.[96] Because the final two findings—on the fraction of class members receiving compensation and attorneys' fees as a fraction of what class members receive—are strikingly at odds with what has previously been reported, we begin by discussing those.

1. The CFPB's class action claims rate data presents a misleading picture of claims rates in class action settlements and obscures evidence that for many and perhaps most class actions,

[91] CFPB (2015), *supra* note 9, section 6, at 17.
[92] *Id.*, section 8, at 12.
[93] *Id.*, section 8, at 27–28.
[94] *Id.*, section 5, at 41.
[95] *Id.*, section 8, at 30.
[96] *Id.*, section 8, at 33.

fewer than 10% of the class actually receive compensation. The CFPB reports that on (unweighted) average 21% of consumer class members received some kind of compensation under class settlements. This report paints a relatively rosy picture of class action settlements. When it comes to consumer compensation under class action settlements, previous research has found wide variation in the fraction of the class that actually receives compensation (the payout or claims rate), with claims rates often below 5% in large class actions where consumers have to fill out forms to receive compensation.[97] As the CFPB Report correctly points out, the defect in this research is that it does not work from case files themselves.[98] Instead, previous researchers have looked for reports of class action settlements in places such as the *BNA Class Action Reporter*[99] or, at best, have studied actual settlements but only in a very small number of class actions.[100]

In the Report, the CFPB got information about class action settlements from the docket sheet case records and through selective interviews with settlement administration companies (the organizations that actually manage the process of notifying and paying class members). Because every class action settlement requires the court to make a fairness determination, the federal court PACER (Public Access to Court Electronic Records) docket sheet data typically includes several documents from which one can discern a good deal about class action settlement

[97] *See*, for example, DEBORAH HENSLER ET AL., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAINS (Rand, 2000); NICHOLAS PACE ET AL., INSURANCE CLASS ACTIONS IN THE UNITED STATES (Rand, 2007); MAYER BROWN LLP, DO CLASS ACTIONS BENEFIT CLASS MEMBERS? AN EMPIRICAL ANALYSIS OF CLASS ACTIONS (2013).
[98] CFPB (2015), *supra* note 9, section 8, at 6–7, 29–30.
[99] For an example of a study that looks to such reporters for data on class action settlements, *see* Mayer Brown LLP, *supra* note 97.
[100] Brian T. Fitzpatrick & Robert C. Gilbert, *An Empirical Look at Compensation in Consumer Class Actions*, (VAND. U. L. SCHOOL, Law and Economic Working Paper No. 15-6, March 2015). The paper looks at actual settlement terms for 15 consumer class actions, but 13 of them come from the consolidated *In Re Checking Account Overdraft Litigation*, the CFPB's major case study, which as we discuss *infra* is highly unrepresentative of the typical consumer class action settlement.

terms. For its 2015 Report, the CFPB looked at the largest sample of class action settlements ever studied, all settlements for selected types of class actions over the 2008–2012 period.

a. The CFPB failed to consistently adhere to its own stated methodology for determining what sorts of class action settlements to include in its study sample. There are several problems with the CFPB's reported numbers on class action claims rates. First, the CFPB did not consistently apply its own stated criterion for determining what kinds of class action settlements it would include in its sample. The CFPB stated that it did not study consumer class actions involving what was obviously a financial service—class actions alleging that ATM machines did not have a notice of fees "on or at" the machine, as the Electronic Funds Transfer Act (EFTA) then required—because ATM plaintiffs might not be customers of the ATM provider and therefore potentially would not be covered by the defendant's arbitration clause.[101]

If the CFPB had applied the same rationale that it applied to exclude ATM notice failure cases, then it would have excluded many and perhaps most of the class settlements in its study. According to the CFPB, 55% of the class action settlements it studied involved debt collection.[102] Debt collection class actions in federal court are typically brought under the Fair Debt Collection Practices Act (FDCPA) or the Telephone Consumer Protection Act (TCPA). The FDCPA protects consumers against a variety of harassing debt collection practices and also requires debt collectors to make certain disclosures, whereas the TCPA protects consumers against autodialed phone calls and text messages (typically made for debt collection or mass marketing and advertising). Both statutes apply to debt collection actions taken by the creditor (e.g., a subprime auto lender) or a debt collection company hired by the creditor (e.g., a law firm

[101] CFPB (2015), *supra* note 9, appendix L, at 74.
[102] *Id.*, section 8, table 8, at 25.

doing debt collection). Debt collection companies are not in a contractual relationship with consumers; they are independent contractors hired by debt holders to collect debts. Hence, the majority of the courts that have decided the issue have said that such independent contractors are not parties to the contract between the consumer and the original creditor and, therefore, may not avail themselves of any mandatory arbitration provision in that contract.[103] Thus, because many of its debt collection settlements likely involved claims against debt collection companies, the CFPB should have excluded many and perhaps most of the settlements in its sample according its own stated criterion for sample construction.

b. The CFPB's aggregate average class claims rate obscures evidence of enormous variation in claims rates across different case types. The CFPB might well counter by arguing that because most debt collection class settlements are quite small,[104] both in terms of the size of the class and the size of the aggregate payout to the class, its inclusion of so many debt collection settlements is unlikely to have had a major effect on its reported claims rate. The kind of claims rate reported by the CFPB, however, is likely to obscure what the bulk of class action settlements actually bring for class members.

The reason for this lack of clarity is that the CFPB's reported claims rate is an aggregate average. The CFPB's claims rate is equal to its estimate of the total number of class members receiving payments in its sample divided by its estimate of the total number of class members in that same sample.[105] Thus, the CFPB's claims rate lumps all types of class action settlements together, simply reporting an aggregated average claims rate.

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[103] Richard M. Alderman, *The Fair Debt Collection Practices Act Meets Arbitration: Non-parties and Arbitration*, 24 LOY. CONSUMER L. REV. 586 (2012).

[104] From CFPB (2015), *supra* note 9, section 8, table 8, at 25, one can see that the total relief in debt collection settlements was only about 4% of the total cash relief across all product categories.

[105] *Id.*, section 8, at 26–27.

The Report shows that the total or aggregate cash payouts to class members for checking account and credit card class actions is about $1.4 billion.[106] This amount is 67% of the total cash relief in all class settlements studied by the CFPB, even though these cases make up a small portion of the total number of class settlements. Some of these cases are among the class settlements that the CFPB covered in its selective report on class action settlements in its 2013 preliminary resullts. Referring to the preliminary results, one sees that in the checking account overdraft litigation (consolidated in the Southern District of Florida) alone, the settlements discussed by the CFPB compensated about 6 million class members.[107] Thus, a very small number of large cases involving huge plaintiff classes are driving the results, even though those cases are likely not typical of most class action cases.

2. The CFPB's Report on attorneys' fees relative to class payouts is also an aggregate average that conceals variation across case types and enormously high attorneys' fees relative to the class payout for some types of consumer class actions. The CFPB reports that attorneys' fees in class settlements are a surprisingly low 21% of the total cash compensation paid to class members (and an even lower 16% of what it calls "total gross relief"). But the CFPB's number for attorneys' fees as a fraction of class payout is generated by the same sort of aggregate average method used to compute class payout rates. The CFPB divided total attorneys' fees paid in all its class settlements by the total amount paid to class members in those settlements.[108] However, the CFPB did apply this method for each case type, so that one may see the fraction of total attorneys' fees paid relative to the total cash relief in class settlements in, for example, settlements that the CFPB categorized as involving credit cards or checking accounts. The CFPB

[106] *Id.*, section 8, table 8, at 25.
[107] CFPB (2013), *supra* note 8, at 105–8.
[108] CFPB(2015), *supra* note 9, section 8, at 33.

also broke down attorneys' fees relative to the amount paid to the class for different categories of total class payments. These data reveal that although attorneys' fees are a relatively small percentage of class payments for the largest class settlements (averaging only 9% for settlements larger than $100 million), they constitute a much higher fraction of the class award for smaller total class payments (averaging 57% for class awards less than or equal to $100,000).[109]

After reporting these relatively disaggregated numbers on attorneys' fees as fraction of class payouts, the CFPB states that "[o]ver 90% of individual class members in consumer financial settlements . . . are in settlements where the fee rate is under 40% . . . [and] the vast majority of class members are in settlements where the fee rates, . . . are less than 20%."[110] Similarly, the CFPB defends its method of presenting a ratio of attorneys' fees to class payouts by aggregating payouts and fees across all cases within a given category (either financial product category or payout amount) as an approach that reflects the fact that attorneys' fees tend to be a lower fraction of the class payout when payouts are bigger.[111]

An obvious consequence of this approach is that the CFPB's reported number for attorneys' fees as fraction of total class payout for both all settlements and any given type of settlement (e.g., credit card or checking account) will reflect the relatively low attorneys' fees in settlements with the biggest class payouts. Thus, it is possible—and perhaps likely—that attorneys' fees for most cases (both overall and for a particular case type) are much higher than the number reported by the CFPB, *even exceeding the class recovery*, but this problem would be completely hidden by the CFPB's methodology.

[109] *Id.*, section 8, tables 10 and 11, at 33–34.
[110] *Id.*, section 8, at 34.
[111] *Id.*, section 8, at 33–34.

3. The CFPB's aggregative data on class settlements does not really illuminate the choice between arbitration and class actions. Perhaps the biggest problem with the aggregate averages that the CFPB reports for both class action claims rates and attorneys' fees as a fraction of total class payout is that such averages are swamped by numbers from settlements in a mere *six* class actions that account for only 2% of the CFPB's class action settlements with cash payouts. The total cash payout to class members of about $812 million in these six settlements makes up 83% of total cash payouts in the 241 settlements studied by the CFPB.[112] Although the CFPB does not report the number of class members paid in these six monster class actions, it seems clear that that the classes were huge. When the CFPB reports that attorneys' fees are relatively low and class claims (payout) rates relatively high, it is really saying that for these six settlements attorneys fees are relatively low and payout rates are relatively high.

This information could have some relevance to the design of public policy regarding arbitration as a substitute for class actions. But that relevance is likely less than it might first appear. Such information might seem to be directly applicable, thereby implying that class actions are a cost-effective method of consumer compensation and deterrence in cases with enormous numbers of consumers and aggregate damages but small harm to the consumers individually. But this reasoning presumes that the defendant's conduct underlying the biggest class action settlements was actually wrongful. Because such settlements do not involve an adjudication of wrongfulness—and, indeed, are virtually always justified by class counsel on the ground that they might not succeed on the merits—they may arise in cases where there is no actual wrong to be compensated or deterred but massive discovery costs to be avoided. Hence, even when the settlements reported by the CFPB have seemingly good outcomes, it is not clear

[112] *Id.*, section 8, at 28–29.

that those settlements were socially desirable. The CFPB's data on class settlements, though somewhat informative, do not shed light on the crucial questions that must be answered to make a relative evaluation of class actions and arbitration.

D. The Misleading Comparison of Class Action Settlement Payouts to Arbitral Awards

Indeed, read as a whole, the CFPB's study does more to mislead the comparison of arbitration and class actions than it does to inform and guide that comparison. Recall that the CFPB reported aggregated data showing that, for the class action settlements it found over the 2008–2012 period, more than 11 million consumer class member received $1.1 billion in compensation,[113] whereas for arbitrations it studied over the period 2011–2012, it could verify arbitral awards to only 32 consumers (or 20% of consumers making affirmative claims for relief) for a total of $172,433.[114] This comparison of aggregate payouts from class actions and arbitration surely could be taken to show that arbitration is the weaker instrument of compensation. The CFPB's presentation, however, is a misleading conflation of two different types of data.

In presenting data on arbitral awards for consumers, the CFPB is careful to note that, in the 20% of AAA arbitrations over the 2011–2012 period in which consumers making affirmative claims received such an award (32 of 158 such claims), they received on average only 57% of what they claimed (or as the CFPB puts it, an average of 57 cents for every dollar that they claimed).[115] Although the CFPB reports on aggregate class action settlement amounts (and amounts per class member) for different types of class actions, nowhere does the CFPB Report present comparable information on how the actual settlement payout to individual class members compares with the per plaintiff damages claimed.

[113] *Id.*, section 8, at 3–5.
[114] *Id.*, section 5, at 41.
[115] *Id.*

This does not mean that class settlements for less than statutory damages are somehow suspect. To the contrary, basic economic theory predicts that settlement amounts will typically be less than the maximum amount recoverable in litigation. The same dynamic may be at work in arbitration, but the CFPB presents no data on AAA consumer arbitration settlements because it did not have access to such data. Still, the CFPB did present data showing that 23% of AAA consumer arbitrations were known to have settled, with another 34% likely to have settled.[116] Thus 57%, or the vast majority of AAA consumer arbitrations studied by the CFPB, were likely or known to have settled. Without data on the settlement amounts in those cases, it is highly misleading for the CFPD to present data on consumer arbitral awards. Had the CFPB made a proper apples-to-apples data comparison, it would have compared consumer recovery in successful consumer arbitrations not to class action settlements but to the 2% of consumer class actions in which consumers got an individual or classwide judgment.[117] Instead, the numbers that the CFPB does report invite a misleading comparison of class settlements to arbitral awards.

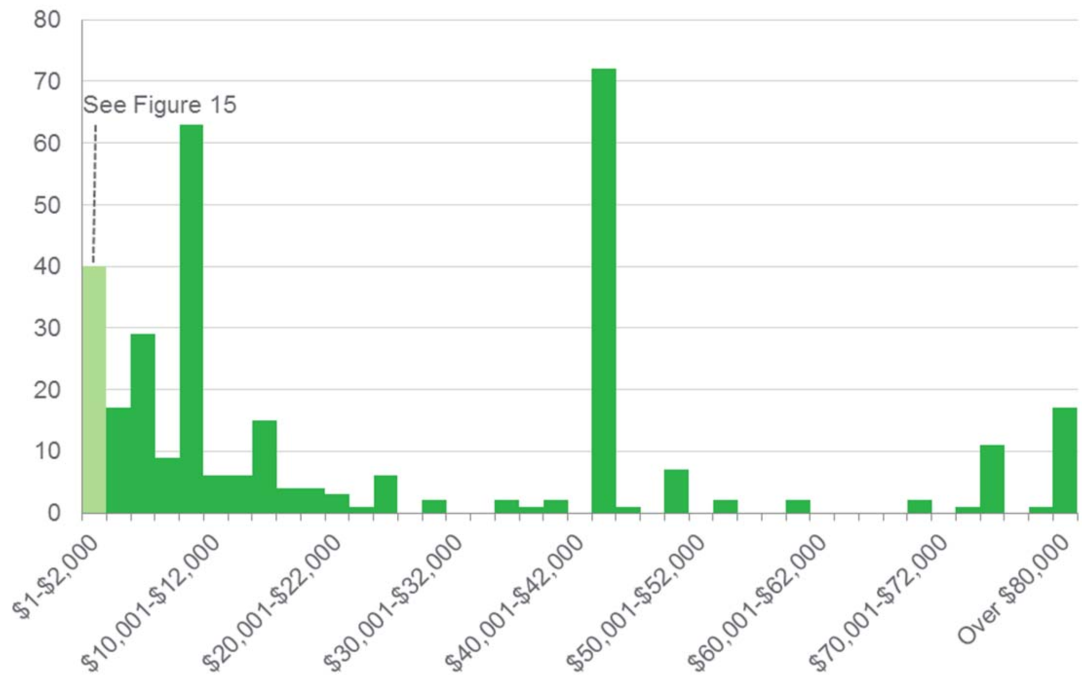
E. Claims Less Than $1,000 against Financial Products and Services Providers Are Relatively Rare—Regardless of Whether They Are Arbitrated or Litigated

In its preliminary results study, the CFPB reported finding "almost no" AAA arbitration filings in the three product markets it studied that involved claims of less than $1,000. Although the CFPB did not give numbers for the fractions of claims falling within different ranges, it did present figure 14, reprinted here as figure 1,[118] which shows the overall distribution of claims. The figure does not indicate that the actual number of claims less than $1,000 found by the

[116] *Id.*, section 5, at 33.
[117] *Id.*, section 6, at 39.
[118] CFPB (2013), *supra* note 8, at 81.

CFPB, 23, is especially unusual; indeed, very small claims appear to be more likely than, say, claims in the $50,000–$70,000 range.

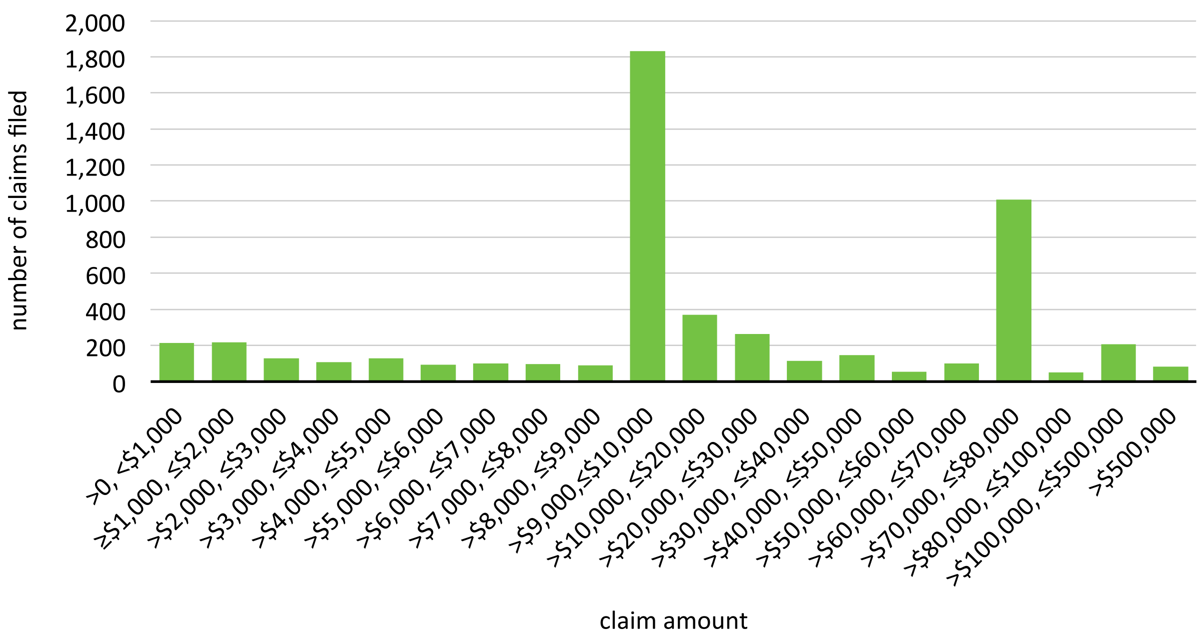
Figure 1. Distribution of Claim Amounts in AAA Arbitrations Studied in the Consumer Financial Protection Bureau Preliminary Results



Source: Consumer Financial Protection Bureau, *Arbitration Study: Preliminary Report*, 81, figure 14 (2013). "See Figure 15" in the chart refers to a figure in the source publication.

Still, clearly CFPB's sample did not include a large number of arbitrations with claim amounts less than $1,000. But it would be wrong to infer from this finding—restricted as it is to arbitrations involving particular product markets—that consumer arbitrations for less than $1,000 are rare among all AAA consumer arbitrations. Figure 2 shows the distribution of claim amounts (in filings with nonzero claims) for all AAA consumer arbitrations filed over the period 2009–2014, the most recent period for which publicly available AAA data exist online. A quick glance at figure 2 indicates that in this dataset, too, few claims for less than $1,000 were filed. But in fact, the 219 claims that were less than $1,000 make up 3.5% of all claims, and claims less than or equal to $2,000 make up 7% of all claims. By comparison, in the CFPB's AAA financial products arbitrations, claims for less than $1,000 make up only 2% of all claims.[119] In other words, small claims were 75% more likely in the overall AAA consumer filing dataset than in the CFPB's financial products AAA consumer dataset. The fact that a nontrivial number of small-dollar AAA arbitrations are brought for other products, suggests that small-dollar arbitrations actually are feasible. In turn, the finding suggests that the relative scarcity of small-dollar consumer arbitrations against financial institutions may reflect something other than the economic feasibility of arbitrations and some factor unique to financial services, such as more robust internal dispute resolution practices.

Figure 2. Frequency of Claim Amounts, All AAA Consumer Arbitrations, 2009–2014



Source: Data compiled from AAA consumer arbitration statistics, available at https://www.adr.org/aaa/faces/aoe/gc/consumer/consumerarbstat?_afrLoop=209719868901203&_afrWindowMode=0&_afrWindowId=8ok8435fw_1#%40%3F_afrWindowId%3D8ok8435fw_1%26_afrLoop%3D209719868901203%26_afrWindowMode%3D0%26_adf.ctrl-state%3D8ok8435fw_51.

[119] This number results from dividing the 23 small arbitrations that the CFPB identified by 1,060, the total number of arbitrations in its sample.

The evidence about both class actions and arbitrations suggests that further work is needed to investigate precisely why one sees a relatively low number of small-dollar claims both in consumer class actions and consumer arbitrations. Such work should recognize, however, that the $1,000 threshold appears to be a poor indicator of whether a claim against a financial products provider is a "small-dollar" claim. One reason that $1,000 is a poor way to define small claims against financial products and servicers providers is that many (and probably most) class actions against financial product suppliers are brought under federal consumer protection statutes that authorize statutory damages up to either $1,000 or $1,500 per claimant without proof of injury. Therefore, those amounts are the effective minimum amounts claimed by a class member in such class actions, regardless of how small the actual individual harm may be.

One of the new pieces of information provided by CFPB concerns the substantive legal basis for AAA consumer arbitrations. The CFPB found that virtually all the arbitrations it studied involve a federal or state statutory claim or both. For example, the preliminary results indicate that for noncollection credit card arbitrations, federal statutory claims make up 59% and state statutory claims another 21%.[120] The federal and state consumer protection statutes that consumers invoke in AAA arbitration are essentially the same (although appearing in different proportions) as those that provide the basis for consumer class actions against financial product providers.[121]

Because AAA consumer financial products arbitrations proceed under the same kinds of federal (and state) consumer protection statutes as do consumer class actions involving these products, it would be surprising to find that many AAA consumer arbitrations claimed less

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[120] CFPB (2013), *supra* note 8, at 86–87.
[121] The CFPB preliminary results find that in the credit card arbitrations, 39% of claims rely on the Fair Debt Collection Practices Act, 22% on the Fair Credit Reporting Act, and 16% on the Fair Credit Billing Act. *Id.* at 86.

than $1,000 (or sometimes $1,500). The CFPB's study, referring as it does to a 1995 opinion by Justice Breyer as its benchmark for a small-dollar consumer claim, seems to ignore the fact that virtually all consumer claims are brought under federal or state consumer protection statutes that entitle consumers to at least $1,000. In such cases, Breyer's $1,000 figure is no longer a useful threshold.

VII. What CFPB Should Do before It Considers Prohibiting Arbitration

The CFPB's Report provides some useful new information about both consumer class actions and arbitrations involving selected financial products and services, but it does not provide data on key measures of the performance of either class actions or arbitrations. Most notably, the Report contains no information on the size of arbitral settlements, and it does not provide data on class action settlements that are sufficiently fine-grained to allow one to see how class payout rates and attorneys' fees vary with case type. Some of the CFPB's findings actually undermine several key arguments that are often asserted to justify restrictions on arbitration, such as the supposed unfairness of arbitration procedures. The Report shows not only that most AAA consumer claimants have counsel but also that they usually do not need it: the CFPB's Report provides evidence that AAA arbitration may be the only way for consumers to successfully seek outside redress without resort to hiring costly legal counsel.

Although the relative absence of small-dollar disputes between consumers and financial institutions in the AAA data might suggest that arbitration is ineffective for dealing with such disputes, the absence of such observations alone cannot sustain the conclusion that the disputes are not economically feasible to arbitrate. First, in an era when virtually all consumer legal actions—whether adjudicated before the AAA or in federal court—are brought under federal consumer protection statutes authorizing statutory damages (often without proof of injury to the consumer), it is difficult even to identify what constitutes such a claim. Second and more importantly, the CFPB's Report provides no evidence for why disputes involving very small claim amounts are not typically arbitrated. However, as we noted, data provided by one financial institution indicates that it grants refunds to 68% of customers who complain, suggesting that the bank has a well-established internal system for resolving meritorious small-dollar consumer claims, pretermitting either arbitration or litigation. Together with the CFPB's survey evidence showing that consumers do, indeed, punish firms that try to attach unreasonable charges and fees by taking their business elsewhere, it may well be that truly small-dollar claims are increasingly being eliminated by the market itself.

Public policy in the United States has long supported the use of arbitration and other means of dispute resolution as an alternative to litigation. Indeed, in at least some areas (such as securities litigation), Congress has acted in recent years to pare back the scope of class action lawsuits. It is generally recognized that reckless and irresponsible class action cases can be harmful to consumers, businesses, and the economy as a whole. Frivolous class action cases impose both direct and indirect costs on businesses that inevitably are passed on to consumers in the form of higher prices, reduced quality, or reduced innovation and consumer choice. In the context of consumer financial products, such lawsuits drive up the cost of doing business, and those costs are passed on to consumers in the form of higher interest rates and restricted credit availability. In perhaps its most glaring omission, however, the CFPB Report makes no attempt to assess the merit of consumer class actions that end in the class action settlements it reports. It does not present any data that even illuminate which firms tend to settle and which do not and how key measures of class action performance (claims rates and attorneys' fees relative to the class payout) vary with the statutory basis of the claim settled. After reading the voluminous Report, one knows no more about whether the settlement of frivolous consumer class actions is a real social problem than one did before reading it. Likewise, one knows no more about whether arbitration realizes its promise of achieving more accurate determination of consumer disputes on the legal merits.

Although the point is largely ignored in the Report, over time courts have developed a robust and evolving jurisprudence to protect consumers in cases involving unfair arbitration clauses.[122] The CFPB's Report does not provide anywhere near the kind of information that would be necessary for the CFPB to craft ex ante regulation of consumer arbitration clauses that would do a better job of weeding out unfair arbitration clauses than what courts have done through ex post adjudication. Indeed, broad regulatory action by the CFPB that might nullify or discourage consumer arbitration could preempt what has become quite precise judicial supervision and fine-tuning of consumer arbitration clauses. Such ex post judicial supervision seems already to have changed that way that companies such as AT&T draft arbitration clauses, leading to arbitration procedures that are cheap and easy for consumers to pursue and that offer consumers large payments (in AT&T's case, $10,000) when the consumer wins. Consumer arbitration is only in its infancy. It has tremendous promise. The CFPB's Report provides no evidence for this promise to be aborted by expansive new CFPB regulation.

[122] And as argued by Drahozal, *supra* note 72, judicial policing is not the only mechanism for ensuring substantively fair terms in mandatory arbitration clauses. Firm reputation and other market sanctions also play a role.