Submitted via regulations.gov

RE: Docket ID CFPB-2023-0047, Petition for Rulemaking: To Require Meaningful Consumer Consent Regarding the Use of Arbitration to Resolve Disputes Involving Consumer Financial Products and Services

Dear Director Chopra:

We, Alan S. Kaplinsky, Mark J. Levin and David Sherwyn, write in our individual capacities to oppose the above-captioned petition and urge the Consumer Financial Protection Bureau (CFPB) not to engage in rulemaking. These comments reflect our personal views on the petition and, more generally, the subject of consumer and employment arbitration.

Mr. Kaplinsky is a senior counsel at Ballard Spahr LLP and the former Practice Leader for 25 years of the firm's Consumer Financial Services Group. For more than five decades he has counseled financial institutions on bank regulatory and transactional matters, particularly consumer financial services law, and defended financial institutions that have been sued by consumers in individual and class action lawsuits and by government enforcement agencies. Mr. Kaplinsky pioneered the use of class action waivers in consumer arbitration agreements, represented the financial services industry at CFPB field hearings on its earlier arbitration rule and testified on consumer arbitration issues before the U.S. Senate Judiciary Committee. For each of the past 25 years Mr. Kaplinsky and Mr. Levin have published an update on important arbitration law developments for *The Business Lawyer*'s annual survey.

Mr. Levin is a senior counsel at Ballard Spahr LLP and a member of the firm's Consumer Financial Services Group and Litigation Department. His practice is focused on consumer financial services litigation, and he has extensive experience in the structuring and enforcement of consumer arbitration clauses and the defense of financial services companies in consumer class actions. Mr. Levin has enforced consumer arbitration agreements with class action waivers in the U.S. Supreme Court and numerous federal and state appellate and trial courts and has tried both individual and class arbitrations. He testified for the industry before a subcommittee of the U.S. House Judiciary Committee at an oversight hearing on whether predispute arbitration provisions in consumer contracts are fair to consumers. Mr. Levin has published more than 50 articles on consumer arbitration.

Mr. Sherwyn is the John & Melissa Ceriale Professor of Hospitality Human Resources and Professor of Law at Cornell University. He is also the director of the Cornell Center for Innovative Hospitality Labor & Employment Relations. He has published numerous law review articles on alternative dispute resolution, including a seminal empirical study of why post-dispute arbitration does not work as a procedure for resolving employment disputes, a copy of which is being submitted herewith. In addition, his forthcoming article in the American Bar Association's Labor and Employment Journal provides data proving that employees fare better in arbitration than in litigation.

<u>Introduction</u>. We respectfully submit that the rule proposed by petitioners is bad for consumers, bad for companies, bad for the judicial system and bad for the U.S. economy, which is already in a fragile state. The proposed rule is a wolf in sheep's clothing that, at its core, is

substantially the same as the Final Arbitration Rule promulgated by the CFPB in July 2017, *see* 82 FR 33210, which was overridden by Congress under the Congressional Review Act (CRA) on November 1, 2017. Make no mistake: notwithstanding petitioners' argument that the CRA "poses no barrier" to the proposed rulemaking, the earlier rule and the rule advocated by petitioners have the exact same goal: the elimination of consumer arbitration agreements containing class action waivers—even though the CFPB itself has acknowledged that individualized arbitration is faster, cheaper and more beneficial to consumers than class action litigation—so that thousands of new class actions can be filed. That would benefit only the lawyers for the class, not the consumer class members that the CFPB is statutorily charged with protecting, would burden companies with billions of dollars in additional litigation costs and would clog the courts. The CRA is only one of many compelling reasons why the CFPB should refrain from initiating the rulemaking proposed by petitioners. Our objections to rulemaking are summarized below, and we attach the following documents in support:

1. "Consumer Advocates Petition CFPB to Undertake Rulemaking to Prohibit 'Pre-dispute' Consumer Arbitration Clauses," published by Messrs. Kaplinsky and Levin on September 15, 2023 in Ballard Spahr's Consumer Finance Monitor (Attachment 1);

2. Transcript of Podcast analyzing the petition and proposed rulemaking, recorded by Messrs. Kaplinsky and Levin and Professor Sherwyn on November 3, 2023 (Attachment 2)

   [The link to the podcast webpage, which will be released on Thursday November 16th, is https://www.ballardspahr.com/Insights/Blogs/2023/11/Podcast-Reasons-CFPB-Should-Deny-Petition-Rulemaking-Post-Dispute-Consumer-Arbitration-Agreements . Please note that this link is not currently live. If the link is clicked before November 16 at 10:00 a.m., it will read as Page Not Found. Once the episode is ready on November 16, this link will access the episode.]; and

3. *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, published by Professor Sherwyn in the Berkeley Journal of Employment and Labor Law (2003) (Attachment 3).

Summary of Comments. The CFPB should not engage in petitioner's proposed rulemaking on post-dispute arbitration clauses for the following reasons, *inter alia*:

A. The Proposed Rule Is Prohibited by the CRA. Under the CRA, a rule that has been disapproved by Congress (as was the CFPB's Final Arbitration Rule) "may not be reissued in substantially the same form, and a new rule that is substantially the same as such a rule may not be issued, unless the reissued or new rule is specifically authorized by a law enacted after the date of the joint resolution disapproving the original rule." Petitioners argue that the CRA would not bar the proposed new rule because it is not directed at class action waivers *per se*, but rather is intended to ensure that consumers have informed consent before they agree to arbitrate, which is only possible after a dispute has arisen. (Pet., p. 8). However, this attempt to evade the strictures of the CRA is hyper-technical, superficial and unconvincing, since the petition exudes overt hostility to class action waivers and an overwhelming policy preference for class action litigation over individual

arbitration. For example, petitioners argue, just as consumer advocates did when the CFPB sought to ban class action waivers in the earlier rule:

> Forced arbitration clauses require private arbitration of disputes, often on an individual basis, because most of these clauses also bar individuals from joining with others in class actions or class arbitration …. [T]he widely used prohibitions on aggregated or class claims in arbitration clauses eliminate the possible adjudication of systemic and widespread violations of the law. When consumers suffer small but serious injuries, banding together in a joint or collective action is often the only practical, cost-effective path for consumers to seek and obtain corporate accountability. Without the ability to go to court and band together, consumers harmed by corporate wrongdoing are deterred from asserting claims against financial institutions because it is costly, risky, and impractical to pursue their claims alone in arbitration.

(Pet, p. 3). As is often said, "If it looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck." The rule that petitioners propose would allow plaintiffs' class action attorneys to reject arbitration on behalf of a putative or certified class. That is really what petitioners are hoping to achieve when they argue that "[i]t is generally only after a dispute arises that consumers have access to counsel to help them make informed decisions about where *and how* to bring their claims." (Pet., p. 4) (emphasis added). Those attorneys have a strong economic incentive to reject arbitration so that they can receive exorbitant attorneys' fees to the detriment of consumers and companies.

To divert attention from their real goal—the elimination of class action waivers—and create the impression that the proposed new rule is not substantially the same as the earlier rule that Congress disapproved, petitioners contend that rulemaking is necessary because, according to several empirical studies they cite, consumers lack awareness and understanding of the existence, meaning and consequences of arbitration clauses in their contracts (Pet., pp. 8-10). However, as petitioners acknowledge (Pet., p. 9), these are the very same arguments the CFPB previously examined when it promulgated the earlier arbitration rule. The Final Arbitration Rule stated:

> [T]he Bureau notes that consumer finance contracts are not negotiated; they are almost always standard-form contracts that consumers may either choose to sign in order to obtain the product or not. Further, the Study's consumer survey of credit card customers found that consumers did not mention dispute resolution features as relevant to them when shopping for credit cards and chose dispute resolution last on a list of nine features that influenced their decision of whether to choose a particular credit card. These findings suggest that consumers do not consider dispute resolution when obtaining consumer financial products. The survey further found that consumers generally do not understand the consequences of entering into a contract that includes an arbitration agreement.

(82 Fed. Reg. 33309). Indeed, the CFPB devoted an entire chapter (Chapter 3) of its 2015 empirical study of consumer arbitration (which was the basis for the Final Arbitration Rule) to the subject of "What do consumers understand about dispute resolution systems?" And, it specifically discussed the St. John's University research paper about consumer understanding of arbitration clauses that petitioners rely on in their petition. (*See* Pet., p. 9 n. 45). Petitioner's arguments are substantially the same as the arguments the CFPB previously analyzed when it promulgated the earlier vetoed rule. Petitioners concede that a more recent study by Professor Sommers, which they describe as an "updated and expanded review of this core aspect of forced arbitration," merely "reinforces … the Bureau's own 2015 survey …. Sommers' article demonstrates that, 8 years later, consumers' awareness and understanding of arbitration clauses remains extremely low." (Pet., p. 9). In other words, nothing has changed since the CFPB issued its Final Arbitration Rule in 2017, which Congress overrode. In any event, the CFPB made clear in its Final Arbitration Rule that no additional research on consumer understanding was necessary:

> The Bureau disagrees with the commenter that suggested that the Bureau should have conducted further analyses of consumer comprehension. The Bureau, in Section 3 of the Study, explored in detail consumer comprehension issues with respect to arbitration agreements using a nationally representative telephone survey. As is discussed in the Study, among other findings, the Bureau determined that a majority of respondents whose credit cards include pre-dispute arbitration agreements did not know if they could sue their issuers in court. Nor does the Bureau agree that asking consumers about their likelihood to file a class action given an arbitration agreement would result in useful information. As the Study showed, the proposal and this final rule discuss, and several industry commenters acknowledged, regardless of the level of individual consumer awareness, arbitration agreements do in fact have the effect of blocking class actions that are filed and suppressing the filing of many more cases, consumers' awareness of this fact does not seem relevant. Insofar as cases are blocked, further focus on consumers' comprehension of this fact is unnecessary.

82 Fed. Reg. 33234. Petitioners are clearly asking for a re-do in an attempt to take a second bite of the apple. The extraordinary time and expense of promulgating the proposed new rule cannot be justified where there is nothing new to consider. The CFPB cannot prohibit the use of class action waivers in consumer arbitration clauses. And, since it already determined in its prior rule that arbitration is not harmful *per se*, how could it now flip-flop and agree with petitioners that even pre-dispute individual arbitration agreements should be prohibited?

It has also been suggested that the CFPB can distinguish the proposed new rule from the earlier vetoed rule by acting under section 1031(d)(2)(A) of the Dodd-Frank Act which addresses the CFPB's authority to declare an act or practice as abusive. However, if Congress had intended that section to encompass the use of arbitration, it could have said so expressly, as it did in Section 1028 of the Act. Reliance by the CFPB on section 1031(d)(2)(A) could therefore create a "major questions doctrine" issue. That doctrine is applicable when "agencies assert … highly consequential power beyond what Congress could reasonably be understood to have granted."

West Virginia v. EPA, 142 S. Ct. 2587, 2609 (2022). Reliance on section 1031(d)(2)(A) would be particularly questionable when the Supreme Court is poised to decide whether to overrule the *Chevron* doctrine. *See Loper Bright Enter. v. Raimondo*, No. 22-451 (cert. granted May 1, 2023).

B. Petitioner's Argument that Rulemaking is Necessary Because Consumers Lack "Informed Consent" and Are "Forced" to Arbitrate Is Based on Unacceptable Policy Positions. In addition to the foregoing, petitioners' argument that rulemaking is needed because consumers do not have informed consent about the forced arbitration clauses in their contracts is premised upon a completely unacceptable policy position—*i.e.*, consumers should be forgiven (indeed, rewarded) for not reading their contracts at all. The study by Professor Sommers they rely on (Pet., p.p. 8-9) found that "real-world data suggest that vanishingly few consumers in everyday settings read contracts of adhesion in their entirety …. [F]ew [consumers] … read the fine print at all, when encountering a consumer contract." (Sommers study, p. 12). Petitioners essentially argue that consumers should be given a free pass insofar as arbitration is concerned for not bothering to read their contracts. Or, as Professor Sherwyn observed during our podcast, petitioners are asserting that "since people are lazy, let's get rid of the contract." Petitioners' argument creates a moral hazard and runs counter to the established law in virtually every jurisdiction that individuals who enter into a contract and accept its benefits are bound by its terms even if they decide not to read it. Moreover, petitioners propose a rule that would invalidate only the *arbitration clause*—but not the non-arbitration terms of the contract—which flies in the face of longstanding policy under the Federal Arbitration Act that arbitration clauses cannot be singled out for special treatment. As discussed later in this section, if the CFPB believes that informed consent is lacking, it should be encouraging consumers to read their contracts, not to ignore them, and educate them about the pros and cons of arbitration and class action litigation.

In addition, consumers are not "forced" (a word that appears 94 times in the 18-page petition) to arbitrate merely because a standard form contract is involved. Most arbitration clauses offer consumers the right to opt out of the arbitration clause by sending a simple opt-out notice back to the company within 30, 45 or 60 days of entering into the contract. In any event, the days when consumer contracts were individually negotiated "are long past," as the U.S. Supreme Court has observed. Furthermore, non-negotiated contracts are not inherently offensive. On the contrary, they benefit both consumers and the companies they deal with. As observed in the American Law Institute's (ALI) recently approved Restatement of the Law, Consumer Contracts "There are many benefits to standard-form contracting …. The efficiencies of mass production and mass distribution of products and services would be hindered if the terms of each transaction with each consumer had to be individually negotiated. These market efficiencies can benefit all market participants …." The Reporters Notes to the Restatement likewise state: "[T]he use of standardization in the production of contract terms is, like standardization in the production of goods and services, a source of potential benefits to consumers and businesses alike. Standardization supports efficient production and distribution, resulting in lower prices and lower transaction costs, and the introduction of new forms of products and services." The Restatement culminated an 11-year project by ALI to address how contractual terms are adopted, modified and enforced in contracts between business and consumers. It reflects the collective input of hundreds of professors, consumer advocates, industry lawyers and other interested persons who carefully considered what rules should apply to consumer contracts.

Petitioners are quick to try to pin consumers' alleged lack of awareness on companies, but the reality is that most companies go out of their way to try to educate consumers about arbitration and make them aware. They highlight the existence of the arbitration clause at the very outset of the contract and urge the consumer to read it carefully. They also explain in detail how the consumer can opt out of the arbitration clause, the rights that will be waived if a dispute is arbitrated, the costs of arbitration, what the applicable arbitration rules provide, appeal rights and so forth. That is why arbitration agreements tend to be lengthy. Moreover, *italics* and **bold-face** and ALL CAPS are used liberally to focus the consumer's attention on the arbitration clause, even though that is more than the law requires. Unfortunately, while the industry is doing its best to make consumers arbitration-literate, the CFPB is not. It has shirked its responsibility to educate consumers about the many benefits of arbitration, particularly when compared with class action litigation, even though it has virtually unlimited resources and a dedicated educational arm, the Division of Consumer Education and External Affairs.

We respectfully suggest that the CFPB (and the consumer advocacy groups that submitted the petition) would be better served by devoting their time and resources to educating the public about the many benefits that arbitration has to offer. The CFPB's own empirical study of consumer arbitration demonstrates that consumers do better in arbitration than in court. Awards are higher, resolution is faster and consumer costs are less in arbitration than in court. Other advantages of arbitration include its convenience and accessibility. Arbitration is more convenient, less expensive, and less intimidating than going to court, making it particularly amenable to small dollar claims. Claimants avoid having to take off time from work and endure the hassles inherent in the court system. And, he or she can speak directly to the arbitrator without the constrains of formal evidence rules and get a result on the merits promptly.

Educating consumers about the pros and cons of arbitration and litigation would go a long way to achieving what the petition purports to strive for—*i.e.*, "competitive markets where [consumers] can make informed and meaningful choices about the products they use and the terms of service they are bound to." (Pet., p. 18). Education, not regulation, is the key to improving consumers' financial literacy. It is patently unfair for petitioners to assume that the consumer will inevitably be in a worse position if a dispute is arbitrated rather than litigated. Litigation also has numerous substantial downsides, and consumers should have a more complete and balanced picture of the options available to them.

C. <u>Post-Dispute Arbitration Does Not Work</u>. As a practical matter, research shows that post-dispute arbitration would fail to resolve consumers' disputes because, in the real world, it is almost never utilized. As shown in Professor Sherwyn's attached article, once a dispute has arisen, one side or the other, or both, inevitably use the in terrorem "threat" of expensive and prolonged litigation as a negotiating tool. That tactic is eliminated if the parties have agreed to arbitrate the dispute prior to the dispute arising. The "overriding problem" with post-dispute arbitration, Professor Sherwyn emphasizes, is that "it is extremely rare for both the plaintiff's and defense's attorneys in a case to select arbitration after the dispute has arisen" and, accordingly, both businesses and individuals "are hurt by a post dispute system." Thus, although post-dispute arbitration is a theory that may sound superficially appealing, it fails in real life. Pre-dispute arbitration puts both sides on a level playing field, and Professor Sherwyn's study backs that up with substantial empirical evidence. To quote Professor Sherwyn, "if you want alternative dispute

resolution, you got to have it where it actually makes a dent and people use it. And so post-dispute voluntary doesn't solve that problem because people don't use it." While Professor Sherwyn's study involved the employment context, it is equally applicable to the consumer context. *See also* P. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 Cardozo J. Conflict Resol. 267, 267-68 (2008) ("Abolishing the system of enforceable pre-dispute agreements, as proponents of the Arbitration Fairness Act urge, would hardly improve the lot of the average individual. Indeed, in such a world, individuals might be far worse off, for they would find it far harder to obtain a lawyer, find the cost of dispute resolution far more expensive, wait far longer to obtain relief and may well never see a day in court. Nor would a system of post-dispute arbitration somehow miraculously salvage the virtues of arbitration while letting its defects sink to the sea floor. There simply is no empirical evidence demonstrating the viability of postdispute arbitration."); V. Schwartz, *Setting the Record Straight About the Benefits of Pre-dispute Arbitration*, Washington Legal Foundation (June 7, 2019) ("The notion of supplanting pre-dispute arbitration agreements with post-dispute arbitration ignores the fact that parties' incentives change dramatically in the post-dispute setting. Unlike in pre-dispute arbitration, where both parties—regardless of position and strength of case relative to each other—agree to arbitrate any dispute, each party in the post-dispute context will insist on either arbitration or litigation where it provides the greatest expected benefit to them and them alone. Consequently, the adversarial parties are unlikely as a practical matter to agree on the same dispute-resolution method. This is why post-dispute arbitration agreements are virtually non-existent in the 'real world.'").

Nothing in the petition argues that post-dispute arbitration actually works. That is not surprising because all of the literature and empirical studies establish that it doesn't work. Petitioners' avoidance of dealing with that critical issue betrays the real intent of the petition, which is to ban arbitration altogether.

D. The Proposed Elimination of Pre-dispute Arbitration Agreements Will Harm Consumers, Businesses, the Courts and the Economy. Without pre-dispute arbitration, most if not all consumer financial services companies would abandon their arbitration programs altogether because post-dispute arbitration simply does not work for all the reasons Professor Sherwyn has identified. That would deprive consumers of all the benefits that individual arbitration has to offer. For example, the CFPB's data in its arbitration study confirmed that arbitration is a faster, less expensive and far more effective way for consumers to resolve disputes with companies than class action litigation. The study showed that consumers who prevailed in an individual arbitration recovered an average of $5,389. By contrast, the average class action settlement for consumers who received cash payments was only $32.35, and those consumers often had to wait as long as two years to receive that paltry sum. Class counsel, however, recovered a staggering $424,495,451 in attorneys' fees. Eliminating pre-dispute arbitration would also inflict serious financial harm on the American federal and state court systems, which are already overburdened, underfunded and bursting at the seams, and on financial services providers. When it promulgated its Final Arbitration Rule, the CFPB estimated that the rule would cause 53,000 providers who presently utilize arbitration agreements to incur between $2.62 billion and $5.23 billion in defending against an additional 6,042 class actions that would be brought within five years after the rule took effect. That data, compiled in 2017, undoubtedly understates what the current numbers would be some six years later.

E. The Petition Is Premature. The CFPB should defer doing anything with respect to the petition unless and until it finalizes its proposed rule that would create a registry of non-banks that use arbitration provisions and it has been in use for a while. Until that is done, the CFPB simply does not have the data it needs about the prevalence of consumer arbitration. In addition, it would trample on Congressional power for the CFPB to undertake the proposed rulemaking while Congress is considering bills (such as the FAIR Act) that would ban consumer arbitration altogether. Also, the petition has been filed at a most inappropriate time since the Supreme Court is poised to decide whether the CFPB has been unconstitutionally funded.

In conclusion, we strongly urge the CFPB to not engage in rulemaking on this matter and appreciate the opportunity to comment on the proposed petition.

Respectfully submitted,

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David Sherwyn