Statement of the U.S. Chamber of Commerce

ON: Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers

TO: House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit

BY: Andrew Pincus, Partner, Mayer Brown, LLP (on behalf of the U.S. Chamber of Commerce)

DATE: May 18, 2016

1615 H Street NW | Washington, DC | 20062

The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

The U.S. Chamber's Institute for Legal Reform is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, fairer, and faster for all participants.

Testimony of Andrew Pincus,
Partner, Mayer Brown LLP on behalf of the U.S. Chamber of Commerce

Before the House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit

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CHAIRMAN NEUGEBAUER, RANKING MEMBER CLAY, AND MEMBERS OF THE SUBCOMMITTEE:

I am honored to appear before the Subcommittee today on behalf of the U.S. Chamber of Commerce and its Center on Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR").

The U.S. Chamber of Commerce (the "Chamber"), the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors and regions, as well as state and local chambers and industry associations, is dedicated to promoting, protecting and defending America's free enterprise system. The Chamber created CCMC to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, faster, and fair for all participants.

The anti-arbitration rule proposed by the Consumer Financial Protection Bureau (the "Bureau" or "CFPB")—if finalized by the Bureau and upheld by the courts—is bad for business and bad for consumers. The rule will harm consumers rather than help them by:

- Eliminating access to justice available to consumers through arbitration and relegating consumers to lawyer-controlled class actions that provide little benefit to consumers; and

- Increasing the cost to consumers of financial goods and services without any corresponding benefit.

Before explaining what arbitration is, how it benefits consumers, and why the Bureau's proposal will harm consumers, three preliminary points are important.

First, as a lawyer, nothing would make me happier than to tell this Subcommittee that our court systems are functioning well and that individuals have a realistic chance to vindicate their rights in court no matter how small the claim. Unfortunately, neither of those things are true. That is why we have a very significant access-to-justice problem in this country that is the topic of numerous articles in legal publications and appeals for charitable donations by bar associations and related groups.

I also would like to be able to say that the class action device effectively vindicates class members' interests and ensures that the interests of class members outweigh those of lawyers (both plaintiff and defense). But, again, experience with the class action system—as well as empirical analysis—leaves no doubt that the current system has major problems.

Arbitration addresses these flaws in our court systems, providing a fair, quick, and cheaper means of vindicating claims. It empowers individuals, freeing them from reliance on lawyers. And it harnesses technology to make dispute resolution easy to access and claims easy to prosecute.

Numerous government and business processes have been modified to use technology to increase efficiency and access. The same approach is appropriate for dispute resolution.

Second, the Subcommittee should view the Bureau's rulemaking in context. The rule is part of a widespread attack on arbitration, championed by those with a vested interest in the judicial litigation system—such as lawyers who are able to reap large fees from class actions. Although the Federal Arbitration Act, enacted in 1925, continues to embody Congress's preference for a "liberal federal policy favoring arbitration agreements," which the Supreme Court has upheld time and time again,[1]

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[1] *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 24-25 (1983). Over the past two decades, the Supreme Court has repeatedly enforced arbitration agreements. *See, e.g., Am. Express Co. v. Italian Colors Restaurant*, 570 U.S. ___ (2013); *Nitro-Lift Technologies, LLC v. Howard*, 568 U.S. ___ (2012); *Marmet Health Care Ctr., Inc. v. Brown*, 565 U.S. ___ (2012); *CompuCredit Corp. v. Greenwood*, 565 U.S. ___ (2012); *KPMG LLP v. Cocchi*, 565 U.S. ___ (2011); *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011); *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (2010); *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247 (2009); *Preston v. Ferrer*, 552 U.S. 346 (2008) (Ginsburg, J.); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006); *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003); *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996) (Ginsburg, J.); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995) (Breyer, J.).

there have been numerous Executive Branch efforts to undermine parties' rights to enforce contractual arbitration agreements:

- The Department of Education's March 11, 2016, announcement that it will take steps to end the use of pre-dispute arbitration agreements in enrollment agreements at institutions of higher learning[2];

- The Department of Labor's proposed fiduciary duty rule, which restricts the use of arbitration[3];

- The FCC's request, in a rulemaking ostensibly focused on consumer privacy, for comments on whether it should prohibit broadband internet service providers from using arbitration with their customers[4]; and

- The NLRB's efforts to invalidate arbitration clauses in employment agreements, which have been set aside by every appellate court to address the issue.[5]

In each of these circumstances, the agency alleges that only a court can properly vindicate the type of legal claim at issue, but those assertions are based on a theoretical assessment of the benefits of class actions that bears no relation to reality and on ignoring the benefits to consumers from arbitration.

Third, although the CFPB's proposal is framed as a requirement that consumers be able to participate in class actions, it will have the very same practical effect as a rule banning pre-dispute arbitration. That is because companies bear all, or virtually all of the costs of arbitration, and those costs can be significant—maintaining a pre-arbitration settlement process and covering all (or nearly all) filing fees, arbitrator fees, and the like. They are willing to do so because they don't have to pay

[2] U.S. Dep't of Educ., Press Release, U.S. Department of Education Takes Further Steps to Protect Students from Predatory Higher Education Institutions, Mar. 11, 2016, http://www.ed.gov/news/press-releases/us-department-education-takes-further-steps-protect-students-predatory-higher-education-institutions.
[3] *Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice*, 81 Fed. Reg. 20,945 (Apr. 8, 2016).
[4] *Protecting the Privacy of Customers of Broadband and Other Telecommunications Services*, 81 Fed. Reg. 23,360, 23,393-94 (Apr. 20, 2016).
[5] *See, e.g.*, *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344, 362 (5th Cir. 2013); *Sutherland v. Ernst & Young LLP*, 726 F.3d 290, 297 n.8 (2d Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1055 (8th Cir. 2013); *Iskanian v. CLS Transp. Los Angeles, LLC*, 327 P.3d 129, 142 (Cal. 2014).

the litigation costs associated with class actions: all of their disputes are resolved in one system, arbitration.

No rational business will pay the costs associated with two systems. Forcing them to spend the millions in legal fees it costs to defend against class actions, and they will drop arbitration rather than voluntarily take on duplicative dispute resolution expenditures. Indeed, that is what companies did before the Supreme Court's 2011 *AT&T v. Concepcion* decision upheld the enforceability of class waivers—they wrote their arbitration clauses to eliminate arbitration if the law required them to defend against class actions.[6]

The CFPB's Unfair, Closed Study Process.

The critical policy question that the CFPB should have addressed is whether the benefits that consumers obtain from class actions are so great that it is worth sacrificing the benefits that consumers gain from arbitration. And, that question should have been assessed based on how class actions work in the real world, not how they are supposed to work on paper. The CFPB's study and proposed rule, instead, take it on faith that class actions are beneficial to American consumers. But that faith is deeply misguided. And, the Bureau's assessment of arbitration's benefits is similarly flawed.

The Bureau's approach was simply to follow the plaintiff's bar attacks on arbitration that rest entirely on theory, not reality. The claims that class actions provide "access to justice" and that arbitration can't do so are grounded in an assessment of these dispute resolution mechanisms are entirely disconnected from reality and an overly idealized view of class action litigation.

To evaluate the effect of the Bureau's proposal, it is essential to understand arbitration, class actions, and the real-world trade-offs associated with eliminating arbitration in favor of class actions.

The Bureau failed to undertake that inquiry.

[6] Thus, one group of businesses explained to the Supreme Court in 2011 that, "when there is no assurance that all claims will be arbitrated in lieu of litigation, and a [company] must shoulder the additional costs of class action litigation, subsidizing the costs of individual arbitration is no longer a rational business option"; the only logical decision is to "disengage from arbitration altogether." Brief for CTIA—the Wireless Association as Amicus Curiae at 21, *AT&T Mobility LLC v. Concepcion.*

It is not surprising, therefore, that the effect of the CFPB's proposal is directly at odds with the Bureau's consumer-protection mission: the closed, nontransparent process that gave birth to the proposed rule was flawed from the start.

Congress directed the Bureau to study arbitration, and use the study's findings as the basis for any proposal to regulate arbitration. The Bureau's response was to solicit public comment once, at the outset of the study process, and never again for the three years that the study was underway. The Bureau never informed the public of the topics it had decided to study and never sought public comment on them—even though a number of commenters suggested that the Bureau utilize that procedure. The Bureau never convened public roundtable discussions on key issues, as many other agencies routinely do. And the Bureau never sought public input on its tentative findings.[7]

The product of this closed process is flawed in numerous respects. The Bureau's study:

- ignores the practical benefits of the procedures available in arbitration as compared to the court system for vindicating the types of disputes that consumers most often have;

- fails to consider the benefits that arbitration can provide to injured parties in a variety of contexts—benefits that plainly would accrue to consumers as well if they were not discouraged by plaintiffs' lawyers and others from invoking arbitration;

- fails to consider the reduced transaction costs resulting from arbitration, which under basic economic theory produce lower prices to consumers;

- exaggerates the supposed benefits of class actions to consumers and ignores the grossly disproportionate gains reaped by self-interested plaintiffs' lawyers; and

[7] The Bureau staff would meet with interested parties and accept written submissions. But the staff refused to provide any information regarding the topics that the Bureau was studying or the timeline for its study process, and those one-way conversations therefore did not permit anything resembling meaningful input.

- ignores the significant role of government enforcement—particularly the CFPB's own enforcement and supervision processes—in protecting consumers.

Indeed, more than eighty members of the House and Senate explained in their letter to the Bureau last summer regarding the study on which the proposed rule is based that:

> the process that led to the Bureau's Arbitration Study has not been fair, transparent, or comprehensive. The Bureau ignored requests from senior Members of Congress for basic information about the study preparation process. The Bureau also ignored requests to disclose the topics that would be covered by the study, and failed to provide the general public with any meaningful opportunities to provide input on the topics. Because the materials were kept behind closed doors, the final Arbitration Study included entire sections that were not included in the preliminary report that was provided to the public.
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> As a result, the flawed process produced a fatally-flawed study. Rather than focusing on the critical question—whether regulating or prohibiting arbitration will benefit consumers—and devising a plan to address the issues relevant to resolving that question, the Bureau failed to provide even the most basic of comparisons needed to evaluate the use of arbitration agreements.[8]

Two prominent academics recently conducted an independent analysis of the CFPB's study, concluding that it "provides no foundation for imposing new restrictions or prohibitions on mandatory arbitration clauses in consumer contracts."[9] In particular, the study "fail[s] to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class

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[8] http://www.cfpbmonitor.com/files/2015/06/McHenry-Scott-to-Cordray-Letter-re-Arbitration.pdf

[9] Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique* 5 (Mercatus Ctr., George Mason Univ., Working Paper, Aug. 2015), *available at* http://www.law.gmu.edu/assets/files/publications/working_papers/LS1507.pdf.

action litigation would be beneficial to consumers and the economy."[10] The CFPB's recent notice of proposed rulemaking offers no response to these scholar's extensive critique.

The study's flaws—and the tremendous amount of evidence ignored by the Bureau—are discussed in detail in the attached appendix.

What is Arbitration and how does it Work?

Everyone knows how courts are supposed to work. Who hasn't watched *Law and Order* or *The Good Wife* or dozens of other television shows? Between television and high school civics, we have the impression that courts are places where people can, and do, receive justice. (As discussed below, that impression is far removed from the current reality of the court system.)[11]

Arbitration seems more mysterious. But we've seen arbitration in operation too.

The People's Court isn't a court; it is arbitration, with Judge Wapner, and now Judge Milian, as the arbitrator. *Judge Judy* also resolves disputes as an arbitrator.[12]

Their common-sense approach is just how consumer arbitration works—the parties come in, present their cases informally, and the arbitrator rules. No complex procedures; a lawyer is not necessary (although lawyers can be used); and there is no obligation to take days off from work or family obligations to sit through lengthy proceedings and postponements—losing pay, while seeking justice—which court cases require.

And the process can even be simpler than the in-person hearings on TV. Arbitration employs web-based technology that allows claims to be filed and prosecuted online or with a telephonic hearing, at the consumer's option.

The American Arbitration Association ("AAA"), for example, requires the business to bear most arbitration costs; many companies pay even the consumer's

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[10] *Id.* at 6.
[11] *See* discussion beginning on Pg. 18.
[12] *See Kabia v. Koch*, 713 N.Y.S.2d 250, 253-55 (Civ. Ct. 2000) (holding that "The People's Court" was an arbitration under New York law and noting that "Judge Judy" used a "similar" arbitration agreement).

share, which the AAA caps at $200.[13] The AAA offers hearings by telephone, and participants can file documents and otherwise communicate with the AAA and arbitrator through email.

And arbitration is fair—studies show that consumers and employees who use this efficient dispute-resolution system prevail in arbitration at least as frequently as, and often more frequently than, they do in court:

- A recent study by scholars Christopher Drahozal and Samantha Zyontz of claims filed with the AAA found that consumers win relief 53.3% of the time.[14] By contrast, empirical studies that have sampled wide ranges of claims have similarly reported that plaintiffs win in state and federal court approximately 50% of the time.[15]

    - Drahozal and Zyontz found that "the consumer claimant[s] won some relief against the business more than half of the time," and were generally awarded between 42% and 73% of the amount they claimed, depending on the size of the claim and how average recoveries were calculated (mean or median). The authors found little evidence for a purported "repeat player" effect. Consumers prevailed more than half the time against repeat and non-repeat businesses alike; prevailing claimants were "awarded on average an almost identical percent of the amount claimed" (approximately 52%). The authors concluded that any discrepancy could be explained by businesses becoming better at screening cases ahead of time to "settle meritorious claims and arbitrate only weaker claims."[16]

- A study of 186 claimants who pursued employment arbitration in the securities industry concluded that employees who arbitrate were more likely to win their disputes than employees who litigate in federal court. The study found that 46% of those who arbitrated won, as compared to only 34% in litigation; the median monetary award in arbitration was higher; only 3.8% of the litigated

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[13] AAA, *Costs of Arbitration*, https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2026862.

[14] Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 896-904 (2010).

[15] *See, e.g.,* Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991-92, plaintiffs won 51% of jury trials in state court and 56% of jury trials in federal court, while in 1979-1993 plaintiffs won 50% of jury trials).

[16] Drahozal & Zyontz, 25 Ohio St. J. on Disp. Resol. at 898, 912-13.

cases studied ever reached a jury trial; and the arbitrations were resolved 33% faster than in court.[17]

- One study of 200 AAA employment awards concluded that low-income employees brought 43.5% of arbitration claims, most of which were low-value enough that the employees would not have been able to find an attorney willing to bring litigation on their behalf. These employees were often able to pursue their arbitrations without an attorney, and won at the same rate as individuals with representation.[18]

- A later study of 261 AAA employment awards from the same period found that for higher-income employees, win rates in like cases in arbitration and litigation were essentially equal, as were median damages. The study attempted to compare "apples" to "apples" by considering separately cases that involved and those that did not involve discrimination claims. With respect to discrimination and non-discrimination claims alike, the study found no statistically significant difference in the success rates of higher-income employees in arbitration and in litigation. For lower-income employees, the study did not attempt to draw comparisons between results in arbitration and in litigation, because lower-income employees appeared to lack meaningful access to the courts—and therefore could not bring a sufficient volume of court cases to provide a baseline for comparison.[19]

- Another study of arbitration of employment-discrimination claims concluded that arbitration is "substantially fair to employees, including those employees at the lower end of the income scale," with employees enjoying a win rate comparable to the win rate for employees proceeding in federal court.[20]

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[17] Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where do Plaintiffs Better Vindicate Their Rights?*, 58 Disp. Resol. J. 56, 58 (Nov. 2003 - Jan. 2004).
[18] Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 785-88 (2003) (summarizing results of past studies by Lisa Bingham that lacked empirical evidence proving the existence of an alleged "repeat player" and "repeat arbitrator" effect).
[19] *See* Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 Disp. Resol. J. 44, 45, 47-50 (Nov. 2003-Jan. 2004).
[20] *See* Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 Disp. Resol. J. 9, 13 (May/July 2003) (reporting employee win rate in arbitration of 43 percent); *see also* Eisenberg & Hill, 58 Disp. Resol. J. at 48 tbl. 1 (reporting employee win rate in federal district court during the same time period was 36.4 percent).

- In 2004, the National Workrights Institute compiled all available employment-arbitration studies and concluded that employees were almost 20% more likely to win in arbitration than in litigated employment cases. It also concluded that in almost half of employment arbitrations, employees were seeking redress for claims too small to support cost-effective litigation. Median awards received by plaintiffs were the same as in court, although the distorting effect of occasional large jury awards resulted in higher average recoveries in litigation.[21]

- Critics of arbitration sometimes point to a now-discredited report from the advocacy group Public Citizen[22] as purported support for the assertion that arbitration is unfair. That report shows the folly of examining outcomes in arbitration without comparing them to analogous outcomes in court.

    - Public Citizen examined data about claims brought by creditors against consumer debtors and concluded from a high win rate for creditors that arbitration is biased. In those cases, however, the consumer often does not appear and does not contest the claim and is therefore liable either because he has defaulted or "because he owes the debt."[23]

    - A more rigorous empirical study showed that "consumers fare better" in debt-collection arbitrations than in court: "creditors won some relief before the AAA in 77.8 percent of individual AAA debt collection arbitrations and either 64.1 percent or 85.2 percent of the AAA debt collection program arbitrations," depending on how the research parameters were defined. By contrast, in contested court cases creditors won relief against consumers between 80% and 100% of the time, depending on the court.[24]

As one study published in the *Stanford Law Review* explained in surveying the empirical research, "[w]hat seems clear from the results of these studies is that the

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[21] National Workrights Institute, *Employment Arbitration: What Does the Data Show?* (2004), https://web.archive.org/web/20090423052708/http://www.workrights.org/current/cd_arbitration.html.
[22] Public Citizen, *The Arbitration Trap* , Sept. 2007, http://www.citizen.org/documents/ArbitrationTrap.pdf.
[23] Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration*, 15 Disp. Resol. Mag. 30, 31 (Fall 2008).
[24] Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 Hastings Bus. L.J. 77, 91, 97, 111-16 (Winter 2011).

assertions of many arbitration critics were either overstated or simply wrong."[25] There simply is no empirical support for the contention that arbitration leads to unfair or subpar outcomes when compared with litigation in our overcrowded court system. Rather, the overwhelming weight of the available evidence establishes that arbitration allows consumers and employees to obtain redress faster, cheaper, and more effectively than they could in court.

Arbitration also has built-in fairness guarantees. The rules of arbitration organizations along with existing law protect consumers and employees against unfair procedures and biased arbitrators.

Thus, when courts find arbitration provisions unfair to consumers or employees under generally applicable principles, they do not hesitate to invalidate the agreements. For example, courts have repeatedly invalidated provisions of arbitration agreements that purported to impose:

- excessive costs and fees to the consumer or employee for accessing the arbitral forum;[26]

- limits on damages that can be awarded by an arbitrator when such damages would be available to an individual consumer or employee in court;[27]

- requirements that arbitration take place in inconvenient locations;[28]

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[25] David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 Stan. L. Rev. 1557, 1567 (2005) (emphasis added).

[26] The Supreme Court has held that a party to an arbitration agreement may challenge enforcement of the agreement if the claimant would be required to pay excessive filing fees or arbitrator fees in order to arbitrate a claim. *See Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 90-92 (2000). Since *Randolph*, courts have aggressively protected consumers and employees who show that they would be forced to bear excessive costs to access the arbitral forum. *See, e.g., Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 923-25 (9th Cir. 2013) (refusing to enforce an arbitration agreement that required the employee to pay an unrecoverable portion of the arbitrator's fees "regardless of the merits of the claim"); *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2310-11 (2013) (reaffirming that a challenge to an arbitration agreement might be successful if "filing and administrative fees attached to arbitration . . . are so high as to make access to the forum impracticable" for a plaintiff). Courts also have reached the same conclusion under state unconscionability law. *See, e.g., Brunke v. Ohio State Home Servs., Inc.*, 2008 WL 4615578 (Ohio Ct. App. Oct. 20, 2008); *Liebrand v. Brinker Rest. Corp.*, 2008 WL 2445544 (Cal. Ct. App. June 18, 2008); *Murphy v. Mid-West Nat'l Life Ins. Co. of Tenn.*, 78 P.3d 766 (Idaho 2003).

[27] *See, e.g., Venture Cotton Coop. v. Freeman*, 395 S.W.3d 272 (Tex. Ct. App. 2013) (limit on damages and attorney's fees under state consumer protection law); *Mortg. Elec. Registration Sys., Inc. v. Abner*, 260 S.W.3d 351, 352, 355 (Ky. Ct. App. 2008) (limited to "actual and direct" damages); *see also Carll v. Terminix Int'l Co.*, 793 A.2d 921 (Pa. Super. Ct. 2002) (limit on damages for personal injury); *Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003) (limit on punitive damages); *Woebse v. Health Care & Retirement Corp. of Am.*, 977 So. 2d 630 (Fla. Dist. Ct. App. 2008) (limit on punitive damages); *cf. Am. Express Co.*, 133 S. Ct. at 2310 (explaining that federal law would require invalidating "a provision in an arbitration agreement forbidding the assertion of certain [federal] statutory rights").

- biased procedures for selecting the arbitrator;[29]
- unreasonably shortened statutes of limitations;[30] and

- "loser pays" provisions under which a consumer or employee might have to pay the full costs of the arbitration,[31] or must pay the drafting party's costs regardless of who wins.[32]

Of course, the vast majority of arbitration agreements do not exhibit these sorts of defects; and the clear trend has been for companies to make arbitration provisions ever more favorable to their customers and employees. But, when courts find that overreaching occurs, they have not hesitated to strike down the offending provision.

In addition to the courts' oversight of arbitration provisions, the leading arbitration forums provide additional fairness protections. The AAA and JAMS—the nation's leading arbitration service providers—recognize that independence, due

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[28] *See, e.g., Willis v. Nationwide Debt Settlement Grp.*, 878 F. Supp. 2d 1208 (D. Or. 2012) (travel from Oregon to California); *College Park Pentecostal Holiness Church v. Gen. Steel Corp.*, 847 F. Supp. 2d 807 (D. Md. 2012) (travel from Maryland to Colorado); *Hollins v. Debt Relief of Am.*, 479 F. Supp. 2d 1099 (D. Neb. 2007) (travel from Nebraska to Texas); *Philyaw v. Platinum Enters., Inc.*, 54 Va. Cir. 364 (Va. Cir. Ct. Spotsylvania Cnty. 2001) (travel from Virginia to Los Angeles); *see also, e.g., Dominguez v. Finish Line, Inc.*, 439 F. Supp. 2d 688 (W.D. Tex. 2006) (travel from Texas to Indiana); *Swain v. Auto Servs., Inc.*, 128 S.W.3d 103, 108 (Mo. Ct. App. 2003) (travel from Missouri to Arkansas); *Pinedo v. Premium Tobacco Stores, Inc.*, 102 Cal. Rptr. 2d 435 (Ct. App. 2000) (travel from Los Angeles to Oakland).
[29] *See, e.g., Chavarria*, 733 F.3d at 923-25 (holding that an arbitration agreement was unconscionable and unenforceable when it "would always produce an arbitrator proposed by [the company] in employee-initiated arbitration[s]," and barred selection of "institutional arbitration administrators"); *see also, e.g., Murray v. United Food & Commercial Workers Int'l Union*, 289 F.3d 297 (4th Cir. 2002) (striking down an arbitration agreement that gave the employer the sole right to create a list of arbitrators from whom the employee could then pick); *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999); *Newton v. American Debt Services, Inc.*, 854 F. Supp. 2d 712, 726 (N.D. Cal. 2012) (refusing to enforce a provision that would have granted a company sole discretion to choose an "independent and qualified" arbitrator for its consumer disputes because, under the circumstances, there was no guarantee that the arbitrator would be neutral); *Roberts v. Time Plus Payroll Servs., Inc.*, 2008 WL 376288 (E.D. Pa. Feb. 7, 2008) (refusing to enforce provision that would have given employer sole discretion to select arbitrator, and instead requiring parties to select arbitrator jointly); *Missouri ex rel. Vincent v. Schneider*, 194 S.W.3d 853 (Mo. 2006) (invalidating provision giving president of a local home-builder association sole discretion to pick arbitrator for disputes between local home-builders and home buyers).
[30] *See, e.g.*, *Zaborowski v. MHN Gov't Servs., Inc.*, 2013 WL 1363568 (N.D. Cal. Apr. 3, 2013); *Adler v. Fred Lind Manor*, 103 P.3d 773 (Wash. 2004) (180 days); *see also Gandee v. LDL Freedom Enters., Inc.*, 293 P.3d 1197 (Wash. 2013) (refusing to enforce arbitration agreement in debt-collection contract that required debtor to present claim within 30 days after dispute arose); *Alexander*, 341 F.3d at 256 (same, for an employee); *Stirlen*, 60 Cal. Rptr. 2d at 138 (rejecting provision that imposed shortened one-year statute of limitations).
[31] *See Gandee*, 293 P.3d at 1197; *Alexander*, 341 F.3d at 256; *Sosa v. Paulos*, 924 P.2d 357 (Utah 1996).
[32] *See, e.g., In re Checking Account Overdraft Litig.*, MDL No. 2036, 485 F. App'x 403 (11th Cir. 2012); *see also Samaniego v. Empire Today LLC*, 140 Cal. Rptr. 3d 492 (Cal. Ct. App. 2012) (attorneys' fees).

process, and reasonable costs to consumers are vital elements of a fair and accessible arbitration system. They, therefore, adhere to standards that establish basic requirements of fairness that provide strong protections for consumers and employees—and refuse to administer arbitrations unless the operative clause is consistent with those standards.

Arbitration's Benefits to Consumers

This fair, efficient arbitration system benefits consumers in multiple ways.

First, particularly in the consumer context, arbitration empowers injured parties by freeing them from dependence on lawyers—consumers can seek and obtain redress for the many claims for which a lawyer is too expensive or that lawyers are unwilling or unable to take on. Indeed, one study reported that a claim must be worth at least $60,000; in some markets, this threshold may be as high as $200,000.[33] Plaintiffs who brave the court system find that a hearing on their claims is long delayed by overcrowded dockets in our underfunded courts.[34]

Most injuries that consumers suffer are small and individualized—excess charges on a bill, a defective piece of merchandise, and the like. These claims are too small to justify paying a lawyer to handle the matter; in any event, most consumers do not have the resources to do so. And, because they are individualized, they cannot be asserted in class actions because the governing standard (embodied in Federal Rule of Civil Procedure 23) requires that common issues predominate for a class to be certified. As Justice Breyer has recognized—in a decision joined by Justices Stevens, Souter, and Ginsburg—"the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)" would be

[33] Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 783 (2003); Recommendations of the Minnesota Supreme Court Civil Justice Reform Task Force 10 (Nov. 23, 2011), http://www.mnbar.org/sections/outstate-practice/11-23-11%20Civil%20Justice%-20Reform.pdf.

[34] In California, for example, repeated budget cuts have forced 52 courthouses and 202 courtrooms to close, prompting the state judiciary to warn that funding for the state's courts is no longer "enough to sustain a healthy [judicial system]." Judicial Council of Cal., *InFocus: Judicial Branch Budget Crisis*, *available at* http://www.courts.ca.gov/partners/courtsbudget.htm. Los Angeles County, the state's largest, reported this year that its remaining courts are facing "unmanageably high" workloads, which is producing "intolerable delay" in civil cases. Judicial Council of Cal., *2015 Budget Snapshot: County of Los Angeles* (Feb. 2015), *available at* http://www.courts.ca.gov/partners/-documents/County_Budget_Snapshot_Combined_2015.pdf.

left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery."[35]

Opponents of arbitration point to small claims court; but, that is not a viable alternative. State budget cuts have severely hobbled these courts and repeated adjournments of cases, together with elimination of night sessions and some court sessions altogether, require individuals to take off multiple days from work or family obligations—often imposing costs greater than the amount at issue.[36]

Critics of arbitration sometimes express skepticism about arbitration's benefits because there are relatively few consumer financial arbitrations. That analysis is wrong for several reasons. To begin with, the actual numbers aren't clear. Most analyses look only at consumer arbitrations formally commenced before the American Arbitration Association, but there are other organizations providing this service.

Also, the attacks on arbitration take a toll, discouraging consumers from using it. Where arbitration has been supported and allowed to develop—under the auspices of the Kaiser Foundation health plan[37], for example, or in the employment context[38] —it has been used with great frequency and success by claimants.

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[35] *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995). Professor Peter Rutledge has observed that, without access to arbitration, consumers would 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." Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 Cardozo J. Conflict Resolution 267, 267 (2008).

[36] *See, e.g.,* Brian Lawson, *Proposed budget cuts for Alabama courts 'crazy, devastating'*, AL.com (May 5, 2015), *available at* http://www.al.com/news/huntsville/index.ssf/2015/05/proposed_cuts_-for_alabama_cour.html (quoting Alabama's administrative director of courts as saying that as a result of proposed cuts to state courts, "Small claims courts . . . those dockets will be heavily decreased or suspended for who knows how long."); Marisa Lagos, *Cutbacks Still Felt Deeply In California's Civil Courts*, KQED (Mar. 11, 2015), *available at* http://ww2.kqed.org/news/2015/03/12/-court-budget-cuts-delay-justice ("L.A. made 10 percent across-the-board cuts to court services in 2012, but it wasn't enough. So the next year, they made further cuts. In all, 79 courtrooms were shuttered, limiting where people can contest traffic tickets or adjudicate small claims cases.");
N.Y. Cnty. Lawyers' Assoc., Task Force on Judicial Budget Cuts, *Courts in Crisis* 7 (Jan. 3, 2014), http://www.nycla.org/siteFiles/Publications/Publications1666_0.pdf ("[S]evere reduction in evening hours in Small Claims Court from four nights a week to one night in most boroughs [of New York City] and to only one or two nights a month in Richmond County makes the Small Claims Court basically unavailable to claimants who cannot take time off during the day to appear. In Brooklyn and Manhattan, it may now take up to several years to get a judgment.").

[37] Annual Report of the Office of the Independent Administrator of the Kaiser Foundation Health Plan, Inc. Mandatory Arbitration System for Disputes with Health Plan Members, January 1, 2014 – December 31, 2014 at 44, http://www.oia-kaiserarb.com/pdfs/2014-Annual-Report.pdf (reporting that almost 50% of the parties and attorneys who went through Kaiser arbitrations that year reported that the arbitration system was better than going to court, another 38% reported that it was the same as going to court—and only 14% reported it was worse).

Most importantly, virtually all arbitration programs have a pre-filing settlement process and the overwhelming majority of disputes are resolved before arbitration; because, the availability of arbitration gives individuals leverage to pressure companies to settle. If an individual's only threat is to "go to court," a company could refuse to settle, knowing that the judicial system is an unrealistic option for consumers because it is too expensive and difficult to navigate. These pre-filing processes do not show up in the AAA's statistics, but they generate hundreds of millions of dollars in relief for consumers—all of which was totally ignored by the CFPB, even though the agency was repeatedly asked to examine this benefit.

Second, companies increasingly are adopting consumer-friendly arbitration agreements that give consumers rights that are greater than those available in court. As the Solicitor General of the United States explained in its briefing before the Supreme Court in *American Express v. Italian Colors Restaurant*, "many companies have modified their agreements to include streamlined procedures and premiums designed to encourage customers to bring claims."[39] The government recognized that consumer-friendly clauses ensure that instances where individuals cannot bring their claims "remain rare." As the brief explained:

> AT&T Mobility modified its arbitration agreement during the course of the litigation to include cost- and fee-shifting provisions and premiums designed to ensure that ***customers could bring low-value claims on an individual basis***. These modifications left consumers '***better off under their arbitration agreement***' ***than they would have been in class litigation***. And by obviating a potential objection to enforcement of the arbitration agreement, those modifications simultaneously served the company's interest in avoiding litigation.

That provision, for example, provided for "bounty payments" as an incentive for an individual to bring a claim in arbitration, and agreed not only to pay any attorney's fees that would be authorized by the underlying law, but double the

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[38] *See, e.g.*, Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 824 (2003) (empirical study concluding that "AAA employment arbitration offers affordable, substantial, measurable due process to employees").

[39] Brief for the United States as Amicus Curiae Supporting Respondents at 28-29, *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) (No. 12-133), 2013 WL 367051 (emphasis added).

attorney's fees if the arbitrator awards more than the company's last pre-hearing settlement offer.

Third, consumers and employees also benefit through the systematic reduction of litigation-related transaction costs, which leads to lower prices for products and services and higher wages.

How does this work? Businesses face many costs in bringing products and services to market. On top of the ordinary costs of running a business, they must absorb costs of litigating business-related claims. The transaction costs of litigation are high; they include settlements, judgments resolving meritorious claims, and the costs of defending against *all* lawsuits. Because those transaction costs are lower in arbitration, businesses can reduce costs that otherwise inflate product and service prices and reduce the availability of margins that could pay for wage increases.

The CFPB's study tried to provide that businesses do not pass on cost savings from arbitration to consumers and employees, but that attempt was unpersuasive: as the academics who reviewed the CFPB's study concluded, the CFPB's findings on this point were plagued by "theoretical problems" and "technical failures," and they fly in the face of "[b]asic economic theory," which "predicts that competition forces firms to pass on to consumers [or employees] at least a portion of any cost decrease."[40]

These are all significant benefits for consumers that will be eliminated by the Bureau's proposed rule. The Bureau's rule can only make sense, therefore, if the benefits to consumers from class actions significantly outweigh the benefits from arbitration that the rule would eliminate. That is not at all the case.

The Reality of Class Actions

Class actions in the federal court system turn fifty years old in 2016. That should be the occasion for a realistic assessment of the pluses and minuses of what in 1966 was a dramatic innovation in the law. Instead, class action proponents portray them as an unalloyed good, and some opponents say they are utterly worthless in both theory and practice.

[40] *See* Johnston & Zywicki, *supra* note 9, at 33-34.

Proponents of class actions argue that the process allows individuals to band together to obtain redress for injuries that are too small to litigate on their own. The class procedure, the theory goes, provides a route to vindicate claims too small to justify an individual lawsuit and allows courts to resolve claims efficiently.

Unfortunately, the reality of class actions today does not come close to fulfilling that promise.

Study after study confirms this fact:

- The CFPB's own review of class actions found that 87% provide ***no*** benefits to class members; the remaining class actions were settled, but the Bureau's data indicates that on average only 4% of class members obtained monetary relief—meaning that 96% got nothing. And, the data indicate that the average payment to a class member was $32.35. Plaintiffs' lawyers, on the other hand, received an average of $1 million per case.[41]

- A recent study of class action data by a professor at Emory Law School found that, although the pre-distribution description of settlements allocated 60% to the class and 37.9% to class members, the likely actual distribution of funds in many settlements resulted in only 9% of the funds going to class members.[42]

- A new empirical study by Professor Jason Johnston of the University of Virginia Law School determined that 60-80% of filed class actions end with no payment to the class (depending on the type of claim); attorneys' fees therefore often amounted to 300-400% of the amount actually paid to class members.[43]

- A study by my law firm found that two-thirds of resolved cases provided no benefit to class members; the remaining cases were settled, but the available data showed that a miniscule percentage of class members

[41] See pages 4-5 of the Appendix to this testimony.
[42] Joanna Shepherd, *An Empirical Survey of No-Injury Class Actions* (2016), *available at* http://ssrn.com/abstract=2726905.
[43] Jason Scott Johnston, *High Cost, Little Compensation, no Harm to Deter: New Evidence on Class Actions under Federal Consumer Protection Statutes* (2016), *available at* http://ssrn.com/abstract=2777618.

> obtained payments—the maximum was 12% and for most of the settlements less than 2% of the class.[44]

Note that these cases are virtually never litigated to a final merits determination. If the motion to dismiss is denied and a class is certified, the case is inevitably settled—meaning some number of meritless cases are ending in substantial payments (most of which go to the lawyers), because the larger downside risk of a loss and the cost of litigation leads defendants to settle even when they might win in the end.

Moreover, class actions are often marked by abusive behavior. Press reports and court decisions document abusive behavior by plaintiffs' lawyers, including possible under-the-table payments to convince individuals to serve as representative plaintiffs[45]; use of payments to charities (termed "cy pres") to inflate the size of settlements in order to justify large fees to plaintiffs' attorneys[46]; the use of relatives, employees, or other related parties to serve as class representatives who will do the bidding of the plaintiffs' lawyers[47] agreeing to settlements that provide class members with mere coupons or vouchers while guaranteeing the plaintiffs' lawyers hefty fees[48];

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[44] Mayer Brown LLP, *Do Class Actions Benefit Class Members?* (Dec. 2013), *available at* https://www.-mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf

[45] *See, e.g.*, Daniel Fisher, *Collapse Of 5-Hour Energy Case Reveals The Secrets Of Class Action Lawyers*, Forbes (Nov., 17, 2015), *available at* http://www.forbes.com/sites/danielfisher/2015/11/17/collapse-of-5-hour-energy-case-reveals-secrets/#9c14b4b1aa40; *Swift v. First USA Bank*, 1999 WL 1212561, at *6 (N.D. Ill. Dec. 15, 1999) (refusing to certify class because plaintiffs' attorneys had initially agreed to pay lead plaintiff's husband a portion of their attorneys' fees as a "finder's fee"); had been Press Release, United States Dep't of Justice, Milberg Weiss Law Firm, Two Senior Partners Indicted in Secret Kickback Scheme Involving Named Plaintiffs in Class-Action Lawsuits (May 18, 2006), *available at* http://online.wsj.com/public/resources/documents/milbergpress05182006.pdf (announcing 20-count indictment against Milberg Weiss and two of its senior partners).

[46] *See Marek v. Lane*, 134 S. Ct. 8, 9 (2013) (Roberts, C.J., respecting the denial of certiorari) (noting the many "fundamental concerns surrounding the use of [cy pres] remedies in class action litigation"); *In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 175 (3d Cir. 2013) (vacating order approving settlement that would have given just $3 million to class members and $18.5 million to cy pres recipients, while awarding plaintiffs' attorneys $14 million in fees);Alison Frankel, *When class money doesn't go to class members: new calls for SCOTUS review*, Reuters (Dec. 14, 2015), *available at* http://blogs.reuters.com/alison-frankel/2015/12/14/when-class-money-doesnt-go-to-class-members-new-calls-for-scotus-review/.

[47] *See, e.g.*, *Eubank v. Pella Corp.*, 753 F.3d 718, 722, 724 (7th Cir. 2014) (Posner, J.) (holding that settlement should have been disapproved, in part because the lead named plaintiff was the father-in-law of the lead plaintiffs' attorney—which created a "grave conflict of interest" and "palpable" "impropriety"); *Apple Computer, Inc. v. Superior Court*, 126 Cal. App. 4th 1253, 1262 (2005) (disqualifying two law firms from serving as class counsel in a class action because the named plaintiff was a lawyer at one of the firms and because during a two-year period, the two firms had jointly filed ten class actions in which "an attorney from [one firm] or a relative of one of the attorneys was the named plaintiff").

[48] *See, e.g.*, *Radosti v. Envision EMI, LLC*, 717 F. Supp. 2d 37, 46-48 (D.D.C. 2010) (class received vouchers toward future conferences put on by defendant; attorneys received nearly $1.5 million in fees);*Bachman v. A.G. Edwards, Inc.*, 344 S.W.3d 260, 264-65 (Mo. Ct. App. 2011) (class received vouchers toward brokerage fees charged by defendant; attorneys received $21 million).

and "clear sailing" agreements in which defendants agree not to challenge the plaintiffs' lawyers' fee requests—likely because the plaintiffs' lawyers have "bargain[ed] away something of value to the plaintiff class," their supposed clients.[49]

One outspoken critic of arbitration—the *New York Times*—has devoted considerable space recently to attacking arbitration. Those stories are not only inaccurate on their own terms,[50] but also are particularly troubling because they simply assume the benefits of class actions without examining whether consumers actually realize any of those benefits.

But another *Times* reporter did take the time to examine a consumer class action and provided a case study of the abuse that is all too commonplace.[51]

The story examined a class action against Netflix and Walmart alleging violations of the antitrust laws. Prior to 2005, the two companies had been competitors in the DVD rental market. That year, they reached an agreement under which Walmart would stop renting DVDs and Netflix would stop selling them—in effect ending competition between the two in the DVD sales and rental markets. The plaintiffs who brought the class action alleged that the deal violated the antitrust laws because it was anticompetitive and inflated the price of Netflix subscriptions.

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[49] *See, e.g.*, *Malchman v. Davis*, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring).

[50] The *Times* stories were criticized by, among others, Yale Law Professor Stephen Carter, Forbes' columnist Daniel Fisher, and legal expert Walter Olson. *See* Stephen Carter, *Arbitration is Everywhere and Not All Bad*, Bloomberg View (Nov. 3, 2015), *available at* http://www.bloomberg.com/view/articles/2015-11-03/arbitration-is-everywhere-and-not-all-bad; Daniel Fisher, New York Times *"Expose" of Arbitration Clauses Leaves Lawyers in the Shadows*, Forbes (Nov. 1, 2015), *available at* http://www.forbes.com/sites/danielfisher/2015/11/01/new-york-times-expose-of-arbitration-clauses-leaves-lawyers-in-the-shadows/#510700466665; Walter Olson, New York Times *Assails Arbitration*, Cato at Liberty (Nov. 2, 2015), *available at* http://www.cato.org/blog/new-york-times-assails-arbitration. The stories' inaccuracies are detailed in several in-depth analyses by the U.S. Chamber Institute for Legal Reform. *See Dog Bites Man: New York Times Prefers Lawyer-Controlled Class Actions over Fair Arbitration that Enables Individuals to Protect Themselves* (Nov. 2, 2015), *available at* http://www.instituteforlegalreform.com/resource/-dog-bites-man-new-york-times-prefers-lawyer-controlled-class-actions-over-fair-arbitration-that-enables-individuals-to-protect-themselves; *New York Times Part 2: Arbitration Responsible for All of the World's Ills (Well, Just About All)* (Nov. 4, 2015), *available at* http://www.instituteforlegalreform.com/-resource/new-york-times-part-2-arbitration-responsible-for-all-of-the-worlds-ills-well-just-about-all; *The New York Times Doesn't Like Arbitration, But It Really Likes Plaintiffs' Lawyers* (Jan. 7, 2016), *available at* http://www.instituteforlegalreform.com/resource/the-new-york-times-doesnt-like-arbitration--but-it-really-likes-plaintiffs-lawyers.

[51] David Segal, A Little Walmart Gift Card for You, a Big Payout for Lawyers, N.Y. Times (Jan. 30, 2016), *available at* http://www.nytimes.com/2016/01/31/your-money/a-little-walmart-gift-card-for-you-a-big-payout-for-lawyers.html?ref=business&_r=0.

Netflix fought the class action (and won on summary judgment); Walmart chose to settle. The headline touted by the plaintiffs' lawyers: "$27 million settlement." But the details tell the real story.

Members of the class were entitled to choose between receiving a check for approximately $12 or a Walmart gift card for the same amount.

And the lawyers? They got fees of $6.8 million and expenses of $1.7 million for a total of $8.5 million.

A settlement in which lawyers got $8.5 million for providing $14 million in $12 increments would be troubling by itself. But the $14 million figure itself is an overstatement unless *all* of the gift cards were cashed. And, as the *Times* explained, "[w]e don't know" how many were cashed: "That information has not been publicly revealed." But, common sense suggests that many class members didn't use the gift cards.

Ted Frank, a critic of class-action settlements that favor lawyers over consumers, explained that gift cards were employed "to maximize the illusion of relief"—so that the lawyers' fee could be justified on the dollar amount of issued gift cards, not the dollar amount actually used by consumers.

Congress addressed this precise problem in the Class Action Fairness Act of 2005, targeting "coupon settlements" in which class members received a credit toward purchases of the defendant's products and the plaintiff lawyers' fee was based on the gross amount of coupons and therefore had no relationship to the real benefit to the class. The law says that plaintiffs' lawyers must be paid based on the value of the coupons *actually redeemed*, not the value of all the coupons made available by the defendant.

The *Times* also explained that this case is "positively pro-consumer compared with others"—for example, another case (on appeal) in which the settlement provided

> $6 million for charity, $5.7 million for plaintiffs' lawyers and a mere $345,000 for consumers. (The case is under appeal, so no one has been paid yet.) The reason the consumer side is so meager is that **less than 1 percent** of the 7.2 million class members actually submitted for

> reimbursement. But the lawyers' fees were calculated based on the $43 million that could have been disbursed if all eligible consumers had asked for a $6 check.

As the *Times* consumer reporter put it, "Everybody won! O.K., not everybody."

The lack of real-world benefit to class members and other problems with class actions are not mere happenstance. They are a result of structural problems inherent in the current class action mechanism.

To begin with, many—probably a significant majority—of class actions today spring from the minds of lawyers, not from injured individuals. A *New York Times* profile[52]of one prominent plaintiffs' lawyer discussed the lawyer's "investigative team, which consists of three lawyers and a computer analyst. The group's job, to put it plainly, is to find ways to sue companies." The lawyers then find individuals who fit the claim. As Professor Martin Redish has noted, this confirms that "[t]he real parties in interest in… [many] class actions are… the plaintiffs' lawyers."[53]

Next, there is the problem that the interests of the class action lawyers and class members may not be aligned—as the *New York Times* story demonstrates. The lawyer's concern—at least in significant part—is on maximizing fees. That means finding claims that are easy to litigate, even if the particular "harm" alleged does not concern many, or even any, consumers.

There might be nothing wrong with that approach in theory—as long as there are effective checks to ensure that the lawyers' interest do not overwhelm the obligation to the (essentially absent and not-in-control) class members. Federal class action procedure assigns that role to the court, which must approve any settlement.

When both the defendant and plaintiffs' counsel are urging the court to approve the settlement as fair and reasonable, however, it is virtually impossible for the court to make an independent assessment of the underlying facts. The court's record is limited to what the parties put before it, and most overburdened judges are happy to see a settlement that removes a significant case from their docket. Certainly

[52] Conor Dougherty, *Jay Edelson, the Class-Action Lawyer Who May Be Tech's Least Friended Man*, N.Y. Times (Apr. 4, 2015), *available at* http://www.nytimes.com/2015/04/05/technology/unpopular-in-silicon-valley.html?_r=1.

[53] Testimony of Martin H. Redish at 7, *Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), available at http://judiciary.house.gov/hearings/Hearings%202012/-Redish%2006012012.pdf.

defense counsel cannot be expected to take a position regarding the allocation of proceeds between class counsel and the class.

In recent years, class members objecting to settlements—represented by independent counsel—have begun participating in settlement proceedings and urging judges to disapprove settlements that favor class counsel over class members. The *New York Times* story reports an instance of this activity.

The problem, however, is that courts only have the power to disapprove settlements. That leaves the defendant in a meritless class action with two choices: expend huge resources litigating the case, or pay more to settle in order to obtain court approval. Neither result benefits consumers, who must pay the bill in either event. The court cannot take the step that often would be most logical when a proposed settlement is rejected: dismiss the action because the settlement terms proffered by the parties indicate that the case has little merit.

For all of these reasons, class actions provide little real-world benefit to consumers.

The CFPB, and other arbitration opponents, argue that even if class actions do a poor job of providing compensation to injured consumers, they nonetheless are justified because the threat of class-action liability deters companies from violating consumer laws. That is simply false.

The rationale for deterrence is the common-sense idea that a party will not engage in wrongdoing if it believes that it will incur costs for acting wrongfully that it will not incur if it complies with the law. If those costs are incurred without regard to the wrongfulness of the underlying conduct, there is no such deterrent effect.[54] That is the precise flaw in the private class action system.

As I have already discussed, plaintiffs' attorneys have little incentive to choose cases based on the merits of the underlying claims—the merits question will virtually never be reached, as the empirical data demonstrates. The plaintiffs' lawyer's goal, rather, is to find a claim for which the complaint can withstand a motion to dismiss

[54] For an analogous discussion of how a failure to distinguish adequately between the culpable and the innocent dilutes the deterrent effect of sanctions in the criminal-law context, see A. Mitchell Polinsky & Steven Shavell, *The Theory of Public Enforcement of Law*, in 1 Handbook of Law and Economics 403, 427-29 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

and that can satisfy the (legitimately) high hurdles for class certification—standards that do not embody an assessment of the underlying merit of the claim.

Because settlement inevitably follows once a class is certified, the class action's burdens are not limited to businesses that engage in wrongful conduct. They are chiefly a function of whom plaintiffs' lawyers choose to sue rather than who has engaged in actual wrongdoing. The threat of a class action therefore cannot—and does not—generally deter wrongful conduct.[55]

Businesses are far more likely to be deterred from wrongdoing by the reputational consequences of engaging in improper behavior, especially because reputational harm is often directly correlated to a business's success or failure. Especially in an age of social media, consumer complaints can quickly go viral, impacting companies immediately and directly leading to changes in practices that garner consumer opposition. Class actions, by contrast, do nothing of the sort.

The CFPB's preliminary analysis of the costs and benefits of its proposed rule assumes that class actions both compensate injured consumers and deter wrongful conduct. It, therefore, counted 100% of projected settlement value as a "benefit" to consumers—but in reality there is no basis for that conclusion. The benefits provided by class actions, if any, are much more limited.

Eliminating Arbitration to Protect Class Actions: Bad for Consumers, Good for Lawyers

Consumers deprived of arbitration would lose access to a means of securing justice that is cheaper and more accessible than court. The ability to vindicate wrongs that can't practically be vindicated in court would disappear. And, those are the sorts of injuries that most consumers complain of. Few consumers are scouring disclosures or privacy policies to find technical violations of law that don't impact their daily lives—that is what lawyers do.

Moreover, those individualized injuries are the types of harms that regulators don't address because there is insufficient "impact" when regulatory resources are

[55] Indeed, to the extent there is any effect associated with class actions, it is likely to deter both lawful and unlawful actions equally—requiring companies to take into account the risk of litigation costs without regard to the legality of the underlying action.

focused on a small injury unique to a consumer, even when the injury is very significant in that consumer's life.

And, there is no reason to believe that consumers would be unable to use arbitration to pursue small claims. Justice Kagan, writing an opinion for herself and Justices Ginsburg and Breyer in *American Express Co. v. Italian Colors Restaurant*, expressly pointed to several ways in which even small claims can be vindicated in arbitration without the use of class action procedures:

> In this case,…the [arbitration] agreement could have prohibited class arbitration without offending the effective vindication rule *if* it had provided an alternative mechanism to share, shift or reduce the necessary costs. The agreement's problem is that it bars not just class actions, but also all mechanisms…for joinder or consolidation of claims, informal coordination among individual claimants, or amelioration of arbitral expenses.[56]

The arbitration provision that the Supreme Court viewed favorably in the *Concepcion* case contains both (i) incentive/bonus payments designed to encourage the pursuit of small claims, and (ii) the shifting of expert witness costs and attorneys' fees to defendants when the consumer or employee prevails on his or her claim. Specifically, if a consumer obtains an arbitral award that is greater than the company's last settlement offer, he or she will receive a minimum recovery of $10,000 plus twice the amount of attorneys' fees that his or her counsel incurred for bringing the arbitration. In addition, the company is required to reimburse such a customer for reasonable expert witness fees.

Both of the lower courts in *Concepcion* found that the plaintiffs would be ***better off under arbitration than in a class action*** because they would be compensated more quickly and more completely.[57] As Justice Kagan explained in *American Express*, any concerns about whether individuals can vindicate their small claims in arbitration without the class-device are eliminated when an arbitration provision "provide[s] an alternative mechanism to…. shift…the necessary costs."[58] A significant number of companies have adopted similar provisions.

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[56] *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2318 (2013) (Kagan, J., dissenting)
[57] *Concepcion*, 131 S. Ct. at 1753.
[58] *Am. Express*, 133 S. Ct. at 2318 (Kagan, J., dissenting).

In addition, Justice Kagan stated that the concern about cost could be addressed through "***informal coordination among individual claimants***" to share the same lawyer, expert, and other elements required to prove the claim.[59] For example, an entrepreneurial plaintiffs' lawyer can recruit large numbers of clients (via the internet, social media, or other similar means), file thousands of individual arbitration demands on behalf of those clients, and distribute common costs over all those claimants, making the costs for expert witnesses and fact development very low on a per-claimant basis.

Given the low cost, efficiency, and fairness of arbitration, it is no surprise that some plaintiffs' lawyers are already beginning to recognize that pursuing multiple individual arbitrations (or small-claims actions) is an economically viable business model—especially in view of the ability to reach multiple, similarly situated individuals using websites and social media.[60] Indeed, this strategy for spreading fixed litigation costs is an increasingly common means of pursuing disputes in arbitration.

Most importantly, the Bureau was created for the very purpose of addressing conduct that causes widespread consumer harms—the same types of claims that can be brought as class actions. Its claim of a lack of enforcement resources rings hollow in light of broad enforcement authority, broad supervision authority, and guaranteed funding. There, simply, is no need to rely on self-interested class action lawyers given the obvious flaws of the class action system and the benefits to consumers from arbitration.

I appreciate the opportunity to appear before the Subcommittee and look forward to answering your questions.

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[59] *Id.* (emphasis added). The dissent concluded that the American Express arbitration agreement prohibited such cost-sharing, but the majority disagreed, and American Express specifically conceded before the Supreme Court that costs could be shared in this manner. *See id.* at 2311 n.4 (majority).

[60] *See* Carolyn Whetzel & Jessie Kokrda Kamens*, Opt Out's Use of Social Media Against Honda in Small Claims Win Possible "Game Changer,"* Bloomberg BNA Class Action Litig. Rep. (Feb. 10, 2012).

Appendix