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The Missed Opportunity Of The CFPB's Arbitration Rule

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Law360, New York (July 31, 2017, 1:35 PM EDT) -- When Congress and the courts turn to consider the Consumer Financial Protection Bureau's new arbitration rule,[1] it may be the process behind the rule — as much as its substance — that determines whether the rule goes into effect. The bureau certainly had the time to carefully consider every alternative: This regulation was finalized almost seven years after the Dodd-Frank Act authorized an arbitration study and rule. Yet despite all that time, the bureau missed or dismissed important sources of data and insight that would have helped it better understand arbitration, its alternatives, and the trade-offs resulting from a rule that will encourage class actions and curtail consumers' access to arbitration. Those missed opportunities help explain why concerns linger about whether the arbitration rule is truly in the public interest.

Notice and Comment

The Administrative Procedures Act is designed to prevent such missed opportunities. First, every federal agency drafting a rule must "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[2] This is doubly important when, as here, Congress has specifically directed an agency to study an issue and to ground its rule in the results of that study.[3] Next, once the rule is proposed, the agency must offer an opportunity for public comment on the rule and provide a "reasoned response" to serious issues raised in comments.[4] Among other benefits, this routine ensures that regulations are "tested via exposure to diverse public comment" and that agencies "maintain [] a flexible and open-minded attitude towards [their] own rules."[5] While not an easy task, this process of analyzing and responding to comments is both a legal obligation and good government.[6]

The comments on the arbitration rule demonstrate the enormous potential of the notice and comment process. The bureau received over 110,000 comments, and they contained thoughtful factual, legal and policy arguments from an array of voices on all sides of the debate over arbitration. But the bureau took this tremendous resource and used almost none of it to improve the final rule. Instead, the bureau merely tinkered with the proposed rule. [7]

In particular, the bureau seemed allergic to any suggestion that its arbitration study, which provided the foundation for the final rule, could be improved or supplemented. Each such suggestion for additional study was met with some combination of the following responses: “it would be too difficult;”[8] it would not matter what we might find;[9] someone else should have done it already.[10] The following are just examples of concerns about the process that led to the arbitration rule.

Costs of Class Actions

Multiple commenters suggested that the bureau’s analysis of the costs of class actions was incomplete without more fulsome data about defense costs.[11] The bureau did not dispute the relevance of these costs, nor did it claim to do more than generate estimates of defense costs, and even those were based solely on settled federal cases.[12] Instead of pursuing a more concrete analysis, the bureau asserted that such data is not publicly available and “would be too difficult or impossible to gather" since the bureau would have faced claims of privilege.[13] A better approach to this issue would have been for the bureau to make an effort to work with regulated entities to obtain relevant information while preserving the privilege. Indeed, the bureau engages in such information-gathering efforts on a regular basis.

The bureau also blamed others for not providing information, arguing that “firms that had been involved in defending class actions could have produced data on their transaction costs during the Bureau’s Study process but did not.”[14] However, the rulemaking process, as noted above, is designed to “examine ... relevant data” — not to reward or punish stakeholders for not providing information. The bureau’s decision to estimate defense costs for settled matters establishes the relevance of such cost data without providing an adequate substitute for it. The bureau should have at least attempted a concrete and comprehensive accounting of defense costs before balancing the costs and benefits of class actions.

Government Enforcement

The bureau was also surprisingly incurious about how government enforcement — including its own enforcement program — has impacted the need for class actions. To demonstrate the need for class actions, the bureau’s arbitration study analyzed the years 2008 to 2012 and estimated that unrestrained federal class actions could generate an additional $342 million a year in payments to consumers of financial products.[15] However, in the years since the period studied, consumers of financial products have already received additional payments — without class actions — that greatly exceed that estimate. The bureau’s enforcement actions have resulted in payments to consumers of $425 million in 2012, $536 million in 2013, over $3.5 billion in 2014, and well over $6 billion in 2015.[16] And these numbers do not even include the over $300 million in restitution provided through the bureau’s supervisory function, or the additional amounts provided through proactive restitution by regulated entities in anticipation of CFPB scrutiny.[17]

This enormous increase in payments to consumers raises an obvious question that is reflected in multiple comments: Has the need for class actions been diminished by the size of the bureau’s own enforcement program?[18] Unfortunately, other than briefly acknowledging that the bureau’s existence may increase compliance (for which it made no downward adjustments to its benefit calculations, despite conceding that it could lead to “overestimates”),[19] the bureau did not reach this issue. And although the bureau repeatedly reminds regulated entities of the need to pay close attention to bureau settlements and supervisory findings,[20] its arbitration study assumes that its actions have done nothing to diminish the deterrence benefits of class actions. Instead, the bureau relied on data from 2008 to 2012 to value the benefit to consumers of additional class actions in the years 2018 and

beyond.[21] While it is odd enough to see an agency make policy in 2017 based on data from 2008 to 2012, it is stranger still when the agency itself has changed the regulatory landscape in ways that make projections from that old data unreliable.

Future of Arbitration Provisions

Although the bureau was willing to predict a rosy future for class actions, it was seemingly disinterested in looking forward into the future of arbitration or taking advantage of this opportunity to improve the existing arbitration process. For example, the bureau treated the low number of arbitrations as entirely static, and was dismissive of the prospects for its expansion or improvement through online services or the types of consumer education materials that the bureau has promoted to address other issues.[22] Nor was the bureau interested in learning what consumers who had been through arbitration thought about their experiences, despite the very real possibility that regulated entities would substantially reduce the availability of arbitration upon issuance of the rule.[23] This unwillingness to explore expanding and improving arbitration, rather than discouraging it, further constrained the bureau's perspective on whether a combination of arbitration and public enforcement could protect consumers.

Conclusion

The bureau is correct when it asserts that "it is always possible ... to think of additional questions that could have been asked."[24] However, this truism does not mean that the bureau asked the right questions or that it fully answered those it did ask. The purpose of notice and comment rulemaking is to bring outside thinking to bear on an agency's process. The bureau's unresponsiveness to that outside thinking suggests that the bureau's focus on lifting barriers to class actions was too intense for it to engage in a complete evaluation of the challenges, alternatives and consequences of the proposed rule. Both Congress and the courts will now need to decide whether this incomplete evaluation provides an adequate basis on which to make such a significant public policy.

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[1] Arbitration Agreements, 82 Fed. Reg. 33,210 (July 19, 2017) (to be codified at 12 C.F.R. pt. 1040) ("Arbitration Rule")

[2] Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43, (1983) ("State Farm").

[3] 12 U.S.C. §§ 5517(a), (b).

[4] See, e.g., Shands Jacksonville Med. Ctr. v. Burwell, 139 F. Supp. 3d 240, 261 (D.D.C. 2015) (citing State Farm).

[5] United States v. Reynolds, 710 F.3d 498, 517 (3d Cir. 2013) (internal citations and quotations omitted).

[6] See NetCoalition v. SEC, 615 F.3d 525, 539 (D.C. Cir. 2010) ("[A]n agency may not shirk a statutory responsibility simply because it may be difficult.") (citation omitted).

[7] Indeed, the final rule substantively mirrors the outline published by the bureau in October 2015. See Consumer Fin. Prot. Bureau, Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements Outline of Proposals (Oct. 7, 2015), http://files.consumerfinance.gov/f/201510_cfpb_small-business-review-panel-packet-explaining-the-proposal-under-consideration.pdf.

[8] See, e.g., Arbitration Rule at 33,243 (it is "exceedingly difficult to find consumers who had experienced arbitration" and "the Bureau doesn't believe that a survey of companies ... would have produced reliable information").

[9] See, e.g., id. at 33,236 ("even if these categories of class action settlements were excluded from the data, the Bureau's conclusion as to the efficacy of class settlements generally would not change"); 33,243 (even if consumers had "very high levels" of satisfaction with arbitration, it would not change the bureau's "assessment of the various alternative dispute resolution mechanisms").

[10] See, e.g., id. at 33,236 ("if an interested person was concerned" with the Bureau's analysis, they could have redone it and firms "could have produced data on their transactions costs" but did not do so).

[11] See, e.g., Community Choice Financial, Inc., CFPB Proposed Rule – Arbitration and Class Action Waivers at 6 (Aug. 22, 2016), https://www.regulations.gov/document?D=CFPB-2016-0020-3950 ("notwithstanding the mandate of Dodd-Frank that the CFPB consider the costs to financial institutions, the CFPB study instead made some ill conceived assumptions to estimate" defense costs); Consumer Data Industry Association, Arbitration Rule Comment Letter at 5 (Aug. 22, 2016), https://www.regulations.gov/document?D=CFPB-2016-0020-4318 (the Bureau "gives no consideration to the costs of class actions that result in no recovery for the class").

[12] Arbitration Rule at 33,401 - 33,404 (Defense cost "data were not available to the Bureau. The Bureau therefore estimated defendant's attorney fees based on plaintiff's attorney fees with appropriate adjustments.").

[13] Id. at 33,236.

[14] Id.

[15]Id. at 33,403. The bureau notes that some additional amounts would be generated in state class actions, and while it does not provide a specific estimate, it argues that the "cases likely will be significantly cheaper." Id. at 33,404.

[16] Christopher L. Peterson, Consumer Financial Protection Bureau Law Enforcement: An Empirical Review. Tulane Law Review, 90 Tul. L. Rev. 1057, 1077 (2016).

[17] See Consumer Fin. Prot. Bureau, Factsheet: Consumer Financial Protection Bureau:

Enforcing Federal Consumer Protection Laws (July 13, 2016), http://files.consumerfinance.gov/f/documents/07132016_cfpb_SEFL_anniversary_factsheet.pdf.

[18] See, e.g., Consumer Bankers Association, American Bankers Association, and Financial Services Roundtable, Comments on the Bureau's Consumer Arbitration Study at 4 (July 13, 2015), https://www.regulations.gov/document?D=CFPB-2016-0020-4294 ("CBA, ABA, FSR Letter") (bureau "has also neglected to mention what elsewhere in its public statements the bureau loudly touts, the power of government enforcement actions"); Advance America, Comments on Proposed Rule re Class Action Waivers at 7, https://www.regulations.gov/ document?D=CFPB-2016-0020-3969 (new rule provides "an inadequate consideration of the significant role of government enforcement in protecting consumers."); Rep. Randy Neugebauer, Neugebauer Submission (Aug. 22, 2016) at 15, https://www.regulations.gov/ document?D=CFPB-2016-0020-4256 ("government enforcement and supervisory actions have eliminated much of the need for customers to bring private arbitration actions").

[19] Arbitration Rule at 33,400 ("[T]he Bureau recognizes that the Bureau's own creation in 2010 may have increased incentives for some providers to increase compliance investments," in which case the benefits and costs of the rule may be "overestimates.").

[20] See, e.g., id. at 33,281; Richard Cordray, Director, Consumer Fin. Prot. Bureau, Prepared Remarks at the Consumer Bankers Association (May 9, 2016), https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-consumer-bankers-association/ (urging regulated entities to review Bureau consent orders).

[21] See, e.g., id. at 33,410-33,411.

[22] Id. at 33,244 (Responding to criticism about lack of study of online dispute resolution by arguing that "[t]he Bureau also disagrees that it overlooked the role of online dispute resolution. The Bureau had no direct way of studying the extent to which consumers were able to resolve disputes informally, and the Study specifically acknowledged that this is a means by which consumers may seek relief."); 33,416 (arguing that even a proliferation of cheaper alternatives such as online dispute resolution would not reduce the need for class actions); 33,296 ("The Bureau is not persuaded that the presence of education or promotional materials would, for dispute resolution, materially alter the dynamics that result in so few individual arbitrations ..."). The bureau also did not "believe that the mere possibility of obtaining relief through class action ... will materially impact the number of consumers who seek to resolve complaints informally." Id. at 33,308.

[23] See, e.g., id. at 33,243 ("Bureau believes that even if it were to find very high levels of satisfaction, that would not affect the assessment of the various alternative dispute resolution mechanisms."); CBA, ABA, FSR Letter at 8 ("The proposed rule also threatens to have an adverse impact on consumers because arbitration is likely to disappear almost entirely if class action waivers are eliminated.").

[24] Arbitration Rule at 33,221.
