ConsumersUnion
POLICY & ACTION FROM CONSUMER REPORTS

August 22, 2016

Ms. Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street, NW
Washington DC 205552

Re: Docket No. CFPB-2016-0020

Dear Ms. Jackson:

Consumers Union, the policy and mobilization arm of Consumer Reports,[1] submits these comments in the above-referenced matter. We strongly support the Consumer Financial Protection Bureau (CFPB)'s proposed rule to limit the use – by banks, credit card and pre-paid card companies, auto lenders, payday lenders, college student loan providers and servicers, other lenders, debt collectors, debt relief services, and other consumer financial service providers – of clauses in their contracts that impose pre-dispute binding mandatory, forced arbitration on consumers. The proposed rule, while stopping short of the complete prohibition on such forced arbitration clauses that we think is warranted, would nonetheless be an important step forward in curbing the worst abuses in the consumer financial services area, restoring consumer rights, improving transparency, and making consumer financial services markets fairer and safer for consumers.

As more fully explained below, we also offer the following suggestions for clarifying and strengthening the rule consistent with its purpose:

- Shorten delay in rule's effective date.

- Apply rule to all contracts and agreements when revised, renewed, or extended.

[1] Consumers Union is the policy and mobilization arm of Consumer Reports. Consumers Union is an expert, independent, nonprofit organization whose mission is to work for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves. It conducts this work in the areas of financial services reform, food and product safety, telecommunications reform, health care reform, and other areas. Consumer Reports is the world's largest independent product-testing organization. Using its more than 50 labs, auto test center, and survey research center, the nonprofit organization rates thousands of products and services annually. Founded in 1936, Consumer Reports has over 8 million subscribers to its magazine, website, and other publications.

- Strengthen the required statement, so that the provider formally relinquishes any right to restrict class actions.

- Have separate contracts for products and services covered and not covered, to avoid unnecessary confusion.

- Require submission to CFPB of all contracts with arbitration clauses.

- Require reporting to CFPB whenever an arbitration clause is invoked.

- Focus on clearly covering the consumer financial service activity, avoiding gaps in coverage.

- Ensure coverage of all business-to-business agreements where consumer could be bound.

- Avoid creating loophole for facilitation of forced arbitration by other entities.

- Apply the rule fully to credit reporting activities.

The Abuse of Arbitration Clauses Is Rampant and Conceals Fraud on Consumers

The use of forced arbitration clauses in standard form, take-it-or-leave-it consumer contracts is a fundamental misuse of a statute, the Federal Arbitration Act of 1925, which was enacted with a far different intent. That statute was enacted to enable *businesses*, with roughly comparable bargaining power, to agree, in negotiating their commercial contracts *with each other*, that if a legal dispute arose in their commercial dealings, they could opt to resolve it through a private system of arbitration, with confidence that if they both did so agree, the arbitrator's decision would be respected by and enforceable in court, and would stand up against collateral attack by the party that did not prevail in the arbitration. At that time, courts were hostile to arbitration, and often refused to honor business agreements to arbitrate their dispute if the losing business decided to re-litigate.[2]

In contrast, individual consumers have nothing close to comparable bargaining power with the companies that insert these clauses into the fine print of their standard-form consumer sales or service contracts, or into an obscure corner of the voluminous "click to agree to terms" buttons on their websites. Even if consumers are aware of these clauses, and even if they fully understand what rights they are giving up by signing, these are classic contracts of adhesion and consumers have no ability to bargain over terms and thus, no meaningful choice. Their only choice is to do without the product or service entirely, or submit to the "agreement." Given the pervasiveness of these clauses, and the need for any modern consumer to participate in the financial dealings that are the subject of these contracts, there is nothing voluntary about a

[2] *See, e.g.*, Haskell v. McClintic-Marshall Co., 289 F. 405, 409 (9th Cir. 1923) (refusing to enforce arbitration agreement because of a "settled rule of the common law that a general agreement to submit to arbitration did not oust the courts of jurisdiction, and that rule has been consistently adhered to by the federal courts").

consumer's decision to sign a complex, lengthy contract containing, among many other clauses, an arbitration clause.

Yet through this act of "agreeing" to arbitration, the consumer gives up the right to a fair trial before an impartial court on a public record, and the right to appeal an unsatisfactory decision. Unlike the courts, which are public, and subject to elaborate checks and balances on fair process, including evidentiary and other standards that level the playing field among participants, the arbitration process is private and secret; discovery is very restricted; there is no public record of the proceeding or the outcome; no appeal is permitted; and the arbitrator is not required to follow established law or procedure. These are essentially "kangaroo courts." All too often, as evidence has demonstrated, the arbitration procedures and outcomes are unfairly tilted in favor of the company, which has ongoing relationships with the arbitrators, and armies of lawyers on hand to write the arbitration rules to its advantage.[3] Because the consumer has absolutely no say in the matter of whether to participate, neither the company nor the arbitrator routinely hired by them to oversee cases has an incentive to make the process fair or balanced.

One particularly pernicious aspect of forced arbitration clauses as they have developed in consumer financial services is that they increasingly deny consumers the right to bring legal claims jointly, thus denying consumers their day in court on a massive scale, and allowing systemic frauds against consumers to remain unchecked. Often, the financial service provider has committed the same deceptive or abusive practice against hundreds or thousands of consumers, but the size of any one consumer's individual claim against the financial service provider is not large enough to cover basic legal costs. As Judge Posner of the Seventh Circuit once aptly observed, "The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30."[4]

Indeed, if all consumers harmed by a provider's widespread deceptive and abusive practices actually *did* bring their claims individually, or if even a significant portion of them did, the repeated legal fees involved would make it far more costly for the provider to deal with them – overwhelmingly costly, in fact. The attractiveness of the class action ban for the financial service provider is based on the certainty that the ban will lead to virtually all consumers simply giving up the pursuit of justice based on the practical hurdles erected by the provider.

Indeed, in our current system, the only way for consumers to hold a financial service provider accountable for this kind of widespread harm is to join their claims together in a class action. Indeed, this is one of the primary purposes for which the class action procedure was created in our law many years ago.[5] In this context then, the so-called "agreement" by consumers to give up their right to bring claims jointly in a class action amounts to giving financial services providers a license to steal.

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[3] *See, e.g.*, Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers (2007).
[4] Carnegie v. Household Int'l Inc., 376 F.3d 656, 661 (7th Cir. 2004).
[5] *See* Arthur R. Miller, The Preservation and Rejuvenation of Aggregate Litigation: A Systemic Imperative, 64 Emory L.J. 294 (2014), http://its.law.nyu.edu/faculty/profiles/representiveFiles/miller%20-arthur%20-preservationandrejuvenation_21BD052C-1B21-6206-606FD89839332A64.pdf.

Ultimately, the best and simplest solution to protect the historical rights of consumers not to be ripped off would be to clarify that the Federal Arbitration Act does not apply to one-sided, standard-form, take-it-or-leave-it sales or service contracts between companies and consumers. The Supreme Court has made it clear in a number of recent cases that the only way this is likely to be accomplished is through legislation. There are efforts underway in Congress to enact such legislation, and Consumers Union strongly supports those efforts. Meanwhile, Congress has already given the CFPB authority to regulate, restrict, or prohibit the use of forced arbitration clauses in consumer financial services, in light of the study and assessment it was directed to conduct under section 1028(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

While the CFPB's proposed rule does not entirely prohibit use of forced arbitration clauses, its prohibition against bans on class actions would curtail one of the worst abuses, and the additional information the rule would require providers to submit regarding their use of arbitration clauses will provide improved transparency that will help clarify the need for further reform. Consumers Union therefore supports this proposed rule, and we offer additional recommended clarifications to further strengthen the rule so that it will more effectively achieve its purposes.

<u>The CFPB Study and Report Amply Demonstrate the Harm and the Need for Reform</u>

As the discussion in the proposed rule amply describes, the CFPB conducted an extremely thorough examination of the use of forced arbitration clauses in consumer financial service contracts, soliciting and accepting input from the full range of parties and perspectives, in a particularly deliberative and inclusive multi-stage process, with extensive public outreach at each stage. The CFPB even published an interim "preliminary results" report on the study in progress.

The resulting final report,[6] published in March 2015, amply documents how forced arbitration clauses deny consumers access to our courts, shielding banks and lenders from accountability for deceptive and abusive conduct that harms consumers. The report confirms the increasing prevalence of these clauses – including bans on class actions – in consumer financial service contracts, adversely impacting tens of millions of consumers. The report also confirms that consumers typically have no idea they are signing away their rights – that more than 75 percent of consumers surveyed did not know whether they were subject to forced arbitration in their financial service contracts, and fewer than 7 percent of those covered by forced arbitration clauses realized that the clauses blocked their right to sue in court. Furthermore, the report demonstrates that even when consumers do realize the clause is in the agreement and what it means, they are essentially powerless to avoid it.

As the report documents, the class action ban in particular has resulted in a situation in which exceedingly few consumer claims are now being pursued against financial service providers, despite the likelihood of rampant consumer harms. During the two years examined, 2010 and 2011, consumers pursued only 52 individual claims under $1000 in arbitration, and

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[6] "Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)," http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

recovered on only 4 of those of those claims.[7] In contrast, there were 562 consumer class actions filed in 2010-2012 against financial service providers, and as of April 2016, 102 of them had final class settlements approved by the court or pending approval.[8] Over the full five-year period studied, the report found, 419 federal consumer financial services class actions reached final settlement, involving 160 million or more consumers who received a total of $2.2 billion in relief, after subtracting out costs and fees.[9] In addition, the report found that in 53 settlements involving 106 million consumers, the financial service providers were required to reform their business practices.[10]

It is thus abundantly clear from the reported results of the study that class actions have provided an effective means for large numbers of consumers who have suffered the same kind of abuse to hold the financial services provider accountable – when the procedure has been available – and that the spreading use of forced arbitration clauses with class action bans is undermining that effectiveness.

The Proposed Rule Is a Direct Response to the Harms Documented in the Study and Report

The proposed rule directly responds to the harms documents in the CFPB's study and report. Indeed, the proposed rule takes a measured approach. While we have urged the CFPB to prohibit the use of forced arbitration clauses entirely, the proposed rule reflects the CFPB's determination that its findings make the strongest case for prohibiting bans on class actions, and that a decision on further reforms will benefit from gathering additional information. And in that regard, the proposed rule requires financial service providers to report information to the CFPB going forward, for publication, regarding individual claims brought in arbitration. These reporting requirements will provide important transparency, thus promoting greater accountability, and will also help develop a stronger footing for considering possible further reforms.

Recommendations for Clarifying and Strengthening the Proposed Rule

In reviewing the proposed rule, we have identified a number of respects in which it can be clarified or refined, consistent with its purpose of more effectively protecting consumer rights, in order to better ensure that it achieves that purpose. Our recommendations include the following:

- **Shorten delay in rule's effective date.** The appropriate rationale for an effective date that is not immediate is to give affected financial service providers a reasonable time to familiarize themselves with the new rule and reform their practices in accordance with it. We believe 180 days, or perhaps even as few as 90 days, is sufficient for this purpose. There is no need, for example, to give 221 days after the final rule is published for pre-paid cards to be covered.

[7] Proposed rule, at 81 Fed Reg. 32845-46 (May 24, 2016).
[8] *Id.* at 81 Fed Reg. 32847.
[9] *Id.* at 81 Fed Reg. 32858.
[10] *Id.*

- **Apply rule to all contracts and agreements when revised, renewed, or extended.** While imposing the new rule on existing consumer contracts immediately on the effective date might be challenging, there is certainly no justification for exempting them indefinitely. Any revision, extension, or renewal of a contract or agreement after the effective date should bring it immediately under the rule, and after a reasonable period, of no more than one year, all existing contracts and agreements should be brought under the rule. As written, the proposed rule could even create a perverse incentive for financial service providers to expedite the addition of class action bans to their contracts in order to "lock them in" before the rule takes effect. The preambles to section 1040.4(a)(1) and section 1040.4(a)(2), should be revised accordingly, as should section 1040.4(a)(2)(iii). And in the Official Interpretation for section 1040.4, the preamble to paragraph 1 should be revised accordingly, and paragraph 1(ii)(A) should be deleted.

- **Strengthen the required statement, so that the provider formally relinquishes any right to restrict class actions.** As written, the provision required under section 1040.4 to be added to consumer financial service contracts is stated in the form of a forbearance – the financial services provider agreeing not to use the contract to stop a consumer from being part of a class action. We believe this would be stronger if it was also stated in the form of an express relinquishment of any right to use the contract in this way.

- **Have separate contracts for products and services covered and not covered, to avoid unnecessary confusion.** As the proposed rule recognizes, some contracts could encompass multiple products and services, including consumer financial services that are covered by the rule, as well as other kinds of products or services that are not covered. The proposed rule, in section 1040.4(a)(2)(ii), would allow this multiplicity to be addressed by a confusing statement that the required provision not to stop a consumer from being a part of a class action applies only sometimes but not always, leaving the consumer to figure out which is which. We recommend instead that there be two separate contracts, one for covered consumer financial services, another for everything else.

- **Require submission to CFPB of all contracts with arbitration clauses.** The requirement that contracts containing arbitration clauses be submitted to the CFPB and made public when a claim is filed in arbitration pursuant to it will provide important transparency. But the requirement will provide better transparency if it is extended to apply to all such contracts entered into. The mere presence of these clauses in contracts will have an effect on consumers beyond what is revealed in actual filings, and the contracts should be disclosed and subject to review before they are actually used to force consumers into arbitration. Indeed, based on the record, most consumers will not even bother to bring an individual case in arbitration.

- **Require reporting to CFPB whenever an arbitration clause is invoked.** A financial service provider should be required to report whenever it invokes an arbitration clause in a legal proceeding, such as in a motion to dismiss or stay the proceeding, not just when a claim is filed in arbitration. The motions may have the effect of ending the claim without it ever being filed in arbitration.

- **<u>Focus on clearly covering the consumer financial service activity, avoiding gaps in coverage.</u>** It should be clear that, by definition, one who provides financial services to consumers is a consumer financial services provider. Therefore, subject to the specific de minimis exceptions set forth in the proposed rule, there should not be any broader exceptions that create gaps in coverage. For example, section 1040.3(a)(1)(iii) requires that the entity be "acting, as a person's primary business activity, as a 'creditor.'" This creates a potential loophole for an entity to so arrange its activities that although it is providing extensive services as a creditor, providing those services is not its sole "primary business activity." This should be revised to cover an entity "acting, as a primary business activity of a person, …" or better, "acting, as a business activity in which the person is regularly engaged, … " The Official Interpretation of section 1040.3(a)(1)(iii) should also be revised accordingly.

- **<u>Ensure coverage of all business-to-business agreements where consumer could be bound.</u>** The rule should be carefully written so that companies contracting with each other cannot agree to relinquish a consumer's right to participate in a class action in a way that indirectly binds the consumer even though the consumer is not a party to the company-to-company contract. The proposed rule already gives some recognition to this issue by defining "consumer" in section 1040.2(b) to also include an agent, trustee, or representative acting on behalf of an individual." We recommend further clarifying this by adding at the end ", or otherwise purporting to obligate, or limit the rights of, an individual."

- **<u>Avoid creating loophole for facilitation of forced arbitration by other entities.</u>** In the Official Interpretation of section 1040.4, paragraph 1(ii)(B) states that a provider does not enter into a pre-dispute arbitration agreement, and is therefore not covered by the rule, if the provider "acquires or purchases a product that is subject to a pre-dispute arbitration agreement but does not become a party to the pre-dispute arbitration agreement." We do not see why this exclusion is even necessary; and we are concerned that it has the potential to allow the acquiring provider to facilitate the imposition of the forced arbitration clause on a subsequent consumer purchaser of the product. The required provisions, as set forth in section 1040.4(a)(2)(i), (a)(2)(ii), (a)(iii)(A), and (a)(iii)(B), all commit that "neither we nor anyone else will use this agreement to stop you …" Not only there is no harm in having the agreement not to use the clause to block a class action apply to this other provider; in fact, it would appear to be necessary to have it apply to this other provider in order to ensure that the agreement is enforceable. We recommend that this exclusion be removed from the Official Interpretations, and that consistent revisions be made elsewhere as needed, including in the Official Interpretation of 1040.4(a)(2).

  (In the Official Interpretation for section 1040.4, indicates that the required provisions would preclude a provider from relying on a pre-dispute arbitration agreement entered into by another person, but that may not be correct in the provisions as written. The provider making the commitment not to stop the consumer from taking part in a class action is the provider who is a party to the contract. In order for a non-party provider to be bound by that commitment, the non-party provider must not be excluded from coverage. If paragraph 1(ii)(B) in the Official Interpretation has a narrower purpose, to excuse the non-party provider from having to file inapplicable reports to the CFPB, that could be accomplished with a clearer, more straightforward statement. Even in that respect, however, if a non-party provider seeks to use an arbitration clause to require a consumer bringing an individual claim to proceed in arbitration, there is no reason why the non-party provider should not have to make the same report to the CFPB.)

- **Apply the rule fully to credit reporting activities.** Section 1043.3(4) should be revised to clarify that it includes the activities of credit reporting bureaus and other companies that provide information to them regarding a consumer's activities for use in relation to determining a consumer's credit score or determining whether to extend credit to a consumer. These activities can have significant impact on consumers, and are a subject of significant numbers of consumer complaints to the CFPB.

Proposed Rule is In Public Interest and for Protection of Consumers

Forced arbitration blocks effective remedial action by consumers harmed by wrongdoing, enables businesses to evade accountability, and undermines incentives to comply with legal requirements. The CFPB's proposed rule takes incremental but important steps to address the most harmful aspects of forced arbitration in the consumer financial services marketplace, by prohibiting the use of forced arbitration clauses to stop consumers from joining claims together in class actions where the abuse and harm are widespread, and brings further transparency to the impacts of forced arbitration in that marketplace more broadly, potentially laying the groundwork for further reforms as may be shown to be warranted. The proposed rule is therefore squarely in the public interest and for the protection of consumers, consistent with Congress's directive and with the findings in the CFPB's thorough study, as documented extensively in its report.

We urge the CFPB to proceed expeditiously to finalize the rule, incorporating the clarifications and refinements we have suggested, in order to restore the fundamental consumer protections that have been severely weakened by the increasingly widespread use of forced arbitration clauses in consumer financial services.

Respectfully submitted,

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