BEFORE THE
BUREAU OF CONSUMER FINANCIAL PROTECTION
WASHINGTON D.C. 20552

	)	
In the Matter of	)	Docket No. CFPB-2016-0020
Arbitration Agreements	)	RIN 3170-AA51
	)	

COMMENTS OF
THE COMPETITIVE ENTERPRISE INSTITUTE

August 22, 2016

Prepared by:
Iain Murray
John Berlau
Competitive Enterprise Institute
1310 L Street N.W., 7th Floor
Washington D.C. 20005
John.Berlau@cei.org

On behalf of the Competitive Enterprise Institute (CEI), we are pleased to provide the following comments on the Consumer Financial Protection Bureau's (CFPB) proposed rule barring many financial service providers from forming binding arbitration agreements with consumers. Founded in 1984, the Competitive Enterprise Institute is a non-profit research and advocacy organization that focuses on regulatory policy from a pro-market perspective. A strong focus of CEI is on removing regulatory barriers that deny access to capital and credit to businesses, consumers, and investors.

1. Interest of the Commenters

CEI institutionally believes very strongly in access to justice. For the past two decades, the Institute has offered pro bono representation for consumers and others affected by overregulation.[1] While statements from the CFPB refer to arbitration clauses in credit agreements as "gotcha" clauses,[2] implying that they deny consumers access to justice, this is far from the truth. In fact, the Bureau's preferred resolution mechanism, class action lawsuits, would more often be the real "gotcha" for consumers. Many class actions are resolved by providing consumers a token item, such as a coupon or product voucher instead of monetary relief, while the attorneys purportedly representing them walk away with the bulk of a multi-million dollar settlement.[3]

That is why we write in strong opposition to the proposed rule, which would take away the rights of consumers and financial professionals to choose to have their disputes resolved by binding arbitration rather than the often-cumbersome and ineffective process of class action lawsuits. Although class action lawsuits have a valid part to play in the judicial system, access to justice does not necessarily mean disputes must be resolved in a courtroom, and certainly does not mean thousands of class members having their claims expunged after the backroom dealings of an attorney they have never met or heard from. The CFPB's own data show that arbitration most often provides the fairest and most efficient method at resolving consumer disputes.[4]

Furthermore, the proposed rule would have a devastating effect on new "sharing economy" financial innovations (known as "FinTech") such as online peer-to-peer lending. As the growth of the peer-to-peer

---

[1] *See*, *e.g.*, *Competitive Enterprise Institute v. National Highway Traffic Safety Administration*, 901 F.2d 107 (D.C. Cir. 1990).

[2] "CFPB Proposes Prohibiting Mandatory Arbitration Clauses that Deny Groups of Consumers their Day in Court," Press Release, May 5, 2016, http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-proposes-prohibiting-mandatory-arbitration-clauses-deny-groups-consumers-their-day-court.

[3] In the universe of class actions that survive dismissal, settlements are ubiquitous, while resolution by a bench or jury trial is vanishingly rare. *Eubank v. Pella*, 753 F.3d 718, 720 (7th Cir. 2014) ("class actions invariably are settled"); Thomas E. Willging & Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does It Make?*, 81 NOTRE DAME L. REV. 591, 606-07 (2006) (noting that, in an empirical study of state and federal class actions, every class action that had been certified and had terminated before the end of the study had settled); Svetlana Starykh and Stefan Boettrich, National Economic Research Associates, Inc., *Recent Trends in Securities Class Action Litigation: 2015 Full-year Review (2016)* (among more than 4,300 federal securities class actions that were filed since the PSLRA, only 21 have gone to trial and only 15 have reached a verdict or a judgment. No trials were held in 2015.). See also Section 3 below.

[4] Consumer Financial Protection Bureau, *Arbitration Study: Report to Congress, pursuant to Dodd–Frank Wall Street Reform and Consumer Protection Act § 1028(a)*, March 2015, (hereinafter "CFPB Study") available at http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

lending industry shows, many ordinary Americans are eager to lend to other consumers, often at more favorable rates than those offered by traditional lender, and sometimes without any interest charges. Under the proposed CFPB rule, peer-to-peer lending will slow and could grind to a halt, due to the prospect of an individual lender having to hire a lawyer if the person or entity to whom they lend has any type of grievance. The result will be fewer choices and higher costs for consumers.

Therefore, we contend that the Bureau has not shown that its proposal to ban arbitration agreements is "in the public interest," as required by the Wall Street Reform and Consumer Protection Act of 2010. If arbitration clauses are to be regulated at all, a better result could be achieved by allowing a voluntary opt-out from arbitration clauses that can be chosen by those who prefer to protect their ability to participate in class action settlements, while still allowing those consumers who prefer the benefits of pre-dispute mandatory arbitration agreements to have that option (if service providers wish to offer it).

2. The rule is not in the public interest because consumers gain benefits from arbitration

While supporters of the proposed rule paint arbitration as a sneaky way for corporations to circumvent class action lawsuits, arbitration actually predates class action lawsuits by centuries.[5] Some form of arbitration or private dispute resolution occurred in all nations before the advent of public civil trials. In the late 18th century, George Washington inserted an arbitration clause into his will that provided for disputes to be resolved by "three impartial and intelligent men"—two chosen by each of the two disputing parties and the third chosen by first two—whose decisions would be "as binding on the Parties as if it had been given in the Supreme Court of the United States."[6]

The era of modern arbitration, used as a mechanism for resolving disputes for which a consumer filing an individual lawsuit would be impractical, began in 1925 with the Federal Arbitration Act.[7] This still predates class actions, which trace their origins to the Federal Rules of Civil Procedure adopted in 1938.[8] And it was not until the mid-1960s that the modern practice of adding consumers to class actions unless they opted out was widely adopted.[9]

Based on the five decades that arbitration and class actions have existed side by side, the evidence is clear: Arbitration more often compensates consumers for damages faster and grants them larger awards than do class action lawsuits. Even such a defender of class actions as Columbia law professor

---

[5] *See* Dean Clancy, "Good News: The CFPB Bans Forced Arbitration," DeanClancy.com, May 5, 2016, http://deanclancy.com/good-news-cfpb-bans-forced-arbitration (Attempts to make argument swaying "Tea Party" voters that arbitration clauses would be something foreign to the Founding Fathers. "I have no love for the CFPB, but the Constitution needs friends wherever it can get them.").
[6] Juan C. Antunez, "George Washington on Arbitration of Probate Disputes," Probate and Trust Litigation Blog, August 16, 2008, http://www.flprobatelitigation.com/2008/08/articles/new-probate-cases/will-and-trust-contests/george-washington-on-arbitration-of-probate-disputes.
[7] Ted Frank, "Class Actions, Arbitration, and Consumer Rights: Why Concepcion Is a Pro-Consumer Decision," Manhattan Institute Legal Policy Report, February 16, 2013, http://www.manhattan-institute.org/pdf/lpr_16.pdf (hereinafter "Frank").
[8] *Ibid*.
[9] *Ibid*.

John Coffee concedes that “procedural complexity and slow pace” characterize the “typical class action.”[10]

Eighty percent of class actions filed are never certified by the courts, either because they are withdrawn or because lawyers cannot meet the burden of proof showing common injuries to multiple plaintiffs.[11] Of those that do go through, the average class action takes more than three years to move to settlement for the consumer.[12] Appeals and administrative obstacles can mean that class members often must wait even more time after a settlement to receive compensation. In contrast, the Searle Center for Civil Justice found that the average time from an arbitration filing to a final consumer award is 6.9 months.[13]

The outcomes of arbitration are not only faster, they often are more favorable to consumers, who ultimately get larger awards than they would from a class action award or settlement. An American Bar Association survey found that 75 percent of the attorneys in its litigation section believe the outcomes of arbitration are equal to or better than those of litigation.[14] Consumers also prefer arbitration when they have the chance to try it. A 2005 survey of 609 adults who had participated in arbitration found 75 percent calling it speedier, 63 percent calling it simpler, and 51 percent calling it more affordable than litigation.[15] An additional indication of satisfaction with outcomes is the fact that, according to an analysis by the American Arbitration Association of cases concluded in 2007, around 60 percent of arbitrations were settled between the parties or withdrawn.[16] Of the cases that went forward to decisions by arbitrators, consumers prevailed 48 percent of the time, whereas 80 percent of putative consumer class actions fail to even achieve certification.[17]

Moreover, arbitration costs consumers less. In most cases, the costs of arbitration are borne by the defendant companies, not the consumers, and consumers get bigger rewards if they win. Courts have acknowledged this. In *AT&T Mobility LLC v. Concepcion*, the Supreme Court, in determining that a California state law restricting arbitration clauses conflicted with and was preempted by the Federal Arbitration Act, noted that, “the District Court concluded that [the plaintiffs] were better off under their arbitration agreement with AT&T than they would have been as participants in a class action.”[18] The AT&T contract at issue in *Concepcion* even offered consumers a $10,000 reward for successfully using

---

[10] Cited in Frank: John C. Coffee, Jr., *Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 710 (1986).
[11] Frank.
[12] *Ibid*.
[13] *Ibid*.; Searle Civil Justice Center, *Consumer Arbitration Before the American Arbitration Assoication*, March 2009, http://www.searle arbitration.org/report/exec_summary.php.
[14] Frank at 5-18 (comparing outcomes of class actions versus arbitrations); *Survey On Arbitration, American Bar Association*, August 2003, http://www.abanet.org/litigation/taskforce/adr/surveyreport.pdf.
[15] Harris Interactive, Arbitration: Simpler, Cheaper, and Faster than Litigation (U.S. Chamber Inst. For Legal reform 2012).
[16] In class action litigation, however, the high incidence of settlement says nothing about class members’ satisfaction. Because unnamed class members need not affirmatively approve the arrangement, a settlement only indicates that the class attorneys, the defendants, and the named class representatives are satisfied.
[17] Frank at 12; *Analysis of the American Arbitration Association’s Consumer Arbitration Caseload*, American Arbitration Association, https://www.adr.org/aaa/ShowPDF?doc=ADRSTG_004325.
[18] *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 1753 (2011).

the arbitration system. (Notably, the plaintiffs' attorney in *Concepcion* had a mandatory arbitration clause in his retainer agreement.)[19]

On balance, arbitration saves both businesses and consumers money compared to litigation. The CFPB claims it has been unable to find proof of this effect. That is because the CFPB Study is flawed owing to the incomparability of the data it attempts to compare. Attorneys routinely challenge arbitration provisions to protect their own special interests. As a result, consumers often have been thwarted in their efforts to exercise their right to submit to arbitration.[20] In *Concepcion*, for instance, a corporation was required to litigate an arbitration clause all the way to the Supreme Court because lower courts refused to enforce the contract at the behest of attorneys who would suffer if such clauses became widely accepted. There is not enough data showing that arbitration works to save money simply because courts have not let it work to save money. Even post-*Concepcion*, courts regularly refuse to enforce arbitration clauses.[21]

The CFPB arbitration study also completely overlooks resolution of customer complaints that do not result in legal disputes. Resolving a consumer's valid complaint is much less expensive than either arbitration or litigation. Businesses resolve customer disputes every day without resorting to arbitration. The CFPB does not even measure such resolutions. All the CFPB acknowledges are the revealed preferences of defendants to arbitrate far more challenging consumer claims. Meanwhile, the Bureau characterizes class actions that result in a fraction of a percentage being paid to the class (often pennies on the dollar, as in the *Checking Overdraft* cases[22]) while the attorneys are awarded millions as a "victory" for consumers. Enriching well-heeled attorneys does nothing to make consumers whole.

We also adopt the criticisms of the CFPB Study made by Professors Jason Johnston and Todd Zywicki and contained in their study, "The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique," published in August 2015.[23] They conclude that: comparing class action settlements with arbitration awards is methodologically flawed; the CFPB paints a misleading picture of class action outcomes; the market's solution to inaccurate charges works better than arbitration or litigation; and consumers perform better in arbitration than litigation.

3. The rule is not in the public interest because class actions can disproportionately benefit the rich

The CFPB's own data show that, even when consumers "win" in a class action, they often lose. Of those class actions that did result in payment, the average award to class members who filed claims was $36.35. However, given that the CFPB's study found a mere 4 percent weighted average claims rate, the average payout when averaged out across all class members was only around $1.45. (Furthermore, 4

---

[19] Frank at 2.

[20] E.g., Concepcion, 131 S.Ct. 1740; *see also* Daniel Fisher, "New York Times 'Expose' of Arbitration Clauses Leaves Lawyers in the Shadows," *Forbes,* Nov. 1, 2015, http://www.forbes.com/sites/danielfisher/2015/11/01/new-york-times-expose-of-arbitration-clauses-leaves-lawyers-in-the-shadows/#6b9045d66665.

[21] *See*, *e.g.*, *In re American Express Merchants' Litig*., 634 F.3d 187 (2d Cir. 2011), *rev'd sub. nom*; *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013).

[22] *In re Checking Account Overdraft Litigation*, No. 09-md-2036 (S.D. Fla.).

[23] Jason Scott Johnston and Todd Zywicki, "The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique," Mercatus Center at George Mason University, August 3, 2015, http://mercatus.org/publication/consumer-financial-protection-bureau-arbitration-study-summary-critique.

percent actually may overestimate the typical consumer class action settlement's claims rate. Plaintiffs' lawyers' own data produced in the *Poertner v. Gillette* litigation asserts that claims rates are "almost always" less than 1 percent in cases when class notice is given by publication).[24] Meanwhile, the lawyers in class action settlements are almost always big winners. In the 419 class action cases the CFPB reviewed in its study, attorneys' fees comprised an average of 21 percent of consumer awards, and attorneys walked away with an average of over $1 million per case.[25] This figure does not include sums paid to defense attorneys and settlement administrators, and it systematically omits all the class actions where there was no disclosure of the amount plaintiffs actually received. It is therefore almost certainly a significant understatement.

It would be absurd to argue that lawyers do not deserve to be paid well for a successful class action. However, the degree to which they benefit compared to the consumer is likely understated by the CFPB because its data seems to have systematically excluded (or, worse, overstated the benefit of) many claims-made settlements where courts have failed to require the disclosure of actual class recovery. If any consumer service could be said to be abusive, lawyers' nonconsensual representation of consumers in class actions is it, in courts that fail to ensure that settlements are not designed to disproportionately benefit attorneys at class members' expense.

Moreover, class actions can act as a form of wealth transfer from consumers to wealthy attorneys. Many courts allow attorneys to keep over 90 percent of settlement proceeds, while others fail to stipulate for class members to receive any benefit.[26] In many class actions, over 90 percent of class members are not compensated at all.[27] Data from Telephone Consumer Protection Act litigation show that consumers

---

[24] *Contrast* CFPB Study (finding a 21 percent unweighted average claims rate and 11 percent weighted average) *with* Daniel Fisher, "Odds of a Payoff in Consumer Class Action? Less Than a Straight Flush," *Forbes*, May 8, 2014, www.forbes.com/sites/danielfisher/2014/05/08/odds-of-a-payoff-in-consumer-class action-less-than-a-straight-flush/; Mayer Brown LLP, Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions (2013), *available at* http://blogs.reuters.com/alison-frankel/files/2013/12/mayerbrownclassactionstudy.pdf (finding claims rates of 0.000006%, 0.33%, 1.5%, 9.66%, 12% and 98.72% in the six cases studies with claims data available).

[25] CFPB Study.

[26] *See*, *e.g.*, Roger Parloff, "Should Plaintiffs Lawyers Get 94% of a Class Action Settlement?," *Fortune*, Dec. 15, 2015; *Poertner v. Gillette*, 618 Fed. Appx. 624 (11th Cir. 2015), *cert den'd* (Mar. 21, 2016) (affirming settlement that paid class counsel more than 90 percent of the available funds); *Landsman & Funk, P.C. v. Skinder-Strauss Assocs.*, 639 Fed. Appx. 880 (3d Cir. 2016) (affirming settlement that paid class counsel more than 75 percent of the available funds); *McCrary v. Elations Co.*, LLC, 2016 U.S. Dist. LEXIS 24050 (C.D. Cal. Feb. 25, 2016) (allowing class counsel to capture over 80 percent of available settlement funds); *Wilson v. Everbank*, No. 14-CIV-22264, 2016 WL 457011, 2016 U.S. Dist. LEXIS 15751 (S.D. Fla. Feb. 3, 2016) (approving claims-made settlement and $2.5 million fee without informing itself of class's claim rate or recovery; *Braynen v. Nationstar Mortg., LLC*, 2015 U.S. Dist. LEXIS 151744 (S.D. Fla. Nov. 9, 2015) (same; $5 million fee); *Lee v. Ocwen Loan Servicing, LLC*, 2015 WL 5449813 (S.D. Fla. Sept. 14, 2015) (same; nearly $10 million fee); *Miller v. Basic Research*, No. 07-cv-00871 (D. Utah, July 28, 2015) (same; $2.45 million fee); *Saccoccio v. JP Morgan Chase Bank, N.A.*, 297 F.R.D. 683, 696 (S.D. Fla. 2014) (same; $20 million fee); *Fladell v. Wells Fargo Bank, N.A.*, 2014 WL 5488167 (S.D. Fla. Oct. 29, 2014) (same; $19 million fee); *Poertner v. Gillette* was described as a "$50 million settlement" even though class members received under $400,000. Similarly, the *Babies'R'Us* settlement struck by the Third Circuit in *In re Baby Prods. Antitrust Litig.*, 708 F.3d 163 (3d Cir. 2013) was described as a "$35.5 million settlement" even though class members were to receive under $3 million.

[27] *Gascho v. Global Fitness*, 822 F.3d 269 (6th Cir. 2016); *Pearson v. NBTY, Inc.*, 772 F.3d 778, 782 (7th Cir. 2014); Daniel Fisher, "Odds of a Payoff in Consumer Class Action? Less Than a Straight Flush," *Forbes*, May 8,

average less than 1 percent of recovery of statutory damages, while attorneys average over $1,000 an hour, win or lose.[28]

Any claim that class actions provide superior outcomes to consumers should be subject to question, given the paucity of data about how much money actually gets to class members. Courts rarely require that information or follow up to see whether settlement money is actually distributed to the class instead of being eaten up by lawyers' and administrators' fees.

Furthermore, the CFPB's cost estimates do not include the costs of defense attorneys or the time spent by business staff complying with litigation discovery—costs that are passed along to consumers. Even when class actions distribute money directly to class members, something as simple as the type of envelope used to send a check can affect how many class members are paid.[29]

Another aspect of class actions that deserves consideration is the common practice of *cy pres*, whereby attorneys divert money to their favored charities instead of the supposedly harmed consumers. The *cy pres* doctrine allows attorneys and courts to divert settlement funds to a nonprofit organization when, for instance, it is prohibitively difficult to identify individual class members[30] or the cost of paperwork would exceed the amount of each claim.[31] In practice, this has led to large sums going to law firms and to charities selected by the plaintiffs' attorneys, with the class members often unaware of any award having been made.[32] This enables plaintiffs' attorneys not just to benefit themselves, but also their friends and family who may work for or gain social prestige from these supposedly charitable beneficiaries. The CFPB generally, but not always, excludes *cy pres* payments from its analysis, but that analysis cannot account for this aspect of the doctrine's effect.

Low-income consumers are the ones most likely to be frozen out by the requirement to negotiate a claims-made[33] process.[34] That the benefits of the claims process flow mostly into the pockets of rich

---

2014, www.forbes.com/sites/danielfisher/2014/05/08/odds-of-a-payoff-in-consumer-class action-less-than-a-straight-flush.

[28] Opening brief of Appellants Collins et al., *in re Capital One Telephone Consumer Protection Act Litigation*, US Court of Appeals, Seventh Circuit, March 27 2015. Case Nos. 15-1400 (L), 15-1490, and 15-1546 Consolidated with Nos. 15-1514, 15-1586, 15-1639, https://www.scribd.com/document/264533017/Collins-TCPA-Fee-Contest.

[29] Brian T. Fitzpatrick and Robert C. Gilbert, *An Empirical Look at Compensation in Consumer Class Actions*, 11 N.Y.U. J. OF LAW & BUS. 767 (2015), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2577775.

[30] Certification of a class without members is allowed in every circuit except the 3rd Circuit.

[31] Martin Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. 617, 618-19 (2010).

[32] W.J. Kennedy, "With class members unaware of settlement, firm, founder and charities cash in," LegalNewsLine, August 9 2016, http://legalnewsline.com/stories/510989019-with-class-members-unaware-of-settlement-firm-founder-and-charities-cash-in.

[33] A "claims-made" settlement is one under which class members must submit a claims form to obtain monetary compensation. The abuse of claims-made settlements to inflate attorneys' fees and deflate defendants' obligations to class members has been the subject of substantial criticism. *E.g.* Barbara J. Rothstein & Thomas E. Willging, Fed. Jud. Center, MANAGING CLASS ACTION LITIGATION: A POCKET GUIDE FOR JUDGES 30 (2010), available at www.fjc.gov/public/pdf.nsf/lookup/ClassGd3.pdf/$file/ClassGd3.pdf; *Pearson v. NBTY, Inc.*, 772 F.3d 778, 787 (7th Cir. 2014) (reversing an attorney-centric "selfish" arrangement where a needless claims process was employed instead of distributing checks to the known class members).

[34] Omri Ben-Shahar, Mandatory Arbitration and Distributive Equity: An Essay on Access to Justice, University of Chicago Institute for Law & Economics Olin Research Paper No. 628 (2013).

attorneys only adds insult to injury. In effect, class actions can act as a form of regressive taxation. When abused, they transfer wealth from low-information consumers to wealthy attorneys.

The CFPB rule justifies all of this by claiming the rule will act as a deterrent against companies exploiting poorer consumers. However, there is no indication that the incentive structures of the rule will achieve this. Plaintiffs' attorneys will be more likely to go after those companies with the deepest pockets, not necessarily the ones providing the most serious breaches of acceptable behavior. As Omar Ben-Shahar of the University of Chicago Law School notes:

> [E]ven this rationale for "access to litigation" is tentative and rests on questionable conjectures regarding the distributive benefits of heightened liability. Class action liability may indeed change firms' conduct in a way that benefits those who brought the suits, but in a way detrimental to others.[35]

4. Banning arbitration could kill the growing FinTech industry.

In cases involving two parties, such individuals and businesses, arbitration is often more beneficial to consumers than class action lawsuits.[36] Increasingly, though, many financial products involve transactions between more than two parties. As it has for other business sectors, the sharing economy has brought "peer-to-peer" innovations to finance.

Across the globe, peer-to-peer lending has taken off as individuals seek to help their fellow citizens by lending at reasonable terms, giving borrowers more credit options. In the United States, the top aggregators of peer-to-peer lending include both for-profit exchanges, such as Prosper and LendingClub, and not-for profit networks, such as Kiva.

Inspired by Nobel Laureate Muhammad Yunus, Kiva started out as a microfinance organization to provide small loans for native entrepreneurs to start businesses in East Africa. It soon expanded to over 80 countries, including the United States.[37] In the U.S., Kiva loans to disadvantaged neighborhood businesses often are provided at no interest.

But, like its for-profit peers, Kiva has a strong arbitration clause in its borrower contract. As stated in Kiva's most recent terms of use agreement:

> If any dispute arises between you and Kiva, including, without limitation, any dispute arising from or relating to the Website or the Program, you agree that all such disputes will be determined exclusively by final and binding arbitration, in accordance with the then existing commercial rules of the American Arbitration Association in San Francisco.[38]

---

[35] *Ibid*.
[36] Frank.
[37] https://www.kiva.org/about.
[38] Kiva Terms of Use Agreement, Kiva.org, Last update June 1, 2016, https://www.kiva.org/legal/terms?Xb=1#disputes.

University of Colorado law professor Andrew Schwartz notes that arbitration clauses hold "special value" for peer-to-peer transactions.[39] Schwartz describes four reasons that this is so: the lower cost of arbitration; the ability to use arbitrators with relevant expertise; the certainty of the forum; and the ease of consolidation.[40] There are other reasons as well. When class action attorneys sue, they tend to go after every party tangentially involved. That means that peer-to-peer lenders, even those acting out of a charitable impulse, would face a much greater risk of being sued by borrowers if their lender agreements lacked arbitration clauses.

Indeed, the recent putative class action, *Bethune v. LendingClub*, which alleges that LendingClub violated New York State's usury cap, includes as defendants "Does 1-10." These "John Does" are presumably the yet unknown "peers" who bought the loans from LendingClub.[41] LendingClub has countered with a "motion to compel arbitration" to preclude the lawsuit and force the aggrieved borrowers to go through the arbitration process outlined in their contracts. If LendingClub's motion is denied, this case may have a chilling effect on peer-to-peer lending. Anyone who might consider acting as a peer lender may have to factor in the costs of defending him or herself against a borrower lawsuit.

5. The questionable benefits of the rule come at the expense of other consumers

The concern the rule purports to address, that consumers could be forced into arbitration without any benefit from the clause, is unfounded. However, if a regulatory approach is necessary, this concern can be addressed better by a requirement to offer consumers the right to opt out of class actions. Although no regulation appears warranted at this time, an opt-out approach would be preferable to depriving consumers of the choice to make a pre-dispute commitment to arbitration and class action waivers. No consumers will be made worse off by being given the choice, and at least some will be better off. Incidentally, this opt-out approach would create a desirable parity with the class action system, which allows disaffected class members the right to opt out.

We know from real world experiences that it is rational for at least some consumers to prefer arbitration. When Ebay permitted its customers to opt out of arbitration clauses, very few did so, despite a campaign by the liberal advocacy group Public Citizen to encourage them to do so.[42] In New Jersey, when auto insurance consumers were offered the choice to waive certain litigation rights to higher noneconomic damages in exchange for lower insurance rates, an overwhelming majority took that option. Over 90 percent of consumers preferred lower costs up front to the opportunity for pain and suffering damage awards in the event of a suit. For the larger group of consumers, the option of seemingly randomly awarded noneconomic damages was simply not worth the price of paying more for insurance.

If the CFPB's concern is that consumers are "forced" into arbitration when they do not wish to be, a CFPB regulation that simply requires giving consumers the *choice* of whether to opt out of an arbitration clause will fix this problem. It would also provide certainty to businesses and permit consumers to

---

[39] Andrew A Schwartz, "Arbitration and the Contract Exchange," *Legal Studies Research Paper Series*, Working Paper 14-7, September 18, 2014, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2498142&download=yes.
[40] *Ibid.*
[41] Class Action Complaint, *Bethune v. LendingClub Corporation*, File April 6, 2016, available at http://debanked.com/lendingclub-bethune.pdf.
[42] Frank, Note 10.

realize savings in competitive markets. Under such a rule, a service vendor wishing to have a contract with a pre-dispute arbitration clause must offer consumers the option of a premium plan that does not have the arbitration clause. The amount of the discounts for those who remain with the binding arbitration plan would be at the discretion of the vendors. There are two possible outcomes in the presence of such a rule in a competitive market for financial services: either arbitration saves consumers money or it does not.

If arbitration does not save money, then service providers will not offer attractive prices for consumers to choose a plan with a mandatory arbitration provision. If that were the case, there still would be no harm in permitting the choice because the vast majority of consumers would refuse mandatory arbitration, or vendors would not find it worthwhile to bother offering the option.

If arbitration does save money, then service providers would have the incentive to offer attractive prices to encourage consumers to choose to stay with mandatory arbitration. Consumers would have the choice of paying for the additional expense of having the opportunity to engage in class litigation without imposing those expenses upon consumers who rationally prefer not to have that opportunity. (And for the CFPB, it would mean having meaningful apples-to-apples comparisons of how much arbitration saves consumers and how much consumers value class action litigation rights.)

This solution is clearly superior to the proposed CFPB regulation. No consumers would be worse off than they would be under the CFPB regulation because anyone who wished to opt out of arbitration would have the opportunity, and at least some people would be unambiguously better off.

6. Conclusion: Withdraw or amend the rule

The current rule is flawed for many reasons. The CFPB's case for the rule is flawed as well. As we have noted in the above comments, the CFPB ignores its own data when it supports arbitration or casts class action lawsuits in a negative light. Moreover, the data for arbitration and class action results are not meaningfully comparable. Thus, the Bureau has not done an acceptable analysis of benefits and costs of its proposal.

What we can say, however, is that the CFPB's arbitration ban would unquestionably make a lot of people who would otherwise benefit from arbitration much worse off.

A rule that seeks to make the terms of arbitration clauses clearer to consumers and allows them the choice to opt out would not provide benefits to some at the expense of these consumers. The CFPB should not take away consumers' choice to avoid class action lawsuits, many of which could be described, in the CFPB's own terminology, as "predatory."

Thank you for consideration of our comments, and please contact us if we can be of assistance.