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**CLASS ACTION WAIVERS****ARBITRATION**

The Consumer Financial Protection Bureau's plan to limit the use of class action waivers in pre-dispute arbitration agreements is unlikely to survive legal scrutiny, attorneys Theane Evangelis, Lauren Blas and Daniel Adler say. The authors say the proposed regulations run headlong into the Federal Arbitration Act and a string of recent Supreme Court cases affirming the legality of class action waivers, including in the consumer finance context.

**The Consumer Financial Protection Bureau and the Future of Class Action Waivers**

BY THEANE EVANGELIS, LAUREN BLAS  
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In May 2016, after conducting a years-long study on the use of arbitration agreements in consumer finance, the Consumer Financial Protection Bureau announced its plan to limit the use of class action waivers in pre-dispute arbitration agreements.

The CFPB's proposal, if enacted into law unchanged, could face significant legal challenges. At bottom, the proposal rests on the flawed premise that class action litigation is the best way to protect consumers from

overreach by financial institutions, but the data—including some of the Bureau's own data—simply do not bear this out.

In any event, it is unlikely that the Bureau's regulations will survive legal scrutiny: The Bureau itself is constitutionally suspect, and its proposed regulations would run headlong into the Federal Arbitration Act and the string of recent Supreme Court cases affirming the legality of class action waivers, including in the consumer finance context.

**The Bureau's Proposed Regulations**

Section 1028 of the Dodd-Frank Act (12 U.S.C. § 5518) specifically charges the Bureau with conducting a study on mandatory pre-dispute arbitration agreements and purports to authorize it to issue regulations prohibiting or limiting their use in the event that the study demonstrates the need for such government in-

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tervention. The Bureau's study, published in March 2015, made several key findings, including that mandatory arbitration agreements are common in consumer financial services contracts; that such agreements generally prohibit not just class actions, but also class arbitrations; and that few individuals initiate proceedings against their financial services providers, either in court or in arbitration.

Following that study, in May 2016, the Bureau published a Notice of Proposed Rulemaking which would make two key changes. First, it would prohibit covered providers of certain consumer financial products and services, such as credit card companies and banks, from using pre-dispute arbitration agreements to bar consumers from filing or participating in class actions, and would require providers to insert designated language into their agreements reflecting this limitation. Second, it would require covered providers to give the Bureau copies of arbitration awards and other records to enable it to monitor arbitral proceedings and decide whether further regulations are warranted. The Bureau would publish these awards in some form with appropriate redactions or aggregation, at its option.

## The Unsung Benefits of Class Action Waivers

The proposed regulations reflect the Bureau's belief that class actions are the best means for deterring undesirable corporate practices and compensating consumers for any losses they may suffer. But class action waivers in fact provide a host of benefits for companies and consumers alike. For companies, class waivers eliminate the grave uncertainty, the relentless distraction, and the sometimes existential threat of substantial liability created by class actions that places, as the Fifth Circuit put it in *Castano v. American Tobacco Co.*, "insurmountable pressure on defendants to settle." Waivers also curtail nuisance litigation by destroying the incentive of opportunistic plaintiffs' attorneys to bring meritless suits whose cost to settle is lower than their cost to litigate. Similarly, waivers eliminate the all-too-common but socially useless "no-injury" class action—a suit, such as the recent Supreme Court case *Spokeo, Inc. v. Robbins*, brought on behalf of a class by attorneys seeking to "remedy" statutory, but not real, harms. Such cases amount to little more than massive wealth transfers from defendants to plaintiffs' attorneys. One recent study by Professor Joanna Shepherd, entitled "An Empirical Survey of No-Injury Class Actions," found that a group of 432 "no-injury" cases yielded settlements and arbitral awards of more than \$4 billion. Thirty-eight percent of that sum went to the attorneys, and, because of low claims rates, only nine percent ever made its way to consumers. Arbitration reduces those social costs insofar as it is more likely to be invoked by someone who has actually been injured and who therefore has a more credible claim for holding the company accountable for any wrongdoing.

Arbitration serves the primary values of class actions—deterrence and compensation—better than class actions themselves do. Arbitration agreements can be structured to promote good behavior without needlessly threatening corporate defendants with bankruptcy. The Supreme Court noted, for example, that in the 2011 case of *AT&T Mobility LLC v. Concepcion*, AT&T guaranteed claimants a \$7,500 minimum recovery and twice the amount of the claimants' attorney's

fees if they won an award larger than AT&T's last written settlement offer. Such provisions encourage aggrieved consumers to pursue even small-dollar claims, and can accordingly meaningfully regulate the behavior of financial services providers. Further, that regulation can happen in real time, not merely in response to high-dollar suits brought in lottery-like fashion and fiercely contested for years in the courts without producing any benefit to consumers. Arbitration is likely to be a far more finely calibrated tool for improving corporate behavior than the imperfect cudgel of high-stakes litigation. And just as an arbitration-only regime can guard against under-deterrence and produce significant and immediate responses from corporate defendants, it can also guard against over-deterrence, the necessary and wasteful byproduct of no-injury class actions. Arbitration may therefore save resources that otherwise would have been spent to avert non-existent harms.

Class waivers are also likely to improve consumer welfare. Consumers' paltry recoveries in class actions are likely more than offset by the higher prices that companies inevitably charge to consumers to cover the cost of litigation and insurance. All things being equal, companies should charge less for their products if they can mitigate the risk of classwide liability. When consumers buy a good or service, they are buying a bundle of rights—among other things, the good or service itself, the right to seek repair or replacement under warranty, and the right to resolve any disputes with the provider of that good or service in a particular way. These assets to the consumer necessarily constitute liabilities to the provider. Eliminating one stick in the bundle of rights—whether by prospectively terminating a warranty program or by barring class actions—generates some amount of "surplus" to be shared between the company and the consumer according to their bargaining power. Even if these welfare gains are enjoyed preponderantly by companies rather than consumers, consumer welfare is nevertheless unlikely to decline in the absence of class actions for the simple reason that consumers receive little benefit from these actions—even in high-dollar suits—after attorney's fees and low claims rates are taken into account.

Contrary to the wisdom of consumer protection advocates, welfare gains may in fact be highest where class action waivers are coupled with mandatory arbitration, particularly when the company pays most or all of the costs of arbitration. As even the Bureau's study reveals—and as the American Bankers Association has explained—arbitration generally yields higher recoveries for individual consumers than class actions do—and tends to reward those who actually suffered some injury. Arbitration is also far less costly than a class action due to substantially lower discovery costs, the fact that consumer's arbitration costs are often fixed in low-dollar sums, arbitration's procedural simplicity, and the near-impossibility, under sections 9 and 11 of the Federal Arbitration Act, of disturbing arbitral awards by means of an expensive appeal. Together, those attributes expand the range of disputes aggrieved consumers can afford to bring. Arbitrators are also often more experienced in the particular subject matter of a dispute than a generalist judge or a lay jury, which can lead to more informed and sophisticated rulings.

In sum, arbitrations tend to be brought for the right reasons and reduce direct and indirect costs to consumers. The same cannot be said of class actions.

## Coming Legal Challenges

In addition to the flawed policies underlying the Bureau's proposed regulations, the regulations are vulnerable to legal attacks, including challenges to the Bureau's constitutionality and arguments that the regulations clearly conflict with the FAA as interpreted by the Supreme Court in a series of recent opinions.

### 1. The Questionable Constitutionality of the Bureau

Section 1011 of the Dodd-Frank Act (12 U.S.C. § 5491) vests the Director of the Bureau with sweeping authority: The Director is removable only for cause, and so he is not accountable to the President for anything but "inefficiency, neglect of duty, or malfeasance in office." Further, the Bureau itself is an independent unit of the Federal Reserve—itself substantially independent from presidential control because its Governors are appointed to 14-year terms on a staggered basis. What's more, under section 1012 of the Act (12 U.S.C. § 5492), the Director is largely independent even from the Federal Reserve, whose Governors are prohibited from, *inter alia*, "interven[ing] in any matter or proceeding before the Director, including examinations or enforcement actions." These multiple layers of insulation from the presidential removal power amount to just the sort of extreme agency independence held by the Supreme Court in *Free Enterprise Fund v. Public Company Accounting Oversight Board* to contravene the President's constitutional obligation to faithfully execute the laws. Although, according to Professor Leonard Kennedy, the Director possesses the authority formerly vested in seven different federal agencies, he is not subject to the practical, financial, and legal safeguards that ordinarily limit their leaders' discretion. And he is barely held accountable by the Federal Reserve, a quasi-governmental institution itself designedly independent from presidential influence.

The Director is just as insulated from congressional restrictions as he is from presidential ones. Under section 1017 of the Act (12 U.S.C. § 5497), the Bureau is funded directly by the financially independent Federal Reserve. The Director may, under section 1017(a)(2)(A)(iii), request up to 12 percent of the Federal Reserve's annual operating budget—and he has done so, projecting a staggering \$606 million budget for fiscal year 2016 according to the 2015 CFPB Strategic Plan available on the CFPB's website. And under section 1017(a)(2)(C), Congress is statutorily barred from exercising any oversight over the Bureau's budget. This structure flatly disregards Congress's constitutionally exclusive control over the power of the purse set forth in Article I, sections 7, 8 and 9. As the Supreme Court put it in *Office of Personnel Management v. Richmond*, the Appropriations Clause has "fundamental and comprehensive purpose" of "assur[ing] that public funds will be spent according to the letter of the difficult judgments reached by Congress as to the common good and not according to the individual favor of Government agents." The Bureau does not even attempt to defend this unconventional financing arrangement, instead celebrating its "full independence" from congressional budgetary oversight in its 2013 Strategic Plan. Were a court to agree that this arrangement is unconstitutional—*PHH Corp. v. Consumer Financial Protection Bureau*, a case before the D.C. Circuit, for in-

stance, presents this very issue—it could significantly impede the Bureau's rulemaking efforts.

### 2. Conflict Between Bureau Proposals and Federal Arbitration Act

Even if the Bureau were to survive constitutional challenge, its proposed regulations, if enacted, would collide with the FAA and the federal policy favoring arbitration.

As the Supreme Court stated in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, the Court has long emphasized the "liberal federal policy favoring arbitration" and, as the Court explained in *Buckeye Check Cashing, Inc. v. Cardega*, the principle that arbitration agreements be placed on "equal footing" with non-arbitration agreements and enforced according to their terms. And the Court is no stranger to class action waivers, having decided their lawfulness several times in recent years, most notably in *AT&T Mobility LLC v. Concepcion* and *American Express Co. v. Italian Colors Restaurant*. *Concepcion* explained that striking down arbitration agreements because of a class action waiver would eliminate any incentive for lawyers to arbitrate on behalf of individuals and for companies to resolve such claims on an individual basis. And it would also require companies to adopt more cumbersome procedures than what the parties had initially bargained for. That would make it even more difficult for consumers to secure individual relief.

*American Express Co. v. Italian Colors Restaurant* further held that courts may not invalidate contractual waivers of class arbitration on the ground that a plaintiff's cost of individually arbitrating a federal statutory claim would exceed his or her potential recovery. The Court reiterated that arbitration agreements were meant to be enforced according to their terms unless overridden by a contrary congressional command, and rejected the notion that Federal Rule of Civil Procedure 23 grants consumers any kind of entitlement to proceed as a class action. As the Court explained, "the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the 'right to pursue' that remedy."

The regulations the Bureau has proposed directly conflict with the Supreme Court's consistent teaching—in *Concepcion*, *American Express*, and other cases—that agreements to arbitrate must be enforced according to their terms, even where they involve small amounts of damages, involve parties with significantly different amounts of bargaining power, and even where they contain class action waivers. The FAA's central provision, 9 U.S.C. § 2, does not contain any statement permitting an arbitration agreement to be invalidated on the basis of an agency rulemaking; thus, only a "congressional command" that is contrary to, and incapable of being harmonized with, the FAA could provide the basis for a court's refusal to enforce an arbitration agreement.

In its defense, the Bureau will likely point to Section 1028(b) of the Dodd-Frank Act as the kind of "contrary congressional command" that authorizes the Bureau to interfere with arbitration and the benefits it brings. That section declares that the Bureau has the power to "prohibit or impose conditions or limitations on the use of an agreement between a [regulated financial services provider] and a consumer for a consumer financial

product or service providing for arbitration of any future dispute between the parties.”

But there’s more to this argument that meets the eye. First, it’s not at all clear that Section 1028 effectively repealed the FAA—as the Supreme Court said in *Whitman v. American Trucking Association*, Congress typically does not “hide elephants in mouseholes” and amend decades-old landmark legislation in an obscure corner of a hastily enacted financial reform statute featuring no clear declaration of this intent. In light of this history and the courts’ general reluctance to over-read specialized statutes, the courts may demand a clearer expression of congressional intent to amend the FAA.

Second, even if the Bureau does have the necessary authority to enact its proposed regulations, challengers might argue that Section 1028 is not “contrary” to the FAA at all and thus does not undermine the FAA’s goals or restrict its applicability in the consumer financial services sector. Section 1028 does not specifically authorize the Bureau to eliminate class action waivers, nor could it have done so explicitly, because Section 1028 was enacted before the Supreme Court authoritatively interpreted the FAA in *Concepcion* to permit such waivers. Thus, although the Bureau may generally promulgate regulations limiting arbitration in the consumer finance context, it can only do so if the Supreme Court has not already spoken on that subject—which, of course, it has done here. Limiting the scope of Section 1028 would be consistent with the Court’s statements in cases such as *Pittsburgh & Lake Erie Railroad Co. v. Railway Labor Executives’ Association* and in Justice Thomas’s dissent in *EEOC v. Waffle House, Inc.*, that federal statutes should be harmonized with one another unless they are in irreconcilable conflict—after all, Section 1028 did not purport to amend the FAA directly or to overrule judicial constructions of it. And the Bureau, as an executive agency (and a constitutionally suspect one, at that) cannot amend the FAA by implication or attempt to “interpret” the FAA through a rulemaking, as the Supreme Court has implied in cases like *Commissioner v. South Texas Lumber Co.* and *Ardestani v. INS*.

While Congress may, of course, carve out categories of disputes for which it believes arbitration is not appropriate, it is far less clear that it may delegate to the Bureau the authority to re-write portions of an arbitration agreement that have been expressly authorized by the Court in a way that would effectively overrule the

Court’s authoritative construction of the FAA in the context of consumer actions. Even if Congress could make such a delegation generally, it might be argued that the Bureau should receive no *Chevron* deference for promulgating regulations effectively overruling the FAA based on such an ambiguous statutory grant of authority.

Finally, while some might argue that Section 1028 of Dodd-Frank should be construed to limit the earlier-enacted FAA, the argument for implied repeal or implied narrowing is not so clear-cut. The FAA deals exclusively with arbitration agreements and repeatedly and consistently has been described as embodying a “liberal federal policy in favor of arbitration.” Dodd-Frank, by contrast, covers a variety of subjects relating to financial institutions and financial regulation, and never addresses—much less overturns or interferes with—the requirement that arbitration agreements be enforced according to their terms with few exceptions. That could make it difficult for parties opposing arbitration to show, as they must, that Congress intended to preclude the waiver of judicial remedies or that doing so is not in conflict with the purposes of the FAA.

## The Road Ahead

Once the Bureau’s proposals become final rules, they will be ripe for legal challenge. If and when one of these cases arrives at the Supreme Court, it is anyone’s guess how the Court’s new composition will affect the outcome. Some may believe that the loss of Justice Scalia, who authored *Concepcion* and *American Express*, might significantly impair the chances for any successful challenge to the Bureau’s regulations. But the Court’s strong view of the FAA has broad support among the Justices. Justice Breyer, for example, endorsed *Concepcion* in his recent opinion for the Court in *DirectTV, Inc. v. Imburgia*, which reaffirmed the primacy of the FAA. That opinion drew dissents only from Justices Ginsburg and Sotomayor, suggesting that the other members of the Court agree with the federal policy favoring arbitration.

In sum, given the Supreme Court’s ruling in *Concepcion*, it seems likely that class action waivers will continue to be upheld unless and until Congress carves out clear exceptions in particular subject areas. And the fate of the Bureau’s proposed rules may directly impact whether those exceptions continue to proliferate.