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REVIEW

THE CFPB ARBITRATION RULE

Andrew Palmer[†]

I. Introduction

This paper analyzes the recent enactment and subsequent rescission of the Arbitration Agreements Rule[1] (Arbitration Rule or Rule) promulgated by the Consumer Financial Protection Bureau (CFPB or Bureau), which bans the use of mandatory arbitration clauses in many types of financial contracts. Specifically, the paper will examine the life and death of the Rule through the lens of the types of cost-benefit analyses (CBA) undertaken by the Bureau in issuing the Rule. This analysis will consider the unique structure and administrative position of the CFPB, and use its authorizing legislation in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act[2] (Dodd-Frank or DFA) to compare and contrast its cost-benefit analysis procedures with that of other administrative agencies, particularly in the financial regulatory space. Beyond the narrow scope of the application to the Arbitration Rule—and its rescission—this analysis will necessarily touch on larger constitutional, procedural, and governance challenges to the existence structure of the CFPB, a major contributor to the ire over the Rule in question.

The paper proceeds as follows: Part II gives an introduction to the CFPB—including its operations, mission, and statutory authorization—and introduces CBA as a framework through which to analyze regulation; it also gives a brief literature review of CBA theory as well as its application to financial regulation (CBA/FR[3]), focusing on the application of CBA at the CFPB as well as other financial regulatory agencies. Part III gives an overview of consumer class action suits and the rise of mandatory arbitration—specifically the context of consumer financial products—and the scope of the authority the CFPB has been granted to regulate these forced

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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).

2 Formally, the statute is the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 The acronym "CBA/FR" to refer to cost-benefit analysis of financial regulation can be attributed to Coates (2014). *See* John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*. 124 YALE L.J. 882, 885 n.1 (2014).

arbitration agreements. Part IV examines in detail the Bureau's final Arbitration Rule, and chronicles the Rule's development, review, implementation, and subsequent recession. Part V explores the aftermath of the death of the Rule, including future developments related to the constitutionality of the CFPB itself.

II. An Overview of the CFPB

The CFPB was created by Title X of the 2010 Dodd-Frank Act and signed into law on July 21, 2010.[4] The purpose of the creation of this new agency was to "implement and . . . enforce federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that [these] markets . . . are fair, transparent, and competitive."[5] The overarching goal of the Bureau is consumer financial protection, which is best achieved through a scheme of stricter limits on financial products as well as associated disclosure requirements, a noted conclusion in the academic literature stemming from the asymmetries and failures inherent in markets for these household financial products.[6] The CFPB was designed to be a comprehensive regulatory authority in the consumer finance space, and as such, the CFPB's activities are wide-ranging, and can be roughly framed into five major categories: (1) Consumer Complaints and Engagement, (2) Partnerships, (3) Regulations & Guidance, (4) Supervision, and (5) Enforcement.

III. An Overview of the CFPB and Cost-Benefit Analysis

A. Cost-Benefit Analysis: Theory

Cost-benefit analysis is an analytical procedure in which the costs of a proposed action or policy are weighed against its benefits. Calculating or otherwise analyzing the costs and benefits of an action—typically an administrative regulation in the legal context—yields either a net cost or a net benefit, depending on which value is larger.[7] The most simplified use of CBA in this context would favor the implementation of the regulation if the net benefit—the benefit minus the cost—has a positive value and disfavor implementation if negative, relative to alternative options.[8]

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1001–1100H, 124 Stat. 1376 (2010).

[5] Dodd-Frank Act § 1021, 12 U.S.C. § 5511 (2010).

[6] *See, e.g.,* Elizabeth Warren, *Unsafe at Any* Rate, DEMOCRACY, Summer 2007, at 5; John Y. Campbell, Howell E. Jackson, Brigitte C. Madrian & Peter Tufano, *Consumer Financial Protection*, 25 J.OF ECON. PERSPECTIVES 91–114 (2011).

[7] *See generally* ANTHONY E. BOARDMAN, DAVID H. GREENBERG, AIDAN R. VINING & DAVID L. WEIMER, COST-BENEFIT ANALYSIS: CONCEPTS AND PRACTICE 3 (2017).

[8] The underlying reality behind the need for and use of CBA in the regulatory context is that for every government intervention through rulemakings, mandates, or other regulatory actions, there will be winners who benefit from the regulations more than they are burdened and "losers" who are burdened more than they benefit. This distributional effect is unavoidable, and CBA can be an ideal technique to evaluate the relative merits of the overall policy given the differing effects it will have on various parties.

Fundamentally, the process of evaluating a policy through the use of CBA acts as a framework for measuring efficiency—both overall efficiency and efficiency relative to a set of alternatives—such that "resources, such as land, labor, and capital, are deployed according to their highest value uses in terms of the goods and services they create."[9] The exact meaning of efficiency can be hard to evaluate. In economic theory terms, CBA and other valuation techniques seek to find Pareto efficiency, the allocation such that no other allocation can make any one better off without making another worse off. A Pareto efficient policy would only approve policies that "yield positive benefits after providing full compensation to all those who bear costs . . . so that there would be no losers, only winners."[10] While theoretically optimal, striving for Pareto efficiency in practice immediately leads to several roadblocks, including information burdens, high administrative costs, and distorted incentives, to name a few.[11] A more simplified version of the impossible-to-implement perfect Pareto efficiency can simply be thought of as a net benefits rule: only implement a policy with positive net benefits. This simpler rule also derives its prescriptions from a principle from economic theory—the Kaldor-Hicks criterion. Kaldor-Hicks prescribes a particular course of action "if and only if those who will gain could fully compensate those who will lose and still be better off."[12]

In reality, particularly in the administrative context, CBA evaluation is not so simple. The fundamental problem with applying CBA when considering regulations—on top of issues with attaining Pareto-efficient outcomes—is the difficulty in quantifying the costs and benefits for evaluation. By nature, a Pareto or Kaldor-Hicks-style analysis requires a quantification of all relevant costs, benefits, and feasible alternatives—Pareto efficiency requires the calculation of an optimal allocation relative to all others and Kaldor-Hicks requires full knowledge of the exact gains of winners in order to calculate compensation to the losers. In reality, this is rarely, if ever, possible—there are too many unknowns in the practical estimation of costs, benefits and alternatives for specific economic theory like Pareto or Kaldor-Hicks to be used as any more than a theoretical framework. Policymakers often overcome this technical limitation on CBA by resorting to a qualitative CBA, wherein non-monetary, intangible results—like human dignity, opportunity, and distributional equity—are considered and weighed, even though they cannot be precisely quantified.

B. Cost-Benefit Analysis: Application

1. Cost-Benefit Analysis at Federal Administrative Agencies

Mandated cost-benefit analysis of administrative regulations is a tool often used by Congress to impose more political accountability on administrative agencies that implement Congressional legislation. To this end, most federal regulatory agencies are governed by Executive Order 12866 and Circular A-4 of the Office of Management and Budget (OMB), which mandates they perform CBA.[13] These two directives, however, do not apply to

[9] BOARDMAN ET AL., *supra* note 7, at 27.
[10] *Id.* at 31.
[11] *See id.*
[12] *Id.* at 32.
[13] Executive Order 12866 mandates a review of "significant regulatory actions" by the Office of Information and Regulatory Affairs, while OMB Circular A-4 issues best practices to agencies conducting rulemaking.

independent regulatory agencies, which often are governed instead with a requirement to merely consider the costs and benefits of the regulation, with less explicit requirements for fully-explicated CBA if any at all.[14] While independent agencies are still encouraged to adopt CBA requirement, the data show they are less likely to perform CBA than an executive agency when rulemaking.[15] However, several recent court decisions, most notably *Business Roundtable v. SEC*,[16] have shifted this paradigm and imposed CBA-like procedures on independent financial regulatory agencies such as the SEC.[17] These developments have forced independent agencies, which include many financial regulators, to rethink and potentially revamp the current CBA analysis they undertake when proposing and implementing new rules and regulations. Regulators now have procedural hurdles coming from potentially three directions—statutory requirements of CBA, Executive Orders guiding CBA, and federal judicial review of the sufficiency of a CBA analysis.

2. Cost-Benefit Analysis of Financial Regulation

Cost-benefit analysis as performed by the CFPB falls under the umbrella of what is sometimes referred to as "CBA/FR"[18]—cost-benefit analysis of financial regulation. While CBA of regulation in many contexts—like public health, consumer product safety, or environmental regulation— focuses on the outcomes of regulations that induce firms to act, financial and economic regulation must also evaluate secondary effects, including "[b]ehavioral, microeconomic, and macroeconomic responses, [such as] businesses scaling down or closing, markets moving to less expensive alternatives, [or] prices changing."[19] This makes it much more difficult to quantify, since much of the response occurs indirectly through transfers, which CBA typically ignores. For CBA/FR to be effective, financial regulators should "pay more attention to

Specifically, OMB guidance in A-4 states that "a good regulatory analysis should include . . . (1) a statement of the need for the proposed action, (2) an examination of alternative approaches, and (3) an evaluation of the benefits and costs—quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis," which in turn require the agency to "explain how the actions required by the rule are linked to the expected benefits . . . . Identify a baseline [relative to] a clearly stated alternative, and identify the expected undesirable side-effects and ancillary benefits of the proposed regulatory action and the alternatives." DAVID W. PERKINS & MAEVE P. CAREY, CONG. RESEARCH SERV., R44813, COST-BENEFIT ANALYSIS AND FINANCIAL REGULATOR RULEMAKING 2 (2017).

[14] MAEVE P. CAREY, CONG. RESEARCH SERV., R41974, COST-BENEFIT AND OTHER ANALYSIS REQUIREMENTS IN THE RULEMAKING PROCESS 2 (2014).

[15] Specifically, as of 2014, "OMB data indicate that [executive] agencies have conducted a full CBA for only 132 of 255 major non-transfer rules since Fiscal Year (FY) 2002. . . [but] [o]ther agencies, such as independent regulatory agencies, are not subject to this OMB requirement but are strongly encouraged via executive order to comply with it. Despite this encouragement, OMB data indicate that such agencies conducted a full CBA on only nine of 143 major rules since FY 2002." BUSINESS ROUNDTABLE, USING COST-BENEFIT ANALYSIS TO CRAFT SMART REGULATION (2014).

[16] *See generally* Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011); Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005).

[17] The D.C. Circuit's finding in *Business Roundtable* that the SEC "arbitrarily and capriciously" failed to assess the economic effects of their rulemakings snatched away a great deal of autonomy for agencies to conduct CBA—so much so that some scholars have characterized the court's decision as "super hard look review." *See, e.g.* Emily Hammond Meazell, *Presidential Control, Expertise, and the Deference Dilemma*, 61 DUKE L.J. 1763, 1773 n.40 (2012).

[18] *See* Coates, *supra* note 3.

[19] John H. Cochrane, *Challenges for Cost-Benefit Analysis of Financial Regulation*, 43 J. LEGAL STUD. 63, 65 (2014).

the process question than just the result question,"[20] and instead focus on "how to structure the process by which regulators, regulated industries, and, somewhere, people or representatives of their interest, produce regulations, and how that inevitably political process can incorporate quantifiable, scientific evidence, so that something resembling the economists' optimal policy is more likely to result."[21]

Given the challenges of both identifying and quantifying costs and benefits in regulatory requirements in financial markets, the question becomes: is CBA/FR feasible or desirable at all? This question has prompted a debate in the academic literature, most prominently between John Coates, critiquing the use of CBA/FR in response to Eric Posner and E. Glen Weyl's promotion of CBA/FR.[22] Coates' major arguments against the strict use of CBA in financial regulation are: (1) the difficulty of quantifying many key values in financial regulation,[23] and (2) the procedural problems and unintended consequences of enshrining a CBA rule in the legal system rather than as a matter of policy.[24] Posner and Weyl posit several responses. To Coates' valuation problem, Posner and Weyl reject the assertion that valuation difficulties are due to the inherent nature of finance, not the lack of research on the subject.[25] They instead propose more research devoted to better CBA quantification, not abandonment of the practice altogether. While Posner and Weyl also disagree with Coates that finance is more artificial, non-stationary, or group-oriented and therefore fundamentally not suited for CBA the way other sectors and markets are, they do broadly agree that given financial regulators' little experience with CBA, judicial review is premature.[26] These tensions—quantitative versus conceptual CBA, CBA requirements at executive versus independent agencies, and the changing legal landscape of judicial review of CBA—all inform the CFPB's current and future use of CBA in its operations, discussed below.

3. Cost-Benefit Analysis at the CFPB

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[20] *Id.*

[21] *Id.*

[22] *See* Coates, *supra* note 3; *see also* John C. Coates IV, *Towards Better Cost-Benefit Analysis: An Essay on Regulatory Management*, 78 L. & CONTEMP. PROBS., no. 3 (2015); John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: A Reply*, 124 YALE L.J.F. 305 (2015).

[23] Coates notes that "[w]hile ranges, bounds, threshold analyses, and incomplete but relevant evidence may all be viewed as part of quantified CBA, they begin to move the final result of the CBA towards guesstimation, leaving it a matter of judgment whether and how they should influence decision-making," and, further complicating matters, OMB gives "little help in how to conduct threshold analyses if important benefits and costs are both unquantifiable." Valuations, especially abstract ones like the statistical cost of a crisis, externalities, and appropriate discount rates, are just too difficult to quantify with any precision to effectively estimate net benefits—and instead must be conceptualized. John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 895 (2015).

[24] Coates' second criticism, of enshrining CBA in the legal system, highlights the potential distorted effects of agency responses to court-ordered CBA. Throwing mandatory CBA to the realm of the courts and legal system inevitable emphasizes process over the actual mandate, which causes "less desirable effects . . . including delay, regulatory inertia, ill-informed judicial second-guessing, creation of incentives for agencies to engage in CBA for show, and waste of regulatory resources." *Id.* at 896.

[25] They argue that Coates "exaggerates the difficulty of determining valuations," especially given that since "financial markets generate a vast amount of data, and because most of the relevant valuations are monetary in nature, financial regulations are ideal for CBA--much more suitable than regulations of the environment and health and safety." Eric A. Posner., & E. Glen Weyl, *Cost-Benefit Analysis of Financial Regulations: A Response to Criticisms*, 124 YALE L.J.F. 246–47 (2014).

[26] *See Id*. at 261.

Statutorily, the CFPB is bound in Dodd-Frank by mandatory cost-benefit analysis of the rules it promulgates—that is, it must consider the costs and benefits to both consumers and companies to which their rules apply. This provision "expressly requires the consideration of costs and benefits of any proposed rules, and thus failure to conduct such a cost-benefit analysis would run afoul of the APA."[27] Specifically, Dodd-Frank Section 1022(b)(2) requires:

> (2) Standards for rulemaking: In prescribing a rule under the Federal consumer financial laws—
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> (A) the Bureau shall consider—
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> (i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule;
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> (ii) the impact of proposed rules on covered persons, as described in section 5516 of this title, and the impact on consumers in rural areas;
>
> (B) the Bureau shall consult with the appropriate prudential regulators or other Federal agencies prior to proposing a rule and during the comment process regarding consistency with prudential, market, or systemic objectives administered by such agencies[28]

In addition to formal CBA procedures, the CFPB is also constrained in its rulemaking by requirements that the Bureau reduce burdensome regulations, particularly for small businesses. Specifically, the Bureau is required to "identify and address 'unduly burdensome regulations,'[29] . . . consult with prudential regulators and state bank regulators in order to minimize the regulatory burden upon large banks or credit unions,[30] [and must] also assess each rule it issues within five years of implementation[31] . . . and seek public input on each analysis . . . to make sure the rules are effective and not overly burdensome."[32] With regards to small businesses, the CFPB "must thoroughly evaluate the potential impact of a rule on small businesses under the Regulatory Flexibility Act."[33] The CFPB is one of just a few agencies with increased duties to small business under §1100G of Dodd-Frank. This section, known as the Small Business Regulatory Enforcement Fairness Act, requires the CFPB to "give small businesses a preview of new proposals and receive extensive feedback from small businesses before even giving notice to the

[27] Dodd-Frank Act §1022(b)(2)(A)(i-ii), PAUL ROSE & CHRISTOPHER WALKER, U.S. CHAMBER OF COM. CTR. FOR CAP. MKTS. COMPETITIVENESS, THE IMPORTANCE OF COST-BENEFIT ANALYSIS IN FINANCIAL REGULATION 28 (2013), http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/CBA-Report-3.10.13.pdf, 28; Dodd-Frank Wall Street Reform and Consumer Protection Act § 1022(b)(2)(A), 12 U.S.C. § 5512(b)(2)(A) (2010) [hereinafter Dodd-Frank Act].

[28] Dodd-Frank Act § 1022(b)(2), 12 U.S.C §5512(b)(2) (2010).

[29] *See* Dodd-Frank Act § 1021(b)(3), 12 U.S.C. § 5511(b)(3) (2010).

[30] *See* Dodd-Frank Act § 1025(b)(2), 12 U.S.C. § 5515(b)(2) (2010).

[31] *See* Dodd-Frank Act § 1022(d)(2), 12 U.S.C. § 5512(d)(2) (2010).

[32] CONSUMER FED'N OF AM., ACCOUNTABILITY OF THE CONSUMER FIN. PROT. BUREAU, 3 (2011), https://consumerfed.org/pdfs/CFPB-Accountability-fact-sheet-6-11.pdf

[33] *Id.*

broader public," and the Bureau must "assess possible increases in the cost of credit for small entities and consider any significant alternatives that could minimize those costs."[34]

IV. Consumer Arbitration and the CFPB

This section focuses on one particular scope of CFPB jurisdiction and supervision, treatment of forced arbitration clauses in consumer financial product contracts. It will contain an overview of the issue, including the development of CFPB jurisdiction and rulemaking, and the criticism and ultimate rescission of the CFPB rules, with a particular emphasis on the role that cost-benefit style arguments played in advocating both for and against arbitration reform.

A. Consumer Class Action Suits and the Rise of Arbitration

Arbitration is "a non-judicial process for the settlement of disputes where an independent third party," acting in the role of a judge, makes a binding decision concerning a dispute between two parties that normally would be resolved in court.[35] Arbitration proceedings can be less formal than litigation and thus confer advantages such as tailored or expedited proceedings, arbitrator expertise and confidentiality, fewer costs and delays, limitations on appeals, and binding and enforceable decision-making.[36] While specifying arbitration as the requisite means of dispute resolution in a contract between two parties can be mutually beneficial due to the benefits described above, one party often has a significantly greater interest in closing off the option of litigation in favor of arbitration as the sole method of resolution. This mismatch of interests is typically seen in contracts between large corporations and their consumers or employees, and is known as "mandatory" or "forced" arbitration. Succinctly:

> In forced arbitration, a company requires a consumer or employee to submit any dispute that may arise to binding arbitration as a condition of employment or buying a product or service. The employee or consumer is required to waive their right to sue, to participate in a class action lawsuit, or to appeal. Forced arbitration is mandatory, the arbitrator's decision is binding, and the results are not public."[37]

Despite the benefits of arbitration described above, it can have significant disadvantages for consumers when imposed by large entities.[38] What's more, many mandatory arbitration

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[34] Dodd-Frank Act § 1100G, 5 U.S.C. §§ 603–04 (2010).

[35] *What is Arbitration?*, CHARTERED INSTITUTE OF ARBITRATORS, http://www.ciarb.org/dispute-appointment-service/arbitration/what-is-arbitration [https://web.archive.org/web/20181011035015/http://www.ciarb.org/dispute-appointment-service/arbitration/what-is-arbitration].

[36] *Id.*

[37] *Arbitration*, NATIONAL ASSOCIATION OF CONSUMER ARBITRATION, https://www.consumeradvocates.org/for-consumers/arbitration.

[38] Richard Alderman identifies four key ways in which arbitration can be bad for consumers: (1) pre-dispute arbitration is typically "imposed upon the consumer by a contract of adhesion in which the consumer has no real choice," (2) "arbitration often is not as prompt or as inexpensive as alternative courts, especially small claims courts," (3) "the informal rules, lack of guidelines, and finality of the decision often favor the business organization, due in large part to its significant role as a 'repeat-player,'" and (4) the "imposition of mandatory arbitration generally precludes the consumer's freedom to choose to litigate in a class action and eliminates any favorable

clauses are hidden away at the end of a long document, the back of a receipt, or the bottom of a webpage, leading many to unknowingly agree to waive their right to litigation[39] and leaving the company free to write the conditions as favorably to itself as it desires. Despite these disadvantages to consumers, arbitration has been increasingly welcomed by reviewing courts as a favored measure of dispute resolution.[40]

The lack of an option to litigate in a class action under mandatory arbitration poses a unique problem for individual consumers: how to recover in a negative value suit wherein the "expected value is negative because litigation costs outweigh the probable award."[41] If the consumer has no incentive to incur litigation costs individually given the likely size of the award, "corporations have the great[] incentive to write class action waivers into mandatory arbitration provisions."[42] Class action suits are fundamentally designed to overcome this negative value suit problem, since "small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights."[43] A class action suit fixes this distortion by "aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor."[44]

B. CFPB Authority over Arbitration Agreements

Dodd-Frank explicitly gave the CFPB authority to study and regulate the use of mandatory arbitration agreements in connection with the offering or providing of consumer

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precedent or law reform that could arise through litigation." Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1240–42 (2001).

[39] Caroline E. Mayer, *Hidden in Fine Print: 'You Can't Sue Us'*, WASHINGTON POST (May 22, 1999), https://www.washingtonpost.com/archive/politics/1999/05/22/hidden-in-fine-print-you-cant-sue-us/7493ebeb-99ed-4a7f-b291-4aba1de6f0cc/?utm_term=.37229bf74102.

[40] The rise of arbitration as a favored method of dispute resolution can be traced back to changing judicial attitudes in the late 20th century. The Supreme Court's view of commercial arbitration "changed dramatically beginning in the 1970s and 1980s." Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1637 (2005). While early cases centered on arbitration between two business entities, by the late 1980s the Court had extended the enforcement of arbitration to apply between businesses and their customers. Then, in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, the Court "enunciated, for the first time, the idea that federal policy *favors* arbitration of commercial disputes." *Id.* This caused a rapid shift in corporate attitudes toward arbitration; "[o]nce the Supreme Court began to issue decisions stating that commercial arbitration was 'favored' and that arbitration of employment claims could be permitted, businesses jumped on the opportunity to compel arbitration in contexts where they previously thought arbitration agreements would not be enforced." *Id.* at 1638. Most recently, the Supreme Court held that the Federal Arbitration Act pre-empted a California state law from barring the use of class action waivers in consumer arbitration agreements, a further boon for forced arbitration agreements. *See* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 352 (2011).

[41] David H. Webber, *Shareholder Litigation Without Class Actions and The "Semi-Circularity" Problem*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Dec. 23, 2014), https://corpgov.law.harvard.edu/2014/12/23/shareholder-litigation-without-class-actions-and-the-semi-circularity-problem/.

[42] J. Maria Glover, *Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements*, 59 VAND. L. REV. 1735, 1737 (2006).

[43] Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) (quoting Mace v. Van Ru Credit Corp., 109 F.3d 338, 344 (7th Cir. 1997)).

[44] *Id.*

financial products or services, since these mandatory arbitration agreements have become commonplace in the realm of consumer financial products and services. Specifically, Section 1028 of Dodd-Frank states that:

> (a) Study and report. The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.
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> (b) Further authority. The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).
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> (c) Limitation. The authority described in subsection (b) may not be construed to prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person after a dispute has arisen.[45]

Notably, despite the broad language of Section 1028, the CFPB has several explicit constraints in the way it may govern arbitration agreements. First, in creating any new rules, including for consumer arbitration, the CFPB is constrained by the rulemaking requirements that apply to all administrative agencies under the Administrative Procedure Act (APA)—most notably a notice-and-comment process.[46] Second, the language of the statute requires any regulations imposed be "in the public interest and for the protection of consumers."[47] Finally, the Bureau is bound by the standards of rulemaking in Section 1022(b)(2), including the requirement of a cost-benefit analysis when issuing new regulations.[48]

V. The CFPB's Arbitration Rule

A. The Arbitration Study

The CFPB conducted a study prior to its rulemaking on arbitration agreements, which

[45] 12 U.S.C. § 5518 (2010).

[46] Briefly, the Administrative Procedure Act "establishes a set of fundamental ground rules—a procedural template—according to which many particularized governmental decisions are made." Steven P. Croley, *The Administrative Procedure Act and Regulatory Reform: A Reconciliation*, 10 ADMIN. L.J. AM. U. 35, 35 (1996). The APA divides federal agency rulemaking into informal, or notice-and-comment, rulemaking and formal, or on-the-record, rulemaking. Formal rulemaking must be supported by "substantial evidence in the 'record'", while notice-and-comment rulemakings do not need to be supported by such evidence. Stephen F. Williams, *"Hybrid Rulemaking" under the Administrative Procedure Act: A Legal and Empirical Analysis*, 42 U. CHI. L. REV. 401, 401 (1975). *See also* 5 U.S.C. § 553(c) (1966); 5 U.S.C. § 556(d) (1976).

[47] 12 U.S.C. § 5518 (2010).

[48] 12 U.S.C. § 5512(b)(2)(A) (2010).

served as a comprehensive survey of the prevalence of these agreements across a variety of types of financial products and services.[49] Building on the findings from the literature on this issue,[50] the Bureau began working on developing a rule regulating arbitration agreements in consumer financial products in 2012 with a Request for Information seeking comments on the scope, methods, and data sources of the preliminary study, released in 2013.[51] The final report—known as the Arbitration Study[52]—was submitted to Congress in March 2015 pursuant to the statutory requirement in Dodd-Frank 1028(a).[53] The comprehensive, 728-page report attempted to draw out as much empirical analysis and data to inform the precise issue as possible to create a direct comparison of the costs and benefits of class action versus arbitration in consumer dispute outcomes.

The Study was purposefully "empirical, not evaluative" in nature.[54] The Study did gather and report some clear empirical data—both collected first-hand and summarized from other sources—that framed the scope of the issue in a way that could assist the quantitative efforts necessary for a cost-benefit analysis of the Rule. Key quantitative portions of the Study are listed below. Specifically, the Bureau:

- Analyzed ~850 consumer finance agreements to examine the prevalence of arbitration clauses and their terms.
- Reviewed ~1,800 consumer finance arbitration disputes filed over a period of three years and ~3,400 individual federal court lawsuits.
- Reviewed ~42,000 credit card cases filed in selected small claims court in 2012.
- Looked at ~420 consumer financial class action settlements in federal courts over a period of five years and ~1,100 state and federal public enforcement actions in the consumer finance area.
- Conducted a telephonic survey of ~1,000 consumers with credit cards concerning their knowledge and understanding of arbitration and other dispute resolution mechanisms.[55]

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[49] CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS, PURSUANT TO DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 1028(A) 5 (2015) [hereinafter ARBITRATION STUDY].

[50] *See, e.g.*, Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 L. & CONTEMP. PROBS. 55, 64 (2004); PUBLIC CITIZEN, FORCED ARBITRATION: UNFAIR AND EVERYWHERE 1 (Sept. 24, 2009), https://www.citizen.org/sites/default/files/unfairandeverywhere.pdf; Amy J. Schmitz, *Legislating in the Light: Considering Empirical Data in Crafting Arbitration Reforms*, 15 HARV. NEGOT. L. REV. 115, 145–46 (2010); Theodore Eisenberg, et. al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 883 table 2 (2008).

[51] ARBITRATION STUDY, *supra* note 49, at 8–9.

[52] *Id*.

[53] *Id*.

[54] *Id*. at 2.

[55] The CFPB's New Arbitration Clause Ban: How to Prepare Your Organization, Venable LLP, 17 (June 15, 2016). https://www.venable.com/files/Event/4ec13791-ba9a-4484-bfd9-644780a2d49e/Presentation/EventAttachment/5a8da694-6ef3-47a3-a7ec-cd0838e1606d/CFPBs_New_Arbitration_Clause_Ban_handouts-06-15-2016.pdf.

The interpretation of the summary data from the Study largely tracked the pre-existing fundamental tensions between consumer and corporate interests at play: "Consumer advocates generally see pre-dispute arbitration as unfairly restricting consumer rights and remedies. Industry representatives, by contrast, generally argue that pre-dispute arbitration represents a better, more cost-effective means of resolving disputes that serves consumers well."[56]

The findings of the Study set the stage for the final rulemaking governing mandatory arbitration clauses, given the extent that the Study found that mandatory arbitration was occurring in the types of consumer financial products over which the CFPB has jurisdiction. Specifically, Table 1 breaks down the incidence of arbitration clauses in various sectors of consumer financial products:[57]

TABLE 1: INCIDENCE OF ARBITRATION CLAUSES IN CONSUMER FINANCIAL SERVICES CONTRACTS, 2013–2014

	Arbitration clause		No arbitration clause	
	# of contracts	% of market	# of contracts	% of market
Credit cards[21]	67 (15.8%)	53.0%	356 (84.2%)	47.0%
Checking accounts[22]	7.7%	44.4%	92.3%	55.6%
Prepaid cards	48 (92.3%)	>82.9%	4 (7.7%)	<17.1%
Storefront payday loans	83.7%	98.5%	16.3%	1.5%
Private student loans	6 (85.7%)	n/a	1 (14.3%)	n/a
Mobile wireless	7 (87.5%)	99.9%	1 (12.5%)	0.1%

In addition to these results, the Study also investigated the wide range of outcomes of disputes relating to these agreements, including the frequency, procedures, outcomes, awards, associated costs, and other metrics associated with both litigation and arbitration. Overall, consumers "filed roughly 600 arbitration cases and 1,200 individual federal lawsuits on average each year in the markets studied."[58] Key findings from this survey are detailed below to the extent that these numbers were used in consideration with the formulation of the Final Arbitration Rule (Rule or Final Rule) or the CBA considerations thereof. Finally, the CFPB Study examined consumer knowledge and understanding of the dispute resolution mechanisms in their own products. The Bureau found that consumers do not consider arbitration agreements when shopping for financial products and that "[t]hree out of four consumers surveyed did not

[56] ARBITRATION STUDY, *supra* note 49, at 2.
[57] ARBITRATION STUDY, *supra* note 49, at 8.
[58] *Consumer Financial Protection Bureau Study Finds that Arbitration Agreements Limit Relief for Consumers*, CONSUMER FINANCIAL PROTECTION BUREAU, 2 (March 2015), , 2. https://files.consumerfinance.gov/f/201503_cfpb_factsheet_arbitration-study.pdf.

know if they were subject to an arbitration clause."[59]

B. The Final Arbitration Rule

The Bureau issued a proposed rule in May 2016,[60] and subsequently published the Final Rule on Arbitration Agreements in July 2017.[61] The Bureau justified the need for a rule after determining through the Arbitration Study that "pre-dispute arbitration agreements are being widely used to prevent consumers from seeking relief from legal violations on a class basis, and that consumers rarely file individual lawsuits or arbitration cases to obtain such relief."[62] The Final Rule has two key components:

> First, the final rule prohibits covered providers of certain consumer financial products and services from using an agreement with a consumer that provides for arbitration of any future dispute between the parties to bar the consumer from filing or participating in a class action concerning the covered consumer financial product or service. Second, the final rule requires covered providers that are involved in an arbitration pursuant to a pre-dispute arbitration agreement to submit specified arbitral records to the Bureau and also to submit specified court records.[63]

The Rule applies to "providers of certain consumer financial products and services in the core consumer financial markets of lending money, storing money, and moving or exchanging money," with exceptions.[64]

Regarding the statutory and procedural standards the Bureau was required to undertake in its rulemaking, the agency "interpret[ed] the public interest standard [from 1028(b)] to include consideration of 'benefits and costs to consumers and firms' [from 1022(b)(2)]."[65] This appears to reflect a certain view of the theory of cost-benefit analysis, discussed earlier in this paper, as necessarily in the public interest if the net benefits of a proposed action are found to be positive. The Bureau explicitly lists non-quantitative, intangible benefits as part of this calculation, including "consumers' 'freedom of contract' and their ability to determine whether or not to participate in class actions,"[66] as well as, in the face of disputed evidence and feedback on the relative quantitative benefits of arbitration versus class action, an "emphasi[s] [on] the non-

[59] *Id*. at 4.

[60] Arbitration Agreements, 81 Fed. Reg. 32,829 (proposed May 24, 2016) (to be codified at 12 C.F.R. pt. 1040).

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

[62] *Id.* at 33,210.

[63] *Id*.

[64] *Id*.

[65] *Id*. at 33,249. More specifically, "The Bureau interprets the phrase 'in the public interest' to condition any regulation under section 1028 on a finding that such regulation serves the public good based on an inquiry into the regulation's implications for the Bureau's purposes and objectives. This inquiry requires the Bureau to consider the benefits and costs to consumers and firms, including the more direct factors considered under the protection of consumers standard, and general or systemic concerns with respect to the functioning of markets for consumer financial products or services, as well as the impact of any changes in those markets on the broader economy and the promotion of the rule of law, in the form of accountability and transparent application of the law to providers." *Id*. at 33,251.

[66] *Id*. at 33,250.

monetary benefits of class actions."[67]

The CFPB explicitly noted the limitations of quantitative estimates of costs and benefits of the Rule in the face of the statutory requirement for CBA, "not[ing] that in some instances, the requisite data are not available or are quite limited. In particular, with the exception of estimating consumer recoveries from Federal class settlements, data with which to quantify the benefits of the final rule are especially limited."[68] Because of the limitations, the Bureau admitted that "portions of this analysis rely in part on general economic principles and the Bureau's experience and expertise in consumer financial markets to provide a qualitative discussion of the benefits, costs, and impacts of the final rule."[69] The Bureau then explicated the specific economic framework through which it based its CBA evaluation, particularly for costs and benefits it admitted were largely non-measurable.

The basis for the Final Rule is, in the words of the agency, based on the finding of a "market failure" that emerged from the market review conducted in the Study.[70] The Bureau provided the economic framework through which it considered the costs and benefits of the Rule, both to "more fully inform the rulemaking" and to describe the market failure identified.[71] The logic of this economic framework proceeds as follows: Congress passed laws governing consumer financial products to address a "range of market failures," and these laws need "enforcement mechanisms to ensure providers conform their behavior to these laws."[72] For the particular issue of consumer arbitration, the key market failure to emerge from the Study was "reduced incentives for providers to comply with the underlying laws," which stem from "an insufficient level of enforcement."[73] Since the incentives to comply are inefficient, "the economic costs of increased compliance are currently less than [their] economic benefits." The Final Rule, then, to the extent it increases compliance, is justified since it will yield the "economic benefits of this increased compliance."[74]

The key assumption made by the CFPB in this framework, which it openly admits is not ripe for analysis using available data, is that "the current level of compliance in consumer finance markets is generally sub-optimal."[75] This assumption is necessary to justify the increased costs—both compliance costs and opportunity costs—that firms will assume in complying with the Final Rule. In particular, this assumption is necessary due to the fact—admitted by the Bureau—that obtaining specific data to undergird this framework is not feasible.[76] The Bureau partially justified this lack of quantitative data on compliance costs by noting the large number of entities that would be covered by this Rule (50,000) and that none of the industry commentators

[67] *Id*. at 33,263.
[68] *Id*. at 33,391.
[69] *Id*.
[70] *Id*. at 33,391.
[71] *Id*.
[72] *Id*.
[73] *Id.*
[74] *Id.* at 33,392.
[75] *Id*.
[76] These costs identified by the Bureau include requirements to "distribute required disclosures or notices, investigate alleged errors . . . resolve disputes . . . forgo[] adjustments in interest rates, limit[] penalty fees . . . limit[] calling hours for debt collections . . . [and] establish[] a compliance management system." *Id*.

had themselves submitted an estimate for the costs of compliance.[77]

The Bureau identified the three effects the Final Rule will have to correct the noted market failure: a deterrent effect ("increased incentives to comply with the law in order to avoid exposure to class litigation"), an additional litigation effect ("additional class litigation exposure will ultimately result in additional litigation expenses and potentially additional class settlements"), and an administrative change effect ("a one-time cost of changing language in consumer contracts . . . or an ongoing cost associated with providing contract amendments or notices").[78] Two of these three effects—additional litigation and administrative change—are examined in depth in Section 1022(b)(2) of the Rule, which evaluates the costs and benefits as mandated statutorily. The Bureau used the Study to analyze these estimated costs and benefits to the extent quantification was available from the Study results.

C. CBA in the Final Arbitration Rule

With this framework described above, the Bureau analyzed specific costs and benefits to consumers and firms in a lengthy section of the Final Rule known as the 1022(b)(2) analysis, referring to the Dodd-Frank mandate to perform CBA in consumer financial rulemaking. In general, the analysis admitted that most, if not all, of the Rule's benefits will accrue to consumers, not providers of financial products, stating that:

> Given that providers using arbitration agreements have chosen to do so and will be limited in their ability to continue doing so by the final rule, these providers are unlikely to experience many notable benefits from the Bureau's final rule. Rather, the benefits of the final rule will flow largely to consumers.[79]

Through its use of a robust quantitative analysis from the Arbitration Study, the Bureau appears to implicitly adopt the Posner-Weyl view of CBA-FR that a good faith effort to conduct more empirical analysis and gather more data where it is lacking can improve the quality of a CBA evaluation, even if the desired estimate cannot be precisely identified.

1. Litigation and Settlement: Costs to Firms and Benefits to Consumers

a. Estimation and analysis of the additional litigation effect

The CBA analysis related to the effect of the Final Rule on litigation and settlement contained the most quantitative estimates of all the effects analyzed under the 1022(b)(2) standard. Overall, the Study examined 312 federal class settlement cases over a five-year period from 2008-2012,[80] and documented "about $2 billion in gross cash relief . . . about $1.09 billion in payments" and $338 million in attorney's fees.[81] This data included "relief provided to consumers and attorney's fees paid to attorneys for the consumers" but notably did not "contain

[77] *Id*. at 33,392.
[78] *Id*. at 33,395.
[79] *Id*. at 33,397.
[80] *Id*. at 33,399–401.
[81] *Id*. at 33,401. This included "both the amount defendants agreed to provide as cash relief (gross cash relief) and the amount that public court filings established a defendant actually paid or was unconditionally obligated to pay to class members because of either submitted claims, an automatic distribution requirement, or a pro rata distribution with a fixed total amount (payments)." *Id*.

data on the defense costs incurred by the providers because these data were not available to the Bureau." Adjustments made, then, to account for "defendant's attorney fees [were] based on plaintiff's attorney fees with appropriate adjustments."[82] Though 312 federal cases over five years is not a relatively robust sample, the Final Rule "did not attempt to monetize the costs of additional State class litigation filings and settlements because limitations on the systems to search and retrieve State court cases precluded the Bureau from developing sufficient data on the size or costs of State court class action settlements."[83] Notably, the language in the Final Rule outlining the dollar amounts—both costs and benefits—are reported at an aggregate level, not as an average payout or cost to an individual or firm, respectively. As discussed later, this way of reporting was criticized as obfuscating the relatively low individual settlement amount by instead choosing to report large-looking aggregate values.[84]

With these historical estimates in mind, the CFPB next turned to examine the projected changes after the implementation of the Rule. The Bureau estimated that "the final class rule will create class action exposure for about 53,000 entities," resulting in about 103 additional federal class settlements each year in federal court.[85] From those cases, the Bureau estimated that each year, "an additional $342 million will be paid out to consumers, an additional $66 million will be paid out to plaintiff's attorneys, and an additional $39 million will be spent by providers on their own attorney's fees and internal staff and management time."[86] The CFPB included alternative estimation of these total costs to industry firms, noting that several industry trade associations submitted comments in which they "asserted that accounting for State class actions could as much as double the total costs to providers from additional class action litigation, to $5.2 billion."[87] A final estimate, which is key to a robust view of the impact of the Rule, is the predicted number of cases "that will be filed as putative class actions but not result in a class settlement."[88] The Bureau estimated that "roughly 17 percent of cases that are filed as class litigations end up settling on a class-wide basis" for an estimated 501 additional suits per year settled on a non-class basis at an annual cost of $76 million.[89]

b. Is litigation preferable to arbitration with respect to consumer benefits?

Estimating the costs and benefits of the Rule as a result of increased litigation activity does not fundamentally justify the creation of the Rule itself. Even if a cost-benefit analysis finds net positive benefits of the proposed rule, there could be other alternatives that produce more desirable results. In this case, the important direct comparison to make to justify the effects of increased litigation is to show that it is more preferable to arbitration, which would be the standard recourse without the Rule in place. In theory, class action proceedings should provide a larger monetary benefit or other indirect benefit to the average consumer than arbitration proceedings to justify the Rule.

Direct comparisons, however, between data on litigation and arbitration costs and

[82] *Id*.
[83] *Id*.
[84] *See infra* note 99.
[85] Arbitration Agreements, *supra* note 61, at 33,403.
[86] *Id*.
[87] *Id*. at 33,406.
[88] *Id*. at 33,403.
[89] *Id*.

outcomes can be difficult to draw due to several layers of complexity.[90] The key assumption pushed by the Bureau—constituting the source of much of the pushback—is that data on average award values to individuals in litigation versus arbitration cannot and should not be compared, at least monetarily, without accounting for other confounding factors. The numbers in the Study, detailed below, should not be lifted out of the context in which they were reported—including their sample size, claim origins, and other unique factors—and put side by side as a defense or criticism of the effectiveness of litigation or arbitration.

The following stylized fact that emerged from the quantitative estimates in the Study fueled those pushing back against the Rule: When the CFPB settlement data is disaggregated, individuals received, on average, only $32 per person from the class action settlements studied but an average of nearly $5,000 from arbitration awards.[91] The Final Rule acknowledged this fact but stressed that behavioral relief (through court mandates) needs to be accounted for as well: "[T]he bulk of the critical comments [the CFPB] received on these preliminary findings concern the actual cash compensation to consumers in class action settlements and other related concerns commenters have about class actions, with far fewer commenters addressing behavioral relief despite its relative importance to the Bureau's preliminary findings."[92] Critics responded that companies "agreed to behavioral relief in only 13 percent of the class action settlements analyzed."[93]

In addition to behavioral relief as an unmeasured benefit of litigation, another key way the stylized facts of average awards are not directly comparable is in sample size and claim amounts. The scope of the Bureau's review was "hundreds of individual arbitrations versus millions of consumers receiving relief through class actions."[94] The sample size quickly dwindles for arbitral awards compared to the large federal class actions surveyed, weakening the explanatory power of a side-by-side comparison.[95] In addition, the claim amounts in arbitration actions are typically quite high relative to class action litigation—in part due to the number of cases involving misconduct claims surrounding debt relief and collection—which may also obscure the value of a direct comparison between the class action and arbitration awards figures.[96]

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[90] As the Bureau stated: "As with our arbitration data, outcome data for litigated disputes cannot be reduced to a simple 'win' or 'loss' tally broken out by case. Particularly on the class side, cases may involve numerous claims and several defendants, creating the potential for a multiplicity of by-party and by-claim outcomes for each case; we could not feasibly analyze how each separate legal claim was resolved as to each separate defendant for the number of cases in our set." ARBITRATION STUDY, *supra* note 49, at 33.

[91] Arbitration Agreements, *supra* note 61, at 33,263.

[92] *Id*.

[93] *Id*. at 33,264.

[94] *Id.* at 33,411.

[95] The Bureau summarized the "outcomes for the affirmative claims in all 668 disputes that involved consumer affirmative claims . . . as follows: Arbitrators provided some kind of relief to consumers on their affirmative claims in 32 of 158 disputes in which consumers brought claims and we could determine the amount of the award (20.3%). In these 32 disputes, the average and median grants of relief on consumers' affirmative claims were $5,389 and $2,682, respectively." ARBITRATION STUDY, *supra* note 49, at 41.

[96] "The average consumer affirmative claim amount in arbitration filings with affirmative consumer claims was around $27,000. The median was around $11,500. Across all six product markets, about 25 disputes a year involved affirmative consumer claims of $1,000 or less. The average disputed debt amount was nearly $16,000. The median was roughly $11,000. Across all six product markets, about eight cases a year involved disputed debts of $1,000 or less." *Id.* at 12.

Despite these nuances, reporting and opinion pieces in the mainstream press discussing the Rule frequently emphasized these two figures without the additional context provided by the Bureau in the Final Rule about why they might not be comparable. For example, a *USA Today* op-ed stated, "[a]ccording to the study, consumers who prevailed in arbitration got an average award of about $5,400, but the average class action settlement payment was a paltry $32," as the crux of their criticism of the Rule, further blasting plaintiffs' lawyers as the real winners since they "pocketed a staggering total of $424,495,451" in the study.[97] Other commentators pushed back. For example, the Economic Policy Institute in an article[98] noted that the direct comparison above was "enormously misleading" and cited several reasons why:

> While the average consumer who *wins* a claim in arbitration recovers $5,389, this is *not even close* to a typical consumer outcome. Why? Consumers obtain relief regarding their claims in only 9 percent of disputes. On the other hand, when *companies* make claims or counterclaims, arbitrators grant them relief 93 percent of the time—meaning they order the consumer to pay. If you consider both sides of this equation, *in arbitration, the average consumer is ordered to pay $7,725 to the bank or lender*.
>
> But let's consider the consumers who do win in arbitration. How do those numbers stack up against class action lawsuits? In an average year:
>
> - *At least* 6,800,000 consumers get cash relief in class actions—compared with just 16 consumers who receive cash relief in arbitration . . .
> - Consumers recover *at least* $440,000,000 in class actions, *after* deducting all attorneys' fees and court costs—compared with a *total* of $86,216 in arbitration.
>
> Banning consumer class actions lets financial institutions keep *hundreds of millions of dollars* that would otherwise go back to harmed consumers every year.[99]

Notice the rhetorical emphasis on different figures in order to draw out arguments that make litigation look better than arbitration and vice-versa. Opponents of the Rule highlight the comparison of the average award amounts, as well as the high aggregate amount of payments to plaintiff's lawyers. Proponents, on the other hand, emphasize the large number of consumers who can and do receive class action relief, as well as the high aggregate value of settlement payments made. The CFPB in the Final Rule made a similar explanation of the reasons why these two award figures should not be compared.[100]

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[97] Alan Kaplinsky & Mark Levin, *Consumer arbitration rule is a bust*, USA TODAY (July 23, 2017), https://www.usatoday.com/story/opinion/2017/07/23/consumer-arbitration-rule-good-for-class-action-lawyers-editorials-debates/103939426/.

[98] Heidi Shierholz, *Correcting the record: Consumers fare better under class actions than arbitration*, ECONOMIC POLICY INSTITUTE (Aug. 1, 2017), https://www.epi.org/publication/correcting-the-record-consumers-fare-better-under-class-actions-than-arbitration/.

[99] *Id*.

[100] The Bureau stated that it "finds that commenters' comparison between the average payment to consumers in a class action (around $32) to the average individual consumer award in arbitration (around $5,000) is not apt. Many commenters have made this comparison to contend that consumers fare better in individual arbitration than in class litigation and, by extension, that class actions do not provide significant relief to consumers. This is an apples-to-

2. Compliance: Costs to Firms and Consumers and Benefits to Consumers

The second major quantifiable effect of the Final Rule is the effect of the changes in pre-dispute activity among firms, largely related to compliance activity, disclosure statements, and behavioral changes. This effect is somewhat less quantifiable than the additional litigation effect described above, but the Final Rule still outlines the costs and benefits of compliance. Each is discussed below, with an exception for benefits to firms, which the Bureau admits in its economic framework will be minimal.

a. Costs to Firms

The Bureau identified three ways in which costs to firms of compliance with the Rule will manifest:

> [F]irst, the Bureau believes that some providers rely exclusively on third-party contract forms providers with which they already have a relationship, and for these providers the cost of making the required changes to their contracts is negligible. . . . Second, there may be providers that perform an annual review of the contracts they use with consumers."[101]

In aggregate, "the final rule's required contractual change will result in a one-time cost of $19 million, or about $4 million per year total for all providers if amortized over five years."[102] Finally "in addition to the one-time change described directly above, some providers could be affected on an ongoing or sporadic basis in the future as they acquire existing contracts as the result of regular or occasional activity, such as a merger."[103] Like other portions of the analysis that were not backed by full monetary estimates, the Bureau noted that commentators were encouraged to submit their own estimates of additional compliance costs, but did not do so.[104]

b. Benefits to Consumers

The Final Rule struggles to quantify consumer benefits with respect to compliance in the same robust way it did for additional litigation, stating that "the Bureau is unable to quantify and monetize the extent of the consumer benefit that would result from this investment or particular subcategories of investment, such as improving disclosures, improving compliance management systems, expanding staff training, or other specific activities."[105] "A full catalog of how all laws applicable to affected products benefit consumers when they are followed is far beyond the scope of this analysis."[106] Despite this lack of quantifiable benefit, the Rule still lays out the economic theory of how benefits will accrue. In addition to settlement payments, consumers will benefit

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oranges comparison. As discussed above, there is not much money at stake in the typical claim of a putative member of a class action, and thus there is little incentive for an individual to devote time and money to litigating the claim. In contrast, the Study found the average claim amount demanded in an arbitration to be $29,308, and the median to be $17,008. No commenters adduced evidence suggesting that the amounts at stake in most consumer class actions are even approaching this magnitude on a per consumer basis. Thus, arbitration claims are not the same magnitude as claims that are brought in class actions. Not surprisingly, the Study found that individual arbitration filings for amounts less than $1,000 were quite rare—only 25 per year." Arbitration Agreements, *supra* note 61, at 33,266.

[101] Arbitration Agreements, *supra* note 61, at 33,406.

[102] *Id.* at 33,407.

[103] *Id*.

[104] *Id.* at 33,397.

[105] *Id.* at 33,410.

[106] *Id.*

(1) from "the class rule to the extent that providers will have a larger incentive to comply with the law," (2) "from any new compliance with the law consumers experience as a result of injunctive relief in a settlement or as a result of changes in practices that a provider adopts in the wake of the settlement to avoid future litigation," and (3) "from the monitoring rule to the extent that the rule provides transparency into the arbitration process."[107] The Bureau noted that it felt this description was sufficient for the analysis particularly because it explicitly "requested comment on any representative data sources that could assist the Bureau in both of these quantifications, but did not receive any responses.[108]

c. Costs to Consumers

The costs the Final Rule will place on consumers come from the pass-through from firms of higher prices and credit costs described above. The Bureau acknowledges that "most providers will pass through at least portions of some of the costs described above to consumers,"[109] and admits that "[e]conomic theory does not provide useful guidance about what the magnitude of the pass-through of marginal cost is likely to be with regard to the final rule."[110] The Bureau cited academic research that tried to quantify these pass-through costs, and found some evidence that "[t]he available pass-through estimates for the consumer financial products or services are largely for credit cards, where older literature found pass-through rates of close to 0 percent."[111] In addition to this literature review the Arbitration Study "analyzed the effect on prices of several large credit card issuers agreeing to drop their arbitration agreements for a period of time as part of a class settlement," but "did not find a statistically significant effect on the prices that these issuers charged subsequent to the contract changes, relative to other large issuers that did not have to drop their arbitration agreements."[112] This conclusion that there is not likely to be significant cost-of-credit increases to consumers due to additional compliance costs on firms became a focal point of contention. Critics—particularly the Treasury Department's critical response to the Final Rule, but also industry responses in the press—disputed this conclusion and used their counterclaim of increased pass-through costs as a reason to oppose the Final Rule.[113]

3. Alternatives

Finally, the Bureau included a robust discussion of another key component of CBA, evaluation of potential alternatives. A combination of internal discussions and explicit

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[107] *Id*.

[108] *Id*.

[109] *Id.* at 33,408.

[110] *Id.* at 33,409. Specifically, "[t]he extent to which these marginal costs are likely to be passed through to consumers cannot be reliably predicted, especially given the multiple markets affected. Empirical studies are mostly unavailable for the markets covered. Empirical studies for other products, mainly consumer package goods and commodities, do not produce a single estimate." *Id*.

[111] *Id.* (citing Lawrence Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50 (1991); *but see* Todd Zywicki, *The Economics of Credit Cards*, (Geo. Mason Sch. of L., Working Paper No. 00-22, 2000); Daniel Grodzicki, Competition and Customer Acquisition in the U.S. Credit Card Market, (Working Paper, 2015) available at https://editorialexpress.com/cgibin/conference/download.cgi?db_name=IIOC2015&paper_id=308).

[112] *Id.*

[113] *See* U.S. Dep't of the Treasury, LIMITING CONSUMER CHOICE, EXPANDING COSTLY LITIGATION: AN ANALYSIS OF THE CFPB ARBITRATION RULE, (October 23, 2017) [hereinafter *Treasury Report*], https://www.treasury.gov/press-center/press-releases/Documents/10-23-17%20Analysis%20of%20CFPB%20arbitration%20rule.pdf.

alternatives advocated for by commenters, the Bureau:

> [C]onsidered four general classes of potential alternatives to the proposed class rule: (1) measures to increase consumer choice with respect to entering into arbitration agreements; (2) measures to improve consumers' access to and the conduct of individual arbitrations; (3) an exemption from the proposed class rule for potentially actionable conduct that providers report to regulators; and (4) an exemption from the rule for small businesses.[114]

The Rule spends considerable time detailing why none of these alternatives are, in the CFPB's view, superior to the adopted rule, and thus were not implemented.

D. Response to the Final Rule

The Final Rule, once issued, received considerable pushback, both from industry and the nascent Trump administration, under which a rule like this almost certainly would not have been commissioned. With the exception of larger-scope critiques of the CFPB in terms of its constitutionality and perceived regulatory overreach, discussed at the beginning of this paper, most of the criticism focused on the relative merits, or lack thereof, of the purported costs and benefits to consumers. Much of this debate, especially between the CFPB and Trump administration agencies like Treasury and Office of the Comptroller of the Currency (OCC), centered on interpretation of key data and empirical analyses.[115]

In general, the major theme of the push-and-pull tension over how to interpret the result of the Study as applied in the Final Rule come down to the applicability and relevance—or lack thereof—of individual data points and metrics. Both sides, the Bureau and its critical commentators, agree that there is no feasible way to design a quantitative study that would effectively answer the two questions necessary to perfectly assess the Rule—(1) what are the exact costs and benefits to both consumers and producers of the Rule, and (2) how do consumers directly fare, outcome-wise, between a class action settlement and an arbitral award.

1. Criticism by the Office of the Comptroller of the Currency

The CFPB, in its Arbitration Study, referred to and relied on, a paper that suggested that there would be no increase in the cost of credit to consumers under arbitration reform.[116] But the OCC in September 2017 issued its own report that analyzed the same dataset and concluded the opposite, finding a "strong probability of a significant increase in the cost of credit cards as a result of eliminating mandatory arbitration clauses."[117] In particular, it found an 88% chance that

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[114] *Id.* at 33,413.

[115] Coverage in the mainstream press, however, tended toward a more political and philosophical critique of the Rule, rather than a full refutation of the data and underlying assumptions. *See, e.g.*, Norbert Michel, *The Senate Just Voted to Protect Banks. But It's Actually a Win for You.*, FORTUNE (Oct. 26, 2017), http://fortune.com/2017/10/26/senate-vote-on-arbitration-rule/.

[116] Arbitration Agreements, *supra* note 61, at 33,409 (citing Alexei Alexandrov, *Making Firms Liable for Consumers' Mistaken Beliefs: Theoretical Model and Empirical Applications to the U.S. Mortgage and Credit Card Markets* (Working Paper, June 27, 2017), available at http://dx.doi.org/10.2139/ssrn.2599424).

[117] OFFICE OF THE COMPTROLLER OF THE CURRENCY, PROBABLE COST TO CONSUMERS RESULTING FROM THE CONSUMER FINANCE PROTECTION BUREAU'S FINAL RULE ON ARBITRATION AGREEMENTS (2017).

the total cost of credit will increase and a 56% chance that costs will increase by 3% or more.[118] The CFPB pushed back on this criticism, claiming that it was the OCC that misinterpreted the data in their own empirical analysis. In a letter to Senate Banking Committee member Senator Sherrod Brown, CFPB director Cordray stated that:

> The OCC review simply misunderstood a basic fact of how probability works. . . . By committing this error in statistical analysis, the OCC review reached a conclusion that is not supported by the available empirical evidence. . . . A change in the cost of credit on the order of 3.43 percentage points is implausible, both as a matter of statistics and as a matter of economics.[119]

The Bureau further criticized the OCC for not raising these concerns during the multi-year consultation and comment review period, when it could (and should) have done so.[120] This hints at the reality that the OCC, an executive agency, was controlled by the CFPB-friendly Democratic party during this consultation period, and the new criticism from OCC appears to be a result of an change in administration.

2. Criticism by the Treasury Department

A similar report criticizing the Rule, issued by the Treasury Department in October 2017 also attacked the data used by the CFPB, though it opted to dispute the interpretation of the data itself—taking the numbers at face value—rather than dispute the veracity of the analysis like OCC did.[121] Treasury claimed that:

> The rule will generate more than 3,000 additional federal court class actions over the next five years which will cause affected businesses to incur more than $500 million in additional legal defense fees, $330 million in payments to plaintiff's lawyers and $1.7 billion in additional settlements. This excludes the cost of additional state court class actions, which the CFPB was unable to calculate but which we have estimated as adding another $2.6 billion to industry defense costs.[122]

Other external organizations offered their own interpretations supporting the CFPB's numbers and pushing back against the OCC and Treasury criticisms.[123] Importantly, it appears that this public discussion is the ideal way of resolving regulatory disagreements in the context of CBA—both sides of the Arbitration Rule debate are agreeing to use quantifiable data on the problem, and are largely in agreement about the accuracy of the data. The dispute comes instead over both the interpretation of the data as well as the assumptions made when translating the empirical findings into a conclusion of a net benefit to consumers.

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[118] *Id.*

[119] Kate Berry, *CFPB fires back at OCC's criticism of arbitration rule*, AMERICAN BANKER (Oct. 13, 2017), https://www.americanbanker.com/news/cfpb-fires-back-at-occs-criticism-of-arbitration-rule.

[120] Consumer Financial Protection Bureau, Memorandum for the Director re: Letter from the Acting Comptroller (July 12, 2017), https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2017/07/July-12-Briefing-Memo-for-Director-Cordray.pdf

[121] *See Treasury Report*, *supra* note **Error! Bookmark not defined.**, at 1–2.

[122] Alan S. Kaplinsky & Mark J. Levin, *Treasury Department Report Eviscerates CFPB Arbitration Rule*, CONSUMER FIN. MONITOR (Oct. 27, 2017), https://www.consumerfinancemonitor.com/2017/10/23/treasury-department-report-eviscerates-cfpb-arbitration-rule/.

[123] *See, e.g.*, Shierholz, *supra* note 98.

Interestingly, the Treasury report also included a process criticism, arguing that the CFPB engaged in inadequate CBA when formulating the Final Rule. Specifically, Treasury concluded that since the Rule "fail[ed] to consider the substantial costs of class action litigation and substantial benefits of arbitration . . . the Rule falls short of both the statutory command to weigh regulatory costs and benefits and established best practices for administrative rulemaking."[124] The report gives several reasons for this accusation, largely criticisms of what it perceives as gaps in the CFPB's analysis due to lack of data or consideration of a counterpoint, but most notably, it charges that "the Bureau's efforts to assess the costs and benefits of the Rule fall well short of agency efforts undertaken for similar rules."[125] In short, the Treasury is satisfied with the individual amount of information and data the CFPB has, but wants the Bureau to aggregate it further, positing that:

> Developing credible estimated costs could be feasible in this case. Given the large volumes of information already collected and analyzed in the Study—not to mention the large consumer complaint database it maintains—the Bureau may already possess much of the data needed to generate aggregate costs and benefit estimates. Deriving the marginal costs of incremental adjustments to the proposed rule could build upon the aggregate estimates.[126]

It remains difficult, however, to fully evaluate these charges at face value, particularly from a report that spends just a few pages leveling process and interpretation claims at a rule and a study which are each several hundred pages long.

3. How Did the Bureau Perform, Overall?

Taking a birds-eye view of the Arbitration Study, the Final Rule, and the CBA analyses included in each, how did the Bureau perform, overall, in accomplishing its goals while staying consistent with CBA best practices? One key theme throughout the Final Rule and Study is how thorough the Bureau was at being honest about where there were data limitations and what assumptions undergird the conclusions that do not stem directly from the data. Both the Study and the Final Rule, clocking in at over 700 pages each, were extremely comprehensive and included a mix of original research, academic literature review, economic theory, and use of detailed statistics from the robust analyses. This commitment to empirical and theoretical justification for the Rule, as well as detailed estimates of its effect, are examples of CBA at its best, even when many estimates are not quantifiable.

The other side of the coin with regards to this thorough analysis is the way that key findings can be misinterpreted or taken out of context in such a large analysis. Criticisms of the Final Rule—with the exception of the OCC credit cost pass-through dispute—largely relied on numbers from the Study itself, and only disagreed on how to interpret them or compare them to each other. To the extent these critiques were in good faith, the Bureau would have done well to anticipate these mis-interpretations that missed some nuance in the Study. They could have, for example, released a type of fact sheet like the one that accompanied the Arbitration Study, which briefly explained the key findings that were likely to be contentious, like the average payouts of arbitration and litigation, and the pass-through costs to consumers. Burying explanations and

[124] *Treasury Report*, *supra* note **Error! Bookmark not defined.**, at 11.
[125] *Id.* at 16.
[126] *Id.*

caveats deep within the Rule makes it difficult to succinctly counterpunch against pushback that relies on out-of-context data.

E. The Death of the Arbitration Rule: Repeal

Following the public criticism of the Rule, in July 2017 the House passed a joint resolution of disapproval, 231-190, and subsequently on October 25, 2017, the Senate voted to repeal the Rule by a vote of 51-50.[127] These actions used a provision of the Congressional Review Act giving Congress a limited time window to rescind an administrative rulemaking by passing a resolution of disapproval by a simple majority vote within a specified time period following the Rule's receipt by Congress.[128] The White House applauded the action,[129] and on November 1, 2017, President Trump signed H.J. Res. 111, the Joint Congressional Review Act resolution passed by formally disapproving the CFPB's Arbitration Rule.[130]

The administration called the rescission of the Rule "a victory for consumers and small and midsize banks across the country" that "stops a rule that likely would have significantly increased the cost of credit for hardworking Americans and taken away a valuable tool for resolving differences . . . preserv[ing] a choice for consumers who can choose among financial providers that offer services with arbitration clauses and those that do not."[131] The administration further claimed that the Rule would have "harmed consumers [since] it provided no benefit in deterring bank misbehavior or preventing customer abuse."[132]

VI. Conclusion

The CFPB's Arbitration Study and Final Rule regarding new limitations on mandatory arbitration agreements precluding class action litigation provide a thorough example of how a cost-benefit statutory mandate (in this case, § 1022(b)(2) from Dodd-Frank) is thoroughly and carefully implemented when estimating both the justifications for a regulation as well as the predicted impacts of its implementation. Though this particular rule never went into effect, future financial regulators would do well to emulate the careful CBA analysis done in this case.

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[127] Zachary Warmbrodt, *Pence breaks tie in Senate vote to ax arbitration rule*, POLITICO (Oct. 24, 2017), https://www.politico.com/story/2017/10/24/consumer-protection-arbitration-senate-pence-244140.

[128] *Id*.

[129] BALLARD SPAHR LLP, *Congress Overrules CFPB Arbitration Rule*, CONSUMER FINANCE MONITOR (Oct. 25, 2017), https://www.ballardspahr.com/alertspublications/legalalerts/2017-10-25-congress-overrides-cfpb-arbitration-rule.aspx.

[130] BALLARD SPAHR LLP, *Now that the CFPB arbitration rule is dead, how should the industry* react? (Nov. 29, 2017), https://www.ballardspahr.com/eventsnews/events/2017-11-29-now-that-the-cfpb-arbitration-rule-is-dead-how-should-the-industry-react.aspx.

[131] Office of the Comptroller of the Currency, *Acting Comptroller of the Currency Issues Statement following the President's Signature Overturning the Consumer Financial Protection Bureau's Rule on Arbitration Agreements*, (Nov. 1, 2017), https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-occ-2017-132.html.

[132] *Id.*