U.S. CHAMBER OF COMMERCE

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July 20, 2015

The Honorable Phyllis Borzi
Assistant Secretary
Employee Benefits Security
Administration
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Office of Regulations and Interpretations
Employee Benefits Security
Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Office of Exemption Determinations
Employee Benefits Security Administration
(Attention: D-11713)
U.S. Department of Labor
200 Constitution Avenue NW
Suite 400
Washington, DC 20001

Re: Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25)

Dear Assistant Secretary Borzi:

This letter is submitted on behalf of the U.S. Chamber of Commerce and the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce (the "Chamber") is the world's largest business federation, representing the interests of more than three million companies of every size, sector, and region. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, faster, and fair for all participants. Collectively, the Chamber and the ILR will be referred to as the "Chamber."

The Chamber appreciates the opportunity to comment on the U.S. Department of Labor's (the "Department" or "DOL") proposed Best Interest Contract Exemption (the "BICE Proposal") issued by the Department and published in the

Federal Register on April 20, 2015.[1] The Chamber has actively followed the Department's efforts to promulgate a proposed regulation redefining who is a "fiduciary" of an employee benefit plan under the Employee Retirement Income Security Act of 1974 ("ERISA"), or of an individual retirement account under the Internal Revenue Code ("the Code"), as a result of giving investment advice to a plan or its participants or beneficiaries. Fiduciaries generally are prohibited from receiving payments from third parties in connection with their fiduciary activities; the BICE Proposal would create an exemption from that prohibition in certain specified circumstances for some individuals who would be encompassed within the proposed expanded definition of "fiduciary," such as broker-dealers, insurance agents, and others who provide investment advice.

In this submission, we address two aspects of the BICE Proposal.[2]

First, the Proposal would unlawfully create a private right of action, a step that, under long-settled legal principles, is reserved to Congress and beyond the authority of an administrative agency. The Proposal quite deliberately does not follow the approach previously used by DOL and the Internal Revenue Service in creating exemptions from fiduciary obligations, prescribing by regulation the requirements that must be met in order to qualify for the exemption. Rather, the Proposal requires – as "the cornerstone of the proposed exemption" – a contract incorporating a variety of representations and warranties, and makes clear that the purpose of the contract requirement is to provide the Retirement Investor "with a basis on which [the contractual] rights can be enforced."[3]

The Department has no authority whatsoever to create private causes of action not authorized by Congress, but that is precisely what the Proposal would do. Indeed, in an effort to promote national uniformity, Congress expressly preempted state-law causes of action to enforce ERISA's prohibited transaction rules and provided no

[1] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (Apr. 20, 2015).
[2] The Chamber and the U.S. Chamber Center for Capital Markets Competitiveness have submitted comments addressing other aspects of the BICE Proposal as well as the related proposed rule amending the definition of a "fiduciary."
[3] 80 Fed. Reg. at 21969.

mechanism for private enforcement of the Code's prohibited transaction rules.[4] The Department has no power to override Congress's determinations.

Requiring a contract in order to create private causes of action is also bad policy that will harm investors. The numerous contractual elements required by the BICE Proposal are so onerous and practically unworkable that they will force broker dealers, insurance agents, and other advisors to abandon the commission model that has been the norm in the industry for decades and instead charge investors for retirement advice and counseling, which will impose greater costs on investors particularly small investors. For those that utilize the contract approach, the unjustified class action lawsuits that will be the inevitable consequence will impose new costs that will be borne by investors through larger commissions and other charges. Those investors who cannot afford these costs will lose access to quality investment advice.

For all of these reasons, the requirement of a "contract [that] creates actionable obligations"[5] must be eliminated.

Second, the Proposal indicates that a contract between a Financial Institution or Advisor and a Retirement Investor may include "a pre-dispute binding arbitration agreement with respect to individual contract claims," but that the exemption would not apply if the contract with the Retirement Investor includes a provision "under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a contract dispute with the Adviser or Financial Institution."[6] That proviso plainly exceeds the Department's authority.

Numerous courts have held that the Federal Arbitration Act[7] bars the National Labor Relations Board from invalidating as an unfair labor practice an arbitration provision containing a waiver of class proceedings, and the same settled legal

[4] *See* pages 7-8 below.
[5] 80 Fed. Reg. at 21969.
[6] *Id.* at 21973, 21985.
[7] 9 U.S.C. §§ 1-16.

principles preclude DOL from barring arbitration agreements with class waivers here.[8] Moreover, the practical consequence of a ban on arbitration provisions with class waivers will be to deter the inclusion of arbitration provisions in contracts, which will harm investors – because they will lose access to a cheaper, quicker, and just as fair method of resolving disputes.

I. The Department Lacks Authority To Structure The Regulation To Create Private Causes Of Action.

The proposal rests on two statutory provisions initially enacted at the same time as parts of one statute reforming federal law governing employee benefits and retirement savings vehicles.[9] These provisions – in ERISA and in the Code[10] – prohibit fiduciaries from engaging in certain prohibited transactions with "parties who may be in a position to exercise improper influence over plan assets, and to prevent plan fiduciaries from taking actions with respect to a plan which involve self-dealing and conflicts of interest."[11] Each provision also permits the DOL to exempt administratively certain transactions and categories of transactions that would otherwise be prohibited by statute.[12]

Every prior exemption created by DOL pursuant to the authority granted in ERISA has been framed in the traditional manner: a regulation sets forth the substantive requirements for eligibility. If the prescribed requirements are satisfied, the exemption applies.[13] If someone claims the exemption but fails to satisfy its prerequisites, DOL can seek to assess civil penalties pursuant to its statutory

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[8] *See* pages 14-15 below.
[9] Employment Retirement Income Security Act of 1974 ("ERISA"), Pub. L. No. 93-406 §§ 408, 2003(a).
[10] *See* 29 U.S.C. § 408(a); 26 U.S.C. § 4975(c)(1).
[11] *Exemption Procedures under Federal Pension Law*, U.S. Department of Labor, http://www.dol.gov/ebsa/publications/exemption_procedures.html (visited July 16, 2015).
[12] *See* 29 U.S.C. § 408(b); 26 U.S.C. § 4975(c)(2). The President transferred from the Secretary of the Treasury to the Secretary of Labor the authority to issue exemptions under Code section 4975. *See* Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 672 (2006).
[13] *See generally Proposed and Granted Class Exemptions*, U.S. Department of Labor, http:// www.dol.gov/ebsa/Regs/ClassExemptions/main.html (visited July 16, 2015).

authority[14] and, to the extent the private causes of action created by ERISA provide a remedy, an injured private party may invoke them.[15]

Every prior exemption created under the authority granted in the Internal Revenue Code has been framed in the same way, through a regulation specifying the substantive requirements.[16] The Internal Revenue Service has the sole authority to enforce failure to satisfy the requirements for an exemption – by requiring the payment of the excise tax penalties specified in the statutory provision.[17] Private parties have no right to recover damages resulting from harm caused by a failure to comply with the Internal Revenue Code provision or regulations promulgated thereunder, because Congress did not create a private cause of action.[18]

The BICE Proposal differs fundamentally from all of these previously-created exemptions. Some of the requirements for claiming the exemption are set forth in the same manner as previous exemptions. Thus, the eligible transactions are specified in Section I(b); transactions excluded from the exemption are specified in Section I(c); disclosures regarding total cost must be made to the investor, as set forth in Section III; the range of investment options that must be made available is specified in Section IV; and certain recordkeeping and related obligations are set forth in Section V.

Other requirements, however, are specified very differently – as terms that must be included in a contract with the investor. For example:

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[14] *See, e.g.,* 29 U.S.C. § 1132(i).
[15] *See, e.g., id.* § 1132(3).
[16] *See Proposed and Granted Class Exemptions*, note 13 above.
[17] *See* 26 U.S.C. § 4975(a)-(b).
[18] *See* 26 U.S.C. § 7801(a) (providing that "the administration and enforcement of" the Internal Revenue Code "shall be performed by or under the supervision of the Secretary of the Treasury"); *see also Reklau v. Merchants Nat'l Corp.*, 808 F.2d 628 (7th Cir. 1986), *cert. denied*, 481 U.S. 1049 (1987) (Section 401 of the Internal Revenue Code does not create substantive rights under ERISA that can be enforced in a private cause of action); *Keane v. Baker*, 187 WL 8052, at *2 (W.D.N.Y. Mar. 6, 1987) (finding lack of prudential standing to enforce the tax laws, because "the government's business of administering and enforcing the tax laws has been delegated by the Congress to . . . the Secretary of the Treasury").

- Rather than simply providing that the Adviser and Financial Institutions are "fiduciaries," the proposal says that "[t]he written contract [must] affirmatively state[] that the Adviser and Financial Institution are fiduciaries under ERISA or the Code, or both, with respect to any investment recommendations";[19]

- Rather than providing that investment advice provided must meet "Impartial Conduct Standards," such as a "Best Interest of the Retirement Investor" standard, the proposal *requires the contract to state* that the advice will satisfy those standards;[20]

- Rather than simply requiring the Financial Institution to adopt policies and procedures to mitigate conflicts of interest, *the contract must include an affirmative warranty* that the Institution "has adopted written policies and procedures reasonably designed to mitigate the impact of Material Conflicts of Interest and ensure that its individual Advisors adhere to the Impartial Conduct Standards";[21]

- Rather than simply barring the use of "quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor," the contract must include an affirmative warranty that these practices are not used.[22]

The Proposal leaves no doubt regarding the reason for this unique and peculiar approach: the contract is the "cornerstone of the proposed exemption" because it creates "actionable obligations." DOL is using the contract as a mechanism to create a private right of action.[23] Indeed, the Proposal explains in detail how, in DOL's view,

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[19] Section II(b); *see* 80 Fed. Reg. at 21984.
[20] Section II(c); *see* 80 Fed. Reg. at 21984.
[21] Section II(d)(2); *see* 80 Fed. Reg. at 21984.
[22] Section II(d)(4); *see* 80 Fed. Reg. at 21984.
[23] 80 Fed. Reg. at 21969. DOL states that the contract "creates a mechanism by which a Retirement Investor can be alerted to the Advisor's and Financial Institution's obligations" (*id.*), but a contract is not needed to fulfill that purpose, as the Proposal's requirement of non-contract disclosures (in Section III) demonstrates.

"this contractual tool" confers "a contract claim" on "IRA Owners"; and on "Plans, Plan Participants and Beneficiaries," which could bring claims under the private action created by ERISA and also "could enforce their obligations in an action based on breach of the agreement."[24]

That candid explanation also provides the reason why these elements of the BICE Proposal are invalid. As discussed below, long-settled principles make clear that the Department has no power to create private rights of action.[25] It therefore lacks the power to issue a regulation imposing a "contractual tool" in order to achieve that impermissible result.

Congress may create private rights of action expressly by statute or impliedly by a clear statement of congressional intent.[26] But it is well settled that administrative agencies lack power to create remedies that Congress has not authorized.[27]

Permitting use of the "contract mechanism" would render meaningless the judicial authority barring agencies from creating private causes of action. Any agency could simply require a "contract" with specified obligations and warranties, secure in the knowledge that the "contract" would give rise to a private cause of action under state law. For that reason alone, imposition of the "contract mechanism" exceeds the Department's statutory authority and would be unlawful if included within a final rule.

But there is more. The relevant statutes here specifically preclude enforcement through state-law causes of action, as explained below.

The Supreme Court has recognized time and again, "ERISA's 'comprehensive legislative scheme' includes 'an integrated system of procedures for enforcement.'"[28]

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24 80 Fed. Reg. at 21972.
25 *See* page 7 below.
26 *See, e.g.*, *Nw. Airlines, Inc. v. Transport Workers Union of America, AFL-CIO*, 451 U.S. 77, 90-91 (1981).
27 *See, e.g.*, *Stew Farm, Ltd. v. Nat. Res. Conservation Serv.*, 767 F.3d 554, 564 (6th Cir. 2014) (holding that because a "regulation [is] not 'created by Congress,' . . . it cannot have created a private right of action to enforce federal law"); *S. Camden Citizens in Action v. N.J. Dep't of Envtl. Prot.*, 274 F.3d 771, 790 (3d Cir. 2001) ("if there is to be a private enforceable right …, Congress, and not an administrative agency or a court, must create this right."); *cf. Abrahams v. MTA Long Island Bus.*, 64 F.3d 110, 120 n.7 (2d Cir. 2011) ("[N]o private right of action [exists] to enforce a regulation that creates obligations that are not imposed by the regulation's controlling statute.").

"[T]he exclusivity and uniformity of ERISA's enforcement scheme remains paramount."[29] ERISA contains an express preemption clause,[30] and courts have also found state-court actions to be impliedly preempted where they conflict with Congress's "comprehensive legislative scheme."[31] "The six carefully integrated civil enforcement provisions found in § 502(a) of the statute as finally enacted ... provide strong evidence that Congress did not intend to authorize other remedies that it simply forgot to incorporate expressly."[32]

ERISA thus precludes state-law enforcement of its prohibited transaction rules. It also therefore would bar the Department from circumventing this prohibition by requiring "contracts" embodying the exemption requirements for the purpose of creating the very state-law enforcement regime that Congress expressly precluded.

Moreover, a system of state-by-state enforcement of these national standards would conflict with ERISA's basic principles. When Congress enacted the statute, it recognized the importance of maintaining national uniformity for matters of employee benefits.[33] Otherwise, multistate employers and fiduciaries operating in multiple states would face a dizzying array of forum-specific obligations and beneficiaries' rights would vary depending on their residences or the locations of their plan administrators. If state courts were to assess compliance with the mandatory terms of the best interest contracts, then those states would develop state-specific interpretations of the requirements, and there would be no judicial mechanism for ensuring nationally uniform interpretations. In short, the result would be the conflicting array of forum-specific obligations that Congress specifically sought to avoid.

The same conclusion applies with respect to the Internal Revenue Code restrictions and exemption authority relating to IRAs. It is long-settled that private

[28] *Aetna Health Inc. v. Davila*, 542 U.S. 200, 208 (2004) (quoting *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 147 (1985)).
[29] *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 393-94 (2002).
[30] *See* 29 U.S.C. § 1144.
[31] *Aetna Health*, 542 U.S. at 208-09.
[32] *Id.* at 209 (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987) and *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985)).
[33] *See Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 98-99 (1983) (citing, *e.g.*, 120 Cong. Rec. 29197, 29933 (1974)).

parties have no authority to enforce the tax laws.[34] By including the statutory provision relating to IRAs in the tax code, Congress clearly intended that principle to apply. That is particularly true for two additional reasons.

First, Congress specified in the tax code provision the method of enforcement: imposing of an excise tax by the Internal Revenue Service.[35] Second, *in the very same statute* that enacted this tax code provision, Congress created the limited, express federal cause of action described above with respect to private enforcement of ERISA. Given the similarity of the prohibited transaction requirements, the Congressional determination not to authorize even a limited federal private right of action with respect to the tax code provision is strong evidence that Congress rejected ***any*** private enforcement of that provision and sought to ensure uniformity of interpretation by granting exclusive enforcement authority to the IRS.

That conclusion is not surprising. Just as it is essential that ERISA prescribe uniform standards for plan fiduciaries, it is essential that the Code prescribe uniform standards for IRA fiduciaries. Exposing the mandated contractual agreements to non-uniform state-by-state enforcement would result in irreconcilable conflicts as to the obligations of IRA fiduciaries.

In sum, Congress has already decided that ERISA's prohibited transaction provisions should be enforced privately only pursuant to the federal cause of action set forth in the statute and that the prohibited transaction provisions of the tax code should be enforced only by the IRS. The Proposal's attempt to condition an exemption to the prohibited transaction rules on contracts to be enforced by non-uniform state laws exceeds the Department's statutory authority and, in addition, would introduce regionalized requirements that conflict with the objectives of ERISA and the Code. The Department therefore may not impose the "contract mechanism" to create an avenue for state-law enforcement of prohibited transaction rules or exemptions.

[34] *See* note 18 above.
[35] 26 U.S.C. § 4975(a) & (b).

Finally, the Proposal's unauthorized private cause of action would extend far beyond claims for violation of the substantive requirements for eligibility for the exemption. One of the "warranties" required to be included in the "contract" is the following:

> The Adviser, Financial Institution, and Affiliates will comply with all applicable federal and state laws regarding the rendering of the investment advice, the purchase, sale and holding of the Asset, and the payment of compensation related to the purchase, sale and holding of the Asset.[36]

The obvious purpose of this "warranty" is to expand the private cause of action created by the "contract mechanism" so that it is not limited to alleged violations of the exemption eligibility requirements but also encompasses claims of violations of ***every*** federal or state statute that in any way relates investment advice.

But, as with ERISA and the federal tax code, many of these laws (and there are a very large number when all federal laws and the laws of every State are taken into account) do not provide for private enforcement – the federal Investment Advisers Act of 1940 is one example.[37] Limiting enforcement authority to government regulators is not an oversight: Congress and state legislatures often draft regulatory statutes broadly, relying on government officials to exercise enforcement discretion and apply these laws only when warranted by an assessment of the costs and benefits, and in a manner that will not deter beneficial conduct.

Private parties, and particularly private class-action plaintiffs' lawyers, are motivated by their own interests, not the public interest. Granting them blanket authority to bring private lawsuits based on regulatory violations is not only outside the Department's authority because it intrudes on an area reserved to Congress, it also overturns important policy judgments made by Congress and the States that enacted these statutes, and would disrupt regulation in this important area of the economy.

[36] Proposed Section II(d)(1).
[37] *Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis*, 444 U.S. 11, 24 (1979).

For all of these reasons, the "contract mechanism" is unlawful and should be eliminated from any final exemption promulgated by the Department.

II. The Department Lacks Authority To Ban Class Action Waivers In Arbitration Agreements And, In Addition, Any Such Ban Would Harm Investors And Would Therefore Be Arbitrary And Capricious.

The Proposal states that "[t]he written contract shall not contain" a provision "under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution."[38] The Federal Arbitration Act bars the Department from imposing that requirement. In addition, the requirement would harm investors by making it more difficult for them to vindicate their rights, and is therefore arbitrary.

A. The Federal Arbitration Act Precludes The Department From Banning Arbitration Clauses Providing That All Disputes Will Be Resolved Through Individualized Arbitration.

"The Federal Arbitration Act reflects an 'emphatic federal policy in favor of arbitral dispute resolution.'"[39] Although arbitration agreements remain subject to generally applicable state contract law, the FAA affords contracting parties the freedom to "structure their arbitration agreements as they see fit," and to "specify by contract the rules under which…arbitration will be conducted."[40]

Two well-settled legal principles demonstrate that DOL may not prohibit parties from specifying in an arbitration clause that arbitrations will be conducted on an individualized basis and thereby waiving the use of class procedures in arbitration or in court. *First*, the Supreme Court has held that requiring class procedures is antithetical to the right to enter into arbitration agreements that is protected by the FAA. *Second*, the Court has held repeatedly that the rights protected by the FAA may

[38] Proposed Section II(f)(2).
[39] *KPMG LLP v. Cocchi*, 132 S. Ct. 23, 25 (2011) (per curiam) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc.,* 473 U.S. 614, 631 (1985)).
[40] *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 479 (1989).

be overridden only by a "clear congressional command," and there is no such congressional command authorizing the Department to override the FAA.

First, federal law protects parties' freedom to determine which issues will be arbitrated and who will participate in each arbitration proceeding; to prescribe the procedural rules that will govern the arbitration; and to select the arbitrator who will resolve their disputes.[41] In short, the FAA "makes arbitration agreements 'valid, irrevocable, and enforceable' as written."[42]

The Supreme Court has twice held that the FAA guarantees the right to enter into enforceable agreements that require the parties to arbitrate on an individual basis and to forgo aggregating their claims through class or collective actions.

The plaintiffs in *Concepcion* argued that because their arbitration agreement precluded them from pursuing class-wide relief, it was unconscionable—and therefore unenforceable – under California's *Discover Bank*[43] rule (which effectively imposed a *per se* ban on agreements to arbitrate modest sized claims on an individual basis).[44] But the Supreme Court rejected that argument, holding that the FAA preempts *Discover Bank* because "[r]equiring the availability of classwide arbitration procedures interferes with fundamental attributes of arbitration."[45]

The Court explained: "The point of affording parties discretion in designing arbitration" is "to allow for efficient, streamlined procedures tailored to the type of dispute" at issue.[46] That purpose would be frustrated if class-action waivers were not fully enforceable. Because class-wide resolution of claims "requires procedural formality" to comply with due process, mandating class arbitration "sacrifices the

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[41] *See, e.g.*, *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748-49 (2011); *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1774 (2010).
[42] *Concepcion*, 131 S. Ct. at 1748 (quoting FAA, 9 U.S.C. § 2).
[43] *Discover Bank v. Super. Ct.*, 113 P.3d 1100 (Cal. 2005).
[44] *Concepcion*, 131 S. Ct. at 1745.
[45] *Id.* at 1748.
[46] *Id.* at 1749.

principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment."[47]

In short, a legal rule requiring class procedures, whether in court or in arbitration, "interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[48]

The Court reached the same conclusion in *American Express Co. v. Italian Colors Restaurant*,[49] holding that the FAA required enforcement of an arbitration agreement requiring individualized resolution of disputes in the context of a federal antitrust claim. The Court held that its prior ruling in *Concepcion* essentially resolved the case:

> There we invalidated a law conditioning enforcement of arbitration on the availability of class procedure because that law "interfere[d] with fundamental attributes of arbitration." "[T]he switch from bilateral to class arbitration," we said, "sacrifices the principal advantage of arbitration – its informality – and makes the process slower, more costly, and more likely to generate procedural morass than final judgment." We specifically rejected the argument that class arbitration was necessary to prosecute claims "that might otherwise slip through the legal system."[50]

The Supreme Court's decisions in *Concepcion* and *Italian Colors* thus make clear that the FAA precludes interference with arbitration contract terms that provide for individualized resolution of disputes and bar class proceedings in arbitration and in court.

Second, the federal policy favoring arbitration is so strong that a "clear congressional command" is necessary to displace the FAA "even when the claims at

[47] *Id.* at 1751 (emphasis omitted).
[48] *Id.* at 1748.
[49] 133 S. Ct. 2304 (2013).
[50] *Id.* at 2312.

issue are federal statutory claims."[51] When federal law is "silent" as to whether Congress intended to override the FAA for a particular type of claim, "the FAA requires the arbitration agreement to be enforced according to its terms," regardless of whether the source of the claim is federal or state law.[52]

Nothing in ERISA or the Internal Revenue Code supplies the necessary clear command – indeed, nothing in either statute indicates any intent whatsoever to limit the availability of arbitration. The FAA therefore applies with full force.[53] Because "[i]t is a fundamental precept of administrative law that an agency action, rule, or regulation 'cannot overcome the plain text enacted by Congress,'"[54] the Department cannot, without express statutory authority, prohibit what the FAA protects.

Certainly Congress knows how to grant the necessary authority when it wants to. In the Dodd-Frank Act, for example, Congress authorized the Securities and Exchange Commission to issue rules "prohibit[ing], or impos[ing] conditions or limitations on the use of" predispute arbitration agreements in agreements between certain broker-dealers and their clients, and between investment advisers and their clients.[55]

Congress used similar language in authorizing the Consumer Financial Protection Bureau to conduct a study and report to Congress regarding the use of arbitration agreements in consumer financial products and services, and to issue a rule prohibiting or effectively eliminating arbitration if it "finds that . . . [it] is in the public interest and for the protection of consumers."[56]

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[51] *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 669 (2012).
[52] *Id.* at 673.
[53] Indeed, a number of federal courts have held that Congress did not intend in ERISA to preclude arbitration of fiduciary breach claims. *See, e.g., Bird v. Shearson Lehman/American Express, Inc.*, 926 F.2d 116, 119-20 (2d Cir. 1991); *Pritzker v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 7 F.3d 1110 (3d Cir. 1993); *Kramer v. Smith Barney*, 80 F.3d 1080 (5th Cir. 1996); *Simon v. Pfizer, Inc.*, 398 F.3d 765, 774 (6th Cir. 2005); *Arnulfo P. Sulit, Inc. v. Dean Witter Reynolds*, 847 F.2d 475 (8th Cir. 1988); *Williams v. Imhoff*, 203 F.3d 758 (10th Cir. 2000); *but see Amaro v. Continental Can*, 724 F.2d 747 (9th Cir. 1988).
[54] *Sierra Club, Inc. v. Sandy Creek Energy Associates, L.P.*, 627 F.3d 134, 141 (5th Cir. 2010).
[55] 15 U.S.C. §§ 78o(o), 80b-5(f).
[56] 12 U.S.C. § 5518(b).

Congress enacted no similar language in Dodd-Frank, ERISA, or anywhere else that would authorize the Department's Proposal.

Indeed, the proposal here closely resembles the National Labor Relations Board's attempt to prohibit as an unfair labor practice any arbitration clause in an employment agreement that provided for individualized decisionmaking and precluded class proceedings.[57] That ruling was set aside by the Court of Appeals for the Fifth Circuit on the ground that it violated the FAA.[58] Every other appellate court to address the issue has reached the same conclusion.[59]

That precedent leaves no doubt that the Department lacks the legal authority to ban arbitration clauses that preclude class proceedings.[60]

B. Arbitration Benefits Retirement Investors By Providing A Fair Means Of Resolving Disputes That They Cannot Practically Litigate In Court.

Not only does the Department lack authority to prohibit arbitration on an individual basis – in lieu of class action litigation in court – but the Proposal is also bad policy. Arbitration enables retirement investors – just as much as consumers, employees, and others – with grievances to obtain redress for a large number of claims for which litigation in court is impractical. Arbitration is quicker and less costly, and it is at least as likely to result in positive outcomes for claimants. Indeed, the empirical evidence demonstrates that individuals in arbitration fare ***at least as well as***

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57 *In re D.R. Horton, Inc.*, 357 NLRB No. 184 (Jan. 3, 2012).

58 *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344, 355-62 (5th Cir. 2013).

59 *See Richards v. Ernst & Young, LLP*, 734 F.3d 871, 873-74 (9th Cir. 2013); *Sutherland v. Ernst & Young LLP*, 726 F.3d 290, 297-98 n.8 (2d Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1055 (8th Cir. 2013); *Iskanian v. CLS Transp. Los Angeles, LLC*, 327 P.3d 129, 141 (Cal. 2014).

60 The Proposal mentions that FINRA's arbitration rules require its members to permit class actions to be brought in court. 80 Fed. Reg. at 21973; *see also* FINRA Rule 2268(d)(3); FINRA Customer Code 12204(d). FINRA has rejected the argument that its rules violate the FAA, finding the requisite congressional intent to override the FAA in the general grant of authority to the SEC to review and approve FINRA rule changes. *In re Department of Enforcement v. Charles Schwab & Co.*, No. 2011029760201 (FINRA Board of Governors, Apr. 24, 2014). That analysis is squarely inconsistent with the holding of the Fifth Circuit in *D.R. Horton* and the rulings of every other appellate court. *See* notes 58-59, above. Whatever FINRA's authority as a membership organization might be, the Department cannot rely on the FINRA precedent in *Charles Schwab* to provide the legal authority to justify its proposal.

– ***if not better than*** – they would have in court. ***Arbitration thus benefits retirement investors by providing a fair means of adjudicating claims that would be left without redress in the absence of arbitration.*** Requiring arbitration agreements to permit the assertion of class actions in court will as a practical matter mean that companies that have a choice will not use arbitration as a means for settling disputes, thereby harming investors.

The relevant arguments and supporting information are set out in detail in Attachment A and summarized below:

- Arbitration enables retirement investors (like consumers, employees, and other individuals) with grievances to obtain redress for the kind of dispute they are most likely to have – small, individualized claims for which litigation in court is impractical. For typical disputes, claimants are unable to hire attorneys to navigate the court system, or find that a hearing on their claims is long delayed by overcrowded dockets in underfunded courts.

- Arbitration is at least as likely, and often more likely, than litigation in court to result in positive outcomes for consumers, as empirical studies repeatedly have shown.

- Arbitration is more user-friendly and inexpensive than litigating in court – especially when (as is increasingly common) parties agree to include fee-shifting or cost-shifting provisions in their arbitration agreements.

- In addition, arbitration agreements offer fair and simplified procedures for consumers – something that is ensured by the protections of generally-applicable state unconscionability law as well as the due process safeguards of the nation's leading arbitration providers, including the American Arbitration Association and JAMS.

- The arguments advanced by critics of arbitration do not stand up to careful scrutiny.

- Some say that, while they recognize the benefits of arbitration, they believe that parties would be better served if they were precluded from committing to arbitration until after a dispute arises. But permitting only "post-dispute arbitration agreements" is an illusory option that actually would have the effect of eliminating arbitration. As scholars have recognized, without arbitration agreements that commit both sides to a potential dispute to arbitrate *before the dispute arises*, arbitration agreements in fact will be rare indeed – and the result will be that consumers are relegated to the judicial system in precisely those cases where burdensome court procedures and overcrowded courts are likely to stymie their claims.

- Class action proponents decry the fact that arbitration typically takes place on an individual basis. But their defense of class actions rests on purely theoretical arguments about the supposed virtues of that procedural device. In reality, consumer class actions deliver (at best) minimal benefits to most consumers.

- Consumers can pursue their claims without the class action device. As even the dissenting Justices in the Supreme Court's recent decision in *American Express Co. v. Italian Colors Restaurant* expressly recognized, "non-class options abound" for effectively pursuing claims on an individual basis. In particular, many arbitration agreements require businesses to pay all or most of arbitration filing fees, authorize the payment of attorneys' fees and other costs of proof in meritorious cases, and provide incentives for individuals to bring claims. And other, more informal, methods of obtaining economies of scale exist, including the use by multiple claimants of the same attorneys and expert witnesses, where necessary.

- The claim that class procedures should be mandated because class actions provide benefits to consumers therefore is not supported by the reality of class actions outcomes. And, because requiring class procedures would result in the elimination of arbitration – companies

> would not be willing to absorb the additional costs of arbitration ***and*** the huge legal fees associated with defending class actions – consumers would lose the ability to pursue the myriad individualized claims that are not practicable to litigate in court. Indeed, the only beneficiaries of such a requirement would be lawyers – both plaintiff's lawyers and defense lawyers – who are the only clear winners in class action litigation.

In short, any rational assessment of the benefits and costs of arbitration must conclude that prohibiting or regulating arbitration will harm retirement investors much more than it would benefit them.[61]

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[61] The Consumer Financial Protection Bureau recently issued a report regarding arbitration. *See* Consumer Financial Protection Bureau, *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)*, http://files. consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf (visited July 17, 2015). That report provides no basis for assessing the benefits and costs of arbitration, for the reasons explained in Attachment B.

* * * * *

Thank you for your consideration of these comments. We would be happy to discuss these issues further with appropriate members of the Department's staff.

Sincerely,

David Hirschmann
President & Chief Executive Officer
Center for Capital
Markets Competitiveness
U.S. Chamber of Commerce

Lisa A. Rickard
President
U.S. Chamber Institute for Legal Reform

Randel Johnson
Senior Vice President
Labor, Immigration & Employee Benefits
U.S. Chamber of Commerce

Attachment A

U.S. CHAMBER OF COMMERCE

1615 H Street, NW
Washington, DC 20062-2000
www.uschamber.com

December 11, 2013

Consumer Financial Protection Bureau
Attention: Ms. Monica Jackson
1700 G Street NW
Washington, DC 20552

Re: ***Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*, Docket No. CFPB-2012-0017—Supplemental Submission**

Dear Ms. Jackson:

This letter and its appendix are submitted on behalf of the U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce (the "Chamber") is the world's largest business federation, representing the interests of more than three million companies of every size, sector, and region. The Chamber created CCMC to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, faster, and fair for all participants.

We write regarding the Consumer Financial Protection Bureau's ("Bureau") study, authorized by Section 1028(a) of the Dodd-Frank Act and now underway, concerning pre-dispute arbitration agreements in consumer financial contracts. Congress provided that the Bureau must conduct a study of pre-dispute arbitration agreements as a prerequisite to any proposed regulation. Specifically, any "prohibit[ion] or impos[ition of] conditions or limitations" on arbitration must be supported by a finding "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)."[1] Stated

[1] 12 U.S.C. § 5518(b) (emphasis added).

another way, the Bureau cannot regulate arbitration without conducting an appropriate study, and any proposed regulations must be based on and supported by that study.

Arbitration is an important means of resolving disputes that provides extremely significant benefits to consumers and businesses. As we have previously explained in comments submitted to the Bureau,[2] arbitration of consumer disputes has been common practice for decades; there are perhaps hundreds of millions of consumer contracts currently in force that include arbitration agreements—many of them relating to consumer financial products or services.

The Bureau initially requested comment on how it should conduct the study. A number of commenters—including CCMC and ILR—suggested topics that should be addressed in the study and, in addition, urged the Bureau to issue a public notice identifying the topics that it had decided to study and requesting public comment regarding those topics.[3]

Unfortunately, the Bureau has done neither—***it has not informed the public of the topics it is studying and it has not solicited information regarding those topics***. As a result, interested individuals and organizations have had no real opportunity to inform the Bureau of available evidence bearing on the issues the Bureau has decided to study, or to develop additional empirical data relevant to those issues. That failure to enable the public to comment on the subjects of the Bureau's study introduces a critical flaw in the study—and, therefore, will completely undermine any rulemaking that may be undertaken on the basis of the study's findings.[4]

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[2] Letter from David Hirschmann & Lisa Rickard to Matthew Burton & PRA Office, *Re: "Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements,"* Docket No. CFPB-2013-0016 (Aug. 6, 2013), http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0016-0015 (*Chamber Comment II*); Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *Re: Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements, Docket No. CFPB-2012-0017* (June 12, 2012), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0051 (*Chamber Comment I*).

[3] *Chamber Comment I* at 3-5, 10-20.

[4] The Bureau has sought one round of comments regarding a proposed consumer survey of "awareness of dispute resolution provisions in their agreements with credit card providers"—and promised the opportunity for a second round of comments—but only because the Paperwork Reduction Act required it to take that step. *Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements*, Docket No. CFPB-2013-

In order to try to ameliorate these deep flaws in the Bureau's study plan, ILR and CCMC submit the information in this letter and its attachment, which are designed to help the Bureau assess the relative benefits and costs of different dispute resolution systems. This information makes clear that ***arbitration before a fair, neutral decision maker leads to outcomes for consumers and individuals that are comparable or superior to the alternative—litigation in court—and that are achieved faster and at lower expense.***

This submission by ILR and CCMC is designed to address empirical issues that *should* be at the center of the Bureau's study. Given the near-total absence of information from the Bureau about its study design, however, it is impossible for interested parties to offer information tailored appropriately to the topics the Bureau is studying. In any event, the information we are providing is highly relevant to *any* rational study of the relevant issues.[5]

We focus on several fundamental points:

- Arbitration enables consumers with grievances to obtain redress for the vast majority of disputes they are likely to have—small, individualized claims for which litigation in court is impractical. This access to an inexpensive and simple system of dispute resolution is an extremely significant benefit that is often overlooked entirely in the debate over arbitration.

- For typical consumer disputes that are small and individualized, consumers are highly unlikely to be able to hire an attorney to help navigate the court system.

0016, 78 Fed. Reg. 34352 (June 7, 2013). It is disappointing that the Bureau has devoted such attention to soliciting comment on what presumably is a minor component of the overall study. Indeed, as ILR and CCMC explained in their comment, the consumer survey will not produce any information useful to the study specified by Congress. *See Chamber Comment II* at 11-21.

[5] We again respectfully urge the Bureau to provide the public with at least some transparency regarding its study plan in order to enable interested parties to provide relevant information and prevent the Bureau from producing a study that is fatally flawed because it was produced in an informational vacuum. Soliciting public input would surely benefit the Bureau's work: Although the Bureau possesses or can retain able staff and consultants, there is a great deal of information regarding both judicial litigation and arbitration that either has been developed or (more likely) could be developed that is highly relevant to the Bureau's statutory mandate. A legitimate study process would welcome—and facilitate—the submission of such information.

- Those consumers who do brave the courts find that a hearing on their claims is long delayed by overcrowded dockets in our underfunded courts.

- Arbitration is at least as likely, and often more likely, than litigation in court to result in positive outcomes for consumers, as empirical studies repeatedly have shown.

- Arbitration is more user-friendly and inexpensive than litigating in court—especially when (as is increasingly common) parties agree to include fee-shifting or cost-shifting provisions in their arbitration agreements.

- In addition, arbitration agreements offer fair and simplified procedures for consumers—something that is ensured by the protections of generally-applicable state unconscionability law as well as the due process safeguards of the nation's leading arbitration providers, including the American Arbitration Association and JAMS.

- The arguments advanced by critics of arbitration do not stand up to careful scrutiny.

- Some say that, while they recognize the benefits of arbitration, they believe that parties would be better served if they were precluded from committing to arbitration until after a dispute arises. But permitting only "post-dispute arbitration agreements" is an illusory option that actually would have the effect of eliminating arbitration. As scholars have recognized, without arbitration agreements that commit both sides to a potential dispute to arbitrate *before the dispute arises*, arbitration agreements in fact will be rare indeed—and the result will be that consumers are relegated to the judicial system in precisely those cases where burdensome court procedures and overcrowded courts are likely to stymie their claims.

- Class action proponents decry the fact that arbitration typically takes place on an individual basis. But their defense of class actions rests on purely theoretical arguments about the supposed virtues of that procedural device. In reality, consumer class actions deliver (at best) minimal benefits to most consumers.

- A new empirical assessment of class actions that the Chamber has commissioned demonstrates that the class actions studied provide little or no benefit to consumers.

- None of the class actions studied resulted in a trial or in a judgment for plaintiffs on the merits.

- The overwhelming majority of cases are dismissed voluntarily by the named plaintiffs—either because they decide not to proceed with the case or because they settle out on an individual basis—or are dismissed by courts because they are not legally sustainable. Either way, the result is that class members do not benefit.

- And the remaining minority of class actions that are settled on a class-wide basis usually provide class members with little, if any, tangible benefit. As a result, only a handful of class members—often fewer than 10 percent, and sometimes less than 1 percent—even bother to submit claims for benefits.

- Consumers can pursue their claims without the class action device. As even the dissenting Justices in the Supreme Court's recent decision in *American Express Co. v. Italian Colors Restaurant* expressly recognized, "non-class options abound" for effectively pursuing claims on an individual basis. In particular, many arbitration agreements require businesses to pay all or most of arbitration filing fees, authorize the payment of attorneys' fees and other costs of proof in meritorious cases, and provide incentives for individuals to bring claims. And other, more informal, methods of obtaining economies of scale exist, including the use by multiple claimants of the same attorneys and expert witnesses, where necessary.

- The claim that class procedures should be mandated because class actions provide benefits to consumers therefore is not supported by the reality of class actions outcomes. And, because requiring class procedures would result in the elimination of arbitration—companies would not be willing to absorb the additional costs of arbitration ***and*** the huge legal fees associated with defending class actions—consumers would lose the ability to pursue the myriad individualized claims that are not practicable to litigate in court. Indeed, the only beneficiaries of such a requirement would be lawyers—both plaintiff's lawyers and defense lawyers—who are the only clear winners in class action litigation.

- In short, any rational assessment of the benefits and costs of arbitration must conclude that prohibiting or regulating arbitration will harm consumers much more than it would benefit them.

I. Arbitration Benefits Consumers By Providing A Fair Means Of Resolving Disputes That Consumers Cannot Practically Litigate In Court.

Arbitration enables consumers, employees, and others with grievances to obtain redress for a large number of claims for which litigation in court is impractical. Arbitration is quicker and less costly, and it is at least as likely to result in positive outcomes for claimants. Indeed, the empirical evidence demonstrates that individuals in arbitration fare ***at least as well as—if not better than—***they would have in court. ***Arbitration thus benefits consumers by providing a fair means of adjudicating claims that would be left without redress in the absence of arbitration.***

A. The Judicial System Is Not A Realistic Means Of Obtaining Redress For Most Injured Consumers.

If the judicial system were free of transaction costs, if every legitimate claimant could obtain legal representation, and if lawsuits were resolved expeditiously, then perhaps the courts could be relied upon as the exclusive means of redress for injured consumers. In fact, of course, today's judicial system falls far short of that ideal; each of these three prerequisites is absent, and the reality of judicial litigation is getting significantly worse each year.

Recourse to the judicial system therefore simply is not a realistic option for most injured consumers. Most claims are individualized and too small to attract the legal representation needed to navigate the complex legal system; costs of litigating are too great; and the courts—even many small claims courts—impose requirements (such as appearing in person during the working day) that make litigating there burdensome and costly. All of these costs are multiplied by the myriad inefficiencies of the judicial system, including time-consuming procedures, delays and postponements in court appearances, and the like.

1. **The Vast Majority of Consumer Claims Cannot as a Practical Matter be Pursued in Court.**

Litigation in court is complicated and expensive—non-lawyers need legal representation to have any hope of successfully navigating the judicial system. And even with a lawyer, claims are difficult and time-consuming to litigate.

Most wrongs suffered by consumers are relatively small and individualized—excess charges on a bill, a defective piece of merchandise claim, and the like. These claims are simply too small to justify paying a lawyer to handle the matter and in any event most consumers do not have the resources to do so.

As Justice Breyer has recognized, without arbitration, "the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)" would be left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery."[6] Thus, for the largest category of injuries suffered by consumers, the choice is "arbitration—or nothing."[7]

In the employment context, for instance, it has been estimated that the potential recovery is too small in 72% of the cases currently resolved using pre-dispute arbitration[8] and in 95% of all potential claims[9] to justify litigation in court and

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[6] *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995).

[7] Theodore J. St. Antoine, *Mandatory Arbitration: Why It's Better Than It Looks*, 41 U. Mich. J.L. Reform 783, 792 (2008) (discussing analogous situation of employees with low-dollar claims).

[8] Jyotin Hamid & Emily J. Mathieu, *The Arbitration Fairness Act: Performing Surgery with a Hatchet Instead of a Scalpel?*, 74 Alb. L. Rev. 769, 785 (2010/2011); *accord*, Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 Wm. Mitchell L. Rev. 313, 318 (2003); *accord* Steven C. Bennett, *The Proposed Arbitration Fairness Act: Problems And Alternatives*, 67 Disp. Resol J. 32, 37 (2012).

[9] St. Antoine, 41 U. Mich. J.L. Reform at 790.

the retention of counsel. There is no reason to believe that the universe of consumer claims differs.[10]

Such claims do not—and could not—attract lawyers willing to work on a contingency-fee basis. Research demonstrates that lawyers accept contingent-fee cases only if the claim promises both a substantial recovery and a substantial percentage of that recovery as a legal fee. One study reported that a claim must be worth at least $60,000 before a lawyer will consider taking it.[11] In some legal markets, this threshold may be as high as $200,000.[12] The vast majority of consumer claims are so small that they will "not . . . elicit a lawyer's attention."[13]

But the complexities of judicial litigation make it difficult, if not impossible, for most individuals to represent themselves effectively in court. The rules are opaque to non-lawyers, and navigating these obstacles can therefore be burdensome to individuals. The requirement of in-person appearances during the workday compounds the economic burden.

Small-claims courts were developed to make it easier for individuals to proceed without representation, but they do not provide a realistic alternative because state budget cuts have severely hobbled these courts. For example, the *New York Times* reported in 2011 that in New York, night court sessions were being cancelled in many locales, waits had quadrupled, and court officials were unable to work through their overburdened daily dockets, forcing individuals to leave empty-handed, only to return another day in the hope that their disputes will eventually be heard.[14]

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[10] *See, e.g.*, Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 898 (2010) (noting that "the number of consumers bringing large claims" in consumer arbitration "is small").

[11] Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 783 (2003).

[12] Recommendations of the Minnesota Supreme Court Civil Justice Reform Task Force 10 (Nov. 23, 2011), http://www.mnbar.org/sections/outstate-practice/11-23-11%20Civil%20Justice%20Reform.pdf.

[13] *Id.*

[14] *See* William Glaberson, *Despite Cutbacks, Night Court's Small Dramas Go On*, N.Y. TIMES, June 2, 2011, *available at* http://www.nytimes.com/2011/06/03/nyregion/despite-cutbacks-new-york-small-claims-courts-trudge-on.html.

Similarly, cases filed in San Joaquin County, California's small-claims court in September 2012 had still not been *scheduled* for trials as of May 2013.[15] The court's presiding judge explained: "In our county, if you file a small claims case it simply sits in the proverbial box waiting to get a trial date. Your case sits and goes nowhere. It's not right, but you have to have sufficient resources to get those cases done, and we don't have those resources."[16] Meanwhile, a Texas law that went into effect in August 2013 "abolish[ed] small claims courts across the state, meaning all those small-price-tag cases—seeking no more than $10,000—[would now] be handled by justice of the peace courts, some of which already are buried under dockets teeming with minor civil matters."[17]

2. **Even for Larger Claims, the Court System Provides Significant Delays and High Costs.**

Some claims are large enough to support contingency fees that would attract the interest of lawyers. But the complexity of the litigation system makes litigation costly and—as a result of budget cuts—many courts are simply unable to keep up with their caseloads, leading to extreme delays. Filing fees also have increased, placing further burdens on plaintiffs.

Forty states had to cut funding to their courts in 2010, according to a report by the American Bar Association's "Task Force on the Preservation of the Justice System," which was co-chaired by David Boies and Theodore B. Olson.[18] The President of the ABA stated that "all over this country," state "[c]hief justices are

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[15] Emily Green, *Budget Woes Mean Big Delays For Small Claims Courts*, Nat. Pub. Radio, May 15, 2013, *available at* http://www.npr.org/2013/05/17/182640434/budget-woes-mean-big-delays-for-small-claims-courts.

[16] *Id.*

[17] Kiah Collier, *Little-known state law doing away with small claims courts*, Houston Chronicle, June 23, 2013, http://www.houstonchronicle.com/news/houston-texas/houston/article/Little-known-state-law-doing-away-with-small-4616571.php; see also *Adoption of Rules for Justice Court Cases*, Misc. Docket No. 13-9023 (Tex. Feb. 12, 2013), http://supreme.courts.state.tx.us/MiscDocket/13/13902300.pdf.

[18] Am. Bar. Ass'n ("ABA"), *The Growing Crisis of Underfunding State Courts*, Mar. 16, 2011 ("ABA Report"); *see also* G. Alan Tarr, *No Exit: The Financial Crisis Facing State Courts*, 100 Ky. L.J. 786, 787 (2011-2012).

closing the courts one day a week" and "court personnel including judges [are] being furloughed without pay."[19]

These funding problems have continued. Due to "los[ing] about 65% of their general fund support from the state during the last five years," California's court system is subject to even more lengthy delays.[20] As the state's Chief Justice noted in calling on the California Legislature to increase funding to the state judiciary, "[t]he cruel irony is that the economic forces that have led to budget reductions to the courts are the same ones that drive more of our residents to court."[21] And the San Diego County Bar Association warned that "local courts—long the shining example statewide of judicial efficiency—have now been hobbled to such an extent that extensive delays, the closure of courtrooms, the unavailability of essential court services, and long wait times now characterize those court systems instead."[22] These dramatic cutbacks have made it impossible for many courts to keep up with their caseload, leading to extended delays that leave "litigants with no expectation of relief or resolution of their cases for extended periods of time."[23]

As the *Los Angeles Times* reported, "[a]t least 53 courthouses have closed," and "[c]ourts in 20 counties are closed for at least one day a month." These and other "court closures have forced some San Bernardino [county] residents to drive up to 175 miles one way to attend to a legal matter."[24] In New York City, similarly, the wait for a court date is now four times as long as it was before recent budget cuts.[25]

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[19] Wm. T. (Bill) Robinson, *ABA President Robinson Explains Nationwide Crisis in Dwindling Court Budgets*, Aug. 4, 2011 (video).

[20] Maura Dolan, *Budget cuts force California courts to delay trials, ax services*, L.A. Times, Apr. 9, 2013, http://articles.latimes.com/2013/apr/09/local/la-me-court-cutbacks-20130410.

[21] Erin Coe, *California Justice Warns of Looming Case Delays*, Law360, Mar. 9, 2012, *available at* http://www.law360.com/legalindustry/articles/319086.

[22] San Diego County Bar Association, *2013 State of the Judiciary in San Diego County*, https://www.sdcba.org/temp/ts_DAFFCDF9-BDB9-505B-DB71DEEC48C1B816DAFFCE09-BDB9-505B-DF72E0368E012958/CFAC%20Annual%20Report-6-7-2013%5BRS%5D.pdf.

[23] Maura Dolan & Victoria Kim, *Budget cuts to worsen California court delays, officials say*, L.A. Times, July 20, 2011 (quoting Los Angeles County Superior Court Presiding Judge Lee Smalley Edmon), http://articles.latimes.com/2011/jul/20/local/la-me-0720-court-cuts-20110720.

[24] Dolan, *supra* note 20.

[25] *See* Glaberson, *supra* note 14; *see also* Jennifer Golson, *Budget Cuts have 'Widespread' Impact on NY State Courts-Report*, Reuters, Aug. 16, 2011 (quoting Michael Miller of the New York County Lawyers' Association).

Budget cuts led to "shortened hours" in the New York City courts that are a "hardship" for litigants—especially the "economically distressed and working poor people" who face "less flexibility in getting to the court."[26]

In New Hampshire, all civil trials were delayed by a full year to "satisfy speedy trial concerns in criminal proceedings."[27] And the presiding judge of the San Francisco County Superior Court announced: "The civil justice system in San Francisco is collapsing. We will prioritize criminal, juvenile and other matters that must, by law, be adjudicated within time limits. Beyond that, justice will be neither swift nor accessible."[28] Indeed, even before recent budget cuts, the situation could be bleak for litigants. In 2003, for example, caseloads in Minnesota were so heavy that "judges had on average only 120 seconds of court time to spend on each case."[29]

Although the vast majority of civil claims are filed in state courts,[30] the federal courts also have extraordinarily high caseloads, especially at the trial-court level, where the backlogs are particularly severe. [31] The Brennan Center for Justice has found that

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[26] *At a Standstill: Budget Cuts Have Brought New York's Court System to a Crawl*, NYPress.com, Dec. 5, 2012, http://nypress.com/at-a-standstill-budget-cuts-have-brought-new-yorks-court-system-to-a-crawl/.

[27] ABA Report, *supra* note 18; see also Karen Weise, *U.S. Courts Face Backlogs and Layoffs*, Bloomberg Businessweek, Apr. 28, 2011, http://www.businessweek.com/magazine/content/11_19/b4227024878939.htm.

[28] *See* Dan Rivoli, *California Trial Court To Lay Off 200, Close 25 Rooms*, Law360.com, July 18, 2011 (quoting San Francisco County Superior Court Judge Katherine Feinstein), http://www.law360.com/legalindustry/articles/258746/calif-trial-court-to-lay-off-200-close-25-rooms.

[29] Constitution Project, *The Cost of Justice: Budgetary Threats to America's Courts* 6, 2006, http://www.constitutionproject.org/wp-content/uploads/2012/10/36.pdf (citing Minn. Sup. Ct. Chief Justice Kathleen A. Blatz, *2003 State of the Judiciary,* Minn. State Bar Ass'n Annual Convention, June 20, 2003).

[30] State courts reported around 19 million new civil cases filed in 2010, while federal courts reported over 280,000 new civil cases filed that same year. *Compare* National Center for State Courts, Court Statistics Project, *Examining the Work of State Courts: An Analysis of 2010 State Court Caseloads* 3, Dec. 2012, http://www.courtstatistics.org/Other-Pages/~/media/Microsites/Files/CSP/DATA%20PDF/CSP_DEC.ashx (state courts in 2010), with Administrative Office of the U.S. Courts, *Judicial Business of the U.S. Courts 2012*, http://www.uscourts.gov/Statistics/JudicialBusiness/2012/us-district-courts.aspx (federal courts in 2010).

[31] Ruben Castillo, the Chief Judge of the Northern District of Illinois, said that budget constraints have created "a crisis" for U.S. district courts, and that he is essentially being asked: "Which limb do you want amputated?" Michael Tarm, *New Hispanic Chief Judge: Need More Jury Diversity*, Associated Press, July 2, 2013; *see also* Michelle R. Smith & Jesse J. Holland, *Budget cuts cause delays, concern in federal court*, Associated Press, April 25, 2013, http://bigstory.ap.org/article/budget-cuts-cause-delays-concern-federal-court ("Federal budget cuts have caused delays in at least one terror-related court case in New York and prompted a federal judge in Nebraska to say he is 'seriously contemplating' dismissing some criminal cases.").

"the number of pending cases per sitting judge reached an all-time high in 2009 and was higher in 2012 than at any point from 1992-2007. A judge in 1992 had an average of 388 pending cases on his or her docket. By 2012, the average caseload had jumped to 464 cases—a 20 percent increase."[32]

A recent report by the New York County Lawyers' Association noted that the two federal district courts covering New York City, the Southern and Eastern Districts of New York, "and other federal courts were hit with a 10% funding allocation below the Fiscal Year 2012 level."[33] Those constraints led to reductions in a wide range of court services, including staffing furloughs, "curtail[ing] [courts'] hours of operation," and "slower processing of civil and bankruptcy cases."[34] Similarly, as a federal district judge in Massachusetts explained, "[n]ext year, with additional sequester cuts, I predict (but I'm not positive) that we will run out of money for civil juries before the end of the fiscal year. July, August, I'm not sure when but we will run out."[35] And just this year, the federal district court of the Central District of California "announced it [would] severely curtail services at its three courthouses on seven Fridays from April through [August 2013], accepting only mandatory and emergency filings."[36]

These delays can have serious consequences for plaintiffs. A lawyer in Washington state explained, for example, that his civil case was postponed for more than two years because criminal cases—which are subject to constitutional and statutory speedy-trial requirements—had priority. "During that period of time, the

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[32] Alicia Bannon, *Federal Judicial Vacancies: The Trial Courts* 5, Brennan Ctr. for Justice, 2013, http://www.brennancenter.org/publication/federal-judicial-vacancies-trial-courts.

[33] New York County Lawyers' Association, *Report on the Continuing Effect of Judicial Budget Cuts on The U.S. District Courts for the Southern and Eastern Districts of New York* 3, Sept. 4, 2013, http://www.nycla.org/siteFiles/Publications/Publications1637_0.pdf.

[34] *Id.* at 11.

[35] Andrew Cohen, *How the Sequester is Holding Up Our Legal System*, The Atlantic, July 12, 2013, http://www.theatlantic.com/national/archive/2013/07/how-the-sequester-is-holding-up-our-legal-system/277704/.

[36] *Budget Cuts Start to Hurt Courts*, The BLT: The Blog of Legal Times, Mar. 29, 2013, http://legaltimes.typepad.com/blt/2013/03/budget-cuts-start-to-hurt-courts.html; see also *Amended Notice Re Reduced Service Days*, Central District of California, August 2013, http://www.cacd.uscourts.gov/news/amended-notice-re-reduced-service-days.

defendant corporation ceased doing business and became insolvent; all assets were distributed to others and the judgment which was obtained became worthless."[37]

Budget cuts have also forced courts to supplement their revenue by increasing fees. The Chief Justice of the Minnesota Supreme Court explained: "[A]s part of the effort to close the revenue gap, significantly increased fees were imposed on a wide variety of cases. As a result, it is going to cost more to go to court and to practice law in Minnesota. This is not what we wanted[.]"[38]

Simply put, the situation for litigants in the underfunded and understaffed courts is grim; and because the trend is toward more cutbacks, the situation will likely get worse.

B. Arbitration Provides A Fair And Effective Remedy For The Injured Consumers For Whom The Judicial System Is Not A Realistic Option.

Arbitration has a number of advantages over pursuing litigation in our overburdened court system. To begin with, arbitration offers flexible proceedings at lower cost. And arbitration proceedings are resolved more quickly than proceedings in court.

As we explain below, studies show that consumers who use this efficient dispute-resolution system prevail in arbitration at least as frequently as—and often more frequently than—they do in court. A wealth of scholarship comparing outcomes of consumers' and employees' claims in arbitration and in litigation reveals that arbitration provides a realistic and fair opportunity for individuals to seek justice before a neutral decisionmaker. "[F]rom the individual's perspective, arbitration" has

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[37] Constitution Project, *supra* note 29, at 8 (citing Washington Courts, Bd. for Judicial Admin., Court Funding Task Force, *Justice in Jeopardy: The Court Funding Crisis in Washington State* 36, 2004, http://www.courts.wa.gov/programs_orgs/pos_bja/wgFinal/wgFinal.pdf.

[38] Chief Justice Eric Magnuson, *The State of the Judiciary: 2009 – Building a 21st Century Judiciary*, Bench&Bar of Minn., Aug. 1, 2009, http://mnbenchbar.com/2009/08/the-state-of-the-judiciary-building-a-21st-century-judiciary/.

the distinct advantage of "provid[ing] an affordable forum with superior chances for obtaining a favorable result."[39]

Existing law, moreover, ensures the fairness and neutrality of arbitration proceedings. The Federal Arbitration Act allows states to regulate arbitration agreements under generally applicable state-law contract principles, including unconscionability. To that end, courts regularly refuse to enforce the small minority of arbitration agreements containing what they consider to be unfair provisions—such as limitations on damages that would be available to individuals in court, inconvenient forum-selection rules, biased arbitrator-selection procedures, or prohibitively expensive costs of accessing an arbitral forum.

In addition to courts' oversight of arbitration provisions, the market has supplied arbitration procedures that are fair to all participants. The leading arbitration providers—such as the AAA and JAMS—have implemented rules and policies tailored for the resolution of consumers' and employees' disputes, which provide basic requirements of procedural fairness that provide strong protections for consumers and employers. And after the Supreme Court emphasized the fairness of the arbitration provision at issue in *AT&T Mobility v. Concepcion*,[40] many businesses have adopted similar pro-consumer provisions.

1. **Arbitration's Flexibility and Lower Cost Makes it Much More Accessible than Courts.**

Arbitration is much more user-friendly and inexpensive than litigating in court. "'The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices.'"[41]

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[39] Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 Cardozo J. Conflict Resol. 267, 279 (2008)

[40] 131 S. Ct. 1740 (2011).

[41] *Allied-Bruce Terminix*, 513 U.S. at 280 (quoting H.R. Rep. No.97-542, at 13 (1982), *reprinted in* 1982 U.S.C.C.A.N. 765, 777); *see also*, *e.g.*, *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1749 (2011) ("[T]he informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution.").

Under the consumer procedures of the American Arbitration Association, for example, consumers cannot be asked to pay more than $200 in total arbitration costs; businesses shoulder all remaining fees.[42] By comparison, the cost of filing a civil suit in a federal district court has recently risen to $400 or more.[43]

It is no wonder that Justice Ruth Bader Ginsburg has described the AAA's and other providers' consumer arbitration fee structures as "models for fair cost and fee allocation."[44] And studies have long found that in practice, a large percentage of individuals who bring claims in arbitration pay exactly nothing to pursue their claim—no filing fees, no attorney fees.[45]

The costs of presenting a claim in arbitration, moreover, typically are far lower than litigating in court. Indeed, arbitration does not require a personal appearance to secure a judgment; claims can be adjudicated on the papers or on the basis of a telephone conference.[46] Plaintiffs can submit the relevant documents and a common-sense statement of why they are entitled to relief, and can do so without a lawyer. There is no need to wait in line at night court or miss work, only to be forced to return another day if the court is unable to get through its docket.

Moreover, plaintiffs with more complicated claims may retain an attorney to assist them in presenting their case—but the cost is less because of the more informal nature of arbitration procedures. In addition, parties can (and often do) agree to include fee-shifting provisions in their arbitration agreements that make it less expensive to resolve disputes in arbitration. Consider the arbitration provision that

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[42] Am. Arb. Ass'n ("AAA"), *Costs of Arbitration (Including AAA Administrative Fees)* 1, March 1, 2013, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTAGE2009593&RevisionSelectionMethod=LatestReleased.

[43] Judicial Conference of the United States, *District Courts Miscellaneous Fee Schedule* (approving a $50 "administrative" filing fee on top of the previous $350 filing fee), available at http://www.uscourts.gov/FormsAndFees/Fees/DistrictCourtMiscellaneousFeeSchedule.aspx.

[44] *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 95 (2000) (Ginsburg, J., concurring in part).

[45] Hill, 18 Ohio St. J. on Disp. Resol. at 802 (lower-income employees "paid no forum fees" in 61% of the cases studied; employees also paid no attorneys' fees in 32% of the cases).

[46] AAA, *Consumer Related Disputes Supplementary Procedures* 6, Mar. 1, 2013, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTAGE2009997&RevisionSelectionMethod=LatestReleased.

the Supreme Court approved in *Concepcion*. As the Court then explained, the Concepcions' claim was "most unlikely to go unresolved" because the arbitration provision at issue provided that AT&T would pay the Concepcions a minimum of $7,500 and twice their attorneys fees if they obtained an arbitration award "greater than AT&T's last settlement offer."[47]

Finally, in contrast to the extreme delays that are typical of our overburdened state and federal courts, consumer arbitrations administered by the American Arbitration Association are typically resolved in four to six months—a huge improvement over the 25.7 months that pass before the average civil lawsuit in federal court first reaches trial (in those rare cases that make it to trial).[48] (Even in 2001—well before the recent rounds of cutbacks—a contract suit tried before a jury took 25 months on average to reach judgment; but now that time frame won't suffice even to begin a trial.[49]) Long delays are a sure-fire way of increasing the transaction costs of dispute resolution.

In short, arbitration gives consumers a practical and accessible way to pursue their disputes far more often than litigating in court would.

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[47] *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 1753 (2011) (noting that "aggrieved customers who filed claims would be 'essentially guarantee[d] to be made whole," and that "the District Court concluded that the Concepcions were *better off* under their arbitration agreement with AT&T than they would have been as participants in a class action") (quoting *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 856 n.9 (9th Cir. 2009)).

[48] AAA, *Analysis of the AAA's Consumer Arbitration Caseload*, 2007, http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_004325 ("AAA Caseload Analysis"); *see also* David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 Stan. L. Rev. 1557, 1572-73 (2005) ("few dispute the assertion that arbitration is faster than litigation"); *U.S. District Court—Judicial Caseload Profile* (2012), http://www.uscourts.gov/Statistics/FederalCourtManagementStatistics.aspx. *See also*, *e.g.*, Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where do Plaintiffs Better Vindicate Their Rights?*, 58 Disp. Resol. J. 56, 58 (Nov. 2003 - Jan. 2004); reporting findings that arbitration was 33% faster than analogous litigation); *see also* 23-9 Insurance Times, Apr. 29, 2003, http://www.insurancejournal.com/pdf/InsuranceTimes_20030429_39125.pdf; GAO Report to Congressional Requesters, *Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards* 32 (June 2000), http://www.gao.gov/archive/2000/gg00115.pdf (reporting that the few securities claims to reach a judgment in court took 1,151 days—or over 3 years—on average); FINRA, *Dispute Resolution Statistics*, *Summary Arbitration Statistics October 2013* http://www.finra.org/arbitrationandmediation/finradisputeresolution/additionalresources/statistics/ ("FINRA Statistics") (arbitration claims closed in 2013 through October were pending only 14.2 months on average).

[49] Bureau of Justice Statistics, *Contract Trials and Verdicts in Large Counties, 2001* 2, Jan. 2005, http://www.bjs.gov/content/pub/pdf/ctvlc01.pdf.

Finally, arbitration is also attractive "from the company's perspective" because it provides a process that is, on average, cheaper than litigation—resolving most consumer or employment complaints quickly and efficiently, to the consumers' or employees' satisfaction—while minimizing unnecessary transaction costs of in-court litigation.[50]

2. **Consumers Prevail in Arbitration at Least as Frequently As—and Often More Frequently Than—They Do in Court.**

The empirical research reveals that claimants who choose to arbitrate their claims against businesses are at least as likely—if not more likely—to prevail than those who proceed in court.

Data on win rates reveal that consumers and employees obtain relief to their satisfaction in a significant proportion of arbitrations.

- A recent study by scholars Christopher Drahozal and Samantha Zyontz of claims filed with the American Arbitration Association found that consumers win relief 53.3% of the time.[51]
    - Empirical studies that have sampled wide ranges of claims have similarly reported that plaintiffs win in state and federal court approximately 50% of the time.[52]
    - Drahozal and Zyontz also found that "[c]onsumer claimants who bring large claims tend to do better than consumers who bring smaller claims," but that "[i]n both types of cases, the consumer claimant won some relief against the business more than half of the time."[53]

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[50] Maltby, 30 Wm. Mitchell L. Rev. at 317.

[51] Drahozal & Zyontz, 25 Ohio St. J. on Disp. Resol. at 896-904.

[52] *See, e.g.,* Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991-92, plaintiffs won 51% of jury trials in state court and 56% of jury trials in federal court, while in 1979-1993 plaintiffs won 50% of jury trials).

[53] Drahozal & Zyontz, 25 Ohio St. J. on Disp. Resol. at 898.

- Prevailing consumer claimants were generally awarded between 42% and 73% of the amount that they claimed—depending on whether they presented a large or small claim and on how the statistics were calculated (mean or median recovery).

- Claimants are able to win not only compensatory damages but also "other types of damages, including attorneys' fees, punitive damages, and interest."[54] In particular, 63.1% of prevailing claimants who sought attorneys' fees were awarded them.[55]

- Moreover, although the study's authors found a higher win rate (83.6%) for businesses that bring claims against consumers, they concluded that this result was attributed to the fact that "businesses tend to bring debt collection actions and other similar cases in which the likelihood of success [on the merits] for the business is high."[56] By contrast, consumers' claims are "much less likely to involve liquidated amounts and more likely to be contested by businesses."[57]

- The study's authors also examined the purported "repeat player" effect, in order to determine the effect on win rates for claimants who pursue arbitration against businesses that appeared in multiple arbitrations before the AAA. Significantly, the authors found that "consumer claimants still recover some amount against both repeat[] and non-repeat businesses over half the time in the case file sample."[58] And when

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[54] *Id.* at 902.

[55] This stands in marked distinction with the "American Rule" that governs attorney's fees in court proceedings. Under that default rule—where not otherwise altered by statute or contract— "each side in civil litigation has ultimate responsibility for its own lawyer's fees," and the losing party does not "pay anything toward the winner's representation." Thomas D. Rowe, Jr., *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 Duke L. J. 651, 651. Although the American Rule is the norm in our courts, its effect on the parties' incentives to litigate is distorted with respect to class actions, in which a court may award class counsel reasonable fees measured by the "lodestar" time cost of litigating the class action or by a percentage of the common fund or common benefits recovered for the class. *See* Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 3-4 (1991).

[56] Drahozal & Zyontz, 25 Ohio St. J. on Disp. Resol. at 898.

[57] *Id.* at 901.

[58] *Id.* at 909.

consumer claimants "do prevail on their claim" against a repeat-player business, "they are awarded on average an almost identical percent of the amount claimed against repeat[] businesses (52.4%) as against non-repeat businesses (52.0%)."[59] The authors concluded, too, that the minor discrepancy between those win rates "does not necessarily show arbitrator (or other) bias in favor of repeat businesses." Rather, they explained, businesses that repeatedly arbitrate may be better at screening cases ahead of time, allowing them to "settle meritorious claims and arbitrate only weaker claims."[60]

- According to data released by the AAA about consumer claims resolved between January and August 2007, consumers obtained settlements (or otherwise withdrew their disputes from arbitration) in 60 percent of the cases that they brought against businesses and, in the remaining 40 percent, they prevailed roughly half (48 percent) of the time.[61]

- Data released by the independent administrator of Kaiser Foundation Health Plan's arbitration system revealed that nearly half of claimants obtained resolution to their satisfaction through settlement (44% of claimants in closed cases) or through an award to the claimant after a hearing (5%). "The average award was $362,161, the median was $258,913, and the range was from $8,550 to $2,528,570."[62]

- Critics of voluntary arbitration sometimes point to a report from the advocacy group Public Citizen as purported support for their assertions that arbitration is unfair. But the Public Citizen report shows the folly of examining outcomes in arbitration without comparing them to analogous outcomes in court.

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[59] *Id.* at 912.

[60] *Id.* at 913.

[61] *See AAA Caseload Analysis*, *supra* note 48.

[62] Office of the Independent Administrator of the Kaiser Foundation Health Plan Mandatory Arbitration System for Disputes with Health Plan Members, *2012 Annual Report* ii-iii, 2013, http://www.oia-kaiserarb.com/oia/Forms/2012%20Report.pdf.

- ○ Public Citizen examined data about claims in arbitration brought by creditors against consumer debtors, and concluded from a high win rate for creditors that arbitration is biased against consumers. But in creditor cases against consumer debtors, the consumer often does not appear and does not contest the claim, and is therefore liable either because he has defaulted or "because he owes the debt."[63]

- ○ A more rigorous empirical study subsequently showed that "consumers fare better" in debt-collection arbitrations than in litigation in court.[64] In particular, "creditors won some relief in 77.8 percent of the individual AAA debt collection arbitrations and either 64.1 percent or 85.2 percent of the AAA debt collection program arbitrations," depending on how the research parameters were defined.[65] By contrast, in contested court cases creditors won relief against consumers between 80% and 100% of the time, depending on the court. And consumers fared even worse in court when they did not contest the creditor's claim—courts routinely award default judgments against consumers when they fail to show up. [66]

- Professor Peter Rutledge of the University of Georgia has reviewed the empirical studies comparing arbitration and litigation, and concluded that "raw win rates, comparative win rates, comparative recoveries, and comparative recoveries relative to amounts claimed . . . do not support the claim that consumers and employees achieve inferior results in arbitration compared to litigation."[67]

In short, consumers consistently achieve outcomes in arbitration that are comparable or superior to the outcomes in court. Although the Bureau is not directly

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[63] Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration*, 15 Disp. Resol. Mag. 30, 31 (Fall 2008).

[64] Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 Hastings Bus. L.J. 77, 97 (Winter 2011).

[65] *Id.* at 91.

[66] *Id.* at 111-16 (Tables D.1-D.5) (comparing creditor claimant wins and consumer respondent wins, in cases without consumer responses).

[67] Peter B. Rutledge, *Whither Arbitration?*, 6 Geo. J.L. & Pub. Pol'y 549, 560 (Summer 2008).

concerned with the use of arbitration in the employment context, it is worth noting that studies of employment arbitration reach the same result: employees in arbitration do as well as, or better than, employees in court. For example:

- A study of 186 plaintiffs who pursued employment arbitration in the securities industry concluded that employees who arbitrate were more likely to win their disputes than employees who litigate in federal court. The study compared the employees' success rate in arbitration to that of 125 employees who litigated discrimination suits to a resolution in the Southern District of New York. The study found that 46% of those who arbitrated won, as compared to only 34% in litigation; the median monetary award in arbitration was higher; only 3.8% of the litigated cases studied ever reached a jury trial; and the arbitrations were resolved 33% faster than in court.[68]

- One study of 200 AAA employment awards concluded that low-income employees brought 43.5% of arbitration claims, most of which were low-value enough that the employees would not have been able to find an attorney willing to bring litigation on their behalf. These employees were often able to pursue their arbitrations without an attorney, and they won their arbitrations at the same rate as individuals with representation.[69]

- A later study of 261 AAA employment awards from the same period found that for higher-income employees, win rates in like cases in arbitration and litigation were essentially equal, as were median damages.[70] The study attempted to compare "apples" to "apples" by considering separately cases that involved and those that did not involve discrimination claims.[71] With respect to

[68] Delikat & Kleiner, 58 Disp. Resol. J. at 58.

[69] Hill, 18 Ohio St. J. on Disp. Resol. at 785-88 (summarizing results of past studies by Lisa Bingham that lacked empirical evidence proving the existence of an alleged "repeat player" and "repeat arbitrator" effect).

[70] Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 Disp. Resol. J. 44, 48, 50 (Nov. 2003-Jan. 2004).

[71] *See id*. at 49. Because prior research had shown that discrimination claimants "fare noticeably worse in litigation [in court] than other claimants" (*id*. at 48), and "civil-rights claims predominat[ed] in the trial group" sample of court cases (*id*. at 49), the study controlled for the makeup of the data set in court cases in order to draw meaningful comparisons. This control was aimed at ensuring that arbitration outcomes would not "look more pro-employee than they should simply based on the makeup of the sample." *Id*. at 49.

discrimination and non-discrimination claims alike, the study found no statistically significant difference in the success rates of higher-income employees in arbitration and in litigation. For lower-income employees, the study did not attempt to draw comparisons between results in arbitration and in litigation, because lower-income employees appeared to lack meaningful access to the courts—and therefore could not bring a sufficient volume of court cases to provide a baseline for comparison.[72]

- Another separate study of the arbitration of employment-discrimination claims concluded that arbitration is "substantially fair to employees, including those employees at the lower end of the income scale," with employees enjoying a win rate comparable to the win rate for employees proceeding in federal court.[73]
- In 2004, the National Workrights Institute compiled all available employment-arbitration studies, and concluded that employees were almost 20% more likely to win in arbitration than in litigated employment cases. It also concluded that in almost half of employment arbitrations, employees were seeking redress for claims too small to support cost-effective litigation. Median awards received by plaintiffs were the same as in court, although the distorting effect of occasional large jury awards resulted in higher average recoveries in litigation.[74]
- Lewis Maltby, a noted employee advocate and current president of the National Workrights Institute, examined a variety of studies and statistics in 1998 and concluded that the litigation system was far less employee-friendly than commonly believed, and that the arbitration system is far ***more*** employee-friendly. Employees in arbitration in the 1993-1995 period won over 63% of their arbitrations, as compared to 14.9% of federal-district-court cases; as a group, employees also fared better in arbitration than in court in terms of

[72] *Id.* at 45, 47-48.

[73] *See* Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 Disp. Resol. J. 9, 13 (May/July 2003) (reporting employee win rate in arbitration of 43 percent); *see also* Eisenberg & Hill, 58 Disp. Resol. J. at 48 tbl. 1 (reporting employee win rate in federal district court during the same time period was 36.4 percent).

[74] National Workrights Institute, *Employment Arbitration: What Does the Data Show?* (2004), https://web.archive.org/web/20090423052708/http://www.workrights.org/current/cd_arbitration.html.

damages received, compared to initial demands.[75] In short, employees who arbitrate prevailed more often that employees who litigate.

As one study published in the *Stanford Law Review* explained in surveying the empirical research, "[w]hat seems clear from the results of these studies is that the assertions of many ***arbitration critics were either overstated or simply wrong***."[76] There simply is no empirical support for the contention that arbitration leads to unfair or subpar outcomes when compared with litigation in our overcrowded court system. Rather, the overwhelming weight of the available evidence establishes reflects that arbitration allows consumers and employees to obtain redress faster, cheaper, and more effectively than they could in court.

3. **Existing Law Protects Consumers Against Unfair Arbitration Procedures and Biased Arbitrators.**

Critics of arbitration sometimes claim that consumers are subjected to unfair arbitration procedures. But current law already contains clear and effective protections against unfair arbitration clauses, and state and federal courts consistently strike down those arbitration clauses that transgress those limits.

State contract law has long recognized that "contracts of adhesion"—take-it-or-leave it standard-form agreements that are essential to the efficient operation of our mass-market economy—can be unfair to consumers or employees in some circumstances. The unconscionability doctrine addresses this concern by empowering courts to invalidate contract provisions that are unfair to consumers or employees. ***Unconscionability standards apply to arbitration contracts***. Section 2 of the Federal Arbitration Act empowers courts to exercise their authority to review arbitration agreements for compliance with generally-applicable state-law contract principles, including unconscionability.

Indeed, just last year in *Marmet Health Care Center, Inc. v. Brown*, the Court recognized that arbitration agreements may be invalidated under unconscionability

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[75] Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 Colum. Hum. Rts. L. Rev. 29 (Fall 1998).

[76] Sherwyn et al., 57 Stan. L. Rev. at 1567 (emphasis added).

standards "that are not specific to arbitration."[77] (Of course, states cannot discriminate against arbitration contracts by subjecting them to different and harsher standards.)

Courts inquire into the fairness of arbitration provisions in the context of particular clauses and cases, but one thing is clear: ***when courts find arbitration provisions unfair to consumers or employees under generally applicable principles, they do not hesitate to invalidate the agreements***. For example:

- **Courts invalidate contractual limits on damages that can be awarded by an arbitrator**: Courts police arbitration agreements to ensure that consumers and employees retain their substantive rights in arbitration and can seek individual remedies in arbitration to the same extent as they could in court.

    - Thus, a Texas court struck down an arbitration provision that barred the consumers from recovering damages or attorneys' fees under that state's Deceptive Trade Practices—Consumer Protection Act.[78] Another court refused to enforce an arbitration agreement that purported to limit damages to "actual and direct" damages, which would have had the effect of limiting individual remedies under the Home Ownership Equity Protection Act, 15 U.S.C. § 1639.[79] Courts regularly refuse to enforce other damages limitations.[80]

    - Numerous courts have refused to enforce arbitration agreements that prevent an individual from recovering punitive damages.[81]

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[77] 132 S. Ct. 1201, 1204 (2012).

[78] *Venture Cotton Coop. v. Freeman*, 395 S.W.3d 272 (Tex. Ct. App. 2013).

[79] *Mortg. Elec. Registration Sys., Inc. v. Abner*, 260 S.W.3d 351, 352, 355 (Ky. Ct. App. 2008).

[80] *See also Carll v. Terminix Int'l Co.*, 793 A.2d 921 (Pa. Super. Ct. 2002) (striking provision that barred consumers from recovering damages for personal injury); *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (Ct. App. 1997) (striking arbitration agreement that barred all relief other than actual damages for breach-of-contract claims).

[81] *See*, *e.g.*, *Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003); *Woebse v. Health Care & Retirement Corp. of Am.*, 977 So. 2d 630 (Fla. Dist. Ct. App. 2008).

- In addition to these decisions, the Supreme Court recently explained that federal law would likely require invalidating "a provision in an arbitration agreement forbidding the assertion of certain [federal] statutory rights."[82]

- **Courts reject requirements that arbitration take place in inconvenient locations**: Courts carefully and closely scrutinize provisions that require consumers to arbitrate in a particular location.

  - A federal court in Oregon refused to enforce an agreement that would have required an Oregon consumer to travel to California to arbitrate a dispute concerning a debt-relief agreement, and a Virginia trial court struck down an arbitration provision as unconscionable in part because it required consumers who had bought used cars in Virginia to arbitrate their claims in Los Angeles.[83] Many other courts have reached similar conclusions. [84]

- **Courts strike down agreements with biased procedures for selecting the arbitrator**: Courts invalidate arbitration provisions found to deprive consumers or employees of a fair opportunity to participate in the selection of an arbitrator.

  - The U.S. Court of Appeals for the Ninth Circuit recently held that an arbitration agreement was unconscionable and unenforceable when it "would always produce an arbitrator proposed by [the company] in employee-initiated arbitration[s]," and barred selection of "institutional arbitration administrators."[85]

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[82] *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2310 (2013).

[83] *See Willis v. Nationwide Debt Settlement Grp.*, 878 F. Supp. 2d 1208 (D. Or. 2012); *Philyaw v. Platinum Enters., Inc.*, 54 Va. Cir. 364 (Va. Cir. Ct. Spotsylvania Cnty. 2001).

[84] *See, e.g.*, *College Park Pentecostal Holiness Church v. Gen. Steel Corp.*, 847 F. Supp. 2d 807 (D. Md. 2012) (travel from Maryland to Colorado); *Hollins v. Debt Relief of Am.,* 479 F. Supp. 2d 1099 (D. Neb. 2007) (travel from Nebraska to Texas); *Dominguez v. Finish Line, Inc.*, 439 F. Supp. 2d 688 (W.D. Tex. 2006) (severing provision that would have required Texas retail store manager to arbitrate in Indianapolis, Indiana); *Swain v. Auto Servs., Inc.*, 128 S.W.3d 103, 108 (Mo. Ct. App. 2003) (severing provision that would have required Missouri consumer to arbitrate in Arkansas); *Pinedo v. Premium Tobacco Stores, Inc.*, 102 Cal. Rptr. 2d 435 (Ct. App. 2000) (refusing to enforce agreement that would have required Los Angeles employee to travel to Oakland for arbitration).

[85] *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 923-25 (9th Cir. 2013).

- The U.S. Court of Appeals for the Fourth Circuit struck down an arbitration agreement that gave the employer the sole right to create a list of arbitrators from whom the employee could then pick.[86] And a federal district judge in California refused to enforce a provision that would have granted a company sole discretion to choose an "independent and qualified" arbitrator for its consumer disputes because (under the circumstances) there was no guarantee that the arbitrator would be neutral.[87]

- **Contracts imposing excessive costs to access arbitration are struck down**: The Supreme Court explained in *Green-Tree Fin. Corp.-Ala. v. Randolph* that a party to an arbitration agreement may challenge enforcement of the agreement if the claimant would be required to pay excessive filing fees or arbitrator fees in order to arbitrate a claim.[88]

    - Since *Randolph*, courts have aggressively protected consumers and employees who show that they would be forced to bear excessive costs to access the arbitral forum.[89] The Ninth Circuit, for example, recently refused to enforce an arbitration agreement that required the employee to pay an unrecoverable portion of the arbitrator's fees "regardless of the merits of the claim."[90] And the Supreme Court reaffirmed in *American Express v. Italian Colors* that a challenge to an arbitration agreement might be successful if "filing and administrative fees attached to arbitration . . .

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[86] *Murray v. United Food & Commercial Workers Int'l Union*, 289 F.3d 297 (4th Cir. 2002); *see also Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999).

[87] *Newton v. American Debt Services, Inc.*, 854 F. Supp. 2d 712, 726 (N.D. Cal. 2012); *see also Roberts v. Time Plus Payroll Servs., Inc.*, 2008 WL 376288 (E.D. Pa. Feb. 7, 2008) (refusing to enforce provision that would have given employer sole discretion to select arbitrator, and instead requiring parties to select arbitrator jointly); *see also Missouri ex rel. Vincent v. Schneider*, 194 S.W.3d 853 (Mo. 2006) (invalidating provision giving president of a local home-builder association sole discretion to pick arbitrator for disputes between local home-builders and home buyers).

[88] *Randolph*, 531 U.S. at 90-92.

[89] *See*, *e.g.*, *Phillips v. Assocs. Home Equity Servs., Inc.*, 179 F. Supp. 2d 840 (N.D. Ill. 2001); *Camacho v. Holiday Homes, Inc.*, 167 F. Supp. 2d 892 (W.D. Va. 2001).

[90] *Chavarria*, 733 F.3d at 923-25.

are so high as to make access to the forum impracticable" for a plaintiff.[91]

- Other courts have reached the same result under state unconscionability law.[92]

- **Arbitration agreements subjecting consumers or employees to unreasonably shortened statutes of limitations are not enforced**: For example, courts have rejected provisions in arbitration agreements that would have required employees to bring claims within six months.[93]

- **Courts invalidate arbitration agreements with "loser pays" provisions**: Courts also protect individuals against arbitration provisions requiring the "loser" of an arbitration to pay the full costs of the arbitration.[94] And courts do not hesitate to invalidate provisions of arbitration agreements that purport to require the consumer to pay for all costs and expenses of the drafting party regardless of who wins.[95]

The vast majority of arbitration provisions do not exhibit these sorts of defects; and the clear trend has been for companies to make arbitration provisions ever more favorable to their customers and employees. But ***when courts find overreaching occurs—in the areas discussed above and many others as well—they have not hesitated to strike down the arbitration provisions.***

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[91] *Am. Express Co.*, 133 S. Ct. at 2310-11.

[92] *See, e.g., Brunke v. Ohio State Home Servs., Inc.*, 2008 WL 4615578 (Ohio Ct. App. Oct. 20, 2008); *Liebrand v. Brinker Rest. Corp.*, 2008 WL 2445544 (Cal. Ct. App. June 18, 2008); *Murphy v. Mid-West Nat'l Life Ins. Co. of Tenn.,* 78 P.3d 766 (Idaho 2003);

[93] *See, e.g., Zaborowski v. MHN Gov't Servs., Inc.*, 2013 WL 1363568 (N.D. Cal. Apr. 3, 2013); *Adler v. Fred Lind Manor*, 103 P.3d 773 (Wash. 2004) (180 days); *see also Gandee v. LDL Freedom Enters., Inc.*, 293 P.3d 1197 (Wash. 2013) (refusing to enforce arbitration agreement in debt-collection contract that required debtor to present claim within 30 days after dispute arose); *Alexander*, 341 F.3d at 256 (same, for an employee); *Stirlen*, 60 Cal. Rptr. 2d at 138 (rejecting provision that imposed shortened one-year statute of limitations).

[94] *See Gandee*, 293 P.3d at 1197; *Alexander*, 341 F.3d at 256; *Sosa v. Paulos*, 924 P.2d 357 (Utah 1996).

[95] *See, e.g.*, *In re Checking Account Overdraft Litig. MDL No. 2036*, 485 F. App'x 403 (11th Cir. 2012); *see also Samaniego v. Empire Today LLC*, 140 Cal. Rptr. 3d 492 (Cal. Ct. App. 2012) (attorneys' fees).

4. **The Leading Arbitration Forums Provide Additional Fairness Protections.**

The American Arbitration Association (AAA) and JAMS—the nation's leading arbitration service providers—recognize that independence, due process, and reasonable costs to consumers are vital elements of a fair and accessible arbitration system. They therefore adhere to standards that establish basic requirements of procedural fairness that provide strong protections for consumers and employees. Those providers will not administer an arbitration unless the operative clause is consistent with standards for procedural fairness.

The not-for-profit AAA has served the public since 1926. With offices throughout the United States and around the world, it is among the largest providers of alternative dispute resolution.[96] The AAA maintains a roster of over 7,500 impartial arbitrators and mediators with differing areas of expertise and vast experience.[97] Similarly, JAMS is another leading provider of alternative dispute – resolution.[98] JAMS resolves over 10,000 cases each year and maintains hearing locations worldwide.[99] JAMS employs over 300 full-time exclusive neutrals, many of whom are retired judges and attorneys.[100]

- **Claim Initiation Is Simple and the Rules Are Fair.** In order to initiate a claim under the AAA's rules, a claimant must: (1) briefly explain the dispute; (2) list the names and addresses of the consumer and the business; (3) specify the amount of money involved; and (4) state what relief the claimant wants.[101]

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96 AAA, *Statement of Ethical Principles for the American Arbitration Association, an ADR Provider Organization*, http://www.adr.org/aaa/faces/s/about/mission/ethicalprinciples?_afrLoop=224757641544354&_afrWindowMode=0&_afrWindowId=null#%40%3F_afrWindowId%3Dnull%26_afrLoop%3D224757641544354%26_afrWindowMode%3D0%26_adf.ctrl-state%3D1c22qa5a7n_18.

97 *Id.*

98 JAMS, *About JAMS*, http://www.jamsadr.com/aboutus_overview/.

99 *Id.*

100 *Id.*

101 AAA, *Consumer Related Disputes, Supplementary Procedures*, *supra* note 46.

JAMS similarly requires simple, straightforward information from consumers who initiate disputes, and provides an easy-to-complete online form.[102]

- **Financial Burden Largely Falls on Businesses, Not Consumers or Employees.** Through its rules and fee schedules, AAA shifts most of the financial burden of arbitration to businesses and provides refunds of unused fees and unused other services to ease consumers' financial burdens even further. For example, "[i]n cases before a single arbitrator, a nonrefundable filing fee capped in the amount of $200 is payable in full by the consumer when a claim is filed . . . [a] partially refundable fee in the amount of $1,500 is payable in full by the business . . ."[103] Similarly, under JAMS rules, when a consumer initiates arbitration against the company, the consumer is required to pay only $250, and all other costs are left to the company.[104] In other words, both organizations require *companies* to bear most of the burdens of consumer claims—without regard to who initiated the arbitration.

- **Consumers Play a Key Role in Selecting the Arbitrator.** Arbitration providers screen and help appoint arbitrators, providing the parties with an equal role in selecting the arbitrators in individual proceedings. For example, the AAA provides parties seven days to submit any objections to the appointment of an arbitrator from a list provided by the AAA.[105] Likewise, JAMS rules reaffirm that "consumer[s] must have a reasonable opportunity to participate in the process of choosing the arbitrator(s)."[106]

- **Easy-to-Attend Hearings.** For those individuals who want a hearing, the AAA gives the parties an opportunity to have an in-person hearing or, to make

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102 JAMS, *Arbitration Forms*, http://www.jamsadr.com/arbitration-forms/.

103 AAA, *Costs of Arbitration (Including AAA Administration Fees)*, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTAGE2009593&RevisionSelectionMethod=LatestReleased.

104 JAMS, *JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness*, http://www.jamsadr.com/consumer-arbitration/.

105 AAA, *Consumer Related Disputes, Supplementary Procedures* C-4, *supra* note 46.

106 JAMS, *supra* note 104.

things easier and cheaper, parties may choose to participate by telephone.[107] The JAMS rules also seek to provide individuals with easy service when it comes to hearings. Under the JAMS policy, "consumer[s] must have a right to an in-person hearing in his or her hometown area."[108]

- **Governed by Due Process Protocols.** All the consumer protections in place at the AAA are driven by standards that set out basic requirements for procedural fairness. The AAA's Consumer Due Process Protocol requires independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court.[109] The AAA will not administer a consumer arbitration unless the arbitration is consistent with the Due Process Protocol.

Likewise, JAMS will administer a pre-dispute arbitration clause between a company and a consumer only if the contract clause complies with "minimum standards of fairness."[110]

5. **Companies Increasingly Are Adopting Consumer-Friendly Arbitration Agreements.**

In the wake of the Supreme Court's decision in *Concepcion*, an increasing number of arbitration agreements include consumer-friendly provisions modeled on the elements of the arbitration agreement upheld in that case.[111]

Companies Shoulder the Costs Of Arbitration. These agreements include provisions making arbitration cost-free to consumers. For example:

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[107] AAA, *Consumer Related Disputes, Supplementary Procedures* C-6, *supra* note 46.

[108] JAMS, *supra* note 104.

[109] AAA, *Consumer Due Process Protocol*, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTG_005014&RevisionSelectionMethod=LatestReleased.

[110] JAMS, *supra* note 104.

[111] Some of these examples were reported in Myriam Gilles, *Killing Them With Kindness: Examining "Consumer-Friendly" Arbitration Agreements After* AT&T Mobility v. Concepcion, 88 Notre Dame L. Rev. 825 (2012). The author of this study is an academic who has been largely critical of consumer arbitration.

Company	Cost-Sharing Provision	Website (last visited Dec. 10, 2013)
Amazon.com	"Payment of all filing, administration and arbitrator fees will be governed by the AAA's rules. We will reimburse those fees for claims totaling less than $10,000 unless the arbitrator determines the claims are frivolous. Likewise, Amazon will not seek attorneys' fees and costs in arbitration unless the arbitrator determines the claims are frivolous."	http://www.amazon.com/gp/help/customer/display.html/?nodeId=508088
AT&T	"For any non-frivolous claim that does not exceed $75,000, AT&T will pay all costs of arbitration."	http://www.att.com/disputeresolution
BMO Harris Bank	"For any non-frivolous Claim with a value of $75,000 or less, we will pay the filing, administration and arbitrator fees charged by the American Arbitration Association (also referred to in this provision as the 'AAA') in connection with the arbitration."	http://www.bmoharris.com/pdf/global/deposit-agreement.pdf
Dell	"Dell will be responsible for paying any individual consumer's arbitration fees."	http://www.dell.com/learn/us/en/19/terms-of-sale-consumer?c=us&l=en&s=dhs&cs=19
Match.com	"If your claim against Match.com is for less than $1,000, we will pay all fees."	http://www.match.com/registration/arbitrationProcedures.aspx
Microsoft (Office 2013)	"Disputes Involving $75,000 or Less. Microsoft will promptly reimburse your filing fees and pay the AAA's and arbitrator's fees and expenses. If you reject Microsoft's last written settlement offer made before the arbitrator was appointed .	http://www.microsoft.com/en-us/legal/arbitration/office2013.aspx

Company	Cost-Sharing Provision	Website (last visited Dec. 10, 2013)
	. . , your dispute goes all the way to an arbitrator's decision . . ., and the arbitrator awards you more than Microsoft's last written offer, Microsoft will give you three incentives: (i) pay the greater of the award or $1,000; (ii) pay twice your reasonable attorney's fees, if any; and (iii) reimburse any expenses (***including expert witness fees and costs***) that your attorney reasonably accrues for investigating, preparing, and pursuing your claim in arbitration. The arbitrator will determine the amount of fees, costs, and expenses unless you and Microsoft agree on them."	
Sprint	"Sprint will pay for any filing or case management fees associated with the arbitration and the professional fees for the arbitrator's services."	http://shop2.sprint.com/en/legal/legal_terms_privacy_popup.shtml

Expert and Other Costs of Proving Claims In Arbitration Can Be Shifted To Companies. In some very complex cases, it is possible that a consumer or employee might require an expert witness or even complex discovery in order to pursue a claim against a company. Many companies have adopted arbitration provisions that allow for such costs to be shifted to companies if the claimant prevails—***even when the underlying law does not provide for such cost-shifting and cost-shifting therefore would not be available in a judicial lawsuit***:

Company	Bounty Provision	Website (last visited Dec. 10, 2013)
American Express (*e.g.,* Green Card)	"If the arbitrator rules in your favor for an amount greater than any final offer we made before arbitration, the arbitrator's award will include: (1) any money to which you are entitled, but in no case less than $5,000; and (2) any reasonable attorney's fees, costs and expert and other witness fees."	https://web.aexp-static.com/us/content/pdf/cardmember-agreements/green/AmericanExpressGreenCard.pdf
AT&T	"If, after finding in your favor in any respect on the merits of your claim, the arbitrator issues you an award that is greater than the value of AT&T's last written settlement offer made before an arbitrator was selected, then AT&T will: • pay you the amount of the award or $10,000 . . . , whichever is greater; and • pay your attorney, if any, twice the amount of attorneys' fees, and reimburse any expenses (including expert witness fees and costs), that your attorney reasonably accrues for investigating, preparing, and pursuing your claim in arbitration...."	http://www.att.com/disputeresolution
BMO Harris Bank	"If, after finding in your favor on the merits of your Claim(s), the arbitrator issues you an award that is greater than the value of our last written settlement offer made before an arbitrator was selected, then we will . . . pay you the amount of the award or $5,000, whichever is greater (the	http://www.bmoharris.com/pdf/global/deposit-agreement.pdf

Company	Bounty Provision	Website (last visited Dec. 10, 2013)
	"alternative payment"); and . . . pay your attorney, if any, the amount of attorney's fees, and reimburse any expenses ***(including expert witness*** fees and costs reasonably necessary to prove your Claim), that your attorney reasonably incurs for investigating, preparing, and pursuing your Claim in arbitration (the 'attorney payment')." (Emphasis added).	
Electronic Arts	"[I]f we cannot resolve our disputes informally and you are awarded a sum at arbitration greater than EA's last settlement offer to you (if any), EA will pay you 150% of your arbitration award, up to $5000 over and above your arbitration award."	http://tos.ea.com/legalapp/WEBTERMS/US/en/PC/
Microsoft Xbox	"[If y]our dispute goes all the way to an arbitrator's decision (called an 'award'), and the arbitrator awards You more than Microsoft's last written offer, Microsoft will give You three incentives: (i) pay the greater of the award or $1,000; (ii) pay twice Your reasonable attorney's fees, if any; and (iii) reimburse any expenses (***including expert witness fees and costs***) that Your attorney reasonably accrues for investigating, preparing, and pursuing Your claim in arbitration."	http://www.xbox.com/en-US/Legal/xbox-live-contract-terms

Company	**Bounty Provision**	**Website (last visited Dec. 10, 2013)**
Sallie Mae (Bar Study Loan)	If: (i) I submit a Claim Notice in accordance with this paragraph on my own behalf (and not on behalf of any other party); (ii) you refuse to provide the relief I request; and (iii) an arbitrator subsequently determines that I was entitled to such relief (or greater relief), the arbitrator shall award me at least $5,100 (not including any arbitration fees and attorneys' fees and costs to which I may be entitled under this Arbitration Agreement or applicable law)."	https://www.salliemae.com/assets/products/library/app_barstudystudentloancoborrower.pdf
Santander Bank	"If: (i) you submit a Claim Notice on your own behalf (and not on behalf of any other party) in accordance with subsection n, and you otherwise comply with subsection n (including its resolution and cooperation provisions); (ii) we refuse to provide you with the relief you request; and (iii) an arbitrator subsequently determines that you were entitled to such relief (or greater relief), the arbitrator shall award you at least $7,500 and will also require us to pay any other fees and costs to which you are entitled."	https://dmob.santanderbank.com/csdlv/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobheadername1=Content-Disposition&blobheadervalue1=inline%3Bfilename%3DN3353_MK0034_Sept2013_PDAA+Agreement_r4.pdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1354923409319&ssbinary=true

Company	Bounty Provision	Website (last visited Dec. 10, 2013)
Verizon	"WE MAY . . . MAKE A WRITTEN SETTLEMENT OFFER ANYTIME BEFORE ARBITRATION BEGINS. . . . IF YOU DON'T ACCEPT THE OFFER AND THE ARBITRATOR AWARDS YOU AN AMOUNT OF MONEY THAT'S MORE THAN OUR OFFER BUT LESS THAN $5000, OR IF WE DON'T MAKE YOU AN OFFER, AND THE ARBITRATOR AWARDS YOU ANY AMOUNT OF MONEY BUT LESS THAN $5,000, THEN WE AGREE TO PAY YOU $5,000 INSTEAD OF THE AMOUNT AWARDED. IN THAT CASE WE ALSO AGREE TO PAY ANY REASONABLE ATTORNEYS' FEES AND EXPENSES, REGARDLESS OF WHETHER THE LAW REQUIRES IT FOR YOUR CASE. IF THE ARBITRATOR AWARDS YOU MORE THAN $5000, THEN WE WILL PAY YOU THAT AMOUNT."	http://www.verizonwireless.com/b2c/support/customer-agreement

Arbitration Agreements Adopt Informal Procedures That Make It Easy For Claimants To Pursue Their Disputes. These agreements include provisions enabling consumers to choose whether the dispute should be resolved on the basis of a written submission, a telephonic hearing, or in-person proceedings. For example:

Company	Cost-Sharing Provision	Website (last visited Dec. 10, 2013)
AT&T	"If your claim is for $10,000 or less, we agree that you may choose whether the arbitration will be conducted solely on the basis of documents submitted to the arbitrator, through a telephonic hearing, or by an in-person hearing as established by the AAA Rules."	http://www.att.com/disputeresolution
Match.com	"If you are seeking less than $10,000, the arbitrator will decide the dispute based only upon the parties' written submissions and, if requested by either party, a telephonic hearing. The parties may submit to the arbitrator written statements setting forth their positions no later than 30 days after the arbitrator's appointment. Each party may also submit a rebuttal or supplemental statement within 10 days after initial statements are due. If a telephonic hearing is requested, it will occur within 45 days after the arbitrator's appointment."	http://www.match.com/registration/arbitrationProcedures.aspx
Netflix	"If your claim is for US$10,000 or less, we agree that you may choose whether the arbitration will be conducted solely on the basis of documents submitted to the arbitrator, through a telephonic hearing, or by an in-person hearing as established by the AAA Rules.."	https://signup.netflix.com/TermsOfUse

Company	Cost-Sharing Provision	Website (last visited Dec. 10, 2013)
Skype	"You may request a telephonic or in-person hearing by following the American Arbitration Association ("AAA") rules. In a dispute involving $10,000 or less, any hearing will be telephonic unless the arbitrator finds good cause to hold an in-person hearing instead."	http://download.microsoft.com/download/6/6/5/6653B3EA-BD4F-4E48-900D-4995146615B4/More-Arbitration-Terms-for-Skype.pdf
Ticketmaster	"If your claim is for $10,000 or less, we agree that you may choose whether the arbitration will be conducted solely on the basis of documents submitted to the arbitrator, through a telephonic hearing, or by an in-person hearing as established by the JAMS Rules."	https://m.concerts.livenation.com/ticket/portal/article.do?offset=27&site=tmus&page=tmustandc&article=terms_and_conditions_1&type=BLOGENTRY

6. **Arbitration's Transaction Cost Savings Lead to Lower Prices That Benefit Consumers.**

In addition to these direct benefits from arbitration, consumers also benefit through the systematic reduction of litigation-related transaction costs, which lead to lower prices for products and services.

Businesses face a number of costs in bringing their products and services to market. In addition to labor, materials, infrastructure, and other costs of running a business, they must absorb the cost of litigating claims related to those products and services. Critically, the costs associated with litigation include not only settlements and judgments resolving meritorious claims brought by plaintiffs, but also the transaction costs of defending against *all* lawsuits, whether or not the plaintiff ultimately prevails on the claim.

The transaction costs associated with judicial litigation are much higher than those incurred in connection with arbitration, for the reasons already discussed. Although arbitration requires businesses to shoulder the costs related to payments to claimants—as shown above, claimants obtain the same or more in arbitration as in litigation—businesses can avoid the higher litigation costs associated with *defending* claims in court.

That enables them to eliminate costs that otherwise would inflate the prices of their products or services. As scholars have noted, "companies . . . include arbitration clauses in their contracts to cut dispute resolution costs and produce savings that they may pass on to consumers through lower prices."[112]

II. The Arguments Advanced By Those Seeking To Prohibit Or Regulate Arbitration Agreements Are Meritless.

Notwithstanding the significant benefits that consumers obtain through arbitration, and the substantial protections in current law and practice against unfair arbitration procedures, some argue that arbitration should be prohibited or restricted in various ways. But the reasons they advance for prohibition or regulation simply do not hold up; and the consequence of their preferred approaches would be the elimination of arbitration agreements, which would deprive consumers of the very significant benefits of arbitration discussed above.

A. Prohibiting Pre-Dispute Arbitration Agreements Would Eliminate Arbitration.

Some critics of arbitration recognize that a generalized attack on alternative dispute resolution flies in the face of ADR's widespread acceptance, especially in light of our overcrowded and overwhelmed court system. To avoid a charge of overt hostility toward alternative dispute resolution, these opponents of arbitration instead frame their attack on "pre-dispute" arbitration agreements—that is, agreements to arbitrate any **future** disputes that might arise between the parties.

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[112] Amy J. Schmitz, *Building Bridges To Remedies For Consumers In International Econflicts*, 34 U. Ark. Little Rock L. Rev. 779, 779–80 (2012); *accord, e.g.*, Bennett, 67 Disp. Resol. J. at 38 n.55; Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. Am. Arb. 251, 254–55 (2006).

They assert that post-dispute arbitration agreements—reached after the dispute has already arisen[113]—will provide "a means of correcting the problems" they perceive to exist with arbitration.[114] They assert that "if arbitration is indeed . . . desirable, it will readily be accepted by claimants in the post-dispute setting."[115]

But both the empirical research and leading scholarship on dispute resolution demonstrate that this argument is completely false. Notwithstanding the clear evidence that arbitration is fair, efficient, inexpensive, and good for consumers, business, and employees, the empirical evidence and academic consensus is that ***once a particular dispute arises, the opposing parties will rarely if ever agree to arbitration. Their unwillingness to do so has nothing whatsoever to do with the relative benefits or burdens of arbitration or litigation in court, and instead has everything to do with the practical burdens of administering dual systems and the tactical choices of lawyers in the context of particular cases***.

The post-dispute arbitration agreement is thus an illusion in the consumer and employment contexts. Permitting only post-dispute arbitration agreements therefore would have the real-world consequence of banning arbitration, and depriving consumers of the benefits of arbitration discussed above.

First, "[p]ost-dispute agreements to arbitrate are extremely uncommon."[116] One study found, for instance, that far less than 1% of employment disputes are resolved by post-dispute arbitration *even when a responsible state agency organizes an arbitration program and routinely makes that program available to parties*.[117] A second study found that at most "6% of all employment arbitration[s]" initiated before the

113 Although post-dispute agreements to arbitration are often referred to simply as "post-dispute arbitration," that label is obviously a misnomer. *All* arbitration is necessarily "post dispute"; otherwise, there would be nothing to arbitrate. For that reason, we avoid the term "post-dispute arbitration" except when quoting materials that use it.

114 David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 Berkeley J. Emp. & Lab. L. 1, 30 (2003).

115 Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 Ohio St. J. on Disp. Resol. 559, 567 (2001) (describing detractors' position and then explaining why it is wrong). Although Estreicher and several of the other authors cited below discuss arbitration in the employment context rather than in the consumer context, their conclusions apply equally to consumer claims.

116 Hamid & Mathieu, 74 Alb. L. Rev. at 785.

117 *See* Sherwyn, 24 Berkeley J. Emp. & Lab. L. at 61-62.

American Arbitration Association resulted "from post-dispute agreements,"[118] notwithstanding that a substantial percentage of consumers—60 percent in 2012—settle their claims in arbitration, and that over 45 percent of the consumers who proceed to an arbitral award receive damages.[119]

"[I]n all but the rarest cases," therefore, post-dispute arbitration agreements "will not be offered by one party [and] accepted by the other."[120] Indeed, many employment and consumer contracts do not include pre-dispute arbitration clauses, yet parties to those contracts almost never agree to post-dispute arbitration.[121]

Second, a company that sets up an arbitration program incurs significant administrative costs in connection with carrying out arbitrations—costs that the company does not incur in connection with judicial litigation. For example, under the AAA's Supplementary Procedures for consumer dispute resolution, filing fees are capped at $200 for consumer arbitration—the company must pay up to $1,500.[122] And a company that promises to shift attorneys' or even experts' fees is likely to take on an uncertain but possibly enormous amount of transaction costs.

Companies are willing to incur these costs because, on average, the aggregate costs of resolving disputes in arbitration are lower than the aggregate costs of resolving disputes in litigation in court. And because the company does not know which consumers "will be claimants," it is "likely to offer the [arbitration] program to broad categories of" consumers.[123]

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[118] Maltby, 30 Wm. Mitchell L. Rev. at 314.

[119] *See, e.g.,* FINRA Statistics, *supra* note 48 (50% of FINRA arbitrations closed in 2012 were resolved by direct settlement by the parties, another 10% were resolved by settlement via mediation, and 45% of cases decided by the arbitrator involved an award to the consumer); Cole & Frank, 15 Disp. Resol. Mag. at 32 (finding that consumers "obtained 'favorable results'" in 80% of "consumer-initiated arbitration[s]"); *see also supra* note 51and accompanying text (consumers win relief in 53.3% of the cases they file in arbitrations before the American Arbitration Association).

[120] Estreicher, 16 Ohio St. J. on Disp. Resol. at 567; *see also* Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 Cardozo J. Conflict Resol. 267, 279 (2008).

[121] *See* Maltby, 30 Wm. Mitchell L. Rev. at 321 (employment contracts); Peter B. Rutledge & Christopher R. Drahozal, *Contract and Choice*, 2013 B.Y.U. L. Rev. 1, 16-18 & table 1 (2013) (credit card agreements); *see also, e.g.*, Rutledge, 9 Cardozo J. Conflict Resol. at 280 (noting that "an overwhelming majority of [lawyers] would advise their clients not to agree to postdispute arbitration").

[122] See *supra* note 103.

[123] Estreicher, 16 Ohio St. J. on Disp. Resol. at 568.

Well-run arbitration programs are expensive to develop and maintain, meaning that companies will offer them only if they cover most or all possible claims, because only then do they both afford economies of scale and meaningfully manage risk across the set of all potential claimants and claims (both of which are required in order to make consumer-friendly arbitration economically rational for companies).

For that reason, companies will be unwilling to adopt a two-track system of dispute resolution. Faced with the prospect of incurring significant incremental transaction costs in connection with setting up an effective, consumer-friendly arbitration system on one hand, and simultaneously dealing with the risk of the costs of litigating in court, any rational company will choose to minimize those transaction costs. And the only way to do that is to decide not to incur the voluntary incremental costs associated with maintaining an arbitration system, and simply relegate all disputes to the judicial system.

Third, less rational factors contribute to the unwillingness of parties to enter into even mutually beneficial post-dispute agreements to arbitrate. "Disputing parties often have an emotional investment in their respective positions," meaning that "the calculus of litigation (higher cost, but with greater procedural protection) versus arbitration (generally lower cost, but more informal) may" shift after a dispute.[124] One or both parties often feel certain—passionately so—that they are correct and have right, justice, and the law on their side; otherwise, the parties would likely have already settled the case. But that (irrational) certainty causes parties to hold out for multi-tiered court proceedings with layers of appellate review in the (usually vain) hope that, sooner or later, a court will come to see that they are right. Visceral dislike for the opposing side in a dispute—exacerbated by the adversarial nature of court proceedings—also plays a role, as "parties are loathe to agree to anything post-dispute when relationships sour."[125] So, too, do the "falsely negative assumptions about arbitration" held by some consumers,[126] not to mention by many lawyers whose default instincts are to trust the court system, no matter how slow, inefficient, and expensive it might be.

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[124] Bennett, 67-Jul. Disp. Resol. J. at 37.

[125] Schmitz, 34 U. Ark. Little Rock L. Rev. at 785.

[126] *Id.* Schmitz notes that despite this erroneous general perception, consumers who actually participate in arbitrations were "generally satisfied with [those] proceedings." *Id.*

In addition, the lawyers for one or both sides may also be enticed by the fee-generating possibilities of prolonged in-court litigation and may therefore advise clients to choose a forum that is really in the lawyers' own best interest rather than in that of the clients—especially in putative class actions, where named plaintiffs assert little control over the litigation and absent class members have no control whatsoever.[127]

All relevant facts therefore point to only one conclusion: post-dispute arbitration agreements "amount to nothing more than a beguiling mirage."[128] They simply do not—and would not—happen.

A very significant reduction in access to justice would accordingly result from any attempt to foreclose pre-dispute arbitration agreements and to force consumers and companies into only a post-dispute choice between arbitration and litigation. Eliminating the option of pre-dispute arbitration agreements, and thereby eliminating any real possibility of arbitration of consumer claims, would "den[y]" most consumers "access to" any means of pursuing their claims.[129] "[P]re-dispute agreements to arbitrate," which preserve the consumer's right to an affordable forum, accordingly represent the only real-world option for addressing this very significant gap in access to justice provided to consumers by the court system.[130]

B. Class Actions Provide Little Benefit To Consumers And Are Not Needed To Enable Consumers To Vindicate Their Rights Effectively; Requiring Class Procedures Would Harm Consumers By Depriving Them Of The Benefits Of Arbitration.

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[127] *See, e.g.*, Eric Goldman, *The Irony of Class Action Litigation*, 10 J. ON TELECOMM. & HIGH TECH. L. 309, 314 (2012) ("[C]lass action lawyers often advance their own financial interests at the expense of the class members' interests.").

[128] St. Antoine, 41 U. Mich. J.L. Reform at 790; *see also* Hamid & Mathieu, 74 Alb. L. Rev. at 785; *see also* Rutledge*,* 9 Cardozo J. Conflict Resol. at 280 ("[T]he infrequency of postdispute arbitration is . . . attributable to its structural defects.").

[129] Maltby, 30 Wm. Mitchell L. Rev. at 318; *see also* pages 5-12, *supra*.

[130] Theodore J. St. Antoine, *Mandatory Employment Arbitration: Keeping It Fair, Keeping it Lawful*, 60 Case W. Res. L. Rev. 629, 636 (2010).

The principal attack on arbitration stems from the fact that virtually all arbitration agreements require that arbitration proceed on an individual basis and bar class procedures in arbitration and in court.[131] The elimination of class actions, the argument goes, deprives consumers of a procedural mechanism that supposedly provides enormous benefits by allowing the vindication of small claims that (according to the argument) would be too expensive for plaintiffs to arbitrate individually. Therefore, the critics contend, arbitration should be prohibited or, at a minimum, waivers of class procedure should be banned.

In fact, the claims of class action proponents do not match the reality of class actions. A new empirical study of class actions that were filed in 2009 reveals that the overwhelming majority of class actions result in ***no recovery at all for members of the putative class***. None of the class actions studied went to trial or otherwise resulted in a judgment on the merits for the class. The named plaintiff voluntarily dismissed about one-third of the cases studied, either because the plaintiff chose not to continue with the lawsuit or because he settled his own claim on an individual basis. Another third of the cases were dismissed by a court on the merits. And among the remaining consumer class actions that settle, most offer recoveries to class members that are so small in value—if they offer any monetary recovery at all—that few class members find it worth the effort to submit claims for payment. While information about claims rates are scarce, the evidence that does exist makes it clear that it is commonplace for fewer than 10 percent of consumers—and frequently one percent or less—to realize any tangible benefit from class actions in which their claims are released.

It would be irrational for any policymaker to rest a decision on the theoretical benefits of class actions when the real-world evidence shows that class actions provide little or no benefit, particularly in the consumer context.

Moreover, claimants can effectively vindicate in individual arbitration any claims that might be asserted through class actions. Many arbitration provisions require businesses to pay costs of filing claims, to pay incentive or bonus payments to encourage arbitration of small claims, or to shift the costs associated with proving

[131] In *Concepcion*, the Supreme Court concluded that the Federal Arbitration Act requires the enforcement of agreements to arbitrate on an individual rather than class-wide basis. 131 S. Ct. 1740 (2011).

claims. And a number of other means for obtaining economies of scale—such as sharing the costs of proof across a set of individual arbitrations—are not only authorized by most arbitration agreements, but provide a fully viable model of effective dispute resolution.

The alternatives—prohibiting arbitration altogether or requiring class procedures—would have the same result: elimination of arbitration, because companies would not be willing to incur ***both*** the incremental costs associated with an arbitration system ***and*** the very high litigation costs associated with class procedures. ***That will leave consumers without any means for vindicating the majority of injuries that they suffer—relatively small, individualized claims that cannot practically be asserted in court. Requiring that result to preserve the negligible benefits that class actions actually provide would be a very bad deal for consumers, and for our economy as a whole.***

1. **Class Actions Provide Little or No Real Benefit to Consumers.**

Proponents of class-action litigation argue that the class device is an effective way for injured individuals to seek recoveries because (in theory) it allows for lawyers to take advantage of economies of scale in representing large numbers of claimants. The reality of class actions falls far short of this promise—***these actions actually deliver little or no relief to consumers.*** Lawyers, both plaintiff's lawyers and defense lawyers, are the principal beneficiaries of these claims.

Although the debate about class action has relied on competing anecdotes, we commissioned an empirical analysis of class actions by Mayer Brown LLP. That study, which examined a sample set of putative consumer and employee class action lawsuits filed in or removed to federal court in 2009, is attached to this letter.[132] The study revealed:

- In the entire data set, ***not one of the class actions ended in a final judgment on the merits for the plaintiffs***. And none of the class actions went to trial, either before a judge or a jury.

[132] For information about the methodology, see Appendix C to the study.

- The vast majority of cases produced ***no benefits to most members of the putative class—class***—even though in a number of those cases the lawyers who sought to represent the class often enriched themselves in the process (and the lawyers representing the defendants always did).

    - ***Approximately 14 percent of all class action cases remained pending four years after they were filed***, without resolution or even a determination of whether the case could go forward on a class-wide basis. In these cases, class members have not yet received any benefits—and likely will never receive any, based on the disposition of the other cases we studied.

    - ***Over one-third (35%) of the class actions that have been resolved were dismissed voluntarily by the plaintiff***. Many of these cases settled on an individual basis, meaning a payout to the individual named plaintiff and the lawyers who brought the suit—***even though the class members receive nothing***. Information about who receives what in such settlements typically isn't publicly available.

    - ***Just under one-third (31%) of the class actions that have been resolved were dismissed by a court on the merits***—again, meaning that class members received ***nothing***.

- ***One-third (33%) of resolved cases were settled on a class basis.***

    - This ***settlement rate is half the average for federal court litigation,*** meaning that a class member is far less likely to have even a chance of obtaining relief than the average party suing individually.

    - ***For those cases that do settle, there is often little or no benefit for class members***.

    - What is more, ***few class members ever even see those paltry benefits—particularly in consumer class actions***. Unfortunately, because ***information regarding the distribution of class action settlements is rarely available***, the public almost never learns what percentage of a settlement is actually paid to class members. But of the six cases in our data set for which settlement distribution data was public, ***five delivered funds to only miniscule percentages of the class: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.*** Those results are consistent with other available information about settlement distribution in consumer class actions.

- Although some cases provide for automatic distribution of benefits to class members, automatic distribution almost never is used in consumer class actions—only ***one of the 40*** settled cases fell into this category.

- Some class actions are settled without even the potential for a monetary payment to class members, with the settlement agreement providing for ***payment to a charity or injunctive relief that, in virtually every case, provides no real benefit to class members***.

In short, class actions do not provide class members with anything close to the benefits claimed by their proponents, although they can (and do) enrich attorneys—both on the plaintiffs' and defense side.

The lesson that should be taken from this study: Policymakers who are considering the efficacy of class actions cannot simply rest on a theoretical assessment of class actions or on a handful of favorable anecdotes to justify the value of class actions. Any decision-maker who assumes that class actions are valuable to consumers would have to engage in significant additional empirical research to conclude—contrary to what this study indicates—that class actions actually do provide significant benefits to consumers.

2. **Consumers Can Effectively Vindicate Even Small Claims In Arbitration Without Class Procedures.**

The ***contention that class procedures are essential to permit vindication of small claims was specifically rejected by both the majority and the dissent in the Supreme Court's recent decision*** in ***American Express Co. v. Italian Colors Restaurant.***[133] The dissenting opinion, joined by Justices who also dissented in the *Concepcion* case, specifically identified several different ways in which consumers could effectively vindicate even small claims in arbitration without the use of class action procedures:

> In this case, . . . the [arbitration] agreement could have prohibited class arbitration without offending the effective-vindication rule *if* it had provided an alternative mechanism to share, shift or reduce the necessary costs. The agreement's problem is that it bars not just class actions, but also all mechanisms . . . for joinder or consolidation of claims, informal coordination among individual claimants, or amelioration of arbitral expenses.[134]

In enforcing the arbitration agreement in *Concepcion*, the Supreme Court referenced the lower courts' finding that consumers would be better off in an individual arbitration under the agreement's provisions than in a class action.[135] The *American Express* dissent also identified that procedure as one that permitted the effective vindication of small claims through individual arbitration.

The arbitration provision that the Supreme Court viewed favorably in *Concepcion* contains both (i) incentive/bonus payments designed to encourage the pursuit of small claims, and (ii) the shifting of expert witness costs and attorneys' fees to defendants when the consumer or employee prevails on his or her claim. If a consumer obtains an arbitral award that is greater than the company's last settlement offer, he or she will receive a minimum recovery of $10,000 plus twice the amount of attorneys' fees that his or her counsel incurred for bringing the arbitration. In

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[133] 133 S. Ct. 2304 (2013).

[134] *Id*. at 2318 (Kagan, J., dissenting). The majority disagreed with the dissent's claim that the agreement at issue in that case barred informal coordination among individual claimants. *Id*. at 2311 n.4.

[135] *Concepcion*, 131 S. Ct. at 1753.

addition, the company is required to reimburse such a customer for reasonable expert witness fees.

As the dissenters in *American Express* explained, any concerns about whether individuals can vindicate their small claims in arbitration without the class-device are eliminated when an arbitration provision "provide[s] an alternative mechanism to . . . shift . . . the necessary costs."[136] A significant number of companies have adopted bonus/cost-shifting approaches similar to the one approved by the Court in *Concepcion*. The tables at pages 28-34 reflect only a sampling of these arbitration provisions.

The *American Express* dissenters further stated that the concern about cost could be addressed through "***informal coordination among individual claimants***" to share the same lawyer, expert, and other elements required to prove the claim.[137] For example, an entrepreneurial plaintiffs' lawyer can recruit large numbers of clients (via the internet, social media, or other similar means), file thousands of individual arbitration demands on behalf of those clients, and distribute common costs over all those claimants, making the costs for expert witnesses and fact development negligible on a per-claimant basis.

Given the low cost, efficiency, and fairness of arbitration, it is no surprise that some plaintiffs' lawyers are already beginning to recognize that pursuing multiple individual arbitrations (or small-claims actions) is an economically viable business model—especially in view of the ability to reach multiple, similarly situated individuals using websites and social media.[138] Indeed, this strategy for spreading fixed litigation costs is an increasingly common means of pursuing disputes in arbitration.

- Counsel for the plaintiffs in *American Express* indicated at a Practicing Law Institute program that if the Supreme Court compelled arbitration the plaintiffs

[136] *Am. Express*, 133 S. Ct. at 2318 (Kagan, J., dissenting).

[137] *Id.* (emphasis added). The dissent concluded that the American Express arbitration agreement prohibited such cost-sharing, but the majority disagreed, and American Express specifically conceded before the Supreme Court that costs could be shared in this manner. *See id.* at 2311 n.4 (majority).

[138] *See* Carolyn Whetzel & Jessie Kokrda Kamens*, Opt Out's Use of Social Media Against Honda in Small Claims Win Possible "Game Changer,"* Bloomberg BNA Class Action Litig. Rep. (Feb. 10, 2012).

could, and would, pursue their claims through individual arbitrations by using this cost-spreading approach.[139]

- A plaintiff filed a putative class action alleging that AT&T improperly measures the amount of data used by so-called smart devices such as iPhones and iPads, thereby supposedly causing customers to pay more for data usage than they otherwise would. The district court, following the Supreme Court's holding in *Concepcion*, compelled the plaintiff to arbitrate in accordance with his arbitration agreement.[140] Subsequently, counsel for that plaintiff filed separate demands for arbitration on behalf of more than 1,000 claimants—each making virtually identical allegations and relying on the same expert witness whom the original plaintiff had proffered in support of a class-action lawsuit.

- The Internet and social media have made it easier than ever for aggrieved consumers to find each other. One lawyer "set up a website to recruit plaintiffs" to bring multiple small-claims cases alleging marketing of credit information.[141] Similarly, a former lawyer who sued an automaker in small-claims court after opting out of a class action set up a website along with profiles on Twitter and Facebook and a video on YouTube to publicize her case. She was as a result "contacted by hundreds of other car owners seeking guidance in how to file small claims suits if they opted out of" the class action.[142]

- Following the *American Express* ruling, a member of a leading plaintiffs' firm recognized this new approach: "I think you'll continue to see firms like mine move into arbitration. If what large corporations want is to have thousands or

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[139] *See* Gary B. Friedman & Andrew J. Pincus, "Arbitration," Consumer Financial Services Institute 2013, Practicing Law Institute (Apr. 23, 2013), *available at* http://www.pli.edu/Content/OnDemand/Consumer_Financial_Services_Institute_2013/_/N-4nZ1z12p2h?fromsearch=false&ID=158662 (video).

[140] *See Hendricks v. AT&T Mobility LLC*, 823 F. Supp. 2d 1015 (N.D. Cal. 2011).

[141] *See* Sara Foley & Jessica Savage, *Court Filings Boost Revenue*, Corpus Christi Caller Times, Nov. 27, 2010, http://www.caller.com/news/2010/nov/27/court-filings-boost-revenue/

[142] *See* Linda Deutsch, *Honda Loses Small-Claims Suit Over Hybrid MPG*, Associated Press, Feb. 1, 2012, http://www.msnbc.msn.com/id/46228337.ns/business-autos/t/honda-loses-small-claims-suit-over-hybrid-mpg/

tens of thousands of individual arbitrations as opposed to class actions ... then that's the direction we'll go in. It's a bit of 'be careful what you ask for.'"[143]

- At oral argument in *American Express*, Chief Justice John Roberts suggested that plaintiffs could use the resources of a common interest group, such as a small-merchant trade organization, to "get together and say we want to prepare an antitrust expert report" that could be used in each of the subsequent arbitrations.[144]

- In other contexts, the pooling approach has helped plaintiffs lower their individual costs. As one study noted, "[a]n example of how such coordination can work is the large number of individual actions filed in litigation by common counsel for alleged violations of the Fair Debt Collection Practices Act, often against the same defendant."[145] In no small part because the fixed costs of proving a claim against the same defendant may be spread across many plaintiffs—and because attorneys' fees are provided by statute[146]—one newspaper reported that "[h]igh-volume consumer law firms are churning out [FDCPA] lawsuits as efficiently as the collectors they battle."[147]

In short, consumers, employees, and other potential plaintiffs have a wide array of tools for developing litigation resources and strategy that can be leveraged across a number of individual arbitrations. Social media and other technological innovations make it easier than ever for people who have common grievances to find each other and utilize common resources.

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[143] Melissa Lipman, Plaintiff's Lawyers Still Hopeful After AmEx Ruling, LAW360 (June 21, 2013), online at http://www.law360.com/articles/452294/plaintiffs-lawyers-still-hopeful-after-amex-ruling (quoting Jonathan Selbin).

[144] Oral Argument at 20-21, *Am. Express v. Italian Colors Restaurant*, 133 S. Ct. 2304 (No. 12-133), http://www.supremecourt.gov/oral_arguments/argument_transcripts/12-133.pdf.

[145] Gregory C. Cook, *Why* American Express v. Italian Colors *Does Not Matter and Coordinated Pursuit of Aggregate Claims May Be a Viable Option After* Concepcion, 2 Mich. J. L. Reform Online, Apr. 14, 2013, http://www.mjlr.org/2013/04/why-american-express-v-italian-colors-does-not-matter-and-coordinated-pursuit-of-aggregate-claims-may-be-a-viable-option-after-concepcion/#fnref-2132-14 (footnote omitted).

[146] *Id.* (citing 15 U.S.C. § 1692k).

[147] Chris Serres, *Debtors in Court—Suing Collectors*, Minn. Star-Trib., Mar. 17, 2011, http://www.startribune.com/investigators/99676349.html?refer=y.

What is more, there are other ways in which consumers' rights can be vindicated. The Bureau itself can "commence a civil action . . . to impose a civil penalty or to seek all appropriate legal and equitable relief" with respect to a "violat[ion of] a Federal consumer financial law,"[148] which will allow the agency to pursue claims that are properly within the reach of its enforcement authority. And the Bureau has recently issued notice of a proposed Final Rule for its Civil Penalty Fund, which collects penalties imposed in enforcement actions, designating "the conditions under which victims" of Federal consumer financial law violations "will be eligible for payment . . . and the amounts of payments that the Bureau may make to them."[149] The Bureau could use its enforcement authority to seek to vindicate consumers' rights, and the Civil Penalty Fund could be used to augment the opportunity that arbitration provides for consumers to pursue relief. Other federal and state agencies similarly possess a wide range of enforcement authority that can be brought to bear in appropriate circumstances..

In short, there are multiple alternatives to private class action lawsuits in court brought by entrepreneurial plaintiffs' attorneys; these alternatives afford individual consumers actual opportunities to pursue their disputes or otherwise vindicate their rights—in sharp contrast to the false promise of private class actions.

3. Consumer Class Actions Do Not Deter Future Wrongdoing—Deterrence Comes From the Threat of Government Enforcement.

Deterrence theory holds that a party will not engage in wrongdoing if the party believes that it will incur costs for acting wrongfully that it will not incur if it complies with the law. If those costs are incurred without regard to the wrongfulness of the underlying conduct, there is no such deterrent effect.[150] That is the precise flaw in the private class action system.

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148 12 U.S.C. § 5564(a).

149 *Consumer Financial Civil Penalty Fund*, 78 Fed. Reg. 26545, 26546 (2013).

150 For an analogous discussion of how a failure to distinguish adequately between the culpable and the innocent dilutes the deterrent effect of sanctions in the criminal-law context, see A. Mitchell Polinsky & Steven Shavell, *The Theory of Public Enforcement of Law*, in 1 Handbook of Law and Economics 403, 427-29 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

Plaintiffs' attorneys have little incentive to choose cases based on the merits of the underlying claims—the merits question will never be reached, as the empirical data demonstrates. The plaintiffs' lawyer's goal, rather, is to find a claim for which the complaint can withstand a motion to dismiss and that can satisfy the (legitimately) high hurdles for class certification—standards that do not embody an assessment of the underlying merit of the claim.

Once a class is certified, settlement virtually always follows, driven by the transaction costs (including e-discovery) that such actions impose—which again have little or no correlation to the underlying merits of the case. The class action thus does not impose burdens only on businesses that engage in wrongful conduct. Instead, the burdens of class actions are chiefly a function of who plaintiffs' lawyers choose to sue rather than who has engaged in actual wrongdoing. The threat of a class action therefore cannot—and does not—generally deter wrongful conduct.[151]

Businesses are far more likely to be deterred from wrongdoing by the reputational consequences of engaging in improper behavior, especially because reputational harm is often directly correlated to a business's success or failure. Especially in an age of social media, consumer complaints can quickly go viral, impacting companies immediately and directly leading to changes in practices that garner consumer opposition. Class actions, by contrast, do nothing of the sort.

In sum, deterrence concerns provide no justification for maintaining the availability of private class actions.[152]

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[151] Indeed, to the extent there is any effect associated with class actions, it is likely to deter both lawful and unlawful actions equally—requiring companies to take into account the risk of litigation costs without regard to the legality of the underlying action.

[152] Nor should arbitration be restricted or prohibited because—as some critics of arbitration sometimes contend—arbitration reduces publicly-available precedent. Most court cases are resolved by settlement, and virtually all class actions are settled; these cases offer no real guidance to other parties about what conduct will subject them to or insulate them from a future lawsuit. And most individual consumer cases brought in arbitration could not practically be litigated in court—and therefore would not produce precedent if arbitration did not exist.

Consumer arbitration does not permit companies to conceal their wrongdoing, however. California, the District of Columbia, and several other states have required arbitration providers to publish information about the disposition of arbitration cases. And we are not aware of any arbitration agreement that prohibits a consumer from disclosing the substance of a claim asserted in arbitration and the disposition of that claim. (Arbitration proceedings themselves—the filings of the parties and any oral presentations—are confidential, but that restriction does not preclude parties from publicly discussing the nature of the claims and how they were decided.)

4. **Requiring Class Procedures Would Eliminate Arbitration and Deprive Consumers of Arbitration's Significant Benefits.**

Based on the erroneous assumption that class-wide procedures are necessary to vindicate small-value claims, some critics of arbitration have urged that arbitration agreements should be required to permit either class-wide arbitration or the filing of class actions in court. Like the argument in favor of permitting only "post-dispute arbitration agreements," however, this contention—if accepted—would eliminate consumer arbitration.

As explained above,[153] a company that sets up an arbitration program incurs significant administrative costs—which they are willing to absorb because, on average, the aggregate costs of resolving disputes in arbitration are lower than the aggregate costs of resolving disputes in litigation in court.

If faced with the prospect of incurring significant incremental transaction costs in connection with setting up an effective, consumer-friendly arbitration system on one hand, and simultaneously dealing with the huge costs of litigating class actions in court, all rational companies will choose to minimize those transaction costs.[154] And the only way to do that is to decide not to incur the voluntary incremental costs

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[153] *See supra* pages 37-38.

[154] Indeed, class actions impose particularly large litigation costs unrelated to the merits of the underlying claims. According to a survey of general counsel or senior litigation officers of over 300 companies conducted by Carlton Fields, corporations spend more than $2 billion annually on class action lawsuits. Carlton Fields, *The 2013 Carlton Fields Class Action Survey: Best Practices in Reducing Cost and Managing Risk in Class Action Litigation* 37 (2013), http://www.carltonfields.com/files/uploads/Carlton-Fields-Class-Action-Report-2013-electronic.pdf (compiling 368 "in-depth interviews with general counsel, chief legal officers, and direct reports to general counsel"). In the modern business world, many class actions that are litigated past the pleading stage impose extraordinarily burdensome e-discovery costs, as plaintiffs' lawyers demand e-mails and other electronic files from dozens, if not more, company employees. In fact, a defendant business generally bears the brunt of discovery costs, which can amount to many millions of dollars.

Thus, a recent study by the RAND Institute for Civil Justice of discovery costs in a representative sample of cases found the cost-per-case for producing electronically-stored information ranged from $17,000 to $27 million, with a *median cost of $1.8 million per case*. Nicholas M. Pace & Laura Zakaras, *Where the Money Goes: Understanding Litigant Expenditures for Producing Electronic Discovery* at 17 (RAND Institute for Civil Justice 2012). Class actions obviously would fall at the upper end of that range.

Requiring companies to continue to face these costs would eliminate the transaction cost savings produced by arbitration—with "arbitration plus class actions" a much more costly system than "court litigation alone," companies would chose court litigation. Ware, 5 J. Am. Arb. at 291.

associated with maintaining an arbitration system, and simply relegate all disputes to the judicial system.[155] Indeed, many companies have publicly stated that they would abandon arbitration entirely if the class-action waivers contained in their arbitration agreements are rendered unenforceable.

* * * * *

Although the proponents of class actions argue that these lawsuits provide a practical mechanism for vindication of consumers' small-value claims, the real-world evidence demonstrates that they do not. As the study of class actions filed in 2009 reveals, few members of putative classes ever see any recovery in a class action; even in those cases that settle, individuals are usually offered small recoveries, and evidently few class members find it worth their while to submit claims for such paltry payouts. Other settlements offer "benefits"—such as injunctive relief or donations to charities—that in fact have little value to individuals.

Although the value of class actions is premised on the economies of scale that may be reached by aggregating low-value claims, achieving those economies does not require slow and costly class-wide proceedings in court. Rather, there are a number of ways for individual claimants to economize on the costs of proving their claims in individual arbitration proceedings. And individual arbitration proceedings are consistent with the deterrent purposes of litigation and the need for fairness to all parties.

In sum, class-wide proceedings do not deliver on the promises that their proponents have made. Conditioning the enforcement of arbitration proceedings on requiring class proceedings will harm consumers by eliminating arbitration and relegating them to a judicial system that completely precludes litigation of the

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155 Class arbitration is an irrational choice for both businesses and consumers. First, class arbitration, by contrast, is every bit as burdensome, expensive, and time-consuming as class-action litigation, if not more so. Thus, as of September 2009 the AAA had opened 283 class arbitrations, *none* of which had resulted in a final award on the merits. *See* Brief of AAA as *Amicus Curiae* at 22-23, *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010) (No. 08-1198), 2009 WL 2896309. For those class arbitrations that were no longer active, the median time from filing to settlement, withdrawal, or dismissal—not judgment on the merits—was 583 days (1.6 years), and the mean was 630 days (1.7 years). *Id.* at 24.

Second, class arbitration may not provide all of the procedural protections for absent class members that are present in judicial class actions. Class arbitration therefore could lead to outcomes that are quite unfair to members of the class.

relatively small individualized claims that make up the majority of consumer injuries and provides no real-world benefit to consumers through the mechanism of class actions.

III. The Bureau Should Not Even Consider Regulations Overturning The Federal Arbitration Act Without Clear Empirical Evidence Of Consumer Harm—And That Evidence Does Not Exist.

Arbitration of consumer disputes has been common practice for over two decades. There are perhaps hundreds of millions of consumer contracts currently in force that include arbitration agreements—many of them relating to consumer financial products or services.

The system we have today of resolving disputes fairly and efficiently in arbitration stands in stark contrast to the court-centric views of earlier times. "Until the early twentieth century, courts in the United States displayed a marked hostility to predispute arbitration agreements," which they considered "illegal attempts to oust courts of their jurisdiction."[156] But Congress concluded that arbitration was beneficial for individuals and businesses alike, and therefore enacted the Federal Arbitration Act (9 U.S.C. §§ 1-16) to ensure that arbitration agreements were enforceable. As Justice Stephen Breyer has observed, "Congress, when enacting th[e FAA], had the needs of consumers, as well as others, in mind."[157]

The criticisms of arbitration being made today resemble those that were rampant at the time Congress enacted the FAA—they are based on false stereotypes rather than reality. Claims about the benefits of the judicial system are based on similar illusions, grounded in the hyper-idealized theory learned in law school rather than the stark reality of what actually happens today in our nation's courts.

And these unsupported, and unsupportable, arguments are being promoted by well-funded interest groups pursuing their own interests, and not the interests of

[156] Rutledge, 6 Geo. J.L. Pub. Pol'y at 552 (citing 1 Ian R. Macneil et al., *Federal Arbitration Law: Agreements, Awards, and Remedies under the Federal Arbitration Act* § 4.3.2.2 (1996)).

[157] *Allied-Bruce Terminix*, 513 U.S. at 280. *See also* S. Rep. No. 68-536, at 3 (1924) ("The settlement of disputes by arbitration appeals to big business and little business alike, to corporate interests *as well as to individuals*.") (emphasis added).

consumers. According to the Associated Press, for example, one of the "[t]op lobbying goals" of the American Association for Justice (formerly the Association of Trial Lawyers of America, or "ATLA") has been to convince "Congress and [President] Obama to outlaw mandatory binding arbitration in consumer contracts."[158] As we have discussed, the individuals who benefit most from arbitration—***the majority of consumers and employees whose individualized claims are too small to be of interest to contingency-fee-driven plaintiffs' lawyers, and too fact-specific to be included in class actions***—would be left with no recourse. Yet plaintiffs' lawyers are willing to trade those individual consumers' claims away so that they may continue to pursue class actions that allow them to reap large fee awards while leaving class members with pennies on the dollar—if anything at all.

In carrying out the Dodd-Frank Act's mandate to study arbitration, the Bureau must ignore false stereotypes, caricatures, and selective anecdotes and focus instead on the realities of arbitration and the realities of the judicial system. Any regulation the Bureau may adopt must be based on a conclusion that "such a prohibition or imposition of conditions or limitations is in the *public interest and for the protection of consumers*. The findings of such a rule *shall be consistent with the study conducted under subsection (a)*."[159] Because the Bureau's rulemaking authority requires it to consider "the potential benefits and costs to consumers and [regulated businesses],"[160] the study must do so as well.[161]

As we have explained, the relevant evidence demonstrates overwhelmingly that arbitration serves the interests of individuals and businesses alike by providing access to justice quickly, fairly, and at low cost. Eliminating arbitration, or imposing regulations that would have that effect, will harm consumers by eliminating this critically important method of adjudicating disputes that simply cannot be resolved practically in court.

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[158] Sharon Theimer & Pete Yost, *The Influence Game: Lobbyists adapt to power shift*, USA Today, Nov. 14, 2008, http://usatoday30.usatoday.com/news/washington/2008-11-14-567071791_x.htm?csp=34.

[159] 12 U.S.C. § 5518(b) (emphasis added).

[160] *Id.* § 5512(b)(2)(A)(i).

[161] Courts rigorously oversee an agency's assessment of costs and benefits. *See, e.g.*, *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

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We thank you for your consideration of these comments and would be happy to discuss these issues further with the Bureau's staff.

Sincerely,

David Hirschmann
President and Chief Executive Officer
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

Lisa A. Rickard
President
U.S. Chamber Institute for Legal Reform

Attachment

Do Class Actions Benefit Class Members?
An Empirical Analysis of Class Actions

By Mayer Brown LLP

Executive Summary

This empirical study of class action litigation—one of the few to examine class action resolutions in any rigorous way—provides strong evidence that class actions provide far less benefit to individual class members than proponents of class actions assert.

The debate thus far has consisted of competing anecdotes. Proponents of class action litigation contend that the class device effectively compensates large numbers of injured individuals. They point to cases in which class members supposedly have obtained benefits. Skeptics respond that individuals obtain little or no compensation and that class actions are most effective at generating large transaction costs—in the form of legal fees—that benefit both plaintiff and defense lawyers. They point to cases in which class members received little or nothing.

Rather than simply relying on anecdotes, this study undertakes an empirical analysis of a neutrally-selected sample set of putative consumer and employee class action lawsuits filed in or removed to federal court in 2009.[1]

Here's what we learned:

- In our entire data set, ***not one of the class actions ended in a final judgment on the merits for the plaintiffs***. And none of the class actions went to trial, either before a judge or a jury.
- The vast majority of cases produced ***no benefits to most members of the putative class***—even though in a number of those cases the lawyers who sought to represent the class often enriched themselves in the process (and the lawyers representing the defendants always did).
    - ***Approximately 14 percent of all class action cases remained pending four years after they were filed***, without resolution or even a determination of whether the case could go forward on a class-wide basis. In these cases, class members have not yet received any benefits—and likely will never receive any, based on the disposition of the other cases we studied.
    - ***Over one-third (35%) of the class actions that have been resolved were dismissed voluntarily by the plaintiff***. Many of these cases settled on an individual basis, meaning a payout to the

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[1] For information about our methodology, see Appendix C.

individual named plaintiff and the lawyers who brought the suit—***even though the class members receive nothing***. Information about who receives what in such settlements typically isn't publicly available.

    - ***Just under one-third (31%) of the class actions that have been resolved were dismissed by a court on the merits***—again, meaning that class members received ***nothing***.

- ***One-third (33%) of resolved cases were settled on a class basis.***
    - This ***settlement rate is half the average for federal court litigation,*** meaning that a class member is far less likely to have even a chance of obtaining relief than the average party suing individually.
    - ***For those cases that do settle, there is often little or no benefit for class members***.
    - What is more, ***few class members ever even see those paltry benefits—particularly in consumer class actions***. Unfortunately, because ***information regarding the distribution of class action settlements is rarely available***, the public almost never learns what percentage of a settlement is actually paid to class members. But of the six cases in our data set for which settlement distribution data was public, ***five delivered funds to only miniscule percentages of the class: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.*** Those results are consistent with other available information about settlement distribution in consumer class actions.
    - Although some cases provide for automatic distribution of benefits to class members, automatic distribution almost never is used in consumer class actions—only ***one of the 40*** settled cases fell into this category.
    - Some class actions are settled without even the potential for a monetary payment to class members, with the settlement agreement providing for ***payment to a charity or injunctive relief that, in virtually every case, provides no real benefit to class members***.

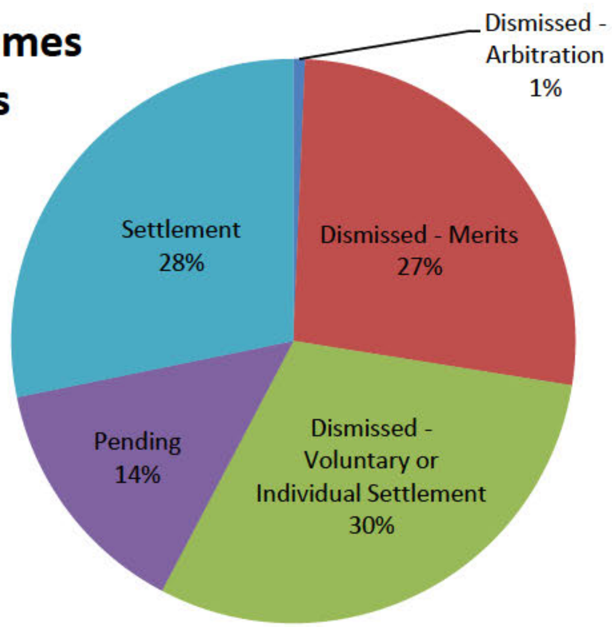
The bottom line: The hard evidence shows that class actions do not provide class members with anything close to the benefits claimed by their proponents, although they can (and do) enrich attorneys. Policymakers who are considering the efficacy of class actions cannot simply rest on a theoretical assessment of class actions' benefits or on favorable anecdotes to justify the value of class actions. Any decision-maker wishing to rest a policy determination on the claimed benefits of class actions would have to engage in significant additional empirical research to conclude—contrary to what our study indicates—that class actions actually do provide significant benefits to consumers, employees, and other class members.

Results

Overall Outcomes

Of the 148 federal court class actions we studied that were initiated in 2009, 127 cases (or nearly 86 percent) had reached a final resolution by September 1, 2013, the date when the study closed.

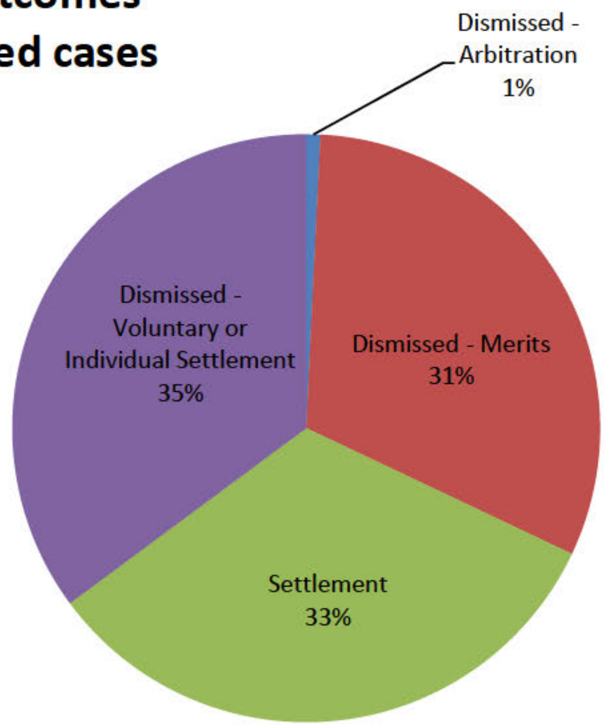
Figure 1: Outcomes in 148 cases



Zero* cases resulted in a judgment on the merits**. Of the 148 cases in our sample set, ***not one had gone to trial—either before a judge or jury. And, as of the closing date of our study, ***not one resulted in a judgment for the plaintiffs on the merits***.

Unlike ordinary (non-class) disputed cases, some of which end with a judgment on the merits in favor of the plaintiffs or defendants, class actions end without any determination of the case's merits. The class action claims that make it past the pleadings stage and class-certification gateway virtually always settle—regardless of the merits of the claims.

Figure 2: Outcomes in 127 resolved cases



Indeed, Justice Ruth Bader Ginsburg has recognized that "[a] court's decision to certify a class * * * places pressure on the defendant to settle even unmeritorious claims."[2] Then-Chief Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit explained that certification of a class action, even one lacking in merit, forces defendants "to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability."[3] And Judge Diane Wood of the Seventh Circuit has explained that certification "is, in effect, the whole case."[4] That may be why another study of class

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2 *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 445 n.3 (2010) (Ginsburg, J., dissenting).

3 *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293, 1299 (7th Cir. 1995).

4 Hon. Diane Wood, Circuit Judge, Remarks at the FTC Workshop: Protecting Consumer Interests in Class Actions (Sept. 13–14, 2004), in *Panel 2: Tools for Ensuring that Settlements are "Fair, Reasonable, and Adequate,"* 18 Geo. J. Legal Ethics 1197, 1213 (2005).

actions reported that "[e]very case in which a motion to certify was granted, unconditionally or for settlement purposes, resulted in a class settlement."[5]

<u>Fourteen percent of the class actions filed remain unresolved</u>. Even though our study period encompassed more than 44 months since the filing of the last case in our sample (and 55 months from the filing of the first case), a significant number of cases—21 of the 148 in our sample, or 14%—remained pending with no resolution, let alone final judgment on the merits.[6]

And there is no reason to believe that these cases are more likely to yield a benefit for class members than the cases that have been resolved thus far. In 15 of these cases either no motion for class certification has been filed or the court has not yet ruled on the motion, and in another 2 the court denied certification. In a significant proportion of these pending cases, it seems likely that class certification will be denied or never ruled upon before the case is ultimately dismissed. After all, prior studies indicate that nearly 4 out of every 5 lawsuits pleaded as class actions are not certified.[7]

<u>Over one-third of the class actions that have been resolved were dismissed voluntarily by the named plaintiff and produced no relief at all for the class</u>. Forty-five cases were voluntarily dismissed by the named plaintiff who had sought to serve as a class representative or were otherwise resolved on an individual basis. That means either that the plaintiff (and his or her counsel) simply decided not to pursue the class action lawsuit, or that the case was settled on an individual basis, without any benefit to the rest of the class. These voluntary dismissals represent 30 percent of all cases studied, or 35 percent of cases that reached a resolution by the beginning of September 2013.[8]

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5 Emery G. Lee III et al., *Impact of the Class Action Fairness Act on the Federal Courts: Preliminary Findings from Phase Two's Pre-CAFA Sample of Diversity Class Actions* at 11 (Federal Judicial Center 2008), http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Preliminary%20Findings%20from%20Phase%20Two%20Class%20Action%20Fairness%20Study%20%282008%29.pdf (discussing 30 such cases).

6 These results are broadly consistent with other studies of class actions. *See, e.g., id.* at 6 (noting that 9% of cases remained pending after at least 3.5 years).

7 *See* Thomas E. Willging & Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does it Make?*, 81 Notre Dame L. Rev. 591, 635-36, 638 (2006).

8 In one of the cases we studied, the court compelled arbitration of the named plaintiff's claims—a determination that almost always precludes class treatment of the case.

In fourteen of the cases that were voluntarily dismissed—approximately one-third of all voluntary dismissals in the data set—the dismissal papers, other docket entries, or contemporaneous news reports made clear that the parties were settling the claim on an individual basis, although the terms of those settlements were not available. Many of the remaining voluntary dismissals also may have resulted from individual settlements.

These settlements often provide that the plaintiff—and his or her attorney—receive recoveries themselves, even though the rest of the class that they sought to represent receive ***nothing***. When parties settle cases on an individual basis, those settlements often are confidential, and the settlement agreements therefore are not included on the court's public docket.[9]

Just under one-third of the class actions that have been resolved were dismissed on the merits. In addition to the 45 cases dismissed voluntarily by plaintiffs, 41 cases were dismissed outright by federal courts, through a dismissal on the pleadings or a grant of summary judgment for the defendant. The courts in these cases concluded that the lawsuits were meritless before even considering whether the case should be treated as a class action. These represented 27 percent of all cases studied, and 31 percent of resolved cases.

In other words, ***in over half of all putative class actions studied—and nearly two-thirds of all resolved cases studied—members of the putative class received zero relief***. These results are depicted in Figures 1 and 2, which appear below. And these results are broadly consistent with other empirical studies of class actions. If anything, for reasons explained in Appendix C, abusive, illegitimate class actions are probably under-represented in our sample, and the sample therefore probably significantly ***overstates*** the extent to which class

[9] Unlike class settlements under Federal Rule of Civil Procedure 23, which must be publicly disclosed and approved by the court, individual settlements of lawsuits in federal court need not be disclosed publicly, nor is court approval required. Typically, parties that agree to settle claims on an individual basis in a lawsuit pending in federal court—whether or not those claims are part of a class action—enter into confidential settlement agreements, a condition of which is that the named plaintiff will voluntarily dismiss his or her individual claims with prejudice; remaining claims that were purported to have been brought on behalf of a class may be dismissed without prejudice with respect to other class members, who may or may not assert the claim in subsequent litigation.

members benefit from the class action. For comparison, another study found that ***84% of class actions ended without any benefit to the class***.[10]

<u>Fewer than thirty percent of the cases filed were settled</u>. All of the remaining class actions that have been concluded were settled on a class-wide basis: The parties reached settlements in 40 cases—28% of all cases studied, or 33% of all resolved cases.[11]

This subset of class actions is the only one in our study in which it is possible that absent class members could possibly receive any benefit at all. As we next discuss, however, the benefits claimed to be associated with such settlements are largely illusory.

<u>*Class Settlements*</u>

<u>Class actions have a significantly lower settlement rate than other federal cases.</u> The settlement rate for our sample of cases—33% of resolved cases—is much lower than for federal court litigation as a whole. One study of federal litigation estimated that "the aggregate settlement rate across case categories" for two districts studied was "66.9 percent in 2001-2002."[12] Even the least frequently settled case category in that study—constitutional litigation—had a higher settlement rate (39%) than the 33% for the class action cases we studied.[13]

Thus, ***class actions are significantly less likely to produce settlements, and therefore significantly less likely to produce any benefit to class members, than other forms of litigation.*** Settlement is the only resolution that produces even the possibility of a benefit to class members, because class actions are virtually never resolved though judgments on the merits, a fact that our study corroborates. And the settlement rate in our sample set is not an outlier: a study of

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10 *See, e.g.,* Lee et al., *supra* note 5, at 6 (noting that in cases not remanded, 55% of cases were voluntarily dismissed without class certification or class settlement, and another 29% were dismissed by the court).

11 This category includes one case in which the parties have announced a class settlement and sought preliminary approval; five cases in which the court has granted preliminary approval (but has not yet finally approved it); one case that resulted in a settlement to fewer than all plaintiff class members; and two cases in which appeals are pending.

12 Theodore Eisenberg and Charlotte Lanvers, *What is the Settlement Rate and Why Should We Care?,* 6 J. Empir. Leg. Stud. 111, 115 (2009).

13 *Id*. at 133.

class actions brought in California state court in 2009 reported a similarly low settlement rate of 31.9%.[14]

Moreover, the fact that 40 of our sample cases were settled says nothing about the extent of the benefit, if any, that those settlements conferred on class members.

Many class settlements—and virtually all settlements of consumer class actions—produce negligible benefits for class members. It is a notoriously difficult exercise to assess empirically how class members benefit from class action settlements. These settlements fall generally into three basic categories:

- "Claims-made" settlements, under which class members are bound by a class settlement—and thereby release all of their claims—but only obtain recoveries if they affirmatively request to do so, usually through use of a claims form.[15] Funds not distributed to claimants are returned to the defendant or, in some cases, distributed to a charity via the *cy pres* process (which creates significant additional problems, as we discuss below). They are not given to class members. Most settlements fall into this category.

- Injunctive relief/*cy pres* settlements, in which the relief provided to settling class members involves only injunctive relief (which may provide little or no benefit to class members) or *cy pres* distributions (in which money is paid to charitable organizations rather than class members).

- "Automatic distribution" settlements, in which each class member's settlement is distributed automatically to class members whose

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[14] Hilary Hehman, *Class Certification in California: Second Interim Report from the Study of California Class Action Litigation*, Judicial Council of California: Administrative Office of the Courts, at Tables D1-D2 (Feb. 2010), http://www.courts.ca.gov/documents/classaction-certification.pdf (observing that 410 of 1294 resolved cases were settled); *see also* Patricia Hatamyar Moore, *Confronting the Myth of "State Court Class Action Abuses" Through an Understanding of Heuristics and a Plea for More Statistics*, 82 UMKC L. Rev. 133, at 165 & n.192 (2013).

[15] *See* 4 *Newberg on Class Actions* § 12:35 (4th ed. 2013) ("[A] common formula in class actions for damages is to distribute the net settlement fund after payment of counsel fees and expenses, ratably among class claimants according to the amount of their recognized transactions during the relevant time period. A typical requirement is for recognized loss to be established by the filing of proofs of claim. . . .").

eligibility and alleged damages could be ascertained and calculated—such as retirement-plan participants in ERISA class actions.

The parties typically have no meaningful choice among these methods of structuring a settlement. Automatic distribution settlements are feasible only if the parties have the names and current addresses of class members as well as the ability to calculate each class member's alleged damages. But companies typically lack the information needed to settle cases using an automatic distribution mechanism—especially in consumer cases, where purchase records may be incomplete or unavailable, and/or class members' claimed injuries may vary widely and unpredictably.

Thus, consumer class actions are almost always resolved on a claims-made basis, and the actual amount of money delivered to class members in such cases almost always is a miniscule percentage of the stated value of the settlement. That is because, in practice, relatively few class members actually make claims in response to class settlements: many class members may not believe it is not worth their while to request the (usually very modest) awards to which they might be entitled under a settlement. And the claim-filing process is often burdensome, requiring production of years-old bills or other data to corroborate entitlement to recovery.

The class members' actual benefit from a settlement—if any—is almost never revealed. Remarkably, the public almost never has access to settlement distribution data. One study found that settlement distribution data were available in "fewer than one in five class actions in [the] sample."[16] Companies and their defense lawyers are hesitant to reveal how much a company has been required to pay out to class members, and plaintiffs' counsel have strong incentives to conceal the information because requests for attorneys' fees based on a settlement's face value will appear overstated when compared to the actual value. Judges are often happy to have the case resolved, and therefore have little to no interest in requiring transparency in the settlement distribution process.

While third-party claims administrators often possess direct information about claims rates, they are routinely bound by contract to maintain the confidentiality of that information in the absence of party permission, a court order, or other legal authority.[17] This may be a function of the incentive shared by class

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[16] Nicholas M. Pace & William B. Rubenstein, *How Transparent are Class Action Outcomes? Empirical Research on the Availability of Class Action Claims Data* at 3, RAND Institute for Civil Justice Working Paper (July 2008), billrubenstein.com/Downloads/RAND%20Working%20Paper.pdf.

[17] *Id.* at 31-32 (explaining that in a survey of class action participants, only 25% of "chief executive officers" at settlement administrators responded to the survey, and even those only "did so solely to inform [the researchers] that the information

counsel and defense counsel to avoid facilitating grounds for a class member to object that a settlement was unfair because it provided too little tangible benefit to the class.[18] Indeed, "[h]ow many people were actually members of this class, how many of these class members actually submitted a claim form, and how much they were actually paid appear to be closely held secrets between the class counsel and the defendant."[19]

<u>In rare cases in which class-settlement distribution data was available, few class members received any benefit at all</u>. In our data set, ***18 cases were resolved by claims-made settlements***—44% of the total. ***We were able to obtain meaningful data regarding the distribution of settlement proceeds in only six of the 18 cases***, which is not surprising given the well-established and widespread lack of publically available information regarding the extent to which class members actually benefit from settlements. ***Five of the six cases resulted in minuscule claims rates: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.***[20] These

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that they held was 'proprietary' to their clients, namely the attorneys that had hired them to oversee the class action claiming process"); *cf.* Deborah R. Hensler, et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 163-64 (2000) (noting difficulty in obtaining "information about the claiming process and distribution" from a "settlement administrator," who "declined to share distribution figures, suggesting that we talk to the attorneys involved with the case," and noting further that the plaintiffs' and defense attorneys had agreed between themselves "not to discuss or divulge matters related to . . . the actual distribution to the class").

18 *See* Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 Fla. L. Rev. 71, 93 (2007) (explaining that when a "notice do[es] not estimate the size of the class, . . . class members are unable to calculate their own individual recoveries" and therefore lack "sufficient bases for objecting to the proposed settlement"); *see also Thorogood v. Sears, Roebuck & Co.*, 547 F.3d 742, 744-45 (7th Cir. 2008) (Posner, J.) ("The defendants in class actions are interested in minimizing the sum of the damages they pay the class and the fees they pay the class counsel, and so they are willing to trade small damages for high attorneys' fees. . . . The result of these incentives is to forge a community of interest between class counsel, who control the plaintiff's side of the case, and the defendants. . . . The judge . . . is charged with responsibility for preventing the class lawyers from selling out the class, but it is a responsibility difficult to discharge when the judge confronts a phalanx of colluding counsel.") (citations omitted).

19 Hensler, *supra* note 17, at 165.

20 The lone outlier—a case with a 98.72% claims rate—involved the settlement of an ERISA case involving claims about the Bernie Madoff Ponzi scheme for which potentially enormous claims could be made. The math explains why an "astonishing

extremely small claim-filing rates are consistent with the few other reports of claim rates in class action settlements that have come to light.

As one federal court observed, "'claims made' settlements regularly yield response rates of 10 percent or less."[21] In fact, the claims rate frequently is ***much lower***—in the single digits. Appendix A contains a list of more than 20 additional cases for which information about distributions is available, all of which involved distributions to less than seven percent of the class and many of which involved distributions to less than one percent of the class.

There is thus ample evidence to infer that ***the extremely small claims rates for cases in our sample is representative of what happens in class actions generally, and particularly in consumer class actions***.[22] And although documents filed in the remaining 12 of the 18 claims-made settlements lacked information about claims rates, there is every reason to believe that class members made claims at the small rates ordinarily observed in such cases. While some may argue that parties should use automatic distribution mechanisms instead

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98.72%" of the 470 members of the damages class filed claims in this $1.2165 billion settlement. Final Order at 11, *In re Beacon Assoc. Litig.*, No. 09-cv-777 (S.D.N.Y. May 9, 2013), PACER No. 77-2. Because each class member's individual claim was worth, on average, over $2.5 million, it is unsurprising that over 460 of the class members decided to submit a claim. Needless to say, virtually no consumer or employment class actions settle for anything approaching such a large amount per class member.

[21] *Sylvester v. CIGNA Corp.*, 369 F. Supp. 2d 34, 52 (D. Me. 2005).

[22] Some earlier studies purported to assess the benefits received by class members, but they examined "only what defendants *agreed to pay*" in settlements, rather than "the amounts that defendants *actually paid* after the claims administration process concluded." Brian Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. Empirical Legal Stud. 811, 826 (2010) (emphasis added); *see also* Theodore Eisenberg & Geoffrey Miller, *Attorney's Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. Empirical Legal Stud. 248, 258-59 (2010) (using same approach).

Moreover, because Fitzpatrick studied only settlements (*see* 7 J. Empircial Legal Stud. at 812), his study failed to take into account that most putative class actions are dismissed or otherwise terminated without any benefits for class members. And Eisenberg and Miller ignored settlements that promised *only* nonpecuniary relief (such as coupons or injunctive relief) to class members. An earlier version of their study—which laid the methodological groundwork for the later expanded study in 2010 (*see id.* at 252)—appears to have counted cases involving such "soft relief" only when it was "included" along with pecuniary relief. Theodore Eisenberg & Geoffrey Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. Empirical Legal Stud. 27, 40 (2004).

of "claims-made" settlements to resolve class actions, the reality is that automatic distribution is difficult, if not impossible, to achieve in many (perhaps most) consumer class actions.

Only *one* consumer class action settlement was resolved through automatic distribution. Of the remaining 22 settled cases in our sample, 13 involved ***settlements with automatic distribution of settlement proceeds.*** Ten of these 13 involved claims by retirement plan participants in ERISA class actions, in which the class members' eligibility and alleged damages could be easily ascertained and calculated based on their investment positions. The plans of distribution in these 10 cases generally involved lump-sum payments to the plan, which would then be allocated directly to plan members' accounts.

The other three automatic-distribution settlements were reached in consumer and employment class actions. In each case—atypical of most class actions—the defendant was in a position to ascertain and calculate class members' eligibility and alleged damages:

- In one, an employer settled claims that it conspired with health care providers and insurers to dictate medical treatment provided to about 13,764 employees injured on the job, whose identities were readily known to the defendant employer; employees who were treated by one health-care provider received a check for $520, while injured employees treated by another provider received a check for $50.[23]
- In a second settlement, a credit-card issuer settled claims that it improperly raised the minimum monthly payment and added new fees in connection with promotional loan offers. The defendant issued class members a flat-rate payment of $25, plus (for certain customers) a share of the remaining settlement fund calculated by taking into account the ways the class member had used the promotional loan and had been charged fees.[24]
- Finally, as we explain in more detail below, a third settlement resolved privacy claims against a mobile-phone gaming app developer in

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[23] Plaintiffs' Unopposed Motion for Order Preliminarily Approving Class Action Settlement at 8, *Gianzero v. Wal-Mart Stores, Inc.*, No. 09-cv-00656 (D. Colo. Nov. 21, 2011), PACER No. 464 ("*Gianzero* Preliminary Approval Motion").

[24] Plaintiffs' Motion for Preliminary Approval of Class Settlement at 5-7, *In re Chase Bank USA, N.A. "Check Loan" Contract Litigation*, No. 09-md-2032 (N.D. Cal. July 23, 2012), PACER No. 338.

exchange for 45 in-game "points" that were automatically distributed to users so they could advance through the game's levels.[25]

Thus, only two consumer cases involved automatic distributions, and in one the distribution involved "game points." ***Only a single settled consumer class action—one of 127 class actions resolved—conveyed real benefits to anything more than a small percentage of the class.***

Cy pres* awards and injunctive relief serve primarily to inflate attorney's fee awards—and benefit third parties with little or no ties to the putative class.** The final group of 9 settled cases largely involved ***injunctive relief or cy pres distributions. Because these cases involve no monetary compensation to class members, it is difficult for outsiders to assess the claimed benefit. Certainly, ***in many cases "injunctive relief" has little or no real-world impact on class members, but is used to provide a basis for claiming a "benefit" to class members justifying an award of attorneys' fees to class counsel*** (as we detail below). The injunctive-relief-only settlements we reviewed included the following:

- Plaintiff subscribers of America Online ("AOL") claimed that it embedded advertisements at the bottom of the subscribers' email messages without their permission. After an early settlement was vacated on appeal for improper *cy pres* awards to unrelated charities, the parties again settled the claims, with AOL promising to tell subscribers how to opt out of email advertisements if it restarted the challenged practice.[26]
- In a class action involving claims that a social-networking app developer failed to protect properly the personally identifiable information of 32 million customers from a data security breach, the settlement provided that the defendant will undergo two audits of its information security policies with regard to maintenance of consumer records, to be made by an independent third party. The settlement explicitly reserves the rights of the plaintiff class to sue for monetary relief.[27]
- Plaintiffs brought false advertising claims against Unilever, contending that it had misrepresented the health or nutritional characteristics of "I Can't Believe It's Not Butter." As part of the

[25] *See* notes 44–46 and accompanying text.

[26] Revised Class Action Settlement Agreement ¶¶ 20-22, *Bronster v. AOL, LLC*, No. 09-cv-3568 (C.D. Cal. July 31, 2013), PACER No. 66-10. The settlement also proposes a *cy pres* award to a more related charitable organization. *Id.* ¶ 23.

[27] Settlement Agreement and Release at 4, *Claridge v. RockYou, Inc.*, No. 09-cv-6032 (N.D. Cal. Dec. 15, 2011), PACER No. 55-1.

settlement, Unilever was to remove all partially hydrogenated vegetable oils from its soft spreads by December 31, 2011, and from its stick products by December 31, 2012, and keep those ingredients out of those products for 10 years. Although they did not receive monetary compensation, class members released all monetary and equitable claims other than claims for personal injury.[28]

- Finally, in a class action alleging the violation of consumer protection laws arising out of the marketing of Zicam supplements (sold as a way of combating the common cold), the parties provided for a number of non-pecuniary "benefits"—all in the form of labeling changes. These include: (1) indicating that the FDA has not approved the supplements; (2) disclosing that customers with zinc allergies or sensitivities should consult a doctor; (3) informing customers that the products are not intended to be effective for the flu or for allergies; and (4) removing language recommending that customers continue to use the products for 48 hours after cold symptoms subside. If the court approves the settlement and requested attorneys' fees, the defendant will pay plaintiff's counsel up to $1.75 million in fees in one case, and another $150,000 in a related MDL proceeding.[29]

Like injunctive relief settlements, ***the* cy pres *doctrine is being used by plaintiffs' lawyers to inflate artificially the purported size of the benefit to the class in order to justify higher awards of attorney's fees to the plaintiffs' lawyers***. In four of the cases we examined, the settlement provided that one or more charitable organizations would receive either all monetary relief, or any remaining monetary relief after claims made were paid out.

Courts often assess the propriety of an attorneys' fee award in the settlement context by comparing the percentage of the settlement paid to class members or charities with the percentage of the settlement allocated to class counsel.[30] That

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[28] Notice of Joint Motion for Final Approval of Class Settlement and Memorandum of Points and Authorities in Support Thereof at 4, *Red v. Unilever United States, Inc.*, No. 10-cv-387 (N.D. Cal. June 6, 2011), PACER No. 153.

[29] Plaintiffs' Memorandum in Support of Motion for Final Approval of Class Action Settlement at 4-5, *Hohman v. Matrixx Initiatives, Inc.*, No. 09-cv-3693 (N.D. Ill. May 26, 2011), PACER No. 81.

[30] *See, e.g., Strong v. BellSouth Telecommunications, Inc.*, 137 F.3d 844, 851 (5th Cir. 1998) (affirming the district court's decision to compare the "actual distribution of class benefits" against the potential recovery, and adjusting the requested fees to account for the fact that a "drastically" small 2.7 percent of the fund was distributed); *see also Int'l Precious Metals Corp. v. Waters*, 530 U.S. 1223, 1223 (2000) (O'Connor, J., respecting the denial of certiorari) (noting that fee

approach has been endorsed by the Manual for Complex Litigation.[31] If no funds are allocated to the class, or a small portion of the amount ostensibly allocated to the class is actually distributed and the remainder of the funds returned to the defendants, the relative percentages could be disturbing to a court reviewing the fairness of the settlement. But if the amount not collected by class members is contributed to a charity that can be claimed to have some tenuous relationship to the class, then the percentage allocated to attorneys' fees may appear more acceptable.

The result, as one district court has warned, is that attorney fee awards "determined using the percentage of recovery" will be "exaggerated by *cy pres* distributions that do not truly benefit the plaintiff class."[32] As Professor Martin Redish has noted, the *cy pres* form confirms that "[t]he real parties in interest in . . . class actions are . . . the plaintiffs' lawyers, who are the ones primarily responsible for bringing th[e] proceeding."[33] One district court has noted that when a consumer class action results in a *cy pres* award that "provide[s] those with individual claims no redress," where there are other "incentives" for bringing individual suits, the class action fails the requirement that the class action be "superior to other available methods" of dispute resolution.[34]

Lawyers (as opposed to class members) were the principal beneficiaries of the remaining settlements in our study. For the "*cy pres*" settlements in our data set, and the "claims made" settlements for which there is no distribution data,

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awards disconnected from actual recovery "decouple class counsel's financial incentives from those of the class," and "encourage the filing of needless lawsuits where, because the value of each class member's individual claim is small compared to the transaction costs in obtaining recovery, the actual distribution to the class will inevitably be small").

31 *See* Federal Judicial Center, *Manual for Complex Litigation (Fourth)* § 27.71 (2004).

32 *SEC v. Bear Stearns & Co.*, 626 F. Supp. 2d 402, 415 (S.D.N.Y. 2009).

33 Testimony of Martin H. Redish at 7, U.S. House of Representatives, Committee on the Judiciary, Subcommittee on the Constitution, *Hearing: Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), available at http://judiciary.house.gov/hearings/Hearings%202012/Redish%2006012012.pdf.

34 *Hoffer v. Landmark Chevrolet Ltd.*, 245 F.R.D. 588, 601-04 (S.D. Tex. 2007) (Rosenthal, J.). In one of the cases in our sample, the same district judge cautioned that *cy pres* awards "'violat[e] the ideal that litigation is meant to compensate individuals who were harmed,'" but ultimately approved the award because prior court precedents had authorized the use of *cy pres*. *In re Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig.*, 851 F. Supp. 2d 1040, 1076 (S.D. Tex. 2012) (Rosenthal, J.).

publicly available information provides further support for the conclusion that little in the way of benefit flows to class members. Examples from our data set include:

- ***Disproportionate allocation of settlement funds to attorneys' fees.*** Plaintiffs brought a class action alleging that the defendants improperly interfered with the medical care of injured employees in violation of Colorado law.[35] Under the settlement agreement, the defendants (who denied wrongdoing) were required to make an $8 million fund available to compensate more than 13,500 class members. But class counsel received over $4.5 million out of the $8 million—more than 55 percent of the fund.[36]
- ***Named plaintiffs object to the settlement***. In a class action against the National Football League, retired players alleged that the league was using their names and likenesses without compensation to promote the league. The NFL and some players settled the class-wide claims under federal competition law and state right of publicity laws. But the original named plaintiffs who spearheaded the litigation objected to the settlement, arguing that it provided ***no direct payout to the retired players***.[37] Rather, it created an independent organization that would fund charitable initiatives related to the health and welfare of NFL players—and would create a licensing organization that would help fund the independent organization. Meanwhile, "[p]laintiffs' lawyers would receive a total of $7.7 million under the proposed agreement."[38]
- ***Low recovery for class members.*** Plaintiffs alleged in eight consolidated class actions that their employer, a bank, violated the federal Employee Retirement Income Security Act (ERISA) by offering its own stock as a retirement plan investment option while hiding the true extent of the bank's losses in the mortgage crisis.[39] The class

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35 *Gianzero* Preliminary Approval Motion at 4.

36 *Id.* at 10.

37 The Dryer Plaintiffs' Opposition to Preliminary Approval of the Proposed Settlement Class, *Dryer v. Nat'l Football League*, No. 09-cv-2182 (D. Minn. Mar. 20, 2013), PACER No. 264.

38 Alison Frankel, Retired NFL stars reject settlement of their own licensing class action, REUTERS (Mar. 25, 2013), available at http://blogs.reuters.com/alison-frankel/2013/03/25/retired-nfl-stars-reject-settlement-of-their-own-licensing-class-action/.

39 Class Action Complaint at 2, 24-25, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Aug. 20, 2009), PACER No. 1.

settlement established a $2.5 million common fund that was ostensibly designed to compensate the employees for their losses arising from the bank's alleged breach of fiduciary duty.[40] But commentators note that, when all of the allegations in the various complaints were taken into account, plaintiffs had alleged more than $50 million in losses, meaning that class members would recover no more than five cents on the dollar.[41] And according to the plan of allocation, members of the settlement class who were calculated to have suffered damages less than $25 would receive *nothing*[42]—meaning that their claims were released without even the opportunity to receive something in exchange. Meanwhile, the plaintiffs' attorneys received a fee award amounting to 26% of the common fund ($645,595.78), plus $104,404.22 in expenses.[43]

- ***Settlement requires further use of defendant's services.*** A plaintiff filed a class action alleging that certain mobile-phone gaming apps were improperly collecting and disseminating users' mobile phone numbers.[44] Under the terms of the settlement agreement, class members were not entitled to any monetary payment. Instead, they were slated to receive 45 in-game "points" (with an approximate cash value of $3.75) per mobile device owned; the points could be used to advance through the gaming apps' levels.[45] These points could be redeemed or used only within the defendant's apps.[46] Unsurprisingly, the plaintiffs' counsel were not paid in points, but instead were awarded $125,000 in attorneys' fees.

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40 *See, e.g.*, Final Judgment at 2-3, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Oct. 12, 2012), PACER No. 207 ("*Colonial Bancgroup* Final Judgment").

41 Bill Donahue, *Colonial Bank Execs Pay $2.5m to Dodge ERISA Claims*, Law360 (June 18, 2012), available at http://www.law360.com/articles/350930

42 Plan of Allocation at 3, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Sept. 14, 2012), PACER No. 192-1.

43 *Colonial Bancgroup* Final Judgment at 8.

44 First Amended Complaint at 2, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. June 22, 2010), PACER No. 27.

45 Motion for Final Approval of Class Action Settlement Agreement at 3, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. Nov. 11, 2010), PACER No. 32.

46 Settlement Agreement at 8, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. June 22, 2010), PACER No. 26-1.

- ***Attorneys seek fees far exceeding class recovery***. Class counsel in a case involving allegedly faulty laptops found their fee request chopped down from $2.5 million to $943,000.[47] The settlement resulted in a recovery of $889,000 to claimants, plus $500,000 in additional costs for administering the settlement—meaning that the attorneys were seeking just under ***three times*** the amount that would have gone directly to the class—and even after the fees were cut down, they still represented 106 percent of the class's direct recovery.

These characteristics are not unique to the sample cases. To the contrary, results are consistent with a significant number of class action settlements that produce minimal benefits for the class members themselves. We summarize additional examples of such settlements—taken from outside our data set—in Appendix B.

Other studies of class settlements and attorneys' fees confirm that these examples are not outliers: Such settlements commonly produce insignificant benefits to class members and outsize benefits to class counsel. A RAND study of insurance class actions found that attorneys' fees amounted to ***an average of 47% of total class-action payouts***, taking into account benefits actually claimed and distributed, rather than theoretical benefits measured by the estimated size of the class. "In a quarter of these cases, the effective fee and cost percentages were 75 percent or higher and, in 14 percent (five cases), the effective percentages were over 90 percent."[48]

In other words, for practical purposes, counsel for plaintiffs (and for defendants) are frequently the only real beneficiaries of the class actions.

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47 Attorney's Fees Slashed in Faulty Laptop Class Action, *BNA Class Action Litigation Report*, 14 Class 1497 (Oct. 25, 2013), available at http://news.bna.com/clsn/CLSNWB/split_display.adp?fedfid=37476946&vname=clasnotallissues&jd=a0e2t3w1f0&split=0. This case was among the ones we studied, but the court's decision awarding a reduced amount of attorneys' fees was issued after the closing date of our study.

48 Nicholas M. Pace et al., *Insurance Class Actions in the United States*, Rand Inst. for Civil Just., xxiv (2007), http://www.rand.org/pubs/monographs/MG587-1.html. Another RAND study similarly found that in three of ten class actions, class counsel received more than the class. *See* Deborah R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* (Executive Summary), Rand Inst. for Civil Just., 21 (1999), http://www.rand.org/pubs/monograph_reports/MR969.html.

Conclusion

This study confirms that class actions rarely benefit absent class members in whose interest class actions are supposedly initiated. The overwhelming majority of class actions are dismissed or dropped with ***no recovery*** for class members. And those recoveries that class settlements achieve are typically minimal—and obtained only after long delays. To be sure, not every class action is subject to these criticisms: a few class actions do achieve laudable results. But virtually none of those were consumer class actions. Certainly our analysis demonstrates—at a bare minimum—that the vast majority of class actions in our sample set cannot be viewed as efficient, effective, or beneficial to class members.

<u>Appendix A</u>: Additional Examples of Settlements With Payments to a Very Small Percentage of Class Members

- The Seventh Circuit vacated an order approving a class action settlement so that the district court could "evaluate whether the settlement is fair to class members," where (among other problems with the settlement) only "a *paltry* three percent" of the quarter-million-wide proposed class "had filed proofs of claim."[49] And the Third Circuit recently noted that "consumer claim filing rates *rarely* exceed seven percent, even with the most extensive notice campaigns."[50]
- One affidavit analyzed 13 cases for which data had been disclosed (and in which the settlement was approved). The median claims rate was 4.70%. The highest claims rate in those cases was 5.98%, and the lowest non-zero claims rate was 0.67%. In two cases, the claims rate was 0%—reflecting that not a single class member obtained the agreed-on recovery.[51]
- A class action alleging antitrust claims in connection with compact disc "music club" marketing settled, with only 2% of the class making claims for vouchers (valued at $4.28) for CDs.[52]
- Indeed, in many cases, the claims rate may be well under 1 percent.
    - Fair Credit Reporting Act case: court noted that "less than one percent of the class chose to participate in the settlement."[53]
    - Case alleging that a software manufacturer sold its customers unnecessary diagnostic tools: court approved settlement despite the fact that only 0.17% of customers made claims for a $10 payment, because "the settlement amount is commensurate with the strength of the class' claims and their likelihood of success absent the settlement."[54]

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49 *Synfuel Techs., Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646, 648, 650 (7th Cir. 2006) (emphasis added).

50 *Sullivan v. DB Investments, Inc.*, 667 F.3d 273, 329 n. 60 (3d Cir. 2011) (en banc) (emphasis added; quotation marks omitted).

51 Declaration of Kevin Ranlett in Support of Defendants' Amended Motion to Compel Arbitration at 8, *Coneff v. AT&T Corp.*, No. 2:06-cv-00944 (W.D. Wash. May 27, 2009), PACER No. 199. Mr. Ranlett is a Mayer Brown lawyer.

52 *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 370 F. Supp. 2d 320, 321 (D. Me. 2005).

53 *Yeagley v. Wells Fargo & Co.*, 2008 WL 171083, at *2 (N.D. Cal. Jan. 18, 2008), *rev'd*, 365 F. App'x 886 (9th Cir. 2010).

54 *LaGarde v. Support.com, Inc.*, 2013 WL 1283325, at *6 (N.D. Cal. Mar. 26, 2013). The court approved a proposed modified settlement under which the class

- Case involving product liability claims related to alleged antenna problems with Apple's iPhone 4: court approved settlement noting that the "number of claims represents somewhere between 0.16% and 0.28% of the total class."[55]
- Class action alleging fraud in the procurement of credit-life insurance: Supreme Court of Alabama noted that "only 113 claims" had been made in a class of approximately 104,000—or a response rate of 0.1%.[56]
- Action alleging that restaurant chain had printed credit-card expiration dates on customers' receipts: "approximately 165 class members" out of 291,000—or fewer than 0.06% of the class—"had obtained a voucher" for one of four types of menu items worth no more than $4.78.[57]
- Class action alleging that Sears had deceptively marketed automobile-wheel alignments: "only 337 valid claims were filed out of a possible class of 1,500,000"—a take rate of just over 0.02%.[58]
- Class action alleging that video game manufacturer had improperly included explicit sexual content in the game: ***one fortieth of one percent*** of the potential class (2,676 of 10 million) made claims.[59]
- Class action involving allegations that a Ford Explorer was prone to dangerous rollovers: only 75 out of "1 million" class members—or ***less than one hundredth of one percent***—participated in the class settlement.[60]

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members "who made a claim" after having been "offered a $10 cash payment * * * will now receive a $25 cash payment, rather than $10." *Id.* at *4.

[55] *In re Apple iPhone 4 Prods. Liab. Litig.*, 2012 WL 3283432, at *1 (N.D. Cal. Aug. 10, 2012).

[56] *Union Fid. Life Ins. Co. v. McCurdy*, 781 So. 2d 186, 188 (Ala. 2000).

[57] *Palamara v. Kings Family Rests.*, 2008 WL 1818453, at *2 (W.D. Pa. Apr. 22, 2008).

[58] *Moody v. Sears, Roebuck & Co.*, 2007 WL 2582193, at *5 (N.C. Super. Ct. May 7, 2007), *rev'd*, 664 S.E.2d 569 (N.C. Ct. App. 2008).

[59] *In re Grand Theft Auto Video Game Consumer Litig.*, 251 F.R.D. 139 (S.D.N.Y. 2008).

[60] Cheryl Miller, "Ford Explorer Settlement Called a Flop," *The Recorder* (July 13, 2009), http://www.law.com/jsp/article.jsp?id=1202432211252.

Appendix B: Additional Examples of Settlements Providing Negligible Benefits to Class Members

- ***Class members receive extended membership in buying club.*** In a class action against DirectBuy—a club for which customers pay a membership fee to purchase goods at lower prices—the plaintiffs alleged that the defendant had misrepresented the nature of the discounts that were available through the club.[61] The settlement afforded class members nothing other than discounts for renewal or extension of their memberships in the very club that was alleged to have tricked them into joining in the first place. Meanwhile, the attorneys for the class "could receive between $350,000 and $1 million."[62]
- ***$21 million for the lawyers, pennies and coupons for the class members.*** One Missouri class settlement in a case against a brokerage house alleging breaches of fiduciary duties provided $21 million to class counsel, but only $20.42 to each of the brokerage's former customers and three $8.22 coupons to each current customer. And most of the coupons are unlikely to be redeemed.[63]
- ***Class members receive right to request $5 refund, lawyers take (and fail to disclose sufficiently) $1.3 million in fees.*** Under the settlement of a class action in which the plaintiffs alleged that Kellogg's had misrepresented that Rice Krispies are fortified with antioxidants, class members could request $5 refunds for up to three boxes of cereal purchased between June 1, 2009, and March 1, 2010.[64] Class counsel sought $1.3 million in attorneys' fees on a claim fund valued at $2.5 million to be paid out to class members.[65]

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61 Michelle Singletary, *Class-action Coupon Settlements are a No-Win for Consumers*, Wash. Post, Apr. 28, 2011 at A14.

62 *Id.*

63 *See* Stipulation of Settlement of Class Action, *Bachman v. A.G. Edwards, Inc.*, No. 22052-01266-03 (Mo. Cir. Ct. St. Louis Feb. 18, 2010), http://www.agedwardsclassactionsettlement.com/bach_20100219094521.pdf; *see also* Daniel Fisher, *Lawyer Appeals Judge's Award of $21 Million in Fees, $8 Coupons for Clients*, FORBES.COM (Jan. 10, 2011), http://blogs.forbes.com/danielfisher/2011/01/10/lawyer-appeals-judges-award-of-21-million-in-fees-8-coupons-for-clients ("The judge didn't even see fit to inquire into the lawyers' valuation of the coupon portion of the settlement, despite strong evidence that less than 10% of coupons in such cases are ever redeemed").

64 Stipulation of Settlement at 2-8, *Weeks v. Kellogg*, No. 2:09-cv-8102 (C.D. Cal. Jan. 10, 2011), PACER No. 121.

65 Memorandum of Law in Support of Plaintiffs' Motion for Award of Attorneys' Fees, Expenses, and Plaintiff Service Awards at 4, *Weeks v. Kellogg*, No. 2:09-cv-8102 (C.D. Cal. July 18, 2011), PACER No. 135-1.

- ***Class receives opportunity to attend future conferences.*** In a 2009 settlement in the District of Columbia, a court approved a settlement against a conference organizer that failed to deliver promised services to those who had paid to attend. The settlement provides class members with nothing other than coupons to attend future events put on by the same company alleged to have bilked them in the first place; class counsel will take $1.4 million in fees.[66]

- ***Class members receive nothing, class counsel take $2.3 million.*** In a $9.5 million settlement of a class action against Facebook over the disclosure to other Facebook users of personal information about on-line purchases through Facebook's "Beacon" program, the class members received no remedy whatever for the invasions of their privacy and were barred from making future claims for any remedy. Instead, approximately $6.5 million went to create and fund a new organization that would give grants to support projects on internet privacy; a few thousand dollars went to each of the named plaintiffs as "incentive payments"; and class counsel received more than $2.3 million.[67] Meanwhile, although Facebook agreed to end the Beacon program—which it had actually already ended months before—it remained free to reinstitute the program as long as it didn't use the name "Beacon."[68] As one federal appellate judge put it (in a dissent from a decision upholding the settlement):

> The majority approves ratification of a class action settlement in which class members get no compensation at all. ***They do not get one cent***. They do not get even an injunction against Facebook doing exactly the same thing to them again. ***Their purported lawyers get millions of dollars***. Facebook gets a bar against any claims any of them might make for breach of their privacy rights. The most we could say . . . is that in exchange for giving up any claims they may have, the exposed Facebook users get the satisfaction of contributing to a charity to be funded by Facebook, partially controlled by Facebook, and advised by a legal team consisting of Facebook's counsel and their own

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66 *See* Memorandum Opinion at 3-5, 8, *Radosti v. Envision EMI, LLC*, No. 1:09-cv-887 (D.D.C. June 8, 2010), PACER No. 40; Order at 1-2, *Radosti v. Envision EMI, LLC*, No. 1:09-cv-887 (D.D.C. Jan. 19, 2011), PACER No. 45.

67 *Lane v. Facebook, Inc.*, 696 F.3d 811 (9th Cir.), *reh'g en banc den.* 709 F.3d 791 (9th Cir. 2013), *cert. denied*, 134 S. Ct. 8 (2013).

68 Petition for Certiorari at 11-13, *Marek v. Lane*, No. 13-136 (filed July 26, 2013), 2013 WL 3944136.

> purported counsel whom they did not hire and have never met.[69]

The Supreme Court ultimately declined to review the Ninth Circuit's decision approving the settlement. As Chief Justice Roberts explained in a rare statement addressing the court's denial of certiorari, the objectors had challenged "the particular features of the specific *cy pres* settlement at issue," but in his view had not addressed "more fundamental concerns surrounding the use of such remedies" and the standards that should govern their use. Such concerns, he pointed out, would have to await a future case.[70]

- ***Court reduced attorneys' fees because of lack of benefit to class members.*** The Sixth Circuit upheld a district court's decision to reduce class counsel's requested fees from $5.9 million to $3.2 million in a settlement of a class action involving auto-insurance benefits.[71] In affirming the decision, the Sixth Circuit pointed out that the district court "did not believe that the class members received an especially good benefit [because] Class Counsel chose to pursue a relatively insignificant claim" as opposed to "other potential claims, . . . and [they] agreed to a settlement mechanism which yielded a low claims rate[.]"[72] Although the court noted that "the settlement makes available a common fund of $27,651,288.83 less any attorney fee award, costs, and administrative expenses," for individual class member benefits up to a maximum of $199.44, "only a small percent of eligible class members have made claims" totaling approximately $4 million—or 14% of the total common fund available.[73] What is more, class counsel represented in their fee motion that they provided notice to 189,305 class members and received "well over 12,000" claims—in other words, a claims-made rate of just over six percent.[74]

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69 *Lane*, 696 F.3d at 835 (Kleinfeld, J., dissenting) (emphasis added).

70 *Marek*, 134 S. Ct. at 9 (Roberts, C.J., respecting the denial of certiorari).

71 *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, 436 F. App'x 496 (6th Cir. Aug. 26, 2011).

72 *Id.* at 500.

73 Opinion and Order at 10-11, *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, No. 1:08-cv-605 (N.D. Ohio, Apr. 30, 2010), PACER No. 308.

74 Class Counsel's Supplemental Memorandum in Support of Class Counsel's Motion for Award of Attorney's Fees and Reimbursement of Litigation Expenses at 3-4, 7, *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, No. 1:08-cv-605 (N.D. Ohio Mar. 19, 2010), PACER No. 296

Appendix C: Study Design and Methodology

Identifying the Study Sample

The first step in studying putative class actions was to select a suitable pool of cases. Identifying every putative class action filed during 2009 would be impracticable—not least without extensive resources and staff support.[75] We instead used two commercial publications—the *BNA Class Action Litigation Reporter* and the *Mealey's Litigation Class Action Reporter*—to identify cases for inclusion in the study. These publications cover a wide array of developments in class action litigation, and therefore provide a diverse sample of filed class action complaints. The publications have an incentive to report comparatively more significant class actions out of all class actions filed, without wasting readers' time and attention on minor or obviously meritless suits. If anything, the sample would be skewed in favor of more significant class actions filed by prominent plaintiffs' attorneys—which should be *more meritorious on average* than a sample generated randomly from all class actions filed.

We reviewed issues of BNA and Mealey's published between December 2008 and February 2010 in order to identify cases filed in 2009. The reason for that limitation was the importance of analyzing "modern" cases that were filed after the passage of the Class Action Fairness Act of 2005, but long enough ago to track how the cases have actually progressed and whether they have been resolved. From those publications, we identified a pool of putative class actions brought by private plaintiffs that were either filed in federal court or were removed to federal court from state court in 2009. To begin with, because data about state court cases is much more difficult to obtain, we excluded a number of cases, such as those brought in state court initially (where the BNA or Mealey's report did not mention that the case was removed). We also excluded one case that was removed to federal court and then remanded to state court. This left us with 188 cases.

Nineteen of these eventually became part of eleven other consolidated cases that were also part of our data set—whether under the multidistrict litigation

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[75] *See, e.g.,* Deborah Hensler, et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* § 4.60 (RAND Institute for Civil Justice, Monograph MR-969/1-ICJ) (1999) ("Enormous methodological obstacles confront anyone conducting research on class action litigation. The first obstacle is a dearth of statistical information. No national register of lawsuits filed with class action claims exists. Until recently, data on the number of federal class actions were substantially incomplete, and data on the number and types of state class actions are still virtually nonexistent. Consequently, no one can reliably estimate how much class action litigation exists or how the number of lawsuits has changed over time. Incomplete reporting of cases also means that it is impossible to select a random sample of all class action lawsuits for quantitative analysis.").

("MDL") procedure, 28 U.S.C. § 1407, or otherwise (for example, cases are often consolidated when they are pending in the same federal district court). When multiple putative class actions appearing in our data set were consolidated, we treated the consolidated case as a single action to avoid the risk of "overcounting" lawsuits.[76] And when a case in our data set was consolidated with other cases not in our data set, we considered activity reflected on the docket of the "lead" consolidated case that was attributable to the individual case as filed. If after consolidation the case was resolved together with the "lead" case—such that we could not trace outcomes for the individual case separate from the "lead" case—we considered activity attributable to the "lead" case. This approach dovetails with the practical mechanics of consolidation: After cases are consolidated into an MDL, for example, the judge to whom the MDL proceeding is assigned will resolve pretrial motions presented in all the consolidated cases. And more generally, to the extent that courts treat a number of separately filed cases together as a single unit for purposes of adjudication, we have followed the courts' lead.[77] Excluding the cases that became part of other consolidated cases in our data set left us with 169 cases.

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[76] By way of example, four cases—*Sansom v. Heartland Payment Sys., Inc.* No. 09-cv-335 (D.N.J.); *Lone Summit Bank v. Heartland Payment Sys., Inc.* No. 09-cv-581 (D.N.J.); *Tricentury Bank v. Heartland Payment Sys., Inc.* No. 09-cv-697 (D.N.J.), and *Kaissi v. Heartland Payment Sys., Inc.* No. 09-cv-540 (D.N.J.)—eventually were consolidated into *In re: Heartland Payment Sys., Inc., Customer Data Security Breach Litigation*, No. 4:09-md-02046 (S.D. Tex.).

[77] The decision to treat these consolidated cases along with the lead case had little effect on our data. A comparison of statistics on outcomes reveals that, if anything, treating consolidated class actions as a single action rather than separately tended to overstate the benefits of class actions.

In our full 188-case sample set (including the consolidated cases), 99 cases (54%) were dismissed, whether on the merits by the court, by the plaintiff voluntarily, or as an inferred settlement on an individual basis; 31 cases (16%) remain pending; 55 cases (29%) were settled on a class-wide basis; and 3 cases (2%) were dismissed after the court granted a motion to compel arbitration. By comparison, in the 169-case sample set (excluding the consolidated cases), 99 cases (57%) were dismissed, whether on the merits by the court, by the plaintiff voluntarily, or as an inferred settlement on an individual basis; 23 cases (14%) remained pending; 47 cases (28%) were settled on a class-wide basis; and 1 (1%) was dismissed after the court granted a motion to compel arbitration.

Similarly, this methodology ensures that me-too actions—cases filed by other attorneys after a complaint in a different case, raising materially identical claims—that are routinely dismissed after consolidation without any award or settlement will instead be treated as sharing in any benefits to class members that were actually obtained.

Our next goal was to identify a set of class actions consisting of claims resembling those asserted by consumers—because that is the area under study by the CFPB. We therefore excluded three non-Rule-23 putative class actions brought by the Equal Employment Opportunity Commission.[78] We also excluded nine Fair Labor Standards Act cases.[79] Finally, we excluded nine securities cases, because the stakes and nature of those claims are very different from the claims asserted in consumer class actions, and because they are litigated in a different manner because of the procedural checks imposed by federal laws governing securities litigation.[80] Excluding these 21 EEOC, securities, and FLSA cases had next to no effect on the statistical results of our study.[81]

Accordingly, the statistics about the total number of class actions filed in 2009 are based on a set of 148 putative class actions.

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78 The Supreme Court has held that the EEOC may pursue enforcement actions under Title VII § 706 without being certified as a class representative under Federal Rule of Civil Procedure 23. *See Gen. Tel. Co. of Nw., Inc. v. EEOC*, 446 US. 318 (1980). The Supreme Court's reasoning would appear to apply equally outside the context of Title VII. Because the EEOC does not need to pursue a Rule 23 class, the dynamics of EEOC class-wide enforcement actions differ markedly from those in Rule 23 actions.

79 Class actions under the FLSA are certified conditionally as "opt-in" classes. Section 216(b) of the FLSA permits a right of action against an employer by an employee on behalf of "other employees similarly situated," who must have opted in by providing and filing with the court "consent in writing" to become a plaintiff. 29 U.S.C. § 216(b). These cases present different incentives for plaintiffs' counsel than consumer class actions, because they typically involve statutory attorneys' fees to prevailing plaintiffs and may involve large backpay and overtime pay awards.

80 As one academic study explained, securities class actions "are managed under a set of class action rules distinct from those used for other Rule 23(b)(3) classes—and . . . the plaintiffs with the largest losses have a significant role in the litigation (including choosing class counsel and defining the terms of the settlement) and can hardly be thought of [as] an 'absent' class member." Pace & Rubenstein, *supra* note 16, at 20; *see*, *e.g.*, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-76, 109 Stat. 737 (1995); Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

81 Recall that our 169-case sample set, which included these cases, resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration. *See supra* note 77. After excluding them, our 148-case sample set resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration. *See* Figure 1.

Constructing the Data Set

We identified and coded a number of variables about each case. Using the federal courts' Public Access to Court Electronic Records ("PACER") system, we evaluated the filings on each case's docket. Where criteria for a case could be coded in more than one way, we scrutinized the underlying filings and rulings to determine whether the criteria better fit one or another category. For administrative purposes, we treated September 1, 2013, as the date on which our study period closed. We did not code filings and events that were entered onto the docket after that date.

Among the data collected for each case were: jurisdiction; date filed; plaintiffs' firm; assigned judge; cause of action (as reported by PACER); nature of suit (as reported by PACER); whether the case was a lead or related case (if it was in a consolidated action);[82] whether the court granted class certification; whether the case was voluntarily dismissed,[83] settled, settled but on appeal, dismissed, otherwise disposed of, or still pending; the current posture of the case;[84] and the date of the last action on the case.

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[82] If a case was a related case in a consolidated action, we collected information based on what happened in the lead case.

[83] If a case was voluntarily dismissed, we attempted to discern from filings (and from sources external to the docket) whether the dismissal should be attributed to a settlement on an individual basis—such as when the filings refer to a settlement, or when the named plaintiff sought to dismiss her own claims with prejudice but without prejudice to absent members of the putative class. On one hand, this is likely to understate the rate at which individual plaintiffs settle their claims individually, which in any event results in no recovery to other absent members of the putative class unless another lawsuit moves forward. On the other hand, we were often not able to discern whether the claims in a lawsuit dismissed voluntarily would continue to be litigated (or settled) by another named plaintiff under a different case caption. Thus our decision to select a readily accessible sample of class actions may understate the extent to which members of a putative class may have their claims dismissed on the merits, or alternatively settled, in a class action under a different docket.

[84] The data set includes two certified class actions in which motions for summary judgment are pending. The data set also includes an additional certified class action in which the court granted summary judgment to the plaintiffs on their claim for injunctive relief, and granted summary judgment to the defendants on all remaining claims. At the time our study closed, on September 1, 2013, the parties proposed text for an injunctive order that would resolve the parties' remaining claims on a class-wide basis.

For cases involving settlements, we also collected information about the date of dismissal or final settlement approval; the terms of the settlement agreement; any attorneys' fees, expenses, and incentive payments to lead plaintiffs; and the presence of any *cy pres* provision in the settlement agreement.

There are, of course, limitations to the data we collected. First, our conclusions are based on the cases that we reviewed. While there is good reason to believe that generalizations can be made to all class actions, the sample is undoubtedly smaller than the total number of class actions filed in 2009. Attempting to estimate that number reliably—let alone to examine those cases—would have exceeded the scope of our review. On the other hand, the sample includes cases from across the country and is drawn from sources that are likely to report on significant class actions—those that are of comparatively greater importance or quality than those actions that neither BNA nor Mealey's considered worth reporting. Because the BNA and Mealey's reporters do not present a random sample of all class actions filed in 2009, it would not be useful to calculate a margin of error or otherwise attempt to quantify the extent to which the sample differs randomly from the population of all class actions filed in 2009.

Attachment B

APPENDIX

Arbitration is an important means of resolving disputes that provides extremely significant benefits to consumers and businesses. As the U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR") have explained in detail,[1] arbitration of consumer disputes has been common practice for decades; there are perhaps hundreds of millions of consumer contracts currently in force that include arbitration agreements—many of them relating to consumer financial products or services.

The Bureau's study is deeply flawed in multiple respects: ignoring the practical benefits of arbitration as compared to the court system for vindicating the types of injuries that consumers most often suffer; exaggerating the supposed benefits of class actions; failing to consider the benefits that arbitration provides to injured parties in a variety of contexts—benefits that plainly accrue to consumers as well if they were not discouraged by plaintiffs' lawyers and others from invoking arbitration; the reduced transaction costs resulting from arbitration, which produce lower prices to consumers; and failing to account for the significant role of government enforcement—particularly the CFPB's own enforcement and supervision processes—in protecting consumers.

A. *The Bureau's study of individual lawsuits confirms that, for most injured consumers, the judicial system is not a realistic means for obtaining redress*.

Arbitration provides consumers, employees, and other injured parties with accessible and fair procedures for obtaining redress for claims that cannot be vindicated in court.

Many criticisms of arbitration are based on a flawed premise that the alternative system—litigation in court—gives individuals a meaningful and realistic option for resolving their disputes. That premise would makes sense only if the judicial system were free of transaction costs, if every legitimate claimant could obtain legal representation, and if lawsuits were resolved expeditiously. But as the Chamber demonstrated in its December 2013 comment letter to the Bureau,[2] these prerequisites are lacking, and today's judicial system falls far short of the ideal.

Most wrongs suffered by consumers are relatively small and individualized—excess charges on a bill, a defective piece of merchandise, and the like—and are simply too small to justify paying a lawyer to handle the matter. Such claims do not—and could not—attract lawyers willing to work on a contingency fee basis, because the claim promises no substantial

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[1] Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *Re: Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*, Docket No. CFPB-2012-0017, Supplemental Submission (Dec. 11, 2013), *available at* http://www.instituteforlegalreform.com/uploads/sites/1/2013_12.11_CFPB_-_arbitration_cover_letter.pdf ("*Chamber Comment II*"); Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *Re: Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*, Docket No. CFPB-2012-0017 (June 12, 2012), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0051 ("*Chamber Comment I*").

[2] *See Chamber Comment II* at 6-9.

recovery (and therefore no substantial legal fee). And because these claims are individualized, they do not share the common factual basis required for a class action to be certified.

Even when a claim is large enough to justify paying an attorney's fees—or to attract a contingency-fee lawyer—the complexity of the litigation system makes litigation costly. In addition, every participant in the legal system faces a significant access-to-justice problem in our overcrowded and underfunded courts: docket backlogs have skyrocketed, courthouses have been closed due to budget cuts, and trials are delayed.

These structural problems have practical real-world consequences that make it extremely difficult for individual consumers to litigate their claims in court. Indeed, the Bureau's study results confirm that litigation in court on an individual basis is not a realistic prospect for most people.

The Bureau examined individual (*i.e.*, non-class) cases brought in federal court by individual plaintiffs. Only in a miniscule percentage of the cases studied—5.6%—did plaintiffs pursue their claims *pro se*, confirming that litigation in court without the assistance of an attorney is impractical for most consumers. The vast majority—90%—of federal-court individual cases the Bureau studied resulted in a known or potential settlement of the individual's claims. But the Bureau found very little data about the settlements; in the few cases where it did, the "amounts of the settlements ranged from $250 to $15,000." Individual arbitration settlements and awards reflect similar or better successes: where data was available "the average and median [debt] forbearance amounts were $ 6,968 and $4,900."

Consumers obtained judgments in only 6.8% of the court cases studied, but most of those judgments involved a default judgment against the company. And for all the emphasis that critics of arbitration place on the importance of a jury trial, only one judgment for a consumer "was the result of a trial."[3]

The Bureau's review of small claims courts—and "what use parties made of" these courts "with respect to consumer financial disputes"[4]—provides little reason to believe that consumers can effectively pursue relief in those forums. The Bureau undertook a limited examination of small claims court, cabining its review to "potential credit card cases involving a set of ten large credit card issuers."[5] It appears that the Bureau simply counted the number of consumer credit card disputes, and did not address other categories of disputes that consumers may have. The report does not make a qualitative assessment of how small claims court operates in practice.

In fact, while small-claims courts were developed to make it easier for individuals to proceed without representation, they do not provide a realistic alternative because those courts are overcrowded and underfunded—as numerous newspaper investigations have

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3 Consumer Financial Protection Bureau, *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* at section 6, page 48-49 (Mar. 1, 2015) ("*CFPB Study*").

4 *Id*. at section 7, pages 2-3.

5 *Id*. at section 7, page 6.

demonstrated.[6] For individuals unable to pursue their claims in arbitration, the outlook in small claims court is grim. Again, the Bureau failed to assess the practical reality for consumers.

B. *The Bureau's study paints an unjustifiably positive and one-sided picture of class actions, which provide virtually no benefits to the vast majority of consumers*.

The principal attack on arbitration—encouraged by the plaintiffs' bar—stems from the fact that arbitration agreements typically require that arbitration proceed on an individual basis—and bar class procedures in arbitration and in court. This argument rests on an incorrect assumption: that the elimination of class actions deprives consumers of a procedural mechanism that supposedly provides enormous benefits by allowing the vindication of small claims that (according to the argument) would be too expensive for plaintiffs to arbitrate individually. The Bureau's study purports to provide empirical evidence addressing that argument.

But even the Bureau's own study does not support that idealized view of the class action system. Indeed, although the language of the study report is carefully crafted to avoid criticizing class actions, the study's underlying data actually establish that class actions are, on the whole, not effective for the kinds of claims that most individuals are likely to have. As explained further below, these details—buried in the Bureau's study among the more conspicuous statements implying that class actions are beneficial—in fact offer further proof that most class actions provide no benefit to consumers.

That conclusion is consistent with an empirical study of class actions filed in 2009, conducted by Mayer Brown LLP on behalf of the Chamber.[7] The study found that the overwhelming majority of class actions result in no recovery at all for members of the putative class.[8] Although the Bureau's study characterized the Chamber study as "not . . . comprehensive,"[9] the Bureau study's own data are consistent with the Chamber study in showing that class actions most frequently do not provide significant benefits to class members.

Most cases filed as purported class actions are not resolved in a manner that provides any benefit to absent class members. According to the Bureau's data, 87% of resolved class actions (excluding claims affected by arbitration agreements) resulted in no benefit to absent class members. Instead, most are dismissed by or settled with the named plaintiff only. The Bureau found that only 12% of putative class actions were finally approved for settlement during the study period.[10] That is even smaller than the proportion observed in the Chamber study, in which 28% of class actions studied had settled by the end of the study period. Although the Bureau's report fails to acknowledge it, the plain fact is that absent class members receive nothing unless a class action is settled on a class-wide basis or there is a class-wide judgment for plaintiffs (something that almost never happens).

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6 *Chamber Comment II* at 9-13.

7 Mayer Brown LLP, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 11, 2013) ("*Chamber Study*"), *available at* http://www.mayerbrown.com/files/uploads/-Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf.

8 *See generally Chamber Study*.

9 *CFPB Study* at section 8, page 6.

10 *Id.* at section 6, page 37.

Even in those cases that do settle, most class members still receive nothing. The Bureau's report attempts to tout the purportedly large number of class members "eligible for relief," but the only relevant metric is the rates at which "eligible" class members actually received relief, typically after submitting claims. In sharp contrast with the flood of statistics provided on other topics—including the numbers of class members eligible for relief when cases settle—the Bureau's report seemed designed to obscure the proportion of eligible class members who submitted claims. Where statistics were available, the Bureau's study reported a "weighted average claims rate" of 4%.[11]

That comports with the Chamber's study, which found that (in the handful of cases where statistics were available, and excluding one outlier case involving individual claims worth, on average, over $2.5 million) the claims rates were miniscule: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.[12] The Bureau's own study thus shows that even in the 13% of class actions that did settle on a classwide basis, approximately 96% of class members received no benefit. The Bureau could have—and should have—provided a precise calculation of the likelihood that a class member would receive a benefit in a class action, but even a back-of-the-envelope estimate suggests that claims-made settlements provide very little to the broader set of individuals on whose behalf seek to bring class actions. If an average of 4 percent of class members (weighted by size of the class) made claims and only 13 percent of class actions result in settlements, then only a very, very tiny percentage of the members of potential classes ever receive any recovery.

Why do claims rates matter? In determining who benefits, it makes no difference how many people are "eligible" to make claims; all that matters is who follows through. As the Chamber's study explained, there are many reasons why a class member might not submit a claim, such as because he or she believes the modest award is not worth their while, or the process is burdensome, or they do not believe they have been injured in the first place.[13]

The Bureau's study revealed other data about how class actions provide little value to individuals (although, again, one has to dig beneath the surface). For example, the study carefully avoids any mention of the ***average*** amount of payments to class members, instead trumpeting "a total of $1.1 billion in 251 settlements." It elsewhere says that 236 settlements involved 34 million class members "who received, or will receive, a cash payment." Assuming that the 15 cases included in the first number and not in the second had classes that were equal in size to the average class size for the 236, the average settlement payment was $30.38.[14]

What is more, claimants had to wait significantly longer in class actions than in arbitration to obtain relief. According to the Bureau, class actions that settled on a classwide basis—and for which it was thus even *possible* that a class action could provide benefits to absent class members—took an average of two years to resolve. And that period may not even include the time for consumers to submit claims and receive payment. By contrast, arbitrations

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11 *Id.* at section 8, page 30.

12 *Chamber Study* at 7 & n.20.

13 *Id.*

14 *CFPB Study* at section 8, pages 27-28.

resolved by the arbitrator took between four and eight months to resolve, and those arbitrations that were settled took between two to five months.[15]

One thing is clear, however: while class members receive little, the lawyers who bring these class actions do very, very well for themselves. Based on the Bureau's report, the amount received by plaintiffs' lawyers—as a percentage of the total announced settlement (not the smaller amount actually distributed to class members)—averaged 41%, with a median of 46%. The total: $424 million for 419 cases, or an average of more than $1 million per case.[16] It is telling that the Bureau did not attempt to compare the amount received by plaintiffs' lawyers with the amount class members ***actually*** received.

These massive fees are but one part of the equation: They do not include the other very large transaction costs associated with litigating class actions—the defense costs that companies must pay in all cases, and the cost to the courts of handling these cases. ***The Bureau does not even attempt to determine whether the costs of the system are worth the $30 benefit that a relatively small number of consumers may receive.***

C. *The Bureau's study does little to evaluate—or even describe—the procedures available in arbitration that afford consumers with fair, faster, and less expensive dispute resolution compared with litigation.*

The Bureau's own study reveals that—especially in contrast to class action litigation—arbitration provides consumers with effective procedures that enable them to obtain relief on claims that would be impractical to pursue in court.

The reasons that consumers cannot pursue most of their potential claims in court are (1) the claims are too small to attract a lawyer (typically more than $50,000 must be at issue in order to do so), and (2) the claims are too individualized to be addressed in a class action. Consumers who use arbitration get decisions on the merits more frequently and more quickly than they would in court.

The Bureau made no serious effort to examine the benefits of arbitration because it did not make any qualitative effort to assess how arbitration's procedures work and whether those procedures would facilitate the ability of consumers to bring claims.

But even the narrow examination of arbitration that the Bureau *did* undertake confirms arbitration's advantages:

- More of consumers' affirmative claims were decided on the merits: 24% in arbitrations, compared to less than 8% in litigation (and all but three of those were default judgments).[17] The success rate for consumers was even higher—27.2%—in the subset of arbitrations where the consumer brought affirmative claims but did not dispute any alleged debts.[18]

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15 *Id.* at section 5, page 72; *id*. at section 8, page 37.

16 *Id.* at section 8, page 33.

17 *See id.* at section 6, pages 48-49.

18 *Id.* at section 5, page 39.

- In arbitrations resolved by arbitrators involving affirmative claims by consumers where data on the amount of the award was available, consumers received relief on 32 claims on the merits; the average payment to consumers was $5,389, and the median amount was $2,682.[19] Those awards are significantly greater than the relief to claimants in class action settlements.

- The one reported court award was $4,925; the average settlement was $2,128; and the median amount was $1,001. Those consumers who were able to use arbitration to obtain a merits decision did much better.

To the extent the Bureau does discuss the terms of arbitration agreements, it presents a false and misleading picture of the arbitral process. The Bureau recites various provisions of certain arbitration agreements—for example, provisions that bar punitive or consequential damages, limit the time period for filing claims, or require hearings in particular locations, or permit a company to recovery attorneys' fees whenever it prevails.[20] But the Bureau fails to explain that courts have routinely and consistently invalidated such provisions on state-law unconscionability grounds—a point that has been made fully clear to the Bureau.[21] That failure is an obvious attempt by the Bureau to create the patently erroneous impression that such provisions are being applied in practice simply because they are included in the terms of some arbitration agreements.

Even more troubling, the Bureau simply failed even to mention—much less analyze—the extent to which arbitration creates incentives for companies to settle individual claims or disputes even before the filing of a formal arbitration proceeding. Because businesses subsidize most or all of the costs of arbitration—under AAA consumer rules, for example, a business must cover at least $1500 in filing fees[22]—it is therefore economically rational for every business that is subject to an arbitration provision to settle disputes of less than $2,000-5,000 before an arbitration is commenced. But that same incentive is lacking in court, where the cost burden falls on the consumer.

In addition, many arbitration agreements create significant incentives to settle claims before arbitration begins, such as through arbitration provisions that—like the provision at issue in *AT&T Mobility v. Concepcion*—contain potential bonus payments to customers who do better in arbitration than a company's last settlement offer (providing, for example, that the customer will be awarded a minimum amount, often $5,000-10,000, plus attorneys' fees and, often, other costs). It is thus a straightforward matter of economics that, if a consumer has a dispute with a company of less than the bonus figure—and the claim is not frivolous or abusive—the company has every reason to settle by offering a payment (often for the full amount of the claim plus an amount for attorneys' fees) that satisfies the customer.

Thus, as the Supreme Court explained in *Concepcion*, the consumers' claim in that case was "most unlikely to go unresolved" because the arbitration provision at issue provided that

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19 *Id.* at section 5, page 41.

20 *Id.* at section 2, pages 45-64.

21 *Chamber Comment II* at 23-28.

22 AAA Consumer Arbitration Rules at 34, *available at* https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&.

the company would pay the Concepcions a minimum of $7,500 and twice their attorneys fees if they obtained an award "greater than AT&T's last settlement offer."[23] And this self-imposed incentive to settle occurs not just at the stages of a formally commenced arbitration or the pre-arbitration negotiation period. Instead, large numbers of AT&T customers have their concerns resolved at a much earlier point by calling or e-mailing AT&T's customer care department, which is remarkably effective: the record in *Concepcion* indicated that AT&T representatives awarded more than $1.3 billion in compensation to customers during a single twelve-month period in response to customer concerns and complaints.

The Supreme Court, and other courts, have found that provisions like these give companies a very significant incentive to settle even marginally meritorious claims on terms favorable to claimants—in order to avoid the downside risk of losing and having to pay the bonus amount.[24] That confers an important benefit not available in litigation, and one that cannot be quantified by looking at the results of arbitration proceedings. But the Bureau failed to examine the issue.

The Bureau also failed to examine how a well-functioning arbitration system works in practice. For example, the Bureau could have—but did not—study the arbitration system for the Kaiser Foundation Health Plan in California, which has more than seven million members. The Kaiser arbitration system gets high marks from health plan members, who have been involved in arbitration proceedings, most of them over medical malpractice claims. According to a 2013 survey conducted by Kaiser's independent arbitration administrator, almost 50% of the parties and attorneys who went through arbitrations that year reported that the arbitration system was better than going to court, another 38% reported that it was the same as going to court—and only 14% reported it was worse.[25]

The CFPB's December 2013 preliminary results of its arbitration study—attached as the Appendix A to the CFPB's report—suggest that few individuals bring small dollar claims in arbitration.[26] But for several reasons, the number of formal claims filed by consumers in arbitration and in court says nothing about the accessibility and fairness of the two methods of dispute resolution.

First, consumers' claims are often resolved before the filing of a formal arbitration proceeding. Individuals who file arbitration demands—just like those who file small claims court cases or lawsuits in court—are almost always a very small group of consumers whose concerns were not resolved through less-formal customer service mechanisms. When companies have millions of customers, it is likely that thousands—perhaps tens of thousands—

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23 *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, 1753 (2011).

24 *See id.*; *see also Coneff v. AT&T Corp.*, 673 F.3d 1155, 1159 (9th Cir. 2012) (noting that 'the *Concepcion* Court [had] examined this very arbitration agreement' and concluded 'that aggrieved customers who filed claims would be essentially guaranteed to be made whole'" because "the arbitration agreement [at issue] has a number of fee-shifting and otherwise pro-consumer provisions") (quoting *Cruz v. Cingular Wireless*, 648 F.3d 1205, 1215 (11th Cir. 2011) (citing *Concepcion*, 131 S. Ct. at 1753)).

25 *Annual Report of the Office of the Independent Administrator of the Kaiser Foundation Health Plan, Inc. Mandatory Arbitration System for Disputes with Health Plan Members, January 1, 2014 – December 31, 2014* at 44, *available at* http://www.oia-kaiserarb.com/pdfs/2014-Annual-Report.pdf.

26 *CFPB Study* at Appendix A, pages 76-82.

of customers will at some point in their relationship have concerns that may or may not develop into full-fledged disputes. But the vast majority of those customer concerns are resolved through informal channels, such as customer service processes, negotiation, or mediation, before a concern ripens into a dispute and a formal arbitration demand is filed.

Indeed, there are significant incentives for businesses to settle claims before arbitration begins. As explained above (at pages 6-7), businesses subsidize most or all of the costs of arbitration, and many have adopted arbitration agreements that provide for potential bonus payments to customers who do better in arbitration than a company's last settlement offer. Significantly, a great many arbitration provisions require the company involved to pay all or nearly all of the arbitration costs, and many of the provisions include bonus provisions. Those agreements provide a very powerful incentive for pre-arbitration settlement of any non-frivolous consumer claim of $5,000 or less.

Second, a concerted campaign to invalidate arbitration agreements was underway for the period studied by the Bureau. Plaintiffs' lawyers vigorously resisted arbitration (with success in certain "magnet" jurisdictions for class actions) before *Concepcion*. And after the Supreme Court held in *Concepcion* that class waivers in arbitration agreements are enforceable, the plaintiffs' bar has continued to search for ways to avoid their clients' agreements to resolve their disputes in arbitration. The unfortunate effect of these widespread efforts is that lawyers who represent consumers and their allies in consumer advocacy organizations have discouraged consumers from pursuing their disputes in simplified, often cost-free arbitration.

Third, the focus on "small-value" claims presents a misleading picture of arbitration. The Bureau arbitrarily reported the incidence of claims involving $1,000 or less and then concludes that few consumers arbitrate small claims.[27] But that definition is odd, given that—based on information compiled by the CFPB's own December 2013 preliminary results—most state small-claims courts permit the assertion of claims of up to $10,000.[28]

Hopefully, the Bureau did not adopt this overly narrow definition in order to be able to assert, erroneously, that consumers do not use arbitration for small claims. In addition, of course, this analysis ignores entirely the fact, discussed above, that the terms of a growing number of arbitration agreements provide a very substantial incentive for the pre-arbitration settlement of such claims.

In sum, the Bureau's examination of how arbitration works is patently inadequate, and will undermine the validity of any regulations that the Bureau might attempt to promulgate.

D. *The Bureau's survey of consumers reveals only that consumers do not focus on dispute resolution when choosing among consumer financial products and services*.

The Bureau's study touts the results of a telephonic survey in asserting that consumers are uninformed about the dispute resolution terms of their credit card agreements. But that survey is completely irrelevant to determining whether regulation of arbitration is "in the public interest and for the protection of consumers."

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27 *CFPB Study* at Appendix A, page 14.

28 *Id.* at Appendix A, page 160-61.

That is because the Bureau refused to obtain information about consumers' baseline level of knowledge of other key provisions of their card agreements.[29] Without that comparative baseline, the Bureau cannot determine whether consumers pay greater, less, or the same attention to dispute resolution clauses as to other clauses important to them—and why that might be so. As a result, the Bureau was not able to place information regarding dispute resolution systems in context—and thereby derive information that might be relevant to assessing consumers' relative awareness of arbitration agreements versus other credit card contract provisions. The Bureau's failure to elicit such information renders the survey data meaningless.

Indeed, the approach taken by the Bureau in constructing the survey unfortunately suggests that the Bureau's analysis is results-oriented. Any neutral evaluation of credit card agreements would have not just inquired about dispute resolution provisions but also about other provisions as comparators (such as whether consumers recalled the interest rate or credit limit). Why didn't the Bureau ask such a basic question? In the absence of an explanation from the Bureau, observers are left to conclude that obtaining such information would not serve the Bureau's pre-ordained goals. If consumers do recall their interest rates and credit limits, that result would confirm that dispute resolution is not as salient as other terms (like the price of credit); and if they did not, that response would indicate that consumers simply don't recall any of the elements of the credit card deal once they have entered into it, even those that are undoubtedly important to their decision. Either way, the irrelevance of the Bureau's survey approach would have been confirmed.

The only data that the Bureau's study delivers is that, unsurprisingly, consumers are not focused on arbitration clauses: ***Not one consumer*** (of 1,007 who completed the survey) volunteered dispute resolution procedures as a feature relevant to selection of their credit card. Even when asked to respond to each of a list of nine elements, dispute resolution was the least-selected choice.

Finally, the Bureau also cites a paper describing a web survey that was authored by Professor Jeff Sovern of St. Johns' Law School (among others).[30] But the Bureau's discussion of that study fails to disclose (as Professor Sovern does) that the study was paid for from a grant by the American Association of Justice—*i.e.*, the trial lawyers who benefit from class action attorneys' fee awards and therefore are invested in maintaining the class action system. Moreover, Sovern's web survey also fails to ask participants about any contract provision ***other*** than the arbitration clause. It is telling (and quite unfortunate) that the Bureau's survey suffers from the same problem that the trial-lawyer-funded Sovern study does.

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[29] The Chamber repeatedly urged the Bureau to obtain such information, but the Bureau refused to do so. *See* Letter from David Hirschmann & Lisa Rickard, *Re: "Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements*," Docket No. CFPB-2013-0016 (June 30, 2014), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2014-0011-0015; Letter from David Hirschmann & Lisa Rickard to Matthew Burton & PRA Office, *Re: "Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements,"* Docket No. CFPB-2013-0016 (Aug. 6, 2013), http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0016-0015.

[30] *See CFPB Study* at section 3, pages 7-8 (citing Jeff Sovern, Elayne E. Greenberg, Paul F. Kirgis, and Yuxiang Liu, *"Whimsy Little Contracts" With Unexpected Consequences: An Empirical Analysis of Respondent Understanding of Arbitration Agreements* (Oct. 29, 2014), *available at* http://ssrn.com/abstract=2516432).

E. *Arbitration clauses lead to lower prices for consumers.*

It cannot be debated that litigation in court—especially class-action litigation—imposes substantial transaction costs on businesses. Because arbitration offers a less-expensive forum for the resolution of disputes, it should reduce the transaction costs that businesses bear in the judicial system, and basic economic principles teach that some portion of those cost savings will be passed along to consumers.[31]

Here's how Professor Stephen Ware explains this phenomenon:

- "The consensus view is that businesses using adhesive arbitration agreements do so because those businesses generally find that those agreements lower their dispute resolution costs."
- "In the case of consumer arbitration agreements, this benefit to businesses is also a benefit to consumers. That is because whatever lowers costs to businesses tends over time to lower prices to consumers."
- "While the entire cost-savings is passed on to consumers only under conditions of perfect competition, some of the cost-savings is passed on to consumers under non-competitive conditions, even monopoly."
- "The extent to which cost-savings are passed on to consumers is determined by the elasticity of supply and demand in the relevant markets. Therefore, the size of the price reduction caused by enforcement of consumer arbitration agreements will vary, as will the time it takes to occur."
- "But it is inconsistent with basic economics to question the existence of the price reduction."[32]

The Bureau's analysis of whether consumers experience cost savings from arbitration is "inconsistent with basic economics," because it claims that cost savings are absent.

The report does include caveats that would allow a careful reader to understand that, in fact, the Bureau's analysis is of little value. Unfortunately, the Bureau failed to highlight those cautions. That said, the Bureau acknowledges that:

- "[t]he assertion that pre-dispute arbitration clauses generate cost savings, in itself, is difficult to test and has not been established or disproved";
- "[w]hether such savings, to the extent they exist, are passed along to consumers is even more difficult to establish or disprove";

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31 *See Chamber Comment II* at 37-38, 54-55.

32 Stephen J. Ware, The Case for Enforcing Adhesive Arbitration Agremeents—With Particular Consideration Of Class Actions and Arbitration Fees, 5 *J. Am. Arbitration* 251, 254-57 (2006) (emphasis added; footnotes omitted; citing, *inter alia*, Richard Posner, *Economic Analysis of Law* (6th ed. 2003)).

- "[i]mportantly, even a correlation between the use of pre-dispute arbitration clauses and price levels should not be construed as a casual relationship between the two, absent additional information." [33]

Despite these acknowledgments—which should have caused the Bureau to undertake a robust analysis rather than a rushed one—the Bureau proceeded to focus on the implications of one particular lawsuit (*Ross v. Bank of America*) in which some settling banks agreed not to use arbitration for a 3-½ year period.[34] The question the Bureau asked is "whether it can find statistically significant evidence, at standard confidence level (95%), that companies that eliminated arbitration raised their prices (measured by total cost of credit) in a manner that was different from that of comparable companies that had not changed their policies regarding arbitration provisions."[35]

But as the Bureau acknowledges (in a footnote), "the result" of its analysis "has limitations."[36] That is a serious understatement. To begin with, while the study uses the language of scientific analysis—describing the settling credit card issuers as a "treatment group" and other issuers as a "control group"—the Bureau states that the "control group" "may or may not have used pre-dispute arbitration provisions" at all.[37] To be blunt, the Bureau is saying "there was no control group."[38]

More troubling, the Bureau's report never assesses whether issuers that used arbitration agreements during the time frame studied actually had experienced any cost savings from the use of arbitration—if there were no cost savings, there would be no price increase when arbitration was eliminated. And when one looks at the time frame studied by the Bureau, it is apparent that there were virtually no cost savings to be had because of the state of the law during that time. Specifically, the Bureau purported to examine the total cost of credit (a defined term subject to its own limitations) with a "before" period from November 2008 to October 2009 and an "after" period from January 2010 to November 2011.[39] But the problem with this time frame is that virtually all of it occurred before the Supreme Court decided *AT&T Mobility LLC v. Concepcion*[40] in late April 2011—*i.e.*, when arbitration clauses were routinely not being enforced in magnet jurisdictions for consumer class actions (including California, New Jersey, Illinois, and Washington state). When courts do not enforce arbitration agreements and allow class-action lawsuits to proceed, it is self-evident that the company that is party to an arbitration agreement does not experience reduced transaction costs from arbitration.

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33 *CFPB Study* at section 10, page 5.

34 *Id.* at section 10, pages 6 & n.14 (citing *Ross v. Bank of America*, No. 05-cv-7116 (S.D.N.Y.)).

35 *Id.* at section 10, pages 5-6.

36 *Id.* at section 10, page 8.

37 *Id.* at section 10, page 8.

38 Bizarrely, the report does not identify specific issuers "[f]or maximum protection of supervisory data." *Id.* at section 10, page 8 n.18. In light of the fact that the Bureau maintains an online database of credit card agreements (http://www.consumerfinance.gov/credit-cards/agreements/), this rationale for concealing information about issuers seems doubtful.

39 *CFPB Study* at section 10, page 9.

40 131 S. Ct. 1740 (2011).

Economic theory (and common sense) suggest that, in the absence of reduced transaction costs to businesses, there are no cost savings to pass along to consumers. There is no doubt that, as a result of *Concepcion*, courts are today enforcing fair arbitration agreements, compelling arbitration, and dismissing class action lawsuits. As a result, credit card issuers are ***now*** experiencing reduced transaction costs because of arbitration, and it is reasonable to expect that some of the cost savings from arbitration place downward pressure on the price of credit (although other types of regulation, including by the CFPB, have placed upward pressure on those prices). But the Bureau's study asks the wrong question by focusing on a time frame when no reasonable person would contend that arbitration agreements were being enforced with the regularity needed to lead to reduced transaction costs.

The better question is whether "prices would . . . increase in the face of an industry-wide repeal of arbitration clauses, when uniform market pressure is no longer in play to keep prices low."[41] Unlike the retrospective analysis the Bureau undertook focusing on the wrong time frame, the real question, as a matter of public policy, is whether the elimination of pre-dispute arbitration in consumer financial service contracts will force financial services companies to increase prices to customers, and whether the benefits of class action litigation are worth imposing the costs of a CFPB "regulatory tax."

F. *Government enforcement plays a significant role in protecting consumers.*

Critics of arbitration have sometimes argued that the threat of judicial litigation—and in particular class actions—is needed to deter companies from engaging in wrongdoing. But there is no evidence that companies alter their behavior based on a threat of class actions, because the costs in class actions are incurred without regard to the wrongfulness of the underlying conduct. As the Chamber has previously explained to the Bureau, the burdens of class actions are a function of who plaintiffs' lawyers choose to sue—for the plaintiffs' lawyer's goal is to find a claim for which the complaint can withstand a motion to dismiss and that can satisfy the (legitimately) high hurdles of class certification—rather than a function of who has engaged in actual wrongdoing.[42]

Businesses are far more likely to be deterred from wrongdoing by reputational consequences, as the Chamber has previously discussed—and they are therefore particularly likely to be deterred by the threat of government enforcement action. That is especially the case in light of the enhanced government enforcement capabilities in the consumer financial protection space. Not only are the monetary penalties higher, but an enforcement action brought by the government reflects the government's judgment that its limited resources should be used to combat what it considers improper activity.[43]

Of course, not all government enforcement actions are brought against covered persons who have actually engaged in wrongdoing. But while companies view class actions as a cost of doing business—rent seeking by any one of a large number of entrepreneurial plaintiffs'

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41 James Kim et al., *Flawed CFPB Study and the Future of Arbitration Clauses*, Corporate Counsel (Mar. 24, 2015), *available at* http://www.corpcounsel.com/id=1202721480235/Flawed-CFPB-Study-and-the-Future-of-Arbitration-Clauses?slreturn=20150409121634.

42 *Chamber Letter II* at 52-54.

43 *CFPB Study* at section 9, page 12.

lawyers who are banking on the possibility that they may be able to coerce a settlement—companies are far more likely to take notice of a government enforcement action. For that reason, government enforcement plays a significant role in protecting consumers. That role is likely to increase substantially given the Bureau's supervision and enforcement authority.

The Bureau's study provides zero support for class action proponents' common claim that class actions play an important role in supplementing government enforcement efforts. The Bureau found, for example, that most government enforcement is independent of private lawsuits. Less than 9% of government enforcement actions were preceded by a private class action.[44]

For cases in which there was no government enforcement action (6%), the study does not indicate how much consumers actually received under class action settlements. (It only provides "gross" numbers.) It is therefore impossible to determine whether these settlements actually provided meaningful consumer benefits. It is also impossible to determine what amount of these settlements companies actually paid out – the amount that would be relevant if, contrary to the evidence, companies were deterred by the prospect of settling class actions brought by entrepreneurial plaintiffs' lawyers.

Most importantly, the study period ended in 2012, and therefore ***entirely fails to take account of the effect of the Bureau's own fully functioning enforcement and supervision programs***. _In the year ending December 31, 2012, the Bureau was a party to 9 enforcement actions.[45] In the year ending September 30, 2014, there were 41 public enforcement actions.[46] And the Bureau has used its supervisory authority to conduct hundreds of examinations.[47]

The entire reason for creating the Bureau was to increase enforcement of consumer laws: the Bureau's existence, combined with the numerous other state, local, and federal enforcement agencies, underscores that class actions have little, if any, role to play in this context—unless the Bureau does not believe that its significant resources and authority will provide consumers with additional protection.

Moreover, the Bureau is likely to focus on the precise types of wrongdoing that are susceptible to class actions: misconduct that affects a large number of consumers. And the Bureau's examination authority, combined with its enforcement activities and consumer complaint database, make it highly likely that the Bureau will detect such wrongdoing. The Bureau's enforcement powers therefore provide an additional, significant factor why the threat of class actions is irrelevant to deterring wrongful conduct in this context.

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44 *Id.* at section 9, page 14.

45 *Semi-Annual Report of the CFPB*, March 2013, at 66, *available at* http://files.consumerfinance.gov/f/201303_CFPB_SemiAnnualReport_March2013.pdf.

46 *Semi-Annual Report of the CFPB*, Fall 2014, at 103, *available at* http://files.consumerfinance.gov/f/201412_cfpb_semi-annual-report-fall-2014.pdf.

47 *CFPB Supervisory Highlights*, Spring 2014, at 5, *available at* http://files.consumerfinance.gov/f/201405_cfpb_supervisory-highlights-spring-2014.pdf ("In 2013, the CFPB conducted over one hundred supervisory activities—such as full scope reviews and subsequent follow-up examinations—and plans to conduct approximately 150 of these activities in 2014.").