August 19, 2016

Ms. Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street
Washington, DC 20552

Re: Docket No. CFPB-2016-0020; RIN 3170-AA51

Comment of DRI – The Voice of the Defense Bar on CFPB Proposed Arbitration Rule

For more than fifty-five years, DRI has been the voice of the defense bar, advocating for 22,000 defense attorneys, commercial trial attorneys, and corporate counsel and defending the integrity of the civil judiciary. DRI's mission includes enhancing the skills, effectiveness, and professionalism of defense attorneys. As part of this mission, DRI addresses issues of import to the defense bar that are critical to defense attorneys and their clients, with an ultimate goal of improving the civil justice system

DRI appreciates the opportunity to provide public comment on the CFPB's proposed arbitration rule. The primary focus of this comment will be upon the following provision of the proposed rule:

> [A] provider shall not seek to rely in any way on a pre-dispute arbitration agreement entered into after [the effective date] with respect to any aspect of a class action that is related to any of the [covered products or services] including to seek a stay or dismissal of particular claims or the entire action, unless and until the presiding court has ruled that the case may not proceed as a class action and, if that ruling may be subject to appellate review on an interlocutory basis, the time to seek such review has elapsed or the review has been resolved.

May 6, 2016 Proposed Rule and Official Commentary at 361, §1040.4(a)(1).

DRI believes that this aspect of the proposed rule is flawed in its premise that class actions efficiently deter violations of the law and is further flawed in attempting to regulate in-court conduct. The former concern is one with which our members have significant experience (and that the Bureau's own studies demonstrate is not accurate) and the latter is one that directly affects our members' ability to diligently

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represent their clients. For these reasons, as discussed below, DRI asks the CFPB to carefully consider these concerns as it moves forward with the proposed rule.

DISCUSSION

In deciding to make this proposal, the CFPB relied heavily on its conclusions that class actions provide compensation to consumers and deter violations of the law in ways that arbitration does not. The CFPB included class settlements in its analysis in reaching these conclusions. DRI wishes to point out information which suggests that class actions and class action settlements are often a function of their "blackmail" settlement effect and not the actual merits of the claim, and because of that, to the extent they produce a deterrent effect they may actually deter lawful conduct and inhibit resolution of legitimate ambiguities in the law. In addition, DRI wishes to point out unforeseen problems that may result from a proposal to regulate in-court conduct instead of merely regulating the content of pre-dispute arbitration agreements themselves.

1. Class Actions Are An Inefficient Vehicle to Achieve Deterrence.

Regardless of what shortcomings the Bureau may see in mandatory arbitration, the Bureau is overstating the utility of class actions as a deterrent and underappreciating their downsides. For example, the Bureau's study considered class settlements as part of its conclusion that class actions are better deterrents of unlawful conduct than arbitration. Yet, class settlements are often engendered by the costs of defending a class action, which may have little or nothing to do with the merits and everything to do with the stakes and cost of defense. *See, e.g., In re Rhone Poulenc Rorer, Inc.* 51 F. 3d 1293, 1299-1300 (7th Cir. 1995) ("certification of a class action, even one lacking 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.... [Defendants] may not wish to roll these dice. That is putting it mildly. They will be under intense pressure to settle."). Indeed, as the Supreme Court recently noted, even class arbitration can have unacceptable risks:

> [C]lass arbitration greatly increases risks to defendants. Informal procedures do of course have a cost: The absence of multilayered review makes it more likely that errors will go uncorrected. Defendants are willing to accept the costs of these errors in arbitration, since their impact is limited to the size of individual disputes, and presumably outweighed by savings from avoiding the courts. But when damages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the risk of an error will often become unacceptable. Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims. Other courts have noted the risk of "in terrorem" settlements that class actions entail, see, e.g., Kohen v. Pac. Inv. Mgmt. Co. LLC & PIMCO Funds, 571 F.3d 672, 677-678 (CA7 2009), and class arbitration would be no different.

AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 350, 131 S. Ct. 1740, 1752 (2011); See also S.Rep. No. 109–14, at 20–21 (2005), as reprinted in 2005 U.S.C.C.A.N. 3, 21.

Moreover, many if not most class actions in the financial services arena involve ambiguities and uncertainties in the law rather than clear violations, and the cost and risk of class actions often forces settlement without any final adjudication and judicial consensus as to these uncertainties. *See, e.g.,* Matthew R. Bremner, *The Fair Debt Collection Practices Act: The Need for Reform in the Age of Financial Chaos*, 76 Brook. L. Rev. 1552, 1556 and1581-89 (2011). To the extent such class actions change business behavior, they may well be over-deterring – that is, deterring conduct that wasn't unlawful at all, but which risks class litigation nevertheless because of ambiguity in the governing law.

Meanwhile, class actions often threaten hefty aggregate liability divorced from any actual harm. *Id.* at 1555. Such "no injury" class actions frequently result in class settlements which produce little or no recovery to the class members. See Shepherd, Joanna, *An Empirical Survey of No-Injury Class Actions* (February 1, 2016), Emory Legal Studies Research Paper No. 16-402. (Available at SSRN: http://dx.doi.org/10.2139/ssrn.2726905)("no-injury class action cases resolved in the last decade resulted in approximately $4 billion worth of settlements and judgments, yet provided a mere 9 percent—or less—of that amount to class members.").

The CFPB has ample tools at its disposal to deter violations of the law directly rather than encouraging or relying upon class actions to perform that function. Moreover, clarity in the statutory law and its regulations would do far more to deter violations of the law than class actions ever will. DRI urges the CFPB to focus more effort on eliminating ambiguity in the statutes and regulations it enforces so as to provide a clearer path to statutory and regulatory compliance, and litigation avoidance, for the financial institutions it regulates.

2. Regulation of In-Court Conduct Is Not the Right Approach for Regulating Arbitration.

Regulation of in-court conduct is not a good approach to policing regulation of arbitration agreements involving financial institutions by CPFB, regardless of the merits of such policing. Changing the rules of in-court conduct is normally within the province of the Judicial Branch and, to a lesser degree, perhaps Congress, but it has never been the province of the Executive Branch. CFPB regulation of in-court evidence, procedure and conduct raises separation of powers concerns. It also may well exceed the authority conferred by the Dodd-Frank Act, which does not purport to grant the CFPB authority over the conduct of judicial proceedings or the conduct of purported class actions. Regardless, however, that approach certainly creates practical problems for the class action defense lawyer, particularly when application of the proposed rule is uncertain.

In order to represent a covered financial institution in a class action, the class action defense lawyer needs the ability to zealously and properly advocate against class certification, and to appropriately preserve the financial institution's rights and defenses, including the right to arbitrate when and where permitted. But because the approach chosen by the CFPB is to proscribe in-court conduct, where the effect of the CFPB's proposed arbitration rule is uncertain or subject to debate, the class action defense lawyer will now be at risk of putting his or her client in regulatory jeopardy by guessing wrongly about the rule's proper application. Even a

ruling by the class action court in the financial institution's favor will not necessarily be any protection, since the CFPB will not be a party to the case and has independent regulatory authority over the financial institution. The current proposal has numerous uncertainties that place the class action defense lawyer and his or her client in these and other practical dilemmas.

For example, when a putative class action complaint is served on a covered financial institution, how does the financial institution preserve its right to arbitrate in the event class certification is ultimately denied? Can the covered entity plead arbitration as a defense in the answer or file a contingent motion to compel arbitration early on to avoid waiver of arbitration under existing arbitration waiver jurisprudence? Those acts may be "relying in any way" on an arbitration agreement with respect to an "aspect" of a class action, namely the pleadings and motions stage of the class action. State and federal courts have previously held that not pleading the right to arbitrate or moving to compel arbitration and instead proceeding to litigate the claims can result in outright waiver of the right to arbitrate. *See, e.g.*, *Voyager Life Ins. Co. v. Hughes,* 841 So.2d 1216 (Ala. 2001); *Garcia v. Wachovia Corp.,* 699 F.3d 1273 (11th Cor. 2006*); Elliott v. KB Home North Carolina, Inc*., 231 N.C.App. 332, 752 S.E. 2d 694 (2013). The CFPB has no clear authority to change these judicial waiver standards, and certainly nothing in the CFPB's currently proposed Rule addresses the issue of preserving the right to arbitrate.

Next, the rule is silent about invoking arbitration as to an *absent* member of a putative class action with whom the covered entity has a dispute, even though that absent class member is not a named party to the putative class action. Would doing that be impermissibly "relying" on an arbitration clause to "limit" the size of the class or "exclude" an individual from it, both of which are expressly prohibited by the proposed Official Interpretation of §1040.4(a)(1)? That Official Interpretation does say that impermissible "[r]eliance on a pre-dispute arbitration agreement with respect to any aspect of a class action includes, but is not limited to … [f]iling a claim in arbitration against a consumer who has filed a claim on the same issue in a class action," but this language says nothing one way or the other about absent class members. If the rule is intended to prevent arbitration filings even as to absent putative class members, how can a large national defendant facing a constantly evolving set of multiple class actions around the country safely manage that analysis, especially given the often vague and preliminary class definitions included in complaints? The currently proposed Rule provides no clear guidance on this issue.

The explanatory memo which the CFPB issued when it proposed the rule says that a covered financial institution can continue a prior arbitration already pending against a consumer even if that consumer later files a putative class action, but the company cannot use that already-pending arbitration to "block" a subsequent class action by that plaintiff. *See* CFPB's May 6, 2016 Notice of Propose Rulemaking at p. 218. This explanation is unclear. If the financial institution wins the first-filed arbitration, can it then plead that arbitral award as binding under the Federal Arbitration Act and raise *res judicata* and mootness defenses to seek a dismissal of the subsequently filed class action? Otherwise, there is no purpose continuing the arbitration, and the intended significance of this commentary is lost. Moreover, there does not appear to be any language in the actual rule or its proposed Official Interpretations that discusses this scenario, which raises the question as to whether this portion of the CFPB's May 6, 2016 Notice of Proposed Rulemaking would provide any protection at all to a financial institution wishing to proceed with such a previously filed arbitration should the rule itself become effective.

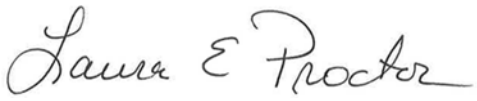
The CFPB's proposed rule also creates significant problems in defending the merits of class certification itself. Federal Rule of Civil Procedure 23(b)(3) expressly requires as a prerequisite to class certification a finding that class adjudication is superior to the alternatives for adjudicating the dispute. A financial institution's argument that resolution through individual arbitration is a superior alternative to class adjudication might constitute "relying in any way" on the arbitration agreement with respect to "any aspect" of a putative class action. Yet, if making that argument is not allowed, the CFPB may be putting its finger on the scales in the determination of whether a class should be certified.

At a minimum, these uncertainties need to be addressed in the actual language of the rule, and should not be left as issues that can be resolved only at the risk of placing the financial institution in regulatory jeopardy. More broadly, because similar uncertainties in the proper application of the rule will undoubtedly be discovered in the future, and because of the regulatory jeopardy that class action defendants and their counsel will face in trying to resolve such uncertainties in an ongoing class action in which the CFPB is not a party, the CFPB should reconsider its proposal to regulate arbitration through regulation of in-court conduct. Even if the CFPB believes that arbitration can and should be limited or proscribed within a portion of its regulatory sphere, regulating only the content of arbitration clauses as opposed to their use in Court would be a better approach, and one which would avoid these types of problems.

CONCLUSION

DRI appreciates the opportunity to submit this public comment, and urges the CFPB to address these concerns as it continues to consider its proposed rulemaking.

Respectfully submitted,



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