COMMENTS

to the

Consumer Financial Protection Bureau

regarding

12 CFR Part 1040

[Docket No. CFPB–2016–00200]

RIN 3170–AA51

81 Fed. Reg. 32830 (May, 24, 2016)

Arbitration Agreements

by the

National Consumer Law Center

on behalf of its low income clients

August 22, 2016

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The National Consumer Law Center ("NCLC")[1] submits the following comments, on behalf of its low-income clients, on the CFPB's arbitration rule. This rule will be of critical importance to the rights of consumers and we support strong action in this area. These comments are generally in support of the proposed rule, but offer a number of suggestions so that the rule will more effectively protect consumers.

Summary

We strongly support the proposal to prohibit forced arbitration clauses that prevent consumers and courts from addressing widespread wrongdoing through class actions. We also support the proposal to increase transparency in the use of forced arbitration in individual cases, although we urge the CFPB to consider also banning forced individual arbitration altogether.

Payday lenders, credit card companies, banks, auto lenders, debt collectors, debt relief scammers and others have used forced arbitration clauses to deprive consumers of access to justice and to prevent courts from holding law-breaking companies accountable. The proposed rule would help ensure that companies follow the law and that, when they do not, injured consumers have access to class actions to be made whole.

Forced arbitration too often is not an alternative dispute resolution forum; in most cases it prevents consumers from obtaining relief at all. Consumers often cannot find an attorney to represent them if a contract has an arbitration clause. Even if the clause is ultimately unenforceable, the threat of extensive litigation prior to the case on the merits discourages legitimate claims. Forced arbitration clauses also force consumers to accept weaker settlements because their attorneys either will not handle a case in arbitration or do not have confidence in the fairness of the arbitration forum and the arbitration process. Forced arbitration clauses also make it difficult to obtain evidence to prove corporate wrongdoing.

Class actions allow consumers that have experienced relatively small harm to band together and find an attorney, without spending the resources needed to bring a case individually. Class actions also allow courts to order the wrongdoer to repay all of its victims. When cases are forced into individual arbitrations, thousands or millions of consumers who do not realize that they have been victimized receive no relief. Class actions are particularly important for low-income and vulnerable consumers, who may not realize that they have been the victim of unlawful predatory practices. Finally, the public nature of class actions provides an important deterrent effect against wrongdoing. For this reason, the monetary awards individual consumers receive through class actions give only a partial picture of the benefits of class actions in making the marketplace fairer, more competitive, and more transparent.

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[1] The National Consumer Law Center® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Consumer Arbitration Agreements, Consumer Class Actions, Consumer Credit Regulation, Truth in Lending, Fair Debt Collection, Fair Credit Reporting, and Consumer Banking and Payments Law. These comments are written by NCLC attorneys Lauren Saunders, Andrew Pizor, Chi Chi Wu, and Jon Sheldon, and by NCLC contributing author David Seligman.

Additionally, the specter of frivolous class actions is significantly overstated. The impediments consumers face when their rights have been violated are a much bigger problem. The Federal Rules of Civil Procedure provide adequate mechanisms for courts to dismiss frivolous claims before discovery ever has to happen. And if industry groups have concerns about litigation and class actions, their recourse should be to the Rule 23 subcommittee and Congress—they should not be permitted to create a contractual fiction that allows them to deny consumers access to the courts entirely. We also oppose any exception to the rule for certain causes of action that provide for uncapped statutory damages.

While the proposed rule is strong, we urge several changes to prevent evasions, to better achieve the CFPB's goals, and to ensure that the rule is enforceable. We summarize some of our suggestions below.

Definitions

Some of the definitions need to be tightened, including:

- "**Class action**" should include mass actions and other actions brought in a representative capacity;
- P**re-dispute arbitration agreement**" should not require that the agreement be between a consumer and a "provider"; should include agreements sent to putative class members after a case is filed, but the class not yet certified; and should include an agreement to delegate to the arbitrator the questions about the rule's application.

Scope and Exemptions

The scope of the rule is critical. The scope determines which financial products and services can be the subject of a class action and which providers must report data on their individual arbitrations. In general, we support the CFPB's decision to delineate the particular products and services to which the rule applies and the broad list in the proposed rule. However, there are several gaps that need to be closed. The CFPB should expand or clarify the proposal to cover:

- **Mortgage settlement services.** These services appear to have been left off of the otherwise appropriately expansive list of services related to credit.
- **All consumer leases**, not just automobile leases.
- **Credit repair services,** which are invariably scams and create great harm not only to consumers but also to the credit bureaus.
- **All lead generators**, including not only those connected to credit but also to debt relief, bank and prepaid accounts, and any other financial product or service.
- **Personal financial management and product advice websites and apps** that aggregate or access personal information from consumer financial accounts or other data.
- **All credit reporting activities,** including the full expanse of services by consumer reporting agencies and all furnishing activities by providers that supply covered financial products and services. The proposal's coverage is limited to credit reports and information provided directly to consumers. This is far too narrow, especially in light of the fact that the credit bureaus are regularly the top subject of complaints to the CFPB.
- **Identity theft prevention products**, even if they do not use information from a consumer report.
- **General-use prepaid gift, loyalty, award or promotional cards, EBT cards and prepaid cards used for needs-tested benefits.**
- **Payment processing** by third party payment processors and financial institutions that do not directly accept data from or interact with the consumer. These entities enable scammers, illegal payday lenders and others to debit consumers accounts. Financial data processing that results in a transfer of funds between consumer accounts but not a "payment" should also be covered.

The CFPB has proposed **exemptions** from the rule. We object to the exemption for federal, state, local or tribal governments. That exemption is unnecessary, undermines the rationale for the rule, and could lead to confusion and evasions. If the exemption is retained, we urge the CFPB to create a **narrower definition of government "affiliate"** following the IRS requirements for tax-exempt status.

Reliance, Entering Into, and Enforcement

When, how and whether a pre-dispute arbitration has been "entered into" play a key role in the proposed rule. The proposed rule only applies to agreements that are "entered into" after the compliance date. When an agreement is initially formed by one party but is later assigned to or relied on by another party, the question of whether subsequent parties are deemed to have "entered into" the agreement impacts what duties the subsequent party has.

We strongly support the rule forbidding providers from relying on pre-dispute arbitration agreements in class actions even where the agreement was originated by others and even if the provider is not a direct party to the agreement. We propose clarifications to better implement this approach.

We strongly object to the proposal to permit pre-existing arbitration agreements to be used indefinitely for decades into the future even if those agreements or the underlying contracts are **amended after the compliance date**. This approach will **insulate millions of credit cards, bank accounts**, and other products that consumers may have for their entire lifetimes. Any material amendment to a contract should result in the "entering into" of a pre-dispute arbitration agreement covering that contract. It is especially critical that the arbitration rule apply to any modifications or amendments that impact pricing, the arbitration clause, class actions, or new potentially unlawful practices.

We strongly support the rule that a provider may not "**rely in any way**" on a pre-dispute arbitration agreement in a class action. However, we also urge the CFPB to prohibit a provider from relying by:

- **Forcing arbitration of an individual action using a clause that does not comply with the rule**. It will aid enforcement if providers truly rely cannot rely "in any way" on a non-compliant clause.
- Seeking **delegation** to the arbitrator of any issues concerning the arbitration clause or the CFPB's arbitration rule.

The CFPB should also declare that any pre-dispute arbitration agreement that does not comply with the rule is **null and void**.

Contract Language and Notices

We support the clear, unequivocal language that providers must use in their contracts if they insert a forced arbitration clause. However, other aspects of the contract and notice provisions need improvement:

- The proposed language for providers that offer **multiple** covered and non-covered products and services is confusing and will encourage evasions. Providers should either use completely separate contracts or should be **required to specify** the products and services that they claim are not covered by the rule and thus may be the subject of an arbitration agreement prohibiting class actions.
- If a provider acquires a pre-existing agreement that does not contain the required language, the provider should be **required to amend** the agreement if it has any ability to do so. The notice option should be used only if amendment is not possible.
- The amendment or notice language should more clearly cover all **service providers** and other third parties, not only those that may become direct parties to the agreement.
- Separate from the agreement with or notice to the consumer, providers should be **required to bind their service providers and assignees** to the rule by including language in their contracts with those entities or otherwise putting them on clear and enforceable notice that they are not third party beneficiaries of a non-compliant arbitration agreement. This is especially important if an agreement is assigned before the 60-day deadline to amend the agreement.
- Language should be added **prohibiting delegation** of questions related to the rule to the arbitrator.

Compliance Date

We do not object to the 211 day compliance date, but do not believe that any safe harbor is necessary for prepaid cards in light of the long timeline before any rule is final and in effect. Any safe harbor should be more narrowly drawn.

Records of Individual Arbitrations

We support the proposal to require providers to submit **records of individual arbitrations**. However, we strongly urge that the submission requirement should be **triggered as soon as providers "rely on"** the agreement in any manner covered by the rule, before any formal arbitration is filed. The most profound impact of forced arbitration clauses is to suppress claims altogether, and many will settle or be dismissed without resulting in an arbitration filing.

The list of **information** that must be submitted is appropriate, but should be expanded to include:

- Information about the cost of arbitration for consumers and providers
- The timing of various steps in the arbitration process to determine its speed.
- Information about the arbitrator and the arbitrator's relationship to the provider
- Information about the arbitration administrator and the administrator's relationship to the provider
- Communications outside the arbitration process between the provider and the arbitration administrator and between the provider and arbitrator
- Records as to the financial relationship between the arbitrator or arbitration administrator and the provider.

In addition to records submitted in connection with disputes, **all entities supervised by the CFPB should be required to submit their arbitration agreements to the CFPB** so that they can be reviewed in connection with the CFPB's examinations. The CFPB should make these agreements public on a website just as it does for the other arbitration agreements it collects. This information is already public for credit card agreements and the CFPB has proposed to collect and publish prepaid card agreements. The publication of arbitration agreements of payday and installment lenders, auto lenders, credit bureaus, student lenders, debt collectors, and other supervised entities will increase transparency and opportunities for research.

Unfair Practices in Individual Arbitrations

Through rules, supervision or enforcement actions, the CFPB should stop especially unfair practices in individual arbitrations, including:

- "Loser pays" provisions;
- Cost-splitting provisions or other provisions that require the consumer to bear excessive costs (including lack of *in forma pauperis* fee waivers)
- "Inconvenient venue" provisions;
- Limitations on substantive rights including shorter statutes of limitations and caps on damages;
- Inherently biased or unavailable arbitrators;
- Procedural hurdles;
- Secrecy provisions;
- Discovery limitations;
- Initiating collection actions in arbitration;
- Delay in paying arbitration fees, affecting commencement of arbitration proceedings; and
- Severance, savings, and delegation clauses.

These and other suggestions are covered in greater detail below.

1. The Rule is "in the public interest and for the protection of consumers"

1.1 Pre-dispute arbitration agreements are harmful

1.1.1. Harms to consumers (and low-income consumers in particular)

We strongly support the proposal to prohibit forced arbitration clauses that prevent (1) consumers from vindicating their rights and redressing their injuries and (2) the public, broadly, from being able to monitor consumer disputes with financial products and services providers.

The unfairness of pre-dispute arbitration agreements in consumer financial products and services is not a close question. The United States Supreme Court has instructed that in enacting the Federal Arbitration Act (FAA),[2] Congress intended to "afford[] parties discretion in designing arbitration processes [that] allow for efficient, streamlined procedures tailored to the type of dispute."[3]

That ideal assumes both mutual consideration of arbitration terms—or even mutual "discretion" in designing terms—and the existence of arbitration terms that allow for efficient and streamlined resolution of disputes. With § 1028 of the Dodd-Frank Act, Congress required the CFPB to study the issue in depth. And the CFPB's study makes abundantly clear that the factual premises underlying the Supreme Court's jurisprudence—whether or not true in 1925 when Congress passed the Federal Arbitration Act (FAA), 9 U.S.C. § 1, et seq.—are no longer true today concerning arbitration involving consumer financial products and services.

First, parties do not have discretion in designing pre-dispute arbitration agreements. Indeed, consumers rarely have any say at all in designing arbitration requirements in boilerplate contracts.

As the CFPB's study demonstrates, these arbitration requirements are so abundant in many industries that it would be hard for consumers to participate in the marketplace without being bound by arbitration requirements covering most specific consumer financial products and services.[4] Consumers cannot turn to a competitor that does not require arbitration because for many products or services the arbitration requirement is almost universal among all market entrants.

Consumers also have effectively no choice about these agreements' most important terms: nearly all of the arbitration requirements studied by the CFPB include a provision stating that the arbitration may not proceed on a class basis.[5] Thus, while pre-dispute arbitration agreements amount to a privately-imposed reordering of public rights, consumers can exercise neither "voice" nor "exit" to express their disapproval of this reordering.[6]

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[2] 9 U.S.C. § 1, et seq.

[3] AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 344 (2011).

[4] The study determined that over 50% of credit card loans included arbitration requirements, 92% of prepaid cards, 83.7% of storefront payday lenders (or 98.5% of storefronts), and 85.7% of private student loans studied. CFPB Study § 2.3.

[5] Id. at § 1.4.1.

[6] See generally Albert Hirschman, EXIT, VOICE, AND LOYALTY (1970).

Moreover, the CFPB's study and other recent data make clear that consumers do not read or understand arbitration agreements in their boilerplate contracts with providers. The CFPB's consumer awareness survey concluded that 7% of consumers whose credit card agreements included pre-dispute arbitration agreements understood that they could not sue their credit card issuers in court. But even when consumers did not have such clauses in their credit card agreements, a similar percentage reported that they did not have the right to assert claims against the company in a public forum. In other words, consumers' awareness of their rights is unrelated to the actual terms of their consumer agreements.[7]

Providers have created various fictions to give the impression that arbitration requirements in consumer financial products and services are a matter of consent and not coercion. For example, consumers sometimes have the ability to "opt-out" of their arbitration agreements, and some argue that consumers thus have a meaningful choice about whether to be bound. The CFPB's study puts that fiction to rest as well: of the over 1,000 survey respondents, only one whose agreement included an opt-out opportunity remembered having been offered that opportunity in his contract.[8]

In considering the harms caused to consumers by the proliferation of pre-dispute arbitration agreements, the CFPB should also consider that these harms are disproportionately imposed on low-income consumers. One of the starkest examples of the disparity in the prevalence of pre-dispute arbitration agreements across industries is between the storefront payday lending industry and the credit union industry. While the CFPB's study concluded that only 8.2% of credit unions included pre-dispute arbitration agreements in their consumer contracts, 83.7% of storefront payday loan contracts included such terms.[9] Furthermore, these payday loan contracts were more likely to include terms that purport to allow the arbitrator to require the consumer to pay the costs of arbitration.[10]

Second, not only do the parties not have discretion in designing arbitration processes, but the arbitration processes unilaterally imposed on consumers do not, in fact, allow for "efficient, streamlined procedures tailored to the type of dispute." Most importantly, for consumer financial products and services, pre-dispute arbitration effectively deprives consumers of meaningful dispute resolution procedures entirely. As the CFPB study reported, from "2010 through 2012, an average of 616 individual AAA cases were filed per year for six product markets combined: credit card; checking account/debit cards; payday loans; prepaid cards; private student loans; and auto loans."[11]

But that does not mean that consumers did not have disputes during this period. For these same markets and over this same period, the CFPB identified 3,462 individual cases filed in federal court in addition to 470 federal consumer class action filings[12]—which, of course, do not account

[7] CFPB Study § 3.1.

[8] Id.

[9] 81 Fed. Reg. 32830 at 32841 (May 24, 2016)..

[10] Id.

[11] CFPB Study § 1.4.3.

[12] CFPB Study § 6.2.1.

for all of the class claims that were not brought at all because of the presence of pre-dispute arbitration agreements with class waivers in consumer contracts.[13]

Some suggest that the dearth of consumer arbitrations arises not from the fact that consumers cannot vindicate their rights in arbitration, but rather because consumers are often able to resolve their disputes informally before arbitration ever needs to happen. They call this the "market solution" to consumer disputes.[14]

This account too is belied by logic and evidence. It assumes, for one, that consumers understand all of their legal rights and can assert all of those rights through informal complaints to the company, like customer service calls. But consumer protection laws are immensely complex and flow from a variety of federal, state, and local sources. Also, if consumers are able to resolve their disputes through informal mechanisms and unable to resolve them through judicial process, then why do so many consumers pursue judicial remedies when they are not foreclosed by pre-dispute arbitration provisions?

Moreover, this account again loses sight of the disproportionate impact of forced arbitration on low-income consumers. Whether because of limited time, resources, or confidence in their rights, low-income consumers are significantly less likely to advocate for their interests by raising their concerns directly with the company through informal mechanisms. And these same low income consumers face providers who are far less likely to resolve a dispute via the consumer's phone call to customer service. For example, a payday lender is unlikely to provide a refund because the consumer calls and says the lender's interest rate exceeds state limits.

1.1.2 Harms to the Public Interest

Arbitration proceedings, when they do happen, are often shrouded in secrecy[15] and are rarely publicly accessible in the same way as are judicial proceedings. Pre-dispute arbitration agreements undermine transparency even more directly when they impede consumers from filing disputes in any forum.

As a consequence of this opacity, consumers, enforcement agencies, and other market actors have difficulty learning about alleged violations of consumer protections. And because our marketplace depends on transparency, pre-dispute arbitration impedes consumers and investors from making rational decisions.[16]

Pre--dispute arbitration agreements also undermine competition. Most companies follow the rules. When they are not held accountable for violating those rules, however, the companies that follow them are put at a relative disadvantage. The CFPB's mere proposal of this rule had a

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[13] Nat. Ass'n of Consumer Advocates & Public Citizen, Cases That Would Have Been, 2014, available at http://www.consumeradvocates.org/sites/default/files/2014%2005%2001%20Concepcion3rdAnniversary_1.pdf.

[14] Marcatus Center, George Mason Univ., The Consumer Fin. Protection Bureau's Arbitration Study 2, available at http://mercatus.org/sites/default/files/Johnston-CFPB-Arbitration-summary.pdf.

[15] See CFPB Study § 2.5.8. Among the products studied by the Bureau, private student loan agreements were particularly likely to include confidentiality provisions. Of those studied, 33% included such terms.

[16] See, e.g., Steve David Solomon, Arbitration Clauses Let American Apparel Conceal Misconduct, The N.Y. Times, July 15, 2014, available at http://dealbook.nytimes.com/2014/07/15/arbitration-clauses-letamerican-apparel-hide-misconduct/?_php=true&_type=blogs&_r=0 ("If American Apparel hadn't been able to use arbitration and confidentiality clauses to keep investors and the public in the dark over those accusations, [the CEO] would most likely have been shown the exit some years earlier.").

recognizable effect on the market distortions caused by forced arbitration. The Bureau noted that a number of firms issued "compliance notices" in the wake of the proposal encouraging providers to begin evaluating their compliance systems.[17] Increased compliance will not only benefit consumers; it will help to level the playing field for the financial product and services providers that follow the law.

Some have argued that arbitration requirements protect providers from expensive litigation costs and that the resulting savings are passed on to consumers in the form of reduced prices. That factual premise is also false. As the CFPB pointed out in its study, there is no evidence that providers that add pre-dispute arbitration terms into their consumer contracts pass on any of the purported savings to consumers (even assuming that those savings exist).[18]

1.2 Class actions are beneficial

1.2.1 Benefits to consumers

The conclusion that pre-dispute arbitration agreements do not provide the benefits presumed by FAA jurisprudence might, on its own, support regulation of such agreements in consumer financial products and services. However, consistent with its commitment to rigorously studying the issue, the CFPB sought to pinpoint precisely the harm caused by the proliferation of forced arbitration.

The Bureau could not identify with specificity any harm caused by the use of pre-dispute arbitration agreements in individual disputes—and for that reason declined to regulate arbitration agreements in individual cases. But the Bureau did identify significant harm flowing from the pervasive use of "class waivers"—or the requirement that individual consumers arbitrate their claims on an individual basis.

There can be no doubt that class actions have provided consumers of financial products and services with substantially greater monetary relief than has individual arbitration. The CFPB analyzed 419 class action settlements over the period from 2008 until 2012 and concluded that the monetary value of the total gross relief provided to consumers in these cases was $2.7 billion. That figure does not include the benefits of "behavioral" relief that could not be quantified.[19]

In response to this data, opponents of the rule point primarily to what they consider to be a low claims rates for consumer class members.[20] As the CFPB has pointed out, however, because some class action settlements pay out automatically and because of the substantial number of class members who do file claims in those class actions when doing so is required, class actions provide consumers with significant monetary benefits—not just potential monetary benefits. Indeed, in the 60% of class actions that actually reported payment data, the CFPB found that $1.1 billion had been or was scheduled to be paid to consumers in cash or debt forbearance.[21]

The class action device is important to consumers (and particularly important to low-income consumers) because it allows them to obtain relief and punish wrongdoers whether or not they

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[17] 81 Fed. Reg. 32830 at 32862. (May 24, 2016).

[18] CFPB Study § 10.

[19] CFPB Study § 8.1.

[20] Mayer Brown LLP, Do Class Actions Benefit Class Members?, available at http://www.instituteforlegalreform.com/uploads/sites/1/Class_Action_Study.pdf.

[21] CFPB Study § 8.1.

have the resources or time to come forward individually, or even when they do not immediately understand that they have been harmed by illegal conduct. The Civil Rules Advisory Committee has been clear that it was critical that Rule 23 class actions bind all class members unless they affirmatively opt out of the class after notice. In taking this position, among other things, the Committee considered the importance of the class action device as a mechanism for giving access to justice for consumers who might be too scared or too poor to bring a claim on their own. The reporter for the Advisory Committee in 1966 explained:

> [R]equiring . . . individuals affirmatively to request inclusion in the lawsuit would result in freezing out the claims of people–especially small claims held by small people–who for one reason or another, ignorance, timidity, unfamiliarity with business or legal matters, will simply not take the affirmative step. The moral justification for treating such people as null quantities is questionable. For them the class action serves something like the function of an administrative proceeding where scattered individual interests are represented by the Government. In the circumstances delineated in subdivision (b)(3), it seems fair for the silent to be considered as part of the class. Otherwise the (b)(3) type would become a class action which was not that at all–a prime point of discontent . . . from which the Advisory Committee started its review of rule 23.[22]

Rule 23 class actions do not require participation from class members. Class members have the right to opt out of the class action to pursue their claims individually, and even to pursue those claims informally or through arbitration. But pre-dispute arbitration agreements with class waivers remove that choice. They unilaterally remove from consumers the possibility of participating in Rule 23 class actions. And even when they provide consumers with the opportunity to opt out of the class waiver, they place on consumers the responsibility to take affirmative conduct to preserve their rights. That is precisely the requirement that the Advisory Committee rejected in proposing the opt-out mechanism of Rule 23.

No area is this truer than in class actions involving consumer financial products and services. The typical class action involves small dollar amounts for each member of the class, but where class sizes can reach into the millions. The complexity of interest calculations and other charges, the extensive use of boilerplate contracts that are never read by the typical consumer, and other factors mean that many class members do not even realize that a provider is overcharging them or otherwise illegally victimizing them.

The amounts involved for each individual also mean that individual actions are not feasible. If for no other reason than the size of filing fees and the difficulty of pro se representation in most consumer credit cases, even individual arbitration actions are not feasible. The proof of this is presented in the CFPB study finding that few individual arbitrations are ever brought concerning consumer financial products or services.

1.2.2 Benefits to the Public Interest

Class actions also provide benefits for the broader marketplace. For one, as the CFPB has addressed at length, the most potent benefits of class actions are their deterrent effects against wrongdoing, particularly where the wrongdoing results in small dollar harm to individual

[22] Benjamin Kaplan, Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (i), 81 Harv. L. Rev. 356, 397-98 (1967).

consumers.[23] Because consumers are generally uninterested in individually pursuing relief for small dollar harm,[24] providers have an obvious incentive to violate the law unless they fear public enforcement or private enforcement through class actions. Without class actions, then, public enforcement agencies bear the entire burden of policing the marketplace for small dollar injuries. In light of strained public resources, public enforcement agencies cannot serve this function on their own.[25]

The CFPB need not study whether the market in fact benefits from increased compliance with consumer protection laws. After all, democratically-accountable policymakers have enacted those laws to prohibit "profit-maximizing behavior . . . that lawmakers have determined disserves the public good by distorting the efficient functioning of those markets."[26] The CFPB recognizes that the proposed rule may, at the margin, inhibit some forms of innovation on the part of providers, who will be more careful not to violate consumer protections and therefore perhaps be more risk-averse. However, the alternative is valuing unbridled innovation over compliance with the law. The CFPB appropriately concludes that where there is a dispute about what would serve the interests of fair and free competition, it must defer to public lawmakers as opposed to private market actors with an interest in maximizing their profits.

1.3 The law protects against frivolous class actions, and forced arbitration is an inappropriate vehicle for altering the class action device

Many opponents of the proposed rule argue that it would open financial firms to a flood of "frivolous or borderline lawsuits"[27] from which they are purportedly now protected by pre-dispute arbitration agreements. This argument is factually wrong. In addition, any risk of frivolous class actions is far outweighed by their benefits. Rule 23 and court involvement in class actions protects against such frivolous actions.

Even if frivolous class actions were a legitimate concern, however, the solution is not providers including in boilerplate language in their form contracts that prohibit all class actions no matter how meritorious. Instead, the value of pre-dispute arbitration agreements should be evaluated by reference to the purposes of the FAA—the federal statute that protects their enforcement.

As explained above, the purposes of the FAA are (1) to ensure that arbitration agreements are enforced according to their terms; and (2) to allow for streamlined and efficient dispute

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[23] One of the most compelling examples of the deterrent power of class actions is the effect that the "Overdraft MDL" litigation has had on the debit card industry. As a result of private, class action litigation, the industry has "largely abandoned" the practice of reordering debit transactions in a day to maximize the number of overdraft charges. 81 Fed. Reg. 32830 at 32863 (May 24, 2016).

[24] Of the over 1,000 respondents to the CFPB's consumer awareness survey, only 1.4% said that they would consider seeking legal advice or sue using an attorney if they learned that their credit card issuer was charging them unauthorized fees. CFPB Study § 3.4.2.

[25] 81 Fed. Reg. 32830 at 32861 (May 24, 2016).

[26] Id at 32865.

[27] See, e.g., Schiff Hardin, CFPB Proposes Rules Banning Use of Class Action Waivers in Consumer Arbitration Agreements, June 7, 2016, available at http://www.schiffhardin.com/insights/publications/2016/cfpb-proposes-rules-banning-use-of-class-action-waivers-in-consumer-arbitration-agreements.

resolution.[28] In other words, the FAA may protect the enforceability of arbitration agreements for the purposes of allowing for streamlined dispute resolution, but it does not protect the enforceability of such agreements for the purposes of allowing drafters to avoid claims that they claim do not have merit. Indeed, although arbitration may alter the procedures applicable for resolving substantive claims, it does not alter the substantive law applicable to a dispute.[29]

Furthermore, the Federal Rules of Civil Procedure (including Rules 12 and 23) serve as effective safeguards against frivolous litigation. The Rules require that the plaintiff allege a "plausible" claim for relief,[30] and they provide district courts with broad tools to stay costly discovery until after any motions to dismiss have been resolved.[31]

Even where a named plaintiff in a putative class action presents a plausible claim for relief, he or she will not be able to pursue classwide claims unless "the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied."[32] Among such prerequisites plaintiffs must establish that their claims involve a "common [classwide] contention . . . of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke."[33] A defendant dissatisfied with an order certifying a class may seek appeal of that order before final judgment has issued and may seek a stay of proceedings pending the outcome of that appeal.[34]

However, even if the Federal Rules provided none of these safeguards or were otherwise ineffective or inefficient, that would not provide a basis for opposing the arbitration rule's class action provisions. If opponents of the arbitration rule have a problem with the availability of class actions or with the procedural rules governing the adjudication of class actions, their recourse is to Congress or the Rule 23 Subcommittee—they should not be permitted to create a contractual fiction that allows them to bypass class actions entirely.

Pre-dispute arbitration agreements do not prevent frivolous class actions. They prevent all class actions no matter how meritorious. The agreements typically do not even allow an arbitrator to award class-wide relief.

Those opposed to particular aspects of class actions or in fact opposed to the class action procedure itself have other avenues for relief, including Congress. Many of the same groups

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[28] AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 334 (2011).

[29] Hayes v. Delbert Servs. Corp., 811 F.3d 666, 675 (4th Cir. 2016) ("[A] party may not underhandedly convert a choice of law clause into a choice of no law clause—it may not flatly and categorically renounce the authority of the federal statutes to which it is and must remain subject.").

[30] See, e.g., Ashcroft v. Iqbal, 129 S. Ct. 1937, 1950, 1952 (2009); Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007); Adam N. Steinman, The Pleading Problem, 62 Stan. L. Rev. 1293, 1348 (2010) (under Fed. R. Civ.l Proc., complaint must provide "notice about the acts or events that, according to the plaintiff, entitles him or her to relief from the defendant.," and those acts or events must, if true, must entitle him or her to relief).

[31] See generally Kevin J. Lynch, When Staying Discovery Stays Justice: Analyzing Motions to Stay Discovery When a Motion to Dismiss Is Pending, 47 Wake Forest L. Rev. 71, 86 (2012).

[32] Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 350–51 (2011) (internal quotation marks omitted).

[33] Id. at 350.

[34] Fed. R. Civ. P. 23(f) ("A court of appeals may permit an appeal from an order granting or denying class-action certification under this rule if a petition for permission to appeal is filed with the circuit clerk within 14 days after the order is entered.").

opposed to the arbitration rule successfully pushed enactment of the Class Action Fairness Act, 28 U.S.C. §§ 1332(d), 1453, and 1711–1715, after "years of intense lobbying . . . partisan wrangling, and, following two successful filibusters, [and] fragile compromises."[35] Many industry groups also fought for the promulgation of Federal Rule of Civil Procedure 23(f), which allows for interlocutory appeal of class certification orders.[36]

The proposed rule would ensure that consumers can file class actions regarding consumer financial products and services, but it would certainly not foreclose an ongoing debate about the most efficient class action procedures. That is a debate in which we expect that the opponents of this rule will be vocal participants.

1.4 Class actions that seek statutory damages are also important

Some Small Entity Representatives (SERs) pushed the CFPB to exclude from the arbitration rule claims that seek statutory damages under statutes that do not cap these damages in class actions, such as the Fair Credit Reporting Act (FCRA) and the Telephone Consumer Protection Act (TCPA).[37] The SERs expressed concern that a small entity may be unable to absorb a class action award or settlement of claims brought under such a statute. We support the CFPB's decision not to exempt any causes of action or statutes from the proposed rule; any exclusion for such statutes would be both unwarranted and inappropriate.

Statutory damages serve a critical role in protecting consumers. They ensure that consumers are appropriately compensated when actual damages are difficult to quantify or to prove. For example, under the FCRA, statutory damages are available when a consumer report is obtained without a permissible purpose,[38] invading the consumer's privacy.[39] These damages are awarded when a merchant discloses a consumer's entire credit card number or expiration date on a receipt, in violation of the FCRA's credit card truncation requirements,[40] exposing the consumer to an increased risk of identity theft.[41] These harms are difficult to quantify, but they are real, meaningful, and particularized.

The TCPA protects consumers from autodialed and pre-recorded calls to their cell phones without consent. These calls are intrusive, unwanted, an invasion of consumers' privacy and—for the 75 million consumers relying on cell phone plans with limited minutes—expensive. Robocalls to cell phones can also be dangerous. Few can resist the imperious ring of the phone and these calls lead to distracted driving and can trigger accidents.

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[35] In re HP Inkjet Printer Litig., 716 F.3d 1173, 1181 (9th Cir. 2013) (internal quotation marks omitted).

[36] See, e.g., Blair v. Equifax Check Servs., Inc., 181 F.3d 832, 834 (7th Cir. 1999).

[37] 47 U.S.C. § 227.

[38] 15 U.S.C. § 1681b(f), enforceable under 15 U.S.C. § 1681n.

[39] See, e.g., Frank v. Financial Lead Services, 2014 WL 7010790 (W.D. Mich. Dec. 10, 2014) (preliminary approval of $145,000 settlement; lists derived from consumer reports purchased without permissible purpose by marketer of debt consolidation services).

[40] 15 U.S.C. § 1681c(g), enforceable under 15 U.S.C. § 1681n.

[41] For cites to a number of class actions involving this provision, see National Consumer Law Center, Fair Credit Reporting § 9.2.5.1 (8th ed. 2013), updated at www.nclc.org/library

The Federal Trade Commission (FTC) received 184,000 complaints *every month* in 2015 about robocalls.[42] Indeed, some estimate that 35 percent of all calls placed in the U.S. are robocalls.[43] And the problem is escalating: the 2.2 million complaints about robocalls that the FTC reported in 2015 were over two and a half times as many complaints as there were in 2010.[44] In one recent TCPA case a private servicer for a student loan debt made 700 robocalls to the student's mother.[45]

Yet, while these complaints are an indication of the level of aggravation and injuries to consumers, these harms difficult to quantify for purposes of proving actual damages, but that does not mean that the harms are not real. Indeed, the harms that trigger statutory damages under the FCRA and TCPA are concrete harms for the purposes of the Supreme Court's recent decision in *Spokeo v. Robbins*.[46] And to the extent consumers do not suffer concrete harm, the *Spokeo* decision precludes them from bringing a case in federal court due to lack of Article III standing, which should alleviate some of the industry's concerns.

Statutory damages are also vital to ensure enforcement of both the FCRA and TCPA, which historically has been largely dependent upon private lawsuits, or so-called private attorney general enforcement. Without statutory damages, there will be even less incentive for private enforcement of two laws that have often suffered from lack of compliance.

Furthermore, we agree with the CFPB that the appropriate entity to change the statutory damages available for particular harms under the FCRA, TCPA or other statutes is Congress.

Indeed, Congress recently considered the issue of allegedly disproportionate damages awards arose with respect to statutory damages class actions alleging violations of the FCRA's credit card truncation requirements. Congress responded to those concerns with the Credit and Debit Card Receipt Clarification Act, which eliminated statutory damages for class actions involving expiration date disclosure violations that occurred prior to the Clarification Act's enactment, but allowed such actions afterwards.[47] In doing so, Congress balanced the needs of consumers for protection of sensitive information versus protecting unwary business from the threat of large damage awards. Congress did so by making the measure temporary, giving business a chance to come into compliance without sacrificing the future deterrent effects of statutory damages.

Congress has however chosen not to cap the damages on FCRA or TCPA actions. It can revisit that issue if it likes, but the CFPB is not the place to limit damages authorized by Congress.

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[42] Federal Trade Commission, National Do Not Call Registry Data Book, FY 2015, at 5 (Nov. 2015).

[43] Consumer Reports, Rage Against Robocalls (July 28, 2015), at http://www.consumerreports.org/cro/magazine/2015/07/rage-against-robocalls/index.htm

[44] Federal Trade Commission, National Do Not Call Registry Data Book, FY 2015, at 4 (Nov. 2015).

[45] McCaskill v. Navient Solutions, Inc., 2016 WL 1367228 (M.D. Fla. April 6, 2016).

[46] 136 S. Ct. 1540, (May 16, 2016). For a discussion of the concrete harms presented by violations of various FCRA and TCP provisions, see National Consumer Law Center, Fair Credit Reporting § 11.2.1.3 (8th ed. 2013), updated at www.nclc.org/library and National Consumer Law Center, Federal Deception Law, § 6.9.2a.2 (2nd ed. 2016), updated at www.nclc.org/library.

[47] Pub. L. No. 110-241, § 2, 122 Stat. 1565 (June 3, 2008) (providing that printing of receipts showing credit card expiration dates prior to June 3, 2008 cannot be regarded as a willful violation of the FCRA).

2. Definitions, § 1040.2

2.1 Clarify that "class action" includes mass actions and actions analogous to Rule 23 actions, § 1040.2(a)

The definition of "class action" is critical to ensure that consumers have a practical procedure for achieving broad-based relief however that court procedure is labeled under federal or state law. The proposed definition should be clarified to achieve this goal.

The definition should clearly include mass actions. Some arbitration clauses explicitly prohibit mass actions, and most other arbitration agreements reach the same result by requiring "individual" arbitration. Corinthian Colleges, for example, used an arbitration clause that specified "I agree not to combine or consolidate any Claims with those of other students, such as in a class or mass action."[48] American Express requires cardholders to "resolve any claim by individual arbitration"[49] and further prohibits "claims brought in a purported representative capacity on behalf of the general public, other cardmembers or other persons similarly situated." Courts have also held that cases brought on behalf of the general public are barred by forced arbitration clauses.[50]

For the same reasons that consumers should be permitted to remedy wrongs through Rule 23 class actions, they should also have access to mass actions, notwithstanding pre-dispute arbitration agreements to the contrary. Courts have noted how class actions and mass actions similarly serve as procedural tools for allowing consumers to band together.[51] Congress has also recognized the similarity by defining "class action" to include mass actions in the Class Action Fairness Act (CAFA)[52] and the Securities Litigation Uniform Standards Act (SLUSA).[53]

SLUSA defines "covered class action" as including any individual or group of lawsuits in which damages are sought on behalf of more than 50 persons.[54] The definition also includes lawsuits that are brought on a representative basis to recover damages whre common questions of law or fact predominate.[55] According to the legislative history of SLUSA "it [was] the Committee's

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[48] Montgomery v. Corinthian Colleges, Inc., 2011 WL 1118942, at *2 (N.D. Ill. Mar. 25, 2011) (quoting arbitration clause).

[49] See Amex https://www.americanexpress.com/us/content/pdf/cardmember-agreements/green/AmericanExpressGreenCard.pdf at 5.

[50] See, e.g., Ferguson v. Corinthian Colleges, Inc., 733 F.3d 928 (9th Cir. 2013) (finding that California law saying that public injunction claims are not subject to arbitration was preempted by the Federal Arbitration Act). Although the Ferguson case was brought as a class action, that fact was not relevant to the court's decision.

[51] See, e.g., Findley v. Falise, (In re Joint Eastern and Southern Districts Asbestos Litigation), 878 F. Supp. 473, 560 (E.D.N.Y. Jan. 19, 1995) (equating "plaintiffs in class and other mass actions"). AT&T Mobility LLC v. Smith, 2011 WL 5924460 (E.D. Pa. Oct. 7, 2011) (construing over 1,000 separate but identical requests for individual arbitration filed by same law firm and seeking same relief—"injunction of the AT & T / T–Mobile merger"—to be a class action prohibited by arbitration clause)

[52] 28 USC 1332(d)(11)(B)

[53] 15 U.S.C. § 78bb(f)(5)(B)

[54] 15 U.S.C. § 78bb(f)(5)(B)(i)(I), (ii).

[55] 15 U.S.C. § 78bb(f)(5)(B)(i)(II).

intent that the bill be interpreted broadly to reach mass actions and all other procedural devices that might be used to circumvent the class action definition."[56]

CAFA specifically defines the term "mass action"[57] and deems them to be a class action for purposes of removal.[58] However, we do not recommend the CAFA definition as it is "an opaque, baroque maze of interlocking cross-references that defy easy interpretation."[59]

Similarly, the definition of class action should include state laws that provide for widespread injunctive relief on behalf of a group of consumers even if the state law is not labeled a class action and is not modeled on Fed. R. Civ. Pr. 23.

To clarify that mass actions are available under both state and federal law, we recommend that the definition of class action in the Rule be changed by adding the following text: "… seek class treatment pursuant to Federal Rule of Civil Procedure 23 or any federal or state process similar to Federal Rule of Civil Procedure 23." Then we suggest that the Comment provide examples of such similar federal or state processes. Much of the language below is derived from the definition found in the federal Securities Litigation Uniform Standards Act of 1998 (SLUSA).[60] The CAFA definition seems less helpful because it is overly complex and convoluted.

> Comment 1040.2(a).
>
> 1. Class actions include the following:
>
> (i) Actions brought pursuant to Federal Rule of Civil Procedure 23 or state processes analogous to Federal Rule of Civil Procedure 23;
>
> (ii) Federal or state actions where relief is sought on behalf of more than 50 persons and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons; or
>
> (iii) Actions where one or more named parties seek relief on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons predominate over any questions affecting only individual persons.
>
> (iv) State procedures where a party brings an action to obtain injunctive relief on behalf of more than 50 persons, such as pursuant to Cal. Bus. & Prof. Code § 17203.

The proposed rule should be as broad as the forced arbitration clauses that prevent consumers from obtaining broad-based relief for widespread violations.

2.2 Adopt the definition of "consumer" as proposed, § 1040.2(b)

The Bureau proposes to define "consumer" as "an individual or an agent, trustee, or representative acting on behalf of an individual." This is identical to the Dodd-Frank

[56] Feitelberg v. Merrill Lynch & Co., Inc., 234 F.Supp.2d 1043, 1047 (N.D. Cal. Oct. 9, 2002) (quoting S.Rep. No. 105-182, at *8 (1998), reprinted in 1998 WL 226714 (Leg.Hist.))

[57] 28 USC 1332(d)(11)(B)

[58] 28 USC 1332(d)(11)(A)

[59] Lowery v. Alabama Power Co., 483 F.3d 1184, 1198 (11th Cir. 2007).

[60] 15 U.S.C. § 77p(f)(2).

definition.[61] We support this definition because it is clear and easy to apply. Including "agent[s], trustee[s], or representative[s] acting on behalf of an individual" is appropriate and important. Doing so will avoid confusion over whether the rule covers surrogates acting on behalf of individuals who cannot act for themselves, for example due to their age or disability. It should also be interpreted to protect seniors who have placed their assets in a trust for estate planning purposes.

2.3 "Provider," § 1040.2(c)

The proposed rule uses the term "provider" to describe the persons to whom the rule is applicable—that is, the entities or individuals that may not include nonconforming arbitration clauses in their agreements and that may not rely on nonconforming arbitration clauses. The proposed definition of "provider" in § 1040.2(c) generally tracks the Dodd-Frank Act definition of "covered person" with two exceptions.

First, the definition of "provider" incorporates a narrower list of consumer financial products and services than those within the scope of the Dodd-Frank Act. We support this general approach, although we do urge inclusion of broader and additional categories of products and services, as discussed below.

Second, unlike the Dodd-Frank definition of "covered person," the definition of "provider" excludes entities that are exempt from the CFPB's jurisdiction or the proposed rule. This is generally not a problem except to the extent that the definition of "provider" is incorporated into the proposed definition of "pre-dispute arbitration agreement," discussed in § 2.4, below.

In addition, proposed Comment 1040.2-2(c) states that a provider of multiple products or services is not covered by the rule in connection with products or services that are outside the rule.

We suggest that the comment be amended to make clear that services that are ancillary to a covered product are covered. For example, debt collectors not only collect debt but may also process payments through preauthorized electronic fund transfers. That payment processing activity would be ancillary to the collection of debt and should be covered even if it would not be for an excluded merchant. As discussed in § 6.1.2 below, the CFPB should not encourage evasions by encouraging providers to split their agreements into purportedly separate products that are not covered.

Like the Dodd-Frank definition of "covered person," the proposed definition of "provider" covers service providers only if they are affiliates of a provider. While the CFPB may not wish to include non-affiliate service providers in the definition of "provider" governed by this rule, the Bureau should nonetheless make clear that it would be unfair, deceptive or abusive for a non-affiliate service provider to rely on unlawful arbitration clauses. The Dodd-Frank Act gives the CFPB the authority to "take any action authorized under part E to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice …."[62] It would be unfair, deceptive and abusive for a service provider employed by a provider that is covered by the arbitration rule to rely on a class action ban that the provider itself could not rely upon.

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[61] 12 U.S.C. § 5481(4).

[62] 12 U.S.C. § 5531(a).

Also, for this reason, as discussed in § 6.1.3 below, it is important to require broad language in all arbitration clauses and required notices (including notices from providers to their service providers) prohibiting use by the provider "or anyone else" – i.e., including a service provider.

2.4 "Pre-dispute arbitration agreement": § 1040.2(d)

Proposed § 1040.2(d) would define the term "pre-dispute arbitration agreement" as an "agreement between a provider and a consumer providing for arbitration of any future dispute between the parties." We suggest four clarifications to this definition.

First, the CFPB must not limit the rule to agreements with "providers" as it will narrow the scope in ways the CFPB does not intend (see § 2.4.1, below). We also ask the CFPB to clarify in a comment that "pre-dispute" includes agreements imposed after filing but before certification of a class action (see § 2.4.2, below). The definition should also be expanded to include an agreement that allows a party to force into arbitration questions regarding the arbitration clause or the application of the CFPB's arbitration rule (see § 2.4.3, below). Finally, the CFPB must reject any suggestion by industry that agreements with opt-out provisions should not be covered (see § 2.4.4, below).

2.4.1 The agreement need not be with a "provider"

Currently, the definition of "pre-dispute arbitration agreement" applies only to agreements between a "provider and a consumer." This constraint (1) is inconsistent with the CFPB's authority and its intent in drafting other rule provisions, (2) leads to confusion and ambiguities throughout the rule, and (3) is unnecessary.

There is no benefit to including a limitation on coverage within the definition "pre-dispute arbitration agreement." The requirements of proposed § 1040.4 are imposed only on providers, and coverage is already dealt with in the definition of "provider" and in the coverage provisions found in proposed § 1040.3. Scope issues are more properly and precisely addressed in these sections, not in a definitional section, and certainly not through this definition's one-size-fits-all approach.

The constraint also leads to ambiguities throughout the rule. As discussed in §§ 3.10.2 and 5.1 below, the CFPB clearly intends for the rule to apply to entities like debt collectors and auto finance companies that acquire or perform services under contracts originally entered into with entities that are not "providers" and are not within the CFPB's jurisdiction. Yet if the core term "pre-dispute arbitration agreement" requires that the original agreement be with a "provider," then those agreements will fall outside the rule.

For example, proposed § 1040.4(a)(1) prohibits providers from relying on any pre-dispute arbitration agreement in class actions, whether or not they are parties to the agreement. Comment 4-2 provides examples of this situation, including a debt collector that could not rely on "a pre-dispute arbitration agreement entered into by a merchant creditor who was excluded from coverage by § 1040.3(b)(5)." Yet if the term "pre-dispute arbitration agreement" requires that the agreement be between a consumer and a "provider," then this comment makes no sense, as an agreement with an excluded merchant creditor (i.e., a hospital) would fall outside of the rule entirely.

We see no reason to include in the definition of "pre-dispute arbitration agreement" any reference to the parties to the agreement. Instead, the definition can simply replace the language "agreement between a provider and a consumer providing for arbitration of any future dispute between the parties" with "agreement providing for arbitration of any future dispute between the parties." Once again, the CFPB can adequately specify the rule's scope in its other provisions.

If the CFPB sees some reason to specify the parties to the arbitration agreement in the definition of pre-dispute arbitration agreement, the definition should be limited to consumers' agreements with covered persons—as defined in the Dodd-Frank Act—and not agreements with "providers." Using the term "covered persons" will enable the rule to operate as the CFPB intends.

Using the term "covered persons" is consistent with the Dodd-Frank provision providing: "The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of arbitration agreements between a *covered person* and a consumer ….." 12 U.S.C. § 5518(b) (emphasis added). As the CFPB explained:

> Notably, entities excluded from Bureau rulemaking authority under sections 1027 and 1029 may still be covered persons as defined by Dodd-Frank section 1002(6). Thus, proposed § 1040.4 may apply to a provider that assumes or seeks to use an arbitration agreement entered into by a covered person over whom the Bureau lacks rulemaking authority under Dodd-Frank sections 1027 and 1029 with respect to the activity at issue.[63]

We agree with this reasoning. Adopting the term "covered person" will ensure that the rule operates as the CFPB intends, e.g. to reach debt collectors that collect debt from excluded merchant creditors. But we believe that the better course is to eliminate entirely the reference to the parties in the definition of "pre-dispute arbitration agreement."

2.4.2 "Pre-dispute" should include an agreement imposed on class members at any point prior to certification

We recommend that the rule or the interpretations clarify that the definition of "pre-dispute arbitration agreement" includes agreements entered into with putative class members (other than the named parties) at any point before a class is certified, even after a class action is filed on behalf of those class members. Sometimes defendants attempt to force putative class members to enter into arbitration agreements after a class action is filed in an attempt to force those putative class members to waive their right to participate in the already-filed class action.

Courts frequently refuse to enforce arbitration agreements transmitted in this manner because they interfere with the proper functioning of the class action device.[64] Nonetheless, defendants continue to employ this tactic to avoid class actions.

The CFPB should clarify that arbitration agreements transmitted to putative class members are still "pre-dispute" arbitration agreements even though an action has been filed on their behalf. Whether or not an agreement is pre- or post-dispute must turn on whether the *particular consumer* is already pursuing litigation. A putative member of a non-certified class is not yet pursuing litigation, even though he or she is protected by the already-filed action. A post-dispute agreement arises only when a named party, or a member of a class that has already been certified, voluntarily agrees to arbitrate that litigation.

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[63] 81 Fed. Reg. at 32884.

[64] See e.g. In re Currency Conversion Fee Antitrust Litig., 361 F. Supp. 2d 237, 254 (S.D.N.Y. 2005); see also Carnegie v. H&R Block, Inc., 687 N.Y.S.2d 528 (N.Y. Sup. Ct. 1999); H&R Block, Inc. v. Haese, 82 S.W.3d 331 (Tex. App. 2000), on remand, 2000 WL 924805 (Tex. App. June 29, 2000).

2.4.3 Include agreements that delegate questions to the arbitrator

The definition term "pre-dispute arbitration agreement" should be expanded to include an agreement that allows a party to force arbitration of questions regarding the enforceability or the scope of the arbitration clause or the application of the CFPB's arbitration rule. As discussed in § 5.2.3 below, clauses that delegate these questions to the arbitrator compound the unfairness of forced arbitration and could undermine enforcement of the CFPB's rule.

Consequently, we urge the CFPB to define the term "pre-dispute arbitration agreement" to include any agreement "for arbitration of any future dispute between the parties, <u>including any issue concerning the validity, enforceability, or scope of the arbitration agreement or the application of, interpretation of, or compliance with this rule."</u>

Separately, in § 5.2.3 below, we also urge the CFPB to ban reliance on a delegation clause and to include language in the agreements and notices prohibiting delegation.

2.4.4 Opt-out option should not prevent agreement from being defined as an arbitration agreement

We strongly oppose any recommendation that may be made by industry commenters that agreements with opt-out provisions be excluded from the definition of a pre-dispute arbitration agreement. That a consumer theoretically has the ability to opt out of an arbitration agreement does not alter the fact that it is still an arbitration agreement.

Nor does the existence of an opt-out essentially change the coercive effect of the arbitration agreement. The CFPB's own study concludes that consumers rarely understand their right to opt-out of an agreement.[65] Nor do consumers have any reason to foresee litigation or to be concerned about remedies at the time that they enter into an agreement with a company that they expect will follow the law. In other words, there is rarely any cause for them to opt out of the agreement.

Similarly, there should be no exemption from the rule merely because an arbitration agreement gives the consumer the right, after litigation is initiated, to opt out of the agreement's terms and to join a court class action.

One of the fundamental characteristics of the Rule 23 class action is that it protects absent class members unless they opt out of the class action, meaning that consumers are part of the class unless they take affirmative steps to opt out. The option to opt out of an arbitration agreement and to join a court class action, even after a class action is filed, amounts to nothing more than an opportunity to opt in to a class action. This imposes a hurdle that will effectively deny many consumers relief from the class action.

Moreover, binding consumers to a forced arbitration clause unless they take affirmative steps to join a class action would effectively prevent class actions in the same way as other existing arbitration requirements. Classes would be substantially smaller, they might not meet numerosity requirements, and the economics might not justify attorney representation in a complicated case. Even if the class did proceed without many potential class members, many victimized consumers would be excluded from the class and obtain no relief from the action. There should be no exemption for arbitration agreements that require the consumer to take affirmative action to become part of the class by opting out of an arbitration agreement.

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[65] CFPB Study p. 20.

3. Covered Products and Services, § 1040.3(a)

Introduction

Proposed § 1040.3(a) sets forth the covered consumer financial products and services whose agreements are governed by the rule. By specifying the products and services that are covered instead of simply using the Dodd-Frank definition of "consumer financial product or service," the proposed rule covers a narrower swath of products and services than those that are subject to the CFPB's jurisdiction.

In theory, we believe that coverage should be as broad as the CFPB's jurisdiction. All consumers should have the right of access to court in a class action if there are widespread violations of the law. Similarly, the CFPB should be collecting information on use of forced arbitration clauses in any consumer financial setting.

Nonetheless, we see the benefit of the CFPB's approach. Providing more precise definitions of the products and services covered will help avoid surprises, promote compliance, and aid courts in determining the scope of the rule.

While we therefore support this approach, it remains essential for the rule's application to be wide. For that reason, we recommend several places where the covered products and services should be broadened or new ones added.

We also support the Bureau's approach of incorporating definitions found in other regulations that could be later amended. We do not believe this will cause any difficulties, as those later amendments will be subject to notice and comment.

Indeed, much greater confusion would be wrought by doing the opposite—setting a definition in stone based on an older interpretation of a regulation that has changed. The CFPB would have to replicate word for word definitions without cross-referencing them, and court decisions that clarify those definitions either would be inapplicable or would be unclear which version they were interpreting.

In addition, consumers would not benefit from new rules that close gaps discovered in statutes and regulations. For example, consumers who use prepaid cards have for years been excluded from the protections of Regulation E because the definition of "account" written in the Electronic Fund Transfer Act in 1974 did not anticipate prepaid accounts. The CFPB is on the verge of closing that gap, and the amendments to Regulation E will be automatically incorporated into the arbitration rule's scope. This prevents the CFPB from having to re-open the arbitration rule, and ensures that consumers are protected as products evolve.

3.1 Credit, § 1040.3(a)(1)

3.1.1 Extensions of consumer credit, § 1040.3(a)(1)(i)

3.1.1.1 Including "credit" in the rule is vital

We strongly support the Bureau's decision to include extensions of credit in the rule, as broadly defined by proposed § 1040.3(a)(1)(i). Arbitration clauses are appearing in credit transactions with increasing frequency and consumers have no ability to negotiate the terms of such contracts—assuming they even have an opportunity to read them before consummation or would understand them even if they did read them.

The vast majority of the problems that promoted the creation of the CFPB and that have dominated its activities have involved credit. Mortgages, credit cards, student loans, payday loans and auto loans, among others, have all been the focus of consumer protection violations and unfair, deceptive and abusive practices. In all of these areas, forced arbitration clauses have caused problems for consumers.

Consumers' inability to bring class actions against credit card companies allowed problems to fester, ultimately forcing Congress to pass the Credit CARD Act. But problems with deferred interest credit card promotions,[66] rewards, and other issues remain.[67] The CFPB's study showed how prevalent forced arbitration clauses are in credit card agreements.[68]

Unmanageable debt and problematic servicing and debt collection practices in connection with student loans are an increasing problem. Private student lenders and for-profit schools, in particular, regularly use forced arbitration schools in their contracts.[69]

Before the widespread use of arbitration agreements in credit contracts, a series of major class actions were brought against the major auto finance companies due to their practice of allowing auto dealers discretion to mark up the price of auto loans for reasons unrelated to credit worthiness—a practice that was proven to result in racial discrimination.[70] Yet those cases could not be brought today, as auto loan contracts now regularly contain class action bans and forced arbitration clauses. Not surprisingly, many of these same problems, initially forestalled by nationwide settlements have reemerged.[71]

Payday lenders, an industry that the CFPB has recently announced is in need of significant regulation, has largely escaped class action remedies for years due to forced arbitration clauses.[72]

Even real estate-secured credit will benefit from the proposed rule because not all forms of such credit are covered by the Truth in Lending Act's ban on forced arbitration clauses in mortgages. The TILA ban is limited to closed-end loans secured by dwellings and open-end loans secured by the consumer's principal dwelling.[73] This permits arbitration clauses in mortgages secured by unimproved land, open-end loans secured by a dwelling that is not the consumer's principal

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[66] See CFPB, Consumer Response Annual Report at 29 (March 2016), available at http://files.consumerfinance.gov/f/201604_cfpb_consumer-response-annual-report-2015.pdf.

[67] See generally CFPB, The Consumer Credit Card Market at 147, 226 (Dec. 2015), available at http://www.consumerfinance.gov/data-research/research-reports/the-consumer-credit-card-market/.

[68] CFPB Study at §2.3 (53% of market uses arbitration clauses; but the incidence would have been 93% of loans outstanding absent the Ross settlement). Id. at n. 21.

[69] See id. (showing 6 out of 7 contracts examined included arbitration clauses).

[70] See NCLC Issue Brief, Racial Disparities in Auto Lending: A State-by-State Reminder Why Auto Dealers Must Be Subject to the Consumer Financial Protection Bureau (May 4, 2010), available at http://www.nclc.org/images/pdf/regulatory_reform/issue-brief-auto-dealer-racial-disparites.pdf.

[71] See CFPB Press Release, CFPB and DOJ Reach Resolution With Toyota Motor Credit To Address Loan Pricing Policies With Discriminatory Effects (Feb. 2, 2016), available at http://www.consumerfinance.gov/about-us/newsroom/cfpb-and-doj-reach-resolution-with-toyota-motor-credit-to-address-loan-pricing-policies-with-discriminatory-effects/.

[72] See e.g. Buckeye Check Cashing, Inc. v. Cardegna, 546 US 440 (2006).

[73] 15 U.S.C. § 1639c(e); Reg. Z § 1026.36(h).

dwelling (such as a vacation home), and other consumer credit secured by non-dwelling real estate.

3.1.1.2 We support using the ECOA's definition of "credit"

As proposed, the rule will apply to "providing an 'extension of credit' that is 'consumer credit' as defined in Regulation B, 12 CFR 1002.2[.]" We support this decision. Regulation B defines "credit" as "the right granted by a creditor to an applicant to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment therefor" §1002.2(j). Regulation B defines "extension of credit" as "granting . . . credit in any form." §1002.2(q). In contrast, Regulation Z's definition of credit does not include the right to "purchase property or services and defer payment therefor."

The long list of non-exclusive examples in § 1002.2(q) and the Official Interpretations to § 1002.2(j) emphasize the breadth of the definition of "credit." Official Interpretation §1002.2(j)-1, in particular, states:

> Regulation B covers a wider range of credit transactions than Regulation Z (Truth in Lending). Under Regulation B, a transaction is credit if there is a right to defer payment of a debt—regardless of . . . the number of installments required for repayment, or whether the transaction is subject to a finance charge.[74]

The choice of ECOA's definition over TILA's is important insures that certain exemptions from TILA coverage are not implied into the arbitration rule's coverage. TILA has numerous exemptions and exceptions that are not related to its definition of credit.

For example, federal student loans are exempt from TILA and Regulation Z, largely because such student loans are covered by a separate disclosure regime found in the Higher Education Act. While the federal government does not put arbitration clauses in its Direct Loans, older loans guaranteed by state guaranty agencies might have arbitration agreements. Debt collection activities by private collectors in connection with those loans would be covered by the proposed rule.

Even though federal student loans are "credit" as defined by TILA, courts could mistakenly hold that the TILA exemptions apply to the proposed arbitration rule as well. Using ECOA's definition will reduce that risk. The broader ECOA definition will also make it harder to evade the rule by manipulating the number of installments in a contract or hiding the finance charge in the purchase price.

3.1.1.3 Include a comment clarifying coverage of Buy Here Pay Here auto dealers

It is important for the Bureau to state explicitly that Buy Here Pay Here (BHPH) auto dealers are subject to the arbitration rule. BHPH dealers (so known because they provide their own financing and require customers to return to the lot to make payments) sell used cars and provide their own financing directly to the buyer.[75] The financing usually includes a finance charge and

[74] See also 81 FR 32873 (May 24, 2016).

[75] For a broader description of the Buy Here Pay Here industry and its abuses, see the LA Times' three-part Wheels of Fortune series by Ken Bensinger: A vicious cycle in the used-car business; Sign, drive, default, repo and resell -- that's the game at Buy Here Pay Here dealerships at A1 (Oct. 30, 2011); Wall Street loves used cars; Equity firms are buying dealership chains, and auto loans are being bundled into securities as risky mortgages were at A1 (Nov. 1, 2011); Hard road for poor needing cars; Few programs help low-income workers get behind the wheel at A1 (Nov. 3, 2011).

the dealer holds the loans. BHPH dealers charge exorbitant interest rates, conceal those rates by pricing cars above their true value, and profit from repeatedly reselling cars they have repossessed from former customers.

Although 12 U.S.C. § 5519(a) excludes most auto dealers from the CFPB's authority, § 5519(b)(2) provides an exception that gives the Bureau authority over the typical BHPH dealer. Under paragraph (b)(2), the auto-dealer exclusion does not apply to the extent a dealer:

> (2) operates a line of business--
>
> (A) that involves the extension of retail credit . . . involving motor vehicles; and
> (B) in which—
>
> (i) the extension of retail credit or retail . . . are provided directly to consumers; and
> (ii) the contract governing such extension of retail credit or retail leases is not routinely assigned to an unaffiliated third party finance or leasing source.

Most BHPH dealers fit this provision exactly. And the proposed rule appears to cover BHPH dealers. After all, the proposed merchant exclusion would not apply when the merchant imposes a finance charge, as BHPH dealers do.

However, the common belief is that all auto dealers are exempt from CFPB rules. In addition, the automobile dealer exemption in Dodd-Frank is complicated and difficult to understand. Because the Bureau's authority over BHPH transactions is based on an exception to the larger rule limiting the Bureau's authority over auto dealers, it is important that the Bureau expressly mention that BHPH dealers are covered by this rule. The Comments are probably the best place to note this fact with a comment giving an illustration of an auto loan made by a BHPH dealer.

3.1.2 Those who regularly participate in credit decisions, § 1040.3(a)(1)(ii)

Proposed § 1040.3(a)(1)(ii) covers a creditor, as defined in Regulation B, that regularly participates in a credit decision, within the meaning of Regulation B. This may include assignees or potential purchasers of contracts[76] as well as real estate brokers, home builders, and home-improvement contractors.[77]

We support using Regulation B's definition of "creditor" (and the related definition of "consumer credit") because it is well understood, widely accepted, and sufficiently broad to cover the appropriate range of products and services. Using these definitions will also minimize the cost of implementing the proposed rule because most "creditors," as defined by Regulation B, already know who they are and already have systems for ensuring compliance with consumer credit regulations.

Clearly, any party that regularly participates in a credit decision has a strong impact on the borrowers of that credit, even if they do not directly provide the credit themselves. Those parties should not be able to hide behind forced arbitration clauses to escape accountability for violating the law. Indeed, using the ECOA definition of creditor is especially appropriate in light of the importance of protecting consumers who are subject to discrimination and holding those who participate in discriminatory credit decisions responsible.

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[76] Reg. B Commentary 1002.2(l)-1.

[77] Id. at ¶ 2.

3.1.3 Referring consumers to or selecting creditors, § 1040.3(a)(1)(iii)

We support the Bureau's decision to include within the rule's scope those who refer applicants to creditors and those who select or offer to select creditors. Proposed § 1040.3(a)(1)(iii) extends the rule to "acting, as a person's primary business activity, as a 'creditor' as defined by 12 CFR 1002.2(l) by 'referring applicants or prospective applicants to creditors, or selecting or offering to select creditors to whom requests for credit may be made' consistent with its meaning in 12 CFR 1002.2(l)."[78]

This provision will include those who broker credit, such as mortgages brokers,[79] auto and manufactured home dealers who make referrals to creditors, credit service organizations, and[80] home improvement contractors.[81] These actors play a significant role in the extension of consumer credit and have been implicated in both misconduct and attempts to evade regulation.

In addition, we assume – but the CFPB should clarify in a comment – that proposed § 1040.3(a)(1)(iii) will also cover lead generators. Lead generators that gather consumer information – either directly from the consumer (i.e. through websites) or indirectly from other sources – and provide that information to potential creditors should be viewed as "referring applicants or prospective applicants to creditors." Providing a lead to the creditor should be viewed as "referring." Similarly, lead generators or others that provide lists of potential creditors to consumers – whether through lists of "the best credit cards for bad credit" or through more refined search tools based on the consumer's individual information – should be viewed as "selecting or offering to select creditors to whom requests for credit may be made."

As discussed in greater length in section § 3.3.3 below, lead generators have been a serious problem and must be fully covered by this rule. Yet the word "lead generator" is not mentioned once and there may be ambiguities over their coverage. Lead generators that simply sell leads may claim that they are not "referring." Ones that do not actually select a creditor but just provide lists may claim they are not "selecting."

Consumers may encounter arbitration clauses that were forced directly on them by the lead generator (i.e., through the terms of its website) or they may claim to be covered as a third party or service provider through the creditor's contract. It is important that lead generators be viewed as "providers" in both situations – whether they "entered into" the agreement or did not.

Consequently, we urge the CFPB to include a specific comment stating that credit lead generators are within this "referring" or "selecting" provision. In addition, as discussed in § 3.3.3 below, the CFPB should separately include all lead generators of financial services (not just credit leads) under its authority over financial advisory services.

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[78] (Alterations omitted). Regulation B's § 1002.2(l) defines "creditor" to include "a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made."

[79] See National Consumer Law Center, Mortgage Lending § 7.2 (2d ed. 2014), updated at www.nclc.org/library.

[80] National Consumer Law Center, Consumer Credit Regulation § 2.3.12.5 (2012), updated at www.nclc.org/library (high-rate lenders' use of credit services laws to evade state usury caps; National Consumer Law Center, Consumer Credit Regulation § 9.6.5 (2012), updated at www.nclc.org/library (using brokers and CSOs to evade regulation). See also CCR 15.4.4 (tax preparers facilitating RALs may be subject to broker or CSO laws).

[81] See National Consumer Law Center, Unfair and Deceptive Acts and Practices § 8.4 (8th ed. 2012), updated at www.nclc.org/library

The Bureau also requested comment on the "primary business" limitation in proposed § 1040.3(a)(1)(iii). As proposed, that section applies the arbitration rule to:

Acting, as a person's primary business activity, as a "creditor" as defined by 12 CFR 1002.2(l) by "refer[ring] applicants or prospective applicants to creditors, or select[ing] or offer[ing] to select creditors to whom requests for credit may be made" consistent with its meaning in 12 CFR 1002.2(l);

We recommend changing "Acting, as a person's primary business activity, as a 'creditor' as defined by 12 CFR 1002.2(l) by 'refer[ring] applicants'" to "Acting, as a person's primary business activity, as a 'creditor' as defined by 12 CFR 1002.2(l) by regularly 'refer[ring] applicants.'"

The phrase proposed by the Bureau could be construed as meaning a person must have only one primary business activity, and that activity must be "referring," "selecting," or "offering to select." Such an interpretation would make the rule unreasonably narrow. The Bureau itself says "[r]egularly engaging in these activities generally makes a person a creditor under Regulation B, 12 CFR 1002.2(l).

Thus proposed § 1040.3(a)(1)(iii) would only apply to persons who are regularly engaging in these activities."82 Using the term "regularly" would be clearer and would reduce the risk of an unduly strict interpretation of the rule. Regulation B already uses the term "regularly" in this context.

3.1.4 Acquiring, purchasing, or selling consumer credit, § 1040.3(a)(1)(iv)

Claims may also arise that are not related to the origination of credit. For example, a consumer could be harmed if a debt buyer purchases and sells a credit account -- without ever collecting on it -- and fails to pass on or falsifies critical information about the debt, such as a cease-contact order from the consumer or the date the statute of limitations ran. For that reason it is important that the rule apply to the act of selling, purchasing, or otherwise acquiring consumer credit contracts.

Even if the original contracting party is not a covered provider, the CFPB has the authority to regulate the contract once it is in the hands of or is being used by a provider. Pursuant to black letter principles of contract law, once one entity assigns an agreement to another, the assignee steps into the shoes of the assignor. At that point in time, the arbitration clause becomes a contract between the consumer and a provider, within the CFPB's authority to regulate.[83]

Covering purchasers or assignees is particularly important in the context of auto finance companies, which often draft retail installment contracts for dealers and then purchase those same contracts afterwards. Auto finance companies and their use of forced arbitration are both squarely within the CFPB's jurisdiction, even if the auto dealer may not be.

Here again, purchasing or selling a contract with an arbitration clause is within the CFPB's authority to regulate the "use" of financial services contracts with arbitration clauses. A company that purchases a contract with an arbitration clause uses that clause as a way to govern its legal rights and diminish its liability, protect itself, and influence consumer behavior. Similarly, a company uses an arbitration clause when it sells that contract, as it is using the

[82] at 32874

[83] See, e.g., Kennamer v. Ford Motor Credit Co., 153 So. 3d 752 (Ala. 2014) (citing case in which "Nissan became a party to the retail-sales contract when the dealership assigned it to Nissan.").

arbitration clause as part of the consideration that it is selling. For example, the Supreme Court has held that a statute governing the "use" of a firearm encompassed the sale of a firearm in exchange for narcotics.[84] Covering purchases, sale and acquisition of contracts with pre-dispute arbitration agreements is critical to avoiding evasions.

3.1.5 Servicing credit, § 1040.3(a)(1)(v)

The proposed rule would include "Servicing an extension of consumer credit covered by paragraph (a)(1)(i)." This is an important component of the rule that should be retained in the final version. Loans are often serviced by companies not party to the original transaction. Importantly, consumers have no control over who services an extension of credit. Yet the consumer will often have a longer relationship with the servicer than with the originator. The recent mortgage foreclosure crisis illustrates the importance of loan servicing. But loan servicing is important in many other areas, including auto loans, student loans, payday loans, and any other installment debt.

Disputes over servicing often involve the servicer's own conduct, such as the misapplication of payments and collection efforts. Servicers should be subject to the proposed rule because they may attempt to invoke arbitration clauses found in the original loan contract[85] where the original provider was not subject to the proposed rule. Or servicers may attempt to bind consumers to their own arbitration clause, for example, by including it in the terms of use for the website consumers use to access their account.

3.1.6 Mortgage settlement service providers should be covered

In addition to the other categories of services related to credit that are covered in proposed §§ 1040.3(a)(1)(i) through (v), we recommend that settlement services in connection with mortgage credit should be added as a category covered by the rule. The CFPB has authority over settlement services under 12 U.S.C. 5481(15)(A)(iii).

After charges for interest, settlement services are the most expensive part of obtaining a mortgage. The recent mortgage crisis has shown us that fraud in connection with mortgage originations is not limited just to the actions of brokers and lenders, but also may involve the active participation of settlement service providers. These providers may also engage in illegal practices on their own, not in conjunction with a wider mortgage origination scheme.

Although Truth in Lending now largely prohibits arbitration agreements in mortgage loans, separate agreements with these settlement service providers are not covered by that Truth in Lending prohibition. Thus these providers are free to insert arbitration agreements into their contracts.

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[84] Smith v. United States, 508 U.S. 223, 229 (1993).

[85] See, e.g., Sherer v. Green Tree Servicing LLC, 548 F.3d 379 (5th Cir. 2008) (nonsignatory loan servicer allowed to enforce arbitration clause in loan contract); Roach v. Navient Sols., Inc., 2015 WL 8479195 (D. Md. Dec. 10, 2015) (student loan servicer invoked arbitration clause in promissory note to compel arbitration of TCPA and FCRA claims arising from servicer's collection efforts); Beach v. Green Tree Servicing LLC, 2009 WL 1759595 (S.D. Tex. June 17, 2009) (military service member compelled to arbitrate claims against mortgage servicer company even though he was not a party to the mortgage on manufactured home taken out by his wife); McCracken v. Green Tree Servicing, LLC, 279 S.W.3d 226 (Mo. Ct. App. 2009) (mortgage servicer/assignee allowed to invoke arbitration clause in FDCPA action for misapplication of mortgage payments).

We encourage the Bureau to extend the proposed rule to cover settlement services in any mortgage otherwise covered by the proposed rule. Doing so will provide equivalent protection in all aspects of mortgage transactions covered by the rule. Otherwise litigation over a mortgage transaction could become overly complex, with some claims sent to arbitration and others allowed in court. This could wreak havoc on the discovery process and attempts to settle disputes.

3.2 Leases

3.2.1 We support the inclusion of automobile leases, § 1040.3(a)(2)

The proposed rule generally applies to pre-dispute arbitration agreements for automobile leases (as defined by 12 CFR § 1090.108), when they are consumer financial products or services. See proposed § 1040.3(a)(2). We support the rule's application to automobile leases. Automobiles are essential for many consumers and also generate a large number of consumer complaints and litigation. Much of that litigation is on a class basis.

According to Edmunds, in early 2016 leasing accounted for 32% of new retail vehicle sales, and Edmunds predicts this percentage will grow in the future.[86] Leasing is also most popular among the very young and the very old.[87] While leasing of used vehicles is not nearly as common as leasing of new vehicles, used car leasing's rate of growth is actually faster than for new vehicles.[88]

Leasing, being the functional equivalent of a purchase on credit, generates the same consumer abuses as a credit sale. In fact, abuses may be greater for leases. Leasing language is often unfamiliar (e.g. residual value or adjusted lease balance). Unlike Regulation Z, Regulation M places sharp restrictions on disclosure of an annual lease rate.[89] Consumers are often far more confused about the nature of a lease transaction than a credit sale. Consumers should have access to the courts when they are subject to unlawful practices in connection with automobile leases.

However, as discussed below, the rule should apply not just to automobile leases, but also to other type of vehicle leases and also to non-vehicle leases.

3.2.2 Expand the rule to cover non-automobile leases

While we support the rule's application to automobile leases, we are concerned that the proposed rule does not apply to other forms of consumer leases within the CFPB's authority. We suggest that the Bureau add a new subsection between §§ 1040.3(a)(2) and (a)(3) that provides:

> (2a) Extending leases as defined by 12 USC § 5481(15)(A)(ii) or brokering such leases;

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[86] http://static.ed.edmunds-media.com/unversioned/img/industry-center/analysis/h1-2016-lease-report.pdf

[87] Id.

[88] See http://www.autonews.com/article/20160416/RETAIL04/304189964/too-many-used-cars%3F-lease-them.

[89] 12 C.F.R. § 1013.4(s); see also 12 C.F.R. § 213.4(s).

A separate subsection is needed for non-automobile leases because the CFPB has broader authority over automobile leases than other forms of consumer leasing. The existing § 1040.3(a)(2) should be retained as is, to apply broadly to automobile leases as the CFPB has defined at 12 CFR § 1001. But the rule should also apply, in a separate subsection, to other consumer leases that fall within the CFPB's somewhat narrower authority for such other leases.

The CFPB has authority over non-automobile leases that fall within the definition found in Dodd-Frank Act, 12 USC § 5481(15)(A)(ii):

> **(ii)** extending or brokering leases of personal or real property that are the functional equivalent of purchase finance arrangements, if—
>
> **(I)** the lease is on a non-operating basis;
>
> **(II)** the initial term of the lease is at least 90 days; and
>
> **(III)** in the case of a lease involving real property, at the inception of the initial lease, the transaction is intended to result in ownership of the leased property to be transferred to the lessee, subject to standards prescribed by the Bureau.

Most non-automobile consumer leases fall within this definition. The Bureau itself has stated that this § 5481(15)(A)(ii) definition is not overly strict and that most consumer automobile leases—and thus by analogy other types of consumer leases that are similarly structured to automobile leases--fall within this standard:

> Having considered the comments discussed above, the Bureau adheres to its position in the proposal that it is reasonable, and best suited to the Bureau's purpose and objectives, to assess the functional equivalence requirement from the perspective of the consumer. For the reasons set forth in the proposal and relayed above, the Bureau believes that, from the consumer's perspective, *most automobile leases are therefore functionally equivalent to purchase finance arrangements*.[55] Accordingly, the Bureau believes that interpreting the phrase ''functional equivalent of purchase finance arrangements'' in section 1002(15)(A)(ii) from the perspective of the consumer to include most automobile leases is both a reasonable interpretation of the statutory language and the interpretation that best fulfills the relevant purposes of the Dodd-Frank Act. 80 Fed. Reg. 37503 (June 30, 2015) (emphasis added, footnote omitted)

Thus, the rule's omission of non-automobile leases from the proposed rule's coverage will exclude many consumer leases that are within the CFPB's authority under § 5481(15)(A)(ii). To the extent that they are structured similarly to the typical automobile lease, they too are the functional equivalent to a purchase finance arrangement.

This omission of non-automobile leases within the CFPB's authority has two consequences. First, many consumer leases found in the marketplace today will not be covered by the rule, even though there is the same potential for abuse for these leases as there is for automobile leases. Because Regulation M provides additional protections only for motor vehicle leases beyond that provided for other leases, there may be even greater potential for abuse among non-motor vehicle leases. See 12 CFR § 1013.4(f); see also 12 CFR § 213.4(f).

The other consequence of the proposed rule's narrow coverage only of automobile leases is just as serious. Excluding many forms of consumer leases also invites creditors to avoid the rule's coverage by restructuring as leases their purchase finance arrangements for non-automobiles.

While the lease will be the functional equivalent of a purchase finance arrangement, the lease will be outside the proposed arbitration rule's scope only because it does not involve an automobile. Congress was concerned with such evasion when it provided for the Bureau's authority under 12 USC § 5481(15)(A)(ii) to regulate credit transactions structured as leases. There is no reason for the proposed rule to offer such a loophole that Congress specifically set out to close.

3.2.3 Non-automobile leases needing protection: § 1040.3(a)(2)

Many motor vehicle leases are excluded from the rule's coverage because the proposed rule applies only to "automobile leases," and not more generally to motor vehicle leases. 12 CFR § 1090.108(a), *Automobile*, defines ''automobile'' to mean "any self-propelled vehicle primarily used for personal, family, or household purposes for on-road transportation. The term does not include motor homes, recreational vehicles (RVs), golf carts, and motor scooters."

Thus the proposed arbitration rule applies to passenger vehicles, but not to recreational vehicles, motor homes or other types of vehicles. These leases can be more expensive than automobile leases, and are at least if not more in need of the rule's protection.

In addition, there has been a dramatic increase recently in consumer leases of solar panels and extensive complaints of false claims as to the savings with such panels and the terms of the leases. There has also been an increase recently in abusive home mortgages structured as leases with an option to purchase. There have also been reports that such leases have particularly victimized low income and minority homeowners. Such leases to purchase homes deny the consumer of fundamental legal protections applicable to mortgages and typically result in the consumer forfeiting all equity if the consumer defaults.

Consumer leases of furniture, electronic gear, alarm systems, and other products are also found in the consumer marketplace. As the recent widespread use of solar panel leases indicates, it is also hard to predict what type of consumer leases will become prevalent in the future. Failing to extend the rule to the CFPB's full authority over all consumer leases will leave significant loopholes in the rule.

3.3 Financial advisory services: debt relief, credit repair, lead generators and financial apps, § 1040.3(a)(3)

Proposed § 1040.3(a)(3) applies the rule to various forms of debt relief, and we support that provision, as described at § 3.3.1, below. We also suggest that the rule be extended to apply to several other services within the CFPB's authority to regulate financial advisory services. Credit repair agencies, lead generators, and financial apps are not explicitly covered by the proposed rule. As discussed at §§ 3.3.2 – 3.3.4, below, these services have significant potential for abuse and it is important that the rule apply to them as it does to various forms of debt relief services.

3.3.1 Debt relief services

3.3.1.1 Broad coverage of debt relief services is appropriate

Proposed § 1040.3(a)(3) would apply the rule to "services to assist with debt management or debt settlement, [to] modify the terms of any extension of consumer credit . . ., or to avoid foreclosure . . . ." The breadth of paragraph (3) is appropriate given the nature of the services included. As explained by the Bureau, this provision "would reach . . . all types of consumer debts, whether arising from secured or unsecured consumer credit transactions, or consumer debts that do not arise from credit transactions."

We support the CFPB's decision to cover all forms of debt management or debt settlement and not solely those arising from credit. The common thread in all of these services is the promise to help a consumer resolve debt-related problems. These services take many forms including mortgage loan modification, student loan assistance, auto lease scams,[90] tax debt relief, debt elimination, debt adjustment, debt proration, debt management, debt settlement, and others.

Regardless of the source of the debt, whether secured or unsecured, the underlying claims that may lead to arbitration or litigation are similar: false advertising, damage to the consumer's credit, outrageous fees for services that are never delivered, violation of state and federal law regulating these services (particularly limits on charging upfront fees), and sometimes outright theft of funds. Although some service providers (legitimate or not) focus on specific types of debts or products, any attempt to limit the proposed rule to a segment of the debt relief market will encourage attempts to evade the rule and will lead to pointless hair-splitting over what services are covered.

Debt relief is one of the most abusive areas that the CFPB covers. The for-profit debt relief industry has been the subject of numerous enforcement actions over the years and an FTC rulemaking and yet continues to be a problem. For example, debt relief firms that target student loan borrowers are a huge problem.[91] Thus, permitting class actions in this area is critical.

We also particularly support the proposed rule's application to debt relief services that relate to debt not originated as credit. The FTC has raised the alarm about debt relief firms that claim to be able to reduce tax debts. The FTC has explained that "most taxpayers don't qualify for the programs these fraudsters hawk, their companies don't settle the tax debt, and in many cases don't even send the necessary paperwork to the IRS …."[92] Consumers have complained to the FTC that, "after signing up with some of these companies and paying thousands of dollars in upfront fees, the companies took even more of their money by making unauthorized charges to their credit cards or withdrawals from their bank accounts."[93]

Many debt relief firms also target medical debt.[94] While some medical debt may arise from credit that is within the proposed definition of credit, not all will. The CFPB has found that 19.5% of consumers have a credit report containing one or more collections trade lines that

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[90] National Consumer Law Center, Automobile Fraud § 1.3.8 (4th ed. 2011), updated at www.nclc.org/library ("A common scam is for a "broker" to prey on those who want to get out of their automobile lease or credit agreement by offering to sublease the car to another consumer who will make the payments.")

[91] Deanne Loonin, NCLC, "Searching for Relief: Desperate Borrowers and the Growing Student Loan 'Debt Relief' Industry" (June 2013), http://www.studentloanborrowerassistance.org/student-loan-debt-relief-industry-targets-desperate-borrowers/.

[92] http://www.consumer.ftc.gov/articles/0137-tax-relief-companies.

[93] Id.

[94] See, e.g.. https://clearoneadvantage.com/debt-FAQ.php - howitworks; http://www.trinitycredit.org/debt-counseling/debt-management-program/; http://www.solidgroundfinancial.org/index.html; http://www.greenpath.com/how-we-can-help/debt-management-plan; http://www.cambridge-credit.org/credit-counseling-faq.html.

originated with a medical provider.[95] If the arbitration rule is confined to credit transactions, debt relief firms may decide to specialize in medical debt or other types of debt (or use dba's or affiliates that appear to be doing only medical debt) in order to evade the rule. In addition, while the debt relief firms that target medical debt may also handle credit-related debt, the plaintiff in a class action may only have sought reduction of medical debt.

Debt relief companies also offer to settle many other accounts in collection regardless of the type of original debt.[96] Indeed, telecommunications and utility payments are one of the largest categories of debts under collection–the top two categories after medical debt.[97] Consumers could also seek out debt relief services to avoid debt collectors who are after them for debts owed to telecommunications services or utilities,[98] a bounced check or electronic payment, or fines owed to government agencies. Indeed, plaintiffs are currently fighting forced arbitration in a check collection lawsuit.[99]

TABLE 1: INCIDENCE OF COLLECTIONS TRADELINES

Collections tradeline type	Percentage of consumer credit reports containing one or more collections tradelines originating from…
Medical or health care	19.4%
Cable, cellular, wireless, other telecommunications	8.7%
Utilities or energy	7.6%
Retail collections	6.9%
Banking	2.7%
Financial	1.5%

Given the CFPB's broad authority over "financial advice services," "credit counseling," and debt settlement and management, the arbitration rule should include providers of debt relief services relating to all these types of debt.

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[95] CFPB, Consumer credit reports: A study of medial and non-medical collections at 18 (Dec. 2014) ("CFPB Collections Study"), http://files.consumerfinance.gov/f/201412_cfpb_reports_consumer-credit-medical-and-non-medical-collections.pdf.

[96] See, e.g., https://clearoneadvantage.com/debt-FAQ.php - howitworks (accounts with collection agencies); http://www.trinitycredit.org/debt-counseling/debt-management-program/ (same); http://www.solidgroundfinancial.org/index.html (utility bills); http://www.greenpath.com/how-we-can-help/debt-management-plan (collection agencies); http://www.cambridge-credit.org/credit-counseling-faq.html (past due balances on utility bills, student loans, collection accounts).

[97] CFPB Collections Study, supra, at 19.

[98] See, e.g., http://www.solidgroundfinancial.org/index.html (utility bills); http://www.cambridge-credit.org/credit-counseling-faq.html (past due balances on utility bills).

[99] See § 3.9, below.

3.3.1.2 Debt relief should not be limited to the FTC's TSR rule; that rule should be an example in the comments

Although the FTC's Telemarketing Sales Rule (TSR) includes a broad definition of "debt relief service," we agree that the proposed arbitration rule's definition should not cross-reference the TSR definition. The Bureau's authority over debt relief services is broad enough to include everything within the scope of the TSR's definition and goes beyond the limitations imposed by the definition of telemarketing within the FTC's jurisdiction.

The CFPB appropriately is not limiting the rule to debt relief services provided by way of telemarketing, nor is it exempting those provided in face-to-face meetings.[100] The FTC adopted its narrower definition of debt relief services pursuant to its authority to regulate telemarketing, so it was limited in a way that the CFPB is not. Debt relief services have at times been conducted over the internet, or the provider arranges for a brief face-to-face contact with an agent in order to avoid the TSR.

For example, the FTC is currently pursuing an enforcement action against the American Bill Pay Organization and the American Benefits Foundation arising out of debt relief conduct over the internet.[101] The case alleges that, through emails and their website, the defendants falsely claimed affiliation with the federal government, made numerous false promises, and obtained payments from consumers without paying consumers' credit or improving their debt. The case was brought under the FTC Act and Credit Repair Organization Act but not the TSR rule.

Consumers seeking debt relief may first interact online with a lead generator. Although lead generators may encourage telephone calls, they also encourage consumers to submit information and email contacts online, and may sell that information without ever using a telephone. Thus, the lead generator's role in defrauding consumers, violating their privacy or compromising their sensitive personal information may not be considered "telemarketing" within the scope of the TSR.

While we thus support not incorporating the TSR definition into the proposed rule, the rule's Comments should make clear that all TSR products are covered. Comment 3(a)(3) should state that the products and services within the scope of the TSR's definition are just one example of what the rule covers. That comment should also list products and services covered by the Mortgage Assistance Relief Services Rule as another example of the arbitration rule's scope.

3.3.2 Credit repair should be covered

We strongly urge the Bureau to add credit repair services to the scope of the proposed rule. Some credit repair services may be encompassed within the debt management or debt settlement services covered under proposed § 1040.3(a)(3) Some may also be within proposed § 1040.3(a)(4) if they provide information specific to a consumer from a consumer report. However, it is not clear whether the proposed arbitration rule applies to services that purport to help consumers improve their credit scores or credit reports without managing their debt or providing information. These credit repair services are almost invariably scams and the rule should explicitly cover these services.

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[100] 12 C.F.R. § 310.6(3) (exempting calls where the sale "is not completed, and payment or authorization of payment is not required, until after a face-to-face sales or donation presentation"). We understand that many debt relief firms incorporate some face-to-face contact in an attempt to evade the debt relief rules.

[101] https://www.ftc.gov/system/files/documents/cases/150211americanbillcmpt.pdf.

Credit repair is within the CFPB's authority over "financial advisory services . . . to consumers on individual financial matters."[102] The CFPB can rely on the established definition of "credit repair organization"[103] in the Credit Repair Organizations Act to add specificity to the credit repair services that would be subject to the arbitration rule.

There have been substantial abuses in the credit repair area, and these providers have used arbitration clauses that hinder consumers from seeking relief. Various scams that claim to be able to improve consumer's credit reports or credit scores have frequently harmed consumers.[104] Credit bureaus have also had trouble with scammers who generate bogus disputes.[105]

Despite explicit provisions in CROA that require notice to consumers that "You have a right to sue" and that prohibit waiver of CROA rights,[106] the Supreme Court has held that credit repair organizations may insert forced arbitration clauses in their contracts.[107] This ruling not only prevents victims of credit repair scams from going to court, but the decision also results in contradictory disclosures to consumers. The contract with an arbitration clause both provide that you have a right to sue and also that you cannot bring a court action. Thus, restoring the right to sue is particularly important for credit repair services.

While the FTC has generally been active on credit repair issues, the CFPB rule should not ignore this area. The FTC has limited enforcement resources and cannot go after every rogue credit repair outfit. Private enforcement is a key adjunct to government enforcement in this area as in many others – especially in light of the pains that Congress took when passing CROA to emphasize the right for credit repair victims to sue on their own.

3.3.3 All lead generators should be covered

3.3.3.1 Introduction

The proposed rule nowhere discusses lead generators. Lead generators often play a critical role in harmful financial products and services as well as in outright scams. They can steer consumers to predatory products, engage in their own deceptive conduct, or disclose consumers' sensitive personal financial information to third parties that can misuse it. Lead generators often use forced arbitration clauses.

The word "lead generator" appears only once in the CFPB's entire discussion of the proposed rule and nowhere in the actual rule or comments. The only mention of lead generators is in the discussion of small entities that are covered, buried in a paragraph about mortgage referral

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[102] 12 U.S.C. § 5481(15)(A)(vii).

[103] 15 U.S.C. § 1679a(3).

[104] See, e.g., FTC v. La Trese & Kevin Enterprises Inc., No. 308-CV-1001-J-34JRK (M.D. Fla. Nov. 30, 2012) (credit repair provider held in contempt for violating previous order to stop promoting bogus credit repair products and services); FTC v. Payneless Credit Repair, LLC, No. 3-08-cv-1160-M (N. D. Tex. Dec. 23, 2008) (stipulated final judgment against credit repair company that lured consumers with false claims for credit repair services and required advance payment ranging from $500 to $2,500)

[105] See, e.g., FTC, Credit Repair Scams, http://www.consumer.ftc.gov/articles/0225-credit-repair-scams; FTC, Press Release, "Court Order Bars Credit Repair Company from Misleading Credit Bureaus, Charging Consumers Up-Front Fees for Its Services" (June 18, 2014), https://www.ftc.gov/news-events/press-releases/2014/06/court-order-bars-credit-repair-company-misleading-credit-bureaus.

[106] 15 U.S.C. §§ 1679c(a), 1679f(a).

[107] Greenwood v. CompuCredit Corp., 132 S.Ct. 665 (2012).

providers. That passage notes: “With respect to brokering of credit more broadly, the Bureau also believes that some credit lead generators may be primarily engaged in the business of brokering and would be affected by the rule.”[108] That passage is likely to be overlooked by courts and others considering whether the proposed rule covers lead generators.

3.3.3.2 Proposed language covering lead generators

The rule should include lead generators as its own category of service when leads are provided in connection with a product or service otherwise covered in the rule. The simplest and most effective way to cover lead generators is through a separate category for entities that broker, refer consumers, or provide advice on selecting the other covered financial products or services.

This is a superior approach than adding lead generators in each provision setting out a category of providers that is covered by the rule. That way, the CFPB does not need to repeat that coverage under each of the other provisions.

The CFPB has broad authority over lead generators under its authority over “financial advisory services … to consumers on individual financial matters.” Any entity that collects information on individuals in order to provide advice or referrals in connection with a financial product or service is within this provision. To avoid over-coverage, the CFPB could limit coverage to companies that collect data from consumers and receive compensation from the providers of the other products (other than simply for advertisements).

In addition, the CFPB should clarify that several of the categories of products and services include lead generators. This clarification is needed in addition to direct coverage of lead generators that provide financial advisory services because it is possible that some lead generators do not provide advice directly to consumers but do collect consumer information on prospective applicants and provide it to other companies.

Lead generators that refer consumers to credit products should already be covered by proposed § 1040.3(a)(1)(iii). That provision covers acting “as a person’s primary business activity, as a ‘creditor’ as defined by 12 CFR 1002.2(l) by ‘refer[ring] applicants or prospective applicants to creditors, or select[ing] or offer[ing] to select creditors to whom requests for credit may be made” consistent with its meaning in 12 CFR 1002.2(l).’” While the language should plainly reach credit lead generation, it may not be obvious to all that a lead generator is a “creditor.” Thus, a comment to this section should explicitly use the term “lead generator” to make clear that they are covered by this section.

The fact that the coverage of automobile leases includes lead generators should also be made explicit. One lead generator, for example, NewCar-Leases.com, collects sensitive information such as credit reports and age, occupation, income, social security number and other credit related data. A comment should make clear that “brokering” automobile leases covers lead generators as well as other brokers.

Similarly, the coverage in proposed § 1040.3(a)(3) of companies that provide “services to assist with” debt management, debt settlement, loan modifications or foreclosure should cover lead generators. Lead generators claim to “assist” consumers in resolving debt even if they do so by referrals and not by providing services directly. Given the widespread harm of caused by debt relief companies, those that provide leads to these predatory products must be covered by the

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[108] 81 Fed. Reg. 32830 at 32917 (May 24, 2016).

proposed rule. Here again, the CFPB should add a comment making clear that lead generators are covered.

As discussed in § 3.3.2, above, credit repair services should be covered by the proposed rule. That coverage should extend to lead generators who steer consumers to problematic services. Like the credit repair firms themselves, these types of lead generators should be considered as providing "financial advisory services" within the CFPB's jurisdiction because they are advising consumers on companies that can purportedly repair their credit.

The coverage of accounts under TISA and the EFTA (proposed §§ 1040.3(a)(5) and (6)) should be expanded or clarified to cover lead generators that broker, refer or advise consumers on those accounts. The CFPB could clarify that "providing" includes lead generation; could add the words "refer" or "broker" to these provisions, or – the best option – could cover these lead generators though its power over financial advisory service, as discussed above.

3.3.4 Include mobile and online financial advisory apps and services using consumer data

One area of CFPB authority that is omitted from the proposed rule is financial advisory services. While we are not urging that all financial advisory services be covered, we do believe that the rule should cover mobile and online personal finance management and aggregator services like Mint, Level Money, Digit and Credit Karma.

Some of these should already be covered under proposed § 1040.3(a)(8) to the extent that they do payments processing. As discussed below, the coverage of financial data processing should also cover services that can transfer funds between accounts (which might not be viewed as "payments").

In addition, these personal finance management services should also be covered if they obtain direct access to consumers' financial accounts for the purposes of providing advice, making recommendations or providing other services beyond moving money. The CFPB has authority over these services both through its authority over financial advisory services and also its authority over the "financial data processing products or services" and "storing of financial or banking data for any payment instrument" (even if no payment is actually processed).

These services include forced arbitration clauses and class action bans in their agreements. Consumers also face perils with these services. Many require consumers to turn over their passwords and login information for their bank and credit card accounts. If the data is held in an unsecure fashion, it could be vulnerable to identity theft and unauthorized charges. Consumers also may find that their sensitive personal financial data is shared with third parties in ways that consumers do not anticipate and would not have authorized.

Covering these types of personal finance services is especially important given the position that some financial institutions are taking, claiming that consumers lose their Regulation E rights when they use these services. Chase, for example, claims that consumers have no right to challenge an unauthorized charge against their account if it occurs as a result of a data breach at Mint or a similar service. While this is an unfounded view of Regulation E, consumers could be caught in the middle if a data breach exposed the bank account data of thousands or millions of consumers and their banks refused to help. Suing the aggregator might be consumer's only recourse to sort out who is responsible.

The proposed rule should cover any provider that obtains access to consumers' financial or banking data and provides financial management or advisory products or services.

3.4 Credit reporting, 1040.3(a)(4)

3.4.1 We support coverage of services providing credit reports, credit scores and credit monitoring

Proposed § 1040.3(a)(4) covers a range of consumer report-related products that are provided directly to consumers, such as consumer reports, credit scores and credit monitoring, in. We strongly support this scope of coverage, although we believe the language of the proposal needs to be modified, as discussed in the next section. There have been numerous problems with these consumer report-related products, most particularly with respect to credit monitoring.

The nationwide consumer reporting agencies (CRAs) and a number of other companies offer expensive subscriptions for credit monitoring, as well as "educational" credit scores, "three-in-one" reports and other paid products. Visitors to the nationwide CRAs' websites may even have difficulty finding how to order their free FCRA-mandated annual file disclosures, because these websites so heavily promote the paid products. Settlements between the state Attorneys General and the nationwide CRAs appear to indicate that the nationwide CRAs go so far as to promote paid products when a consumer calls them with a dispute.[109]

Because of this heavy promotion, more consumers pay for their reports than receive them for free. CFPB data reveals that 15.9 million consumers obtained free annual credit reports through the official centralized source, but 26 million obtained them through various credit monitoring services.[110] These products generate more than $1 billion in revenue for the nationwide CRAs, making up roughly a quarter of their U.S. revenue.[111] In addition to direct-to-consumer sales, some of the nationwide CRAs sell these services at wholesale to other businesses, such as financial institutions, which then offer the services to their customers under the financial institution's brand name.[112]

The manner in which these credit monitoring products are sold is questionable at best, and deceptive at worst. The nationwide CRAs and other sellers offer "free" credit reports or credit scores that are really introductory teasers that convert to a paid subscription. The FTC took action against Experian as early as 2005 for this type of marketing.[113] In addition, the CFPB has taken enforcement actions against most of the major credit card issuers over deceptive marketing of credit monitoring and identity theft prevention products.[114] In addition to deceptive marketing, consumers have reported difficulties in canceling the service or getting refunds.[115]

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[109] See Assurance of Voluntary Compliance/Assurance of Voluntary Discontinuance, In the Matter of Equifax Info. Serv. LLC, Experian Info. Sol., Inc., and TransUnion LLC, § IV (G) (May 20, 2015). As part of this settlement, the nationwide CRAs have agreed to at least wait until the dispute portion of the telephone call is over before engaging in such marketing

110 Consumer Fin. Prot. Bureau, Key Dimensions and Processes in the U.S. Credit Reporting System: A review of how the nation's largest credit bureaus manage consumer data 27 (2012).

111 Consumer Fin. Prot. Bureau, The Impact of Differences Between Consumer- and Creditor-Purchased Credit Scores: Report to Congress 9 (2011).

112 Id. at 10.

113 FTC v. Consumerinfo.com, Inc., SACV05-801 AHS(MLGx) (C.D. Cal. Aug. 15, 2005) (stipulated final judgment and order for permanent injunction).

[114] See In the Matter of: Citibank, N.A.; Department Stores National Bank; and Citicorp Credit Services, Inc. (USA)., Administrative Proceeding File No. 2015-CFPB-0015 (CFPB July 21, 2015); In the Matter

Also potentially deceptive is credit monitoring services providing consumers with “educational” credit scores, which are not generally used by lenders and which 20% of the time are meaningfully different from the scores that lenders do use (FICO scores).[116] The recent decision in Sgouros v. TransUnion Corp.[117] specifically involved FCRA and state law UDAP claims over the fact that an educational score sold by TransUnion was 100 points higher than the actual score used by an auto lender.

Another problem is that credit monitoring services are often marketed as a way to prevent identity theft, yet they are ineffective in detecting certain forms of identity theft, such as when a thief uses the consumer’s Social Security number, but not the consumer’s name, to obtain credit.[118] Credit monitoring is absolutely useless when the breach involves theft of existing credit or debit card information. Furthermore, a security freeze is much more effective, since it actually prevents identity theft instead of merely telling the consumer about it after the fact.

All of the nationwide CRAs (or more accurate their subsidiaries, as discussed in the next section) include mandatory arbitration clauses in their credit monitoring products agreements. The terms and conditions from Experian’s subsidiary that provides direct-to-consumer products, consumerinfo.com (CIC), aka Experian Consumer Services (ECS), state:

> ECS and you agree to arbitrate all disputes and claims between us arising out of this Agreement directly related to the Services or Websites, except any disputes or claims which under governing law are not subject to arbitration. This agreement to arbitrate is intended to be broadly interpreted and to make all disputes and claims between us directly relating to the provision of any Service and/or your use of any Website subject to arbitration to the fullest extent permitted by law.[119]

Equifax has a very broad umbrella mandatory arbitration provision that states:

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of: U.S. Bank N.A., Administrative Proceeding File No. 2014-CFPB-0013 (CFPB Sept. 25, 2014); Consent Order, In re Bank of Am., Administrative Proceeding File No. 2014-CFPB-0004 (CFPB Apr. 9, 2014); Consent Order, In re JPMorgan Chase Bank, Administrative Proceeding File No. 2013-CFPB-0007 (CFPB Sept. 18, 2013); Stipulation and Consent Order, In re Capital One Bank, Admin. Proc. File No. 2012-CFPB-0001 (CFPB July 17, 2012); Joint Consent Order, Order for Restitution, and Order to Pay Civil Money Penalty, In re Discover Bank, Greenwood, DE, Docket Nos. FDIC-11-548b, FDIC-11-551k, and 2012-CFPB-0005 (FDIC/CFPB Sept. 24, 2012).

115 Ron Lieber, Cutting Off Those Recurring Charges You Forgot About, N.Y. Times, Jan. 29, 2016 (noting that the #1 recurring charge that consumers want off their credit and debit card accounts originate from Experian); Stacey L. Bradford, FreeCreditReport.com: Not So Free—Still, SmartMoney.com, Dec. 5, 2008.

116 Consumer Fin. Prot. Bureau, Analysis of Differences Between Consumer- and Creditor-Purchased Credit Scores 4 (2012).

117 817 F.3d 1029 (7th Cir. 2016).

118 See, e.g., Millett v. TrueLink, Inc., 533 F. Supp. 2d 479 (D. Del. 2008) (lawsuit against credit monitoring service that failed to prevent identity theft; dismissal of UDAP and contract claims).

119 ECS Terms of Use Agreement, revised April 5, 2016, at https://usa.experian.com/login/#/index?c=22&p=%2FtermsAndConditions (viewed July 20, 2016).

> THIS PRODUCT AGREEMENT AND TERMS OF USE ("AGREEMENT") CONTAINS THE TERMS AND CONDITIONS UPON WHICH YOU MAY PURCHASE AND USE OUR PRODUCTS THROUGH THE WWW.EQUIFAX.COM, WWW.IDENTITYPROTECTION.COM AND WWW.IDPROTECTION.COM WEBSITES AND ALL OTHER WEBSITES OWNED AND OPERATED BY EQUIFAX AND ITS AFFILIATES ("SITE"). YOU MUST SCROLL DOWN, READ AND ACCEPT THE TERMS OF THIS AGREEMENT, INCLUDING THE ARBITRATION AGREEMENT CONTAINED IN SECTION 35 BELOW, BEFORE YOU WILL BE PERMITTED TO REGISTER FOR AND PURCHASE ANY PRODUCT FROM THIS SITE. BY REGISTERING ON THIS SITE AND SUBMITTING YOUR ORDER, YOU ARE ACKNOWLEDGING ELECTRONIC RECEIPT OF, AND YOUR AGREEMENT TO BE BOUND BY, THIS AGREEMENT.[120]

TransUnion's subsidiary TUI also imposes an arbitration provision. In fact, the Sgouros decision specifically involved an attempt by TransUnion to enforce an arbitration provision that originated from its subsidiary TUI. In Sgorous, the consumer avoided arbitration only because TUI did not adequately highlight the arbitration provision through its website click wrap.[121]

Accordingly, preserving consumers' access to the courts when CRAs violate the law in connection with products that contain consumer report-related information is critical.

3.4.2 Revisions are needed to effectively cover credit monitoring and credit file information provided consumers

The CFPB has expressed its belief that the proposed rule should cover a range of consumer report-related products, such as credit scores and credit monitoring. However, the proposed § 1040.3(a)(4) language is seriously deficient if it is to cover all of these products and services, because it references a FCRA definition for consumer report that has narrowly interpreted by the courts.

That proposed subsection provides:

> (4) Providing directly to a consumer a consumer report as defined by the Fair Credit Reporting Act, 15 U.S.C. 1681a(d), a credit score, or other information specific to a consumer from such a consumer report, except [in connection with an adverse action notice not related to a financial product or service];

There are two major problems with this description. First, many federal courts (with the notable exception of the Ninth Circuit) have held that a "consumer report" under § 1681a(d) is limited to a disclosure provided to a third party.[122] In contrast, a communication provided to a consumer is a "consumer file disclosure" under 15 U.S.C. § 1681g(1). Thus, defining the scope of covered product or services as a "consumer report" under § 1681a(d) could exclude "consumer file

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[120] https://help.equifax.com/app/answers/detail/a_id/28 (viewed July 20, 2016).

[121] 817 F.3d 1029 (7th Cir. 2016).

[122] See, e.g., Collins v. Experian Info. Solutions, Inc., 775 F.3d 1330 (11th Cir. 2015), on petition for rehearing, Collins v. Equable Ascent Financial, LLC,781 F.3d 1270 (11th Cir. March 19, 2015); Brown v. Wal-Mart Stores, Inc., 507 Fed. Appx. 543 (6th Cir. 2012) (unpublished); Cousin v. Trans Union Corp., 246 F.3d 359 (5th Cir. 2001). See generally National Consumer Law Center, Fair Credit Reporting §§ 2.3.1.2 and 4.4.3 (8th ed. 2013), updated at www.nclc.org/library

disclosures" provided directly to consumers. This would leave consumers unprotected when they obtain what is commonly referred to as a "credit report" from a CRA.

The second major problem with the scope of proposed § 1040.3(a)(4) is that it probably excludes credit monitoring products. Just this past March, the Sixth Circuit held in Miller v. Trans Union, 2016 WL 1055869 (6th Cir. Mar. 16, 2016), that TransUnion Interactive (TUI), the credit monitoring subsidiary of Trans Union, is not a "a consumer reporting agency" under FCRA § 1681a(f). As a result, the Sixth Circuit held that the report sold by TUI was not a "consumer report" under § 1681a(d), nor was it a consumer disclosure under § 1681g – leaving it completely ungoverned and unprotected by the FCRA.

Because of the Miller decision, proposed § 1040.3(4)(a) could be completely ineffective in preventing the application of arbitration clauses to credit monitoring products. As the Miller case shows, the nationwide CRAs have set up their credit monitoring products to be sold through entirely separate business entities. If a consumer attempts to obtain her annual free file disclosure from TransUnion, as Ms. Miller did, there is a good chance she will mistakenly end up with a "credit monitoring report" from TUI. Similarly, a consumer attempting to obtain her free annual file disclosure from Experian might end up with a product from its subsidiary consumerinfo.com (CIC) aka Experian Consumer Services (ECS). As discussed in 4.4.1 above, all of these "non-CRA" entities include mandatory arbitration clauses in their agreements.

Furthermore, the fact that proposed § 1040.3(a)(4) also covers "other information specific to a consumer from such a consumer report" would not prevent this serious gap in coverage, because it too depends on the concept of a "consumer report." A provider could easily argue that its "credit monitoring report" did not originate from a "consumer report" because either the information originated from a source that was not provided to a third party or it did not originate from a "consumer reporting agency" per the Miller decision.

To avoid all of these gaps in coverage, we urge a few simple changes to proposed § 1040.3(a)(4) to include the concept of "consumer file" and "affiliate." Even if the CFPB decides to keep the scope of this provision narrow (which we disagree with, as discussed below), the provision should be revised to read:

> (4) Providing directly to a consumer a consumer report as defined by the Fair Credit Reporting Act, 15 U.S.C. 1681a(d), a consumer file disclosure or any other disclosure required under 15 U.S.C. § 1681g, a credit score, or other information specific to a consumer from a consumer's file at a consumer reporting agency or its affiliate ~~such a consumer report~~, except when such consumer report or consumer file information is provided [in connection with an adverse action notice not related to a financial product or service];

We note that there is a strong precedent for the use of the "consumer file" concept in the FCRA itself, in that § 1681i(a)(1)(A) specifically gives the consumer the right to dispute "the completeness or accuracy of any item of information contained in a consumer's file at a consumer reporting agency…"

The CFPB has noted that "[t]o the extent a future Bureau regulation were to further interpret the definition of consumer report under 15 U.S.C. 1681a(d), or other terms incorporated into that definition such as a consumer reporting agency, 15 U.S.C. 1681a(f), the definition in the implementing regulation would be used, in conjunction with the statute, to define this component of coverage of this proposed rule."[123] Thus, in addition to the above suggestion, we urge the

[123] 81 Fed. Reg. at 32,975, n. 465.

CFPB to engage in an FCRA rulemaking that would define "consumer report" to cover credit monitoring products and "consumer reporting agency" to cover the subsidiaries of the nationwide CRAs that provide such products.

3.4.3 Investigations and other CRA activities should be covered

The CPFB has asked for comment on whether the proposed § 1040.3(a)(4) should cover a broader range of activities undertaken by a CRA, including the conduct of dispute investigations as required by § 1681i(a).[124] We think it is critically important that the proposed rule cover dispute investigations.

The failure of CRAs to conduct reasonable investigations of disputes in compliance with the FCRA is well-documented.[125] The proposed rule needs to protect consumers in the situation where a CRA engages in its usual practice of conducting perfunctory, unreasonable investigations in violation of § 1681i(a)(1). There have been class actions filed under § 1681i(a), including White v. Trans Union[126] that resulted in a strong settlement injunction that forced the nationwide CRAs to improve their reporting of post-bankruptcy accounts.[127]

Practitioners have reported the presence of arbitration clauses when consumers submit disputes online. And as discussed in § 3.4.1, above, Equifax has a very broad umbrella mandatory arbitration provision that covers any "purchase or use" of products through, inter alia, www.equifax .com. While a dispute would not be a "purchase" for purposes of this arbitration provision, it could be a "use".

Furthermore, until recently, the arbitration provision in the CIC/ECS credit monitoring agreements also covered disputes under the FCRA. This is the version of the CIC arbitration provision in its Terms and Conditions dated April 5, 2013, which is still available on the Internet:

> YOU UNDERSTAND AND AGREE THAT **ALL CLAIMS, DISPUTES OR CONTROVERSIES** BETWEEN YOU AND CIC, AND ITS **PARENT, AFFILIATES, SUBSIDIARIES OR RELATED COMPANIES**, INCLUDING BUT NOT LIMITED TO TORT AND CONTRACT CLAIMS, **CLAIMS BASED UPON ANY FEDERAL, STATE OR LOCAL STATUTE, LAW, ORDER, ORDINANCE OR REGULATION**, AND THE ISSUE OF ARBITRABILITY, SHALL BE RESOLVED BY FINAL AND BINDING ARBITRATION….[128]

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[124] The Bureau has noted that proposed § 1040.3(a)(4) would cover the CRA's transmission of the results of a reinvestigation to the consumer pursuant § 1681i(a)(6) of the FCRA. However, this does not cover the conduct of the investigation itself.

[125] See generally National Consumer Law Center, Fair Credit Reporting § 4.5.6 (8th ed. 2013), updated at www.nclc.org/library; Chi Chi Wu et al., National Consumer Law Center, Automated Injustice: How a Mechanized Dispute System Frustrates Consumers Seeking to Fix Errors in Their Credit Reports (2009).

[126] 462 F. Supp. 2d 1079, 1082 (C.D. Cal. 2006)

[127] See National Consumer Law Center, Fair Credit Reporting § 4.4.6.10.2.4 (8th ed. 2013), updated at www.nclc.org/library (describing White settlement). Other examples include Williams v. LexisNexis Risk Mgmt. Inc., 2007 WL 2439463 (E.D. Va. Aug. 23, 2007)(certifying a more limited class under 1681i(a)) and Geter v. ADP Screening & Selection Servs., Inc., 2015 WL 1867041 (D.N.J. Apr. 23, 2015).

[128] https://www.creditexpert.com/Message.aspx?PageTypeID=TermsConditions (dated April 5, 2013; viewed July 20, 2016).

CIC/ECS has since issued a new Terms and Conditions dated April 5, 2016 that excludes disputes under the FCRA from the arbitration provision. However, there is nothing to prevent CIC/ECS from revising these Terms and Conditions to once again to include FCRA disputes.

Finally, we strongly urge the CFPB to cover other activities required of CRAs by the FCRA or state law. Most importantly, proposed 1040.3(a)(4) should cover the CRA's duty to follow reasonable procedures to ensure the maximum possible accuracy of information as required by FCRA § 1681e(b). This is one of the most critical duties of a CRA under the FCRA, and the failure to comply can lead to widespread inaccuracy problems that are amenable to being addressed by class claims.

Additionally, we urge the CFPB to include in the proposed rule coverage of the following duties:

- opting consumers out of information sharing, as required by FCRA § 1681e(3);
- placing a fraud alert on a consumer's credit report, as required by FCRA § 1681c-1;
- blocking information resulting from identity theft as required by FCRA § 1681c-2;
- removing obsolete information as required by FCRA § 1681c(a); and
- placing a security freeze on a consumer's credit report, as required by state laws.

There is no reason not to cover the broad range of credit reporting activities that could violate the law.

3.4.4 Identity theft prevention products should be covered

The CFPB has asked whether the proposed rule also should cover products and services that provide or monitor information obtained from sources other than a consumer report, for example as part of a broader suite of identity theft prevention services. We strongly believe that these services should be covered.

The nationwide CRAs as well as other companies will offer identity theft prevention products that purport to monitor a multitude of information in addition to consumer credit file information. Some of these claimed services include:

- Equifax WebDetect claims to "proactively scans suspected underground Internet trading sites for your Social Security number (if you choose) and up to 10 credit/debit card account numbers you provide."[129]
- TrustedID claims they offer "scanning black market sites for stolen information."[130]
- LifeLock claims that it "uses advanced technology to constantly monitor over a trillion data points to help detect suspicious uses of your identity information to get loans, credit and services in your name."[131]

These activities directly relate to services offered to protect a consumer's financial assets or reputation. If the service monitors consumer file information (as well as other information), then it should be covered by the language we have proposed in the previous section concerning the activities of CRAs and their affiliates.

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[129] http://www.equifax.com/howto/webdetect/

[130] https://www.trustedid.com/

[131] https://www.lifelock.com/how-it-works/how-we-protect-you/ (viewed July 22, 2016).

If the service involves information monitoring that does not come from a CRA but involves access to a consumer's financial or banking data, then the service is within the CFPB's authority over "financial advisory services … to consumers on individual financial matters." These services are effectively a form of financial advisory services, which we discuss in section 3.3, above.

3.4.5 Furnishing information to a CRA should be separately considered a covered product or service

The CFPB has asked for comment as to whether the furnishing of information to a consumer reporting agency (CRA) by any person covered by proposed § 1040.3(a)(1) should also be separately identified as a covered product or service. The answer to this question should be an unequivocal "yes." In addition, the Bureau should go further than just covering the furnishing of information regarding credit or credit servicing under proposed § 1040.3(a)(1) and should cover the furnishing of information to a CRA regarding *any* product or service within the scope of proposed § 1040.3(a).

As the CFPB notes, furnishing of information is a common activity performed by creditors and credit servicers. It can have a very significant impact on the financial lives of consumers. Inaccurate negative information from a furnisher, such as incorrectly attributing a defaulted account to a consumer,[132] can cut off a consumer's access to credit or force him to pay much more – not to mention the impact on access to insurance, employment, and other financial necessities.

Thus, leaving out furnishing of information would exclude an activity that can have a critical (and devastating) impact on consumers. Consumer advocates have consistently advocated for scrutiny of furnishing activities.[133]

Moreover, forced arbitration clauses have impeded courts from addressing problems related to furnishing. To the extent that defendants have sought to compel arbitration in FCRA cases, about half of such cases involve furnishers of information.[134]

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[132] For a discussion of inaccuracies caused by furnishers, see National Consumer Law Center, Fair Credit Reporting § 4.3.2 (8th ed. 2013), updated at www.nclc.org/library

[133] See, e.g., Comments of National Consumer Law Center On Defining Larger Participants in Certain Consumer Financial Product and Service Markets (Debt Collection and Consumer Reporting), April 17, 2012, available at http://www.nclc.org/images/pdf/rulemaking/nclc_larger_participant_debt_collector_april2012.pdf (opposing the exception for furnishers from the definition of consumer reporting at 12 C.F.R. § 1090.104(a)).

[134] For example, from June 2015 to July 2016, a Westlaw search reveals approximately twenty FCRA cases involving arbitration. Of those, about ten involved claims against furnishers of information. Some of these cases include Malik v. Equifax Info. Servs., LLC, 2016 WL 3900829 (E.D. Mich. July 19, 2016)(compelling arbitration of FCRA claim against rent-to-own company); Bey v. Midland Credit Mgmt., Inc., 2016 WL 1226648, (D. Md. Mar. 23, 2016)(compelling arbitration of FCRA, FDCPA and state law claims against debt buyer); Newell v. Am. Ins. Administrators, LLC, 2016 WL 627357 (W.D. Va. Feb. 16, 2016); Roach v. Navient Sols., Inc., --- F. Supp.3d ---, 2015 WL 8479195 (D. Md. Dec. 10, 2015) (compelling arbitration of FCRA and TCPA claims against student loan lender); Yaroma v. Cashcall, Inc., 130 F. Supp. 3d 1055 (E.D. Ky. 2015)(FCRA and FDCPA claims against payday lender were subject to arbitration; dismissing case);

There is no reason to omit furnishing activities by entities that are within the CFPB's jurisdiction and that will already be covered by the proposed rule. As the Bureau has noted, the furnishing of information to a CRA is governed by the Fair Credit Reporting Act (FCRA), 15 U.S.C. 1681s-2, which is one of the statutes over which the CFPB has primary rulemaking authority. See id. § 1681s(e). Thus, it would be entirely appropriate for the CFPB to cover the furnishing of information about covered products or services that are already within the scope of the proposed rule.

Failure to cover furnishing would leave consumers vulnerable, because the protections of proposed § 1040.3(a) only apply to an aspect of a class action that relates to a consumer financial product or service covered by proposed § 1040.3(a). Thus, if furnishing is not covered, the proposed rule would prevent a creditor from compelling arbitration of a class action under the Truth in Lending Act (e.g. a claim that the creditor sent unsolicited credit cards in violation 15 U.S.C. § 1642), but the creditor could freely compel arbitration or prevent a class action over its failure to comply with § 1681s-2(b) of the FCRA when consumers disputed with a CRA to remove inaccurate information regarding the same conduct (e.g., that the CRA should remove the tradeline for that unsolicited credit card account).[135]

Furthermore, designating the furnishing of information about credit does not go far enough. Any information that is provided to a CRA in connection with an entity and a product or service within the scope of proposed § 1040.3(a) should be covered.

Many other types of information furnished to CRAs can impact consumers and their consumer reports. For example, many providers of deposit accounts furnish information to specialty CRAs, such as ChexSystems and Early Warning Services. Debt collectors are a major category of furnishers, as discussed in § 3.10.3, below, and yet some of the debt may not involve credit. Check cashers sometimes report to specialty subprime CRAs such as Clarity.[136]

Furnishing of information related to each of these products or services should be designated a covered product or service. Otherwise, consumers will be left unprotected from the consumer reporting consequences of unlawful behavior involving deposit accounts, check cashing, etc.

For example, if furnishing is not covered under the proposed rule, a bank could not compel arbitration of a claim that it imposed overdraft fees for one-time debit card transactions without consent in violation of Regulation E, 12 C.F.R. § 1005.17, but it could prevent a class action over its failure to comply with FCRA § 1681s-2(b) when consumers disputed with ChexSystems over those same overdraft fees.

There is simply no reason to narrow the category of furnishing activity that will be covered by this rule. Once the entity and its products or services are covered by the rule, there is no additional burden in applying the rule to all activities in connection with those products or services. Indeed, to leave out furnishing would encourage providers to develop complicated arbitration clauses that segregate their activities in ways that present the problems described in § 6.1.2, below.

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[135] For an example of an FCRA class action against a furnisher, see Shaw v. Experian Info. Sols., Inc., 49 F. Supp. 3d 702 (S.D. Cal. 2014).

[136] Clarity states that its data sources include "a variety of financial service providers, including auto financers, check cashers, prepaid card issuers, short-term installment lenders, peer-to-peer micro lenders, small dollar credit lenders, online small dollar credit lenders, telecommunications, and many more…" About Clarity, https://www.clarityservices.com/history/ (viewed July 20, 2016).

3.5 Deposit and share accounts, § 1040.3(a)(5)

Proposed § 1040.3(a)(5) covers deposit and share accounts as defined by the Truth in Savings Act (TISA) and its implementing regulations governing credit union share accounts, 12 C.F.R. part 707, and Regulation DD, 12 C.F.R. part 1030. We support the inclusion of these accounts in the proposed rule.

Unlawful practices involving overdraft fees on bank accounts have been among the most important class actions in recent years. It is also an area where the claim suppression impact of a forced arbitration clause is most apparent. Many banks have become part of the Multi-District Litigation involving overdraft fees and have paid hundreds of millions of dollars to members of class actions involving overdraft fees. But some banks have escaped the MDL – and appear to have escaped paying meaningful compensation to the would-be class members – as a result of forced arbitration clauses and class action bans.

TISA, as currently interpreted through Regulation DD, has a fairly limited definition of "account," which does not appear to reach prepaid accounts and other newer forms of accounts that hold consumer funds. Those accounts should also be covered, but it appears likely that they will be soon be covered through the incorporation of the definition of accounts under Regulation E, discussed at § 3.6, below.

3.6 Accounts and remittance transfers under the EFTA, § 1040.3(a)(6)

3.6.1 In general

Proposed § 1040.3(a)(6) covers accounts and remittance transfers within the scope of the Electronic Fund Transfer Act and Regulation E. We support this coverage.

The accounts that are currently subject to Regulation E include many that are also subject to Regulation DD. However, Regulation E also covers payroll card accounts and non-needs tested public benefits cards, such as those used to distribute unemployment compensation or child support. These accounts hold important funds, and Regulation E provides important rights regarding these accounts.

Consumers should be able to enforce these rights if they are violated. For example, some employers have violated the Regulation E ban on compulsory use of a payroll card.

Many other prepaid accounts are not currently covered by Regulation E. Those accounts also need the protection of this proposed rule. As the CFPB found in its study, over 92% of the general purpose reloadable prepaid cards studied had forced arbitration clauses, and essentially 100% of those had class action bans. Prepaid cards can hold a consumer's primary income and be an essential financial product.

Recent problems that prevented RushCard and Green Dot cardholders from accessing their funds highlight the importance of making sure that consumers are protected and can enforce their protections. Some RushCard holders could not access their money for two weeks or longer. Although the RushCard agreement contained a forced arbitration clause and a class action bank, RushCard chose not to enforce it and instead settled the case on a classwide basis, agreeing to pay $20.5 million to affected cardholders. If RushCard had chosen to enforce the agreement, the forced arbitration clause could have prevented most of these individuals from getting relief.

However, we are hopeful that, before the arbitration rule is finalized, the proposed amendments adding prepaid accounts to Regulation E will be final. We support the CFPB's approach of incorporating future amendments to regulations automatically into the coverage of the arbitration rule – both for prepaid accounts and for any other products or services that later become covered by the regulations incorporated into this proposed rule.

We also support the inclusion of remittance transfers in the arbitration rule. Regulation E includes important new protections for international remittances that provide more transparency of fees and other costs, and protect consumers against unauthorized charges. These protections should be enforceable if they are violated.

The Regulation E definition of "remittance transfer" covers only international remittances. Agreements involving domestic remittances and person-to-person payments should also be within this scope of this rule, but we understand that they will be covered through the coverage of transmitting or exchanging funds in proposed § 1040.3(a)(7), discussed at § 3.7, below.

3.6.2 General use prepaid cards and other stored value accounts

In addition to the accounts, remittance transfers and, eventually, prepaid cards that will be covered, the CFPB also seeks comment on whether the proposed rule should cover other types of stored value products and services within the meaning of Dodd Frank Act § 1002(15)(A)(v). We believe that additional categories should be covered. This subsection discusses gift cards and other general-use prepaid cards that will not be within the scope of the "prepaid accounts" covered under proposed amendments to Regulation E. The next subsection considers EBT and related cards, and 3.6.4, below, discusses preauthorized funds transfers.

The biggest category of stored value accounts left out of the proposed rule is gift cards. Many gift cards are issued by merchants to pay for their own merchandise, merchants who may be outside of CFPB's jurisdiction and are not proposed to be covered by the proposed arbitration rule.

However, general-use prepaid cards should be covered, whether they are gift cards or not. Regulation E defines "general-use prepaid card" as part of the regulations governing gift certificates and gift cards. The definition covers cards that are redeemable at unaffiliated merchants or usable at ATMs.

Many general-use prepaid cards will be considered "accounts" covered by Regulation E (and thus, also, by the arbitration rule). But several types of these cards may not be considered "accounts" under Regulation E, including:

- General-use gift cards;
- Loyalty, award or promotional cards;
- Cards used with health savings accounts, flexible spending accounts, medical savings accounts or health reimbursement arrangements.

General-use prepaid cards, such as those issued by Visa or American Express, are covered by the Regulation E gift card rules, but are not covered by the rest of Regulation E if they are labeled or marketed as a gift card. These cards differ from other gift cards in that they are not issued by a merchant exempt from CFPB jurisdiction, but rather involve parties – the card networks and a financial institution that holds the funds – that clearly are within its jurisdiction. Moreover, these cards differ from the "accounts" covered by Regulation E only in that they have the label "gift card." There is no reason to leave these cards out of coverage or why consumers should not be able to enforce in court the Regulation E protections that limit expiration dates and inactivity fees.

Loyalty, award, or promotional gift cards should also be covered by the proposed rule, subject to the exemptions for merchants. While these cards are exempt from the Regulation E gift card rules regarding expiration dates and fees, making the cards all the more susceptible to problems. These cards may be network-branded general-use prepaid cards indistinguishable from other cards expect for the context in which they are provided.

Similarly, the arbitration rule should cover prepaid cards used in connection with health savings accounts, flexible spending accounts, medical savings accounts or health reimbursement arrangements. These cards, too, are exempt from the Regulation E gift card protections and the CFPB has proposed to exempt them from the prepaid account rules. But these cards could still have problems with unauthorized charges or error resolution or could run afoul of prohibitions on unfair, deceptive or abusive practices. Without specific regulations to protect them, consumers may especially need the aid of the courts.

3.6.3. EBT cards and prepaid cards for needs-tested benefits

Two other critical categories of consumer accounts are left out of the proposed rule: EBT cards and prepaid cards used by government agencies to distribute needs-tested benefits. (By EBT card, we are referring to cards that hold Supplemental Nutrition Assistant Program (SNAP, formerly Food Stamps) benefits and operate through the ACH system, such as those that are part of the Quest Operating Network. By prepaid card, we are referring to Visa- or MasterCard-branded cards that hold Temporary Assistance to Needy Families or other needs-tested cash benefits.) Both of these types of accounts hold the primary and perhaps only income for poverty level families.

Like any other prepaid or debit card, EBT and prepaid cards that hold needs-tested benefits can have problems with fees, unauthorized charges or error resolution. However, both are currently exempt from the protections of the EFTA and Regulation E. This lack of protections can cause serious problems for consumers.

EBT cards and needs-tested prepaid cards both are stored value cards within the CFPB’s jurisdiction. The financial institutions and payment processors that issue or manage EBT and needs-tested prepaid cards are also within the CFPB’s jurisdiction. Thus, there is no reason why these cards should be left out of the proposed rule.

3.6.4 Preauthorized and other electronic fund transfers

In addition to imposing duties on the providers of “accounts” that are within the scope of the EFTA, the EFTA also has requirements and prohibitions for other persons who perform electronic fund transfer (EFT) functions. For example, Regulation E imposes rules on persons who initiate preauthorized electronic fund transfers (PEFTs) or use PEFTs to pay wages or government benefits. Similarly, businesses must comply with the Regulation E rules governing electronic check conversions, and any person who uses an electronic fund transfer to collect a returned item fee for a dishonored electronic fund transfer or check must comply with the provisions governing such fees.

The CFPB has stated that “PEFTs, while not described as a separate category of coverage, generally would be covered [by the proposed arbitration rule] when offered as part of a covered product or service.” However, two important refinements must be made to the proposed rule to ensure that that is the case.

First, the CFPB should revise or include a comment to proposed § 1040.4(a)(2)(ii), discussed in § 6.1.2, below, regarding agreements for multiple products or services. The proposed rule permits providers to use forced arbitration clauses that do not comply with the rule in connection with products and services that are not covered. The CFPB must make clear that ancillary services like use of EFTs or PEFTs in connection with credit are considered to be part of the underlying product or service covered by the rule and may not be the subject of a noncompliant arbitration clause.

Second, as discussed in §§ 3.8 and 3.9 below, the CFPB must include payment processing by third party payment processors and originating depository financial institutions as a covered product or service, even if the underlying purpose of the EFT is not covered. For example, if a work-at-home scam uses EFTs to collect payments, the work-at-home service may not be a covered service but the payment processing by the processor should be.

Alternatively, it would be clearer for the CFPB to define both EFTs and PEFTs as a covered consumer financial product or service, but only when used in connection with another covered product or service (including third party payment processing).

3.7 Transmitting and exchanging funds, § 1040.3(a)(7)

Proposed § 1040.3(a)(7) covers transmitting or exchanging funds as defined in the Dodd-Frank Act, 15 U.S.C. § 5481(29), except when integral to another product or service that is not covered by the proposed rule. This provision covers, for example, domestic money transfer services. The CFPB has also noted that this provision would cover mobile wireless third-party billing services.

We support the inclusion of transmitting and exchanging funds in the proposed rule. These services are core consumer financial services that should comply with the law and be subject to private enforcement in court if they are not.

We also support the observation that mobile wireless third-party billing services would be covered by this provision and the proposed rule. Cramming of wireless bills is a serious problem, and forced arbitration clauses in class action bans in wireless contracts could impede millions of consumers from getting relief for unlawful practices.

The CFPB requests comment on whether its exclusion for non-covered products and services should reach funds transmissions that are "integral" to the non-covered product or service or only those that are "necessary or essential". We believe that a narrower exclusion only for transmissions that are necessary or essential would prevent evasions.

3.8 Payment and financial data processing, § 1040.3(a)(8)

Proposed § 1040.3(a)(8) covers accepting financial or banking data (or providing a product or service to accept the data) directly from a consumer for the purpose of initiating a payment by a consumer. However, this provision does not include merchants who accept data in order to obtain payment for their own nonfinancial good or service.

For example, this provision would cover Square or PayPal when a consumer uses those services to pay for a meal at a food truck or a purchase on Ebay. The provision would not cover a store that accepts a consumer's check, or that takes a consumer's credit card information on the phone and then transmits it to its payment processor.

We support the inclusion of payment and financial data processing. Payment processing is a critically important area for consumers, especially in this age of internet transactions. Consumers should have access to courts when things go wrong. For example, consumers brought a class action against PayPal alleging that PayPal improperly handled disputed transactions, improperly placed holds, reserves, or limitations on accounts or closed or suspended accounts, and failed to provide them with annual error-resolution notices or monthly account statements.

We do urge the CFPB to broaden the payment and financial data processing category in two ways.

First, acceptance of data for purposes of transferring or managing funds should be included even if no "payment" is made. For example, there are personal finance apps that transfer funds between checking and savings accounts and vice versa, or may otherwise segregate and hold consumer funds. These services should be considered "financial data processing products or services" within the CFPB's authority even if no payment is involved.

Second, the CFPB should delete the requirement that the data be accepted "directly from a consumer." There is no need for this limitation, which excludes payment processing services that can be very problematic and that are within the CFPB's jurisdiction.

Thus, proposed § 1040.3(a)(8) should be revised to read:

> Accepting financial or banking data or providing a product or service to accept such data directly from a consumer for the purpose of transferring or managing funds in a consumer's account, initiating a payment by a consumer via any payment instrument as defined by 15 U.S.C. 5481(18), or initiating a credit card or charge card transaction for the consumer, ….

Removing the "directly" limitation is important in order to prevent abuse of forced arbitration clauses by payment processors. For example, the CFPB recently sued a third-party payment processor, Intercept, that systematically enabled its illegal payday lender and debt collector clients to withdraw millions of dollars' worth of unauthorized or otherwise illegal charges from consumers' bank accounts. The CFPB alleged that "Intercept is a covered person under the CFPA because it provides payments or other financial data processing products or services to consumers by technological means, including through a payments system or network used for processing payments data." However, Intercept, like other payments processors, likely received consumer's bank account data indirectly through its payday lender clients, not directly from consumers.

Payment processors and originating depository financial institutions (ODFIs) play a critical role in enabling scammers, illegal payday lenders and other criminals to obtain payments from consumers. Yet forced arbitration clauses and class action bans can be a problem insulating these entities from accountability.

It appears that these types of payment processing activities would be covered under proposed § 1040.3(a)(7) even if the data is accepted indirectly from consumers. However, it is not completely clear how the CFPB interprets the differences between proposed (a)(7) and proposed (a)(8). From the examples given by the CFPB, (a)(7) appears aimed more at person-to-person money transfer services, whereas (a)(8) is focused more on the processing of payments in connection with another activity. The CFPB does note that certain forms of payment processing would be covered by both provisions. But entities that process payments in connection with loans, debt settlement or other services could point to the "directly" requirement to argue that they are excluded from the rule. This confusion could be avoided by deleting that limitation.

It is also not clear why the "directly" limitation is even necessary. Proposed § 1040.3(a)(8) separately excludes persons that are selling or marketing nonfinancial goods or services.

If the CFPB wishes to exclude indirect payment processing services used in connection with nonfinancial products, then it should limit the exclusion of indirect processing to those nonfinancial services. For example, the CFPB could cover both (1) entities that accept consumer data directly, and (2) entities that accept the data indirectly in connection with a financial good or service.

Arguably, payment processors that do not deal directly with consumers would not have an arbitration agreement with those consumers. But payment processors and ODFIs have argued that they are covered by arbitration clauses in the underlying contract. Those underlying contracts may be covered by the rule. But the contract may violate the rule, or the contract may not involve a financial product or service covered by the rule, such as the scams just described.

In fact, even an exclusion for nonfinancial products could be problematic. Many payment scams involve the sale of a nonfinancial good or service. For example, payment scams have involved the sale of work-at-home schemes, a fake dating service, prize scams, medical discount cards, and other sham nonfinancial products. Yet if the scammer itself accepts payment information from the consumer and only indirectly passes that information on to its payment processor, the payment processor would not be covered by the proposed rule. While many of these scams are conducted through telemarketing efforts and may not involve a contract with an arbitration clause, scams that happen on the internet could easily have such a clause in the fine print.

Consequently, it is important (1) that payment processing be covered as a separate service, and (2) that it not be limited to circumstances where the consumer provides the data directly to the processor.

3.9 Check cashing, check collection, and check guarantee services, § 1040.3(a)(9)

Proposed § 1040.3(a)(9) covers check cashing, check collection, or check guaranty services. We support including these services within the scope of the rule. The Dodd-Frank Act gives the Bureau authority over these services.[137] And the Bureau has brought at least one enforcement action against a debt collection program related to check collection.[138]

Under the guise of a contract with a district attorney's office, a debt collection firm engaged in unfair and deceptive practices to coerce consumers into repayment programs.

A similar private class action is pending against the same parties but faced a motion to compel arbitration.[139] There are no contracts with arbitration clauses between the consumer and the merchant to whom the consumers wrote checks. But the debt collectors include a fine-print arbitration clause in the notice – sent on district attorney letterhead – that gives the consumer the option of paying instead of facing prosecution and the threat of imprisonment.

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[137] 12 U.S.C. § 5481(15)(A)(vi).

[138] CFPB, Press Release, "CFPB Takes Action Against 'Bad Check' Debt Collector" (Mar. 30, 2015), http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-bad-check-debt-collector/.

[139] See Defendant Victim Services, Inc.'s Notice Of Motion And Motion To Compel Arbitration And Stay Action, Breazeale et al. v. Victim Services, Inc., d/b/a Corrective Solutions et al., No. 3:14-cv-05266-VC (N.D. Cal. Oct. 19, 2015).

While check diversion programs are a type of debt collection, they may fall outside proposed rule's debt collection activities because they may not involve a financial product or service. Consumers using check-cashing services are likely to be unbanked or under-banked, financially stressed, and particularly vulnerable to abusive contract terms.

Check guaranty services can pose similar consumer protection problems. Companies like Telecheck provide services to supermarkets and other merchants that review and guarantee consumer checks. If a check that has been guaranteed later bounces, the company pays the merchant and takes the responsibility of collecting the payment from the consumer. Even if the CFPB broadens the arbitration rule to cover credit reporting, the act of collecting a check that was guaranteed but bounced would not be considered credit reporting. As with check diversion programs, these efforts to collect on bounced checks can involve false threats of criminal prosecution. Forced arbitration clauses could arise under payment plans just as they have with check diversion programs.

3.10 Debt collection, § 1040.3(a)(10)

3.10.1 In general

The CFPB proposes to cover the collection of debt that arises from one of the consumer financial products or services discussed above and defined in §§ 1040.3(1) through (9):

(1) Extensions of credit as defined by the ECOA, including credit extended by medical providers and in connection with mobile device third-party billing, as well as referrals, acquisition, purchase, selling, and servicing of credit;

(2) Automobile leases;

(3) Debt management or debt settlement;

(4) Providing consumer reports or scores to consumers;

(5) Deposit accounts;

(6) Other accounts or remittance services covered by Regulation E;

(7) Transmitting or exchange funds;

(8) Processing payments for consumers;

(9) Check cashing, check collection or check guaranty services.

We support the inclusion of debt collection. Debt collection has long been a top (and usually "the" top) subject of complaints to the FTC and has quickly risen to the top of the CFPB's list since the Bureau began accepting debt collection complaints. Despite important protections adopted nearly 40 years ago in the Fair Debt Collection Practices Act (FDCPA), the routine debt collection abuses prohibited by the FDCPA remain rampant. In addition, abuses by creditors such as payday lenders, who are not covered by the FDCPA, and new problems create by the debt buyer industry have also led to numerous unfair, deceptive and abusive practices that are far too common.

While the FTC, CFPB, bank regulators and state attorneys general have brought numerous enforcement actions involving debt collection, private litigation, including class actions, remains critical to protecting consumers. We agree with the CFPB that covering collection activities is one of the most important components of this rule. The CFBP's arbitration study found that FDCPA class actions were the most common type of class action. The prevalence of debt collection problems and of class actions addressing those problems support the CFPB's conclusion that "debt collection is an activity in which it is especially important to allow for private enforcement, including class actions, to guarantee the consumer protections afforded by the FDCPA, among other applicable laws."

While consumers do not typically have agreements with debt collectors, forced arbitration can still be a problem. Debt collectors can claim to be covered by the clause in the contract with the original creditor, and courts may allow the collectors to enforce such agreement. In addition, debt collectors may offer payment plans and may include forced arbitration clauses in those plans. First party creditors that engage in collection activities for their own debts often do have forced arbitration clauses. Debt buyers collecting on debts they purchase will also claim coverage as assignees of the originating creditor's arbitration agreement.

It is especially appropriate to prohibit forced arbitration of debt collection class actions because debt collectors and other creditors routinely file collection suit against consumers. Collectors take advantage of the courts and consumers should be able to as well. Indeed, many collection problems arise from abuses by collection attorneys. The CFPB is also well aware of the history of abusive arbitrations involving debt collection cases handled by the National Arbitration Forum, which purported to be neutral but where was interlocking ownership between the forum and the largest collection law firm practicing before the forum.

We also agree that medical debt is a form of credit covered by the ECOA, and that servicers and collectors of that debt should be within the scope of this rule. While hospitals and doctors are exempt from the CFPB's jurisdiction, contingent debt collectors and debt buyers are not. A large portion of debt collection activities involves medical debt. The CFPB has found that nearly one in five consumers (19.5 percent) has a credit report containing one or more collections trade lines that originated with a medical provider.[140] While the CFPB may not be able to prohibit doctors or hospitals from including forced arbitration clauses or class action bans in their contracts, the agency can prohibit debt collectors from relying on those clauses.

3.10.2 Entities covered

Proposed § 1040.3(a)(10) provides that debt collection is within the rule's scope when the collection is done by:

- Original creditors – a person offering or providing the product or service giving rise to the debt, their affiliate, or a person acting on their behalf, § 1040.3(a)(10)(i);
- Purchasers of consumer credit – a person purchasing or acquiring an extension of consumer credit, their affiliate, or a person acting on their behalf, § 1040.3(a)(10)(ii); or
- Third-party debt collectors as defined by the Fair Debt Collection Practices Act, § 1040.3(a)(10)(iii).

We agree that all three of these categories of entities that engage in debt collection should be covered, and that delineating the categories aids in clarity.

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140 CFPB, Consumer credit reports: A study of medial and non-medical collections at 18 (Dec. 2014) ("CFPB Collections Study"), http://files.consumerfinance.gov/f/201412_cfpb_reports_consumer-credit-medical-and-non-medical-collections.pdf.

Original creditors, such as payday lenders, routinely engage in debt collection abuses. For example, the CFPB took action against the payday lender ACE Cash Express for illegal debt collection threats and harassment. A recent case brought against the high-cost installment lender CashCall also revealed that CashCall made 84,371 calls to its 292 West Virginia borrowers – an average of more than 288 calls per person.

We agree with the CFPB that the coverage of debt collection activities should be broad, including activities that some may refer to as servicing. The line between servicing and collection is very thin, and companies must act fairly and obey the law when collecting debts no matter what side of that line they are on.

The CFPB should make clear in a comment that all entities that collect medical debts for first party creditors fall within the scope of proposed § 1040.3(a)(10)(i) if they are not FDCPA collectors. Debt collectors who receive medical debt collection accounts prior to default are not covered by the FDCPA. Yet these collectors are acting on behalf of the creditor under (i). As long as the collector itself is not exempt from the rule, its collection activities should be covered even if the creditor is not. The CFPB should make this clear under (i), just as it has made clear under (ii) and (iii) that collectors of medical credit are covered even when the medical provider is not.

Assignees and purchasers of consumer credit – including indirect auto finance companies and debt buyers, including assignees or purchases of medical debt – should also be covered. Listing this category separately makes clear that the assignee is covered even if the original creditor (i.e., an auto dealer) is not within the rule.

Certainly third-party debt collectors covered by the FDCPA should be covered. They are the source of most of the complaints to the FTC and CFPB.

It is important for the CFPB to make clear in a comment that debt buyers fit within proposed § 1040.3(a)(10)(iii) as third-party debt collectors covered by the FDCPA. Courts have found that debt buyers are debt collectors under the FDCPA for nearly three decades. However, some debt buyers continue to argue that they are not covered, and, in a few cases, the courts have found that certain debt buyers are not debt collectors under the FDCPA. While some debt buyers may be covered as purchasers under proposed § 1040.3(a)(10)(ii), others may not be if the debt did not arise from credit. And while debt buyers argue that they are the original creditor for purposes of the exemption from the FDCPA, they might claim that they do not offer or provide the service for the underlying product or service, as described in proposed § 1040.3(a)(10)(i). Making clear that debt buyers are covered under (iii) as FDCPA collectors will avoid unnecessary confusion and litigation.

The CFPB has asked whether it is important to list FDCPA debt collectors separately or rather whether they are adequately covered through the definition of activities related to “credit.” We believe that it is important to list debt collectors separately for several reasons. First, not all of the covered debts will arise from “credit” as defined in this rule. Debts could arise from deposit accounts, automobile leases, or check collection activities, for example. Second, the rule will be clearer if debt collection is listed separately rather than buried in a long string of words following another activity. This is especially important for the collection of debts like medical debt, where it may not be obvious to all readers that the debt is credit. Listing debt collection as a separate activity is also consistent with the organization of the Dodd-Frank Act and will avoid the confusion of leaving out this central area.

3.10.3 FCRA issues

We also strongly urge that entities that hold or collect consumer debts should be covered when they furnish information to consumer reporting agencies, as discussed in § 3.4.5 above. As discussed in that section, any furnishing activity by a covered person should be within the scope of the rule. If that change is made, we suggest a comment to § 1040.3(a)(10) making the connection to debt collection clear. However, if the Bureau declines to include furnishing more broadly under the definition of credit reporting, it is essential that furnishing be within the scope of the debt collection activities under § 1040.3(a)(10).

Debt collectors frequently report debts to credit bureaus as a way of collecting debts. As one court put it, credit reporting is a “powerful tool designed, in part, to wrench compliance with payment terms….” For some debts, “parking” debts on credit reports is the primary method of collection. Yet all of the problems of inaccurate information that have led to problems with debt collection generally can also impact credit reports when inaccurate debts are reported. Thus, the full range of debt collection activities should be covered by this rule, including furnishing.

4. Excluded Persons, § 1040.3(b)

4.1 Eliminate, narrow, or at least clarify the exemption for governments and their affiliates, § 1040.3(b)(2)

4.1.1 Introduction

Proposed § 1040.3(b)(2) excludes from the rule "[t]he federal government and any affiliate of the Federal government" and "[a] State, local, or tribal government, and any affiliate of a State, local, or tribal government, to the extent it is providing any product or service described in paragraph (a)." We believe that this exclusion is unnecessary and inappropriate. If the CFPB nonetheless retains this exemption, it must narrow the definition of government "affiliate." We strongly support limiting any government exemption to services providing directly by the government entity, not by third parties, and to services provided only to consumers who reside within the government's territorial jurisdiction.

4.1.2 The democratic process will not be sufficient to protect aggrieved consumers

We do not understand why the CFPB feels that it necessary to exempt government entities from the proposed rule. We are unaware of government agencies that use forced arbitration clauses or class action bans in their contracts; of any reason why government agencies would have any difficulty complying with the rule if they did; or of any reason to sanction forced arbitration by government entities. While the absence of such clauses may also mitigate concerns about the exemption, we are concerned about misuse by "affiliates," as discussed in § 4.3, below. In addition, class actions against the government are so important that we fear any precedent that blesses suppressing them.

The Bureau has explained the exemption for government entities in the NPRM:

[G]overnments and their affiliates are uniquely accountable through the democratic process to consumer for products and services the governments and their affiliates provide directly to consumers . . . . The Bureau additionally believes that the democratic process may compel governments and their affiliates to treat consumers . . . fairly with respect to dispute resolution over the product and services the governments and affiliates provide directly to those consumers.[141]

The democratic process will not adequately protect consumers who face a class-action ban. The tyranny of the majority is a well-known feature of democracy.[142] The democratic process inherently favors the majority over the minority.

In contrast, the plaintiffs in a class action are almost universally a minority of the potential voters. As a result, litigation may be the only realistic way that an aggrieved minority can force the government to take notice and correct problems.[143] This is particularly the case where a class

[141] 81 Fed. Reg. 32830 at 32881 (May 24, 2016).

[142] Alexis de Tocqueville, Democracy in America 239-242 (Harvey C. Mansfield & Delba Winthrop, trans., University of Chicago Press 2000) (1835), quoted in Philip C. Kissam, Alexis De Tocqueville and American Constitutional Law: On Democracy, the Majority Will, Individual Rights, Federalism, Religion, Civic Associations, and Originalist Constitutional Theory, 59 Me. L. Rev. 35, 52 (2007).

[143] The minority may be a racial or ethnic group, the users of a particular government service, or an economically or physically disadvantaged group. Cf. Blanchard v. Forrest, 1994 WL 396332 (E.D. La.

has been historically neglected, discriminated against, or hated. Examples of groups that have been forced to use class-action litigation to stop the government from violating their rights include Native Americans,[144] black farmers,[145] homosexual servicemembers,[146] and prisoners.[147]

Furthermore, in addition to the incentives that encourage private entities to suppress class actions, elected officials face political pressures that may discourage the fair resolution of claims against the government. Class actions are politically unpopular. Class-action settlements may require public funding, embarrass politicians, and force unpopular changes in government policies or programs. In contrast, the small-value claims that class actions best serve are less expensive and less likely to attract attention when pursued on an individual basis. So the Bureau is incorrect to assume that the democratic process will encourage governments to act fairly. Instead, the democratic process may encourage the government to do the opposite.

Courts have repeatedly recognized the need to protect the minority from the majority. This obligation is embedded in our Constitution through the Bill of Rights.[148] The right to file a class

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July 28, 1994) (class action brought by New Orleans Legal Assistance Corporation against Louisiana state Medicaid agency for violating constitutional and federal law by failing to process applications and appeals timely; settled by consent judgment (71 F.3d 1163, 1165 n.1 (5th Cir. 1996))).

144 See, e.g., Brooke Campbell, Cobell Settlement Finalized After Years of Litigation: Victory at Last?, 37 Am. Indian L. Rev. 629 (2013) (discussing class litigation over federal government mismanagement of Native American trust accounts) (settlement and collected pleadings at http://www.indiantrust.com).

145 See, e.g., Stephen Carpenter, The USDA Discrimination Cases: Pigford, in Re Black Farmers, Keepseagle, Garcia, and Love, 17 Drake J. Agric. L. 1 (2012) (recounting history of discrimination and class-action litigation against African American, Hispanic, Native American, and female farmers by USDA). Although Congress ultimately enacted legislation to help some of these farmers, the duration of the problem suggests that the farmers would not have received such wide-scale relief without the pressure brought on the government by the class actions. See id. at *8-*9 (summarizing multiple reports issued over two decades documenting discrimination, one of which stated "[d]espite the fact that discrimination in program delivery and employment has been documented and discussed, it continues to exist to a large degree unabated.").

146 See, e.g., Collins v. United States, 101 Fed. Cl. 435 (2011) (denying motion to dismiss claims of servicemembers discharged for homosexuality and given less separation pay than other soldiers); Carlo Muñoz, 'Don't ask, don't tell' dischargees to receive full back pay from DOD, The Hill (Jan. 7, 2013), (regarding settlement), available at http://thehill.com/policy/defense/275971-service-members-discharged-under-dont-ask-dont-tell-to-receive-full-back-pay.

147 See, e.g., Ruiz v. Estelle, 503 F.Supp. 1295 (S.D. Tex. 1980), affirmed in part, reversed in part by Ruiz v. Estelle, (5th Cir. 1982) (finding prison conditions violated U.S. Constitution).

148 W. Virginia State Bd. of Educ. v. Barnette, 63 S. Ct. 1178, 1185 (1943) ("The very purpose of a Bill of Rights was to withdraw certain subjects from the vicissitudes of political controversy, to place them beyond the reach of majorities and officials and to establish them as legal principles to be applied by the courts."); Washegesic v. Bloomingdale Pub. Sch., 813 F. Supp. 559, 560 (W.D. Mich. 1993), aff'd, 33 F.3d 679 (6th Cir. 1994) ("one of the objects of the Bill of Rights was to protect the minority from the tyranny of the majority."); Congregation Lubavitch v. City of Cincinnati, 807 F. Supp. 1353, 1358 (S.D. Ohio 1992), aff'd, 997 F.2d 1160 (6th Cir. 1993) ("The Bill of Rights was never required to guarantee the rights of the majority. By definition, the rights of the majority will be protected by that majority. The Bill of Rights was intended to protect the rights of minorities against the majority which may be unpopular to that majority."); United States v. Hashmall, 97 F. Supp. 42, 43 (D.D.C 1951) ("The very purpose of the Bill of Rights is to protect the individual, and to protect a minority if need be."); Vance v. Roedersheimer, 597 N.E.2d 153, 161 (Ohio 1992) (dissent) ("But our Bill of Rights was not enacted to satisfy the shifting whims of a constantly changing majority. The Bill of Rights is designed to protect the misfortunate minority into which the fickle winds of fate may blow any one of us at any time. These are the individuals

action before an impartial court of law is a key aspect of how the weak can demand equal treatment under the law.[149]

It would also upset the system of checks and balances to allow one branch of government (usually the executive) to contractually eliminate the right of citizens to seek class relief from the judiciary. The Supreme Court has concluded in other contexts that "it would be destructive of rights of association and of petition to hold that groups with common interests may not . . . use the channels and procedures of state and federal agencies and courts to advocate their causes and points of view . . . ." Allowing the government or its affiliates to contractually eliminate someone's right to participate in a class action would ultimately reduce accountability and harm the public.

Even if the democratic process would have a salutary effect (an idea we dispute), that effect is likely to be limited due to the structure of governments. Many government activities are designed to be insulated from political pressures. The Bureau is itself an example of that.

The lack of political accountability is particularly the case with government affiliates. The proposed commentary on the government exemption suggests government-affiliated banks and utilities as examples of affiliates that would benefit from the proposed exemption. But such entities are not (and should not be) subject to the democratic process. Instead, government affiliates are more like private entities than government institutions. So, even if the government is exempt from the proposed rule, affiliates should not receive any exemption.

4.1.3 The definition of "government affiliate" is overly broad and ambiguous

The most troubling part of the proposed exemption for government entities is the fact that "affiliates" of federal, state, local or tribal governments would also be excluded. Proposed

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who need the protection of a Bill of Rights. For our Constitution either protects everyone or it protects no one, a fact that many modern politicians cannot seem to grasp.) (quoting American Jury Trial Foundation, A Tribute to Trial by Jury at 20 (1992)) (emphasis omitted); Kansas Malpractice Victims Coal. v. Bell, 757 P.2d 251, 258 (Kan. 1988) disapproved of on other grounds by Bair v. Peck, 811 P.2d 1176 (Kan. 1991) ("The Bill of Rights of the Kansas Constitution and the Bill of Rights of the United States Constitution are there to protect every citizen, including a person who has no clout, and the little guy on the block. . . . . They are not there to see that the will of the majority is carried out, but to protect the rights of the minority."); Stone v. Graham, 599 S.W.2d 157, 162 (Ky.), rev'd on other grounds, 101 S. Ct. 192 (1980) (regarding the Kentucky constitution: "In this Commonwealth our leaders are selected by the majority will. But . . . our constitution provides: 'Absolute and arbitrary power over the lives, liberty and property of free men exists nowhere in a republic, not even in the largest majority.' The Kentucky Bill of Rights protects the minority from the arbitrary imposition of moral precepts and philosophies by the majority, no matter how right or desirable it may seem to do so."); Engel v. Vitale, 176 N.E.2d 579, 587 (N.Y. 1961), rev'd on other grounds, 82 S. Ct. 1261 (1962) ("The guarantees of the Bill of Rights . . . were designed to protect minorities . . . . While majority rule is an accepted incident of the political aspects of the democratic process, nothing in the Bill of Rights permits imposing the will of a majority even in the slightest degree upon an objecting minority . . . .").

[149] See Hudson v. Palmer, 468 U.S. 517, 523 (1984) ("[L]ike others, prisoners have the constitutional right to petition the Government for redress of their grievances, which includes a reasonable right of access to the courts."); Christopher v. Harbury, 536 U.S. 403, 415 n.12 (2002) (collecting cases locating the right of access to courts within the Article IV Privileges and Immunities Clause, the First Amendment Petition Clause, the Fifth Amendment Due Process Clause, and the Fourteenth Amendment Equal Protection, and Due Process Clauses).

Comment § 1040.3(b)(1)-2 provides that "'affiliate' is defined in 12 U.S.C. 5481(1) as any person that controls, or is controlled by, or is under common control with another person."

But this definition was originally intended for affiliates of business entities[150] and is ill-suited to identifying which entities truly have enough governmental control to be considered governments themselves rather than private entities. The failure to clearly identify who or what is an affiliate of a government will inevitably result in controversy over whether an entity falls within the exemption. Depending on the state of the case law regarding arbitrability, it is even possible that a court will interpret a contract as delegating this question to an arbitrator.

Case law and other developments in this area demonstrate the problems of leaving ambiguous when a private company performing services for a government agency can claim government immunity. In one case, the Supreme Court in a 5-4 decision has found that "uniquely federal interests" supported immunizing a private defense contractor from state tort liability.[151] The dissent criticized the majority for broadening the previously narrow protection of "affiliates of the Federal Government" to reach "nongovernment employees whose authority to act is independent of any source of federal law and that are as far removed from the 'functioning of the Federal Government' as is as Government contractor."[152]

The Supreme Court recently rejected the idea that a private advertising company that was a federal contractor shared in the government's unqualified immunity from liability and litigation for violating the Telephone Consumer Protection Act (TCPA).[153] Nevertheless, the Federal Communications Commission responded with a ruling that federal contractors acting within the scope of their contractual relationship are not "persons" under the TCPA.[154]

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[150] The same definition appears in a number of contexts indicating that drafters were thinking of non-governmental entities. For example, the Department of Defense's regulations implementing the Military Lending Act use the same definition of "affiliate." 32 C.F.R. § 232.3(a). The MLA was adopted to protect servicemembers and their families from abusive payday lenders, many of which operated storefronts outside the front gates of military installations and which were privately owned. According to the Federal Register notice issuing the regulation, "this definition is designed to prevent evasion of the rule, specifically with respect to an entity that would not, when considered alone, qualify as a creditor, but, when considered together with its affiliates, would be engaged in extending credit . . . ." 80 FR 43560-01. Another example is the Oklahoma Banking Code, which uses the same definition of "affiliate" (Okla. Stat. Ann. tit. 6, § 208.1(F)(1)) and elaborates on the word "control" by reference to the percentage of voting shares a person owns and []a person's control over the designation of an entity's directors, trustees, or other managing officers. Id. New York City also used the same definition in a law specifically aimed at predatory lending. The preamble to the ordinance even more clearly suggests that it focused on private entities: "To amend the New York city charter and administrative code of the city of New York, in relation to prohibiting the City from doing business with institutions that engage, directly or indirectly, in predatory lending practices, and to regulate the participation of home improvement contractors in the home-loan market. New York City, N.Y., Local Law No. 36 Int. 67-A (2002) (invalidated as preempted by Mayor of City of New York v. Council of City of New York, 780 N.Y.S.2d 266 (Sup. Ct. 2004).

[151] Boyle v. United Technologies Corp., 487 U.S. 500 (1998).

[152] 487 U.S. at 522-23 (Brennan, J., dissenting).

[153] Campbell-Ewald Co. v. Gomez, 136 S.Ct. 663 (2016).

[154] Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991, Petitions for Declaratory Ruling by Broadnet Teleservices LLC, National Employment Network Association, RTI International, CG Docket No. 02-278, Declaratory Ruling, FCC 16-72, (July 5, 2016) .

Some courts have used the government exemption from the Fair Debt Collection Practices Act to hold that a private, nonprofit student loan guarantee agency collecting a defaulted student loan owed to the U.S. Department of Education was excluded from the definition of "debt collector."[155] While not going quite that far, a recent Supreme Court case noted that a private debt collector collecting state debt using attorney general letterhead implicated "a core sovereign function" of the state.[156] These government check collectors have used forced arbitration clauses to protect themselves from when they use false threats of criminal prosecution and deception of consumers.[157]

In the context of a state government, courts are likely to look to "arm of the state" case law to resolve whether an entity is entitled to state sovereign immunity. But this case law is highly problematic. For example, student loan authorities that service student loans have been found to be arms of the state in some states but not in others.[158] The collection tactics of the New Jersey student loan agency have been so egregious they have been labeled "state-sanctioned loan-sharking."[159]

The tribal equivalent of the arm-of-the-state doctrine is even more troubling. Courts have found that private payday lenders that provide only 1% of their revenue to the tribe are an "arm of the tribe" for purposes of sovereign immunity.[160] While the limitations that the CFPB has proposed on the state, local and tribal government exemption will help (discussed below), it remains a concern that the exemption is too broad and is unwarranted. The many permutations of the relevant analysis and the absence of any consensus illustrate the difficulty of resolving when an artificial entity is sufficiently close to the government to be treated as the sovereign.

We have previously explained why the Bureau should abandon the proposed governmental exemption (see § 4.2, supra). If the Bureau decides to keep the exemption, "affiliate" must be more clearly defined.

4.1.4 IRS Definition of Affiliate

If the Bureau keeps the exclusion for affiliates, the Bureau should consider using the IRS's definition of "affiliate of a governmental unit," as set forth in Revenue Procedure 95-48, 1995-2 C.B. 418.[161] This Procedure identifies which tax-exempt governmental units and affiliates of a governmental unit are not required to file annual tax returns on Form 990 (Return of Organization Exempt From Income Tax). This is a relevant guideline for the proposed rule

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[155] See, e.g., Games v. Cavazos, 737 F. Supp. 1368 (D. Del. 1990); but see Student Loan Fund v. Duerner, 951 P.2d 1272 (Idaho 1997).

[156] Sheriff v. Gillie, 136 S.Ct. 1594, 1602 (2016) (citation omitted).

[157] See discussion in § 3.9, supra.

[158] Compare United States ex rel. Oberg v. Pennsylvania Higher Educ. Assistance Agency, 804 F.3d 646, 650-51 (4th Cir. 2015) (finding that Arkansas Student Loan Authority was arm of the state) with Pele v. Penn. Higher Educ. Assistance Agency, 2015 WL 6162942 (4th Cir. Oct. 21, 2015) (reversing district court finding that Pennsylvania student authority was an arm of the state).

[159] Annie Waldman, New Jersey's Student Loan Program is 'State-Sanctioned Loan-Sharking', Pro Publica (July 3, 2016), available at https://www.propublica.org/article/new-jerseys-student-loan-program-is-state-sanctioned-loan-sharking.

[160] American Prop. Mgmt. Corp. v. Superior Court, 141 Cal. Rptr. 3d 802 (Cal. Ct. App. 2012); Colorado v. Cash Advance, Case No. 05CV1143 (Colo. Dist. Ct. Feb. 18, 2012),available at www.nclc.org/unreported.

[161] https://www.irs.gov/pub/irs-tege/rp1995-48.pdf.

because entities meeting the IRS's definition will be closely aligned with the government's mission and will be closely controlled by the government. As a consequence, they are more likely than others to fit the Bureau's goal of exempting entities that are "accountable thorough the democratic process."

The definition can be summarized as stating that an entity is an affiliate of a government if it is tax exempt under section 501(c) of the Internal Revenue Code and meets the requirements of paragraph (a) or (b) below:

a) The IRS has determined that it meets one of the following three requirements:

- it's tax-exempt income accrues to the government and is from a public utility or exercising an essential governmental function; or otherwise accrues to the government;
- it is entitled to receive deductible charitable contributions because the contributions are "for the use of" governmental units; or
- it is a wholly owned instrumentality of a state or a political subdivision, for employment tax purposes;

b) The IRS has not made such a determination but the entity meets both of the following requirements:

- It is either "operated, supervised, or controlled by" a government, or by organizations that are affiliates of governmental units, or the organization's governing body is elected by the public, pursuant to local statute or ordinance; and
- It has two or more of the factors listed in section 4.03 (summarized below)

The factors in section 4.03 can be summarized as:

- The organization was created by the government or an affiliate;
- The organization is principally funded by taxes, tolls, fines, government appropriations, or fees collected pursuant to statutory authority (not including government grants or other contract payments);
- The organization is financially accountable to the government as shown by (i) an annual requirement to report information comparable to Form 990, and (ii) financial audits by the governmental unit it reports to.
- The government or an affiliate controls or oversees some or all of the organization's expenditures;
- If the organization is dissolved, its assets will be distributed to the governmental or an affiliate.

The IRS procedure also states that an entity will not meet the definition if it "has taxable subsidiaries or participates in joint ventures with non-exempt entities; . . . it engages in substantial public fund-raising efforts; [or] . . . its activities provide significant benefits to private interests." In contrast, the Bureau's proposed definition would allow for-profit entities to qualify as exempt affiliates. There is also room to debate the extent of "control" required by the Bureau's definition.

Instead, the IRS's definition of affiliate is both narrower and less ambiguous than the one proposed by the Bureau. Adopting such a definition is important to prevent abuse of the government exemption.

4.1.5 Any government exemption should be limited to products or services provided *directly by governments* to consumers *residing* in the government's *territorial jurisdiction*

The proposed § 1040.3(b)(2)(ii) excludes state, local, and tribal governments and their affiliates when providing a covered product or service directly to a consumer who resides in the government's territorial jurisdiction. There are three components to this exclusion—all of which are required to prevent abuse of the exclusion and evasion of the rule:

- The service or product must be provided *directly* by the government or its affiliate to the consumer;
- The exclusion is limited to the government's *territorial jurisdiction*.
- The exclusion depends on where the consumer resides.

The first component – limiting the exemption to the government itself, rather than private entities under contract with the government – has clear importance to private debt collectors and servicers hired by state agencies to collect student loans or hired by other state or local agencies to collect debts, run credit checks or perform other functions for the government entity. For example, debt collectors would not be considered affiliates of the state agencies and thus their collection actions should be covered by the rule.

Just as there has been extensive litigation and reporting on private debt collectors hired by the Department of Education and other federal agencies,[162] so too there is a strong potential for abuse by private collectors hired by state or local agencies to collect on state guaranteed student loans and other debts to the state. For example, the Bureau has brought at least one enforcement action against a debt collection program related to bad check collection.[163] Many of these programs are run by companies that enter into contracts with state and local prosecutors' offices to collect bounced check debt. These debt collectors must be covered by the rule even if the prosecutor's office is not.

In addition, the importance of these three conditions can best be seen in the context of internet-based payday lending, especially tribal payday lending. These lenders frequently claim to be based outside the United States or, more often, to be owned by and located on Indian reservations. Making these claims, they then assert that they are free to ignore all state usury caps and other lending regulations. Lenders claiming a tribal affiliation also claim to be immune from suit by anyone except the federal government.[164]

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[162] See NCLC, Pounding Student Loan Borrowers: The Heavy Costs of the Government's Partnership with Debt Collection Agencies (Sept. 2014), available at http://www.nclc.org/issues/pounding-student-loan-borrowers.html; U.S. Dept. of Education, Press Release, U.S. Department of Education to End Contracts with Several Private Collection Agencies (Feb. 27, 2015), available at https://www.ed.gov/news/press-releases/us-department-education-end-contracts-several-private-collection-agencies.

[163] CFPB, Press Release, "CFPB Takes Action Against 'Bad Check' Debt Collector" (Mar. 30, 2015), http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-bad-check-debt-collector/.

[164] See National Consumer Law Center, Consumer Credit Regulation § 9.6.3 (2012), updated at www.nclc.org/library

Tribal payday lenders have been particularly abusive[165] and frequently use forced arbitration clauses that ban class actions.[166] Rather than being truly owned and operated by Native American tribes, tribal payday lenders are often fronts for wealthy non-Indians who merely rent the tribe's sovereign status for pennies on the dollar.[167] For example, *Bloomberg News* report that the American Web Loan company pays only 1% of its revenue to the tribe hosting it.[168] The remaining 99% goes to a New York-based hedge fund. Some operators of allegedly tribe-owned lenders are under investigation for RICO and other violations.[169]

The residency and territorial-jurisdiction components of the government exclusion are particularly important for tribal payday suits. These entities claim that the contracts are made on the tribe's reservation by an arm of the tribal government.[170] But, even if that argument is true, the loans are usually made to borrowers living outside the reservation. In practice, this means transactions with most of a tribal lenders' customers would be subject to the arbitration rule even if the loans are truly made by the tribe. The tribe's jurisdiction is limited to the reservation, so the exclusion would only apply to loans made to residents of the reservation by the tribe. Even if a tribe established a storefront payday lender on the reservation, the lender will be covered by the rule if a consumer residing outside the reservation travels there to obtain the loan.

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[165] See Julia Harte, Joanna Zuckerman Bernstein, Al Jazeera America, Payday Nation (June 17, 2014) ("Almost 3,500 complaints were filed against 63 tribal payday lending businesses between February 2012 and February 2013, according to records obtained from the Federal Trade Commission's Consumer Sentinel Network through a Freedom of Information Act request."), available at http://projects.aljazeera.com/2014/payday-nation/index.html. http://projects.aljazeera.com/2014/payday-nation/.

[166] Cf. Bilyk, Jonathan, Cook County Record, "Seventh Circuit Revives Class Action Suit over Payday Loans; Calls Arbitration Clause (Aug. 25, 2014) (recounting history of sham arbitration program asserted by Native American operating privately owned payday lending business, which was also being sued for racketeering) available at http://cookcountyrecord.com/stories/510578810-seventh-circuit-revives-class-action-suit-over-payday-loans-calls-arbitration-clause-unconscionable-and-process-a-sham.

[167] See, e.g., Zeke Faux, Bloomberg, Behind 700% Loans, Profits Flow Through Red Rock to Wall Street (Nov. 24, 2014) (describing loan with 700% interest rate made by tribal lender; describing lack of control tribe has over loan operations), available at http://bloom.bg/1vDZAkN.

[168] Id.

[169] See, e.g., Dept. of Justice, E.D. Pa., Press Release, RICO Conspiracy Charged In Payday Lending Case (June 22, 2015), available at https://www.justice.gov/usao-edpa/pr/rico-conspiracy-charged-payday-lending-case; Dept. of Justice, S.D.N.Y., Press Release, Manhattan U.S. Attorney Announces Charges Against Owner Of, And Attorney For, $2 Billion Unlawful Internet Payday Lending Enterprise (Feb. 10, 2016), available at https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-charges-against-owner-and-attorney-2-billion-unlawful.

[170] For other internet based lenders, most courts have rejected the argument that they are beyond the reach of state regulators. See National Consumer Law Center, Consumer Credit Regulation § 9.3, 9.6.2 (2012), updated at www.nclc.org/library

4.2 The exclusion for those who serve no more than 25 consumers per year is appropriate; § 1040.3(b)(3)

Proposed § 1040.3(b)(3) excludes a narrow class of providers. The person and any affiliate collectively must provide a product or service to no more than 25 consumers in the current calendar year and in the preceding calendar year.

This exclusion should be kept as narrow as it is to prevent rule evasions. For example, if the 25 limit applied only to the current calendar year, a provider in early January might be able to claim exclusion from the rule even though the provider would be covered later in the year.

The proposal should have minimal impact on consumers. If a company and all its affiliates sell to fewer than 25 consumers a year, numerosity considerations make class actions against the company unlikely. Twenty five transactions a year also tracks a similar standard found in Truth in Lending Regulation Z. [171] The Regulation Z standard is well understood, has not created problems, and using the same standard for both regulations makes for consistency and clarity.

4.3 The narrower proposed merchant exclusion is an improvement but needs clarification regarding third parties, § 1040.3(b)(4)

Proposed § 1040.3(b)(4) would exclude from the arbitration rule a narrow category of merchants that are otherwise within the CFPB's authority under the Dodd-Frank Act. That category is merchants that provide credit for their own nonfinancial products or services and that assign or sell that credit but do not impose a finance charge and do not extend credit that significantly exceeds the value of the goods or services. The proposed exemption would apply to the merchants but not to other persons who may conduct servicing, debt collection or other covered activities regarding the product or service.

We do not object to the exclusion. However, we are concerned that servicers, debt collectors, payment processors or others that the CFPB does not intend to exempt might nonetheless take advantage of the exemption. Therefore, we urge the CFPB to add comments to clarify that this exclusion applies only to the merchants themselves.

The Dodd-Frank Act provides that the Bureau does not have authority over merchants that extend purchase-money credit directly to consumers who are buying the merchant's own nonfinancial goods or services.[172] That exclusion also covers merchants that collect those debts (directly or through an agreement with a debt collection agency) or that sell that same debt after the consumer's default.[173]

But the Dodd-Frank merchant exemption does not apply – that is, the merchant is within the CFPB's authority – if one of the following factors exists:

(1) the merchant sells debt that is not yet in default;

(2) the credit extended exceeds the value of the item sold or the transaction is otherwise an attempt to evade the law; or

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[171] See Reg. Z § 1026.2(a)(17)(v)

[172] 12 U.S.C. 5517(a)(2)(A)(i)

[173] 12 U.S.C. 5517(a)(2)(A)(ii) and (iii)

(3) the merchant regularly extends credit that is subject to a finance charge.[174]

The Dodd-Frank merchant exemption also does not supersede any authority the Bureau may have over merchants under other statutes.[175]

The Bureau originally considered a merchant exemption in the arbitration rule that could have been interpreted as excluding from the rule credit under the second category – exceeding the value of the item sold and merchants attempting to evade the law. Such credit is within the CFPB's authority because finance charges can be disguised through an inflated sales price.

Instead, the proposed rule narrows the exemption to the first category alone, as long as the circumstances of the second (inflated price) or third (finance charge) categories are not present. The purpose of the proposed exemption is to prevent merchants that do not generally sell or assign their credit – and that would therefore normally be exempt from the CFPB's authority – from becoming covered simply because they use certain types of commercial borrowing that involve assigning an interest in their receivables. While we have concerns about some of these borrowing arrangements, which can expose small merchants to dangers similar to consumer payday loans,[176] those arrangements generally should not impact the merchants' consumers.

The proposed exemption is much better than the broader exemption in the CFPB's initial outline because it closes potential loopholes. As we understand the proposed exemption, the proposed arbitration rule would still apply to merchants that regularly extend credit subject to a finance charge and to credit where the cost of credit is hidden in an excessive sales price.

These provisions are important because they will reduce attempts to use the merchant exemption to abuse or evade the rule. Corinthian Colleges is a clear example of abusive merchant credit offered for a nonfinancial product (education). The college offered student loans with a planned default rate in excess of 50%, simply as a ruse to qualify for federal aid dollars. Corinthian initially asserted an arbitration clause in response to class actions over its conduct. While Corinthian Colleges charged a finance charge, its loans could have been structured as interest free. The interest was beside the point, as the college had no expectation of collecting even the loan itself from many of the students. That is, the school's tuition was artificially inflated in order to make it appear as though federal funds were covering no more than 90% of tuition, in order to comply with Department of Education rules.

It is critical that the CFPB has made clear that the proposed exemption "would not affect coverage of other persons who may conduct servicing, debt collection activities, or provide covered products and services pursuant to proposed § 1040.3(a)" in connection with the credit extended by the merchant.[177] Nonetheless, that might not be clear to those reading the rule without the supplementary information.

Therefore, we urge the CFPB to add a comment stating explicitly that debt collectors, servicers, payment processors and others that engage in covered activities in connection with the merchant credit are not exempt.

This clarification is especially important because the very factoring arrangements that give rise to the CFPB's desire to exempt merchants may also be unlawful or a method to facilitate a scam.

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[174] 12 U.S.C. 5517(a)(2)(B)

[175] 12 U.S.C. 5517(a)(2)(C)(ii)(II).

[176] Cite Woodstock's Treasury or OCC comments.

[177] 81 Fed. Reg. at 32884.

Scammers that cannot get their own credit card or ACH payment processing relationships sometimes sell their receivables to payment processors in order to launder the source of the payments.[178] Just recently, the FTC and the State of Florida brought an enforcement action against a credit card factoring arrangement.[179] These factoring arrangements can violate the Telemarketing Sales Rule if telemarketing is involved.[180]

Consequently, if a payment processor uses factoring to help a merchant perpetuate a scam, the processor must not be able to use a forced arbitration clause in the consumer's agreement with the merchant to escape accountability. A comment clarifying that third parties are not covered by the merchant exemption would also prevent debt collectors or others from misconstruing the intention of this exemption.

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[178] See National Consumer Law Center, Federal Deception Law § 5.7.3 (2d ed. 2016), updated online at www.nclc.org/library.

[179] The action is described in the FTC's press release, https://www.ftc.gov/news-events/press-releases/2016/01/ftc-state-florida-sue-payment-processing-operation-credit-card?, with more details on the factoring arrangement in the complaint, https://www.ftc.gov/system/files/documents/cases/160108emsystemscmpt.pdf.

[180] 16 C.F.R. § 310.3(c).

5. **Rule prohibiting providers from “relying” on an agreement “entered into,” § 1040.4(a)(1)**

Proposed § 1040.4(a)(1) sets forth the general rule that providers shall not, in connection with a class action, “rely in any way” on a pre-dispute arbitration agreement “entered into” after the compliance date until the class claims are dismissed and the time to appeal has elapsed. In the sections below we comment on several aspects of this prohibition.

5.1 “Entered into”

5.1.1 The importance of “entering into”

The meaning of the term “enter into” is particularly important to the arbitration rule. First, in order for an arbitration agreement to fall within any aspect of the rule, the agreement must be “entered into” after the compliance date – although not necessarily by the provider. Even if the provider was not the one that entered into the agreement, proposed § 1040.4(a)(1) prohibits the provider from relying on certain arbitration agreements and proposed § 1040.4(b) requires the provider to submit records to the CFPB.

Second, the contract language requirements in § 1040.4(a)(2) only apply to providers after they have themselves “entered into” an arbitration requirement.

The proposed rule does not provide a definition of the term “entering into,” but the NPRM defines it as “includ[ing] any circumstance in which a person agrees to undertake obligations or gains rights in an agreement.”[181] Proposed Comment 4-1 then provides multiple illustrations of what is and is not entering into an arbitration agreement.

We generally support the CFPB’s approach, but suggest three areas where the rule’s use of “entered into” should be clarified or extended to prevent confusion or evasions.

5.1.2 We support the examples of “entering into” in Comment 4-1.i

Proposed Comment 4-1.i makes clear that a provider “enters into” a pre-dispute arbitration agreement even in situations where the provider was not the original contracting party. We support this approach.

Proposed Comment 4-1.i.A is a straight forward example of a provider entering into a new contract for a product or service. Comment 4-1.i.B significantly provides that a provider enters into an agreement when it acquires or purchases a pre-existing agreement. If the provider has stepped into the shoes of the original contracting party, clearly the provider has “entered into” the agreement and should have duties with respect to that agreement. Similarly, in example 4-1.i.C, if a provider claims the authority to add a pre-dispute arbitration agreement, then it has entered into that agreement and has duties under the rule.

5.1.3 Clarify that a party other than a “provider” may have done the “entering into”

Providers cannot rely on a pre-dispute arbitration agreement entered into after the compliance date. It is important for the rule to be clear that the provider seeking to rely on an arbitration agreement need not be the party that entered into the agreement. Another provider or covered

[181] 81 Fed. Reg. 32830 at 32885 (May 24, 2016).

person could have entered into the agreement. This is consistent with the CFPB's statutory authority under 12 USC § 5518(b) for the rule to limit the use of an agreement between a consumer and a "covered person." See the discussion at § 2.4.1, above and § 5.1.6, below.

Proposed Comment 4-1 provides that "Section 1040.4 applies to providers that enter into pre-dispute arbitration agreement…." Although Comment 4-2 makes clear that aspects of the proposed rule apply even if the provider was not the one that entered into the agreement, the language of Comment 4-1 could be read to imply the opposite. This reading is possible despite the fact that all that Comment 4-1 is doing is giving examples of when a provider enters into a pre-dispute arbitration agreement and when a provider does not enter into such an agreement.

Therefore, to prevent any possible misunderstanding, we recommend that Comment 4-1 be revised to read:

> 1. *Enters into a pre-dispute arbitration agreement*. Section 1040.4 applies to ~~providers that enter into~~ pre-dispute arbitration agreements that are entered into after the date set forth in § 1040.5(a). Section 1040.4(a)(1) and Section 1040.4(b) apply to any provider that attempts to rely on a pre-dispute arbitration agreement entered into after that date, even if the provider is not the person that entered into the agreement. Section 1040.4(a)(2) applies only to providers that themselves enter into the agreement.
>
> i. Examples of when ~~a provider entered into~~ a pre-dispute arbitration agreement is entered into for purposes of § 1040.4 include but are not limited to when the provider or another party:
>
> …
>
> ii. Examples of when ~~a provider does not enter into~~ a pre-dispute arbitration agreement has not been entered into for purposes of § 1040.4 include but are not limited to when the provider or another party:
>
> …

These changes will prevent confusion and make clear that the rule applies if the agreement was entered into after the compliance date, even if the provider is not the one that did the entering into.

5.1.4 Delete comment 4-1.ii(A). Modifying or amending an agreement ***is*** "entering into"; credit cards and bank accounts should not be exempt for decades

We oppose the example in proposed Comment 4-1(ii)(A), which states that a provider does not enter into an agreement when it modifies, amends or implements the terms of an agreement that was previously entered into before the compliance date. The CFPB states that it has the authority to take the opposite view, but has chosen not to:

> The Bureau believes that the phrase entered into an agreement as used in Dodd Frank section 1028 can be interpreted to permit application of a Bureau regulation issued under the provision to agreements modified or amended after the compliance date, in certain circumstances. However, for the purposes of this proposal, the Bureau is

> proposing to interpret the phrase more narrowly, as reflected by, for example, proposed comment 4–1.ii.B. The Bureau solicits comment on whether, for the purposes of the proposal, it should instead interpret the phrase more broadly to encompass certain modifications or amendments of an agreement after the compliance date and what the impacts of such an interpretation would be.[182]

It is critical that the CFPB reconsider its position that a party does not enter into an agreement by modifying it. To rule otherwise would mean that existing credit cards, bank accounts, and other contracts that can continue for decades to apply to consumers will remain outside the rule, despite being constantly amended in material ways. This creates a gaping hole in the rule's operation and two classes of consumers would be created for many years into the future. It would also put new entrants into a field at a competitive disadvantage with pre-existing providers.

It is one thing to have a grandfather clause that applies to settled expectations under an old contract. It is quite another thing to permit providers to amend an agreement in any way they want and to shield those agreements from challenge under the grandfather clause.

We urge the CFPB make clear that a covered person enters into an agreement when it makes a material change in that agreement. This would be consistent with the CFPB's own definition of "entering into." The NPRM says that a provider enters into an arbitration agreement when it "undertake[s] obligations or gain[s] rights." [183] A covered person that modifies or amends a contract gains new rights. Especially important material changes include:

- Changes in price;
- Any change in the arbitration clause;
- A change that itself reflects an unfair or unlawful practice.
- Modifying an agreement to require the consumer to waive legal rights;
- Modifying an agreement to change the state law selected to govern the agreement;
- Adding a new party or co-signer (not just an authorized user).

Also any change in the price of a product or service should make the agreement a new one "entered into" at the time of the price change. Providers should not be able to have it both ways – updating an older agreement and changing the most fundamental element of it, and yet relying on an older arbitration clause that no longer complies with the law.

Any change the arbitration agreement should also result in the "entering into" of a new arbitration agreement. Ironically, the proposed rule would allow providers after the compliance date to amend arbitration agreement to explicitly prohibit class arbitration. Similarly, it would allow arbitration agreements to add a clause delegating to the arbitrator the enforceability of an arbitration clause, or prohibiting class arbitrations. Here again, the provider should either have to rely on the old clause or follow the rules applicable to a new one.

Indeed, where changes to arbitration clauses remain outside the rule's application this would encourage the spread of especially broad and abusive clauses before the compliance date. If it is later found that courts will strike down some of the most

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[182] 81 Fed. Reg.32830 at 32885 (May 24, 2016).

[183] Id.

oppressive arbitration provisions found in the agreement, the provider can merely amend the arbitration agreement without fear of falling under the CFPB rule.

Contracts that are subject to modification tend to be ones that last for many years. Any material modification to those contracts should be viewed as entering into a new agreement, including the underlying arbitration clause.

5.1.5 Delete or revise comment 4-1.ii.B on a provider that acquires or purchases an agreement but does not become a party to the arbitration agreement

Proposed comment 4-1.ii.B is a confusing counterpart to proposed comment 4-1.i.B. Comment 4-1.i.B says that a provider "enters into" an agreement if it acquires or purchases a product or service subject to an arbitration agreement and becomes a party to the arbitration agreement. Comment 4-1.ii.B says that a provider does not enter into the agreement if it acquires or purchases a product subject to an arbitration agreement but does <u>not</u> become a party to the arbitration agreement.

As drafted, this comment could encourage evasions. It could be read to mean that the arbitration agreement could be de-coupled from the agreement for the underlying product or service, preserving the provider's ability to rely on the arbitration clause as a third party beneficiary even if the provider was only assigned the product agreement but did and not become a party to the arbitration agreement relating to that product agreement (such as where the arbitration agreement was in a separate document).

We assume that this was not the comment's intent and that the CFPB instead intended these comments to address situations where the arbitration agreement specifies that it does not apply to the purchaser or acquirer. It is hard to envision such an arbitration agreement—perhaps one that provides it applies only to the original parties and not to any assigns..

We assume that the CFPB's intention is simply to make clear that a provider that is not covered by and not relying on an arbitration clause does not have duties under the rule. And this comment should certainly be limited to that situation. Therefore, we recommend that Comment 4-1.ii.B be revised to read that a provider has not entered into a pre-dispute arbitration agreement when it:

B. Acquires or purchases a product that is subject to a pre-dispute arbitration agreement that clearly excludes the provider from becoming a party to or relying on the pre-dispute arbitration agreement.

With that change, Comment 4-1.i.B should also be amended to delete the phrase "and becomes a party to that pre-dispute arbitration agreement."

5.1.6 We support the examples of providers that rely on agreements entered into by others, Comment 4-2

We support Comment 4-2 that clarifies an important distinction about the rule's application. The rule appropriately prohibits a provider from relying on a pre-dispute arbitration agreement even if the provider was not the entity that entered into the agreement. That is, a provider may not assert a right as a third-party beneficiary to rely on an arbitration agreement, as long as the agreement was entered into after the compliance date.

For example, a debt collector or other provider should not be able to rely on an arbitration agreement entered into by a merchant creditor even if that merchant is excluded from the rule's obligations by § 1040.3(b)(5) or otherwise. As described more fully at § 2.4.1, above, this is consistent with the CFPB's statutory authority under 12 USC § 5518(b) for the rule to limit the use of an agreement where there is an agreement between a consumer and a "covered person."

The CFPB not only has authority to make this distinction, but it is critical to the coverage of debt collectors and certain other providers. To fail to prohibit debt collectors and other core providers from relying on arbitration agreements would leave large holes in the rule's application to the significant detriment of consumers.

5.2 "Rely", § 1040.4(a)(1)

5.2.1 Ban any reliance on a non-compliant clause, including requests to sever or reform the clause or to use it in individual actions

Proposed § 1040.4(a)(1) only prohibits providers from relying on a forced arbitration clause "with respect to any aspect of a class action." The rule should also prohibit reliance on an arbitration clause in an individual action if the provider has not complied with the rule's requirements. If the provider has not complied with proposed § 1040.4(a)(2), the CFPB should prohibit the provider from relying on the clause in an individual action or even after any class claims have been dismissed. In other words, reliance in such a situation would be a separate violation and the rule should make clear that a noncompliant arbitration clause cannot be severed or reformed after an individual litigation has commenced.

To support compliance with proposed § 1040.4(a)(2), the general rule should be amended to read:

> (1) General rule. A provider shall not seek to rely in any way on a pre-dispute arbitration agreement entered into after the date set forth in § 1040.5(a) ~~with respect to any aspect of a class action~~ that is related to any of the consumer financial products or services covered by § 1040.3 including to seek a stay or dismissal of particular claims or the entire action, unless both ~~and until~~:
>
> (A) the agreement complies with the requirements of § 1040.4(a)(2)(i) or (ii) or the provider has complied with the requirements of § 1040.4(a)(2)(iii), AND
>
> (B) with respect to a class action, 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.

Prohibiting any reliance on noncompliant clauses, including in individual actions, will give providers an incentive to follow the law. Merely having the noncompliant clause may inhibit some class actions, and providers may take their chances in the hopes of having their cake and eating it too. They should not have the benefit of using a noncompliant clause to suppress a class action. The CFPB will never know about these suppressed actions. Prohibiting providers from using an unlawful clause in individual actions deters violations of the rule.

Providers should not be able to enforce a noncompliant clause in individual or class proceedings by offering to reform the clause or urging severance of its non-compliant terms. The CFPB should include a comment explaining that this ban on the use of noncompliant clauses also means that prohibited provisions may not be severed or reformed after litigation has commenced. Companies often try to get away with especially egregious provisions in arbitration clauses in the hopes that, at the worst, the court will reform the contract. While some courts refuse to do so, many have severed or reformed unconscionable provisions in light of the federal policy favoring forced arbitration.

In addition, as discussed in section 5.3, below, noncompliant clauses, and severability and delegation provisions, should be deemed null and void.

5.2.2 We support the broad examples of reliance: Comment 4(a)(1)-1

We support the non-exhaustive list in Comment 4(a)(1)-1 of the ways in which a provider might rely on a pre-dispute arbitration agreement in violation of the rule. Clearly the rule should prevent providers from seeking to dismiss, defer or stay any aspect of a class action. Nor should the provider be able to strip out a class member from the benefits of a class solely because the consumer has entered into an arbitration agreement. Stripping out a class representative could also delay or prevent the prosecution of the class action.

The rule should equally apply to any other use by a provider of the arbitration agreement to delay or complicate the resolution of the class claim in court. The Comment provides a number of examples that we support as non-exhaustive of the ways in which a provider may seek to delay the class action.

The Comment provides an example of objecting to or seeking a protective order intended to avoid responding to discovery in the class. Filing a claim in arbitration against a consumer who has filed a class action claim on the same issue would similarly delay or complicate prosecution of the class action or an appeal of the denial of class certification or the refiling of a class action after an initial dismissal with leave to amend. We support all these as non-exclusive examples of ways in which a provider should not be able to use an arbitration clause to hinder the prosecution of a class action in court.

5.2.3 The CFPB should prohibit providers from relying on terms that purport to delegate to an arbitrator questions relating to the enforceability of the rule

To give effect to the rule, courts will play a critical role in applying it to specific cases. For example, in considering a provider's motion to compel arbitration of a class action claim based on an arbitration agreement between a different covered person and a consumer, courts might have to decide whether the pre-dispute arbitration agreement at issue was "entered into" after the compliance date. In some cases, courts may have to decide whether an entity seeking to rely on a pre-dispute arbitration agreement is a provider under the rule, or whether that entity is an "excluded person" under § 1040.3(b). In cases involving the amendment set out in § 1040.3(a)(2)(ii) for pre-dispute arbitration agreements covering "multiple products and services," courts might need to decide whether a particular class action claim concerns a product or service covered by the Rule.

These examples are, of course, not intended to be entirely comprehensive. Rather, they provide an illustration of the many cases in courts will be involved in the interpretation and application of the rule and, through this process, in the development of the rule.

The CFPB should ensure that courts can play this important role by prohibiting the "delegation" to an arbitrator of questions regarding the interpretation or application of any component of the rule. The Supreme Court's arbitration jurisprudence teaches that in general "gateway" issues of arbitrability—i.e., whether the parties are bound by a given arbitration clause in a particular case—are for the court (and not the arbitrator) to decide.

However, the Court has provided that where the arbitration agreement "clearly and unmistakably" delegates any of those questions to the arbitrator, they are for the arbitrator to decide. Under this principle, arbitrators are sometimes called upon to decide whether a particular dispute falls within the scope of an arbitration agreement[184] or even whether an arbitration clause is unconscionable and unenforceable as a matter of state law.[185]

For these reasons, many of the most important questions about the interpretation of the rule could, in theory, be delegated to an arbitrator to decide. And because many of the rule's protections are only triggered after a court makes certain findings—e.g., that the agreement was entered into after the compliance date—providers could argue in some situations that the arbitrate must make a threshold determination of coverage before any court can prevent the provider from relying on a pre-dispute arbitration agreement in class litigation.

This possibility poses obvious dangers to consumers who are much less likely to be successful in arbitration than in court.[186] Arbitrators would seem even less likely to rule for consumers when the question before them is whether the consumer's claims should be allowed to proceed in court as a class action or must be arbitrated.

At least as importantly, though, the delegation of issues related to the application of the rule would dramatically undermine the predictability of the application of the proposed rule. As one notable scholar recently observed, "[t]he various procedures and specific arbitration clauses offer more of a maze than a roadmap to which rules apply and how much discretion individual arbitrators have in a system that is unbounded by precedent."[187] Stuck in this maze, cases about the application of the rule will not lend themselves to the healthy development of precedent regarding interpretation of the rule. Instead, both consumers and the companies with which they do business will face considerable uncertainty in pursuing litigation where the scope or meaning of this rule might be at issue.

To prevent forced arbitration of questions concerning the interpretation, applicability and compliance with this rule, the CFPB should do two things. First, it should add an example to proposed Comment 4(a)(1)-1 explaining that any attempt to delegate those questions to the arbitrator (in either a class action or individual action) is an attempt to rely on the arbitration agreement.

Second, a provision should be added after the general rule in proposed § 1040.4(a)(1) -- ideally as a new (a)(2), with proposed (a)(2) becoming (a)(3))-- stating:

No delegation. A provider may not rely on a pre-dispute arbitration agreement by seeking to delegate any questions about the applicability or interpretation of or compliance with this rule to the arbitrator. In case of such a dispute, the provider may not rely on the arbitration agreement in any way unless and until the presiding court has ruled that this rule does not prohibit reliance on the arbitration agreement 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.

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[184] First Options of Chicago v. Kaplan, 514 U.S. 938 (1995).

[185] Rent-A-Center, West, Inc. v. Jackson, 130 S. Ct. 2772 (2010).

[186] CFPB Study at 32.

[187] Judith Resnick, Diffusing Disputes: The Public in the Private of Arbitration, the Public in Courts, and the Erasure of Rights, 124 Yale L.J. 2804, 2912 (2015).

5.2.4 Prohibiting reliance until after dismissal of class claims and exhaustion of appeals is appropriate

We support the general approach of § 1040.4(a)(1) that a provider cannot rely in any way with respect to any aspect of a class action until the court refuses certification and the time for any appellate review of that decision has elapsed or the review has been resolved. The provision would be clearer if it added at the end: "or the review has been resolved such that a class action may not proceed."

With this change, we support the provision. The rights of the class members would be seriously impeded if the case could be forced into arbitration while determination of whether the case can proceed as a class is still ongoing. Consumers could incur costs, lose time from work, or even potentially be subject to an order that is later determined to be without authority. If that determination on appeal results in the case being allowed to go forward as a class, that action will be prejudiced if in the interim the case is forced into arbitration.

5.3 Make non-compliant arbitration agreements, including delegation clauses, null and void

To ensure that consumers are protected and that courts know how to treat noncompliant clauses, the CFPB should declare that forced arbitration clauses that do not comply with the rule are null and void. An impermissible delegation clause (discussed in § 5.2.3, above) should also be null and void.

An arbitration clause entered into after the compliance date should be null and void:

(1) As to anyone, if a provider originally enters into the agreement;

(2) As to anyone except the original non-covered party or parties, if a provider acquires and thus enters into an agreement that was originally entered into by a non-covered party;

(3) As to a provider that does not enter into an agreement but purports to be covered by an agreement with a non-covered party.

The simplicity and effectiveness of such a provision is apparent. By making non-compliant arbitration agreements null and void, the rule would be clearly enforceable in court, in situations where the rule might not otherwise be enforceable as the proposed rule is presently drafted.

A null and void rule would be especially helpful in situations where the arbitration clause was originally entered into by a non-covered person, and a provider who later obtains the agreement and has with the clear authority to amend it to comply with the rule fails to do so. Faced only with the original contract, the court will have an easier time with a null and void rule than with sorting through the implications of the rest of the CFPB's rule.

Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to promulgate rules "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof." By voiding non-compliant arbitration agreements, the Bureau could protect against gamesmanship on the part of providers.

Indeed, the CFPB recognized in the proposed payday loan rule how declaring a contractual provision to be null and void can be useful to enforcing the underlying rule. The payments section of the payday rule prohibits a lender from submitting a preauthorized debit against a consumer's account (using a contractual authorization) after two consecutive unsuccessful attempts to debit the consumer's account.[188] That prohibition has an exception that permits the lender to obtain a new authorization from the consumer. However, the rule declares that the new authorization "becomes null and void" if either it is replaced by yet another authorization, or if two consecutive payments bounce under the new authorization.[189]

Thus, just as the "null and void" language in the payday rule helps to enforce a rule that prohibits a lender from relying on a contractual payment authorization, a null and void rule in the arbitration rule would enforce the prohibition on relying on a forced arbitration clause. Indeed, the rationale for the null and void language would be even stronger in the arbitration rule, because the original contractual clause would be unlawful from the outset in most situations and its use by providers would be completely prohibited.

In the payday situation, the payment authorization is originally permissible and only becomes void upon later events. Indeed, this is analogous to an arbitration clause that is permissible for a non-covered person but should become null and void once acquired by or otherwise in the hands of a covered provider.

The direct prohibitions that are in the proposed rule are helpful. But adding the null and void language will aid in the clarity of enforcement and court authority.

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[188] 81 Fed. Reg. 47864, 48175 (July 22, 2016) (proposed 12 C.F.R. § 1041.14(b)).

[189] 81 Fed. Reg. at 48176 (proposed 12 C.F.R. § 1041.14(c)(4)).

6. The required language in arbitration agreements, § 1040.4(a)(2)

6.1 The general rule provides clear, simple language, § 1040.4(a)(2)(i)

We support § 1040.4(a)(2) and its requirement that simple language be included in agreements so that consumers know their rights as to class actions and to bind not only the provider, but any other person seeking to rely on that agreement. The language specifically states that "neither we nor anyone else" can rely on the arbitration agreement to prevent class actions.

The language should be understood by consumers and should prevent both the provider and anyone else from relying on the agreement to prevent consumers from participating or initiating a class action in court. Being part of the contract between the consumer and the provider, it is a binding term as any other contract provision.

As discussed in the sections that follow, to the extent possible, the clear and simple language of proposed § 1040.4(a)(2)(i) should be used instead of the more ambiguous and confusing alternatives for providers with multiple products or those who acquire preexisting agreements.

6.2 The proposal regarding multiple products or services is confusing and could lead to evasions: § 1040.4(a)(2)(ii)

Proposed § 1040.4(a)(2)(ii) provides alternative language for arbitration agreements that apply to multiple products or services, only some of which are covered by the proposed rule. The proposed alternative language states:

We are providing you with more than one product or service, only some of which are covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau. We agree that neither we nor anyone else will use this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action even if you do not file it. This provision applies only to class action claims concerning the products or services covered by that Rule. [emphasis added]

The CFPB believes that "th[is] alternative provision would improve consumer understanding because [it] would more accurately describe consumers' dispute resolution rights."[190]

We suggest that this language instead undermines the enforceability of the contractual language and is likely to confuse consumers. Use of this language puts at issue in any class action whether the product or service that is the subject of the action is covered by § 1040.3, thus leading to extensive litigation on this point. That is, even if an entity does not intend, when drafting the arbitration clause, to question coverage of the rule, the explicit mention of the scope issue in the clause will force courts to answer it. It is even possible that a court might send this question of scope to an arbitrator.

In contrast, the impact of the language required by § 1040.4(a)(2)(i) is straight-forward. No matter what product or service is the subject of the suit, whether within the CFPB's authority or not, if a company adds that language to the agreement, then it cannot rely on the agreement to prevent the class action in court.

[190] 81 Fed. Reg. 32830 at 32890 (May 24, 2016).

Far from improving consumer understanding, proposed § 1040.4(a)(2)(ii) would require the consumer to develop a nuanced understanding of the rule's scope. The language does not inform the consumer which products or services may be the subject of a class action and which may not, and places the burden on the consumer to make that legal determination—highly unlikely for the typical consumer.

Providers with any plausible argument to having non-covered products or services as part of a transaction have an incentive to opt for this alternative language, because it will create roadblocks for the consumer's prosecution of a class action.

The CFPB seems concerned that, without the alternative § 1040.4(a)(2)(ii) language, the rule will have the impact of regulating contracts outside of the CFPB's jurisdiction. There are better ways of preventing the rule from regulating contracts outside the CFPB's jurisdictions—ways that do not sow confusion with consumers and encouraging litigation challenges.

If a provider is concerned that its non-covered products will be swept up by the rule, it has the simple option of setting out two separate agreements: one for covered products and another for non-covered products. Since the rule's compliance date is well after the rule's effective date, this gives providers or their assignors sufficient opportunity to change their paperwork to accomplish this result.

If the provider must for some reason resort to a single agreement for both covered and non-covered products or services, the provider (not the consumer) should have the burden of identifying those products and services to which the rule does not apply.

In that case, the language should be revised as follows:

> *Class actions permitted*. Except as described in the next paragraph, neither we nor anyone else will use this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action even if you do not file it.
>
> *Class actions not permitted*. We may stop you from being part of a class action only if it concerns the following itemized products or services: ________________. These products or services are not covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau.

The burden should be on the provider and not the consumer or the court to determine which specific products or services are not covered by the rule and to specify those in the agreement.

Requiring these products to be itemized in the clause will also permit the CFPB to monitor these clauses and correct any efforts by industry to misconstrue the scope of the rule. (This is another reason why we strongly urge the CFPB to require entities that it supervises to submit their arbitration clauses for review, as discussed in § 8.2 below.)

6.3 Requirements for acquisition of pre-existing, non-compliant agreements: § 1040.4(b)(2)(iii).

Introduction

Proposed § 1040.4(b)(2)(iii) sets out requirements when a provider enters into an arbitration agreement that existed previously between other parties and that does not contain the language specified in §§ 1040.4(a)(2)(i) or (ii). The rule proposes that the provider be given two options. Within 60 days of entering an agreement, the provider can either amend the contract by including mandated language or provide a notice to the consumer using mandated language.

As described in proposed Comment 4(a)(2)-1, the rule only applies to providers, such as a debt buyer or auto finance company, that "enter into" an agreement, such as by purchasing it or taking an assignment. The amendment and notice requirements do not apply to a contingent debt collector that does not enter into the agreement, although such collectors are nonetheless prohibited under proposed § 1040.4(a) from relying upon the agreement.

6.3.1 The 60 Day Deadline

The proposed rule allows the provider 60 days to either amend the agreement or send the notice. In general, we do not object to giving providers 60 days to take these steps (although the provider of course must still be prohibited from relying on the arbitration clause during that 60 day period).

However, the provider must be required to take steps to bind third parties if, during that period, the provider assigns the agreement to another party or contracts with a third party to provide services in connection with the agreement. The provider should be required to incorporate the required language into the contract or otherwise put the third party on notice that it cannot rely on the non-compliant arbitration clause.

If a provider is capable of selling an agreement almost immediately, it is also capable of complying with § 1040.4(a)(2)(iii) almost immediately. There is no reason why a consumer should have fewer rights just because a provider sells an agreement within 60 days instead of after 60 days.

6.3.2 The amendment to non-compliant arbitration agreements should more clearly cover all third parties: § 1040.4(a)(2)(iii)(A)

When a provider opts to (or, as discussed at § 6.3.3, below, is required to) amend an existing contract, proposed § 1040.4(a)(2)(iii)(A) sets out the language to be used. That language should track the standard language set out in § 1040.4(a)(2)(i) that prohibits the provider "or anyone else" from relying on the arbitration clause.

However, there is significant variation in the language required by the proposed rule's two subsections with respect to third parties. The language of subsection (iii)(A) applies only to anyone "who later becomes a party" to the pre-dispute agreement, while subsection (i) applies to anyone at all.

The difference is critical. The section (iii) language, since it only applies to parties, does not apply to non-parties relying on the arbitration agreement. These non-parties could include the provider's agents, service providers, credit bureaus, debt collectors, or anyone else. For example, the (i) language would prohibit a debt collector from relying on the creditor's arbitration agreement while a court might not apply the (iii) language to the same debt collector. Instead, the (iii) language should track as closely as possible the (i) language.

If the provider acquires the agreement from another provider that was required to, but did not put in the section (i) language, then the new provider should put in the exact section (i) language. Nor does this language prejudice a party that originated the contract that was not obligated to include the § 1040.4(a)(2)(i) language. That party can still rely on the arbitration agreement that party had entered into with the consumer, which may prohibit class actions.

6.3.3 Amendment under (iii)(A) rather than notice under (iii)(B) should be required if the provider has authority to amend

When an existing contract does not include the required language permitting class actions in court, the proposal gives a provider entering into that agreement the option of either amending the agreement or sending a notice to the consumer. Where the provider cannot amend the agreement, such a notice may be the best that can be done.

Nevertheless, a notice is far less protective for the consumer than an amendment to the agreement. The amendment binds other parties seeking to rely on the agreement—either those subsequently acquiring the agreement or those only relying upon the agreement. An amended agreement also more effectively codifies the consumer rights than a notice that the consumer may in the future no longer possess or remember.

There also may be questions about the legal implications of the notice. If it does not amend the agreement, a provider could claim it has no legal force and there was no consideration for the notice. Hopefully, the notice should operate to tell the provider and court that the arbitration clause is not enforceable (and merely to reflect the existing implied covenant of good faith and fair dealing, which requires compliance with the law). But there could still be litigation over the issue – especially as to third parties that seek to rely on the agreement but do not enter into it. Some of those third parties may even be outside the CFPB's jurisdiction, and amending the agreement itself prevents its misuse.

If the provider has any ability to amend the agreement, the rule should require that it to do so. For example, the provider may offer other amendments to the product or service agreement, with the consumer's continued use of the product or service being treated as acceptance of the offer. If it has the right to do so with other amendments, it should be required also to offer to the consumer the § 1040.4(a)(i) amendment language as an amendment to the agreement. At a minimum, if the provider amends the agreement in way the provider should be required to include the required arbitration language at the same time.

This rule should apply whether the provider is amending the underlying contract or the arbitration provision. If the provider is capable of amending the agreement in one way, it is capable of amending the arbitration clause.[191]

6.3.4 Providers should give more clear notice, and take other steps, to prevent use of a noncompliant clause by third parties

When the provider sends a notice instead of amending the agreement, further steps also should be taken to protect the consumer's rights when third parties seek to rely on an arbitration agreement that continues to prohibit class actions. These third parties may include non-provider assignees of that provider, service providers, debt collectors and others. The CFPB should strengthen § 1040.4(a)(3) so that the notice is binding on others.

One way to accomplish this is to require the provider to incorporate the notice into agreements with others with whom it has a relationship. The provider's contracts with debt collectors and service providers must provide that not just the provider but the debt collector or service provider

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[191] This requirement will also prevent evasions where the main contract for the good or service is decoupled from the arbitration agreement, and only the former is assigned. Even if the arbitration agreement is not technically assigned, the provider would have the ability to amend the underlying contract to nullify the arbitration agreement.

is also waiving the right to enforce the arbitration agreement as to class actions. Any assignment of the contract should include a similar agreement in the assignment that the assignee and any subsequent assignees waive the right to enforce the agreement as to class actions, and that the consumer is an intended third party beneficiary of this agreement. The provider should also consider the notice to be part of the agreement and to supply it whenever the agreement is requested by a third party.

With this additional requirement, the notice language should then be amended to add the last paragraph as follows:

> We agree not to use any pre-dispute arbitration agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action even if you do not file it.
>
> We consider this promise to be part of our agreement with you and to be binding on our agents, affiliates, service providers, assignees, and any other third parties that may attempt to rely on the original arbitration agreement to prevent you from being a member of a class action. We also agree to provide these parties notice of our promise and to take other steps so that others cannot use the arbitration agreement in your contract to prevent you from being a member of a class action..

Providers should also be required to store the record of this notice in the same way that they would store the agreement itself so that the documents together are considered to be the complete agreement – in the same way that a company would store an amendment to an agreement.

6.4 Required language preventing delegation

We recommend that proposed § 1040.4(a)(2) be amended to require language in any arbitration clause that makes it clear to a court and to others that questions about the applicability or interpretation of, or compliance, with this rule make not be delegated to the arbitrator. While the CFPB should also prohibit any attempt to delegate those questions as impermissible reliance (as discussed in § 5.2.3, above), having the language in the contract will also aid enforcement and the courts.

At the end of the language required to be included in agreements as set out in proposed § 1040.4(a)(2)(i), (ii) and (iii)(A), this sentence should be added:

You cannot be required to arbitrate any questions about whether or how this agreement is covered by the Consumer Financial Protection Bureau’s Arbitration Agreements Rule.

At the end of the notice language, as set out in proposed § 1040.4(a)(2)(iii)(B), this should be added:

We also agree not to use any pre-dispute arbitration agreement to require you to arbitrate questions about whether or how our agreement is covered by the Consumer Financial Protection Bureau's Arbitration Agreements Rule.

Addressing the delegation issue explicitly will avoid confusion and prevent defeating the rule by giving these questions to a self-interested arbitrator.

7. Effective Date, § 1040.5

Proposed § 1040.5(a) provides that compliance with the rule is required for any pre-dispute arbitration agreement entered into after a date that is 211 days after publication of the final rule in the *Federal Register*. We support this provision. Making the rule effective 30 days after publication in the *Federal Register* complies with 5 USC § 553(d). Making a compliance date at least 180 days after the effective date complies with 12 USC § 5518(d).

Thus 211 days complies with legal requirements, and there is no need to extend the period beyond that date. This is already a very delayed compliance date and it should provide sufficient time for providers to meet the rule's requirements, particularly since compliance is required only for agreements entered into after that date.

Proposed § 1040.5(b) provides an exception for certain prepaid card agreements. Where the consumer acquires the card at a retail store with the arbitration agreement inside of packaging material, the provisions of proposed § 1040.4(a)(2) governing the written agreement would only apply to arbitration agreements packaged after the compliance date. However, notwithstanding language in the written agreement to the contrary, proposed § 1040.4(a)(1) prohibiting reliance on an arbitration clause that does not permit class actions would still apply to any agreement entered into after the compliance date. In addition, if the provider has the ability to contact the consumer in writing, it would have to provide an amended agreement in compliance with proposed § 1040.4(a)(2) within 30 days.

While we appreciate the efforts to limit the impact of this exception, it would nonetheless permit prepaid cards to contain inaccurate and misleading written agreements for a substantial period of time if the prepaid card package sits unsold in a store or at the provider during that time until it is eventually purchased. We fear that providers would have an incentive to manufacture an oversupply of cards with noncompliant agreements in order to delay the impact of the rule.

In light of the fact that the proposed rule already gives prepaid card providers 211 days to amend their packaging materials – and likely several months on top of that while the rule is being finalized – this open-ended exception appears to be unnecessary and overly broad. We urge the CFPB to eliminate it altogether. If the CFPB retains it, we suggest a number of ways it can be revised to more narrowly meet its concerns.

First, we suggest that the Comments clearly indicate that proposed § 1040.4(a)(1) continues to apply to prepaid cards. Thus, a comment should give an example showing that a provider cannot rely on the arbitration agreement to limit class actions after the compliance date.

Second, the rule should not apply to prepaid cards still in the provider's possession after the compliance date. This would not require the store to go through the cards and determine which ones must be discarded. The prepaid card provider will be familiar with the arbitration rule and can easily keep track of which cards have been packaged with noncompliant agreements and stop shipping them after the compliance date. This will give the provider an incentive not to produce an excess number of noncompliant agreements and to prepare for compliance as soon as possible. Prohibiting shipment of noncompliant agreements will ensure that consumers have accurate information about an important right that the old packaging has misrepresented.

Third, we suggest that the exception only be made for cards packaged 60 days after publication in the *Federal Register*, not 211. The CFPB will provide notice of the rule's adoption some time before publication in the *Federal Register* and more than 60 days is sufficient to change the language in an insert in the packaging. The arbitration rule would continue to apply only after the full 211 days have elapsed and would not require any action before then. But narrowing the exception after that date would serve the purpose of giving prepaid card providers time to adjust their packaging without misleading consumers unnecessarily.

Fourth, there should be an outer limit as to a prepaid card's exclusion from § 1040(a)(2). Providers can notify merchants that non-complying card packages will be de-activated after six months after the compliance date, and that the provider will supply complying replacement cards.

Proposed rule § 1040.5(b) requires that a provider that has the ability to contact the consumer via the mail or email do so and provide an amended arbitration agreement. We support this provision.

While the CFPB only has statutory authority to regulate arbitration agreements entered into after the compliance date, we are also concerned about credit cards, bank accounts and other products or services entered into prior to the compliance date, but that will remain in effect for years or even decades after the compliance date. As described more fully at 5.1.4, above, we strongly recommend that material amendments to such agreements should trigger compliance with the rule because such amended agreements would thus be entered into after the compliance date.

8. Submission of arbitral records, § 1040.4(b)

8.1 Introduction

While NCLC recommends that the rule limit individual arbitration (see § 9, below), we support the proposal that requires providers to disclose various records about their arbitration proceedings. This evidence should allow the CFPB to make judgments about further rulemaking and enforcement proceedings in this area. The increased transparency may also deter particularly unfair conduct on the part of providers and arbitrators and will allow regulators, advocates, and consumers to continue studying individual arbitration to learn more about its negative consequences for consumers.

To accomplish these ends, however, the CFPB should significantly expand the scope of the required disclosures. The proposed disclosure requirements focus on arbitration proceedings. But this limitation fails to recognize that some of the most unfair aspects of individual arbitration have little to do with the proceedings themselves.

8.2 The CFPB should require supervised entities to disclose pre-dispute arbitration agreements

While the information that the CFPB plans to collect when providers force arbitration of individual claims will help the Bureau to understand the impact of arbitration clauses, in many cases, consumers are harmed by an arbitration agreement even before the company invokes it. In order to provide the CFPB and the public with more information about the use of forced arbitration clauses, we urge the CFPB to require all entities that the CFPB examines to submit their arbitration agreements as part of the examination process. We also urge the CFPB to post those agreements to a public website.

Often the terms of the pre-dispute arbitration agreement (or even the mere existence of a pre-dispute arbitration agreement) chill the consumer from asserting claims in any forum.[192] For example, consider terms that purport to limit the consumers remedies or claims or terms that require the consumer to split the costs of arbitration either explicitly or by reference to the arbitration administrators "commercial rules," which often allow the arbitrator to allocate costs as the arbitrator deems appropriate.[193] An attorney advising that consumer about the risks of pursuing his or her claims would have to inform her that one of the terms of the arbitration clause might require him or her to pay the costs of the provider. Even if the attorney tells the consumer that this term is likely unenforceable, it is unlikely that the consumer will decide to pursue his or her claims—particularly when told that it might be the arbitrator (and not the court) deciding whether to enforce these provisions.[194]

In the lead up to the Supreme Court's *Concepcion* decision, the U.S. Chamber of Commerce assured the Court that terms like these were rare—that individual arbitration was designed to be

[192] CFPB Arbitration Study, § 5.5.1.

[193] See, e.g., AAA Commercial Arbitration Rules and Mediation Procedures, R-47(c), available at http://info.adr.org/feeschedule/.

[194] See Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63 (2010).

accessible and affordable to consumers.[195] But the case law[196] and the CFPB's examination of arbitration agreements in its 2015 study demonstrate that especially unfair (and likely unenforceable) terms like these persist.[197]

Although these terms may be unenforceable as a matter of state and federal law, in most cases, providers bear few risks in including them in their contracts. Many courts conclude that if the pre-dispute arbitration agreement contains a "severability" or "severance" clause, the unenforceable terms are severed and the arbitration agreement enforced in their absence.[198]

Furthermore, although in the past consumer contracts that referenced AAA's "commercial rules" might be deemed unenforceable because those rules allow for cost splitting in contravention of the fee-shifting provisions in most consumer protection laws, this outcome is less likely today. Because AAA says it will enforce its consumer rules in any consumer dispute, courts may be less concerned that consumers will ***actually*** be forced to pay costs in accordance with the commercial rules.[199]

This dynamic creates perverse incentives for drafters to overreach and include aggressive and likely unenforceable terms. The very worst that can happen in many contexts is that a court or an arbitrator will enforce the arbitration requirement but ignore the unenforceable term. But in many cases the consumer will decline to bring his or her claims entirely.[200]

While large financial institutions may choose to eliminate their arbitration clauses altogether in order to maintain their class action bans,[201] smaller, especially predatory providers may have different incentives. These providers might have a greater interest in using arbitration requirements to chill individual claims and to ensure that, when individual arbitrations happen, they happen on terms that are favorable to the provider. Not afraid that such terms will poison the enforceability of class waivers—which would not be enforceable under the CFPB's rule—these providers may be even more likely to include terms like loser pays and cost splitting. And, interested in ensuring that these terms are actually enforced, these providers may migrate to smaller arbitration administrators that, unlike AAA and JAMS, do not have minimum required protections for consumers.

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[195] Br. of Chamber of Commerce of the U.S.A. as Amicus Curiae, AT&T Mobility v. Concepcion, 563 U.S. 333 (2011) (09-893)

[196] National Consumer Law Center, Consumer Arbitration Agreements (7th ed. 2014), Chs. 4 & 6, updated at www.nclc.org/library.

[197] CFPB Arbitration Study, § 2.5.10.

[198] See, e.g., Smith v. Vmware, Inc., 2016 WL 54120, at *2 (N.D. Cal. Jan. 5, 2016); Roberts v. Blue World Pools, Inc., 2015 WL 5315213, at *4 (W.D. Ky. Sept. 11, 2015); Valle v. ATM Nat., LLC, 2015 WL 413449, at *7 (S.D.N.Y. Jan. 30, 2015).

[199] See, e.g., Damato v. Time Warner Cable, 2013 WL 3968765 (E.D.N.Y. July 31, 2013).

[200] Cf. Harlan M. Blake, Employee Agreements Not to Compete, 73 HARV. L. REV. 625, 682 (1960) ("For every covenant [not to compete] that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors.").

[201] In the absence of an arbitration provision, a class action ban would be subject to challenge under state law on grounds of unconscionability. See, e.g., National Consumer Law Center, Consumer Class Actions §7.4.2 (8th ed. 2013), updated at www.nclc.org/library.

For all of these reasons, the CFPB should require that all entities that the CFPB examines submit to the agency all of the pre-dispute arbitration agreements into which they enter with consumers. For example, this requirement would apply to the larger participants in the credit reporting, auto lending and debt collection markets, and the payday lenders, mortgage lenders and servicers, foreclosure relief providers, and student lenders that the CFPB supervises.

The entities would be required to submit the arbitration agreements to the CFPB prior to or as part of a scheduled examination. We hope that the CFPB is already planning, once the arbitration rule is in effect, to expand its examination program to include a review of compliance with the arbitration rule. Obtaining the arbitration agreements would be necessary as part of this examination in any event.

Limiting this requirement to entities that are being actively examined (and, in addition, to larger participants that do not have an examination planned in the next year) will limit the burden on smaller entities. Most of the entities subject to examination have already been deemed “larger participants” in their respective markets. Even in the markets such as payday, mortgage and student lending where the CFPB’s authority is not limited to larger participants, it is unlikely that the CFPB is examining the smallest entities.

In addition, to the extent that the CFPB is already conducting an exam, asking the entity to respond to a request to product its arbitration agreements is a trivial burden. Most likely all supervised entities are required to turn over their contracts to the CFPB as part of the broader examination process.

These arbitration agreements should be made available in an online database. Public enforcement and regulatory agencies, including the CFPB, can then review those terms to ensure that none violate state or federal UDAAP protections. *See* § 9, *infra* (regarding discussion of unfair terms). Public disclosure will also permit research and public discussion about the way in which these arbitration provisions are being used.

This information is already public for credit card agreements and the CFPB has proposed to collect and publish prepaid card agreements. Transparency and research will be promoted if the agreements of payday and installment lenders, auto lenders, credit bureaus, student lenders, debt collectors and other supervised entities are also public.

8.3 A provider’s reliance on a pre-dispute arbitration agreement should trigger application of the submission requirements.

The CFPB should also require providers to submit arbitration records whenever they *rely* on a pre-dispute arbitration agreement—not just at the point that the consumer initiates the arbitration proceeding. Whenever a provider relies on an arbitration agreement—for example, by using it to attempt to compel arbitration of a claim filed in court—the provider should have to disclose that agreement, the complaint filed in court by the consumer, and any other relevant records that the CFPB requires providers to submit under § 1040.4(b). In other words, a provider’s reliance on a pre-dispute arbitration agreement—however “rely” is defined under § 1040.4(a)(1)—should trigger the submission requirements of § 1040.4(b)(2) to the extent they apply.

Like the recommendation to require submission of arbitration agreements, this recommendation is designed to ensure that the CFPB collects data about the use of arbitration agreements, even when that use does not result in an arbitration proceeding. Frequently, courts compel arbitration of consumer disputes, but the consumer declines to pursue his or her case in arbitration. The proposed rule would not capture data about these cases.

8.4 Suggestions for additional records subject to the submission requirement

NCLC recommends requiring submission of the following records in addition to those that the proposed rule would require providers to submit under § 1040.4(b)(1).

8.4.1 Information about how much the parties pay the arbitrator and arbitration administrator

The costs to a consumer of pursuing a claim in arbitration can be considerably higher than the costs of pursuing that same claim in court. Industry advocates point to administrator rules requiring the consumer to pay only the initial arbitration filing fee—and the fact that AAA will refuse to enforce cost-allocation terms that impose more costs on the consumer—to argue that arbitration is affordable. However, not all arbitration is before the AAA, the AAA could change its rules, or could fail to follow its rules.

Even AAA filing fees in consumer transactions may be unaffordable for many consumers. This leads to an important question as to whether the arbitration provider has a mechanism to allow a consumer to pay decreased filing fees where the standard consumer filing fee is unaffordable, and whether the provider actually allows for such reduced fees.[202]

We recommend that the rule require submission of the following records for each arbitration proceeding: (1) the costs of the arbitration paid by both the provider and the consumer; and (2) whether the arbitrator or arbitration administrator provided an opportunity for the consumer to seek a reduction in filing costs, and whether the consumer sought or obtained a reduction in filing costs.

8.4.2 Information about the timing of the arbitration proceeding

Too often arbitration is not as fast and efficient as arbitration supporters portray. Moreover, providers increasingly are manipulating the arbitration process to prevent consumers from gaining timely relief or even from gaining access to the arbitral forum.

In many cases, providers will not pay their arbitration fees or not pay them in a timely way.[203] In response, arbitrators will delay administration of the arbitration or deny administration entirely.

When this occurs, arbitration administrators may issue a notice to the parties that the administrator will not administer the arbitration. In many cases, the consumer will remain stuck

[202] Judith Resnick, Diffusing Disputes: The Public in the Private of Arbitration, the Public in Courts, and the Erasure of Rights, 124 Yale L.J. 2804, 2914 (2015).

[203] For example, AAA recently announced that it would not administer arbitrations involving one of the nation's largest debt buyers because the debt buyer previously "did not timely submit its share of the filing fees and/or failed to waive a provision in its consumer contract that the AAA identified as a material and substantial deviation from the [AAA Consumer Due Process Protocol]." See http://www.nclc.org/images/pdf2/pubs/MidlandDeniedAAARedacted.pdf.

in an arbitration limbo, unable to assert his or her claims in any forum. And, even if the consumer is ultimately able to proceed to court or arbitration, the provider will have successfully delayed the consumer's ability to seek redress.

We recommend that the rule require providers to submit the following information about each arbitration proceeding in which they are involved: (1) the date the demand for arbitration was filed; (2) the date the provider paid its arbitration fees; (3) the date the arbitrator was appointed; (3) the date or dates during which the arbitration proceeding occurred; and (4) the date when the arbitrator issued an award. If the dispute was resolved without an arbitration award, including by settlement, the provider should disclose the date of that resolution.

8.4.3 Information about the arbitrator administrator and their history with the parties

A significant concern with consumer arbitration is that the provider will select the arbitration administrator, will typically pay the lion's share of the arbitration fees and costs, and may appear before that administrator many times. It may even be that the provider will appear before the same arbitrator multiple times. The consumer on the other hand will not select the administrator, may pay only a small portion of fees and costs to the administrator and arbitrator, and will appear only once before the arbitrator and administrator.

This leads to at least the perception if not the fact that both the administrator and arbitrator will have a repeat player bias in favor of the corporation and not the consumer. In some cases, the corporation might even have an ongoing relationship with the arbitrator. This is particularly likely in cases where multiple individual consumers arbitrate similar claims against the same provider. In those cases, arbitration administrators may allow the same arbitrator to resolve all similar disputes involving the provider.

To allow consumers, advocates, and regulators access to this information, the CFPB should require providers to disclose for each arbitration: (1) the name of the arbitration administrator; (2) the name of the arbitrator; (3) a description of any direct dealing between the provider and the arbitrator outside of an arbitration proceeding of the sort that would subject a judicial officer to disqualification under Rule 2.11 of the Model Code of Judicial Conduct[204]; (4) the amount the provider and consumer pay to both the arbitrator and the administrator; (5) the dates within the last three years when the arbitration administrator is or has ever administered an arbitration involving the provider; and (6) the dates within the last three years when the arbitrator is or has ever presided over an arbitration involving the provider.

8.4.4 Information about communications between providers and arbitration administrators or arbitrators

We recommend that the rule require submission of communications not part of an arbitration proceeding between providers and arbitration administrators and also between providers and arbitrators. This includes not only communications from the provider but also communications to the provider.

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[204] See Model Code of Judicial Conduct, Rule 2.11, available at http://www.americanbar.org/groups/professional_responsibility/publications/model_code_of_judicial_conduct/model_code_of_judicial_conduct_canon_2/rule2_11disqualification.html.

Communications between arbitration administrators and providers outside an arbitration proceeding can take many forms. As one example, consider a 2005 communication from attorneys representing AT&T to AAA.[205] At that time, AT&T was the respondent in a consumer action in arbitration. Notwithstanding that the arbitration clause at issue prohibited class arbitration, AAA staff apparently concluded that AAA's Supplementary Rules for Class Arbitration applied. AT&T's letter urged AAA to "overrule [its] staff['s]" determination that class arbitration was available.

A direct petition from a party to an arbitration to the company administering the arbitration is concerning, but more problematic than that may be the nature of the pressure that AT&T placed on AAA in its attempt to extract a good outcome. AT&T observed that AAA's biggest competitor, JAMS, had implemented an express policy that it would ignore class arbitration waivers and instead administer all putative class arbitrations under its class arbitration rules. This policy, AT&T warned, had dire financial consequences for JAMS: "As a result of the JAMS policy, it appears that ADR users are changing their clauses to delete JAMS as the chosen forum."

Sometimes the financial pressure that providers exert over arbitration administrators is evident in express communications from providers, but sometimes it may only become apparent in communications from administrators to providers soliciting business from the provider. Anecdotally, it seems that administrators increasingly are contacting businesses to solicit business. These communications can include explicit assurances regarding how the administrator will administer disputes involving the provider, or they may merely reflect the nature of the "repeat player" status held by the provider.

For these reasons, NCLC recommends that the CFPB require disclosure of communications between providers and (1) arbitration administrators and (2) arbitrators.

8.4.5 Any records and information about the financial relationship between (1) the arbitrator or arbitration administrator and (2) the provider

As the CFPB's March 2015 study recognized, one of the most appalling examples of the use of arbitration to harm consumers involves the National Arbitration Forum's (NAF) undisclosed financial relationship with Mann Bracken, one of the country's largest debt collection law firms. According to a complaint filed by the Minnesota Attorney General, Mann Bracken filed 125,000 collection actions with NAF in 2006, while NAF was holding itself out to the public as independent, neutral, and unaffiliated with any party.[206]

There is nothing in the proposed rule that would prevent a provider from forming similar ties with a pre-existing or newly formed arbitration administrator. There is also nothing in the proposed rule that would prevent providers from bringing affirmative claims against consumers in arbitration. Although AAA does not currently administer debt collection actions,[207] other arbitration administrators might.

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[205] See http://www.nclc.org/images/pdf2/pubs/ATTAAAthreatletter.pdf.

[206] Compl., Swanson v. Nat'l Arbitration Forum, Inc., No. 27-CV-09-18550 (Minn. Dist. Ct. Hennepin County July 14, 2009), available at www.nclc.org/unreported.

[207] Consumer Arbitration Fact Sheet, American Arbitration Ass'n, available at http://info.adr.org/consumer-arbitration/.

A number of states have recently adopted procedures that require debt collectors to produce information about a debt before the collector can obtain a default judgment in court.[208] This may create an incentive for creditors and debt collectors to encourage the creation of arbitration administrators that will administer debt collection actions and quickly award default judgment against the consumer without complying with these new procedures.

In that case, it is not hard to foresee various unfair relationships between providers and arbitration administrators. For example, in the 1990s, MCI had a contractual relationship with JAMS that, among other things, "require[d] JAMS to provide weekly reports on the status of current arbitrations [involving MCI], 24-hour electronic docketing containing any change in the status of cases, . . . [and] a centralized case scheduling system."[209]

To ward off against the development of close ties between providers and arbitration administrators (or, at the very least, to ensure that such ties are made public), the CFPB should require disclosure of any documents or information about the financial relationship between the arbitrator or arbitration administrator and the provider. This information should include shared ownership interests and any ongoing contractual relationships.

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[208] Maria Aspan, Top N.Y. Judge Toughens Debt-Collection Lawsuit Rules, Am. Banker, April 30, 2014, available at http://www.americanbanker.com/issues/179_83/top-new-york-judge-toughens-debt-collection-lawsuit-rules-1067234-1.html.

[209] MCI Telecomm'ns Corp. v. Matrix Comm'ns Corp., 135 F.3d 27, 36 n.17 (1st Cir. 1998).

9. Unfairness in Individual Arbitrations

9.1 All forced arbitration is inherently unfair

The Bureau has declined to prohibit forced arbitration of individual claims. The Bureau stated that the evidence on the impact of forced arbitration of individual claims "is inconclusive due in part to the low number of claims resolved in arbitration."[210] We disagree, and urge the CFPB to ban forced individual arbitration as well as forced class arbitrations.

Claiming that requirements for individual arbitrations will not be regulated because of the low number of individual arbitrations creates a catch 22. The reason there are so few individual arbitrations is that the very requirement of arbitration in consumer cases is so unfair that it discourages consumers from pursuing arbitration.

Just as forced arbitration clauses deter class actions, they also inhibit consumers from retaining attorneys or bringing claims, or can result in weaker settlements or dismissals, without the case ever ending up in arbitration. The CFPB has missed a major component of the unfairness of forced arbitration in individual cases by focusing only on the outcome of filed arbitrations and not examining their deterrent effect or the outcome of cases that were dismissed from court but never made it to arbitration.

Sections 9.3 – 9.13 below list a large number of unfair requirements found in arbitration agreements. Moreover, the very nature of arbitration discourages consumer utilization.

- Arbitrators have an incentive to favor the repeat player – the company – over a consumer the arbitrator will never see again;
- The inability to do full discovery and obtain evidence that is only in the hands of the company impedes consumers from proving their cases or determining the full impact of the harm;
- Arbitrators do not have to follow the facts or the law and their decisions are not reviewable. This is particularly a problem with their interpretation of consumer statutes that are meant to not only compensate but also to deter;
- Arbitrations are usually secret and do not have the cleansing and deterrent impact of public court cases that reveal a company's wrongdoing.
- Arbitration fees and costs are typically higher than a court filing fee.

It will never be possible to measure precisely the impact of arbitration clauses on consumers. It will be hard to determine how often a consumer or attorney does not pursue a case because of the presence of an arbitration agreement.

Bias and other adverse aspects of consumer arbitration will also be hard to pinpoint. Arbitrators rarely reveal their bias in explicit ways. Looking at an arbitration will not reveal whether there was no evidence to prove the plaintiff's contentions or whether that evidence existed but the

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[210] Small Business Advisory Review Panel For Potential Rulemaking On Arbitration Agreements, Outline Of Proposals Under Consideration And Alternatives Considered (Oct. 7, 2015), http://files.consumerfinance.gov/f/201510_cfpb_small-business-review-panel-packet-explaining-the-proposal-under-consideration.pdf.

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plaintiff was unable to discover it. Arbitrators are not required to write detailed opinions that show how they ignored evidence or the law. And one can never say what would have been different if a company's wrongdoing had been exposed. More fundamentally, every case turns on its individual facts, and finding apples-to-apples data that enables a comparison between cases resolved in court and in arbitration is nearly impossible.

In addition, when confronted with the inherent unfairness of the arbitration forum, consumers are likely to accept weak settlements. Those settlements are often confidential (and, indeed, the CFPB is not even proposing to collect them). Even the settlements could be examined, they are not they do not reveal the difference in what the consumer would have obtained or accepted in court compared to in arbitration.

Merely monitoring arbitrations that are actually brought will not address unfair practices that deter those arbitrations in the first place or that result in an intangible but definite unfairness to the forum. Accordingly, we urge the CFPB to consider all the available evidence and ban forced consumer arbitrations in their entirety.

9.2 The CFPB should make clear that certain practices in individual arbitration are UDAAPs

If the CFPB decides not to ban individual consumer arbitration agreements, it should specify unfair, deceptive or abusive terms in arbitration agreements and consider bringing enforcement actions against providers using these terms. In sections 9.3 – 9.13, below, we set out unfair terms found in consumer arbitration agreements today.

(1) "Loser pays" provisions

(2) "Cost splitting" provisions or other provisions that require the consumer to bear excessive costs

(3) "Inconvenient venue" provisions

(4) Limitations on substantive rights

(5) Inherently biased arbitrators

(6) Procedural hurdles

(7) Secrecy provisions

(8) Discovery limitations

(9) Initiating collection actions in arbitration

(10) Delay in paying arbitration fees, affecting commencement of arbitration proceedings

(11) Severance, delegation, and savings clauses.

To illustrate the use of these terms and the employment of these unfair practices, this discussion cites a number of judicial decisions declining to enforce these terms or admonishing defendants for engaging in these practices. This should not, however, signal to the Bureau that it has no place in policing the use of clearly unfair terms and practices in individual arbitration. For every case that ends up in court, there are likely countless others that never make it that far because a consumer (or her attorney) is discouraged from bringing claims. Or, the practice may not be challenged in a way that results in a published decision.

As discussed below, entities also have an incentive to insert unfair terms because, in the event those terms are challenged, delegation clauses, savings clauses, severability clauses, and offers to undo unfair terms after the fact can preserve the arbitration requirement. Predatory merchants and lenders should not be allowed to "have their cake and eat it too" by inserting unfair terms into their arbitration clauses—terms that will likely chill valid claims—while salvaging their arbitration agreements if a consumer ever challenges these unenforceable terms.[211]

9.3 Loser Pays

Many arbitration clauses include "loser pays" provisions that allow or require the arbitrator to award fees and costs to the prevailing party. Some courts deem these provisions unenforceable as unconscionable or as conflicting with a federal statute.[212] Yet, the issue continues to arise today.[213] Additionally, some lenders and merchants pack their arbitration clauses with "loser pays" provisions that not only apply to the arbitration proceeding but that also apply to – and deter – challenges to any aspect of the arbitration agreement in court.[214]

Loser pay provisions also contradict and undermine carefully crafted attorneys' fees provisions in many consumer protection statutes, which award fees only to prevailing consumers, not to prevailing defendants. Companies can absorb legal costs as part of the cost of doing business. But the risk of ruinous liability will prevent consumers from bringing meritorious claims at all.

9.4 Unfair Costs and Fees

Many arbitration clauses require potential plaintiffs to pay exorbitant arbitration fees, even in individual cases.[215] But even when a clause requires the merchant or lender to pay for the costs

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[211] See, e.g., Harlan M. Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 683 (1960) ("If severance is generally applied, employers can fashion truly ominous covenants [not to compete] with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable. This smacks of having one's employee's cake, and eating it too.").

[212] See, e.g., In re Checking Account Overdraft Litig., 685 F.3d 1269 (11th Cir. 2012) (concluding that "loser pays" provision is unconscionable under South Carolina contract law).

[213] See, e.g., Coronado v. D.N. W. Houston, Inc., No. H-13-2179, 2015 WL 5781375, at *10 (S.D. Tex. Sept. 30, 2015); Saravia v. Dynamex, Inc., 310 F.R.D. 412, 422 (N.D. Cal. 2015); Valle v. ATM Nat., LLC, No. 14-CV-7993 KBF, 2015 WL 413449, at *6 (S.D.N.Y. Jan. 30, 2015) (involving arbitration clause stating that "[t]he losing party must pay the expense of the prevailing party's attorneys, experts and witnesses"); Brinkley v. Monterey Fin. Servs., Inc., 242 Cal. App. 4th 314, 323 (2015); DeVito v. Autos Direct Online, Inc., 37 N.E.3d 194, 202 (Ohio Ct. App. 2015) (in case against auto dealer, stating that "the undisclosed, unlisted costs of the process under the loser-pays provision would result in prohibitive assessed costs for almost all vehicle buyers"); Hedeen v. Autos Direct Online, Inc., 19 N.E.3d 957, 969 (Ohio Ct. App. 2014) ("[T]he loser-pay provision chills consumers from pursuing their statutory claims through arbitration.").

[214] Dish Network L.L.C. v. Tena-Mendivil, 2015 WL 6645769 (Tex. App. Oct. 28, 2015) (describing Dish employment agreement that includes clause stating that if either party "files a judicial or administrative action asserting claims subject to this Agreement, and the other party successfully stays such action and/or compels arbitration of the claims made in such an action, the party filing the administrative or judicial action shall pay the other party's reasonable attorneys' fees and costs incurred in obtaining a stay and/or compelling arbitration").

[215] See, e.g., Nesbitt v. FCNH, Inc., No. 14-1505, --- F.3d ---- (10th Cir. Jan. 5, 2016); Chavarria v. Ralphs Grocery Co., 733 F.3d 916 (9th Cir. 2013); Brownlee v. Lithia Motors, Inc., 49 F. Supp. 3d 875, 881 (D. Colo. 2014); Mance v. Mercedes-Benz USA, 901 F. Supp. 2d 1147, 1165 (N.D. Cal. 2012); Simmons v.

of arbitration, the consumer must still pay a "filing fee," which is $200 under AAA's rules, and may be more with other arbitration administrators. Unlike most courts' filing fees, AAA's rules do not explicitly provide a mechanism for proceeding in forma pauperis.[216] In most places, then, an indigent consumer will have to pay hundreds of dollars for the right to assert a claim in individual arbitration, whereas they would have to pay nothing in court. Unaffordable fees can deter consumers from pursuing meritorious cases in arbitration.

9.5 Inconvenient Venue

Some arbitration clauses in standardized form contracts include venue provisions that require arbitration to take place in a venue that may be convenient for the business that drafted the clause but exceptionally inconvenient for the consumer who seeks to assert claims under the agreement.[217] For example, the Second Circuit upheld a delegation clause in a debt relief scam contract that required a New York Social Security recipient who made only $700/month to go before an Arizona arbitrator to determine whether it was unfair and unconscionable to force her to arbitrate her case in Arizona.[218]

In another case, a clause between an Oregon consumer and an Oregon business required arbitration in Dallas, Texas.[219] That plaintiff was lucky and the requirement was found unenforceable, but another consumer might have been deterred from bringing the action in the first place.

Congress already recognized the unfairness of suing a consumer in an inconvenient venue by banning the practice in the Fair Debt Collection Practices Act.[220] Numerous courts have also held that it is unfair under state UDAP laws to sue a consumer in an inconvenient venue.[221]

9.6 Limitations on substantive rights and shorter statutes of limitations

Many arbitration clauses include terms that infringe or limit a consumer's substantive rights. Often these provisions limit remedies provided by state or federal law, such as punitive or statutory damages or equitable relief.[222] They sometimes also prohibit the arbitrator from

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Morgan Stanley Smith Barney, L.L.C., 872 F. Supp. 2d 1002 (S.D. Cal. 2012); James v. Conceptus, Inc., 851 F. Supp. 2d 1020 (S.D. Tex. 2012); Antonelli v. Finish Line, Inc., 2012 WL 525538 (N.D. Cal. Feb. 16, 2012); Wolf v. Nissan Motor Acceptance Corp., 2011 WL 2490939 (D.N.J. June 22, 2011).

[216] See, e.g., Judith Resnik, Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights, 124 Yale L.J. 2804, 2912-14 (2015) ("In 2013, the AAA instituted a filing fee for consumers, pegged it at $200, and continued applying that fee in the 2014 revisions. . . . [A]side from [arbitrations in] California, robust and publicly accessible analogues to court-based "in forma pauperis" proceedings are not available in arbitration.").

[217] See, e.g., Duran v. J. Hass Group, L.L.C., 531 Fed. App'x 146 (2d Cir. 2013) (summary order); Sanchez v. Nitro Lift Techs., L.L.C., 91 F. Supp. 3d 1218, 1223 (E.D. Okla. 2015); Whataburger Restaurants LLC v. Cardwell, 446 S.W.3d 897, 911 (Tex. App. 2014).

[218] See, e.g., Duran v. J. Hass Group, L.L.C., 531 Fed. App'x 146 (2d Cir. 2013).

[219] Hurst v. Monitronics, Int'l, 2016 WL 523385 (N.D. Ga. Feb. 10, 2016).

[220] 15 U.S.C. § 1692i(a)(2)(B).

[221] See NCLC, Unfair and Deceptive Acts and Practices § 6.10.9 (citing cases).

[222] See, e.g., Hurst v. Monitronics, Int'l, 2016 WL 523385 (N.D. Ga. Feb. 10, 2016) (finding unconscionable clause that barred punitive damages and capped actual damages at $1000); Roberts v.

awarding attorney's fees, even where state or federal law provides for attorney fees for a prevailing consumer.[223] Some clauses attempt to shorten the relevant statute of limitations.[224]

In the extreme, some tribal arbitration clauses prohibit the arbitrator from applying or considering the applicability of state or federal law. The Fourth Circuit struck down a clause that "purportedly fashions a system of alternative dispute resolution while simultaneously rendering that system all but impotent through a categorical rejecting of the requirements of state and

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Blue World Pools, Inc., No. 15-cv-00335, 2015 WL 5315213, at *4 (W.D. Ky. Sept. 11, 2015) (concluding that term in arbitration agreement with pool installation and financing company that prohibits arbitrator from awarding any damages besides pool repair is unconscionable); Gorman v. S/W Tax Loans, No. 14-civ-00089, ECF Doc. No. 55 (D.N.M. March 17, 2015) (in suit against tax refund anticipation lender, concluding that plaintiff could not "effectively vindicate" her rights under the Truth in Lending Act because the arbitration clause prevented her from recovering statutory damages and attorney's fees provided under TILA); Willis v. Nationwide Debt Settlement Group, 878 F. Supp. 2d 1208 (D. Or. 2012) (concluding that term that bans punitive damages is unenforceable, violates public policy); Newton v. Am. Debt Services, Inc., 854 F. Supp. 2d 712 (N.D. Cal. 2012) (concluding that limitation of liability provision stripping plaintiffs of statutory rights under Credit Repair Organizations Act was substantively unconscionable), aff'd, 549 Fed. App'x 692 (9th Cir. 2013); Rajagopalan v. NoteWorld, L.L.C., No. 11-civ-05574, 2012 WL 727075 (W.D. Wash. Mar. 6, 2012) (arbitration clause substantively unconscionable when it stripped consumer of statutorily mandated recovery of fees and costs), aff'd, 718 F.3d 844 (9th Cir. 2013); Davis v. Global Client Solutions, L.L.C., 765 F. Supp. 2d 937 (W.D. Ky. 2011) (concluding that provision in arbitration clause limiting damages and disclaiming any special, incidental, consequential, exemplary, or punitive damages was unconscionable and unenforceable); Narayan v. Ritz-Carlton Dev. Co., 350 P.3d 995, 1007 (Haw. 2015); Caplin Enterprises, Inc. v. Arrington, 145 So. 3d 608, 617 (Miss. 2014) ("The arbitration clause and the limitation-of-liability clause, taken together, effectively deny the plaintiffs an adequate remedy against Zippy Check."); Bickel v. Sunrise Assisted Living, 141 Cal. Rptr. 3d 586 (Ct. App. 2012) (concluding that provision in arbitration clause requiring nursing home patients to waive protections of Elder Abuse statute invalid and unenforceable).

[223] See, e.g., Nino v. Jewelry Exch., Inc., 609 F.3d 191, 203 (3d Cir. 2010) ("Provisions in arbitration clauses requiring parties to bear their own attorney's fees, costs, and expenses work to the disadvantage of an employee needing to obtain legal assistance . . . [and] also undermine the legislative intent behind fee-shifting statutes like Title VII."); Sanchez v. CleanNet USA, Inc., 78 F. Supp. 3d 747, 757 (N.D. Ill. 2015); O'Hanlon v. JPMorgan Chase Bank, N.A., No. 15-civ-06640, 2015 WL 5884844, at *6 (C.D. Cal. Oct. 7, 2015) ("There is also no provision for awarding attorneys' fees to a prevailing employee as would be done under several civil rights statutes."); Southerland v. Corp. Transit of Am., No. 13-14462, 2014 WL 4906891, at *9 (E.D. Mich. Sept. 30, 2014).

[224] See, e.g., Hurst v. Monitronics, Int'l, 2016 WL 523385 (N.D. Ga. Feb. 10, 2016) (finding unconscionable clause that imposed one year statute of limitations); Long v. BDP Int'l, Inc., 919 F. Supp. 2d 832, 846 (S.D. Tex. 2013) ("The Court concludes that the one-year limitation period as applied to FLSA claims is unconscionable."); Mazurkiewicz v. Clayton Homes, Inc., 971 F. Supp. 2d 682, 687 (S.D. Tex. 2013); Unimax Express, Inc. v. APL, Ltd., 2012 WL 2366401 (C.D. Cal. June 21, 2012) ("This thirty-day notice period operates as a statute of limitations shorter than the four-year claim period available under California law, and works solely to [the stronger party's] benefit."); Pinela v. Neiman Marcus Grp., Inc., 238 Cal. App. 4th 227, 254 (2015); Gandee v. LDL Freedom Enterprises, Inc., 293 P.3d 1197, 1201 (Wash. 2013) (finding arbitration clause's requirement that claim be submitted within thirty days unconscionable and in contravention of Washington Consumer Protection Act's four-year statute of limitations); Hill v. Garda CL Nw., Inc., 308 P.3d 635, 638 (Wash. 2013) (concluding that an arbitration agreement's 14-day statute of limitations was unconscionable); Holcomb Condo. Homeowners' Ass'n, Inc. v. Stewart Venture, LLC, 129 Nev. Adv. Op. 18, 300 P.3d 124, 130 (2013).

federal law…. [A] party may not underhandedly convert a choice of law clause into a choice of no law clause."[225]

While courts often find these provisions unconscionable, in other cases, pursuant to a delegation clause, the issue may be sent to the arbitrator with an uncertain outcome or the consumer may be deterred from bringing the claim in the first place. Of course, the cost and delays inherent in litigation multiply when the consumer must engage in litigation over the enforceability of an arbitration clause before the merits of the case can even commence. In light of the Bureau's express charge to preserve and enforce many of this country's most important consumer protection statutes, the Bureau should prohibit terms that limit or infringe a consumer's substantive rights.

9.7 Biased or Bogus Arbitration

A serious problem with arbitration proceedings between consumers and corporations is the risk of repeat player and other more invidious forms of bias. The corporation selects the administrator and typically pays most of the cost of the arbitration. The corporation is likely to appear before the administrator multiple times and the consumer only once.

The most prominent recent case of bias is illustrated by the National Arbitration Forum's administration of tens of thousands of debt collection arbitrations initiated by a prominent debt collection law firm with which it had a close and undisclosed financial relationship. That practice was ended after an investigation by the Minnesota Attorney General, but prior to that, consumers had no way of knowing about the ties between NAF and the debt collection law firm.

Courts have struck down arbitration provisions clearly intended as deterrent and not as a real method of dispute resolution. The Eleventh Circuit struck down a clause that sent the plaintiffs to arbitrate under a set of rules—the Cheyenne River Sioux Tribal Nation consumer dispute rules—that "do not exist."[226] A district court made a similar finding – striking down an arbitration clause that specified a nonexistent arbitrator – in a recent nontribal case.[227]

One court recently found a clause to be substantively unconscionable for several reasons including: "Rather than selecting a neutral third-party arbitrator, the contract requires that a lawyer familiar with the security industry in the distant forum of Dallas, Texas conduct the secret arbitration."[228]

Yet the problems that consumers face when trying to challenge a clause that specifies a biased or unavailable arbitrator are perhaps best illustrated by the long road traveled by Abraham Inetianbor, a Florida consumer challenging CashCall's false reports to the credit bureaus that he had not paid his Western Sky payday loans:

The court first compelled the plaintiff to arbitrate before a tribal arbitrator in accordance with the Cheyenne River Sioux Tribal Nation's consumer dispute rules. After the tribe responded that it did not authorize arbitration, the plaintiff asked the court to reconsider its holding on the grounds that the rules did not exist and the forum was unavailable, and the court agreed.

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[225] Hayes v. Delbert Servs. Corp., --- F.3d ----, 2016 WL 386016, at *8 (4th Cir. Feb. 2, 2016) (Wilkinson, J.).

[226] Inetianbor v. CashCall, Inc., 768 F.3d 1346 (11th Cir. 2014).

[227] Hurst v. Monitronics, Int'l, 2016 WL 523385 (N.D. Ga. Feb. 10, 2016).

[228] Hurst v. Monitronics, Int'l, 2016 WL 523385 (N.D. Ga. Feb. 10, 2016).

CashCall then filed a new motion to compel arbitration with evidence that a tribal elder had agreed to serve as an arbitrator, and a new letter from the tribe, stating that while the tribe does not provide arbitration or involve itself in the hiring of the arbitrator, arbitration in a contractual agreement is permissible. The court then again ordered the plaintiff to arbitration and rejected the plaintiff's argument that the agreement was unconscionable because it allowed CashCall to unilaterally choose the pool of arbitrators: "Plaintiff has not given the Court any reason to believe that the selection process would lead to a biased arbitrator."[229]

The plaintiff then filed a motion to reconsider based on new evidence that the arbitrator's daughter was employed by Western Sky and an email chain showing that CashCall and Western Sky colluded to pick the arbitrator and prepare the arbitrator's letter. The court refused to reconsider and stated that claims of bias are available only to overturn an arbitration decision, not to avoid arbitration in the first place.[230]

The plaintiff then attended a preliminary arbitration hearing and obtained a transcript where the arbitrator admitted that Western Sky had asked him to be an arbitrator and that the tribe had nothing to do with selecting him or authorizing the arbitration. Based on this evidence, plaintiff filed yet another motion to reconsider, which the court granted.[231]

Courts, have struck down as unconscionable clauses that dictate an arbitrator selection procedure that will inherently favor the merchant or lender and inherently disadvantage the consumer.[232] Provisions that give the company greater control over which arbitrator is selected run an especially great risk of leading to a biased arbitrator, even if the consumer cannot point to any specific evidence of conflict of interest.

9.8 Procedural Hurdles

Arbitration clauses can contain procedural hurdles that not only bar access to court but also make it difficult to go to arbitration. One court called a tribal arbitration clause a "procedural

[229] Inetianbor v. CashCall, Inc., 2013 WL 2156836 (S.D. Fla. May 17, 2013).

[230] Inetianbor v. CashCall, Inc., 962 F. Supp.2d 1303, 1308 (S.D. Fla. Aug. 19, 2013).The court noted: "'[I]t is well-established that "reviews [of an arbitrator's alleged bias] are confined under the [FAA] to judicial decisions to confirm, modify, or vacate an arbitration award after a final arbitration decision has been made.' Brandon, Jones, Sandall, Zeide, Kohn, Chalal & Musso, P.A. v. MedPartners, Inc., 203 F.R.D. 677, 687 (S.D.Fla.2001) (emphasis in original); see also Gulf Guar. Life Ins. Co. v. Conn. Gen. Life Ins. Co., 304 F.3d 376 [476], 490 (5th Cir.2002) (holding that 'where arbitrator bias is at issue, the FAA does not provide for removal of an arbitrator from service prior to an award, but only for potential vacatur of any award.')." Id.

[231] Inetianbor v. CashCall, Inc., 962 F. Supp.2d 1303, 1308 (S.D. Fla. Aug. 19, 2013).

[232] See, e.g., Chavarria v. Ralphs Grocery Co., 733 F.3d 916 (9th Cir. 2013) (clause that always gives employer two strikes and employee only one is unconscionable); Nino v. Jewelry Exch., Inc., 609 F.3d 191, 204 (3d Cir. 2010) (provision is unconscionable because "DI is permitted to strike two arbitrators from the four-member AAA panel, whereas the employee is permitted to strike just one"); Zaborowski v. MHN Gov't Services, Inc., 936 F. Supp. 2d 1145 (N.D. Cal. 2013) (arbitration clause substantively unconscionable when method for choosing arbitrators was unfair; defendant would select three arbitrators and plaintiff had to choose from among them); Brown v. MHN Gov't Services, Inc., 306 P.3d 948 (Wash. 2013) (provision of arbitration clause allowing the defendant alone to select a slate of three arbitrators from which plaintiff would select one was substantively unconscionable).

nightmare," lacking in any ability to ensure the "orderly administration of justice," with multiple conflicting, ambiguous, or downright impossible sections. [233]

Another court, which found several unconscionable aspects of the arbitration clause, noted that the contract "does not name an arbitration forum for a consumer to file her claim; rather the consumer has to go to court, pursuant to 9 U.S.C. § 5, to have an arbitrator appointed."[234]

9.9 Secrecy Provisions

A number of arbitration clauses include secrecy provisions that prohibit consumers from sharing information related to the arbitration.[235] These types of terms stand in stark contrast to the normal rules governing dispute resolution in this country. Judicial proceedings are presumptively open to the public, and may be sealed only in response to good cause.

In many cases, arbitration clauses "impose a gag order such that [consumers] are unable to mitigate the advantages [for the lender or merchant] inherent in being a repeat player."[236]

Just as importantly, and especially relevant to the Bureau in light of its role in enforcing consumer protections, secrecy provisions inhibit public enforcement by interfering with the exchange of information between consumers and public enforcement agencies. As the CFPB found in its study, class actions tend to precede public enforcement, showing the important role that litigation has in revealing wrongdoing. Arbitration's secrecy undermine the legitimacy of the entire system of private dispute resolution, and interfere with the Bureau's ability to monitor arbitration outcomes to ensure their fairness.

9.10 Discovery Limitations

Arbitration clauses often greatly restrict the amount of discovery that is available to consumers.[237] These terms prevent individual consumers from obtaining the information that they need to protect their rights. In the typical consumer case, it is the consumer that needs discovery and not the corporation, so that a contractual provision limiting discovery is tilting the dispute resolution process in favor of the corporation. Limits on discovery not only hurt the consumer plaintiff but the public at large and enforcement agencies as these limits prevent the discovery of illegal and unfair practices.

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[233] Heldt v. Payday Fin., L.L.C., 12 F. Supp. 3d 1170 (D.S.D. 2014).

[234] Hurst v. Monitronics, Int'l, 2016 WL 523385 (N.D. Ga. Feb. 10, 2016).

[235] See, e.g., Pokorny v. Quixtar Inc., 601 F.3d 987 (9th Cir. 2010) (confidentiality provision unconscionable); Ting v. AT&T, 319 F.3d 1126, 1152 (9th Cir. 2003); In re Checking Account Overdraft Litig., 718 F. Supp. 2d 1352 (S.D. Fla. 2010) ("the confidentiality provision in this Agreement is one-sided and only benefits the Defendant").

[236] Longnecker v. Am. Exp. Co., 23 F. Supp. 3d 1099, 1110 (D. Ariz. 2014) (internal quotation marks omitted).

[237] Reyes v. United Healthcare Services, Inc., 2014 WL 3926813 (C.D. Cal. Aug. 11, 2014) (provisions limiting parties to one interrogatory and one set of twenty-five requests for production, along with only two eight-hour days of depositions were unconscionable); Hamerick v. Aqua Glass, Inc., 2008 WL 2853881, at *3 (D. Or. July 21, 2008) (provision limiting parties to one deposition was unconscionable in employment case because it was "impermissibly biased in favor of the employer"), aff'd on reconsideration, 2008 WL 3411303 (D. Or. Aug. 11, 2008).

9.11 Initiating Collection Actions in Arbitration

In the early 2000s, creditors and debt collectors initiated hundreds of thousands of debt collection actions in arbitration. In the wake of the NAF scandal, debt collection actions in arbitration dropped precipitously, because almost all such collections had been done through the NAF.

The AAA, seeing the potential for abuse, declines to handle consumer debt collection actions.[238] There is, however, no legal prohibition on the use of private dispute resolution mechanisms to collect debts incurred by consumers.

The threat of a return to arbitration for debt collection is constantly looming. And this threat may be more acute now than it has been in years in light of creditors' and collectors' migration toward smaller arbitration providers whose rules may allow for the administration of debt collection via arbitration. In addition, new procedural rules in state courts that may make it more difficult for predatory creditors and collectors to obtain an unsubstantiated default judgment may encourage collectors to resort to collection via arbitration.[239]

The potential for repeat player bias in consumer debt collection is particularly acute. The NAF was a perfect example of this. Even before there was interlocking ownership between NAF and the nation's largest collection law firm that was regularly bringing cases before the NAF, NAF showed dramatic repeat player bias. Literally hundreds of thousands of cases were brought before the NAF from a small number of card issuers, and the NAF's income was largely based on filing fees from those card issuers. NAF advertised to creditors the advantages of using the NAF and NAF rules and arbitrators were conspicuously biased in favor of creditors.

There cannot help but be at the least the appearance of bias where an arbitration forum receives fees in thousands of cases from one creditor and consumers neither pay fees nor appear before that forum more than once. In addition, it is the creditor who selects the forum in the form contract and the consumer has no say in the selection process. In one dramatic example, JAMS limited consumer arbitration agreements prohibiting class arbitration, and the creditors all changed their contracts to select AAA or NAF, forcing JAMS to renounce that policy.

The debt collection area is also plagued with problems of the wrong person, wrong amount and sewer service. The growth of the debt buyer industry and the well documented abuses in poorly documented or substantiated debts and robo-signing compound these problems. Public scrutiny, discovery, rules of evidence, an obligation to follow the facts and the law, and a right of appeal are especially critical in this area—all missing from collection via arbitration.

9.12 Failure to Pay Arbitration Fees or Otherwise Stalling the Arbitration Process

The lender or merchant that imposed the arbitration requirements sometimes delays, neglects or refuses to pay its required share of the arbitration expenses. The arbitrator may eventually refuse to proceed because the arbitration provider's rules require payment before adjudication of the

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[238] See, e.g.. Am. Arbitration Ass'n, Notice on Consumer Debt Collection Arbitrations, available at www.adr.org (describing AAA moratorium on consumer debt collection actions); but see Consumer Fin. Protection Bureau, Arbitration Study § 5.6.4 (March 2015) (identifying 24 filings during the relevant study period that likely conflicted with AAA's moratorium).

[239] See, e.g., N.Y. Comp. Codes R. & Regs. tit. 23, § 1.1.

dispute. However, it can be a considerable period of time – several months or a year – before that happens.

This conduct amounts to a breach of the arbitration terms and should be grounds for the consumer to bring her claim in court. However, arbitration administrators are often slow to enforce their own rules concerning payment of fees and costs.[240] And even when they do enforce their rules, this still results in serious delays before the consumers' claims to be heard.

Bringing a motion to compel arbitration and then refusing to go forward with the arbitration by refusing to pay fees or take other steps is inherently unfair, deceptive and abusive. It results in fraud on the court by claiming that the party intends to arbitrate when it does not.

The Bureau should prohibit deliberate stalling and manipulation of the arbitration process. For example, parties that file a motion to compel arbitration should be required to pay any arbitration fees within 30 days. Consumers should be able to automatically resume their court cases if the company does not pay or if the party engages in other stalling tactics.

9.13 Severance, delegation, and waiving of unfair terms

The prevalence of the terms detailed in the prior eleven sections is encouraged by the fact that there is little adverse consequence for providers putting such terms in their agreements. The terms are successful even if never utilized. Many consumers confronting these terms are discouraged from pursuing arbitration, are unable to find attorneys, or are discouraged from initiating lengthy litigation over these terms before the case on the merits can even proceed.

In the rare case that the consumer finds an attorney and challenges the unfair terms in the arbitration clause, the corporation is virtually in a win-win situation and the consumer in virtually a lose-lose situation. The litigation over the arbitration agreement will cost the consumer time and money. Even if the consumer succeeds in obtaining a ruling that a term is unfair, the consumer will still be forced into arbitration.

Arbitration agreements often have severability clauses that mean that the unfair term is severed from the agreement and the arbitration requirement is enforced without that term. Such clauses

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[240] An attorney who represents consumers bringing claims against predatory auto dealers and lenders recounted the following story about the American Arbitration Association's (AAA) failure to follow its own rules requiring the business to pay fees in a timely manner and refusing to administer an arbitration if the arbitration clause is not registered with AAA. See American Arbitration Association, Consumer Arbitration Rules, R-12, available at https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&revision=latestreleased. "We filed a YoYo car sale case against a car dealer where dealer kept the down payment and repo'd the car. Car dealer hires a known automobile dealer defense firm who for the first time provides my client with a copy the arbitration agreement she signed right before discovery is due. I don't think we can win against it, so I call the other attorney and we agree to file a joint motion to stay the case compel arbitration to save time rather than waiting two months for a hearing date that I know I will lose. It is with AAA, so I file under the consumer rules. AAA takes approximately 90 days before contacting the dealer. Car dealer has not had the arbitration agreement previously approved with AAA and does not pay the fees so case gets dismissed—another couple of months. We file a motion with the Court to lift the stay and deem arbitration waived. Court sets it for a hearing a month and a half out. Shortly before hearing, dealer pays the $250.00 to get AAA to approve the Arbitration and gets a letter from them saying they will now agree to hear cases involving the dealer. Court denies our motion and makes us start over from the beginning after almost a Year has passed!" Email to David Seligman, National Consumer Law Center, Oct. 29, 2015 (on file with NCLC).

are unfair in their own right.[241] If an arbitration contract contains an unfair term, the entire arbitration contract should fail and courts should not be permitted to sever the unfair term and enforce the remainder. But courts do in fact often merely sever unfair provisions rather than throwing out the whole arbitration agreement.

Arbitration clauses may also have “savings” clauses that provide for the enforcement of unfair terms “to the extent allowable by law.”[242] This has the same effect as a severability clause, in that the arbitration requirement is still enforced without the unfair term.

A similar tactic is often used by corporations when a consumer challenges an unfair term. The corporation merely tells the court that it will waive the enforcement of the unfair term, but still require arbitration.[243] This has the same effect as severability and savings clauses.

Challenging unfair terms becomes even more difficult with the presence of delegation clauses that specify that the arbitrator, not the court will determine issues of the arbitration agreement’s enforceability.[244] This means that arbitrators who are paid by the hour are the ones deciding if an arbitration agreement is enforceable, so that the case will go forward in arbitration before the same arbitrator, who will then financially benefit. And of course simply appearing before the arbitrator to determine the arbitration clause’s enforceability will require arbitration fees and other costs.

Because of these reasons, providers have little incentive not to include unfair terms--their presence does nothing to undermine the enforceability of the arbitration agreement as a whole.[245]

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[241] See Restatement (Second) of Contracts § 184 cmt. b (1981) (“[A] court will not aid a party who has taken advantage of his dominant bargaining power to extract from the other party a promise that is clearly so broad as to offend public policy by redrafting the agreement so as to make a part of the promise enforceable.”). Courts have recognized in a number of contexts—including when examining landlord-tenant agreements and covenants not to compete—courts should refuse to sever illegal terms where the inclusion of those terms may prevent parties from asserting their legal rights or, perversely, from challenging the enforcement of the same illegal terms. Summers v. Crestview Apartments, 236 P.3d 586, 593 (Mont. 2010); Baierl v. McTaggart, 629 N.W.2d 277, 285 (Wis. 2001); Harlan M. Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 682 (1960) (“For every covenant [not to compete] that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors.”). This same analysis should apply to the question of whether unfair terms can be severed from an arbitration agreement.

[242] For examples of cases discussing similar clauses in other contexts, see In re Dominguez, 995 F.2d 883, 887 (9th Cir. 1993) (examining “savings clause” in potentially usurious mortgage loan contract); Blue Growth Holdings Ltd. v. Mainstreet Limited Ventures, LLC, 2013 WL 4758009, at *3 (N.D. Cal. Sept. 4, 2013) (concluding that lender had “usurious intent regardless of the presence of the savings clause”); Kolani v. Gluska, 64 Cal. App. 4th 402, 408 (1998) (refusing to narrow covenant not to compete notwithstanding “savings clause”).

[243] Lelouis v. W. Directory Co., 230 F. Supp. 2d 1214, 1225 (D. Or. 2001) (rejecting similar tactic in context of employment arbitration agreement).

[244] The Bureau’s study found that delegation clauses appear frequently in contracts for consumer financial products, and appear especially frequently in products that target low-income consumers in particular. Consumer Fin. Protection Bureau, Arbitration Study § 2.5.4 (March 2015) (noting that delegation clauses appeared in over 60% of studied storefront payday loan agreements).

[245] Charles A. Sullivan, The Puzzling Persistence of Unenforceable Contract Terms, 70 Ohio St. L.J. 1127, 1175 (2009) (“[I]t seems likely that the low level of risk in insisting on invalid terms results in many

Moreover, relegating these determinations to the arbitrator means that there will be no public scrutiny or precedential effect of a ruling on an unfair arbitration provision.

Conclusion

Thank you for the opportunity for the National Consumer Law Center to submit on behalf of its low income clients these comments on the Bureau's proposed arbitration rule. This rule will be of critical importance to the rights of consumers and we support strong action in this area. These comments are generally in support of the proposed rule, but offer a number of suggestions so that the rule will more effectively protect consumers.

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thousands of contracts containing such terms, contracts that will have adverse real world effects on their signatories because of information asymmetries.").