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FREE-MARKET FAILURE: THE WELLS FARGO ARBITRATION CLAUSE EXAMPLE

*Jeff Sovern**

ABSTRACT

In September 2016, regulators charged Wells Fargo Bank, N.A. ("Wells Fargo" or "Wells") with opening millions of unauthorized accounts on behalf of its customers. When some of those customers filed class actions against Wells, the bank initially responded by moving to compel arbitration on the ground that the consumers had agreed to arbitrate disputes and waive their class action rights. Because most customers with claims in small amounts would probably have foregone filing an arbitration claim, the effect would have been to leave their damages uncompensated except for the refunding of fees, which Wells agreed to in the consent order it entered into with regulators.

The Consumer Financial Protection Bureau ("CFPB" or the "Bureau") has promulgated a regulation which, if it had been in effect at the relevant time, would have enabled the injured Wells customers to obtain class action relief. But Congress blocked the rule, partly because of free-market economic theory. This Article argues that free-market economics is not sufficient to protect consumers from the type of problem present in the Wells Fargo case for two reasons. First, free-market economics assumes that consumers have complete information while empirical evidence shows that consumers do not understand arbitration clauses, much less that consumers realize that such clauses would bar class actions as to fraudulent accounts of which the consumers had no knowledge. Second, the number of primary checking accounts at Wells consistently increased as the fraud became

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* Professor of Law, St. John's University School of Law. The author thanks Dee Pridgen, Adam Levitin, Christine Lazaro, David Horton, Nicole C. Rende, Amanda M. Schaefer, Kathleen Spellman, and, for inviting him to participate in this symposium, the editors of *Rutgers University Law Review*.

public, suggesting that the free market did not discipline Wells for its misconduct until regulators intervened, and did so only modestly at that point. It is even possible that by enforcing arbitration clauses as written, free-market economics prolonged the Wells fraud, thus enabling more consumers to be injured.

In short, some device beyond the free market is necessary to prevent financial institutions from cheating many consumers out of small amounts. Class actions are one such device, but arbitration clauses, as currently enforced, enable financial institutions to prevent their use, thus reducing their incentive to comply with the law.

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INTRODUCTION

Our country uses four main mechanisms to restrain companies from misconduct. Three are self-restraint,[1] the marketplace,[2] and governmental enforcement of consumer laws.[3] The fourth is lawsuits from injured consumers, especially in the form of class actions. In

1. For examples where self-restraint has failed, see *infra* note 119.
2. *See infra* notes 48–56 and accompanying text.
3. *See infra* notes 7, 167–70 and accompanying text.

recent decades, however, many companies have shielded themselves from class actions and most consumer lawsuits by inserting arbitration clauses into their contracts with consumers.

The Wells Fargo sham account scandal—one of the most significant recent consumer frauds involving a financial institution—offers a case study in the relative effectiveness of these mechanisms. This Article proceeds as follows: Part I reports on the Wells Fargo scandal. Part II explores the Consumer Financial Protection Bureau's arbitration regulation. Part III discusses the opposition to that regulation based on free-market economics, while Part IV points out the problems with free-market economics as applied to arbitration, with particular reference to the Wells Fargo scandal. In brief, Part IV shows how the assumptions underlying free-market economics do not apply to arbitration and that the market did not effectively discipline Wells when it came to the unauthorized accounts.

I. THE WELLS FARGO SCANDAL

On September 4, 2016, regulators charged Wells Fargo Bank, N.A. with opening as many as two million unauthorized accounts in its customers' names.[4] To take only one example, the bank reportedly opened a credit card account for a customer, Aaron Brodie, without his knowledge.[5] By the time Mr. Brodie learned of the account from debt collectors, it had accumulated more than $1300 in unpaid fees, which lowered his credit score, making it difficult for him to obtain a mortgage and increasing his borrowing expenses.[6]

In a consent order with the regulators, Wells promised to refund the fees it had charged customers on the unauthorized accounts and pay $185 million in fines.[7] News of the agreement prompted nationwide

4. *See* Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0015 (Sept. 4, 2016), 2016 WL 6646128, http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsent order.pdf. Wells later estimated the number of unauthorized accounts at 3.5 million. Emily Glazer, *Wells Fargo's Sales-Scandal Tally Grows to Around 3.5 Million Accounts*, WALL ST. J. (Aug. 31, 2017, 6:59 PM), https://www.wsj.com/articles/wells-fargos-sales-scandal-tally-grows-to-around-3-5-million-accounts-1504184598.

5. Emily Glazer et al., *Wells Fargo Is Trying to Fix Its Rogue Account Scandal, One Grueling Case at a Time*, WALL ST. J. (Dec. 27, 2016, 11:24 AM), https://www.wsj.com/articles/wells-fargo-is-trying-to-fix-its-rogue-account-scandal-one-grueling-case-at-a-time-1482855852.

6. *Id.*

7. *See* CFPB No. 2016-CFPB-0015, at 14–17; Glazer et al., *supra* note 5.

headlines and congressional hearings.[8] But, because Mr. Brodie's account was already in collection, the bank allegedly told him it could not help him.[9] Meanwhile, attorneys responded to stories like Mr. Brodie's by filing a dozen class action suits on behalf of Wells customers against the bank to recover damages.[10]

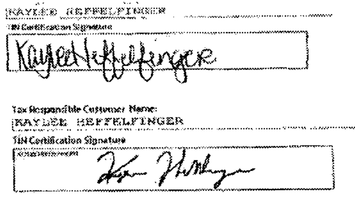
Despite clear evidence that customers' signatures had been forged when sham accounts were opened,[11] and Wells Fargo's acknowledgments that it had opened unauthorized accounts,[12] Wells initially responded by moving to compel arbitration on the theory that

8. For samples of news coverage, see *supra* note 5 and *infra* note 25. For the congressional hearings, see *An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 114th Cong. (2016), https://www.banking.senate.gov/public/index.cfm/hearings?ID=B80F9B81-4331-4F95-91BC-718288EC9DA0; *Holding Wall Street Accountable: Investigating Wells Fargo's Opening of Unauthorized Customer Accounts: Hearing Before the H. Fin. Servs. Comm.*, 114th Cong. (2016), http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=401082 [hereinafter *Holding Wall Street Accountable: Hearing*].

9. Glazer et al., *supra* note 5.

10. For an example of a class action complaint against Wells for opening fake accounts, see Class Action Complaint at 1–3, Mitchell v. Wells Fargo Bank, N.A., No. 2:16-cv-00966-CW (D. Utah Sept. 16, 2016), ECF No. 2. What may have been the earliest case brought against Wells Fargo for opening unauthorized accounts was filed in 2013, but was not a class action. *See* Rebekah Kearn, *Man Complains of Forgery at Wells Fargo*, COURTHOUSE NEWS SERV. (Sept. 13, 2013), http://www.courthousenews.com/man-complains-of-forgery-at-wells-fargo.

11. *See* Consolidated Amended Complaint Class Action at 13–18, Jabbari v. Wells Fargo & Co., No. 3:15-cv-02159-VC (N.D. Cal. July 30, 2015), ECF No. 37, 2015 WL 12859455; Michael Hiltzik, *How Wells Fargo Exploited a Binding Arbitration Clause to Deflect Customers' Fraud Allegations*, L.A. TIMES (Sept. 26, 2016, 11:55 AM) [hereinafter Hiltzik, *How Wells Fargo Exploited a Binding Arbitration Clause*], http://www.latimes.com/business/hiltzik/la-fi-hiltzik-wells-arbitration-20160926-snap-story.html. The two signatures below, which appear in the Jabbari complaint, purport to be from the same Wells customer:


Tax Responsible Customer Name:
KAYLEE HEFFELFINGER
TIN Certification Signature

Consolidated Amended Complaint, *supra*, at 17.

12. *See Holding Wall Street Accountable: Hearing*, *supra* note 8 (statement of John G. Stumpf, Chairman and Chief Executive Officer, Wells Fargo & Company) ("[A]ccounts were opened and products were provided to customers that they did not authorize or want.").

the cases could not be heard in court or in a class action because the consumers had agreed to arbitrate the disputes, to waive their class action rights, and to leave the question of arbitrability to the arbitrator.[13] The motions succeeded in at least one case.[14]

Wells's arbitration clauses were in fact written broadly enough to cover unauthorized accounts as to existing customers. For example, one Wells agreement defined a dispute as "any unresolved disagreement between you and the Bank. It includes any disagreement relating in any way to the Card or related services, Accounts, or matters . . . . It includes claims based on broken promises or contracts, torts, or other wrongful actions."[15]

When small consumer disputes are diverted to individual arbitration, the impact is often not only to change the forum in which the dispute is heard, but also to make it economically unfeasible to bring the case at all.[16] In contrast, claims for smaller amounts that are heard in court can be resolved, when appropriate, by class actions—a device that arbitration clauses typically forbid, as was true of the Wells arbitration clauses.[17] As a result, it appeared that the effect of Wells Fargo's invocation of its arbitration clause would be to block injured consumers with small claims from obtaining compensation beyond that provided by the consent decree. Even consumers who brought claims in arbitration were likely to lose procedural options available in court litigation, options that might spell the difference between winning and losing.[18] Moreover, research has shown that companies that arbitrate

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13. *See Wells Fargo Asks Court to Force Customers to Arbitration in Fake Accounts Cases*, N.Y. TIMES (Nov. 24, 2016), https://www.nytimes.com/2016/11/24/business/wells-fargo-asks-court-to-force-customers-to-arbitration-in-fake-accounts-cases.html?_r=0. For an example of such a Wells motion, see Defendants' Notice of Motion & Motion to Compel Arbitration of Plaintiff Kaylee Heffelfinger's Claims at 7–8, *Jabbari*, No. 3:15-cv-02159-VC, ECF No. 50, 2015 WL 13544478 (arguing that under the arbitration agreement, the arbitrator rather than the court was to decide whether the case was to be resolved through arbitration).

14. *See* Order Granting Defendants' Motions to Compel Arbitration at 1, *Jabbari*, No. 3:15-cv-02159-VC, ECF No. 69 (holding that the issue of arbitrability is for the arbitrator to decide under the agreement). *See generally* Michael Corkery & Stacy Cowley, *Wells Fargo Moves to Smother Lawsuits over Sham Accounts*, N.Y. TIMES, Dec. 7, 2016, at A1.

15. *See* WELLS FARGO BANK, N.A., CONSUMER CREDIT CARD CUSTOMER AGREEMENT & DISCLOSURE STATEMENT § 31(a), at 5 (2016), https://www.wellsfargo.com/assets/pdf/personal/credit-cards/agreements/private_bank_platinum.pdf.

16. *See infra* notes 37–40 and accompanying text.

17. WELLS FARGO BANK, N.A, *supra* note 15, § 31(b), at 9–10. Class actions can also be heard in arbitration if the parties agree.

18. Such options include the right to appeal and access to discovery devices. *See* Michael L. Rustad et al., *An Empirical Study of Predispute Mandatory Arbitration*

very often—so-called "extreme repeat players"—have a significant advantage over consumers.[19] In other words, invocation of the Wells Fargo arbitration clause was likely to have a profound impact on the ability of injured Wells customers to obtain compensation. Perhaps even worse, Wells Fargo's use of an arbitration clause might have enabled Wells to extend its fraud, thereby afflicting more consumers.[20]

The Wells Fargo motions generated considerable criticism.[21] Members of Congress proposed legislation to prevent Wells from shifting the cases to arbitration.[22] Wells may also have feared that the likelihood of a battle in Congress and the press over the then-anticipated CFPB regulation barring financial institutions from using arbitration clauses would further damage the bank's reputation.[23] In any event, notwithstanding its success in defeating the class actions in court, on March 28, 2017, Wells reported reaching a $110 million settlement of the class action claims,[24] which was later raised to $142

Clauses in Social Media Terms of Service Agreements, 34 U. ARK. LITTLE ROCK L. REV. 643, 663 (2012) ("Mandatory arbitration requires consumers to agree in advance to submit disputes to a private arbitral provider and divests consumers of important rights that would otherwise be available, such as their Seventh Amendment right to a jury trial, discovery, and appeal.").

19. *See* David Horton & Andrea Cann Chandrasekher, *After the Revolution: An Empirical Study of Consumer Arbitration*, 104 GEO. L.J. 57, 119 (2015) (finding that "extreme repeat-playing companies dominated awarded [arbitration] cases"); Michael Hiltzik, *Here's Why Wells Fargo Forces Its Customers into Arbitration: It Wins Most of the Time*, L.A. TIMES (Apr. 7, 2017, 3:10 PM) [hereinafter Hiltzik, *Wells Fargo Forces Its Customers into Arbitration*], http://www.latimes.com/business/hiltzik/la-fi-hiltzik-wells-arbitration-20170407-story.html.

20. *See infra* notes 111–123 and accompanying text.

21. *See* Jim Puzzanghera & James Rufus Koren, *Senator to Push Bill to Let Wells Fargo Customers Sue over Unauthorized Accounts*, L.A. TIMES (Oct. 3, 2016, 6:40 PM), http://www.latimes.com/business/la-fi-wells-fargo-arbitration-20161003-snap-story.html ("We are not going to let corporations like Wells Fargo use these fine-print 'gotchas' to escape accountability." (quoting presidential candidate Hillary R. Clinton)); Hiltzik, *How Wells Fargo Exploited a Binding Arbitration Clause*, *supra* note 11 ("In the category of adding insult to injury—or perhaps piling one injury on top of another—Wells Fargo is an expert."). Wells Fargo's strategy has been referred to as "abusive." *Id.*

22. Justice for Victims of Fraud Act of 2017, H.R. 1414, 115th Cong. (2017).

23. *See* Renae Merle, *What Wells Fargo Dodged by Agreeing to Pay $110 Million to Settle Fake Accounts Case*, WASH. POST (Mar. 30, 2017), https://www.washingtonpost.com/news/business/wp/2017/03/30/what-wells-fargo-dodged-by-agreeing-to-pay-110-million-to-settle-fake-accounts-case/?utm_term=.ef23c8244610 ("Resolving the suit, legal experts say, could help keep Wells Fargo, already struggling to repair its imagine [sic] from the sham accounts scandal, from becoming the center of what many expect to be a contentious debate next year over the fairness of the arbitration process.").

24. *See* Dorothy Atkins, *Wells Fargo to Pay $110M to End Phony Accounts Suits*, LAW360 (Mar. 28, 2017, 7:31 PM), https://www.law360.com/consumerprotection/articles/907284/wells-fargo-to-pay-110m-to-end-phony-accounts-suits

million,[25] and has since been modified in an attempt to insure that all injured consumers will be fully compensated for damages.[26] The settlement is subject to court approval, and while some class members opposed the settlement,[27] the court has granted a motion for preliminary approval.[28] It may be that Wells still benefited from the arbitration clauses despite deciding to waive arbitration because, conceivably, the threat of refusing to waive the clause enabled Wells to negotiate a more favorable settlement than would otherwise have been the case.[29]

In light of Wells Fargo's decision to waive its arbitration clause, it may be less useful as a case study in examining the impact of arbitration on consumer protection than it might otherwise have been. But in any event, it remains highly instructive as a case study with

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?nl_pk=757d28d3-3e54-41fb-b1f1-3bf59ec4e167&utm_source=newsletter&utm_medium =email&utm_campaign=consumerprotection. Commentators have speculated on Wells Fargo's motivations in settling rather than relying on its arbitration clauses to defeat the class action litigation. *See* Merle, *supra* note 23 ("[P]ressure on the bank, one of the largest in the country, has been building. Democratic lawmakers in the House and Senate have introduced legislation to allow Wells Fargo customers to sue despite the arbitration clauses . . . .").

25. James Rufus Koren, *Wells Fargo Ups Sham-Account Settlement to $142 Million, Making More Customers Eligible*, L.A. TIMES (Apr. 21, 2017, 12:10 PM), http://www.latimes.com/business/la-fi-wells-settlement-plan-20170421-story.html.

26. *See* James Rufus Koren, *Wells Fargo Guarantees Settlement Will Repay All Customers Hurt by Unauthorized Accounts*, L.A. TIMES (June 14, 2017, 11:15 AM), http://www.latimes.com/business/la-fi-wells-fargo-guarantee-20170613-story.html. That is accomplished by providing in an amended settlement agreement for a "gross-up" if damages exceed a specified amount. *See* Amended Stipulation & Agreement of Class Action Settlement & Release at 6, Jabbari v. Wells Fargo & Co., No. 3:15-cv-02159-VC (N.D. Cal. June 14, 2017), ECF No. 162, 2017 WL 3478869; Plaintiffs' Brief in Support of Amended Settlement Agreement & in Response to Order on Motion for Preliminary Approval at 4, *Jabbari*, No. 3:15-cv-20159-VC, ECF No. 160.

27. A number of class members have filed objections to the settlement. *See, e.g.*, Objections of Plaintiffs/Class Representatives & Certified Classes in MDL 2036 to Preliminary Approval of Stipulation & Agreement of Class Action Settlement & Release at 3, *Jabbari*, No. 3:15-cv-20159-VC, ECF No. 136; Mitchell Plaintiffs' Objection to Proposed Settlement Agreement & Motion for Preliminary Approval at 1, *Jabbari*, No. 3:15-cv-20159-VC, ECF No. 118, 2017 WL 3439006; Alex Chernavsky & William Castro's Response in Opposition to Plaintiffs' Motion for Preliminary Approval of Class Action Settlement & for Certification of a Settlement Class; & Renewed Motion to Intervene on Behalf of Privacy Class at 2, *Jabbari*, No. 3:15-cv-20159-VC, ECF No. 116.

28. *See* Order Granting Motion for Preliminary Approval, Denying Motions to Intervene, *Jabbari*, No. 3:15-cv-02159-VC, ECF No. 165, 2017 WL 3478868.

29. *See* Michael Hiltzik, *No Surprise: Wells Fargo Is Leveraging Its Arbitration Clause to Win an Advantageous Scandal Settlement*, L.A. TIMES (Mar. 31, 2017, 4:45 PM), http://www.latimes.com/business/hiltzik/la-fi-hiltzik-wells-settlement-20170331-story.html (arguing that Wells Fargo may have leveraged its ability to force litigation into arbitration to reduce the size of settlement).

regard to what happened *before* Wells entered into the settlement agreement. Nor is Wells Fargo's decision to waive its arbitration clause a typical response to the filing of a class action. The considerations that probably led Wells to do so are rare for consumer financial disputes subject to arbitration. Congressional committees do not normally hold hearings devoted to the misconduct of a single financial institution, and members of Congress do not commonly introduce bills directed at a single company's misbehavior. Wells did not have a legal obligation under existing law to forego its class action waivers, and if the settlement agreement fails to obtain final court approval, Wells might yet resume its insistence on arbitration. In short, there remain important lessons about arbitration to learn from the Wells Fargo cases.

II. THE CFPB'S ARBITRATION REGULATION

Arbitration clauses are normally enforceable under the Federal Arbitration Act.[30] But in 2010, Congress authorized the CFPB to regulate arbitration clauses in consumer financial contracts, provided it first studied them.[31] Any resulting regulation had to be based on findings "consistent with the study" and "in the public interest and for the protection of consumers."[32] On March 10, 2015, the Bureau issued its study, representing the most exhaustive study ever conducted of consumer arbitration.[33]

30. *See* 9 U.S.C. § 2 (2012) ("A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."). Congress has provided that arbitration clauses are not enforceable in certain types of contracts, such as mortgages issued after June 1, 2013. *See* 15 U.S.C. § 1639c(e)(1) (2012) (prohibiting arbitration clauses in residential mortgage loans and open-end credit loans secured by the consumer's principal dwelling); *see also* 12 C.F.R. § 1026.36(h) (2017); *36(h) Prohibition on Mandatory Arbitration Clauses and Waivers of Certain Consumer Rights*, CONSUMER FIN. PROTECTION BUREAU, https://www.consumerfinance.gov/eregulations/sxs/1026-36-h/2013-01503_20130601?from_version=2014-30405 (last visited May 3, 2018).

31. *See* 12 U.S.C. § 5518(a)–(b) (2012).

32. *Id.* § 5518(b).

33. CONSUMER FIN. PROT. BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS, PURSUANT TO DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 1028(a) (2015), http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf [hereinafter CFPB ARBITRATION STUDY]; *Field Hearing on Arbitration in Newark, NJ*, CONSUMER FIN. PROTECTION BUREAU, https://www.consumerfinance.gov/about-us/events/archive-past-events/field-hearing-on-arbitration (last updated Jan. 30, 2017).

On May 5, 2016, the CFPB proposed a regulation to bar the use of class action waivers in arbitration clauses,[34] and on July 10, 2017, it adopted a final arbitration rule.[35] The Bureau's rule would permit companies to continue inserting arbitration clauses in their agreements, but would block arbitration clauses from including class action waivers.[36] Had such a rule been in effect in time to apply to the Wells sham accounts, Wells would not have had the option of shunting the class action claims off to arbitration.

The CFPB's rule rests in part on the claim-suppressing effect of class action bans.[37] While consumers could theoretically still assert individual claims in arbitration, the Bureau study provided empirical confirmation of Judge Posner's famous observation that "[t]he *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30."[38] Thus, the CFPB study found that consumers rarely bring claims for $1000 or less to arbitration.[39] The study also reported that when arbitration clauses

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34. Arbitration Agreements, 81 Fed. Reg. 32,830 (proposed May 24, 2016) (to be codified at 12 C.F.R. pt. 1040). There was a lag between the Bureau's issuance of its proposed rule and its publication in the Federal Register.

35. Arbitration Agreements, 82 Fed. Reg. 33,210 (July 19, 2017) (to be codified at 12 C.F.R. pt. 1040).

36. *Id.* at 33,428–29. A class action waiver is a term for a provision that waives the right of a party to participate in a class action.

37. *Id.* at 33,210 ("This final rule is based on the Bureau's findings—which are consistent with the Study—that pre-dispute arbitration agreements are being widely used to prevent consumers from seeking relief from legal violations on a class basis, and that consumers rarely file individual lawsuits or arbitration cases to obtain such relief."). Indeed, the blocking of class actions appears to be the reason for the use of arbitration clauses in consumer contracts. *See id.* at 33,275; Jeff Sovern, *CFPB Arbitration Plan Provokes Dubious Industry Claims*, AM. BANKER (Nov. 13, 2015, 9:30 AM), https://www.americanbanker.com/opinion/cfpb-arbitration-plan-provokes-dubious-industry-claims.

38. Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004).

39. CFPB ARBITRATION STUDY, *supra* note 33, § 5, at 21, 23–24 (noting that of 1185 disputes in which parties sought monetary relief, only seventy-four involved claims of $1000 or less); *see also* Horton & Chandrasekher, *supra* note 19, at 117 ("In the entire four-and-a-half years covered by our study, only 184 of all 4,839 consumers in our sample demanded under $1,000."); Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, N.Y. TIMES (Oct. 31, 2015), https://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html?action=click&contentCollection=DealBook&module=RelatedCoverage®ion=EndOfArticle&pgtype=article ("[B]y assembling records from arbitration firms across the country, The Times found that between 2010 and 2014, only 505 consumers went to arbitration over a dispute of $2,500 or less.").

caused the dismissal of class actions, few of the putative class members brought individual claims.[40]

III. OPPOSITION TO THE CFPB'S REGULATION AND FREE-MARKET ECONOMICS

The CFPB's initial proposal and final arbitration rule drew opposition from several quarters. One was congressional Republicans. Their opposition took multiple forms. On July 25, 2017, the House voted to rescind the rule, using authority conferred by the Congressional Review Act.[41] The Senate followed suit on October 24 and President Trump signed the resolution blocking the rule from taking effect on November 1, 2017.[42] Even before the Bureau had issued the rule, the House Financial Services Committee had approved on May 4, 2017 the Financial CHOICE Act,[43] authored by the Committee's Chair, Jeb Hensarling. That bill would eliminate the CFPB's power to regulate arbitration clauses in consumer financial contracts.[44]

Chairman Hensarling's support for the Financial CHOICE Act is rooted at least in part in his belief in free-market economics. In his view, "the best consumer protection there is is a competitive, innovative market with freedom of choice for consumers."[45] During a hearing on the Wells Fargo scandal, he observed that he believes in markets rather

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40. *See* Arbitration Agreements, 82 Fed. Reg. at 33,276 ("[F]or the 46 class cases identified in the Study in which a motion to compel arbitration was granted, there was only an indication of 12 subsequent arbitration filings in the court dockets or the AAA Case Data, only two of which the Study determined were filed as putative class arbitrations.").

41. *See* 5 U.S.C. §§ 801(b)(1), 802(g) (2012). The House vote appears at 163 CONG. REC. H6278 (daily ed. July 25, 2017).

42. 163 CONG. REC. S6760 (daily ed. Oct. 24, 2017); J. Res. of Nov. 1, 2017, Pub. L. No. 115-74, 131 Stat. 1243.

43. H.R. 10, 115th Cong. § 737 (2017) (repealing the section authorizing the Bureau to regulate arbitration clauses); H.R. REP. NO. 115-153, pt. 1, at 153, 179 (2017).

44. H.R. 10 § 737. Conceivably, the Bureau could issue a completely different arbitration rule, notwithstanding the vote under the Congressional Review Act to rescind the rule it did issue, but if the Financial CHOICE Act were to pass, the CFPB would no longer have even that power.

45. Brad Wolverton (@bradwolverton), TWITTER (Mar. 17, 2017, 3:15 PM), https://twitter.com/bradwolverton/status/842861977047371777 (quoting Rep. Jeb Hensarling) ("More from my @RepHensarling interview[:] 'I believe that ultimately that [sic] the best consumer protection there is is a competitive, innovative market with freedom of choice for consumers. That's what prevents consumers from getting ripped off with a $50 hamburger—it's called competition.'").

than individual businesses.[46] Hensarling arrived at his love of free-market economics while studying economics:

> I didn't know why I was a Republican until I studied economics. I suddenly saw how free-market economics provided the maximum good to the maximum number, and I became convinced that if I had an opportunity, I'd like to serve in public office and further the cause of the free market . . . .[47]

Free-market economics has considerable appeal, stemming in part from its view that sellers and buyers who are able to enter into whatever agreements they want will reach agreements that are efficient, meaning, among other things, that consumers obtain what they want at the lowest possible cost.[48] The theory assumes that market participants have perfect information and behave rationally.[49] Suppose that government obliges sellers to provide a term, such as making it possible to resolve disputes in class actions. If that term increases sellers' costs, they will need to raise their prices to recoup the additional

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46. Tom Benning, *Disappointed Wells Fargo Customer Jeb Hensarling Grills Bank's Scandal-Ridden CEO*, DALL. MORNING NEWS (Sept. 29, 2016), http://www.dallasnews.com/news/politics/2016/09/29/disappointed-wells-fargo-customer-jeb-hensarling-grills-banks-scandal-ridden-ceo ("This sordid affair reminds me why I trust markets but not individual businesses[.]").

47. Joseph Guinto, *Jeb Hensarling: The GOP's Most Powerful Nobody*, D MAG. (Nov. 2009), http://www.dmagazine.com/publications/d-magazine/2009/november/jeb-hensarling-the-gops-most-powerful-nobody. For Mr. Hensarling's views on the CFPB specifically, see Elizabeth Gurdus, *House Financial Services Chair: CFPB Is an Unelected 'Dictator' That Must Be Stopped*, CNBC (last updated Feb. 16, 2017, 12:08 PM), http://www.cnbc.com/2017/02/16/house-financial-services-chair-cfpb-is-an-unelected-dictator-that-must-be-stopped.html ("[N]o person in America . . . should have the power, unilaterally, to decide what credit cards should go in our wallet, whether or not we can have a mortgage, and whether or not, if we like our banker, we can keep her[.] . . . [The CFPB] is damaging the most important consumer protection there is, and that is competitive, innovative, transparent markets that give Americans the freedom of choice." (third alteration in original) (quoting Rep. Jeb Hensarling)). *But see Credit Card Agreement Database*, CONSUMER FIN. PROTECTION BUREAU, https://www.consumerfinance.gov/credit-cards/agreements (last visited May 3, 2018) (database of hundreds of credit card issuers' credit card agreements available to consumers).

48. *See* JAMES KWAK, ECONOMISM: BAD ECONOMICS AND THE RISE OF INEQUALITY 18–24 (2017) (showing how economic theory predicts prices will equal the marginal cost of producing the item sold); PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 152 (19th ed. 2010) (same).

49. *See* SAMUELSON & NORDHAUS, *supra* note 48, at 164 ("The invisible-hand theory assumes that buyers and sellers have complete information about the goods and services they buy and sell.").

cost.[50] Put another way, buyers will be obliged to pay a higher cost to obtain the product. But buyers presumably do not want that term at the increased cost, or sellers would provide that feature without being forced to do so by regulation.[51] Consequently, regulation obliges buyers to pay more for products because they are obtaining the products with a feature they value less than it costs.[52] As a result, consumer surplus declines, and we have a less than optimal equilibrium.[53] Alternatively, buyers buy less of the items than they would have purchased at the lower cost, and again we have a less than optimal equilibrium.[54] In sum, free-marketers believe any deviation from the agreement that sellers and buyers want to strike, forced by regulation, necessarily leaves buyers worse off than they would be in the absence of regulation.[55] Consequently, free-market economics argues that government should generally leave contract terms alone.[56]

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50. *Cf.* KWAK, *supra* note 48, at 132 ("From the standpoint of economism . . . financial regulations simply prevent people from engaging in mutually beneficial transactions . . . .").

51. For more about the traditional approach of economics to government intervention, see PAUL KRUGMAN & ROBIN WELLS, ECONOMICS 131–55 (4th ed. 2015).

52. *See* SAMUELSON & NORDHAUS, *supra* note 48, at 30 ("[Adam] Smith wrote hundreds of pages railing against countless cases of government folly and interference. . . . Smith argued that such restrictions . . . limit the proper workings of the market system and ultimately hurt both workers and consumers.").

53. *See id.* at 96 ("The gap between the total utility of a good and its total market value is called *consumer surplus*. The surplus arises because we 'receive more than we pay for' as a result of the law of diminishing marginal utility."). Put another way, consumers receive less value for their dollar when providers are subject to government regulation than when they are not.

54. Another way of thinking of this phenomenon is that the regulation has shifted the supply curve leftward, which raises prices and so lowers the quantity buyers are willing to purchase. *See generally id.* at 55–56 (providing a useful explanation and illustration of a leftward supply shift).

55. *See* THOMAS A. DURKIN ET AL., CONSUMER CREDIT AND THE AMERICAN ECONOMY 416 (2014).

> Those who take the opposite position frequently argue that competition in the marketplace protects consumers more effectively than regulation. In this view, if markets are competitive, then malefactors and unsavory practices ultimately will lose out to better ones, and governments will not have to make decisions about how markets should operate or tell consumers what they can and cannot choose to do. . . . Since strong adherents to this position typically also contend that markets are quite competitive, they often argue that there is little need for government intervention beyond basic rules establishing a legal system that recognizes the validity of contracts between willing parties.

Id.

56. *See generally* Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1208 (2003) ("Economic analysis suggests that in a perfectly functioning market with complete information contracts between

Commentators have in fact applied this logic to arbitration clauses.[57] Stephen J. Ware has explained "businesses using adhesive arbitration agreements do so because those businesses generally find that those agreements lower their dispute-resolution costs. . . . [T]his benefit to businesses is also a benefit to consumers . . . because whatever lowers costs to businesses tends over time to lower prices to consumers."[58]

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buyers and sellers will contain only efficient terms, defined as those for which the differential between benefits and costs is greatest, regardless of how distributed between buyers and sellers. Economic theory also suggests that substituting an inefficient term into the contract would make both buyers and sellers worse off. The implication of these two propositions is that, in the absence of significant negative externalities to third parties, courts should never refuse to enforce contract terms, even if the terms are embedded in pre-printed forms and offered on an adhesive basis. To do so would be socially inefficient, and it would make buyers, as well as sellers, worse off than they otherwise would be." (footnotes omitted)).

57. *See* Letter from Nessa Feddis, Vice President & Senior Counsel, Am. Bankers Ass'n, Steven I. Zeisel, Exec. Vice President & Gen. Counsel, Consumer Bankers Ass'n & K. Richard Foster, Senior Vice President & Senior Counsel, Fin. Serv. Roundtable, to Hon. Richard Cordray, Dir., Consumer Fin. Prot. Bureau 9 (Aug. 22, 2016) (on file with the Am. Bankers Ass'n), https://www.aba.com/Advocacy/commentletters/Documents/joint-trades-arbitration-comment-letter.pdf [hereinafter Feddis, Zeisel & Foster Letter] ("The additional costs associated with the increase in class action lawsuits will result in higher prices, fewer choices, and lower quality services for consumers as providers pass their costs onto their customers."); *see also* Letter from David Hirschmann, President & Chief Exec. Officer, Ctr. for Capital Mkts. Competitiveness & Lisa Rickard, President, Inst. for Legal Reform, to Monica Jackson, Consumer Fin. Prot. Bureau 68–69 (Aug. 22, 2016) (on file with the U.S. Chamber of Commerce), http://www.instituteforlegalreform.com/uploads/sites/1/2016_8_22_Chamber_Arbitration_Comment_Letter.pdf [hereinafter Hirschmann & Rickard Letter] ("One reason businesses prefer to resolve disputes in bilateral arbitration is that arbitration offers a less expensive forum for the resolution of disputes, which lowers businesses' legal costs. This, in turn, leads to cost savings that can be passed along to consumers.").

58. Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 254–55 (2006) (footnote omitted). Ware acknowledged, however, that no empirical evidence supported his claim, though he also pointed out that at that time, no empirical evidence undermined his claim either. *Id.* at 256 n.8. More recently, the CFPB Arbitration Study refuted Ware's claim. *See* CFPB ARBITRATION STUDY, *supra* note 33, § 10, at 5–6. For more sources claiming that arbitration clauses or class action waivers reduce costs, see Amy J. Schmitz, *Building Bridges to Remedies for Consumers in International eConflicts*, 34 U. ARK. LITTLE ROCK L. REV. 779, 779–80 (2012) ("[C]ompanies often include arbitration clauses in their contracts to cut dispute resolution costs and produce savings that they may pass on to consumers through lower prices."); Letter from Dennis Shaul, Chief Exec. Officer, Cmty. Fin. Serv. Ass'n, to Monica Jackson, Consumer Fin. Prot. Bureau 4 (Aug. 22, 2016), https://www.regulations.gov/document?D=CFPB-2016-0020-4248 ("[A] ban on class action waivers would increase the legal exposure and legal defense costs of companies that provide consumer financial products . . . . For some lenders, absorption of these costs may be unsustainable and lead to an exit from the marketplace,

This reasoning is seductive. It is, in fact, an illustration of what James Kwak calls "economism" in his book of the same name: "the premise that people, companies, and markets behave according to the abstract, two-dimensional illustrations of an Economics 101 textbook, even though the assumptions behind those diagrams virtually never hold true in the real world."[59] Kwak views "economism" as an ideology used to justify restraints on regulation. He argues that unrealistic assumptions create theories that inaccurately describe the results of policy judgments.[60] In fact, when it comes to arbitration clauses, free-market theories do indeed rest on assumptions at odds with actual consumer behavior, and like other models that depend on unrealistic assumptions, they lead to inaccurate conclusions as to the functioning of the markets.[61] For example, the CFPB Arbitration Study found that credit card issuers offering contracts with arbitration clauses did not raise prices after eliminating arbitration clauses; thus contradicting the theory that arbitration clauses reduce prices.[62] The next section more fully explores whether the assumptions undergirding free-market economics hold true when applied to arbitration clauses, as well as how the market responded to the Wells Fargo account scandal.

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resulting in fewer choices for consumers."). Courts have also made similar comments about forum selection clauses, which are somewhat similar to arbitration clauses. *See* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 594 (1991) ("[I]t stands to reason that passengers who purchase tickets containing a forum clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued."); IFC Credit Corp. v. United Bus. & Indus. Fed. Credit Union, 512 F.3d 989, 993 (7th Cir. 2008) (analogizing to arbitration clauses: "[a]s long as the market is competitive, sellers must adopt terms that buyers find acceptable; onerous terms just lead to lower prices").

59. KWAK, *supra* note 48, at 6–7.

60. *Id.*

61. Among the many examples Kwak provides is one that seems analogous to arbitration clauses. Here is his description of the toxic mortgages that led to the foreclosure crisis and the Great Recession in turn:

> The fact that ordinary human beings could not understand the legal documents they were signing was a crucial feature of the entire [mortgage] system, not a bug. According to economism, an unregulated mortgage market will maximize the number of value-creating transactions between buyers and suppliers of credit. Instead, the lack of regulation made it possible for millions of borrowers—aided and abetted by mortgage brokers and lenders—to take out loans they had little chance of repaying.

Id. at 145. Similarly, consumers seem unable to understand arbitration clauses, as discussed *infra* note 63 and accompanying text.

62. *See* CFPB ARBITRATION STUDY, *supra* note 33, § 10, at 5–6.

IV. THE PROBLEMS WITH APPLYING FREE-MARKET ECONOMICS TO ARBITRATION CLAUSES AND THE WELLS FARGO SCANDAL

A. *The Assumptions Underlying Free-Market Economics Do Not Apply to Arbitration Clauses*

When it comes to arbitration clauses, the assumptions that consumers have perfect information and are rational seem particularly in question. In combination, these assumptions lead free-market economists to believe that consumers will make decisions in accordance with their own best interests and preferences. If that were so, then departures from the deals sellers and buyers strike would indeed yield the inefficiencies free-market economists warn against. But consumers often do not have perfect information and are not always rational, with the result that the agreement consumers and sellers enter may in fact not be optimal.

Two recent studies bear on the question of whether consumers have, or even can have, perfect information about arbitration clauses.[63] Though the studies used different methodologies, they both raise serious doubt about the extent to which consumers understand arbitration clauses. Obviously, if consumers do not understand arbitration clauses, the assumptions underlying free-market economics are inapplicable to them.

One of the studies, *Whimsy Little Contracts*, which I co-authored, surveyed 668 consumers online. We showed the respondents a contract with an arbitration clause printed in bold and italics. Key parts were also in ALLCAPS, including a section that said they could not participate as a representative or member of a class.[64] Then we asked them questions about the arbitration clause, including two questions

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63. *See* Jeff Sovern, Elayne E. Greenberg, Paul F. Kirgis & Yuxiang Liu, *"Whimsy Little Contracts" with Unexpected Consequences: An Empirical Analysis of Consumer Understanding of Arbitration Agreements*, 75 MD. L. REV. 1, 2 (2015) [hereinafter *Whimsy Little Contracts*]. The research reported in the article "was supported by a $29,510 grant from the American Association for Justice Robert L. Habush Endowment and by a grant from the St. John's University School of Law Hugh L. Carey Center for Dispute Resolution." *Id.* at 1; *see also* CFPB ARBITRATION STUDY, *supra* note 33, § 1, at 2.

64. *See Whimsy Little Contracts*, *supra* note 63, at 90 ("***YOU WILL NOT HAVE THE RIGHT TO PARTICIPATE AS A REPRESENTATIVE OR MEMBER OF ANY CLASS OF CLAIMANTS, OR AS A PRIVATE ATTORNEY GENERAL, PERTAINING TO ANY CLAIM SUBJECT TO ARBITRATION.***"). In addition, the first page of text in the contract (the second overall) said, again in bold: "**This agreement contains an arbitration provision (including a class action arbitration waiver). It is important that you read the entire Arbitration Provision section carefully.**" *Id.* at 86.

about class actions. Despite the contract provision providing that consumers could not participate in class actions arising out of the credit card agreement, four times as many respondents thought they could be in a class action as realized that they could not.[65] Only 12% recognized that the arbitration clause blocked them from being included in a class action, while 48% believed it did not.[66]

The *Whimsy Little Contracts* study also attempted to determine whether respondents understood that class action waivers are enforceable. Another question described a scenario, concluding: "Suppose the contract said you could not join with other consumers to bring a class action. Could you be included in a class action against the credit card company, either in court or arbitration or both?"[67] Less than a third of the respondents correctly replied that they could not be.[68] As one respondent put it, "I don't see how they could preclude us from filing a class action suit through a whimsy little contract."[69] The United States Supreme Court does.[70]

When the answers to the two survey questions were read in conjunction, they raised even more troublesome questions about the ability of consumers to understand the impact of arbitration clauses containing class action waivers. Only 6% of the respondents answered both questions in the negative, while more than a fourth wrongly gave positive answers to both questions.[71] In other words, more than four times as many respondents believed a contract with a class action waiver did not include an arbitration clause—or, if it did, wrongly thought that clause was unenforceable—as those who recognized a class action waiver and knew it was enforceable.

The performance of the *Whimsy Little Contracts* respondents on class action questions was not an aberration. Overall, the study raises concerns both about whether consumers correctly interpret arbitration clauses and whether they appreciate that they are enforceable. Respondents entered more than five thousand answers to the

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65. *Id.* at 51–52.

66. *Id.* at 52.

67. *Id.* at 54.

68. *Id.* Specifically, 36.5% answered "yes"; 28.9% clicked "no"; and 34.6% selected "I don't know." *Id.* Though the differences between "yes" answers and "no" answers were within the survey's margin of error, more than twice as many respondents chose either "yes" or "I don't know" as correctly replied "no." *Id.*

69. *Id.* at 55.

70. *See* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 340, 352 (2011) (holding that states cannot categorically invalidate class action waivers in arbitration clauses as unconscionable).

71. *Whimsy Little Contracts*, *supra* note 63, at 55.

eight questions that had correct and incorrect answers—but only a quarter of their answers were right.[72] While less than 1% selected correct answers to all eight questions, nearly a fifth did not choose any correct answers.[73]

The second survey of consumers' understanding and awareness of arbitration clause was conducted by the CFPB as part of its massive study of arbitration.[74] The Bureau asked consumers about their actual credit card contracts and then examined those contracts to determine if the respondents correctly understood their credit card terms. Though the Bureau's study employed a different methodology from the *Whimsy Little Contracts* study, to the extent that its survey addressed the same issues as the *Whimsy Little Contracts* survey, its results were similar. For example, the Bureau study found that 56.7% of the respondents whose credit card contracts included class action waivers nevertheless believed they could participate in class actions.[75] The Bureau also reported that less than 7% percent of its respondents whose contracts *included* arbitration clauses realized that they could not sue the credit card issuer in court—which was statistically similar to the proportion of respondents whose credit card contracts *lacked* arbitration clauses who believed they could not sue their credit card company in court.[76]

The Bureau's study also found that consumers generally did not take into account dispute resolution terms when deciding which credit card to seek.[77] Similarly, the *Whimsy Little Contracts* survey found that

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72. *Id.* at 64.

73. *Id.*

74. CFPB ARBITRATION STUDY, *supra* note 33, § 3.

75. *Id.* § 3, at 4. The 8% difference between the *Whimsy Little Contracts* respondents and the CFPB study respondents may owe something to the fact that the Bureau's respondents were asked to remember a credit card contract they might not have reviewed in some time (or ever) while the *Whimsy Little Contracts* respondents had been shown the contract immediately before answering the questions.

76. CFPB ARBITRATION STUDY, *supra* note 33, § 3, at 4 (adding that 7.7% of respondents without arbitration clauses believed they could not sue their credit card issuer in court). Similarly, only 14% of the *Whimsy Little Contracts* respondents realized that the contract they saw would block them from suing in court. *Whimsy Little Contracts*, *supra* note 63, at 46.

77. CFPB ARBITRATION STUDY, *supra* note 33, § 3, at 3.

> When asked an open-ended question regarding all the features that factored into their decision to get the credit card that they use most often for personal use, no consumers volunteered an answer that even implicitly referenced dispute resolution procedures . . . .
>
> When presented with a list of nine features of credit cards (*e.g.*, interest rates, customer service, rewards) and asked to identify those features that factored into their decision, consumers identified dispute resolution procedures as being relevant less often than any of the other eight options.

the arbitration clause was salient to few respondents. In response to an open-ended question asking respondents to list five items they recalled from the credit card contract, only 3% of the respondents mentioned the arbitration clause, despite the fact that it appeared in bold print and italics, with portions in ALLCAPS.[78] Two other items that respondents remembered at least as frequently did not appear in bold, italics, or ALLCAPS.[79]

To the extent that the free market requires rational actors with perfect information, it is difficult to see how it will function on behalf of consumers who typically overlook class action waivers and, when they do become aware of them, often assume that the waivers are unenforceable.[80] If consumers cannot determine which contracts include arbitration clauses and which do not, they will be unable to tell which companies use such clauses and so cannot effectively try to avoid companies which do, if they want to do so. Moreover, consumers who believe that arbitration clauses do not bar them from joining a class action or suing in court have little reason to avoid contracts with arbitration clauses. That may help explain why the Wells Fargo customers agreed to a term that enabled Wells to defraud them and leave them without any effective means of redress. If consumers cannot understand arbitration clauses, we surely cannot expect them to anticipate that the clauses protect banks that open sham accounts in their names.[81]

Id.

78. *Whimsy Little Contracts*, *supra* note 63, at 40–41.

79. *Id.* at 41.

80. According to one economic theory, markets can achieve efficient results even when some consumers are unable to act in their best interests or uninterested in doing so as long as a large enough critical mass of other consumers exists that merchants want to meet the needs of that critical mass and can't distinguish between them and less informed consumers. *See* Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 638, 663 (1979). But, as noted in *Whimsy Little Contracts*, the theory seems inapplicable to arbitration clauses in general and class action waivers in particular, in part because it is unlikely that the requisite critical mass of awareness and understanding exists for arbitration clauses. *See Whimsy Little Contracts*, *supra* note 63, at 74–76.

81. *See* Declaration of Kaylee Heffelfinger in Support of Plaintiffs' Opposition to Defendants' Motion to Compel Arbitration para. 9, at 2, Jabbari v. Wells Fargo & Co., No. 3:15-cv-02159-VC (N.D. Cal. Sept. 10, 2015), ECF No. 54-5 ("When I opened my original accounts with Wells Fargo and enrolled in online banking with Wells Fargo, I did not intend to agree to give up my right to sue Wells Fargo for opening up accounts that I did not know about and that were not related to my original accounts.").

B. *The Market Did Not Discipline Wells Fargo Effectively for the Unauthorized Accounts*

Free-market advocates argue that the market disciplines bad actors by depriving them of customers and ultimately putting them out of business.[82] Consequently, it is useful to examine how consumers have responded to Wells for opening the unauthorized accounts.

That task is complicated by uncertainty concerning the timing of the fraud, as might be expected of a fraud carried on without official sanction by employees responding to incentives created by their employer. The consent decree refers to the period from 2011 to 2015, implying that this was when employees were opening the unauthorized accounts,[83] though some fraudulent accounts were opened nearly a decade earlier.[84] In January 2010, the Office of the Comptroller of the Currency discussed with senior bank management 700 whistleblower complaints it had received concerning the fraud.[85] The fraud first drew media attention in 2013 when the Los Angeles Times reported that Wells employees were opening unauthorized accounts for customers.[86]

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82. *See* E. Scott Reckard, *Lawsuits Put Heat on Wells Fargo, but Investors Barely Notice*, L.A. TIMES (May 14, 2015, 6:12 PM), http://www.latimes.com/business/la-fi-wells-fargo-class-action-20150515-story.html (quoting Susquehanna Financial Group's analyst Jack Micenko as to the Wells scandal that "the free-market system suggests clients would leave if they were uncomfortable").

83. *See* Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0015 (Sept. 4, 2016), 2016 WL 6646128, http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsent order.pdf; *see also* Paul Blake, *Timeline of the Wells Fargo Accounts Scandal*, ABC NEWS (Nov. 3, 2016, 4:15 PM), http://abcnews.go.com/Business/timeline-wells-fargo-accounts-scandal/story?id=42231128.

84. *See, e.g.*, INDEP. DIRS. OF THE BD. OF WELLS FARGO & CO., SALES PRACTICES INVESTIGATION REPORT 31, 73 (2017), https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf (reporting that Wells Fargo's Internal Investigation found an increase in annual sales gaming cases from 2000 to 2004 and that it also disclosed employees in the Colorado branch issuing unauthorized debit cards in 2002); Stacy Cowley, *At Wells Fargo, Complaints About Fraudulent Accounts Since 2005*, N.Y. TIMES (Oct. 11, 2016), https://www.nytimes.com/2016/10/12/business/dealbook/at-wells-fargo-complaints-about-fraudulent-accounts-since-2005.html.

85. *See* OFFICE OF ENTER. GOVERNANCE & THE OMBUDSMAN, OFFICE OF THE COMPTROLLER OF THE CURRENCY, ENTERPRISE GOVERNANCE SUPERVISION: LESSONS LEARNED REVIEW OF SUPERVISION OF SALES PRACTICES AT WELLS FARGO 5 (2017) [hereinafter OCC, ENTERPRISE GOVERNANCE SUPERVISION].

86. *See* E. Scott Reckard, *Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost*, L.A. TIMES (Dec. 21, 2013, 12:00 PM), http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html [hereinafter *Wells Fargo's Pressure-Cooker*] ("[E]mployees have opened unneeded accounts for customers, ordered credit cards without customers' permission and forged client signatures on paperwork."); E. Scott Reckard, *Wells Fargo Fires Workers Accused of Cheating on Sales Goals*, L.A. TIMES (Oct. 3, 2013), http://articles.latimes.com/2013/oct/03/business/la-fi-mo-wells-fargo-workers-fired-

That was also the year that the CFPB received its first whistleblower tip on the matter[87] and in which former Wells CEO John Stumpf later testified that he learned of the fraud.[88] While 2015 may be a plausible ending date for the scandal, as it was the year in which both the Los Angeles City Attorney suit and the first class action were filed,[89] a consultant Wells engaged reported allegations of employee-related sales misconduct continuing into the first quarter of 2016.[90]

Whatever dates for the fraud are chosen, it appears the marketplace did little, if anything, to discipline Wells for its misconduct

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20131003 [hereinafter *Wells Fargo Fires Workers*] ("Wells Fargo & Co. has fired about 30 branch employees in the Los Angeles region who the bank said had opened accounts that were never used . . . . One of the fired employees said that in some cases signatures were forged and customers had accounts opened in their names without their knowledge."); *see also* INDEP. DIRS. OF THE BD. OF WELLS FARGO & CO., *supra* note 84, at 26 (noting that the fraud "first came to public attention" through the L.A. Times articles); Brian Tayan, *The Wells Fargo Cross-Selling Scandal* 2 (Stanford Univ. Graduate Sch. of Bus., Research Paper No. 17-1, Dec. 2, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2879102 (follow "Download this Paper" hyperlink) ("In 2013, rumors circulated that Wells Fargo employees in Southern California were engaging in aggressive tactics to meet their daily cross-selling targets.").

87. *See* Richard Cordray, *Prepared Opening Statement of CFPB Director Richard Cordray Before the House Committee on Financial Services*, CONSUMER FIN. PROTECTION BUREAU (Apr. 5, 2017), https://www.consumerfinance.gov/about-us/newsroom/prepared-opening-statement-cfpb-director-richard-cordray-house-committee-financial-services; Brena Swanson, *Cordray Answers Charges that CFPB Didn't Take Lead on Wells Fargo Scandal*, HOUSING WIRE (Apr. 5, 2017), https://www.housingwire.com/articles/39782-cordray-answers-charges-that-cfpb-didnt-take-lead-on-wells-fargo-scandal (reporting that CFPB Director Richard Cordray testified in Congress that the CFPB first received a whistleblower tip about the Wells unauthorized accounts in 2013).

88. *See* Ashlee Kieler, *Wells Fargo CEO Stumpf Admits He Learned of Fake Accounts in 2013*, CONSUMERIST (Sept. 30, 2016), https://consumerist.com/2016/09/20/wells-fargo-ceo-stumpf-admits-he-learned-of-fake-accounts-in-2013; *see also* INDEP. DIRS. OF THE BD. OF WELLS FARGO & CO., *supra* note 84, at 55 (describing how Stumpf was notified of one incident in 2002 and received numerous customer and employee complaints which "he or his assistants referred to appropriate subordinates without further follow-up. According to Wells Fargo employees, concerns about sales practices and 'gaming' were raised with Stumpf during the 2012–2014 timeframe."). While the Independent Directors' report indicated that the Wells board first heard of the problem in 2014, *id.* at 67, a court opinion put it at 2013. *See* Shaev v. Baker, No. 16-cv-05541-JST, 2017 WL 1735573, at *5 (N.D. Cal. May 4, 2017).

89. *See* Complaint for Equitable Relief and Civil Penalties, California v. Wells Fargo & Co., No. BC580778 (Cal. Super. Ct. filed May 4, 2015), http://freepdfhosting.com/c7384fa6fc.pdf. In 2015, the *Jabbari* complaint was also filed. Complaint at 1, Jabbari v. Wells Fargo & Co., No. 3:15-cv-02159-VC (N.D. Cal. May 13, 2015), ECF No. 1. Both filings drew media attention, albeit without immediately lowering Wells's stock price. *See* Reckard, *supra* note 82 (indicating that Wells shares gained the day after the filing of the class action, which occurred the week after the City Attorney's filing).

90. *See* INDEP. DIRS. OF THE BD. OF WELLS FARGO & CO., *supra* note 84, at 33–34.

before regulators stepped in. For example, Wells experienced more than twice as much growth in average deposits from 2014 to 2015 as did competitors like Bank of America, JPMorgan Chase, and Citigroup.[91]

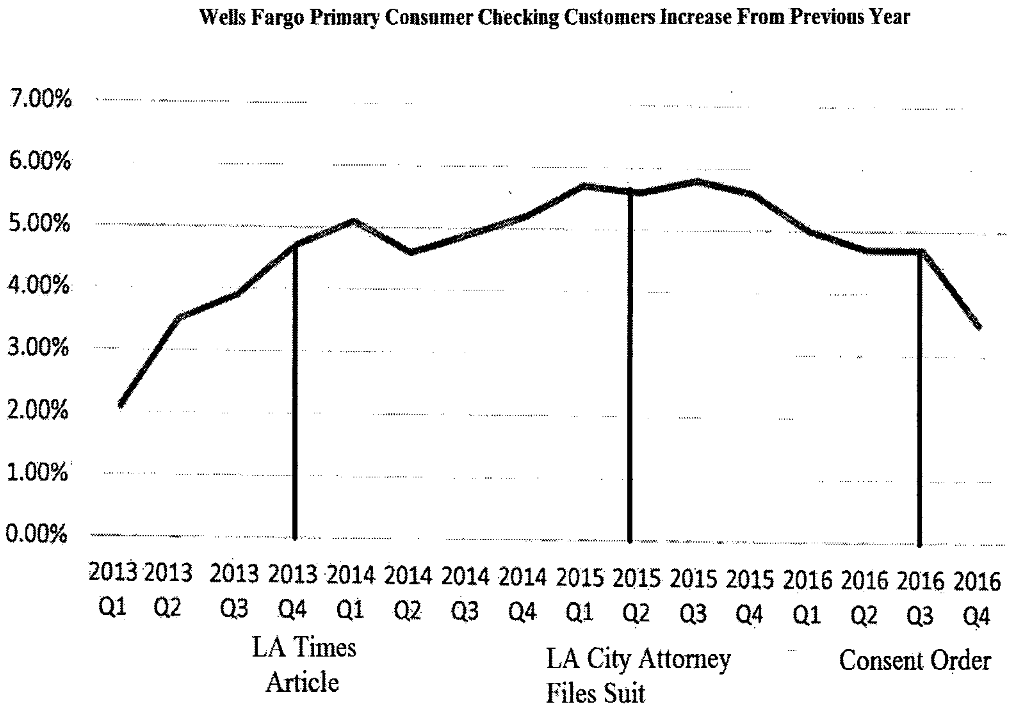
One measure of market response is the number of active checking accounts: existing customers could punish banks by closing checking accounts while non-customers might open accounts elsewhere. Yet, as Figure 1[92] shows, in every quarter since the beginning of 2013—the year in which the scandal first became public—the number of primary checking accounts at Wells increased by at least 2.1% over the same quarter in the preceding year. In the first quarter of 2014—the first full quarter after the Los Angeles Times reported that Wells employees were opening unauthorized accounts—the number of checking accounts rose by 5.1% over the previous year. In each of the ten succeeding quarters, the number increased by at least 4.6%. In short, there is little reason to think the market would have put a stop to Wells Fargo's fraud if Wells itself or regulators had not done so. But belief in the free market as a check on misconduct persisted. After the filing of at least one class action and the Los Angeles City Attorney's suit in 2015, a stock analyst explained "the free-market system suggests clients would leave if they were uncomfortable . . . and we have certainly not seen that with Wells."[93]

91. Tayan, *supra* note 86, at 7 (reporting that Wells's growth was 7%, Bank of America's 3%, and JPMorgan's 2%, while Citigroup lost 5%; PNC and US Bank experienced slightly larger growth at 8%).

92. *See infra* Figure 1.

93. Reckard, *supra* note 82 (quoting Susquehanna Financial Group's analyst Jack Micenko).

Figure 1: Wells Fargo's Primary Consumer Checking



Customers Increase from Previous Year[94]

2016: Quarter 4: 3.5%[95]

Quarter 3: 4.7%[96]

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94. Wells defines "primary consumer checking customers" as "[c]ustomers who actively use their checking account with transactions such as debit card purchases, online bill payments, and direct deposit." Press Release, Wells Fargo, Wells Fargo Reports $5.3 Billion in Quarterly Net Income 8 & n.5 (Jan. 13, 2017), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-53-billion-quarterly-net-income.

95. *Id.* at 8.

96. Press Release, Wells Fargo, Wells Fargo Reports $5.6 Billion in Quarterly Net Income 8 (Oct. 14, 2016), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-56-billion-quarterly-net-income.

Quarter 2: 4.7%[97]

Quarter 1: 5.0%[98]

2015: Quarter 4: 5.6%[99]

Quarter 3: 5.8%[100]

Quarter 2: 5.6%[101]

Quarter 1: 5.7%[102]

2014: Quarter 4: 5.2%[103]

Quarter 3: 4.9%[104]

Quarter 2: 4.6%[105]

Quarter 1: 5.1%[106]

2013: Quarter 4: 4.7%[107]

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97. Press Release, Wells Fargo, Wells Fargo Reports $5.6 Billion in Quarterly Net Income 8 (July 15, 2016), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-56-billion-quarterly-net-income-0.

98. Press Release, Wells Fargo, Wells Fargo Reports $5.5 Billion in Quarterly Net Income 7 (Apr. 13, 2016), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-55-billion-quarterly-net-income.

99. Press Release, Wells Fargo, Wells Fargo Reports $5.7 Billion in Quarterly Net Income 8 (Jan. 15, 2016), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-57-billion-quarterly-net-income-diluted.

100. Press Release, Wells Fargo, Wells Fargo Reports $5.8 Billion in Quarterly Net Income 8 (Oct. 14, 2015), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-58-billion-net-income.

101. Press Release, Wells Fargo, Wells Fargo Reports $5.7 Billion in Quarterly Net Income 8 (July 14, 2015), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-57-billion-net-income.

102. Press Release, Wells Fargo, Wells Fargo Reports $5.8 Billion in Quarterly Net Income 9 (Apr. 15, 2015), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-57-billion-net-income.

103. Press Release, Wells Fargo, Wells Fargo Reports Record Full Year Net Income 9 (Jan. 14, 2015), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-record-full-year-net-income.

104. Press Release, Wells Fargo, Wells Fargo Reports $5.7 Billion in Quarterly Net Income 9 (Oct. 14, 2014), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-57-billion-net-income-0.

105. Press Release, Wells Fargo, Wells Fargo Reports $5.7 Billion in Quarterly Net Income 9 (July 11, 2014), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-57-billion-net-income-1.

106. Press Release, Wells Fargo, Wells Fargo Reports Record Quarterly Net Income 9 (Apr. 11, 2014), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-record-quarterly-net-income.

Quarter 3: 3.9%[108]

Quarter 2: 3.5%[109]

Quarter 1: 2.1%[110]

Not only did the market fail to penalize Wells for its misconduct, but some have charged it might actually have lengthened the period in which Wells continued its fraud by allowing Wells to rely on its arbitration clause.[111] An arbitration clause might have such an impact for a variety of reasons. For example, had a class action proceeded, adverse court orders might have prompted Wells to alter its practices more quickly to reduce possible damages. Of course, as with any counterfactual, it is impossible to know, but in other cases, banks, and indeed Wells itself, have reacted to orders in a class action in one state by abandoning the challenged practices in other states whose citizens were not part of the class. Thus, after a court ruled that Wells had unlawfully reordered checks in a California class action, Wells changed its practices in other jurisdictions not subject to the court's ruling.[112] Conceivably, even a realistic threat of a class action might have caused Wells to move more quickly. Class actions are thought to deter misconduct[113] by changing the incentives a company faces when

107. Press Release, Wells Fargo, Wells Fargo Reports Record Full Year and Quarterly Net Income 9 (Jan. 14, 2014), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-record-full-year-and-quarterly-net.

108. Press Release, Wells Fargo, Wells Fargo Reports Record Quarterly Net Income 9 (Oct. 11, 2013), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-record-quarterly-net-income-0.

109. Press Release, Wells Fargo, Wells Fargo Reports Record Quarterly Net Income 9 (July 12, 2013), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-record-quarterly-net-income-1.

110. Press Release, Wells Fargo, Wells Fargo Reports Record Quarterly Net Income (Apr. 12, 2013), https://newsroom.wf.com/press-release/corporate-and-financial/wells-fargo-reports-record-quarterly-net-income-2.

111. *See* Hiltzik, *How Wells Fargo Exploited a Binding Arbitration Clause*, *supra* note 11; Robert Weissman & Lisa Donner, *Why Wells Fargo Got Away with It for So Long*, THE HILL (Sept. 20, 2016, 10:15 AM), http://thehill.com/blogs/pundits-blog/finance/296706-why-wells-fargo-got-away-with-it-for-so-long; *see also* Hiltzik, *Wells Fargo Forces Its Customers into Arbitration*, *supra* note 19 ("The absence of a public record may have allowed the Wells Fargo scandal to persist for years out of public view.").

112. *See* Arbitration Agreements, 81 Fed. Reg. 32,830, 32,858 (proposed May 24, 2016) (to be codified at 12 C.F.R. pt. 1040) (describing Wells Fargo's reaction to the court decision in *Gutierrez v. Wells Fargo Bank, N.A.*, 730 F. Supp. 2d 1080, 1082 (N.D. Cal. 2010), *aff'd in pertinent part*, 704 F.3d 712, 725–28 (9th Cir. 2012)).

113. *See id.* at 32,861–64 ("[D]eterrence is one of the primary objectives of class actions."); *see also* Reiter v. Sonotone Corp., 442 U.S. 330, 344 (1979) (discussing how class actions deter violations of the law).

contemplating bad conduct. But the arbitration clause eliminated the possibility of adverse court orders, unless Wells agreed to submit to a class action.

Another, albeit less persuasive, reason a class action might have caused Wells to end its misconduct earlier is rooted in the contrast between the public nature of court proceedings and the private nature of arbitration proceedings.[114] An arbitration—possibly even including a trial—probably draws less publicity than proceedings in open court. In theory, the marketplace not only failed to penalize Wells Fargo's misconduct, but by reducing its perfidy's profile may even have made it less likely that consumers would become aware of that perfidy, ironically insulating Wells from the scrutiny of the marketplace that free-marketers claim disciplines wayward businesses.

Whether that aspect of arbitration really made a difference is debatable in the Wells case. On the one hand, the bank's agreement to waive its arbitration clause suggests that Wells was sensitive to the public criticism it endured and would likewise have been sensitive to adverse publicity from, say, a trial. But the market seemed less sensitive. The filing of the *Jabbari* class action and the Los Angeles City Attorney's lawsuit against Wells, both in May 2015, were followed by a 5.8% increase in deposits the following quarter.[115] Whether the *Jabbari* class action would have had more of an impact on the market if the Wells motion to compel arbitration had not been granted and the class action had been allowed to proceed is an unanswerable question.

Even after regulators trumpeted Wells Fargo's misconduct in the September 2016 consent order, eliciting nationwide media attention and congressional hearings, the market seems to have punished Wells only modestly. In the first full quarter after the consent order, checking accounts at Wells increased by 3.5% over the same quarter in the preceding year.[116] That figure is lower than in any quarter since 2013, but it still shows an increase, demonstrating that many consumers are willing to bank at Wells, notwithstanding the fraud.

114. *See* Arbitration Agreements, 81 Fed. Reg. at 32,844 (noting that court proceedings are usually public while arbitration is private). For another example of a company allegedly using arbitration clauses to conceal misconduct, see Drew Harwell, *Sterling Discrimination Case Highlights Differences Between Arbitration, Litigation*, WASH. POST (Mar. 1, 2017), https://www.washingtonpost.com/business/economy/sterling-discrimination-case-highlights-differences-between-arbitration-litigation/2017/03/01/cdcc08c6-fe9b-11e6-8f41-ea6ed597e4ca_story.html?utm_term=.a6711fa81ce1.

115. *See supra* note 100 and accompanying text. The *Jabbari* class action complaint was filed on May 13, 2015. Complaint at 1, Jabbari v. Wells Fargo & Co., No. 3:15-cv-02159-VC (N.D. Cal. May 13, 2015), ECF No. 1, 2015 WL 3485066.

116. *See supra* note 95 and accompanying text.

Of course, other measures of consumer engagement exist. Brian Tayan has reported that customer visits to branches, credit card applications, and debit card applications all fell after the consent order was announced.[117] According to the Los Angeles Times in March 2017: "New checking account openings are running an average of 40% behind the same months a year earlier, and new credit card accounts are down by almost 50%. It isn't entirely clear whether the comparisons are so bad because the year-ago period includes bogus accounts."[118]

But it appears that Wells is doing far better than a failing bank would, despite its fraud, and was doing so before it settled the class actions. And during the period between the reporting of the fraud and the announcement of the consent order, Wells did not show ill effects from the scandal.

Markets can also work through creating incentives. Those incentives encourage the supplying of consumers with items they want at appropriate prices, but they can also create incentives to generate profits by creating the illusion that consumers are receiving something of value.[119] Banks can increase revenue by serving more of their

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117. *See* Tayan, *supra* note 86, at 4 ("The long-term impact on the bank was unclear. Customer visits to branches declined 10 percent year-over-year in the month following the scandal. Credit card and debit card applications also fell. Deposits and new checking accounts, however, continued to grow—albeit at below-historical rates."); *see also* Jen Wieczner, *Here's How Much Wells Fargo's Fake Accounts Scandal Is Hurting the Bank*, FORTUNE (Jan. 13, 2017), http://fortune.com/2017/01/13/wells-fargo-fake-accounts-scandal-closing-branches-earnings ("In Wells Fargo's community banking unit—the retail division in which the scandal took place—quarterly revenues declined 5% while profits sank 14% compared to the same period in 2015. While the bank's new CEO Tim Sloan said the impact of the scandal itself on Wells Fargo's revenue 'has not been significant,' he acknowledged that if the slowdown in customer account growth were to continue at the current rate, 'that would have a bigger impact.'"). And note that a decline in profits does not mean a loss.

118. Michael Hiltzik, *Customers Still Seem Wary of Doing Business with Wells Fargo—with Good Reason*, L.A. TIMES (Mar. 21, 2017, 3:50 PM), http://www.latimes.com/business/hiltzik/la-fi-hiltzik-wells-struggle-20170321-story.html; *see also Wells Fargo Customers Continue to Shy Away from the Bank amid Fallout from Its Accounts Scandal*, L.A. TIMES (Mar. 20, 2017, 3:35 PM), http://www.latimes.com/business/la-fi-wells-account-slowdown-20170320-story.html ("[T]here is a silver lining for the bank: Its February numbers are up from December lows.").

119. *See* Jeff Sovern, *The Risks of Unfettered Capitalism*, N.Y. TIMES (Aug. 15, 2016), https://www.nytimes.com/2016/08/16/business/dealbook/the-risks-of-unfettered-capitalism.html ("Capitalism may be the best economic system ever devised, but one of its drawbacks is that it provides financial incentives to harm and even kill people. Just ask those people who say they have been victimized by cigarettes, predatory lenders, Volkswagen diesel emissions, Takata airbags, General Motors ignition switches, Trump University, Vioxx, asbestos . . . .").

customers' banking needs, and so during the years before its misconduct came to light, Wells Fargo created incentives for Wells employees to "cross-sell"; that is, to persuade existing customers to open additional accounts.[120] As then-CEO John Stumpf wrote, Wells "fight[s] like cats and dogs for those numbers!"[121] Some Wells employees responded to these incentives by fraudulently opening unauthorized accounts.[122] This enabled Wells to boast of its cross-selling success, which probably boosted stock prices.[123] But it also eventually led to the scandal.

In sum, if the world posited by free-market economics were realistic, we would expect that the market would create disincentives to behave the way Wells did. But the market seems not to have done that, at least not until regulators became involved. In fact, Wells Fargo's use of arbitration clauses, sanctioned by the market, may have prolonged its fraud. If the extraordinary attention given to the Wells fraud—nationwide media attention, regulatory intervention, congressional hearings, and proposed legislation—elicited such a

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120. *See* Emily Glazer, *At Wells Fargo, How Far Did Bank's Sales Culture Go?*, WALL ST. J. (Nov. 30, 2015, 5:34 AM), https://www.wsj.com/articles/at-wells-fargo-how-far-did-banks-sales-culture-go-1448879643 ("In 1999, the bank said its customers on average used three of its products or services—the bank calls them 'solutions'—and hoped to increase that number to eight. . . . That success, when many rivals have flailed, has its roots in a high-pressure sales culture, according to the lawsuit and conversations with employees. . . . The employees, all of whom worked at the bank within the last five years, described having multiple meetings every day to discuss sales quotas and feeling intense pressure to meet those targets. Khalid Taha, a Wells Fargo personal banker in San Diego since November 2013, said he has daily and hourly sales goals in his branch in addition to the quarterly goals set by the company. Depending on the time of year, he said he has to produce 10 to 20 solutions a day."); *see also* Reckard, *supra* note 82 ("Wells Fargo & Co. branches create a high-pressure sales environment for employees—one in which the threat of being fired weighs heavily on front-line bankers given quotas for new accounts, cards and credit lines.").

121. INDEP. DIRS. OF THE BD. OF WELLS FARGO & CO., *supra* note 84, at 54 (alteration in original) (quoting John Stumpf e-mail).

122. Thousands of such employees were fired. *See Wells Fargo's Pressure-Cooker*, *supra* note 86; *Wells Fargo Fires Workers*, *supra* note 86.

123. *See* Shaev v. Baker, No. 16-cv-05541-JST, 2017 WL 1735573, at *2 (N.D. Cal. May 4, 2017) (quoting the Wells 2010 annual report as describing Wells as "the king of cross-sell"); ELIZABETH WARREN, THIS FIGHT IS OUR FIGHT: THE BATTLE TO SAVE AMERICA'S MIDDLE CLASS 231–32 (2017) ("Every three months, just like clockwork, John Stumpf, the CEO of Wells Fargo, got on the phone with the Wall Street players and talked about the amazing number of new accounts they had opened and modestly proclaimed his bank's genius at cross-selling. And when he did this, the bank's stock price went up and up and up, right along with his own bonuses and stock options."); Reckard, *supra* note 82 (reporting that Wells "boasts of selling more add-on products to customers than any other financial institution").

modest market response, it is difficult to see why a financial institution would fear a stern response from the market to less egregious behavior or conduct that did not inspire a penalty from regulators.

C. Is Informal Dispute Resolution a Substitute for Collective Action?

Free-market supporters of arbitration clauses have mounted a secondary argument. While arbitration defenders have generally not taken issue with the findings that consumers do not understand arbitration clauses,[124] two commentators, Professors Johnston and Zywicki, have argued that whether consumers take arbitration

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124. Indeed, one industry trade association seemingly conceded that consumers do not read arbitration clauses in its comments on the CFPB's proposal to conduct its survey. *See* Letter from Bill Himpler, Exec. Vice President, Am. Fin. Servs. Ass'n, to Consumer Fin. Prot. Bureau 2–3 (Aug. 6, 2013), https://www.regulations.gov/document?D=CFPB-2013-0016-0011 ("The results of the [proposed CFPB] Survey will undoubtedly show that the vast majority of consumers are not aware of most of the provisions in their card agreements . . . . [S]tudies have shown that consumers do not generally read contracts. Accordingly, if consumers do not read contracts generally, there is no reason to assume that they may read an arbitration provision, in particular. . . . [The proposed CFPB telephone] Survey is likely to show that consumers are not generally aware of the arbitration provision in their credit card agreement . . . ."); *cf.* Andrew Pincus, Chamber of Commerce of the United States of America, Statement on Examining the CFPB's Proposed Rulemaking on Arbitration: Is It in the Public Interest and for the Protection of Consumers app. at 14–15 (May 18, 2016), https://financialservices.house.gov/uploadedfiles/hhrg-114-ba15-wstate-apincus-20160518.pdf ("The only data that the Bureau's study delivers is that, unsurprisingly, consumers are not focused on arbitration clauses . . . ."); Hirschmann & Rickard Letter, *supra* note 57, at 31. Critics have also argued that the Bureau's survey

> is completely irrelevant to determining whether arbitration offers benefits to consumers . . . [because t]he Bureau refused to obtain information about consumers' baseline level of knowledge of other key provisions of their card agreements. Without that comparative baseline, the Bureau cannot determine whether consumers pay greater, less, or the same attention to dispute resolution clauses as to other clauses . . . .

Id. at 30–31 (footnotes omitted); *see also id.* at 30 n.95 (making the same complaint about *Whimsy Little Contracts*). In fact, the statement is partly inaccurate. Both the CFPB study and the *Whimsy Little Contracts* study attempted to determine the salience of arbitration clauses to consumers as compared with other contract terms, and they found that some other aspects of the contract were more significant to consumers. *See* CFPB ARBITRATION STUDY, *supra* note 33, § 3, at 11–15 (noting that respondents considered a variety of factors in choosing credit, such as interest rate, customer service, rewards, credit limit, fees, reputation, and card acceptance, ahead of the method of dispute resolution); *Whimsy Little Contracts*, *supra* note 63, at 40–41 (finding that arbitration was tied for the fourteenth most salient contract term, mentioned by about three percent of respondents). But to the extent that the critics point out that the studies did not examine consumer comprehension of other terms, they are correct. *See id.* at 73 n.229. Understanding of other contract terms does not bear on whether consumers recognize or grasp the effect of arbitration clauses.

provisions into account in making shopping decisions is not pertinent to the question of whether arbitration clauses should be regulated, because markets function in such a way as to make it unnecessary for consumers to understand arbitration clauses.[125] They argue that because financial institutions are quick to waive disputed fees in the interest of retaining customer business, the form of dispute resolution is irrelevant.[126] They further explain:

> [W]e were able to examine data provided by a mid-sized regional bank in Texas with respect to its internal processes for resolving disputes. . . .
>
> . . . Overall, the bank offered refunds in about 68% of cases in which a consumer complained, resulting in refunds of over $2.275 million in 2014. . . . Credit card issuers have every incentive to respond to valid complaints brought by their cardholders precisely because consumers do what they told the CFPB they would do: terminate a card when the issuer does not respond. *Given the effectiveness of this market response, consumers do not need to know anything about the details of the potential legal response they might have available when a company declines to refund charges and fees*, and they have no reason to assume that being required to arbitrate rather than litigate would be an important reason to select one card over another.[127]

125. *See* Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique* 28–32 (Mercatus Ctr., George Mason Univ., Working Paper No. LS 15-07, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2650846. Johnston and Zywicki address only the Bureau's study, but much of what they say, if it were well-taken, would also apply to *Whimsy Little Contracts*, *supra* note 63; *see also* Hirschmann & Rickard Letter, *supra* note 57, at 28, 31–32.

126. Johnston & Zywicki, *supra* note 125. They also provide the example, without any substantiation, of a financial institution that "may have inadvertently placed individual social security number information in a location on a document where it is visible to third parties" and that "[i]n such cases, the provider may itself take corrective action, such as providing free credit monitoring." *Id.* at 30–31.

127. *Id.* at 31–32 (emphasis added); *see also* Jason S. Johnston et al., Mercatus Center at George Mason University, Comment on Proposed Rule on Arbitration Agreements, 12 CFR Part 1040, at 4–5 (Aug. 22, 2016), https://www.mercatus.org/system/files/Mercatus-Arbitration-PIC-v1.pdf ("The Bureau dismisses evidence that financial firms have a very strong, market-driven incentive to nternally [sic] resolve consumer claims quickly and fairly. . . . The Bureau's data . . . show that consumers prefer the market to the legal response for perceived service failures by a credit card company. When a company does

This argument is flawed in no fewer than ten respects. First, it tells us nothing about whether other banks have made a similar calculation, or even whether the Texas bank continues the same policy today. Second, it offers no aid for the 32% of the bank's customers who did not obtain a refund. Similarly, we cannot be certain that the 68% of consumers who received relief obtained the full relief to which they were entitled. Third, it is impossible to tell from this bare statistic the reasons for the bank's decision. The bank may base its decision on any number of considerations other than whether it has acted wrongly—which would normally be the principal consideration in litigation.[128] Instead, the bank could offer a refund because it finds the risk of losing a particular customer's patronage sufficiently great if it does not, or deny a refund because it expects the customer to maintain the account regardless of what the bank does. Or the bank could base its decisions on whether or not the customer's business is sufficiently remunerative to justify forgoing the lost fee,[129] or on any other grounds it chooses, including grounds that are considered odious and discriminatory.

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not internally resolve disputes to the customers' satisfaction, they take their credit card business elsewhere, and they are unlikely to see a need to sue." (footnote omitted)). Similar arguments have been made about consumer use of social media. *See* Hirschmann & Rickard Letter, *supra* note 57, at 73 ("[C]onsumers can and do use social media to stop unjustified business conduct, without the need to retain a lawyer or to turn to complex, lengthy and time-consuming class action procedures."). While consumers aroused by social media do seem to have had an impact on some business practices, *see id.* at 73–74, social media did not stop Wells Fargo's misconduct, nor does it provide a mechanism for compensating injured consumers.

128. *See* Arbitration Agreements, 81 Fed. Reg. 32,830, 32,857 (proposed May 24, 2016) (to be codified at 12 C.F.R. pt. 1040) ("[Even w]here consumers do make complaints informally, the outcome of these disputes may be unrelated to the underlying merits of the claim.").

129. *See id.* ("[I]f two consumers bring the same dispute to a company, the company might resolve the dispute in favor of a consumer who is a source of significant profit while it might reach a different resolution for a less profitable consumer. Indeed, in the Bureau's experience it is quite common for financial institutions . . . to maintain profitability scores on each customer and to cabin the discretion of customer service representatives to make adjustments on behalf of complaining consumers based on such scores." (footnote omitted)). In a later comment, Johnston and Zywicki, joined by Michael P. Wilt, responded to the Bureau's statement by suggesting that profitability is an appropriate basis for deciding whether to grant consumers relief: "In practice, however, profitability seems to amount to a determination of whether the consumer is a responsible borrower who has made an inadvertent late payment or an inveterate late payer with a low average balance who is likely to leave the issuer with a large unpaid and uncollectible balance." Johnston et al., *supra* note 127, at 13. But this response seems to miss the mark, as it is difficult to see what bearing a customer's profitability would have had on whether Wells should have compensated the customer for injuries caused by opening an unauthorized account.

Fourth, it is not clear that any of the waived fees involved bank misconduct, as in the Wells example. Professors Johnston and Zywicki later filed a comment on the CFPB's then-proposed regulation, together with Michael P. Wilt, in which they seemingly focused on the frequency of bank forgiveness of fees that were in fact due.[130] Similarly, in a separate report, Professor Johnston referred multiple times to "fee forgiveness" in connection with the information he and Professor Zywicki had obtained from the bank.[131] There is a difference between a bank forgiving fees it is entitled to charge, because of *customer* behavior, such as an inactivity fee or a late fee, and refunding a fee because of *bank* behavior. When, for example, a bank forgives a late fee at the request of a careless customer, the bank can expect the customer to feel grateful to the bank, and the customer might accordingly be more likely to continue banking there. But when a bank, say, opens an account the customer has not authorized, and later refunds fees charged on the account, the customer might feel that the bank has done no more than it should have done and so might feel gratitude is not warranted. Consequently, the fact that a bank is willing to adopt a strategy of currying favor with customers by forgoing fees that are due might not shed any light on what the bank does when the bank is at fault.

Fifth, it is not certain that disappointed consumers will in fact take their business elsewhere, even when the bank has acted wrongly. Fewer than sixty percent of the Bureau's survey respondents indicated that they would cancel their credit card if their credit card issuer charged them a fee that they had not signed up for[132]—a number not that different from the percentage of the Texas bank's customers who

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130. The comment argued that "[e]ven a brief survey of the online personal-finance literature indicates that, had the Bureau done more research into market incentives for financial institutions to grant refunds or fee reversals when consumers complain, it would have found that such reversals are common." Johnston et al., *supra* note 127, at 13. In support of this claim, the authors cite an article reporting on a survey finding that 86% of customers who have sought reversal of a late payment fee have obtained it. *See* Kerri Anne Renzulli, *The Crazy Easy Trick to Getting a Credit Card Fee Waived or Your Rate Lowered*, TIME (Sept. 25, 2014), http://time.com/money/3425668/how-to-get-credit-card-fee-waived-rate-lowered. The comment failed to note, however, that the article indicated that consumers are more likely to obtain the fee waiver if they are older or higher-income—again, factors which do not bear on whether the financial institution engaged in misconduct. Moreover, as the fees in question amounted to twenty-six dollars or less, the survey offers little guidance for how banks respond when the amounts at issue are larger, as in the Wells example.

131. *See* Jason Scott Johnston, *Preliminary Report: Class Actions and the Economics of Internal Dispute Resolution and Financial Fee Forgiveness*, MANHATTAN INST. 12 (Aug. 19, 2016), https://www.manhattan-institute.org/sites/default/files/R-JJ-0816-v1.pdf.

132. CFPB ARBITRATION STUDY, *supra* note 33, § 3, at 16, 18.

obtained refunds.[133] The implication is that banks need not fear loss of patronage from a substantial minority of customers. And of course, while customers may predict that they will close their accounts during a telephone survey, when the issue actually arises, they may decide differently. Moving bank accounts from one institution to another is also more cumbersome than replacing one credit card with another. Consumers who have set up direct deposit from employers or for government benefits, and who have arranged for automatic bill payments, must repeat that process with a new bank. Consequently, consumers faced with actually closing bank accounts may find the inconvenience of doing so causes them to change their plans instead of their bank. According to a Consumers Union report, "[s]witching bank accounts takes time, money and substantial attention to detail . . . ."[134] That may explain in part why Wells Fargo, within months of its fraud becoming national news, experienced an increase in its number of deposits and checking accounts.[135] Indeed, it is not even certain that the consumer will notice an improperly charged fee or challenge it if the consumer becomes aware of it.[136]

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133. *See* Arbitration Agreements, 81 Fed. Reg. at 32,857 n.369. The Bureau's finding was confined to credit card accounts. *Id.* at 32,843. Consumers may incur greater switching costs for other financial products, such as checking accounts, *see infra* note 134 and accompanying text, and so fewer may switch checking account providers.

134. *See* SUZANNE MARTINDALE ET AL., TRAPPED AT THE BANK: REMOVING OBSTACLES TO CONSUMER CHOICE IN BANKING 19 (2012), http://consumersunion.org/wp-content/uploads/2013/09/TrappedAtTheBank1.pdf; *see also id.* at 1 ("We found that indeed it can be a hassle to move one's money—because, simply put, it takes time and money to move your money. The process takes several steps and banks don't always make it clear how to close accounts. Consumers face many obstacles, such as: the transfer of automatic deposits and debits from the old account to the new account; wait times while automatic deposit and debit transfers are processed; fees for closing accounts or for certain methods of receiving or transferring remaining balances; risk of old accounts reopening; and inadequate information about bank account closing policies." (emphasis omitted)); Haiyan Shui & Lawrence M. Ausubel, Time Inconsistency in the Credit Card Market 25 (May 3, 2004) (unpublished manuscript) (available at https://ssrn.com/abstract=586622) (finding consumers reluctant to switch between credit cards and that the average switching cost is $150).

135. *See supra* Figure 1.

136. *See, e.g.*, Arthur Best & Alan R. Andreasen, *Consumer Response to Unsatisfactory Purchases: A Survey of Perceiving Defects, Voicing Complaints, and Obtaining Redress*, 11 LAW & SOC. REV. 701, 712 (1977) (finding that only 30.7% of consumers noticing problems complain); Rex H. Warland et al., *Dissatisfied Consumers: Who Gets Upset and Who Takes Action*, 9 J. CONSUMER AFF. 148, 152 (1975) (describing a study finding that about half of consumers do not complain to sellers or external agencies when dissatisfied).

Sixth, a waived fee does little for consumers who seek more than a refund.[137] Recall Mr. Brodie, the Wells customer whose credit score allegedly dropped because of an unauthorized account, and who consequently was charged higher interest rates on other loans.[138] Reimbursement of fees on an unauthorized account is hopelessly inadequate redress for such a consumer.

A seventh problem is Johnston and Zywicki's assumption that financial institutions wish to retain the customer's good will. That is surely true in many markets, including markets in which Wells operates, but in others—such as debt collection, mortgage, or student loan servicing—consumers cannot choose their counterparties, and so retention of consumer good will is less valuable to businesses.[139] Indeed, one reason sometimes given for Congress to enact the Fair Debt Collection Practices Act ("FDCPA") in a form which regulates the behavior of debt collectors but largely leaves original creditors unregulated is that external debt collectors are less likely to be restrained by concerns for consumer good will.[140]

An eighth flaw in the argument is that if such private resolution of problems were completely effective, we would expect that few consumers would complain to the CFPB's complaint database, or at least no one who does so would obtain relief, because they would already have been satisfied by the company, assuming they first complained to the company, something informed consumers would do if such complaints reliably produced satisfactory outcomes. Yet the Bureau reports having received more than 1,100,000 complaints, and in one recent year, nearly a fifth of complaining consumers obtained some relief.[141] As for Wells Fargo itself and the database, during one recent year, 2015, the CFPB complaint database posted 9510 consumer

137. *See* Arbitration Agreements, 81 Fed. Reg. at 32,857 ("Nothing requires a company to . . . award complete relief to that consumer . . . .").

138. *See* Glazer et al., *supra* note 5 and accompanying text.

139. *See* Arbitration Agreements, 81 Fed. Reg. at 32,857 n.367.

140. *See* Jerry D. Brown, *Painting a Mustache on the Mona Lisa—How Tinkering with the Validation Notice Will Get You Every Time*, 53 CONSUMER FIN. L.Q. REP. 42, 51 (1999) ("[I]n-house collectors (at least theoretically) will use self-control in collecting debts, because they want repeat business from the consumer."). The FDCPA is codified at 15 U.S.C. §§ 1692–1692p (2012).

141. The CFPB report of more than 1,100,000 complaints appears on its website. *See Consumer Complaint Database*, CONSUMER FIN. PROTECTION BUREAU, https://www.consumerfinance.gov/data-research/consumer-complaints (last visited May 3, 2018); CONSUMER FIN. PROT. BUREAU, CONSUMER RESPONSE ANNUAL REPORT 1, 43 (2016), http://files.consumerfinance.gov/f/201604_cfpb_consumer-response-annual-report-2015.pdf (finding that 6% of complaining consumers obtained monetary relief and 12% secured non-monetary relief).

complaints concerning Wells Fargo.[142] Wells provided monetary relief to 658 of the complaining consumers, though 82 of those remained sufficiently unsatisfied that they disputed the outcome, perhaps because they thought the amount provided was not enough. Another 409 received non-monetary relief. Non-monetary relief could include, for example, changing an entry in a credit report. In any event, 73 of those complainants disputed the result. The remaining 8443 consumers received an explanation from Wells but not a remedy, and of those 1952 still registered a dispute. In all, 2107 consumers, or 22% of those who complained, disputed the result even after complaining to the Bureau. It is impossible to know how many of the complainants had legitimate complaints, or what percentage of those were remedied, but plainly the opportunity to complain to Wells itself, as opposed to the CFPB, did not obviate the need for the CFPB complaint database. Given that some of those taking advantage of the Bureau's complaint mechanism were able to obtain relief by so doing, it appears that the opportunity to voice concerns to the CFPB provides value—which should not be the case if Johnston and Zywicki were correct.

Ninth, even assuming that all financial institutions employ a similar policy and refund fees for all consumers entitled to such a refund, the argument still proves too much. Taken to its logical conclusion, Johnston and Zywicki's contention suggests that financial institutions—and indeed, any business that fears loss of a customer's patronage—would never violate the law and so should be immune from suit in any forum. Their theory argues that businesses which depend on customer good will should always value that good will enough to resolve disputes in favor of the customer. But that obviously is not true, as the Wells Fargo example itself demonstrates. Countless other cases do as well, including class actions.[143] Indeed, since its inception in 2011, the CFPB has secured nearly $12 billion in relief for more than 29 million consumers.[144]

142. These figures were calculated by my research assistant, Amanda M. Schaefer, from the CFPB consumer complaint database.

143. For an example of a class action in which the court imposed liability on a financial institution for unfair and fraudulent conduct, see Gutierrez v. Wells Fargo Bank, 730 F. Supp. 2d 1080, 1124–26 (N.D. Cal. 2010), *aff'd in pertinent part*, 704 F.3d 712, 725–28 (9th Cir. 2012). Similarly, the CFPB Arbitration Study summarizes class actions brought against eleven banks arising out of overdraft reordering that resulted in settlements with 6,493,837 consumers and payments of $377,430,000. *See* CFPB ARBITRATION STUDY, *supra* note 33, § 8, at 43.

144. *See Consumer Complaint Database*, *supra* note 141.

Tenth, Johnston and Zywicki overlook the deterrent function of class actions.[145] Financial institutions risking a class action for misconduct have a significant incentive to refrain from misbehavior. If, on the other hand, financial institutions know that they can cheat customers and still retain consumer good will by refunding the fees of complaining consumers, they have a much-reduced incentive to avoid misconduct. That seems especially likely to be true when damages are small enough that few consumers will bother to pursue the matter, whether in court or arbitration.[146] Under Johnston and Zywicki's system, non-complaining consumers receive no compensation, whereas, in a class action regime, they will in cases in which money is automatically credited to class members' accounts, and they may in other class actions if they complete the requisite forms. As aggrieved consumers generally do not complain,[147] this difference in the amount of compensation paid can have a significant impact on whether wrong-doers are deterred.

One possible test of the effectiveness of Johnston and Zywicki's claim is what happened in the Wells Fargo unauthorized account case itself: given that millions of such accounts were opened, did consumers complain in like numbers? Unfortunately, the number of consumers who complained to Wells is not publicly available. But the CFPB complaint database may be a partial substitute. It is not a perfect proxy, not only because consumers may complain to Wells and not to the Bureau—or vice versa—but also because the Bureau does not make public all the complaints it receives: the CFPB allows consumers to choose whether their complaints will be made public, and some prefer privacy.[148] There is no way to know how many complaints the Bureau has received about unauthorized Wells accounts that are not public, but there is also no reason to believe that complainants about such accounts would choose to conceal their complaints from the public in disproportionate numbers. In any event, my research assistant, Amanda M. Schaefer, read the public complaint information filed with the Bureau in 2015 about Wells Fargo. She found that at most, nineteen people filed public complaints about unauthorized accounts opened by Wells Fargo employees. In some cases, it was impossible to determine whether the account was opened by a Wells Fargo employee,

145. *See supra* note 113.

146. *See supra* notes 16–17, 37–40 and accompanying text.

147. *See supra* note 136 and accompanying text.

148. *Submit a Complaint*, CONSUMER FIN. PROTECTION BUREAU, https://complaint.consumerfinance.gov/submit-a-complaint/s/products (follow "Next" button to step 3) (last visited May 3, 2018).

an external identity thief, or an employee of a retailer that offered an affiliated Wells Fargo credit card. But even assuming that all nineteen were opened by Wells employees—or even assuming that ten times that number of consumers complained to the Bureau and did not authorize public disclosure of their complaint—the number of complaints seems absurdly small for a fraud repeated millions of times.[149]

While it is not possible to determine why the Bureau received so few complaints about so widespread a fraud, some speculations are possible. Conceivably, many consumers complained to Wells, obtained satisfaction, and saw no need to notify the Bureau. While some probably did just that, it seems unlikely to be a complete explanation.[150] Other explanations include that consumers did not know about the unauthorized accounts or did not see them as worth complaining about.[151] In any event, the paucity of complaints to the CFPB database about Wells Fargo's millions of unauthorized complaints raises red flags about the effectiveness of relying on complaints as the sole consumer protection mechanism.

D. More on Consumer Behavior

Another way of understanding Johnston and Zywicki's theory is that it implies that consumers have made a conscious decision not to concern themselves with how disputes will be resolved out of a belief that financial institutions will so value their patronage that the institution will accede to their requests. Maybe some consumers—economists, perhaps—indeed go through such a thought process. But given that many of the respondents in the *Whimsy Little Contract* study believed even properly-written arbitration clauses would not bind them,[152] an explanation that is at least as plausible is that

149. Ms. Schaefer calculated that twenty-six percent of the Wells complaints filed in 2015 are public. *See* E-mail from Amanda M. Schaefer, Research Assistant, to author (July 12, 2017) (on file with author). If we assume the number of public complaints on an issue bears the same proportion to the total complaints on that issue as the number of public complaints does to total complaints, the Bureau received about seventy-six possible complaints about Wells employees opening unauthorized accounts. Again, even if we assume that number understates the number of complaints by a factor of ten or twenty, it still seems very low for a scam that resulted in at least three million unauthorized accounts.

150. Of the nineteen complainants, seven objected to Wells Fargo's response; the other dozen did not, so it is likely that at least the other dozen did not complain first to Wells and then to the CFPB, as presumably Wells would have responded the same way initially and they still complained to the Bureau.

151. *See supra* note 136.

152. *See Whimsy Little Contract*, *supra* note 63, at 52–53.

numerous consumers—wrongly—believe that arbitration clauses are not enforceable and so are not worth their attention. The well-known optimism bias—the tendency of consumers to be unduly optimistic[153]—may also play a role here, in that consumers may think that nothing in the contract matters.

But these explanations probably presuppose that consumers give more thought to whether to read contracts than is in fact the case. The widespread reluctance of consumers to read contracts has been well-documented.[154] For example, in one study, 543 college students were offered a chance to sign up for a new social network and were given the opportunity to read the terms of service and privacy policy.[155] Though the terms of service would have taken the typical person sixteen minutes to read, the average student devoted less than a minute to it.[156] That may explain why all the students agreed to it, even

153. *See* David A. Armor & Shelley E. Taylor, *When Predictions Fail: The Dilemma of Unrealistic Optimism*, *in* HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT 334, 334 (Thomas Gilovich et al. eds., 2002) [hereinafter HEURISTICS AND BIASES] ("One of the most robust findings in the psychology of prediction is that people's predictions tend to be optimistically biased."); Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CALIF. L. REV. 1743, 1782 (2000) (stating that contracting parties tend to be "unrealistically optimistic"); Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 VAND. L. REV. 1653, 1659 (1998) ("[P]eople are often unrealistically optimistic about the probability that bad things will happen to them. A vast number of studies support this conclusion."); Neil D. Weinstein, *Unrealistic Optimism About Future Life Events*, 39 J. PERSONALITY & SOC. PSYCHOL. 806, 806, 818–19 (1980); *see also* Dale Griffin & Amos Tversky, *The Weighing of Evidence and the Determinants of Confidence*, *in* HEURISTICS AND BIASES, *supra*, at 230, 248 ("Although overconfidence is not universal, it is prevalent, often massive, and difficult to eliminate."); Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 453–54, 483 (2002) ("People intending to purchase a product likely will overstate their own ability to assess the reputation and good faith of the person or company with whom they are interacting."); Dan N. Stone, *Overconfidence in Initial Self-Efficacy Judgments: Effects on Decision Processes and Performance*, 59 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 452, 453–54, 468–70 (1994) (citing studies that demonstrate consumer optimism). For examples of optimistic behavior, see Cass R. Sunstein, *Hazardous Heuristics*, 70 U. CHI. L. REV. 751, 772–74 (2003) (reviewing HEURISTICS AND BIASES, *supra*) ("With respect to most of the risks of life, people appear to be unrealistically optimistic.").

154. *See, e.g.*, OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATORY DISCLOSURE 55, 79 (2014); *Whimsy Little Contracts*, *supra* note 63, at 15–17.

155. *See* Jonathan A. Obar & Anne Oeldorf-Hirsch, The Biggest Lie on the Internet: Ignoring the Privacy Policies and Terms of Service Policies of Social Networking Services 11–12 (Aug. 24, 2016) (working paper) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2757465).

156. *Id.* at 16–17.

though it obliged them to surrender their first-born child.[157] Similarly, an online company with a whimsical streak ended up the owner of the souls of 7500 consumers under its contract.[158] Nor are ordinary consumers alone in ignoring such documents. Chief Justice Roberts,[159] Judge Richard Posner,[160] and other legal luminaries[161] acknowledge that they do not read contract terms.

If consumers do not read contracts, a system based on the assumption that they do can hardly be expected to reach optimal results. The practice of not reading contracts is so widespread that it is more plausible to say that reasonable people do not read contracts than to say that they do. A legal regime that penalizes people for following a universally observed custom makes little sense. Indeed, it is difficult to see why people should be penalized for not reading contracts that they do not understand and do not believe are enforceable.

The attack on free-market economics finds support in the work of scholars like Nobel Prize winner Richard H. Thaler and Cass R. Sunstein.[162] Thaler and Sunstein have argued that too much economic theory is based on imaginary people they call "Homo Economicus" or "Econs": rational people who do not behave as behavioral economics has

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157. *See id.* at 13, 17.

158. *See 7,500 Online Shoppers Unknowingly Sold Their Souls*, FOX NEWS (Apr. 15, 2010), http://www.foxnews.com/tech/2010/04/15/online-shoppers-unknowingly-sold-souls.html; *see also Whimsy Little Contracts*, *supra* note 63, at 36 (noting that the average respondent spent enough time with the credit card contract to read only fourteen percent of it); Debra Pogrund Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 N.Y.U. J.L. & BUS. 617, 677–82 (2009) (noting that seventeen percent of subjects signed a genuine consent form without reading, and that the average subject spent sixteen seconds reading, even after experimenters had subjects sign a phony consent form that required signers to do push-ups on command and administer electric shocks to other signers, even if they screamed or asked for medical assistance).

159. *See* Debra Cassens Weiss, *Chief Justice Roberts Admits He Doesn't Read the Computer Fine Print*, A.B.A. J. (Oct. 20, 2010, 12:17 PM), http://www.abajournal.com/news/article/chief_justice_roberts_admits_he_doesnt_read_the_computer_fine_print.

160. *See* Debra Cassens Weiss, *Judge Posner Admits He Didn't Read Boilerplate for Home Equity Loan*, A.B.A. J. (June 23, 2010, 1:37 PM), http://www.abajournal.com/news/article/judge_posner_admits_he_didnt_read_boilerplate_for_home_equity_loan.

161. Daniel White, *Read Hillary Clinton's Remarks from a Rally in Toledo, Ohio*, TIME (Oct. 3, 2016), http://time.com/4517335/hillary-clinton-transcript-toledo-ohio ("You know, who reads all that fine print? I don't. And you get defrauded or you get mistreated and then all the sudden they, well you can't sue us." (quoting presidential candidate Hillary R. Clinton)).

162. *See* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 97–99 (2009).

shown actual people do.[163] As Nobel laureate Daniel Kahneman has written:

> In a nation of Econs, government should keep out of the way, allowing the Econs to act as they choose . . . .
>
> Humans, more than Econs, also need protection from others who deliberately exploit their weaknesses . . . . An Econ will read and understand the fine print of a contract before signing it, but Humans usually do not. An unscrupulous firm that designs contracts that customers will routinely sign without reading has considerable legal leeway in hiding important information in plain sight.[164]

Financial institutions like Wells Fargo that use arbitration clauses that consumers cannot process fit within the description of firms hiding information in plain sight.[165]

I have argued elsewhere that just as economists who strive for realistic models have moved from assuming that people are Econs to taking into account predictable irrationalities, lawmakers should undergo a similar transition from creating rules based on unrealistic assumptions about human behavior—such as that people ("Homo Lex"

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163. *See, e.g.*, DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS 239 (2008); DANIEL KAHNEMAN, THINKING, FAST AND SLOW 411–12 (2011); RICHARD H. THALER, MISBEHAVING: THE MAKING OF BEHAVIORAL ECONOMICS 4–5 (2015).

164. KAHNEMAN, *supra* note 163, at 412–13 (2011). Kahneman goes on to suggest that disclosures in simple text and large print might solve the problem. *See id.* at 413. *But see Whimsy Little Contracts*, *supra* note 63, at 79 (noting that printing terms in italics, bold, and partly in ALLCAPS did not improve awareness, indicating that prominent text is not by itself a solution). In addition, because many consumers believe class action waivers are unenforceable, even providing such a waiver in simple language would not cure the problem. *See id.* at 4.

165. Similarly, Russell Korobkin has argued that businesses have an incentive to include terms that favor the businesses regardless of whether the terms are efficient when the terms are not salient to consumers—something that is true of arbitration clauses. *See* Korobkin, *supra* note 56, at 1206 ("Assuming that price is always a salient product attribute for buyers, market competition actually will *force* sellers to provide low-quality non-salient attributes in order to save costs that will be passed along to buyers in the form of lower prices. Ironically, the consequence of market forces in a world of boundedly rational buyer decisionmaking is that contracts will often include terms that are socially inefficient, leave buyers as a class worse off . . . than they would be if their contracts included only efficient terms, and leave sellers as a class worse off as well."). Thus, the mere fact that businesses choose to include arbitration clauses in their contracts does not mean that arbitration clauses are efficient and government regulation is unnecessary.

or "lexons") read contracts—to crafting rules that take into account actual behavior.[166] In the context of arbitration clauses, such an approach would do exactly what the CFPB rule would do: substitute for rules founded in ideology rules based on empirical research into what is in consumers' best interest when such research demonstrates that consumers do not understand arbitration clauses well enough to protect themselves. Doing anything else runs the risk of not sufficiently incentivizing the Wells Fargos of this world to resist the temptation to take advantage of consumers.

E. *Returning to the Broader Context: Mechanisms to Restrain Business Misconduct*

Of the four mechanisms that could restrain companies from misconduct, two—self-restraint and the market—were ineffective when it came to Wells, and in fact, the free market might have exacerbated the problem. The third—lawsuits from injured consumers—was largely disabled by the Wells arbitration clause. Only the fourth—governmental intervention—was effective.

Is government action sufficient, as some arbitration advocates have argued?[167] The Bureau Study found that "public enforcement is not itself a sufficient means to enforce consumer protection laws."[168] In any event, the same members of Congress that seek to block the Bureau from banning class action waivers in consumer financial contracts are also seeking to limit or even eliminate the CFPB.[169] Indeed, House Financial Services Chair Jeb Hensarling's proposed Financial CHOICE Act would abolish the authority the CFPB used to force Wells to agree to the consent order concerning unauthorized accounts.[170] If

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166. *See* Jeff Sovern & Kate E. Walton, *Are Validation Notices Valid? An Empirical Evaluation of Consumer Understanding of Debt Collection Validation Notices*, 70 SMU L. REV. 63, 120 (2017).

167. Feddis, Zeisel & Foster Letter, *supra* note 57, at 16–18; Hirschmann & Rickard Letter, *supra* note 57, at 4–5.

168. Arbitration Agreements, 81 Fed. Reg. 32,830, 32,860 (proposed May 24, 2016) (to be codified at 12 C.F.R. pt. 1040). *See generally* CFPB ARBITRATION STUDY, *supra* note 33, § 9.

169. *See, e.g.*, S. 370, 115th Cong. (2017) (bill that would eliminate CFPB); Jeff Sovern, *Ratcliffe/Cruz Bill Would Eliminate the CFPB*, PUB. CITIZEN: CONSUMER L. & POL'Y BLOG (Feb. 15, 2017, 12:44 PM), http://pubcit.typepad.com/clpblog/2017/02/ratcliffecruz-bill-would-eliminate-the-cfpb.html.

170. The Bureau used its powers to prevent financial institutions from engaging in unfair or abusive practices under 12 U.S.C. § 5531 (2012) to restrain Wells. *See* Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0015 (Sept. 4, 2016), 2016 WL 6646128, http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf. House

the free-marketers succeed, consumers who wish to avoid being defrauded will be forced to depend on market sanctions or financial institutions' consciences—both of which proved inadequate as to Wells until regulators intervened.[171] In such a scenario, it is not clear what would discourage financial institutions from maximizing earnings by engaging in misconduct that injures many individuals only slightly. Possibly even worse is that companies that increase shareholder returns in such a fashion might drive more scrupulous companies with lower returns out of the marketplace.

Bill 10 would repeal those powers. Financial CHOICE Act, H.R. 10, 115th Cong. § 736 (2017). Two other regulators joined the CFPB in its action against Wells: the Office of the Comptroller of the Currency ("OCC") and the Los Angeles City Attorney, though the fines they levied against Wells were smaller even when combined than the Bureau's fine. Presumably, neither of those offices would be affected by the Financial CHOICE Act, and so they could still have proceeded against Wells even if the Bureau could not have. But relegating enforcement to the OCC raises concerns about how effective it would be at protecting consumers. While the CFPB was established, as its name implies, solely to protect consumers, the OCC has a broader set of goals. *Compare* 12 U.S.C. § 5511(a) (2012) ("The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."), *with About the Office of the Comptroller of the Currency (OCC)*, OFF. COMPTROLLER CURRENCY, https://www.occ.gov/annual-report/about-the-occ/index-about-the-occ.html (last visited May 3, 2018) ("The mission of the OCC is to ensure that the federal banking system . . . operates in a safe and sound manner, provides fair access to financial services, treats customers fairly, and complies with applicable laws and regulations."). Moreover, the OCC has a history of being captured by banks, and if that had been the case during the Wells Fargo investigation, it is conceivable that the OCC would have been less aggressive. For example, during the George W. Bush administration, the OCC was led by a former bank lawyer and lobbyist, John Dugan. During that administration, much of which coincided with the period in which subprime lenders were making predatory loans that contributed to the subprime lending crisis that in turn led to the Great Recession, the OCC proclaimed that state anti-predatory lending laws were preempted as to national banks. 12 C.F.R. § 34.4 (2017). The OCC also sued to prevent state attorneys general from enforcing fair lending laws as to national banks. *See* Cuomo v. Clearing House Ass'n, 557 U.S. 519 (2009). In the actual Wells Fargo example, an internal OCC review found that the "OCC did not take timely and effective supervisory actions after the bank and the OCC identified significant issues . . . ." OCC, ENTERPRISE GOVERNANCE SUPERVISION, *supra* note 85, at 4. Though the OCC was aware of the problems as early as 2010, it appears it did not pursue them, beyond conducting meetings in 2010, until years later. *See id.* at 5. While states could still act, and the Los Angeles City Attorney was the first governmental entity to sue Wells over the unauthorized accounts, individual states face jurisdictional limits that limit their effectiveness as nationwide regulators.

171. Perhaps the best-known recent example of the failure of financial institutions' consciences can be found in the subprime lending that led to the Great Recession. *See generally* Jeff Sovern, *Preventing Future Economic Crises Through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers*, 71 OHIO ST. L.J. 761, 803–07 (2010).

CONCLUSION

Free-market advocates claim that the free market produces ideal outcomes for consumers, thus obviating the need for government regulation. Yet when it came to the Wells Fargo phony account fiasco, which surely ranks among the most significant recent bank scandals, the free market failed in multiple respects. First, it failed to discipline Wells. Indeed, the number of active checking accounts increased during the period that the Wells fraud drew public attention, suggesting that at least some consumers were not dissuaded from banking at Wells by its misconduct.

Second, the free market may have facilitated the Wells fraud by enabling Wells to avoid class action litigation over the fraud, if it wished to. Had Wells faced the risk of a class action, it might have taken steps earlier to end its fraud, for fear of incurring excessive liability for its misbehavior. But Wells inserted in its contracts an arbitration clause barring class actions, eliminating the possibility that a class action would have deterred its misconduct. The Consumer Financial Protection Bureau's rule would have eliminated such class action waivers in future arbitration clauses, but Congress has blocked the regulation from taking effect.

Legislators who wear the mantle of the free market may be doing free-market economics an injustice by employing it when its underlying assumptions do not hold true. Free-market theory assumes that consumers understand their contracts, but studies show that consumers do not comprehend arbitration clauses or class action waivers. If consumers do not understand such terms, it is unreasonable to expect them to realize that the contracts they sign strip them of their right to bring a class action against a bank that opens accounts for the consumers without their knowledge or consent. In short, a class action waiver, as envisioned by the CFPB, might well have brought an early end to the Wells scandal and saved consumers a great deal of pain.