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ARBITRATION FAIRNESS ACT OF 2007

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

H.R. 3010

OCTOBER 25, 2007

Serial No. 110–163

Printed for the use of the Committee on the Judiciary

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ARBITRATION FAIRNESS ACT OF 2007

THURSDAY, OCTOBER 25, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:41 p.m., in room 2141, Rayburn House Office Building, the Honorable Linda Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Sánchez, Johnson, Lofgren, Cohen, and Cannon.

Staff present: Norberto Salinas, Majority Counsel; Daniel Flores, Minority Counsel; and Adam Russell, Professional Staff Member.

Ms. SÁNCHEZ. This hearing of the Committee on the Judiciary, Subcommittee on Commercial and Administrative Law will now come to order.

I will recognize myself for a short statement.

Several months ago, this Subcommittee held an oversight hearing on the Federal Arbitration Act. At our hearing, we learned through testimony about the history of arbitration and the reasons that Congress felt it wise to promote it through the FAA. Congress wanted to free-up the courts from an increasingly heavy docket, to place arbitration agreements on the same footing as contracts, and to encourage arbitration between businesses possessing equal bargaining powers.

We learned how the use of arbitration has evolved since 1925, and how its use has expanded today. We also learned from the testimony that although arbitration may offer some benefits for parties to a dispute, an increasing number of businesses and employers have begun to utilize arbitration to their advantage, and thus to the distinct disadvantage of consumers, employees and others.

Now, several months later, we hold this legislative hearing on H.R. 3010, the "Arbitration Fairness Act of 2007," which my esteemed colleague from Georgia, Representative Hank Johnson, introduced shortly after our June hearing. H.R. 3010 seeks to amend the Federal Arbitration Act to require that agreements to arbitrate employment, consumer, franchise or civil rights disputes may be valid and enforceable only if they were made voluntarily and after the dispute had arisen.

[The bill, H.R. 3010, follows:]

I

110TH CONGRESS
1ST SESSION

H. R. 3010

To amend chapter 1 of title 9 of United States Code with respect to arbitration.

IN THE HOUSE OF REPRESENTATIVES

JULY 12, 2007

Mr. JOHNSON of Georgia (for himself, Mr. BARROW, Mr. LEWIS of Georgia, Ms. SCHAKOWSKY, Mr. BRALEY of Iowa, Mr. CUMMINGS, Mr. GONZALEZ, Mr. COHEN, and Mr. ELLISON) introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To amend chapter 1 of title 9 of United States Code with respect to arbitration.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Arbitration Fairness
5 Act of 2007".

6 **SEC. 2. FINDINGS.**

7 The Congress finds the following:
8 (1) The Federal Arbitration Act (now enacted
9 as chapter 1 of title 9 of the United States Code)

was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power.

(2) A series of United States Supreme Court decisions have changed the meaning of the Act so that it now extends to disputes between parties of greatly disparate economic power, such as consumer disputes and employment disputes. As a result, a large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their right to have disputes resolved by a judge or jury, and instead submit their claims to binding arbitration.

(3) Most consumers and employees have little or no meaningful option whether to submit their claims to arbitration. Few people realize, or understand the importance of the deliberately fine print that strips them of rights; and because entire industries are adopting these clauses, people increasingly have no choice but to accept them. They must often give up their rights as a condition of having a job, getting necessary medical care, buying a car, opening a bank account, getting a credit card, and the like. Often times, they are not even aware that they have given up their rights.

(4) Private arbitration companies are sometimes under great pressure to devise systems that favor the corporate repeat players who decide whether those companies will receive their lucrative business.

(5) Mandatory arbitration undermines the development of public law for civil rights and consumer rights, because there is no meaningful judicial review of arbitrators' decisions. With the knowledge that their rulings will not be seriously examined by a court applying current law, arbitrators enjoy near complete freedom to ignore the law and even their own rules.

(6) Mandatory arbitration is a poor system for protecting civil rights and consumer rights because it is not transparent. While the American civil justice system features publicly accountable decision makers who generally issue written decisions that are widely available to the public, arbitration offers none of these features.

(7) Many corporations add to their arbitration clauses unfair provisions that deliberately tilt the systems against individuals, including provisions that strip individuals of substantive statutory rights, ban class actions, and force people to arbitrate their

claims hundreds of miles from their homes. While some courts have been protective of individuals, too many courts have upheld even egregiously unfair mandatory arbitration clauses in deference to a supposed Federal policy favoring arbitration over the constitutional rights of individuals.

SEC. 3. DEFINITIONS.

Section 1 of title 9, United States Code, is amended—

(1) by amending the heading to read as follows: **"§ 1. Definitions"**;

(2) by inserting before "'Maritime'" the following:

"As used in this chapter—";

(3) by striking "'Maritime transactions'" and inserting the following:

"(1) 'maritime transactions';";

(4) by striking "commerce" and inserting the following:

"(2) 'commerce'";

(5) by striking ", but nothing" and all that follows through the period at the end, and inserting a semicolon; and

(6) by adding at the end the following:

"(3) 'employment dispute', as herein defined, means a dispute between an employer and employee arising out of the relationship of employer and employee as defined by the Fair Labor Standards Act;

"(4) 'consumer dispute', as herein defined, means a dispute between a person other than an organization who seeks or acquires real or personal property, services, money, or credit for personal, family, or household purposes and the seller or provider of such property, services, money, or credit;

"(5) 'franchise dispute', as herein defined, means a dispute between a franchisor and franchisee arising out of or relating to contract or agreement by which—

"(A) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor;

"(B) the operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate; and

"(C) the franchisee is required to pay, directly or indirectly, a franchise fee; and

"(6) 'pre-dispute arbitration agreement', as herein defined, means any agreement to arbitrate disputes that had not yet arisen at the time of the making of the agreement.".

SEC. 4. VALIDITY AND ENFORCEABILITY.

Section 2 of title 9, United States Code, is amended—

(1) by amending the heading to read as follows: **"§ 2. Validity and enforceability"**,

(2) by inserting "(a)" before "A written";

(3) by striking ", save" and all that follows through "contract", and inserting "to the same extent as contracts generally, except as otherwise provided in the title"; and

(4) by adding at the end the following:

"(b) No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of—

"(1) an employment, consumer, or franchise dispute; or

"(2) a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power.

"(c) An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.

"(d) Nothing in this chapter shall apply to any arbitration provision in a collective bargaining agreement.".

SEC. 5. EFFECTIVE DATE.

This Act, and the amendments made by this Act, shall take effect on the date of the enactment of this Act and shall apply with respect to any dispute or claim that arises on or after such date.

○

Ms. SÁNCHEZ. Arbitration was never intended as a tool to advantage one side over the other in a dispute. To be a respected and reasonable alternative to the courts, arbitration must provide a level and fair playing field. But since our June hearing, several reports have been issued revealing how arbitration favors businesses, employers and securities firms. These reports do not paint a rosy picture for fairness in arbitration. However, we hope to elicit more testimony today on the accuracy of these reports to help us determine whether H.R. 3010 is needed legislation.

Finally, during our June hearing on this issue, the Ranking Member on the Subcommittee, Mr. Cannon, stated that we should review proposals to restrict the freedom of contract cautiously. I concur with Mr. Cannon's statement, but also firmly believe that we should thoroughly review any process such as arbitration that may restrict constitutional and statutory rights and that may cement any unfair advantages at the expense of consumers, and particularly employees.

Today, we gather to hear testimony from several individuals with knowledge of the arbitration process. I want to emphasize that today's testimony is very important for our understanding of the legislation. Accordingly, I look forward to hearing today's testimony and welcome a thorough discussion of the issues and legislation.

I would now like to recognize my colleague, Mr. Cannon, the distinguished Ranking Member of the Subcommittee, for his opening remarks.

Mr. CANNON. Thank you, Madam Chair.

I would like to welcome our witnesses today. I got to shake some hands down there. I apologize, Ms. MacCleery, we didn't have a chance to shake hands. I will step down after the hearing.

Arbitration is an important subject, and I am glad that we are having this hearing to help us sort out some of the serious issues and consequences of H.R. 3010. In June, we held a hearing on mandatory binding arbitration clauses in consumer contracts. These clauses have become more and more common over the years. What we found, as I recall the hearing, was this. It appears that those clauses are fair. Results for consumers in arbitration tend to be somewhat better than in court, costs tend to be lower, and consumers tend to be happier with the results.

If an individual is told that arbitration is mandatory, the general reaction from most, including me, is one of concerned skepticism. But when one looks at the facts, one can see that arbitration on the whole is a good deal, and year by year becomes better and better as consumer-friendly procedures like due process clauses and opt-outs and off-ramps to small claims court and fee-shifting become more and more common in mandatory binding arbitration clauses.

Arbitration is cheaper, simpler, faster and more effective than litigation, and makes sure the consumer's complaint is heard. Arbitration is a process that provides protection to consumers because there are few consumers who have the deep pockets of a large corporation if the dispute heads to litigation.

All these facts came out at our hearing, and so when the hearing was concluded, I expected that we wouldn't be entertaining legislation to roll back mandatory binding arbitration clauses in consumer

contracts. I was surprised to read the extent of H.R. 3010. Not only does it propose to prohibit mandatory binding arbitration clauses in consumer contracts, it reaches back and proposes to render null and void all such clauses in existing contracts, something that would undo bargains struck in probably millions of contracts over the years.

It also proposes to prohibit mandatory binding arbitration in franchise and employment contracts. It even proposes to rule out and undo mandatory binding arbitration clauses in any setting in which the contracting parties had unequal bargaining power. I suspect that could even apply to disputes between groups or companies like Citibank and Chase Manhattan, as I am certain that one of them has more money than the other.

Not one of these areas was considered in our hearing in June. The breadth of this bill is so great, the sectors affected so varied, and the potential solutions to any problems that do exist so many that we cannot possibly sort that out all today, even with two panels of witnesses.

So my strong suspicion is that were we to get the real facts on the fairness of arbitration in all these settings, we would find the same thing we did with arbitration in consumer contracts—that arbitration is a good deal. That is why Congress and the courts have so strongly supported it for so long through so many acts and decisions.

I appreciate the interest of my colleague from Georgia, Mr. Johnson, in arbitration, and I appreciate the interest reflected in the title of his bill, that arbitration be fair. As I said, our earlier hearing already showed arbitration, including mandatory binding arbitration, to be generally fair. I am not aware of any other proceeding of the Committee that has given us a reason to believe that mandatory binding arbitration isn't delivering similarly fair results in all of these sectors.

I am left to wonder who really benefits from this proposed legislation. Would it be consumers and companies large and small that are vital to our economy? Would they really benefit if we took a widespread effective arbitration option off the table? We know from basic economics that when you artificially limit available services you can bank on driving up the cost and driving down the quality of the services that remain.

So how will it benefit consumers—the little guy, the working man—to take an arbitration option off the table? Or would the only ones guaranteed to be helped be the ones who lost business to arbitration? Would the only ones guaranteed to benefit be the trial lawyers? I venture a yes. Common sense and the laws of economics suggest that if this bill were to pass, trial lawyers would be the largest beneficiaries.

I expect that today's testimony will help us sort that out. I am interested in hearing from today's panel of witnesses. I am particularly interested in the testimony of Professor Rutledge, who has dedicated serious academic study to this issue. I am also interested in the testimony of Mr. Naimark of the American Arbitration Association. No one at the witness table can offer us anything near the association's hands-on familiarity with arbitration, all of its fea-

tures, fine points and foibles, and with all of the efforts over the years to assure that it does indeed deliver fairness.

Thank you, Madam Chair. I look forward to the testimony of the witnesses, and yield back the balance of my time.

Ms. SÁNCHEZ. I want to thank the gentleman for his statement.

I would also like to recognize Mr. Johnson, a distinguished Member of this Subcommittee and the author of the bill that we are examining today, for an opening statement.

Mr. JOHNSON. Madam Chair, thank you. I appreciate your holding this hearing.

This Subcommittee is holding its second hearing on the troubling trend toward binding arbitration clauses becoming ubiquitous in consumer, employment and franchise agreements. Most people would think twice before they signed away their right to free speech, their freedom to worship, or their right to vote. But every day, people are forced by stronger parties to give up their constitutional right to a jury trial, often unknowingly, and compelled to agree to pre-dispute mandatory binding arbitration.

The result? Well, businesses will say that they are a good thing. Consumers fare well under these agreements. They enjoy a fast economical and efficient means to settle their disputes through a neutral third party arbitrator. But what do consumers have to say about that? The reality is quite different. As a witness in previous hearings stated, arbitration hearings are neither economical nor neutral. Rather, pre-dispute binding arbitration strips consumers of a number of rights and procedural protections designed to produce impartial and fair justice.

Arbitration sessions are largely conducted in secret, with limits on discovery and the appealability of decisions rendered, which limits the ability of consumers to sometimes bring class action suits and often saddles consumers with high administrative fees. Historically, the Federal Arbitration Act was enacted as an alternative dispute resolution process for resolving disputes voluntarily between businesses on equal footing. It was not enacted to force parties of unequal bargaining power into arbitration, but to enforce voluntary arbitration agreements between parties of equal bargaining strength.

During floor debate on the Federal Arbitration Act in 1924, Representative George Graham, who chaired the House Judiciary Committee, clearly stated, "This bill provides for one thing, and that is to give an opportunity to enforce an agreement in a commercial contract, when voluntarily placed in the document by the parties to it."

Rather than upholding the spirit of that law, big businesses have turned that law on its head and have made alternative dispute resolution a trap for the unwary, locking consumers into a process that is neither consumer-friendly nor fair. The arbitration companies that are supposed to administer this type of justice are neither unbiased nor neutral. Arbitration is a lucrative business. Although advocates say arbitration is much more economical than court action, the truth is consumers are often saddled with fees that they would not be charged with if they went to court.

For example, the National Arbitration Forum's fee schedule published in August of this year, if a consumer files a claim, the filing

fee can range anywhere from $25 to $240, depending on the size of the claim. Administrative fees start at $200 and a participatory hearing session fee starts at $150. If you or I have a claim for under $2,500, we could face a $325 filing fee just to get the case into the arbitration process.

To some, that doesn't seem like a lot, but in life there are always unexpected events. So if you need to expedite the hearing, that is an extra $500. You need an extension? $50; What about a discovery order? $250; a request to open or reconsider? $250 for the fee. As I said, arbitration is a lucrative business not only through fees generated by the cases, but also through repeat business.

The danger to consumers is obvious—a system where the arbitrator has a financial interest to reach an outcome favorable to the commercial interest which his company receives its referrals from is no longer a fair process of resulting disputes. The current system is flawed as it grants stronger commercial interests the upper hand against consumers.

That is why I, along with my colleague, Senator Feingold, introduced the Arbitration Fairness Act of 2007, which has of today enjoys bipartisan support of over 35 members. This bill does not eliminate arbitration agreements as a means to settle a dispute. It would simply return the Federal Arbitration Act to its original intent and render unenforceable pre-dispute mandatory binding arbitration clauses in consumer, medical and franchise agreements.

I think all of us can agree, a fundamental feature of a fair justice system is that both sides to a dispute have a fair system of resolving the dispute. This legislation will ensure that citizens have a fair choice between arbitration and the civil court system to which they are entitled by the seventh amendment of the Constitution of the United States of America.

I yield back.

Ms. SÁNCHEZ. I thank the gentleman for his statement.

We are joined also by the gentleman from Tennessee, Mr. Cohen, and without objection, other Members' opening statements will be included in the record.

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

I am of the firm belief that consumer protection must be among the foremost considerations for Congress when it considers legislation affecting commerce. That is why I am a cosponsor of H.R. 3010, the Arbitration Fairness Act of 2007. I do not oppose arbitration in principle. Anecdotal evidence, however, suggests that companies' use of mandatory pre-dispute arbitration clauses in consumer, employment, and other contracts may be unfairly stacking the arbitration system against the interests of consumers, employees, and others with relatively less bargaining power. While parties are certainly free to agree to arbitrate a dispute, consumers and employees are unable to negotiate away the mandatory arbitration clauses that I referred to because of the unequal bargaining power between them and the corporations with which they are conducting the transaction. The result, I fear, is that people are giving up their right to have their disputes heard in court without any meaningful choice in the matter. H.R. 3010 is one way to address this imbalance.

Ms. SÁNCHEZ. Without objection, the Chair will be authorized to declare a recess of the hearing at any point.

I am now pleased to introduce the witnesses on our first panel for today's hearing. Our first witness is Ms. Laura MacCleery. Ms. MacCleery is director of Public Citizen's Congress Watch Division. She works to promote public access to civil justice and a more ethical and sound government with public financing of elections. Prior to joining Congress Watch, Ms. MacCleery was deputy director of Public Citizen's Auto Safety Program. She has worked for the general counsel of the Federal Trade Commission, the Office of the Federal Public Defender in San Francisco, California, and at the Legal Aid Society Federal Defender Division in New York City.

Our second witness of our first panel is Richard Naimark. Mr. Naimark is the senior vice president of American Arbitration Association at the International Center for Dispute Resolution. He is the founder and former executive director of the Global Center for Dispute Resolution Research, which conducted research on arbitration and ADR for business disputes in cross-border transactions. Mr. Naimark is an experienced mediator and facilitator, having served in a wide variety of business and organizational settings. Since joining the association in 1975, Mr. Naimark has conducted hundreds of seminars and training programs on dispute resolution and published several articles on alternative dispute resolution. We welcome you.

Our third witness is Governor Roy Barnes. I would like to hand the honor of introducing him over to my distinguished colleague from Georgia, Mr. Johnson.

Mr. JOHNSON. Thank you, Madam Chair.

Roy Barnes won a seat in the state of Georgia Senate and became one of the youngest legislators in the State. As the chair of the State Senate Judiciary Committee, he used his legal talents to rewrite the Georgia constitution. He served in the Senate for a number of years before running for governor unsuccessfully.

Thereupon, he returned to the House of Representatives of the Georgia legislature, where he again was assigned to the House Judiciary Committee, and distinguished himself. He later ran for governor and won, but while serving as a legislator, he, as an attorney, scored a number of tremendous legal victories on behalf of consumers, most notably a victory against Fleet Finance, which had been involved in predatory lending activities in Georgia. He held them accountable and forced them to exit that business.

When Governor Barnes became Governor of Georgia, among his many accomplishments was a tough, probably the toughest, anti-predatory lending ordinance or statute in the country that was passed. It was later watered down, but if that legislation had been in effect over the last 4 years, Georgia would not be facing the extent of the foreclosure crisis that it now faces.

One of the things that Governor Barnes will always be remembered for in Georgia is his courageous act in removing the Confederate battle flag from the state of Georgia flag. For that, he won the Profiles in Courage Award from the JFK Library Foundation. After leaving office as governor, Governor Barnes lended his legal talents to the Atlanta Legal Aid, where he practiced for free, representing indigent men and women in need of legal services. He did that for 6 months before going back into private practice at his

hometown in Marietta, Georgia, where he practices law with his daughter and son-in-law.

So Governor Barnes, we are pleased to have you here with us today.

Ms. SÁNCHEZ. Thank you for joining us.

Our final witness of the first panel is Mr. Ken Connor. Mr. Connor co-founded the Center for a Just Society in 2005, and serves as the organization's chairman and one of its principal spokesmen. Affiliated with the law firm of Wilkes and McHugh, Mr. Connor recently served as counsel to Governor Jeb Bush in *Bush v. Schiavo*, the matter involving Terri Schiavo, and the court order to remove her feeding tube.

Mr. Connor is also an advocate on behalf of nursing home residents, and was appointed to Florida's Task Force on the Availability and Affordability of Long-Term Care. He has served as chairman of the state of Florida Commission on Ethics, and as a member of the state Constitution Revision Commission.

I want to thank you all for your willingness to participate in today's hearing. Without objection, your written statements will be placed into the record in their entirety, and we are going to ask that you limit your oral testimony to 5 minutes. We have a lighting system that will turn green when you are recognized. After 4 minutes, it turns yellow as a warning that you have 1 minute left, and then it will turn red at 5 minutes. If your light turns red, please quickly try to summarize your last and final thought so that we can move on to all of the witnesses.

After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions subject to the 5-minute limit.

Now that we have all the rules out of the way, I am going to invite Ms. MacCleery to please proceed with her testimony.

TESTIMONY OF LAURA MacCLEERY, ESQ., DIRECTOR, PUBLIC CITIZEN'S CONGRESS WATCH DIVISION, WASHINGTON, DC

Ms. MACCLEERY. Madam Chairwoman, Congressman Cannon, Representative Johnson, who is the sponsor of the Arbitration Fairness Act, and honorable Members of the Committee, good afternoon. Thank you very much for the opportunity to provide this testimony. My name is Laura MacCleery. I am the director of Public Citizen's Congress Watch Division.

We oppose the use of pre-dispute binding mandatory arbitration for three main reasons. First, it is imposed on consumers and is mandatory, rather than voluntary. Second, proceedings and decisions are shrouded in secrecy. And third, it utterly lacks due process and impartiality.

For example, there are only very limited grounds for appeal of a decision. Under current case law, decisions which are, in the words of the courts, "silly," "wacky," or "contrary to law," are routinely allowed to stand. Moreover, binding mandatory arbitration is poisoned by the fact that arbitrators and their firms have a direct financial stake in business-friendly outcomes.

The framers of our Constitution sought to create the public courts and to enshrine due process in our laws because they understood that secrecy is anathema to democracy and that unfettered

power of any kind will become abuse. Binding mandatory arbitration, or BMA, in contrast, disregards fundamental notions of fairness. It is wrong by design.

BMA is imposed on consumers in millions of take-or-leave-it contracts of adhesion for routine matters, often without signers' full or even partial understanding of the consequences. It lacks basic mechanisms for transparency and accountability and threatens hundreds of hard-won State and Federal consumer protection statutes with legal irrelevance.

We recently concluded an 8-month investigation of 34,000 cases in binding mandatory arbitration used by credit card companies and other firms that buy credit card debts. Only one State in the country, California, requires any public disclosure whatsoever of these decisions. We used the data from reports made public under California's law by the National Arbitration Forum, NAF. In the approximately 19,000 cases in which an arbitrator was appointed, we found that consumers lost a shocking 94 percent of the time and prevailed only 4 percent. Ninety percent of the cases were handled by a small cadre of 28 arbitrators, and the busiest arbitrators processed as many as 68 cases in a single day, or one case every 7 minutes.

Other findings are in our report, a copy of which is submitted for the record.

We also found arbitrators decided more than 83 percent of the cases based entirely on documents supplied by companies making the claims, without a hearing or any consumer involvement. In this large subset of cases, arbitrators ruled for business a stunning 99 percent of the time, and for consumers only twice out of 16,000 cases.

Our research shows that consumers often either do not receive notice of arbitration or do not understand the notice when they do receive them. Ronald Kahn, an NAF California arbitrator, who has decided 820 cases, recently discussed his work. Mr. Kahn's comments confirm that NAF arbitrators routinely rubber-stamp company requests in violation of its own procedural rules. "Because they are defaults," Kahn said, "the power of an arbitrator is such that you have no choice as long as the parties have been informed. There is no one there to argue due process." Kahn's decisions show his lopsided record. He decided 96 percent of cases in favor of business, and 1.7 percent of the time for consumers.

Yet, NAF's own procedural rule 36(b) provides that if a party does not respond to a claim, the arbitrator will review the merits. And NAF's rule 36(E) provides that no award or order shall be issued against a party solely because of a failure to respond, appear or defend.

So a consumer's failure to respond should not mean that NAF arbitrators would award a bank or other claimant every penny of the amount requested without further review of the merits. But several consumers interviewed for our reports told us that arbitrators confirmed awards where there was no evidence that an account even existed beyond the credit card company's bald assertions. And one victim, Troy Cornock, in fact told us that even after he repeatedly protested that he had never signed up for that account, he was still pursued for the debt.

Of the nearly 34,000 consumer arbitrations that NAF identified in California, 99 percent were collections cases, and more than half involved the cardholders of MBNA. If arbitration firms are acting as part of a debt collections mill, they are in effect circumventing Federal regulations that protect consumers under the Fair Debt Collection Practices Act and other statutes. While default rates for collection cases in small claims court may be high, in any court there are far more assurances of due process, including notice to consumers through service of process, than in binding mandatory arbitration.

Indeed, it is an open question whether arbitrators are making awards on the basis of records far too spotty or poorly maintained to support the same claim in court. BMA may be an elaborate shell game set up to hide the fact that companies are seeking to collect on debts that have long since run past their expiration date, or are otherwise uncollectible under prevailing law. Congress should investigate whether arbitrators are being used as a scrim to conceal these legally dubious practices.

Ms. SÁNCHEZ. Ms. MacCleery, your time has expired. Could you just finish your final thought?

Ms. MACCLEERY. Absolutely.

The fundamental thought is that arbitration runs contrary to constitutional rights that are core notions of fairness, and that Congress should enact the Arbitration Fairness Act.

Thank you very much.

[The prepared statement of Ms. MacCleery follows:]

PREPARED STATEMENT OF LAURA MACCLEERY

Testimony of Laura MacCleery
Director, Public Citizen's Congress Watch division
before the
House of Representatives Committee on the Judiciary,
Subcommittee on Commercial and Administrative Law

October 25, 2007

"I had no idea such a system existed...I had an immediate flashback to the Soviet Union. I thought: this is impossible. I was so proud to become a citizen of this country. It was the happiest day of my life because I knew that individuals have a voice here and this is the country that is run by law."
Anastasiya Komarova, victim of mistaken identity pursued for the debt of another person following a National Arbitration Forum (NAF) award[1]

Madam Chairwoman, Congressman Cannon, honorable members of the committee, good afternoon and thank you very much for the opportunity to provide this testimony. My name is Laura MacCleery and I am the Director of Public Citizen's Congress Watch division. Public Citizen has more than 150,000 members and activists nationally. For more than 36 years, the organization has represented consumer interests in Congress, the courts and before executive branch agencies.

We oppose the use of pre-dispute, binding mandatory arbitration for three main reasons. First, it is imposed on consumers and is mandatory rather than voluntary. Second, proceedings and decisions are shrouded in secrecy. And third, it utterly lacks due process and impartiality. For example, there are only very limited grounds for appeal of a decision. Under current case law, decisions which are, in the words of the courts, "silly," "wacky" or contrary to law are routinely allowed to stand.[2] Moreover, binding mandatory arbitration is poisoned by the fact that arbitrators and their firms have a direct financial stake in business-friendly outcomes.

The framers of our Constitution sought to create the public courts, and to enshrine due process in our laws because they understood that secrecy is anathema to democracy and that unfettered power of any kind will become abuse. Binding mandatory arbitration, or BMA, in contrast, disregards fundamental notions of fairness. It is wrong by design.

BMA is imposed on consumers in millions of take-it-or-leave contracts of adhesion for routine matters such as cell phones, employment, cable services, auto loans or credit cards, often without signers' full or even partial understanding of the consequences. The system

lacks basic mechanisms for transparency and accountability and threatens hundreds of hard-won state and federal consumer protection statutes with legal irrelevance.

Once trapped inside this system, each motion or hearing costs the parties more. In one case, an NAF arbitrator's three-page explanation of his decision cost $1,500. The financial incentives mean that "repeat players" in arbitration, such as large corporations, have a structural advantage over individuals. Given its myriad other oppressive features, it is clear that BMA is designed to produce a stacked deck and to dissuade individuals from pursuing their legal rights.

Even without knowing of its disparate impact on consumers, someone merely appraising BMA in the cold and honest light of first principles would be very hard-pressed to defend this system. To sidestep such questions, its outcomes are pushed as its major selling point. Supporters allege that BMA is more efficient and cost-effective than the courts; the facts do not support these claims.

We recently concluded an eight-month investigation of 34,000 cases of binding mandatory arbitration used by credit card companies and firms that buy credit card debts.[3] Only one state in the country – California – requires any public disclosure whatsoever of arbitration decisions. We used the data from reports made public under California law by the National Arbitration Forum, or NAF.

In the approximately 19,000 cases in which an arbitrator was appointed, we found that:

- Consumers lost a shocking 94 percent of the time and prevailed only 4 percent;
- 90 percent of the cases were handled by a small cadre of 28 arbitrators; and
- the busiest arbitrators process as many as 68 cases in a single day, or one case every seven minutes in a typical workday.

Other findings are in our report, a copy of which I am submitting with my testimony for the record.

We also found that arbitrators decided more than 83 percent of the cases based entirely on documents supplied by companies making the claims, without a hearing or any consumer involvement. In this large subset of cases, arbitrators ruled in favor of business a stunning 99.99 percent of the time and for consumers only twice out of more than 16,000 cases. Our research shows that consumers often either do not receive notice of arbitration or do not understand these letters when they do receive them.

Ronald Kahn, an NAF California arbitrator who has decided 820 cases, recently discussed his work in a California publication.[4] Mr. Kahn's comments confirm that NAF arbitrators routinely rubber-stamp company requests in violation of NAF's own procedural rules.

"Because they're defaults," Kahn said, "the power of the arbitrator is such that you have no choice as long as the parties have been informed. There's no one there to argue due process." Kahn's records show the lopsided record these comments suggest: he decided 96.6 percent of cases in favor of business and only 1.7 percent of the time for consumers.

Yet NAF procedural rule 36(B) provides that if a party does not respond to a claim, the arbitrator "will timely review the merits of the Claim for purposes of issuing an Award or Order." And NAF's rule 36(E) provides that "[n]o Award or Order shall be issued against a Party solely because that Party failed to respond, appear, or defend."[5]

So a consumer's failure to respond should *not* mean that NAF arbitrators would award a bank or other claimant every penny of the amount requested without further review of the merits of a claim. But several consumers interviewed for our report told us that arbitrators confirmed awards where there was *no evidence* that an account even existed beyond the credit card company's bald assertions.

Identity theft victims profiled in our report all suffered from this kind of appalling indifference to the need for evidence to support credit card companies' claims. Yet it took time and thousands of dollars for each to attempt to clear their good names. Some are still burdened by the devastation wreaked on their credit ratings.

Curiously, many consumers also told us that they failed to get any notice of the arbitration proceeding until it was too late to appeal the award against them, suggesting that arbitration firms wait until an appeal deadline has run before seeking to enforce a judgment in court. And under the tragic state of prevailing law, even those few who do meet the deadline for appeal cannot appeal on the merits of the case.

NAF's arbitrator Kahn admitted in the same article that most of his cases – "probably 95 percent" – take only a few minutes. These admissions show that NAF arbitrators' handling of so-called "default judgments" is sketchy at best. Several recent decisions by New York state judges threw out NAF arbitration awards despite the failure of consumers to appear to contest the claims.[6] After close scrutiny of the meager documents submitted to support the claims, one judge noted that evidence presented in such cases is often riddled with "fatal procedural and substantive defects."[7]

Of the nearly 34,000 consumer arbitrations NAF identified in California, 99.9 percent were "collections" cases, and more than half involved the cardholders of a single company – MBNA (now a subsidiary of Bank of America). If arbitration firms are acting as part of a debt collections mill, they are, in effect, circumventing regulations that protect consumers under the Fair Debt Collection Practices Act and other statutes.[8] While default rates for collections cases in small claims court may be high, in any court there are far more assurances of due process (including notice to consumers through service of process) than in binding mandatory arbitration.

Indeed, it is an open question whether arbitrators are making awards on the basis of records far too spotty or poorly maintained to support the same claim in court. BMA may be,

in part, an elaborate shell game set up to hide the fact that companies are seeking to collect on debts that have long since run past their expiration date or are otherwise uncollectible under prevailing law. Congress should investigate whether arbitrators are being used as a scrim to conceal these legally dubious practices.

All indications are that the traps for consumers we uncovered in California are typical of the arbitration industry as a whole. The incentives are certainly a constant across all jurisdictions. And another large dataset of nearly 20,000 NAF arbitrations that came to light in an Alabama court case and was described in our report shows an overall decision rate against consumers of 99.6 percent.[9] There are reports, one confirmed by a sworn deposition, that even highly qualified arbitrators such as Harvard Law professor Elizabeth Batholet, who decide cases in favor of consumers, get blackballed by the arbitration companies.[10]

Consumers should be able to use the public disclosures of arbitration firms that operate in California, as lawmakers in that state intended. Yet all of the firms post information to their Web sites in a manner intended to defeat understanding and analysis. To process NAF's records, which were posted one page per case, we converted the files into a searchable, sortable spreadsheet, which is now on our Web site for all to use.[11]

The American Arbitration Association, or AAA, has managed to render its California reports completely impenetrable to analysis by failing in many cases to complete them. Although the reports name the non-consumer party to the arbitration, they fail to say which party filed the case. The column labeled "prevailing party" is left blank in most cases. While the amount of the award is listed, it is not clear from the reports which party received the award.

Any arbitration firm that fails to meaningfully disclose basic consumer information required by law in California – information needed for consumers – should not be able to come before Congress and claim the system is fair, efficient or cost-effective.

Competition among arbitration providers has created a race to the bottom, in which arbitration companies compete to see who can favor corporate interests more. While NAF is notorious for its aggressive marketing, much of which is described in our report, a review of AAA's business practices also shows an exceedingly close identification of the company with its business "clients":

- In its annual reports, AAA refers to the corporations that file cases with it as its "clients and customers."[12] AAA spends, on average, more than $1 million per year on marketing.[13]
- It asked its Northern California arbitrators, who are supposed to remain "neutral," to help market AAA's services to corporations.[14]
- It intervenes in litigation between corporations that use its services and consumers, taking the side of the corporations.[15]
- In one arbitration case cited in our report, AAA reversed an important internal decision on the permissibility of class actions after the corporate party bitterly complained to AAA's president and not-so-subtly threatened to take its business – and the business of other corporate "clients"— to another arbitration company.[16]

While AAA touts its internal protocols, it does not pledge to always follow them. For example, in 2000, an AAA official acknowledged under oath that the firm does not require compliance with its health care due process protocol, calling them merely advisory: "the Protocol consists of recommended procedures with and compliance with the procedures is voluntary."[17]

Moreover, the protocols acknowledge serious disagreements among participants along critical fault lines, including: the mandatory or voluntary nature of arbitration, whether there should be judicial review of claims, and whether arbitration should be allowed as a pre-dispute condition of a contract.[18] Because, in development, AAA set aside fundamental questions about the propriety of arbitration, its internal protocols provide no assurance that binding mandatory arbitration, as imposed on consumers and employees in the real world, is just. The protocols are silent where it matters most.

The arbitration firms' public relations efforts repeatedly rely upon a tiny handful of industry-funded studies, as well as mere slurs. Although NAF maligned our report as "largely fictional,"[19] they have yet to point to a single error in its 70 pages. The report was largely based on NAF's own published data, which we presume is not fictional.

The studies cited by arbitration firms and their industry defenders typically slant the data two ways. They: 1) focus only on the tiny fraction of claims initiated by consumers; and 2) misleadingly combine voluntary and mandatory arbitration cases into one statistic.

Pointing to arbitration cases filed by consumers, NAF's Roger Haydock stated that, "in the California data, the consumer prevails in approximately 60 percent of these cases."[20] This number is misleading. Only 118 of the 33,949 arbitration cases filed with NAF in California were initiated by consumers – a miniscule *one-third of one percent* of all filings. In contrast, 99.6 percent of the claims were filed by the corporate interests. Moreover, it makes sense that the few consumers who *initiate* claims in arbitration would seek, and garner, more positive results than the vast majority of consumers who are forced into the system.

The 60 percent figure is apparently based on an NAF analysis of its California cases for only 2003 and 2004 and should no longer be cited. Our review of all of NAF's reports to date shows the consumer prevailed in merely 30 of those cases, or 25.4 percent of the total – not 60 percent. Of the remainder, business prevailed in 61 cases (51.7 percent). (Twenty-six cases, or 22 percent, were N/A.)

Moreover, some of the paltry 30 consumers identified as the prevailing party would be unlikely to celebrate a victory. One consumer seeking $35,820 from First North American National Bank was awarded a mere $1,110. Another consumer received only $1,788 from a claim for $63,338 against JK Harris Company.

A 2005 Ernst and Young study was promoted by the American Bankers Association (ABA) in a press release issued in response to our report. The study, funded by ABA, similarly focused a small number of consumer-initiated claims. As we point out in the report,

the Ernst and Young study included only 226 cases, ignoring the tens of thousands of cases filed against consumers over the same four-year period (2000 to 2004).[21]

Further, its finding that 69 percent of consumers were at least "satisfied" was meaningless: Only 40 consumers were contacted, and a mere 29 responded – or less than 13 percent of the study's already small sample of 226 cases.

This particular study is also unscientific because, unlike our own study, it is impossible to confirm. Stunningly, it relied entirely on confidential data NAF provided to Ernst & Young.

The ABA also cites an on-line survey by Harris Interactive, which, it claims, demonstrates consumers were satisfied with arbitration and believe it is faster, cheaper and simpler than going to court. This 2005 online survey of 609 adults who had participated in arbitration was conducted on behalf of the U.S. Chamber Institute for Legal Reform, a fierce defender of BMA.

To participate in the survey, respondents had to agree in advance to use BMA in any dispute arising with the survey company – an effective pre-screening of participants that likely establishes a pro-arbitration bias. Even more importantly, the group of 609 people surveyed bears little resemblance to the 19,000 cases from NAF's California data:

- Only 20 percent were required by contract to use arbitration. *The other 80 percent participated voluntarily.* (We have no objection when arbitration is agreed to by both parties after a dispute arises.)
- Two-thirds of the participants had a lawyer, in contrast to 4 percent in the California data.
- Less than half of the cases involved a dispute between an individual and a business, compared to 100 percent in NAF's California data on consumer claims.

(Other differences are explained in Appendix A.)

There is a third claim from NAF that has surfaced recently: that consumer outcomes in court and arbitration should be compared. While NAF certainly has all the details, the dearth of in-depth public information on arbitration cases, as the company well knows, makes it virtually impossible to conduct such a study.

NAF claims that in a Department of Justice analysis of 779 California court cases from 2001, "seller plaintiffs" won 77 percent of cases they initiated. But as I previously mentioned, consumer-initiated cases are a tiny fraction of the overall picture. And these success rates bear no relation to our actual findings from the NAF data in California, in which consumers lost 94 percent of the time.

To truly compare an arbitration award with a court case is a complicated and demanding task. It requires a nuanced inquiry and identification of two highly similar cases, producing evidence that will necessarily be anecdotal in nature.

We have found such a pair of cases in Alabama. Both cases involved consumer complaints, the same issue and same defendant. There was an award of $431,000 in the arbitration case conducted by the American Arbitration Association and a jury award of $435,000 in the court case. The time it took to complete the cases from initial filing to decision was roughly the same – 54 and one-half weeks in one case; 55 weeks in the other. So arbitration was not more efficient.

Yet it *was* far more costly. The court case, filed in Alabama trial court, cost less than $600, excluding attorney's fees. In contrast, the arbitration case cost $42,000, excluding attorney's fees. Costs included $36,000 for the arbitrator – for 120 hours, or three work weeks – at $300 per hour. The consumer in the arbitration paid the $6,000 filing fee plus half the arbitrator's fee, or about $18,000.

The plaintiff in the court case was able to avoid arbitration because she signed a contract with the same termite company in 1988 – before the firm included an arbitration clause in its contracts. She is an elderly widow who receives disability payments and who would have had great difficulty paying a $6,000 filing fee or the cost of the arbitrator. Indeed, BMA is designed to produce up-front fees that are so high that they dissuade consumers from enforcing their rights under the law. (Further detail on the two cases may be found in Appendix B.)

Any system that lacks transparency and accountability is ripe for abuse. As our report shows, claims by arbitration firms to deliver fairness and cost-effectiveness are merely a misleading marketing ploy. They do advertise, out of one side of their mouths, cost savings from BMA to their business prospects in large companies.[22] In contrast, consumers' sacrifice of their fundamental due process rights and their limited right to appeal when they are wronged is buried in the tiny print of a form contract and sold on the cheap.

The most efficient system of justice is one that relies on the development of public information and the operation of precedent to expose and deter abuse. When new facts are brought to light in the public courts, and judges issue public decisions that bind others to the law, all of society moves forward and the law progresses.

Any system that hides its operations in secrecy, eviscerates due process, and claims, meanwhile, to benefit consumers is a fraud on the American people that must be exposed and rooted out. I urge Congress to end these abuses, let the sunlight in, and restore the operation of justice for millions of consumers by passing the Arbitration Fairness Act of 2007 (H.R. 3010 and S. 1782).

Thank you so much for the opportunity to testify. I look forward to questions from the committee.

Appendix A

Below is a fuller comparison of key and telling differences between the Harris interactive survey participants and NAF's California data.

Harris Interactive Survey	NAF's California Data
609 Respondents in a 10-minute online interview.	National Arbitration Forum reports on 19,294 cases in which arbitrator assigned.
20% of consumers required by pre-dispute contract to go to arbitration.	100% of consumers required by pre-dispute contract to go to arbitration.
64% of interviewees filed the complaint.	0.3% of cases filed by consumer.
21% "Other side filed the complaint."	99.7% of cases filed by business.
16% of cases jointly filed by parties.	0.0% jointly filed.
66.7% of interviewees represented by an attorney.	4 percent of consumers represented by an attorney.
48% of cases involved business and consumer.	100% of cases involved business and consumer.
4% of cases involved allegedly unpaid bills/loans.	100% of cases involved allegedly unpaid bills/loans.
48% said "ruled in my favor."	4% ruled in favor of consumer.
33% of monetary awards exceeded $10,000.	41.4% of monetary awards exceeded $10,000.

The adults in this survey were participants in the Harris Poll Online (HPOL). To participate in HPOL, participants must accept an on-line agreement, a 20-clause list of terms and conditions. Among other things, the agreement requires the settlement of all disputes between HPOL participants and Harris by binding mandatory arbitration in upstate New York. Below is the clause.[23]

> **19. Arbitration**: Any controversy or claim arising out of or relating to this Agreement shall be settled by binding arbitration in accordance with the commercial arbitration rules of the American Arbitration Association. Any such controversy or claim shall be arbitrated on an individual basis, and shall not be consolidated in any arbitration with any claim or controversy of any other party. The arbitration shall be conducted in Monroe County, New York, and judgment on the arbitration award may be entered into any court having jurisdiction thereof. Either you or Harris may seek any interim or preliminary relief from a court of competent jurisdiction in Monroe County, New York necessary to protect the rights or property of you or Harris pending the completion of arbitration."

Appendix B

Below is a fuller comparison of a court case and an arbitration proceeding brought by two different consumers in Alabama against the same termite company. The information was provided by Thomas F. Campbell, a Birmingham, Alabama, attorney who both represented the plaintiff in the court case and the claimant in the arbitration.

	Arbitration	Court
Filing Fee	$6,000	$319
Arbitrator fee/Jury Fee	$36,000	$100
Issuance of subpoenas	$0	$144
No. of days of witness testimony	4	5
No. of non-party witness depositions	6	7
Number of weeks pending before decision issued	54.5	55
Compensation for arbitrator/judge	$36,000/ 3 weeks	$112,000/year
Time taken to issue ruling after testimony	30 days	19 minutes

The termite company was accused in both cases of failing to provide treatment services that it was required to provide under a contract with the homeowner (and under Alabama law) and of concealing from the homeowners during annual inspections the true condition of their homes and the true nature of the infestation. In both cases, serious infestation was finally revealed to the homeowners.

The court case was filed by an elderly widow who is on SSI disability and in poor health. She learned of the serious termite problem, requiring up to $70,000 in repair costs, just after she emerged from bankruptcy.

The arbitration case was filed by a young college professor and his wife, a stay-at-home mom with three young children – a middle class couple who no doubt found it difficult to come up with the funds to finance the arbitration case.

They signed a contract with the termite company in 1999 that was supposed to inspect their house when they bought it, certify it as termite-free, inspect it annually thereafter – and take steps to prevent termite damage. Due to extensive termite damage they discovered subsequently, the young couple had to have their one-story bungalow almost completely demolished. It was torn down "to the floors," their attorney said. They built a large two-story home on the same footprint using savings, a large construction loan and a lot of sweat equity while living nearby in a rented house. Indeed, they could not afford to live in their rebuilt house. They sold it and eventually left town.

They will owe $18,000 – their half of the arbitrator's costs for which a bill was issued in late September, a bill fattened by a unilateral decision of the arbitrator to prolong his work on the case. The arbitrator wrote a longish written decision even though the Joneses and the termite company both asked for a one-line decision. Later, after the deadline for such requests, the termite company asked for a written "reasoned award." Despite the objection of

the claimants, the arbitrator, James P. Alexander, a Birmingham attorney who represents corporations in employment disputes, issued a 6 and one-half page "abbreviated reasoned award." The cost for reviewing documents and exhibits and writing the "reasoned award" was $11,625.

Endnotes

[1] "Rights at Risk with Binding Arbitration," ABC 7 KGO-TV, Sept. 27, 2007.
[2] Wise v. Wachovia Securities Inc., 450 F.3d 265, 269 (7th Cir. 2006) and Major League Baseball Players Assn. v. Garvey, (per curiam) 532 U.S. 504, 509 (2002).
[3] *The Arbitration Trap: How Credit Card Companies Ensnare Consumers,* Public Citizen, available at http://www.citizen.org/documents/Final_wcover.pdf.
[4] Justin Scheck, "Neutral Takes Path from Construction to Credit Cards," *The Recorder,* Oct. 2, 2007.
[5] National Arbitration Forum Code of Procedure, Aug. 1, 2007, available at http://www.adrforum.com/users/naf/resources/20070801CodeOfProcedure.pdf.
[6] *See* In the Matter of the Arbitration Between MBNA America Bank, N.A., Appellant, v. Calciano, Respondent. Order denying petitioner's application to confirm arbitration award is affirmed. Supreme Court of the state of New York, May 24, 2007. 2006-1067 K C; In the matter of the Arbitration Between MBNA America Bank, N.A., Appellant v. Walls, Respondent, Order denying petitioner's application to confirm arbitration award is affirmed, Supreme Court of the state of New York, May 24, 2007, 2006-1065 K C.; In the matter of MBNA America Bank, N.A., Appellant, v. Dasilva, Respondent. Order denying petitioner's application to confirm arbitration award is affirmed. Supreme Court of the state of New York, June 21, 2007, 2006-1062 K C.; In the Matter of the Arbitration Between MBNA America Bank, N.A., Appellant, v. Turnill, Respondent. Order denying petition to confirm is affirmed. Supreme Court of the state of New York, June 21, 2007. 2006-1088 K C.
[7] MBNA America Bank, N.A. v. Paul E. Nelson, Index No. 13777/06, Civil Court of the City of New York, County of Richmond. Decision of Judge Philip S. Straniere, June 19, 2007.
[8] For just one example, any collection activity by a debt collector must be preceded by a letter that sets out a process for the consumer to both dispute the debt in writing and request verification of the debt. The law also provides that, upon such notice from a consumer, all collection activity must cease until the consumer is sent verification of the debt. *See* 15 U.S.C. § 1692(g).
[9] Michael A. Bownes v. First USA Bank, N.A., *et al.* Circuit Court of Montgomery, Ala., Civil Action No. 99-2479-PR.
[10] Deposition of Elizabeth Bartholet in William Carr v. Gateway Inc., Circuit Court for the Third Judicial Circuit, Madison County, Ill., Sept. 26, 2006.
[11] Spreadsheet of NAF reports available at http://www.citizen.org/congress/civjus/arbitration/NAFCalifornia.xls.
[12] "Proud Past, Bold Future," American Arbitration Association annual report for 2000, available at http://www.adr.org/si.asp?id=3445. See also, "2006 President's Letter and Financial Statements," available at http://www.adr.org/si.asp?id=4661.
[13] See 990 forms filed by the American Arbitration Association with the Internal Revenue Service for 2002, 2003 and 2004, available at http://www.guidestar.com.
[14] Paul L. Van Loon, regional vice president, American Arbitration Association, to Northern California Panelists, Re: Corporate Contacts, Jan. 14, 2000.
[15] See, for example, Amicus Curiae brief of American Arbitration Association in Circuit City Stores, Inc. v. Saint Clair Adams, Supreme Court of the United States, October Term 2000, No. 99-1379, Aug. 7, 2000, and Amicus Curia brief of American Arbitration Association in Green Tree Financial Corp. v. Larkeita Randolph, Supreme Court of the United States, October Term 2000, No. 99-1235, Supreme Court of the United States, June 8, 2000.
[16] Judge John W. Lungstrum, Memorandum and Order in re: Universal Service Fund Telephone Billing Practices Litigation, Case No. 02-MD-1468, United States District Court for the District of Kansas, May 27, 2005. See also, Letter from William J. Nissen, attorney for AT&T, to William K. Slate II, president CEO, American Arbitration Association, March 7, 2005.
[17] Declaration of Robert E. Meade, senior vice president, American Arbitration Association, in Kent W. Stahle v. Blue Cross of California, et al., Feb. 17, 2000, Case No. BC 218082, Superior Court of California, County of Los Angeles.
[18] On AAA's Consumer Due Process protocol, see the Reporter's Notes for Principle 11: "In convening the Advisory Committee which developed this Protocol, the AAA requested that the Committee focus its attention upon due process standards for the conduct of Consumer ADR processes and not directly address the process of forming an agreement to mediate or to arbitrate. Committee deliberations revealed a range of opinions regarding the use of pre-dispute binding arbitration agreements in Consumer contracts." Available at

http://www.adr.org/sp.asp?id=22019#INTRODUCTION:_GENESIS_OF_THE_ADVISORY_CO. See also AAA Employment Due Process Protocol, in which Section A gingerly notes wide range of views among participants on judicial review, voluntariness and the timing of agreements to arbitrate. It concludes: "The Task Force takes no position on the timing of agreements to mediate and/or arbitrate statutory employment disputes."

[19] E-mail from Roger Haydock, managing director, National Arbitration Forum LLC, to NAF panelists, Sept. 30, 2007.

[20] Undated cover letter from Roger Haydock, managing director, National Arbitration Forum LLC that transmitted Public Citizen report to NAF arbitrators

[21] On Nov. 27, 2002, Edward C. Anderson, managing director of the National Arbitration Forum, testified that NAF routinely handled "tens of thousands" of cases a year. Testimony was taken in a deposition in May in Ebarle v. Household Retail Services *et al*, Case No. CGC-02-403708, Superior Court of California, City and County of San Francisco.

[22] For some examples of arbitrations firms' activities in marketing their services to business, see pp. 18-20 of *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, available at http://www.citizen.org/documents/Final_wcover.pdf.

[23] "Harris Poll Online Terms of Use," available at http://www.harrispollonline.com/AdultReg.asp?lang=1.

Ms. SÁNCHEZ. Thank you very much for your testimony.

I would invite Mr. Naimark to begin his testimony.

TESTIMONY OF RICHARD NAIMARK, SENIOR VICE PRESIDENT, AMERICAN ARBITRATION ASSOCIATION, WASHINGTON, DC

Mr. NAIMARK. Thank you. Good afternoon, Madam Chair, Congressman Cannon, Congressman Johnson. Thank you for the invitation, spending your time and attention with us this morning.

I would like to say at the outset the AAA is a not-for-profit service organization with an 81-year history in the administration of justice. AAA does not represent the ADR industry or other arbitral institutions. We feel as a result of our unique position, we have something valuable to add to the proceedings today.

I want to say at the outset that the public policy in the United States on consumer and employment arbitration is something that could use some fixing, could use some balancing. We would like to discuss briefly with you here about how Congress might accomplish that.

About a decade ago, before there was any turmoil and controversy about consumer cases, AAA recognized that when you looked at the horizon, that these issues would begin to arise. So we assembled a group which is in Annex A of our submission if you get a chance to look at it, a very broad coalition of people from all different diverse interest groups to work on what we call the due process protocol for mediation and arbitration of consumer disputes.

These protocols provide for rules of fair play in the arbitration process and were the best consensus thinking at that time and currently for what provides for fair play in the arbitration process that applies to consumer disputes.

To date, the AAA and a few other organizations have implemented this protocol, but others have not. By the way, in the employment arena, we have a similar task force which developed due process protocols for employment cases and as a result there has been fairly broad recognition by the courts of these protocols as the standard of fair play all the way up to Supreme Court justices citing them, at least in oral commentary, as the standard of fair play for employment disputes.

A couple of highlights in the due process protocols. They do common sense things. They, for instance, provide that consumers and employees always have a right to representation; that the costs of the process must be reasonable; that the location of the proceedings should be reasonably accessible; that no party should have a unilateral choice of arbitrator; that there shall be full disclosure by arbitrators of any potential conflict or appearance of conflict or previous contact between the arbitrator and the parties. The arbitrator shall have no personal or financial interest in the matter.

Perhaps most important, I would like to highlight there shall be no limitation of remedy that would be otherwise available in court of administrative hearing. There are other features as well to the protocols, but I think that gives you a bit of a flavor.

I was told a few years ago by a very prominent plaintiffs' employment attorney that at least 95 percent of the meritorious claims that come into his office will never get legal representation because

no one can afford to pay for it. The lawyer can't afford to bankroll all these cases and the individual often cannot afford to pay for it. So for those that do get to court, only 2 percent ever get to trial before a judge or a jury.

So the idea of "my day in court" is in reality a myth for more mere mortals. Most Americans can't afford the court process. This is a problem. Lack of access to justice is a drag on our democracy and our social system. But, and I say "BUT" in capital letters, arbitration needs to be done right—no sloping of the playing field, no structural advantages for either side, the need to be these procedural safeguards built into the process.

That essentially is my message for the Committee. Congress can address these problems in the use of arbitration in consumer and employment disputes by codifying the standards and protections that were built by the National Consumer Disputes Advisory Committee and the Task Force on Alternative Dispute Resolution in Employment. In that way, fairness in consumer and employment arbitration will no longer be voluntary.

Thank you.

[The prepared statement of Mr. Naimark follows:]

PREPARED STATEMENT OF RICHARD NAIMARK

Statement on Consumer Arbitration by the American Arbitration Association

Submitted to the
Subcommittee on Commercial and Administrative Law Committee on the Judiciary
United States House of Representatives
Thursday, October 25, 2007

Good afternoon, Madam Chair, Congressman Cannon and Members of the Subcommittee. I am Richard Naimark, Senior Vice President of The American Arbitration Association. We appreciate the opportunity to testify before the Subcommittee today.

As the world's largest provider of alternative dispute resolution ("ADR") services, including arbitration, the AAA has pioneered the development of arbitration rules, protocols and codes of ethics and we share our experience with the Subcommittee.

AAA is a not-for-profit public service organization with an 81-year history in the administration of justice. Arbitrators who hear cases that are administered by the AAA are not employees of AAA, but are independent neutrals screened and trained. AAA does not represent the ADR industry or other arbitral institutions, but as a result of our unique position, and important and longstanding work in the field of alternative dispute resolution, we believe we have an important contribution to make to the subject matter of the hearings taking place today.

We wish to make these key points:

- For the vast majority of consumers and employees, arbitration presents the only viable access to justice for their grievances.
- Arbitration must be properly constructed, with safeguards to ensure a level playing field.
- Modern Arbitration has an 80 year history in this country, with a rich body of judicial decisions guiding and shaping the process, defining "fair play" in arbitration.
- Mandatory arbitration clauses are the only means by which a consumer or employee can have assurance of meaningful access to justice in most cases.
- If Congress wishes to protect consumers and employees with disputes against businesses it should implement due process safeguards and ensure the availability of arbitration and mediation for resolution of the disputes.

Recognizing that the use of arbitration in consumer agreements presented some unique issues, the AAA, nearly a decade ago, convened a group of representatives of consumer, academic, government, and industry groups to examine these issues. This National Consumer Disputes Advisory Committee (Annex A) ultimately issued the *Due Process Protocol for Mediation and Arbitration of Consumer Disputes* (Annex B).

The AAA and a few other organizations have implemented this Protocol, but others have not.

In the employment arena, the AAA similarly convened the Task Force on Alternative Dispute Resolution in Employment, a coalition of employee, business and regulatory interests, to develop

the *Due Process Protocol on Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship* (See Annex C).

Arbitration between a consumer and a business, or an employee and a business, must incorporate these safeguards to ensure a level playing field, maintaining basic procedural fairness of the process. These Protocols have been in operation for over 9 years and have proven effective and reliable. Courts have repeatedly referred to the Protocols as a standard of fair play in this context.

Consumer Due Process Protocols

- Consumers and businesses have a right to an independent and impartial neutral and independent administration of their dispute
- Consumers and employees always have a right to representation
- Costs of the process must be reasonable (See Annex E)
- Location of the proceeding must be reasonably accessible
- No party may have unilateral choice of arbitrator
- There shall be full disclosure by arbitrators of any potential conflict or appearance of conflict or previous contact between the arbitrator and the parties. The arbitrator shall have no personal or financial interest in the matter
- There shall be no limitation of remedy that would otherwise be available
- Small claims may opt out where there is small claims court jurisdiction
- Parties to the dispute must have access to information critical to resolution of the dispute.
- The use of mediation to foster voluntary resolution of the matter.
- Clear and adequate notice of the arbitration provision and its consequences, including a statement of its mandatory or optional character;

Congress can address the problems in the use of arbitration in consumer and employment disputes by codifying the standards and protections developed by the National Consumer Disputes Advisory Committee and the Task Force on Alternative Dispute Resolution in Employment. Fairness in consumer and employment arbitration will no longer be voluntary.

One final note:

Any legislation designed to shape the consumer and employment arbitration process should not modify the Federal Arbitration Act (FAA), but rather, should be accomplished with a piece of companion legislation. The FAA is a piece of omnibus serving a very broad sphere of arbitration activity in this country. It has been in existence since 1923 and has been continually shaped and refined by the courts, up through the U.S. Supreme Court to the point where it functions exceedingly well in the vast majority of business to business and other types of arbitration. What is more, the shaping of the FAA has been consistent with international standards of practice in arbitration, making the US a jurisdiction successfully aligned with the predominant cross border system of justice – International arbitration. To modify the FAA would upset 80 years of judicial wisdom and guidance for a process that works quite well in tens of thousands of business arbitrations annually. Modification would unnecessarily send a message of ambiguity and policy hostility to arbitration to the international community. Companion legislation can accomplish the goals of Congress, without disruption to a venerable and successful process.

Annex A

SIGNATORIES TO A DUE PROCESS PROTOCOL FOR MEDIATION AND ARBITRATION OF CONSUMER DISPUTES

Dated: April 17, 1998

Some of the signatories to this Protocol were designated by their respective organizations, but the Protocol reflects their personal views and should not be construed as representing the policy of the designating organizations.

The Honorable Winslow Christian
Co-chair
Justice (Retired)
California Court of Appeal

William N. Miller
Co-chair
Director of the ADR Unit
Office of Consumer Affairs
Virginia Division of Consumer Protection
Designated by National Association of Consumer Agency Administrators

David B. Adcock
Office of the University Counsel
Duke University

Steven G. Gallagher
Senior Vice President
American Arbitration Association

Michael F. Hoellering
General Counsel
American Arbitration Association

J. Clark Kelso
Director
Institute for Legislative Practice
University of the Pacific
McGeorge School of Law

Elaine Kolish
Associate Director
Division of Enforcement

Ken McEldowney
Executive Director
Consumer Action

Michelle Meier
Former Counsel for Government Affairs
Consumers Union

Anita B. Metzen
Executive Director
American Council on Consumer Interests

James A. Newell
Associate General Counsel
Freddie Mac

Shirley F. Sarna
Assistant Attorney General-In-Charge
Consumer Frauds and Protection Bureau
Office of the Attorney General
State of New York
Designated by National Association of Attorneys General

Daniel C. Smith
Vice President and Deputy General Counsel
Fannie Mae

Terry L. Trantina
Member
Ravin, Sarasohn, Cook, Baumgarten, Fisch

Bureau of Consumer Protection
Federal Trade Commission

Robert Marotta
Wolcott, Rivers, Wheary, Basnight & Kelly, P.C.
Formerly Office of the General Counsel
General Motors Corporation

Robert E. Meade
Senior Vice President
American Arbitration Association

& Rosen, P.C.

Deborah M. Zuckerman
Staff Attorney
Litigation Unit
American Association of Retired Persons

Thomas Stipanowich
Academic Reporter
W.L. Matthews Professor of Law
University of Kentucky College of Law

Annex B

Consumer Due Process Protocol

Statement of Principles of the National Consumer Disputes Advisory Committee

Statement of Principles
Introduction: Genesis of the Advisory Committee
Scope of the Consumer Due Process
Glossary of Terms
Major Standards and Sources
Principle 1. Fundamentally-Fair Process
Principle 2. Access to Information Regarding ADR Program
Principle 3. Independent and Impartial Neutral; Independent Administration
Principle 4. Quality and Competence of Neutrals
Principle 5. Small Claims
Principle 6. Reasonable Cost
Principle 7. Reasonably Convenient Location
Principle 8. Reasonable Time Limits
Principle 9. Right to Representation
Principle 10. Mediation
Principle 11. Agreements to Arbitrate
Principle 12. Arbitration Hearings
Principle 13. Access to Information
Principle 14. Arbitral Remedies
Principle 15. Arbitration Awards
LIST OF SIGNATORIES

STATEMENT OF PRINCIPLES

PRINCIPLE 1. FUNDAMENTALLY-FAIR PROCESS

All parties are entitled to a fundamentally-fair ADR process. As embodiments of fundamental fairness, these Principles should be observed in structuring ADR Programs.

PRINCIPLE 2. ACCESS TO INFORMATION REGARDING ADR PROGRAM

Providers of goods or services should undertake reasonable measures to provide Consumers with full and accurate information regarding Consumer ADR Programs. At the time the Consumer contracts for goods or services, such measures should include (1) clear and adequate notice regarding the ADR provisions, including a statement indicating whether participation in the ADR Program is mandatory or optional, and (2) reasonable means by which Consumers may obtain additional information regarding the ADR Program. After a dispute arises, Consumers should have access to all information necessary for effective participation in ADR.

PRINCIPLE 3. INDEPENDENT AND IMPARTIAL NEUTRAL; INDEPENDENT ADMINISTRATION

Independent and Impartial Neutral. All parties are entitled to a Neutral who is independent and impartial.

Independent Administration. If participation in mediation or arbitration is mandatory, the procedure should be administered by an Independent ADR Institution. Administrative services should include the maintenance of a panel of prospective Neutrals, facilitation of Neutral selection, collection and distribution of Neutral's fees and expenses, oversight and implementation of ADR rules and procedures, and monitoring of Neutral qualifications, performance, and adherence to pertinent rules, procedures and ethical standards.

Standards for Neutrals. The Independent ADR Institution should make reasonable efforts to ensure that Neutrals understand and conform to pertinent ADR rules, procedures and ethical standards.

Selection of Neutrals. The Consumer and Provider should have an equal voice in the selection of Neutrals in connection with a specific dispute.

Disclosure and Disqualification. Beginning at the time of appointment, Neutrals should be required to disclose to the Independent ADR Institution any circumstance likely to affect impartiality, including any bias or financial or personal interest which might affect the result of the ADR proceeding, or any past or present relationship or experience with the parties or their representatives, including past ADR experiences. The Independent ADR Institution should communicate any such information to the parties and other Neutrals, if any. Upon objection of a party to continued service of the Neutral, the Independent ADR Institution should determine whether the Neutral should be disqualified and should inform the parties of its decision. The disclosure obligation of the Neutral and procedure for disqualification should continue throughout the period of appointment.

PRINCIPLE 4. QUALITY AND COMPETENCE OF NEUTRALS

All parties are entitled to competent, qualified Neutrals. Independent ADR Institutions are responsible for establishing and maintaining standards for Neutrals in ADR Programs they administer.

PRINCIPLE 5. SMALL CLAIMS

Consumer ADR Agreements should make it clear that all parties retain the right to seek relief in a small claims court for disputes or claims within the scope of its jurisdiction.

PRINCIPLE 6. REASONABLE COST

Reasonable Cost. Providers of goods and services should develop ADR programs which entail reasonable cost to Consumers based on the circumstances of the dispute, including, among other

things, the size and nature of the claim, the nature of goods or services provided, and the ability of the Consumer to pay. In some cases, this may require the Provider to subsidize the process.

Handling of Payment. In the interest of ensuring fair and independent Neutrals, the making of fee arrangements and the payment of fees should be administered on a rational, equitable and consistent basis by the Independent ADR Institution.

PRINCIPLE 7. REASONABLY CONVENIENT LOCATION

In the case of face-to-face proceedings, the proceedings should be conducted at a location which is reasonably convenient to both parties with due consideration of their ability to travel and other pertinent circumstances. If the parties are unable to agree on a location, the determination should be made by the Independent ADR Institution or by the Neutral.

PRINCIPLE 8. REASONABLE TIME LIMITS

ADR proceedings should occur within a reasonable time, without undue delay. The rules governing ADR should establish specific reasonable time periods for each step in the ADR process and, where necessary, set forth default procedures in the event a party fails to participate in the process after reasonable notice.

PRINCIPLE 9. RIGHT TO REPRESENTATION

All parties participating in processes in ADR Programs have the right, at their own expense, to be represented by a spokesperson of their own choosing. The ADR rules and procedures should so specify.

PRINCIPLE 10. MEDIATION

The use of mediation is strongly encouraged as an informal means of assisting parties in resolving their own disputes.

PRINCIPLE 11. AGREEMENTS TO ARBITRATE

Consumers should be given:

clear and adequate notice of the arbitration provision and its consequences, including a statement of its mandatory or optional character;

reasonable access to information regarding the arbitration process, including basic distinctions between arbitration and court proceedings, related costs, and advice as to where they may obtain more complete information regarding arbitration procedures and arbitrator rosters;

notice of the option to make use of applicable small claims court procedures as an alternative to binding arbitration in appropriate cases; and,

a clear statement of the means by which the Consumer may exercise the option (if any) to submit disputes to arbitration or to court process.

PRINCIPLE 12. ARBITRATION HEARINGS

Fundamentally-Fair Hearing. All parties are entitled to a fundamentally-fair arbitration hearing. This requires adequate notice of hearings and an opportunity to be heard and to present relevant evidence to impartial decision-makers. In some cases, such as some small claims, the requirement of fundamental fairness may be met by hearings conducted by electronic or telephonic means or by a submission of documents. However, the Neutral should have discretionary authority to require a face-to-face hearing upon the request of a party.

Confidentiality in Arbitration. Consistent with general expectations of privacy in arbitration hearings, the arbitrator should make reasonable efforts to maintain the privacy of the hearing to the extent permitted by applicable law. The arbitrator should also carefully consider claims of privilege and confidentiality when addressing evidentiary issues.

PRINCIPLE 13. ACCESS TO INFORMATION

No party should ever be denied the right to a fundamentally-fair process due to an inability to obtain information material to a dispute. Consumer ADR agreements which provide for binding arbitration should establish procedures for arbitrator-supervised exchange of information prior to arbitration, bearing in mind the expedited nature of arbitration.

PRINCIPLE 14. ARBITRAL REMEDIES

The arbitrator should be empowered to grant whatever relief would be available in court under law or in equity.

PRINCIPLE 15. ARBITRATION AWARDS

Final and Binding Award; Limited Scope of Review. If provided in the agreement to arbitrate, the arbitrator's award should be final and binding, but subject to review in accordance with applicable statutes governing arbitration awards.

Standards to Guide Arbitrator Decision-Making. In making the award, the arbitrator should apply any identified, pertinent contract terms, statutes and legal precedents.

Explanation of Award. At the timely request of either party, the arbitrator should provide a brief written explanation of the basis for the award. To facilitate such requests, the arbitrator should discuss the matter with the parties prior to the arbitration hearing.

Annex C

Employment Due Process Protocol

The following protocol is offered by the undersigned individuals, members of the Task Force on Alternative Dispute Resolution in Employment, as a means of providing due process in the resolution by mediation and binding arbitration of employment disputes involving statutory rights. The signatories were designated by their respective organizations, but the protocol reflects their personal views and should not be construed as representing the policy of the designating organizations.

Genesis

This Task Force was created by individuals from diverse organizations involved in labor and employment law to examine questions of due process arising out of the use of mediation and arbitration for resolving employment disputes. In this protocol we confine ourselves to statutory disputes.

The members of the Task Force felt that mediation and arbitration of statutory disputes conducted under proper due process safeguards should be encouraged in order to provide expeditious, accessible, inexpensive and fair private enforcement of statutory employment disputes for the 100,000,000 members of the workforce who might not otherwise have ready, effective access to administrative or judicial relief. They also hope that such a system will serve to reduce the delays which now arise out of the huge backlog of cases pending before administrative agencies and courts and that it will help forestall an even greater number of such cases.

A. Pre or Post Dispute Arbitration

The Task Force recognizes the dilemma inherent in the timing of an agreement to mediate and/or arbitrate statutory disputes. It did not achieve consensus on this difficult issue. The views in this spectrum are set forth randomly, as follows:

Employers should be able to create mediation and/or arbitration systems to resolve statutory claims, but any agreement to mediate and/or arbitrate disputes should be informed, voluntary, and not a condition of initial or continued employment.

Employers should have the right to insist on an agreement to mediate and/or arbitrate statutory disputes as a condition of initial or continued employment.

Postponing such an agreement until a dispute actually arises, when there will likely exist a stronger re-disposition to litigate, will result in very few agreements to mediate and/or arbitrate, thus negating the likelihood of effectively utilizing alternative dispute resolution and overcoming the problems of administrative and judicial delays which now plague the system.

Employees should not be permitted to waive their right to judicial relief of statutory claims arising out of the employment relationship for any reason.

Employers should be able to create mediation and/or arbitration systems to resolve statutory claims, but the decision to mediate and/or arbitrate individual cases should not be made until after the dispute arises.

The Task Force takes no position on the timing of agreements to mediate and/or arbitrate statutory employment disputes, though it agrees that such agreements be knowingly made. The focus of this protocol is on standards of exemplary due process.

B. Right of Representation

1. Choice of Representative

Employees considering the use of or, in fact, utilizing mediation and/or arbitration procedures should have the right to be represented by a spokesperson of their own choosing. The mediation and arbitration procedure should so specify and should include reference to institutions which might offer assistance, such as bar associations, legal service associations, civil rights organizations, trade unions, etc.

2. Fees for Representation

The amount and method of payment for representation should be determined between the claimant and the representative. We recommend, however, a number of existing systems which provide employer reimbursement of at least a portion of the employee's attorney fees, especially for lower paid employees. The arbitrator should have the authority to provide for fee reimbursement, in whole or in part, as part of the remedy in accordance with applicable law or in the interests of justice.

3. Access to Information

One of the advantages of arbitration is that there is usually less time and money spent in pre-trial discovery. Adequate but limited pre-trial discovery is to be encouraged and employees should have access to all information reasonably relevant to mediation and/or arbitration of their claims. The employees' representative should also have reasonable pre-hearing and hearing access to all such information and documentation.

Necessary pre-hearing depositions consistent with the expedited nature of arbitration should be available. We also recommend that prior to selection of an arbitrator, each side should be provided with the names, addresses and phone numbers of the representatives of the parties in that arbitrator's six most recent cases to aid them in selection.

C. Mediator and Arbitrator Qualification

1. Roster Membership

Mediators and arbitrators selected for such cases should have skill in the conduct of hearings, knowledge of the statutory issues at stake in the dispute, and familiarity with the workplace and employment environment. The roster of available mediators and arbitrators should be established on a non-discriminatory basis, diverse by gender, ethnicity, background, experience, etc. to satisfy the parties that their interest and objectives will be respected and fully considered.

Our recommendation is for selection of impartial arbitrators and mediators. We recognize the right of employers and employees to jointly select as mediator and/or arbitrator one in whom both parties have requisite trust, even though not possessing the qualifications here recommended, as most promising to bring finality and to withstand judicial scrutiny. The existing cadre of labor and employment mediators and arbitrators, some lawyers, some not, although skilled in conducting hearings and familiar with the employment milieu is unlikely, without special training, to consistently possess knowledge of the statutory environment in which these disputes arise and of the characteristics of the non-union workplace.

There is a manifest need for mediators and arbitrators with expertise in statutory requirements in the employment field who may, without special training, lack experience in the employment area and in the conduct of arbitration hearings and mediation sessions. Reexamination of rostering eligibility by designating agencies, such as the American Arbitration Association, may permit the expedited inclusion in the pool of this most valuable source of expertise.

The roster of arbitrators and mediators should contain representatives with all such skills in order to meet the diverse needs of this caseload.

Regardless of their prior experience, mediators and arbitrators on the roster must be independent of bias toward either party. They should reject cases if they believe the procedure lacks requisite due process.

2. Training

The creation of a roster containing the foregoing qualifications dictates the development of a training program to educate existing and potential labor and employment mediators and arbitrators as to the statutes, including substantive, procedural and remedial issues to be confronted and to train experts in the statutes as to employer procedures governing the employment relationship as well as due process and fairness in the conduct and control of arbitration hearings and mediation sessions.

Training in the statutory issues should be provided by the government agencies, bar associations, academic institutions, etc., administered perhaps by the designating agency, such as the AAA, at various locations throughout the country. Such training should be updated periodically and be required of all mediators and arbitrators. Training in the conduct of mediation and arbitration could be provided by a mentoring program with experienced panelists.

Successful completion of such training would be reflected in the resume or panel cards of the arbitrators supplied to the parties for their selection process.

3. Panel Selection

Upon request of the parties, the designating agency should utilize a list procedure such as that of the AAA or select a panel composed of an odd number of mediators and arbitrators from its roster or pool. The panel cards for such individuals should be submitted to the parties for their perusal prior to alternate striking of the names on the list, resulting in the designation of the remaining mediator and/or arbitrator.

The selection process could empower the designating agency to appoint a mediator and/or arbitrator if the striking procedure is unacceptable or unsuccessful. As noted above, subject to the consent of the parties, the designating agency should provide the names of the parties and their representatives in recent cases decided by the listed arbitrators.

4. Conflicts of Interest

The mediator and arbitrator for a case has a duty to disclose any relationship which might reasonably constitute or be perceived as a conflict of interest. The designated mediator and/or arbitrator should be required to sign an oath provided by the designating agency, if any, affirming the absence of such present or preexisting ties.

5. Authority of the Arbitrator

The arbitrator should be bound by applicable agreements, statutes, regulations and rules of procedure of the designating agency, including the authority to determine the time and place of the hearing, permit reasonable discovery, issue subpoenas, decide arbitrability issues, preserve order and privacy in the hearings, rule on evidentiary matters, determine the close of the hearing and procedures for post-hearing submissions, and issue an award resolving the submitted dispute.

The arbitrator should be empowered to award whatever relief would be available in court under the law. The arbitrator should issue an opinion and award setting forth a summary of the issues, including the type(s) of dispute(s), the damages and/or other relief requested and awarded, a statement of any other issues resolved, and a statement regarding the disposition of any statutory claim(s).

6. Compensation of the Mediator and Arbitrator

Impartiality is best assured by the parties sharing the fees and expenses of the mediator and arbitrator. In cases where the economic condition of a party does not permit equal sharing, the parties should make mutually acceptable arrangements to achieve that goal if at all possible. In the absence of such agreement, the arbitrator should determine allocation of fees. The designating agency, by negotiating the parties' share of costs and collecting such fees, might be able to reduce the bias potential of disparate contributions by forwarding payment to the mediator and/or arbitrator without disclosing the parties' share therein.

D. Scope of Review

The arbitrator's award should be final and binding and the scope of review should be limited.

Signatories

Christopher A. Barreca, Co-Chair
Partner
Paul, Hastings, Janofsky & Walker
Rep., Council of Labor & Employment Section, American Bar Association

Max Zimny, Co-Chair
General Counsel, International
Ladies' Garment Workers' Union Association
Rep., Council of Labor & Employment Section, American Bar Association

Arnold Zack, Co-Chair
President, Nat. Academy of Arbitrators

Carl E. VerBeek
Management Co-Chair Union Co-Chair
Partner
Varnum Riddering Schmidt & Howlett
Arbitration Committee of Labor & Employment Section, ABA

Robert D. Manning
Angoff, Goldman, Manning, Pyle, Wanger & Hiatt, P.C.
Union Co-Chair
Arbitration Committee of Labor & Employment Section, ABA

Charles F. Ipavec, Arbitrator
Neutral Co-Chair
Arbitration Committee of Labor & Employment Section, ABA

George H. Friedman
Senior Vice President
American Arbitration Association

Michael F. Hoellering
General Counsel
American Arbitration Association

W. Bruce Newman
Rep., Society of Professionals in Dispute Resolution

Wilma Liebman
Special Assistant to the Director Federal Mediation & Conciliation

Joseph Garrison, President
National Employment Lawyers Association

Lewis Maltby
Director - Workplace Rights Project, American Civil Liberties Union

Annex D

AAA Case Numbers

Approximately 1500 consumer cases per year.

- 41% of consumer arbitrations were conducted by documents only. The remaining cases included telephonic or in person hearings.
- Cases conducted by documents only were awarded in approximately four months. In-person hearings were awarded in approximately six months.
- Consumers prevailed in 48% of cases in which they were the claimant.
- Businesses prevailed in 74% of cases in which they were the claimant.

Significantly, 60 % of those cases are settled or withdrawn by the parties to the dispute prior to a decision by the arbitrator.

Approximately 2000 non-union employment cases per year.

Annex E

Costs of Consumer Arbitration

Consumer Arbitration COSTS
Effective July 1, 2003

There are two fees applicable to the arbitration process. Trained and experienced arbitrators charge a fee for the time they spend on cases. The AAA also charges an administration fee. This fee covers the case administration services provided to the parties, including assistance in selecting the arbitrator, handling documents, scheduling a hearing if required, and distributing the arbitrator's decision.

Administrative Fees

Administrative fees are based on the size of the claim and counterclaim in a dispute. They are based only on the actual damages and not on any additional damages, such as attorneys' fees or punitive damages. These fees are not refundable.

Arbitrator Fees

For cases in which no claim exceeds $75,000, arbitrators are paid based on the type of proceeding that is used. The parties make deposits as set forth below. Any unused deposits are returned at the end of the case.

Desk Arbitration or Telephone Hearing $250 for service on the case
In Person Hearing $750 per day of hearing

For cases in which a claim or counterclaim exceeds $75,000, arbitrators are compensated at the rates set forth on their panel biographies.

Fees and Deposits to be Paid by the Consumer:

If the consumer's claim or counterclaim does not exceed $10,000, then the consumer is responsible for one-half the arbitrator's fees up to a maximum of $125. This deposit is used to pay the arbitrator. It is refunded if not used.

If the consumer's claim or counterclaim is greater than $10,000, but does not exceed $75,000, then the consumer is responsible for one-half the arbitrator's fees up to a maximum of $375. This deposit is used to pay the arbitrator. It is refunded if not used.

If the consumer's claim or counterclaim exceeds $75,000, or if the consumer's claim or counterclaim is non-monetary, then the consumer must pay an Administrative Fee in accordance with the Commercial Fee Schedule. A portion of this fee is refundable pursuant to the Commercial Fee Schedule. The consumer must also deposit one-half of the arbitrator's compensation. This deposit is used to pay the arbitrator. This deposit is refunded if not used. The arbitrator's compensation rate is set forth on the panel biography provided to the parties before the arbitrator is appointed.

Fees and Deposits to be Paid by the Business:

Administrative Fees:

If neither party's claim or counterclaim exceeds $10,000, the business must pay $750 and a Case Service Fee of $200 if a hearing is held. A portion of this fee is refundable pursuant to the Commercial Fee Schedule.

If either party's claim or counterclaim exceeds $10,000, but does not exceed $75,000, the business must pay $950 and a Case Service Fee of $300 if a hearing is held. A portion of this fee is refundable pursuant to the Commercial Fee Schedule.

If the business's claim or counterclaim exceeds $75,000, or if the business's claim or counterclaim is non-monetary, the business must pay an Administrative Fee in accordance with the Commercial Fee Schedule. A portion of this fee is refundable pursuant to the Commercial Fee Schedule.

Arbitrator Fees:

The business must pay for all arbitrator compensation deposits beyond those that are the responsibility of the consumer. These deposits are refunded if not used.

If a party fails to pay its fees and share of the administrative fee or the arbitrator compensation deposit, the other party may advance such funds. The arbitrator may assess these costs in the award.

AAA Administrative Fee Waiver/Deferral/Hardship Provisions In cases where an AAA Administrative fee applies, parties are eligible for consideration for a waiver or deferral of the administrative fee. These requirements are detailed in the AAA Administrative Fee Waiver/Deferral/Hardship Provisions section of the AAA Administrative Fee Waivers and Pro Bono Arbitrators Services document.

Pro Bono Service by Arbitrators: A number of arbitrators on the AAA panel have volunteered to serve pro bono for one hearing day on cases where an individual might otherwise be financially unable to pursue his or her rights in the arbitral forum. See the *Pro Bono Service by Arbitrator* section of the AAA Administrative Fee Waivers and Pro Bono Arbitrators Services document for more details.

Questions

Further information on fees is available in the Supplementary Procedures for Consumer-Related Disputes, effective July 1, 2003. These rules are available in the Consumer section of Focus Areas on the AAA Web site.

For more information, please contact the AAA's Customer Service Department at 1-800-778-7879.

Ms. SÁNCHEZ. Thank you, Mr. Naimark, and you came in under 5 minutes.

I would now at this time invite Governor Barnes to please give his oral testimony.

TESTIMONY OF THE HONORABLE ROY BARNES, THE BARNES LAW GROUP, LLC, MARIETTA, GA

Mr. BARNES. Madam Chair, Mr. Cannon, Mr. Johnson and others, I want to talk about just one category of cases. I began to see these when I was down at Legal Aid, and they have become the result of a decision of the Supreme Court of the United States. I came up and listened to the argument. Paul Bland made the argument over there that you previously heard from.

That is contracts that are illegal. You would think that an illegal contract, that is a contract for a crime, that you wouldn't have to worry too much about arbitration. For example, the chief justice asked the counsel for the bank, if Murder Incorporated were still in existence and it had an arbitration provision, would we have to go to arbitration on a dispute over whether the fee had ever been paid on Murder Incorporated?

Well, the answer under the law as it exists today is yes, you would have to go to arbitration about it. You would have to go to arbitration and argue before arbitration on a ridiculous, or as Ms. MacCleery says, as the courts have said, "crazy" decisions that are made. Now, the case that arose in *Cardegna v. Buckeye*, which is the case that came up from Florida, is that in most States the making of payday loans is a crime. It is in Georgia. It was a felony in Florida.

With all due respect, Mr. Cannon, I will tell you I never found anybody at Legal Aid that thought it was fair and efficient after they had been taken advantage of, that they were told they had to go to arbitration to prove that they were a victim of a crime.

The other point I want to make, these claims are so small. If you ever file an arbitration, they may pay the claim. But it doesn't stop the conduct, even though it is illegal. Let me tell you something, there are more payday lenders in the United States than there are McDonald's stores, more payday lenders than there are McDonald's'.

They charge anywhere from 250 percent to 1,000 percent interest. It is a practice that has been universally condemned over the years. Let me give you some examples of cases that we have been involved in that I can tell you about. Ina Claire Evans, one of Mr. Johnson's constituents over there—make sure I don't run over my time here—she was charged 829.55 percent interest on a $500 loan. Ms. Shamburger, also from over in DeKalb, was charged $701. That case was filed on August 6, 2004. We have been to the court of appeals twice on the arbitration.

And then you say, well, you tried to go to court. Why didn't you just go to arbitration? We did go to arbitration. We took two of them and put them in arbitration, and I want to say and benefit Mr. Naimark over here, it wasn't AAA now. But we went to arbitration on two of them. Do you know how long those cases have been pending? They have been pending 3 years. And do you know why? Because the arbitrator ruled in our favor in one of the cases.

It said, well, if it is a crime under the Georgia law, then of course the arbitration provision, all the restrictions of not being able to group the cases together and stop this practice, of course it is illegal.

And then on motion to reconsider after a letter was sent up and objection was made about the decision, upon reconsideration the arbitrator said, "Well, no, I can't decide that." And so you can only litigate one case, and we have to let the criminal activity continue.

One of the cases, a lady came to me. She worked for the State. I would see her when I would go down to the World Congress Center. She was a secretary down there, a young African American woman. She came up to me after I left the governor's office, and she said, "I am so embarrassed." I said, "Well, what is wrong?" She said, "I have a child, and I have been raising the child by myself. Christmas came, and I wanted some money to buy Christmas for my child, so I went down and I borrowed $300 from a payday lender. I have been paying every month″—this was July—″and I paid $900 and I still owe the $300." And I said, "Don't pay another penny," and they took the money out of her account before I could stop the automatic withdrawal. I filed suit for her. We have been litigating that case 3 years over the arbitration provision.

So I will tell you, at least if you do nothing else, take arbitration provisions out of criminal acts. At least say if it is a criminal act, you don't have to go to arbitration, and take it away from the Supreme Court of the United States. The Supreme Court of the United States says, well—and this is my last word I am going to take—the Supreme Court said, and I heard it from the justice myself, because they ruled that the arbitration provision was valid in the Supreme Court, *Cardegna v. Buckeye*. They said, "Well, if Congress didn't want us to do this, they would stop us."

Well, here it is and it is up to you all to see if it is going to be stopped.

Thank you.

Ms. SÁNCHEZ. We appreciate your testimony, Governor. It is very compelling. Thank you.

At this time, I would invite Mr. Connor to give his oral remarks.

TESTIMONY OF KENNETH L. CONNOR, ESQ., WILKES AND McHUGH, P.A., WASHINGTON, DC

Mr. CONNOR. Thank you very much, Madam Chair, Congressman Cannon, and Members of the Committee. I appreciate the chance to come and share some experiences with you about arbitration in the context of nursing home cases. I think it is important for you to understand the background of these cases so that you can understand the implications of the waiver of the rights that frequently come up in these cases.

For over 25 years I have represented victims of abuse and neglect in nursing home cases around the country, from Florida to California. I have reviewed hundreds of charts, represented hundreds of clients. I can tell you without hesitation, but with great sadness, that the way in which we treat many of our frail, elderly families and adults in this country is really America's shame and dirty secret.

Daily, I encounter nursing home residents who suffer from avoidable pressure ulcers, some literally as big as pie plates, infected to the bone, infected because they were left languishing in their urine and feces for so long that their wounds became contaminated and their skin became increasingly excoriated. They often suffer from avoidable malnutrition and dehydration. They have gaunt bodies and hallow eyes and parched tongues that are a testimony of the lack of time that harried and often overworked nursing home employees have to devote to their care and attention in the nursing homes.

They frequently suffer from multiple falls and avoidable fractures because again, given the short staffing in nursing homes which is a product of nursing home operators' decisions to consciously seek to maximize profits by minimizing their labor costs. These residents are allowed to fall and suffer horrific fractures. We frequently find that nursing home employees have to use shaving cream and other substances to try to soften the feces that have dried so hard on their bodies. Their bed linens have become covered with brown rings, a testament to the length of time the urine has been there and been left to dry.

But the point I make, very simply, is it is these kinds of circumstances that give rise to the claims that nursing home residents have against their caregivers, against the institutions that typically are being paid money by Medicare and Medicaid to take care of these residents. I guarantee you, if the results of these kinds of outcomes were occurring at Abu Ghraib or Guantanamo, there would be no end to the congressional hearings into the matter. There would be no end to the outrage that the media would be expressing about the consequences of those actions.

But these facts are often suppressed by nursing home operators by shredding the records or falsifying the records. I routinely come in contact with records that have been so poorly falsified, they are documenting care as having been given before residents are admitted to the facility, long after they are dead or buried, while they are in the hospital. I look at their time cards and find they are giving care on days when the employee isn't even at work.

But it is in this context in which issues relating to nursing home arbitration arise. I can assure you that there is no more stressful emotional difficult experience than families who are now admitting for the first time their inability to care for their loved one at home and are putting them into the care of a nursing home, who in soothing tones is assuring them of their ability to care for their loved one.

Typically, these families and often the residents who suffer from dementia or who are medicated or who are blind or deaf or both or otherwise lacking in some mental capacity to appreciate the significance of what they are signing, they are presented with 50 or 60 pages in an admission packet. They are told that they need to sign these documents so that grandmother can be admitted to the nursing home, and if they don't, she won't be. That is not acceptable because usually these folks have a monopoly in many communities, and the family would have to travel miles to see them otherwise.

Typically, these documents are signed by someone who merely makes their mark, because they are so illiterate they can't understand. They can't read or write, and frequently, as I mentioned, their sight or hearing is compromised, and they are unable to appreciate the significance of what they are signing. Yet because they were afforded an opportunity to sign, the courts often enforce these agreements notwithstanding the unconscionable circumstances in which they are entered into.

As a result, typically you find a waiver of all kinds of rights, not just the right to a jury trial, but the right to discovery, limitations on witnesses, limitations on the ability to present your case, limitations on the ability to interview witnesses. And yet typically, all of this information is available to the nursing homes.

When they are finally arbitrated, Congressman Cannon, I would submit to you, you will find that the costs in these settings are typically higher than they are in cases involving litigation, and the rewards are lower. As a result, the costs as a percentage of the awards are much higher than they would be in the case of a jury verdict.

Ms. SÁNCHEZ. Mr. Connor, your time has expired. I will allow you to summarize your final thought and we will get a chance to visit more testimony through our questions.

Mr. CONNOR. Thank you, Madam Chairman.

I would simply say that in the nursing home context, the mandatory binding arbitration regime is a playing field that is tilted substantially in favor of the nursing home and against our most frail and vulnerable members of society, who are most desperately in need of the protection of the rights that they are accorded under the law.

Thank you.

[The prepared statement of Mr. Connor follows:]

PREPARED STATEMENT OF KENNETH L. CONNOR

Mr. Chairman and Members of the Subcmmittee:

Thank you for the opportunity to share some thoughts with you about the use of binding mandatory arbitration in the context of nursing home cases. In order to fully appreciate the implications of what is at stake for nursing home residents and their families, some background is in order.

For almost twenty five years I have represented nursing home residents who have suffered abuse and neglect at the hands of their caregivers in long term care institutions. I have been involved in cases from Florida to California and have been exposed to the charts of hundreds of patients in facilities all over the country. I am saddened to tell you that the care and treatment that many of our elders receive in long term care facilities is nothing short of scandalous and is America's shameful and dirty secret. This problem is pervasive and extends to every part of the country.

Daily, I encounter frail elderly adults in nursing homes who have suffered from avoidable pressure ulcers (bed sores) which penetrate all the way to the bone. Some of these wounds are as big as pie plates. Often they are infected and so foul smelling that when you approach their room from down the hall, you can smell the resident before you can see them. The wounds often become infected because residents are left to languish in urine and feces for so long that the feces becomes hardened and stuck to their bodies and the urine dries in tell-tale brown rings on their bed clothes. Residents often suffer from avoidable malnutrition and dehydration and their gaunt bodies, hollow eyes and parched tongues are testimony to the lack of time and attention that overworked and harried staff are able to afford them. Many times these residents suffer from multiple falls and associated fractures resulting from a lack of supervision—that lack resulting from nursing home operators consciously understaffing their facilities seeking to maximize profits by minimizing labor costs. All too often my clients are the victims of rape or sexual assault—some-

times by their caregivers, and sometimes by fellow residents who, because of their diminished capacity and lack of supervision, are allowed to prey on weaker residents.

The results of this abuse and neglect are so horrific that if it were happening to detainees at Guantanamo or Abu Ghraib, there would be no end to the Congressional hearings investigating the problem or to the hue and cry of America's media howling in outrage. Yet, year after year, these problems persist and they are multiplying.

These facts are often suppressed by unscrupulous nursing home operators who falsify records or shred them in an attempt to conceal them from regulators, residents' family members, and their lawyers. These attempts at falsification are often so poorly executed that in my practice I regularly review records that reflect care as having been given on non-existent days (February 30 or 31), on days when the resident was in the hospital rather than in the nursing home, and before the resident was even admitted. Sometimes I find care charted on days that occur long after the resident has been dead and buried. Often, when I compare the care givers' time cards with their charting, I find that the care givers are not even at work when the care was purportedly administered.

In an interview with the Washington Post published February 4, 2000, John T. Bentivoglio, special counsel for health-care fraud at the Department of Justice, said in an interview, "A number of highflying nursing home chains appear to have incorporated defrauding Medicare as part of their business strategy." In my experience, those words are just as true today as they were when they were uttered seven hears ago.

It is into this milieu that families bring their precious, elderly loved ones to be cared for by the nursing home industry. Most people seeking care for their loved ones don't have a clue about the scope of problems that exist in the nursing home industry (and, of course, the problems I have outlined above, while pervasive are not universal). They just know that they no longer can provide the care needed by their aging parent or grandparent and their local nursing home has assured them that it can do so. Comforted though they are by those assurances, the admission process is, nevertheless, stressful to say the least.

Few decisions are as difficult or as painful as the decision to surrender one's loved one to be cared for by strangers. Families are often wracked with remorse and guilt at the time of the nursing home admission. The elderly person is often filled with apprehension and fear and worries about being abandoned to the care of strangers. Emotions typically run high. An admissions packet of 50–60 pages is often presented for review by the patient or their family. The briefest of explanations is offered and the patient or their representative is asked to sign on multiple pages. The agreement for binding mandatory arbitration is commonly sandwiched toward the end of the documents and is explained, if at all, in the briefest of terms and in the most soothing of tones. Prospective new residents frequently suffer from dementia or are on medication or are otherwise mentally compromised. Often they suffer from poor vision or illiteracy. Rarely do they have the capacity to understand the significant and complex documentation with which they are presented. Sometimes, the nursing home representative will acknowledge, after the fact, that they, themselves, didn't really understand the significance of the arbitration agreement they were asking the resident or their family member to sign. The goal, however, is to get patient's or family member's signature or mark on the document. If the family balks, they are told that admission will be denied. That is not acceptable to most family members since the next nearest available nursing home is often miles away and it will be extremely difficult to visit their loved one on a regular basis. Equality of bargaining position between the nursing home and the resident or their family does not exist.

The terms of the binding mandatory arbitration agreement are often as unconscionable as the circumstances under which the agreement is executed. There is no mutuality. The residents and their families typically aren't afforded an opportunity to negotiate the terms. As to the proposed agreement, they must "take or leave it." The nursing home often retains the right to modify the contract, but that same right is not afforded to the resident or her family. The nursing home reserves the right to pursue a collection action in the courts against the resident or their family, but the resident is usually left with only the right to pursue any claims against the facility through arbitration. Discovery pursuant the agreement is emasculated. The agreement typically imposes draconian limits on (1) the number of witnesses who can be deposed or called at the arbitration, (2) the number of experts who can be called, (3) the number of interrogatories, requests for admission and requests for production that can be filed, and (4) the length of time to be allotted for the arbitration hearing. The arbitrator or arbitral forum is typically selected by the nursing

home and often the home (or the chain of which it is a part) provides repeat business for the decision maker. This is a process which hardly leads to a fair and just result for the resident who is a victim of abuse and neglect in a nursing home. Not surprisingly, therefore, arbitration awards are usually substantially lower than court awarded jury verdicts.

The current system of binding mandatory arbitration employed by nursing homes creates a playing field that is tilted in favor of nursing homes and against frail, vulnerable residents who suffer terribly at the hands of their caregivers. Sadly these residents are, all too often, the victims of abuse by their caregivers. They should not be further abused by an arbitration system that dispenses anything but justice.

Ms. SÁNCHEZ. Thank you. I appreciate your testimony, Mr. Connor.

We will now begin the first round of questioning, and I will begin by recognizing myself for 5 minutes.

Ms. MacCleery, I want to start with you. Consumer advocates argue that some businesses forbid class action lawsuits with the use of arbitration clauses. I am curious to know what effect do you believe that this has on consumers who are arbitrating their claims?

Ms. MACCLEERY. I think it means that a lot of claims that might be brought won't be, because there are abuses by corporations, particularly ones that have financial impact in small aggregate amounts—credit cards, cell phones—where the company has unrightful gains. They have obtained ill-gotten gains through some kind of accounting practice. There was a credit card company out in California that was sitting on people's payments until they were late, and then dinging them with late fees—that sort of abusive behavior, but any individual consumer would not suffer a huge loss. So that if it was not able to be aggregated into a class action, you would not in fact be able to ever correct that abuse or bring it to light.

Also, one other thing about this which is that there was a move by some of the arbitration providers, the firms, to allow class actions, including AAA, and yet when their members revolted and essentially threatened to pull their business out of that arbitration provider, that pressure was enough to get them to cave on that decision. That is documented in our report.

Ms. SÁNCHEZ. So in other words, if I have this correct, if you are a consumer who has been harmed, if there are thousands of consumers who have been harmed let's say $50 or under, for an individual it may not be worthwhile to try to recoup that $50 because you might have to pay $250 in fees to get back that $50. But if you could aggregate it, you might be able to punish companies who are doing bad business practices, or perhaps even illegal business practices and force them to compensate the whole class of people that have been affected.

Ms. MACCLEERY. The issue is the deterrent effect that a case like that has against similar abuses.

Ms. SÁNCHEZ. And if I am understanding you correctly, Governor Barnes, even with illegal actions, each individual plaintiff, if you will, has to arbitrate each claim and in the aggregate they can't say this is a wrong business practice and you have to stop this immediately. Is that correct?

Mr. BARNES. That is correct, to answer your question directly. Even where there is a crime, well, why doesn't the solicitor pros-

ecute them? Well, we have tried that a time or two, and we have had a few that have been prosecuted. But you go to most solicitors, and they said, "Listen, I have mayhem and murder in the streets. The courts have to take care of this." This is more in a civil nature. Even though the general assembly said, "Listen, you ought not to be in this business." The only way you can ever litigate these cases is to aggregate them some way.

The courts, you all have put the Class Action Fairness Act, you have put all these requirements. Most of the States have. You have an interim appeal from it. Whether I agree with them or disagree with them, they have been controls on the abuses of class actions, but let me tell you something. In consumer cases, if a business, particularly an illegal one, knows they can get by with it because everybody is too busy, and they know they don't have any responsibility or accountability because they can't be brought, they are going to do it. That is just the way it is, and they are going to make the money.

Ms. SÁNCHEZ. Because it is profitable.

Mr. BARNES. And then when you sue them and when you go to arbitration with them, you have every white-shoe law firm from New York to Atlanta because this business is so profitable.

Ms. SÁNCHEZ. Correct.

Mr. Connor, I was very touched by some of the problems that you have outlined in care facilities. Now, you are a Republican, is that correct?

Mr. CONNOR. I am. I am a conservative Republican trial lawyer.

Ms. SÁNCHEZ. Okay.

Mr. CANNON. Thank heaven for a few. [Laughter.]

Mr. CONNOR. An oxymoron, some less charitably call me.

Ms. SÁNCHEZ. I would never call it an oxymoron or any other kind of moron, I dare say. [Laughter.]

I appreciate your testimony. I am interested in hearing from you and Mr. Naimark, and it is sort of a joint question. In your opinion, is this is partisan issue, the pre-arbitration mandatory arbitration clauses? Do you think that that is a partisan issue?

Mr. CONNOR. I don't. I think that this bill gets at frankly some bedrock fundamental conservative principles that Republicans ought to be affirming. Accountability and responsibility run hand in hand. If you don't hold wrongdoers fully accountable for the consequences of their wrongdoing, that wrongdoing is going to multiply. Republican conservatives have typically said we believe decisions made at the local level by people with their feet on the ground are the best decisions. That is what the jury system is all about.

What the arbitration system does, certainly in the nursing home context, is just exactly what Mr. Naimark was critical of. It slopes the playing field in favor of one side against the other. It doesn't result in full accountability for wrongdoing. Wrongdoers calculate the cost of doing business. They can calculate the profit as easily as you and I can. Their wrongdoing multiplies and the profiteering increases, and it is at the expense of our frailest and most vulnerable residents for whom Republicans maintain they have high esteem for the sanctity of their lives, but are actually in many respects I think undermining the protection of those lives.

Ms. SÁNCHEZ. I appreciate that. I have one last question I would beg everybody's indulgence to go over my time by 1 additional minute to just ask Mr. Naimark. Is there any objection? Okay.

The AAA does not support pre-dispute binding arbitration in the health care context such as disputes involving medical malpractice or health insurance coverage. I am interested to know why does AAA take this stand, and yet support arbitration involving civil rights employment cases or consumer protection cases or in other contexts? Why is there that carve-out, and how can you justify that?

Mr. NAIMARK. In a word, the health care cases are qualitatively different. I mean, they can literally be matters of life and death and very similar to the situation Mr. Connor described, where people under great duress may be signing documents and not knowing what they are signing. So it was the considered opinion of the advisory committee that they are qualitatively different, different stakes.

Ms. SÁNCHEZ. I can understand and appreciate that, but to me the idea that that somehow deserves exception and people signing away their civil or statutory rights is somehow not as important, to me is a distinction that I couldn't place the line there.

Mr. NAIMARK. Well, let me say a couple of things. First of all, this is a public policy issue, whether mandatory clauses in the consumer and employment context are acceptable or not. The courts in fact are very split on this. It is a very contentious issue. You asked about the class actions, is that contentious? This is also. They are both contentious issues.

So it really is not an issue that AAA necessarily supports or defends. It is an issue that we have to deal with. So if the cases come in, what we try to do is make sure that you have the protections with the due process protocols so that people are not giving away their civil rights or any rights. That was one of the issues that I pointed to about all remedies should be available that they would otherwise get in court or in an administrative hearing. It is merely a change in forum, and we try to make sure that that is followed through all the way so people aren't losing.

Ms. SÁNCHEZ. Okay. I appreciate that. My time has expired.

I would now recognize Mr. Cannon for 5 minutes of questions.

Mr. CANNON. Thank you, Madam Chair.

I appreciate the testimony received from this panel. Let me just say, this is to a large degree not a partisan issue. This is a question of how we do things that make some sense, and both Mr. Connor and Governor Barnes have made cases for particular classes of people.

I don't think these things are so simplistic. For instance, after we passed the bill that disallowed payday loans, Utah has a disproportionate number of people in Iraq and Afghanistan, and we have a bunch of wives who can go in and for a $25 fee get a loan until the next pay day. That can be a horrible thing when those fees pile up, and in those cases you often have criminality. But it is a huge burden on families when they can't make it to the next pay day because we have a problem with payday loans. So it is something where we need some balance.

Governor Barnes, you were talking about a case in particular, and you ended by saying that it had to wait until the criminality was over. Was there a criminal charge in that case?

Mr. BARNES. It is a crime, but there was not a criminal charge in that case. I don't know which one, of course, sometimes——

Mr. CANNON. Yes, there were both. But what you are saying essentially is the criminality continues then because there is no civil solution——

Mr. BARNES. Oh, I see what you are talking about. Yes, because I mean it is just an enforcement problem. In other words, it is a crime. It is a crime in Georgia and has been, to do payday lending, but you go down there and solicitors just don't have the time to do it. And if they are shielded from civil responsibility, there is no impediment at all.

Mr. CANNON. Right. But in that particular issue, it did not have some criminal activity going on. Thank you.

Mr. BARNES. Well now, there was criminal activity.

Mr. CANNON. Right, but no criminal prosecution. I am sorry. That is exactly what I meant.

Ms. MacCleery, your study as I understand it was limited to the National Arbitration Forum, and you did not study things like the AAA?

Ms. MACCLEERY. Well, here is the problem. The NAF is actually, and I hate to say this really, better than AAA in terms of their disclosures on the California reports in the sense that they have created a consistent dataset that allowed us to build a mechanism to dump it into a sortable database. So NAF still——

Mr. CANNON. So it was an easier thing for you to do to study them.

Ms. MACCLEERY. Well, it is still 34,000 records.

Mr. CANNON. There are some limitations on that study. Those are mostly credit card debt studies or collection cases, right? So you have——

Ms. MACCLEERY. It was all of the NAF cases in their data, all 34,000.

Mr. CANNON. What kind of cases did they deal with?

Ms. MACCLEERY. It was mainly debt collection cases. Now, AAA doesn't even complete its records in the California disclosures. So we have been trying to build——

Mr. CANNON. It is hard to get conclusions, is what you are saying.

Ms. MACCLEERY. Well, they don't complete the records. I mean, you cannot——

Mr. CANNON. I understand that. What we are trying to figure out here is what kind of weight to put on your study. There is a huge difference between a consumer who says, "my widget broke," and goes to an arbitration process, and a person who says, "I paid that bill," when maybe they did or maybe they didn't. Certainly, there will be outlandish cases where bills were paid and were not credited. You mentioned the case where a payment is held and then a late charge is added. Those kind of things happen. We recognize that. Those are terrible things and should not happen. But generally speaking, credit cases are overwhelmingly going to go against the person who failed to pay the bill.

Ms. MACCLEERY. There is a high level of what you would call default in credit card cases. There was another database of 20,000 cases in an Alabama court case that came to light that showed similar decision rates against consumers about 99 percent that were NAF data records. We would love to analyze the AAA data.

Mr. CANNON. Were those also——

Ms. MACCLEERY. Those were also collections.

Mr. CANNON. So in the collection cases, you had 94 percent of the cases that were decided by NAF in favor of the company and against the creditor.

Ms. MACCLEERY. That is right.

Mr. CANNON. Would that have been different, for instance—did you take a look at whether or not that would have been different if those people had been in the court system and been litigating in the court system?

Ms. MACCLEERY. The only two studies we found on default judgments in the court systems are dated. They pre-date a lot of identity theft problems. There is one from 1990 and one study in the late 1960's. Both of them have default rates for consumers that are lower than the default rates in our study. But there is very little data on a comparison basis to look at whether small claims court data are similar to the arbitration outcomes.

But I think the argument is really fundamental. It is about fairness in the structural problems that we highlighted.

Mr. CANNON. With your data, you are dealing with a very narrow slice, and I just think we need as a Committee to be thoughtful about how narrow that slice of data you looked at is as you look at it. We have particular problems that Governor Barnes raised, particular problems that Mr. Connor raised, but what your data shows is what it is in a very narrow slice of the issue of arbitration clauses. I think I understand what the position is. I think the record is fairly clear that this is a very narrow study in a very narrow environment with the best data available, but not data that particular is illuminating in other areas.

Ms. MACCLEERY. Well, I would disagree that it is narrow. It was all the cases. We didn't exclude any cases by subject matter.

Mr. CANNON. Well, it is narrow by nature of the question——

Ms. MACCLEERY. Well, it is 19,000 cases.

Mr. CANNON. That is a lot of cases, but it is a very narrow category of cases.

Ms. MACCLEERY. We would love to look at AAA's data if they would only complete their records in California. We would love to expand the power of the study, but this is the only empirical data that is currently available.

Mr. CANNON. But I think we understand each other that you are not disagreeing that the nature of the study is very, very narrow. That is, it is related to cases that are consumer credit cases, debt cases where you have collections. There is no way even to compare that data—and I apologize, I am going over my time, but I would like to just clarify the point.

Ms. SÁNCHEZ. Yes, finish. Yes.

Mr. CANNON. Which is that there is no way even to compare that narrow kind of data with what would happen in courts. You are not purporting that your study compares with courts, and so it is a

data point that we can look at, but it is hard to associate with the larger issue.

Ms. MACCLEERY. I think there are a lot of stories in our report that go outside the credit card context and look at the same kind of patterns of problems in decision-making in arbitration that point to the structural deficiencies. So I would agree that it deals with a certain type of case, but I would disagree that its implications are narrow.

Ms. SÁNCHEZ. The time of the gentleman has expired.

Mr. CANNON. Thank you. I yield back.

Ms. SÁNCHEZ. Thank you.

At this time, I will recognize Mr. Johnson, the gentleman from Georgia, for his questions.

Mr. JOHNSON. Thank you.

Mr. Naimark, would you say that AAA would be the largest arbitration firm in the Nation?

Mr. NAIMARK. Yes, but with a qualifier. Our annual consumer caseload is approximately 1,500 cases, of which 60 percent settle before they ever get to an arbitrator, so we are talking about a relative few hundred a year that actually get to an arbitrator. In employment cases, it is roughly 2,000 per year. So we do lots and lots of arbitration of all types with unions, companies and international. These caseloads for us are fairly small.

Mr. JOHNSON. Do you advertise your services in the yellow pages or newspapers?

Mr. NAIMARK. I don't know if we have listings anymore in the yellow pages. We have run a number of ads over the years in a variety of publications.

Mr. JOHNSON. Typically what type?

Mr. NAIMARK. What type?

Mr. JOHNSON. Yes.

Mr. NAIMARK. For the international business disputes, we will run them in the international business journals.

Mr. JOHNSON. You typically run them in business journals, in publications that are directed toward businesses. Is that correct?

Mr. NAIMARK. For business-to-business dispute resolution, yes.

Mr. JOHNSON. Because it is rare that a consumer would ever choose AAA to arbitrate a dispute.

Mr. NAIMARK. I don't know that that is so.

Mr. JOHNSON. Let me rephrase the question. How does AAA get the bulk of its business?

Mr. NAIMARK. How do we get the bulk of it?

Mr. JOHNSON. Isn't it through referrals from businesses that either are instituting arbitration proceedings against a consumer, or a consumer that is limited in the choice of the arbitration panel that he or she can employ to pursue a dispute against a commercial interest?

Mr. NAIMARK. In the consumer caseload—I assume that is what we are addressing—we get both. A significant number—I can't tell you the exact percentage—are filed by consumers. Our stats show they win basically half of those cases, and the businesses file the rest.

Mr. JOHNSON. I guess the point I am trying to make is you get most of your referrals from business interests. Isn't that correct?

Most of your arbitrations are done as a result of referrals from business interests, commercial interests?

Mr. NAIMARK. Unions and businesses primarily, yes.

Mr. JOHNSON. Who typically pays the fee for the arbitration process?

Mr. NAIMARK. If we are talking about the consumer process, we have two levels of fees for consumers. Claims up to $10,000, they pay a maximum of $125. For claims up to $75,000, they pay a maximum of $375. Business will pay the rest.

Mr. JOHNSON. Most of your claims are instituted by commercial interests against consumers, however. Isn't that correct?

Mr. NAIMARK. No, that is not correct.

Mr. JOHNSON. Well, let me ask you this question. What class of disputes do you get where consumers tend to file more than the commercial interests?

Mr. NAIMARK. I don't know that they file more, but in our consumer caseload—those 1,500 cases I mentioned—a significant number are filed by consumers because they are seeking redress against the business. Let me try to explain it this way, if a company——

Mr. JOHNSON. Okay. I am running out of time. I want to switch to a different tack now.

The arbitrators who you employ, approximately how many do you employ?

Mr. NAIMARK. Well, if you look at the entire panel for every category, roughly 9,000 I would say.

Mr. JOHNSON. Are they judges?

Mr. NAIMARK. Most of them are not judges, no.

Mr. JOHNSON. Are they lawyers?

Mr. NAIMARK. Most of them are lawyers, yes.

Mr. JOHNSON. Yes. And most of them are selected by AAA based on, I guess, their connections to businesses that employ them?

Mr. NAIMARK. Absolutely not. We have committee that reviews. We look especially for diversity and try to get as much balance between, especially plaintiff and defense as possible. What you try to do is get senior respected people in the community.

Mr. JOHNSON. Let me ask you this question. Is there a court reporter that takes down the typical proceeding?

Mr. NAIMARK. For a consumer case, typically no.

Mr. JOHNSON. So there is no record upon which to appeal on?

Mr. NAIMARK. No. I have to say typically under U.S. law, even if you had one, it would be tough to appeal.

Mr. JOHNSON. There is basically no effective right to appeal the arbitrator's decision, correct?

Mr. NAIMARK. That is correct.

Mr. JOHNSON. And there is no right to discovery of documents or witnesses?

Mr. NAIMARK. No, the protocols provide that there is right to discovery.

Mr. JOHNSON. And those are the protocols that AAA follows, but not necessarily all of the others?

Mr. NAIMARK. Yes. The discovery may be limited. It is controlled by the arbitrator, but this is an especially important issue in the employment cases where typically the employee needs records that

the employer has, so you have to make provision that they can at least get some of the documentation.

Mr. JOHNSON. Well, if the arbitrator rules unfairly against the consumer and in favor of the employer, there is no right to appeal is there?

Mr. NAIMARK. No.

Mr. JOHNSON. So it pretty much means that whatever the arbitrator says goes.

Mr. NAIMARK. Yes.

Mr. JOHNSON. And there is no requirement that the arbitrator be an attorney.

Mr. NAIMARK. No. In the employment area, the parties pick their arbitrators.

Mr. JOHNSON. And you do have some arbitrators who are not even lawyers.

Mr. NAIMARK. In the consumer area, virtually none.

Ms. SÁNCHEZ. The time of the gentleman——

Mr. JOHNSON. Virtually none are lawyers?

Mr. NAIMARK. No, they are virtually all lawyers.

Mr. JOHNSON. All right.

Ms. SÁNCHEZ. The time of the gentleman has expired.

I am going to thank the first panel for their testimony. I am going to excuse you, and we will invite the second panel to please come up and be seated.

I am now pleased to introduce the witnesses for our second panel for today's hearing. Our first witness is Ms. Deborah Williams. Ms. Williams is a Coffee Beanery franchise owner, along with her partner Richard Welshans, and was a victim of a binding mandatory arbitration clause. She resides in Annapolis, Maryland. We appreciate your being here today.

Our second witness is Ms. Cathy Ventrell-Monsees. Ms. Ventrell-Monsees has been practicing in employment discrimination law since 1983. She litigated several ADEA class actions and has written more than 50 amicus briefs in the U.S. Supreme Court and circuit courts. Ms. Ventrell-Monsees has a part-time law practice and teaches employment discrimination law at the Washington College of Law at American University. From 1985 to 1998, she worked in and directed an age discrimination litigation project at AARP and, with Steve Platt, she is coauthor of "Age Discrimination Litigation." Ms. Ventrell-Monsees has appeared in numerous national and local media as a commentator on employment issues. We welcome you to today's hearing.

Our third witness is Professor Peter Rutledge. Professor Rutledge is an associate professor of law at The Catholic University of America, where his teaching and research interests include international dispute resolution and criminal law. A former law clerk at the United States Supreme Court and the United States Court of Appeals for the Fourth Circuit, Professor Rutledge regularly advises parties and lawyers on matters before the U.S. Supreme Court. Before entering the academy, Professor Rutledge practiced at Wilmer, Cutler and Pickering, where his practice included Supreme Court work, and at Freshfields Bruckhouse Derringer, where his practice concentrated on international arbitration. We welcome you to our second panel.

Our final witness is Theodore Eppenstein. Mr. Eppenstein is a member of Eppenstein and Eppenstein, a law firm with an international practice. He has testified previously before Congress on matters of compulsory arbitration and arbitration reform. Mr. Eppenstein was appointed to be one of three public members of the Securities Industry Conference on Arbitration, an advisory committee to the U.S. Securities and Exchange Commission on arbitration. He is a member of the American Arbitration Association's Security Advisory Committee and has coauthored many articles on securities arbitration and litigation.

I want to thank you all for your willingness to participate in today's hearing. You understand the rules about the lights from the previous panel. So with that, I will invite Ms. Williams to please begin her oral testimony.

TESTIMONY OF DEBORAH WILLIAMS, ANNAPOLIS, MD

Ms. WILLIAMS. I want to thank Chairwoman Sánchez and the Members of the Subcommittee for giving me the opportunity to share my story.

My name is Deborah Williams. I am 54 years old, and I am bankrupt and on the verge of being homeless, all because of a binding mandatory arbitration clause. In February 2004, my partner and I opened a Coffee Beanery franchise in Annapolis, MD. Included in our franchise contract hid a binding mandatory arbitration agreement.

Within 3 months, our dream of owning our own small business was becoming a nightmare. The franchise rapidly fell apart through no fault of our own. The Coffee Beanery had sold us a failed business concept that generated massive losses. We were required to purchase expensive, faulty equipment, such as a discontinued lighting system that cost $14,000, and a defective display case that cost $8,000, a $2,000 markup from what it normally sells for.

We were forced into illegal third-party contracts which required ongoing fees and additional equipment such as a gift card program, a required DMX music and security system, and a Pepsi contract. The DMX music and security system was listed in our contract as already paid for, but the Coffee Beanery forced us to pay an additional $8,000 for the system. The gift card program and Pepsi contract were not disclosed in our initial contract as required by law, but we had invested so much money that we had no choice but to accept the exorbitant additional fees. We would have never bought the franchise if these contracts had been disclosed.

We conducted more research and discovered over 73 other failed Coffee Beanery franchises, and that the Coffee Beanery was being investigated in other States. We also learned that a Coffee Beanery cafe had an average life span of 3 years. That is pretty unbelievable considering that the investment is over $375,000 for the average cafe.

We immediately alerted the Maryland attorney general of our situation. The attorney general's office conducted an investigation and, based on Maryland franchise law and the Federal Trade Commission franchise rule, they concluded that the franchisor committed fraud in the sale of our small business. When someone com-

mits fraud they should be held accountable. In December 2005, we filed our civil case in Maryland district court, but despite the Maryland attorney general's finding and the protection of Maryland franchise law, we were forced to resolve our dispute through binding mandatory arbitration.

The arbitration company that the Coffee Beanery used in our case is called the American Arbitration Association, the AAA. The AAA arbitrator was selected without our input and without our consent at a fee of $200 an hour. We had no information about her history as an arbitrator, or if she had been hired by the Coffee Beanery before to arbitrate, and how often she ruled in their favor.

We also discovered that our arbitrator shared an accounting firm with the Coffee Beanery, an obvious conflict of interest. We tried to have her replaced, but were unsuccessful. If a judge had a similar connection to the defense in a court case, it would have been thrown out immediately, but not in the kangaroo court known as arbitration. We also found later that the Coffee Beanery's attorney also doubled as an arbitrator for the AAA.

Because discovery is very limited in arbitration, we had difficulty obtaining copies of the Coffee Beanery's illegal third-party contracts to use as evidence in our case. The Coffee Beanery did not respond to our discovery requests, dragging out the process for 7 months, knowing that we couldn't afford the exorbitant costs that accompany a long arbitration process. We later obtained some of these contracts from another franchisee, and not the Coffee Beanery.

The arbitration took place in Michigan, 500 miles from our home. We flew back and forth with our attorney four times for a total of 11 days of proceedings. We felt that we had a great chance of prevailing since the attorney general had already found the franchisor had committed fraud.

Our cost of the arbitration proceedings totaled over $100,000, hardly a cheaper alternative to litigating locally in Maryland. In the end, the arbitrator ruled that, contrary to the findings of the Maryland attorney general's office, we were at fault. In addition to our costs, we were required to pay the Coffee Beanery $150,000, plus their attorneys' costs and fees. That is a total of over $250,000. We are trying to appeal our decision, but we have been told by several attorneys that it is a lost cause. It is virtually impossible to overturn a decision of an arbitrator on appeal.

It has been 4 years since we have opened our franchise. We haven't made a profit. We haven't paid ourselves wages. We are in enormous debt. We have invested over $1.5 million in this failed business, and every year we owe the Coffee Beanery more money in royalties. Since we signed a 15-year franchise agreement with the Coffee Beanery, our only options have been to sell this business to another unsuspecting person which we refuse to do, or to file for bankruptcy.

Recently, our landlord terminated our lease due to our inability to pay rent and the doors to our Coffee Beanery cafe will be locked as of next Wednesday, October 31. We are borrowing money from our family so that we can file for bankruptcy. However, we still owe the Coffee Beanery royalties for the remaining 11 years on our franchise even if our cafe is no longer open.

Losing our right to a trial by jury has crippled us, but we are not alone. Binding mandatory arbitration has harmed the livelihoods of thousands of others. The Arbitration Fairness Act of 2007 would ensure that all Americans have access to the courts and trials by juries to resolve disputes. It would still permit arbitration in cases like ours, but only if both parties voluntarily agree to it.

Please do not force more consumers into a privatized system that has no oversight and almost no opportunity to appeal. That kind of power is dangerous and too easily abused. We never knew how precious our constitutional rights were until they were stolen from us by a binding mandatory arbitration clause.

It is the American dream to own your own business. Our dream has been trampled upon by binding mandatory arbitration. I hope hearing our story will make a difference and you will protect hard-working Americans across the country by eliminating these abusive clauses.

Thank you.

[The prepared statement of Ms. Williams follows:]

PREPARED STATEMENT OF DEBORAH WILLIAMS

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Within three months, our dream of owning our own small business was becoming a nightmare. The franchise rapidly fell apart through no fault of our own. The Coffee Beanery had sold us a failed business concept that generated massive losses. We were required to buy expensive, faulty equipment, such as a discontinued lighting system that cost $14,000, and a defective display case that cost $8000, a $2000 mark-up from what it normally sells for.

We were forced into illegal third-party contracts which required ongoing fees and additional equipment such as a Gift Card program, a required DMX music and security system, and a Pepsi contract. The DMX music and security system was listed in our contract as already paid for, but the Coffee Beanery forced us to pay an additional $8000 for the system. The gift card program and Pepsi contract were not disclosed in our initial contract as required by law, but we had invested so much money that we had no choice but to accept the exorbitant additional fees. We would have never bought the franchise if these contracts had been disclosed.

We conducted more research and discovered over 73 other failed Coffee Beanery franchises, and that the Coffee Beanery was being investigated in other states. We also learned that a Coffee Beanery cafe had an average life span of three years—hat's pretty unbelievable considering the average cost to open one of these cafes is over $375,000.

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It is the American dream to own your own business. Our dream was trampled upon by binding mandatory arbitration. I hope hearing our story will make a difference and you will protect hardworking Americans across the country by eliminating these abusive clauses.

Ms. SÁNCHEZ. Thank you, Ms. Williams. We appreciate your testimony.

At this time, I would invite Ms. Ventrell-Monsees to give her testimony.

TESTIMONY OF CATHY VENTRELL-MONSEES, ESQ., LAW OFFICES OF CATHY VENTRELL-MONSEES, CHEVY CHASE, MD, ON BEHALF OF THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION

Ms. VENTRELL-MONSEES. Thank you, Madam Chair, Congressman Cannon and Members of the Subcommittee. My name is Cathy Ventrell-Monsees. I am an executive boardmember of the National Employment Lawyers Association, known as NELA. NELA advances employee rights and serves lawyers who advocate for equality and justice in the American workplace. NELA's concern, and why we are here today, is the widespread use of pre-dispute mandatory arbitration to resolve employment cases, and the

deterrent effect that system has on the ability of employees to enforce their employment and civil rights.

Every day, NELA members see how companies stack the deck in their favor in their disputes with employees, and the use of mandatory arbitration has grown exponentially over the past 15 years. In 1991, a mere 3.6 percent of private employers used arbitration systems. Today, approximately 15 percent to 25 percent of private employers from Circuit City to Hooters to Halliburton, use mandatory arbitration to keep the potential claims of more than 30 million employees out of court.

Companies put mandatory arbitration provisions into employment applications, employment handbooks and employee benefit plans. Employees must sign those documents if they want to get the job or keep the jobs they already have, despite whatever theoretical due process protocols may bar imposing mandatory arbitration as a condition of employment.

The workers we represent face many different kinds of employment and discrimination problems, such as being fired while on family or medical leave; our military and reserve personnel who return from Iraq and Afghanistan only to find their jobs gone, blue- and white-collar workers who are forced to work off the clock so their employers don't have to pay them overtime; and retaliation against whistleblowers who risk their careers to report dishonest or risky corporate or government behavior.

But the courts have held that all of these claims are subject to mandatory pre-dispute arbitration. So what is wrong with that? What is wrong is that mandatory arbitration creates a modern-day version of separate and unequal justice for employees, and here is how. Under mandatory pre-dispute arbitration, employees lose their day in court before an impartial judge. They lose their right to a trial of their peers and their right to appeal.

They lose the protection of our laws because arbitrators do not have to follow the law. They do not even have to know the law. Employees lose important remedies because mandatory arbitration programs and arbitrators can and do limit the damages an employee can get in court by Federal or State law. An employer who forces its employees into this separate system can pick its favorite arbitrator and use that same arbitrator over and over again to rule in its favor in other cases brought by other employees of the company.

The effect of this repeat player phenomenon is dramatic as shown by two recent examples taken from public reports of the American Arbitration Association. From January 1, 2003 to March 31, 2007, the AAA held 62 arbitrations for Pfizer in employment cases, of which 29 went to decision. Of the 29, an arbitrator found for the employee just once, and for the employer 28 times. That is a rate of 97 percent for the employer. Halliburton in its cases won 32 out of 39 cases that went to a decision, a telling 82 percent win rate in arbitration.

The result? Companies that routinely discriminate against their employees are never held accountable to the public because of this private separate system. Pre-dispute mandatory arbitration provides no deterrent effect to prevent employers from discriminating again and again. Rather, pre-dispute binding mandatory arbitra-

tion deters employees from pursuing their employment rights. That is a significant cost that employees in our society bear under the current separate and unequal system.

Arbitration is often touted as inexpensive. Not true in employment cases. Employees often have to pay exorbitant fees just to get a hearing. Arbitrators typically charge $250 to $450 an hour and arbitrations can last more than 100 hours. A worker who has been fired from her job simply cannot afford this cost.

Ms. SÁNCHEZ. I am sorry, Ms. Ventrell-Monsees. Your time has expired. I want you to summarize your final thoughts.

Ms. VENTRELL-MONSEES. Yes. NELA urges Congress to act without delay to pass the Arbitration Fairness Act. Congress should no longer allow this separate and very unequal system to continue.

Thank you.

[The prepared statement of Ms. Ventrell-Monsees follows:]

PREPARED STATEMENT OF CATHY VENTRELL-MONSEES

Testimony of Cathy Ventrell-Monsees
On Behalf of the National Employment Lawyers Association
Before the
Subcommittee on Commercial and Administrative Law
House Judiciary Committee
October 25, 2007

Madame Chair and other Members of the Subcommittee, good afternoon. I am Cathy Ventrell-Monsees, of Chevy Chase, Maryland. I am a member of the Executive Board of the National Employment Lawyers Association (NELA) and co-chair of its Mandatory Arbitration Task Force. I am testifying today on NELA's behalf.

NELA advances employee rights and serves lawyers who advocate for equality and justice in the American workplace. It is the largest professional organization of lawyers who represent primarily workers in disputes with their employers. In addition, 67 regional, state, and local employment lawyers associations are affiliated with NELA. The 3,000 members of NELA and its affiliates have extensive experience with representing clients who are bound by mandatory arbitration clauses – with challenging such mandatory arbitration clauses; with representing clients in arbitration; and with having to turn prospective clients away because they are bound by mandatory arbitration clauses.

My experience with the issue of mandatory arbitration in employment cases began in 1990, when I wrote an *amicus* brief opposing involuntary pre-dispute mandatory arbitration on behalf of the AARP in the United States Supreme Court case of *Gilmer v. Interstate Johnson*. My biography is attached to this testimony.

Madame Chair, we very much appreciate your holding this hearing and the opportunity to testify. My remarks today will focus on the widespread use of pre-dispute, binding, mandatory arbitration programs to resolve employment disputes and its effect on employees' ability to enforce their employment and civil rights. (For brevity, I will refer to these programs as "MA programs.") I would like to stress that I will not be talking about MA clauses contained in contracts that are voluntarily negotiated between employer and employee after a dispute arises. *NELA strongly supports arbitration when it truly is voluntarily agreed to by the employee post-dispute.* Nor are we concerned with MA clauses contained in collective bargaining agreements.

This testimony will address three topics – the current prevalence of MA programs in employment; how MA programs undermine employees' rights; and how the courts treat MA programs – and conclude with a brief discussion of what Congress can and should do about the problem.

Prevalence

As NELA members can attest from the cases they see in their practices, the use of MA programs as a tool for companies to "stack the deck" in their favor in disputes with their employees has grown exponentially over the last 15 years. Today, 15% to 25% of United States employers use MA programs – covering a conservatively estimated 30 million workers, a greater number than union contracts cover. The attached NELA fact sheet, "Data Points: Increasing Prevalence of Mandatory Arbitration Programs Imposed on Employees," reviews available statistics showing the dramatic growth of these programs.

Thousands of American companies use or have used mandatory arbitration, including such household names as Circuit City, Hooter's, Dillard's Department Stores, Cisco Systems, Anheuser-Busch, and Halliburton. These companies are in virtually every industry – retail, food services, manufacturing, and financial services, to name a few. The attached list of companies for which the American Arbitration Association (AAA) held at least five employment arbitrations between January 1, 2003, and March 31, 2007, is, of course, just the tip of the iceberg, but it again shows that the use of mandatory arbitration is alive and well in the United States in the 21st century.

How Mandatory Arbitration Programs Undermine Employee and Civil Rights

When employees are forced into arbitration, they are forced into a system of separate and unequal, private, second-class "justice." In arbitration, employees lose their rights to:

- Trial by a jury. Indeed, avoiding jury trials is perhaps one of the main reasons why employers implement mandatory arbitration programs.
- An impartial judge who is on the public payroll. By definition, an arbitrator is paid not by the public, but by the parties to the arbitration. In employment cases, the employer frequently pays the entire cost.
- A public ruling based on law and precedent. Arbitrators can, and frequently do, refuse to follow the law. They don't even have to be lawyers.
- An appeal to a higher civil authority. Arbitrators' decisions cannot be appealed except in the most limited circumstances. This is true even if the arbitrator completely misinterprets the law, refuses to look at evidence presented, or even sleeps through the arbitration proceeding.

None of these safeguards that we take for granted in the legal system are guaranteed in arbitration.

The private pay aspect of arbitration is one of its most troubling features. First, to be truly impartial, decision-makers must avoid even the appearance of impropriety – much less a conflict of financial interest. Unlike judges, who are public servants paid by the

tax-payers, arbitrators' professional careers and even livelihoods depend on the repeat business of employers who are in a position to hire them again in the future. In one case, almost *half* of an arbitration provider's annual income came from just one employer's fee. In another, the panel of arbitrators was partners of the accounting firm *the employee was suing*. No single employee is likely to have more than one opportunity to hire an arbitrator in her or his entire working life.

It is not surprising that studies show a higher rate of success for repeat players like employers than for individuals such as employees. An employer who forces its employees into this separate system can pick its favorite arbitrator or arbitration company, and then use that same arbitrator or company again and again to rule in its favor in other cases brought by other employees. Indeed, some mandatory arbitration programs limit an employee's "choice" of arbitrator to those that the employer has already chosen.

Here are just two examples of the repeat player phenomenon, taken from the AAA's public reports – between January 1, 2003, and March 31, 2007, the AAA held 62 arbitrations for Pfizer, of which 29 went to a decision. Of the 29, the arbitrator found for the employee once, and for the employer 28 times – that's *97%* of the cases. Halliburton's win rate was only 32 out of 39 cases that went to decision – still a telling 82%.

Second, despite arbitration often being touted as an inexpensive system, arbitrators of employment and discrimination cases are frequently quite costly. Fees can be exorbitant just to schedule a hearing. Arbitrators typically charge $250 to $450 an hour, and arbitrations can drag on for 100 hours or more. In fact, unlike salaried public judges, arbitrators have financial incentives to allow the proceedings to drag out, since they are paid by the hour. In some places, the arbitrators' fee average between $2,000 and $5,000 per day, and most clock for a minimum of half a day for anything that they do. In some instances, not one but three arbitrators are required. If the fee is split between the employer and employee, a worker who has been fired from her job simply cannot afford such prices. If, on the other hand, the fee is paid entirely by the employer, the arbitrator's conflict of financial interest is exacerbated.

The high cost of arbitration is not the only barrier that arbitration clauses can create for employees pursuing their claims of employment or civil rights violations. Mandatory arbitration programs can, and do, require that the arbitration be held at a location distant from the employee – making it difficult if not impossible for an employee to participate. For example, an employee returning from active military service was required to go to Virginia to arbitrate his claims for reinstatement and retaliation – even though he lived and worked in Georgia. Mandatory arbitration programs can, and do, eliminate disclosure of highly relevant documents and data that can help show if, for example, discrimination was a motivating factor of the challenged employment decision. Mandatory arbitration programs in most places can, and do, allow the employer to change the terms of the program unilaterally, even after the employees have (supposedly) agreed to one set of terms. Mandatory arbitration programs (or individual arbitrators) can, and

do, limit the total time allocated to an arbitration hearing, regardless of the amount of time the employee needs to put on evidence.

The problems that employees face when forced into mandatory arbitration are by no means only procedural. Despite the Supreme Court's admonition that arbitration should not affect parties' *substantive* rights (see discussion below), employees attempting to enforce their civil and employment rights frequently do lose the law's substantive protections in arbitration:

- As noted above, arbitrators can, and do, refuse to follow the substantive law. In one example of this, an employee who alleged that her co-worker ogled her breasts, gyrated against her from behind, complimented her on her "onion shaped butt," bragged of his sexual prowess, and asked repeatedly for one-night stands, lost her sexual harassment case in mandatory arbitration. On appeal, the judge agreed that, under the law, she should have won – but could not reverse the arbitrator's failure to follow the law correctly because arbitrators' decisions are binding.

- Mandatory arbitration provisions can, and do, limit the injunctive relief that arbitrators can order. Moreover, judges have the authority to enforce injunctive relief; arbitrators do not. Thus, some of the most important remedies that judges can order and oversee – such as prohibitions of future discrimination and orders to implement new, non-discriminatory hiring practices – are not realistically available in arbitration.

- Mandatory arbitration provisions can, and do, specifically limit or even prohibit the award of remedies that an employee would be entitled to under the law as enforced in court. The following remedies limitations – none of which would be enforceable in court – are common: back pay only; caps on front pay, compensatory, or punitive damages; no exemplary or punitive damages; no attorneys' fees or expenses to prevailing plaintiffs; no class or collective relief; and all costs paid by non-prevailing party. In one reported case, an employee had to pay her employer's legal fees for the unsuccessful arbitration of her wrongful discharge claim – to the tune of *over $207,000*.

- Mandatory arbitration provisions can, and do, shorten the statutory limitations period that would otherwise be available for filing a lawsuit. In Mary Kay Morrow's case (which is attached to this testimony), her employer's arbitration program required that all claims must be filed within 30 days of the end of internal dispute resolution procedures. Although she filed her age discrimination claim well within the time limit for such claims under Missouri law, the arbitrator dismissed her action, with prejudice, because of the 30-day rule. (Amazingly, the arbitrator made this decision in spite of the fact that Missouri law specifically prohibits arbitration agreements from placing artificial time limits on legal claims.) The case is currently on appeal before the Court of Appeals for the Western District of Missouri.

- Mandatory arbitration programs in most places can, and do, specifically prohibit employees from bringing class actions, even if doing so is the most efficient way of righting the wrong.

Experts agree that in all these ways, MA programs create a modern version of SEPARATE – AND UNEQUAL – JUSTICE for employees (see the attached fact sheet, "What The Experts Say About Binding Mandatory Arbitration"). *Our employment and civil rights laws mean nothing if an employee cannot go to court to enforce them.*

How the Courts Treat Mandatory Arbitration of Employment Claims

For many years, the United States Supreme Court has given great deference to agreements to submit to mandatory binding arbitration as an alternative to courts for resolving employment disputes. This is true when arbitration is agreed to before any dispute arises ("pre-dispute") and therefore before the parties have any idea what the dispute is about, much less what their rights in court might be. This principle of deference derives from the Federal Arbitration Act (FAA), which directs courts to enforce valid contracts to arbitrate disputes. In a landmark case in 1991, the Court enforced a pre-dispute, binding, mandatory arbitration agreement in an age discrimination case, even though the Age Discrimination in Employment Act explicitly gives the right to a trial before a judge and jury.

The deference to arbitration agreements applies in virtually every kind of employment case. NELA members' clients face many different kinds of employment or civil rights problems – sex, race, religious, national origin, age, disability, sexual orientation, and gender identity discrimination; being fired for taking family or medical leave; military and reserve personnel returning from Iraq or Afghanistan not getting their jobs back; employees who are required to work "off the clock" so their employers don't have to pay them overtime; whistleblowers risking their careers to report dishonest or risky corporate or government behavior who are being retaliated against; wrongful termination; failure to receive pension benefits; and retaliation for asserting workers' compensation claims. It does not matter which laws are involved, or whether they are federal or state laws – the courts have held that *all* of them are subject to mandatory arbitration. The attached fact sheet, "Mandatory Arbitration Prevents Employees from Holding Their Employers Accountable in Court in All Kinds of Employment Cases," collects cases compelling arbitration under many different employment-rights statutes.

The premise behind the Supreme Court's jurisprudence on enforcing mandatory arbitration of statutory claims is that arbitration does not change employees' *substantive* rights; it is just a change in forum. Following that reasoning, many courts presented with the issue in recent years have invalidated mandatory arbitration provisions that limit remedies, shorten the statute of limitations, restrict the award of attorneys' fees, or otherwise substantively affect employees' rights. On the other hand, some courts *do* enforce MA programs that contain such provisions.

In any event, even if these provisions wouldn't stand up to legal scrutiny, employers continue to insert remedies or other substantive limitations in MA clauses. For example, the MA program that Neiman Marcus instituted this past July prohibits class actions, shortens the limitations period, and limits the pool of potential arbitrators to Texas residents who are also members of that state's bar. Circuit City attempts to enforce its nationwide MA program that limits remedies and imposes costs on the employee. Seeing such provisions, most employees who believe their employment rights have been violated either accept them and go to arbitration under these conditions, or are deterred from challenging the employers' practices at all. Unless they consult counsel, they certainly don't realize that they can fight the conditions.

Mandatory arbitration provisions can also be challenged under state law contract principles (*e.g.*, contract formation, such as offer, acceptance, and consideration; defenses to contract enforceability, such as fraud, duress, and unconscionability; and any other generally applicable grounds available under governing state law). An agreement to arbitrate is not enforceable if it is not a valid contract under state law, or if excessive fees imposed on the employee render the contract unconscionable. Nevertheless, many courts validate MA provisions that are challenged on these grounds.

For example, courts have enforced MA "agreements" even when employees specifically refused to sign them. This is precisely what happened in the cases of Fonza Luke and Debbie Dantz (whose stories are attached). Briefly, Ms. Luke, of Princeton, AL, worked loyally as a nurse for a hospital for almost 30 years. She was asked to sign a document agreeing to use of an MA program. She *explicitly refused to sign the agreement.* Nevertheless, a court forced her to bring her case of race and age discrimination to arbitration, and she drew an arbitrator who ruled entirely against her. Ms. Dantz's experience was similar.

Employees are frequently informed of MA programs only in the fine print of official company documents, such as employment applications, employment handbooks, and pension plans, which they must sign if they want to get a job or to keep the job they have. For example, in a recent case involving Halliburton, the preprinted, boilerplate "contract" that the employee signed as a condition of employment stated, way down in paragraph 26, that she agreed to the "terms of the Halliburton Dispute Resolution Program which are herein incorporated by reference" – which, however, she was never given. In another case, employees were informed of the MA program *via* a link at the bottom of an e-mail. Yet many courts have enforced such MA programs as valid contracts against employees' arguments that they are contracts of adhesion or that the employee could not have accepted a contractual provision she or he didn't even know about.

Courts have even enforced, as contracts, MA provisions that are completely one-sided, binding only the employee to arbitration of disputes; that can be changed at any time by the employer, unilaterally; and that designate interested parties as arbitrators. At the same time, there are courts that do not view such sham contracts as binding employees to use arbitration, creating significant confusion about the law in many jurisdictions.

Conclusion: Time For Congress To Step In

From the Supreme Court down, the courts have so protected the private, separate and unequal system of arbitration as a way of resolving employment disputes that companies that routinely discriminate against their employees are simply not held accountable to the public. When it enacted the various civil and employment rights statutes that protect employees, Congress never intended to permit employers to subvert those statutes' enforcement schemes in this way. It is time for Congress to step in to correct this injustice.

Indeed, Congress has acted to ban binding predispute arbitration in other contexts. Due to the Motor Vehicle Franchise Contract Arbitration Fairness Act of 2001, automobile manufacturers are not permitted to require mandatory arbitration of their disputes with automobile dealers. And last year's Defense Authorization Act contained a provision *voiding* contracts to loan money to members of the military or their families that contain mandatory arbitration clauses.

The Arbitration Fairness Act of 2007 (AFA) would deal with the problem comprehensively, in consumer as well as in employment cases. NELA applauds Representative Hank Johnson for introducing the AFA, which restore Congress's original intent in enacting the Federal Arbitration Act by eliminating the mandatory arbitration of employment claims unless pursuant to a collective bargaining agreement or agreed to *after* a dispute has arisen.

NELA urges Congress to enact the Arbitration Fairness Act without delay. Congress should no longer allow the employment rights of nearly a quarter of America's non-union workforce to be subject this separate and very unequal system.

Attachments

Biographical Information for Cathy Ventrell-Monsees, Esq.

Data Points: Increasing Prevalence of Mandatory Arbitration Programs Imposed on Employees (NELA Fact Sheet)

Companies for Which the American Arbitration Association Held Five or More Employment Arbitrations (List)

What the Experts Say About Binding Mandatory Arbitration (NELA Fact Sheet)

Mandatory Arbitration Prevents Employees from Holding Their Employers Accountable in Court in All Kinds of Employment Cases (NELA Fact Sheet)

Binding Mandatory Arbitration of Employment Claims:
- The Story of Mary Kay Morrow
- The Story of Fonza Luke
- The Story of Debbie Dantz

Biographical Information for Cathy Ventrell-Monsees, Esq.

Cathy Ventrell-Monsees has been practicing in employment discrimination law since 1983. She litigated several ADEA class actions and has written more than 50 amicus briefs in the U.S. Supreme Court and circuit courts She has a part-time law practice and teaches employment discrimination law at the Washington College of Law at American University. From 1985 to 1998, she worked in and directed an age discrimination litigation project at AARP. With Steve Platt, she is the co-author of AGE DISCRIMINATION LITIGATION (James Publishing 2000). Ms. Ventrell-Monsees has appeared in numerous national and local media as a commentator on age discrimination and employment issues.

Since 1996, Ventrell-Monsees has been a member of the Board of Directors of the National Employment Lawyers Association, where she served as its Vice-President of Public Policy. She is currently President of Workplace Fairness, a nonprofit dedicated to educating workers about their employment rights.

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DATA POINTS:
INCREASING PREVALENCE OF MANDATORY ARBITRATION SYSTEMS IMPOSED ON EMPLOYEES

More Than 30 Million Non-Union American Workers Are Covered By Binding Mandatory Arbitration Programs

Good research about the prevalence of employer-promulgated binding mandatory arbitration programs is notoriously hard to find. In fact, the only large-scale, nationally representative survey was done by the Government Accountability Office (GAO) in 1994, more than 13 years ago. But as the data points beginning on the next page show, we *do* know that use of mandatory arbitration of employment claims has been on the increase since at least the 1980s, and his risen rapidly since the early 1990s after Congress made jury trials and money damages available under Title VII (in 1991), the passage of the Americans with Disabilities Act in 1992, and the number of discrimination charges filed skyrocketed. 1991 was also the year in which the United States Supreme Court upheld imposition of mandatory arbitration of an age discrimination claim in *Gilmer v. Interstate/ Johnson Lane Corporation*.[1]

> "*Gilmer* 'unleashed a torrent' of mandc arbitration provisions in (non-collectivel bargained) employment contracts that employees were required to sign as cor of employment."
> -- Law Professor Jean Stemlight

The best estimates we have today are that 15% to 25% of employers nationally have adopted mandatory employment arbitration procedures, and that (conservatively) 25% of the total non-union workforce is covered by such procedures.[2] This means that more than 30 million employees (out of a non-union workforce of 121 million employees)[3] are covered by mandatory arbitration programs. Their employers have effectively removed themselves from the Congressionally mandated enforcement of employment rights laws.

The data points beginning on the next page report available information about the prevalence of mandatory employment arbitration programs since 1979. While they are not comparable – some describe the incidence of mandatory arbitration plans among employers, others, among employees, for example – together they do tell one clear, simple story: the imposition of binding, mandatory arbitration by employers has increased exponentially in the past decades, and now covers a significant portion of the workforce.

Mandatory Arbitration of Employment Claims:
Data Points

1979: Only 1% of employers used arbitration for employment disputes.[4]

1991: The percentage of employers in the private sector using employment arbitration was 3.6%.[5]

1993: Fewer than 1.5 million employees were covered by arbitration plans administered by the American Arbitration Association.[6]

1994: 10% of a nationally representative sample of businesses with more than 100 employees used arbitration; about 40% of these, or 4% of all businesses of this size, explicitly made arbitration mandatory for all employees.[7]

1997: 3 million employees were covered by arbitration plans administered by the American Arbitration Association – more than double the number covered in 1993.[8]

1998: Fully 62% of Fortune 1000 corporations surveyed had used employment arbitration at least once between 1995 and 1998.[9]

2000: 5 million employees were covered by arbitration plans administered by the American Arbitration Association, adopted by approximately 500 corporations. The covered employees were in a "wide range of jobs including clerical workers, sales personnel, first line supervisors, middle managers and top executives in virtually every industrial and service sector."[10]

2000: 19% of firms had adopted employment arbitration procedures, according to one small study.[11]

2001: By now, 6 million employees were covered by arbitration plans administered by the American Arbitration Association – double the number in 1997 and quadruple that in 1993.[12]

2002: 37% percent of the employment contracts made with key employees by a sample of more than 2800 publicly-held companies included pre-dispute mandatory arbitration clauses. Of the 13 types of contracts studied, employment contracts were most likely to have such arbitration provisions.[13]

2003: 14% of establishments in the telecommunications industry had adopted employment arbitration procedures. This covers fully 23% of nonunion employees in that industry.[14]

2006: In California, private arbitrators handle more commercial cases than the courts do, according to industry experts.[15]

2007: 15% to 25% of employers nationally impose binding mandatory arbitration on their employees, covering (conservatively) 25% of non-union American workers.[16] That's ***more than 30 million American workers*** who have lost their right to a trial by jury in an impartial, public forum.[17]

ENDNOTES

[1] GAO, *Alternate Dispute Resolution: Employers' Experiences with ADR in the Workplace* (August 12, 1997), GGD-97-157 http://www.gao.gov/archive/1997/gg97157.pdf, pp. 9-10. Sternlight, "Mandatory Binding Arbitration and the Demise of the Seventh Amendment Right to a Jury Trial," 16 *Ohio State Journal on Dispute Resolution* 669 (2001) ("[*Gilmer*] unleashed a torrent..."). *Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20 (1991).

[2] Colvin, "Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?" forthcoming, *Employee Rights and Employment Policy Journal,* Vol. 12 (2007), at p. 7 ("Empirical Research") (employer figures); NELA Legislative and Public Policy Director Donna Lenhoff's conversation with Alexander Colvin, October 23, 2007 (employee figure). Calling it a conservative estimate, Professor Colvin extrapolates the 25% figure from his 2003 finding that 23% of the non-union telecommunications workforce was covered by mandatory arbitration programs. *See* note 14, *infra,* and accompanying text.

[3] Bureau of Labor Statistics, "Current Employment Statistics: Highlights" (August 2007), http://www.bls.gov/web/ceshighlights.pdf, p. 2; union workforce statistic from tp://www.census.gov/compendia/statab/tables/07s0645.xls. The assumption that 20% of employers employ 20% of the workforce is a substantial underestimate, because the employers who are likely to adopt mandatory arbitration programs are likely to be those with larger than average workforces. Empirical Research at 6.

[4] Bureau of National Affairs, "Policies for Unorganized Employees" (PPF Survey No. 125) (1979), *cited in* Maltby, "Private Justice: Employment Arbitration and Civil Rights," National Workrights Institute (no date) ("Private Justice"), http://www.workrights.org/issue_dispute/adr_columbia_article.html#1.

[5] Hill, "AAA Employment Arbitration: A Fair Forum at Low Cost," *Dispute Resolution Journal* (May/July 2003), http://www.adr.org/si.asp?id=2532 ("AAA Employment Arbitration") at 2, *citing* Feuille & Chachere, "Looking Fair or Being Fair: Remedial Voice Procedures in Nonunion Workplaces," 21 *Journal of Management* 27 (1995).

[6] "Private Justice."

[7] GAO, *Employment Discrimination: Most Private-Sector Employers Use Alternative Dispute Resolution* (July 1995), GAO/HEHS-95-150, pp. 7, 21. The employers surveyed were those who had 100 employees in 1992. Later GAO calculations put the incidence of binding mandatory arbitration *outside the union context* at 8%. "Empirical Research," at p. 5.

[8] "AAA Employment Arbitration" at 2. Of course, this represents only a portion of the universe of employees subject to binding mandatory arbitration, as there are many other arbitration service providers besides the AAA.

[9] D. Lipsky & R. Seeber, "Patterns of ADR Use in Corporate Disputes," 5 *Dispute Resolution Journal* 66 (Feb. 1999), http://findarticles.com/p/articles/mi_qa3923/is_199902/ai_n8838884 (excerpted from Cornell/ PERC Institute on Conflict Resolution, Cornell University, *The Appropriate Resolution of Corporate Disputes: A Report on the Growing Use of ADR by U.S. Corporations* (1998)); D. Lipsky & R. Seeber, "Patterns of ADR Use in Corporate Disputes," *reprinted at* http://www.marquette.edu/disputeres/downloads/patterns.pdf (Table 4, p. 4) (no date); D. Lipsky & R. Seeber, "In Search of Control: The Corporate Embrace of ADR," 1 *U. Pa. J. of Lab. & Emp. L.* 133 (1998) (describing survey).

[10] Brief *Amicus Curiae* of the American Arbitration Association in Support of Reversal, filed in *Circuit City Stores v. Adams,* U.S. Supreme Court, October Term, 2000, No. 99-1379 (August 7, 2000), p. 6.

[11] "Empirical Research" at 6-7, *citing* Galle and Koen, "Reducing Post-Termination Disputes: A National Survey of Contract Clauses Used in Employment Contracts," 9 *Journal of Individual Employment Rights* 227-241.

[12] "AAA Employment Arbitration" at 2, *citing* American Arbitration Association (AAA), National Rules for the Resolution of Employment Disputes (eff. June 1, 1997) at 1.

[13] Eisenberg, Miller, "The Flight from Arbitration: An Empirical Study of *Ex Ante* Arbitration Clauses in Publicly-Held Companies' Contracts," *N.Y.U. Law and Economics Working Papers*, Paper No. 70 (2006) (available at http://lsr.nellco.org/nyu/lewp/papers/70), at 37, 1.

[14] "Empirical Research" at 6. *See also,* Colvin, "Mandatory Arbitration and the Reconfiguration of Workplace Dispute Resolution," 13 *Cornell Journal of Law and Public Policy 581*-597 (2004).

[15] Berkowitz, "Is Justice Served?" *West* (*LA Times Sunday Magazine?)*, October 22, 2006, p. 20 (*citing* Stanford/Rand study).

[16] "*See* notes 2 and 3 and accompanying text.

COMPANIES THAT HAD FIVE OR MORE EMPLOYMENT ARBITRATIONS WITH THE AMERICAN ARBITRATION ASSOCIATION

January 1, 2003 To March 31, 2007

Company
ACE INA
AIG
Accredited Home Lenders
Ace American Insurance Company
Aetna
Affiliated Computer Services
American General
Ameriquest Mortgage Company
Anheuser-Bush Company, Incorporated
Arizona State University
Austin Industrial
BFS Retail & Commerical Operations
Baptist Health System Inc.
Bayer
Bechtel
Behr Process Corp
Bill Heard Chevrolet
Blue Cross Blue Shield
Bridgestone
Brookwood Medical Center
Burns International Security
Busch Entertainment Corporation
CBSK Financial Group
CIGNA Corp. (Connecticut General Life Insurance)
Chevron
Cintas
Cisco Systems, Inc.
CitiGroup
Clear Channel
Coca-Cola Enteprises, Ltd.
Country Wide Financial
Darden Restaurants, Inc.

Delta Faucet Company
Diamond Shamrock
Dillard's, Inc.
Dollar Financial Group
Doskocil Manufacturing Corporation
Duke University

El Dorado Enteprises
Equity Properties

Four Seasons Hotels
Friendly Ice Cream Corporation

GMRI
General Dynamics
General Electric
GlaxoSmithKline

H.E. Butt Grocery Company
Halliburton
Hallmark Cards, Inc.
Harris County Hospital District
Hooters Restaurant
Hovensa

Igloo Products Corp.

J.C. Penny
Johnson & Johnson

KBR
KLA-Tencor Corporation
Kellogg, Brown and Root, Inc.
Kinko's
Kraftmaid Cabinetry, Inc.

Labor Ready, Inc.
LensCrafters
Long John Silver's, Inc.
Los Alamos National Laboratory
Lowe's HIW

Mariner Health Care
Marriott International
Masco Corporation
Menard Inc.
Merillat Corp.
Merrill Lynch
Metal Container Corp.

Milgard Manufacturing Corp.
Mills Pride
Morgan Tire & Auto Inc.
Morton's of Chicago

NCR Corporation
Nabors Drilling Corporation
Nintety Nine Restaurant & Pub
Nordstrom, Inc.
Northern Arizona University
Northrop Gruman Coporation

O'Charley's, Incorp.

Pfizer, Inc.
Prudential Financial
Public Storage, Inc.
Publix Super Markets

Qwest Communications

Raytheon Company
Rent-A-Center
Ritz Carlton Hotel

SAIC (Science Applications International Corp.)
Securitas Security Services, Inc.
Selma Automall
Shell International Petroleum Company
Sherwin Williams Company
Software Spectrum, Inc.
Sports and Fitness Clubs of America
St. Paul Travelers Insurance
Sterling Jewelers, Inc.
Swift Transportation Company, Inc.

TRW Automotive, Inc.
Tenet Healthcare Systems
Terminix
The Boeing Company
The Krystal Company
Toll Bros., Inc.
Turner Construction Company

UPS Supply Chain
USAA (United Services Automobile Association)
Uniprise, Inc.
United Healthcare Group (UnitedHealth Group, United-Healthcare Group)
University of Southern California

Valero Energy Corporations
Visteon Corporation
Volt

Waffle House, Inc.
Washington Mutual
Wells Fargo
World Aviations Systems, Inc.

4751 Total Employment Arbitration Cases

Taken from **American Arbitration Association, "CCP Section 1281.96 Data Collection Requirements** (From Jan 01, 2003 To Mar 31, 2007)" (April 2, 2007), http://www.adr.org/si.asp?id=4591

WHAT THE EXPERTS SAY ABOUT BINDING MANDATORY ARBITRATION

"Civil rights laws have no meaning if you cannot go to court to enforce them but instead are relegated to a private forum where the sometimes untrained decision maker is not even required to know or follow the law."
-- Cliff Palefsky, civil rights lawyer and a co-founding member of the National Employment Lawyers Association[1]

Arbitration is "[d]espotic decisionmaking..."
-- U.S. Supreme Court Justice John Paul Stevens[2]

"Private judging is an oxymoron because those judges are businessmen. They are in this for money."
-- California State Appellate Judge Anthony Kline[3]

"We should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges."
-- U.S. Supreme Court Justice Hugo Black[4]

"Let us assume for a minute that for some reason all the rabbits and all the foxes decided to enter into a contract for mutual security, one provision of which were [*sic*] that any disputes arising out of the contract would be arbitrated by a panel of foxes. Somehow thot shocks our consciences, and it doesn't help the rabbits very much either.[5]
-- West Virginia Supreme Court of Appeals Justice Richard Neely

"What the (Supreme) Court has not yet recognized is that it has allowed corporations to avoid not only the courts, but the regulatory impact of the law."
-- Professor David Schwartz, University of Wisconsin Law School[6]

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[1] "The Civil Rights Struggle Against Mandatory Arbitration," 1 *Employee Rights Quarterly* 22, 23 (2001).
[2] *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 656-657 (1985) (J. Stevens, dissenting).
[3] *Quoted in* Berkowitz, "Is Justice Served?" *West (LA Times Sunday Magazine)*, October 22, 2006, http://www.latimes.com/features/magazine/west/la-tm-arbitrate43oct22,1,3335771,story?coll=la-headlines-west&ctrack=1&cset=true, p. 22.
[4] Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145, 149 (1968).
[5] *Board of Education of Berkeley County v. Miller, Inc.*, 160 W. Va. 473, 236 S.E.2d 439, 443 (W. Va. 1977).
[6] *Quoted in* R. Holding, "Private Justice: Millions are losing their legal rights," *San Francisco Chronicle* (October 7, 2001) ["Private Justice"].

"Employment arbitration is well on its way to replacing the courts as the primary method of resolving statutory employment disputes. If arbitration does not provide justice to those who have been victims of racial discrimination or sexual harassment, *our civil rights laws are in great danger*."

-- Lewis Maltby, President, National Workrights Institute[7]

Arbitration is "...a service to corporations that don't like jury trials."

-- Professor Paul Carrington, Duke University Law School[8]

Mandatory arbitration "subverts our system of justice as we have come to know it."

-- Montana Supreme Court Justice Terry Trieweiler[9]

Most people who exempt themselves from the law are called criminals and end up behind bars. But when an employer does the same thing [via mandatory arbitration clauses], it's considered good business."

-- Professor Ellen Dannin, California Western School of Law[10]

"Clearly, a contract agreeing to binding arbitration was to the advantage of the subcontractor, who had attorneys on staff with nothing to do but delay, throw curves and run up attorney fees for the partners.... Always consult with an attorney before signing a contract. Question the section about arbitration[ ] or trial...."

-- Jeffrey Moses, writing for the National Federation of Independent Business's "Business Toolbox" website section[11]

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[7] Testimony Regarding Civil Rights Procedures Protection Act (S. 121) before the U.S. Senate Subcommittee On Administrative Oversights and the Courts (March 1, 2000), http://www.workrights.org/issue_dispute/adr_house_testimony.html) [emphasis supplied].

[8] *Quoted in* "Private Justice."

[9] *Quoted in* "Private Justice."

[10] E. Dannin, "Employers Can Just About Bank on Winning in Arbitration," *L.A. Times* (December 24, 2000), M-2.

[11] J. Moses, "Beware of Contracts Calling for Mandatory Arbitration," *Business Toolbox*, National Federation of Independent Business (2004), http://www.nfib.com/object/IO_16916.html.

MANDATORY ARBITRATION PREVENTS EMPLOYEES FROM HOLDING THEIR EMPLOYERS ACCOUNTABLE IN COURT IN *ALL* KINDS OF EMPLOYMENT CASES

Americans with Disabilities Act (ADA)
Nelson v. Cyprus Bagdad Copper Corp., 119 F.3d 756 (9th Cir. 1997); *Miller v. Pub. Storage Mgmt., Inc.*, 121 F.3d 215 (5th Cir. 1997)

Age Discrimination in Employment Act (ADEA)
Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991)

Employee Polygraph Protection Act
Saari v. Smith Barney, Harris Upham & Co., Inc., 968 F.2d 877 (9th Cir. 1992)

Employee Retirement Income Security Act (ERISA)
Bird v. Shearson Lehman American Express, 926 F.2d 116 (2d Cir. 1991)

Equal Pay Act
Hurst v. Prudential Securities, Inc., 21 F.3d 1113 (9th Cir. 1994)

Fair Labor Standards Act (FLSA)
Carter v. Countrywide Credit Indus., Inc., 362 F.3d 294 (5th Cir. 2004)

Family and Medical Leave Act (FMLA)
Martin v. SCI Mgmt., L.P., 296 F. Supp. 2d 462, 467 (S.D.N.Y. 2003)

Older Workers Benefit Protection Act
Williams v. Cigna Fin. Advisors, Inc., 56 F.3d 656 (5th Cir. 1995)

Race, National Origin, Sex, and Religious Discrimination (1964 Civil Rights Act, Title VII)
Booker v. Robert Half Int'l, Inc., 315 F. Supp. 2d 94 (D.D.C. 2004) (race discrimination); *Prudential Insurance Co. of America v. Lai*, 42 F.3d 1299 (9th Cir. 1994) (sexual harassment); *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 170 F.3d 1, 18 (1st Cir. 1999) (sex discrimination)

Section 1981
Gillispie v. Village of Franklin Park, 405 F. Supp. 2d 904 (N.D. Ill. 2005)

State Employment Discrimination claims
Circuit City Stores, Inc. v. Adams, 532 U.S. 105 (2001) (discrimination on basis of sexual orientation)

Uniformed Services Employment and Reemployment Rights Act (USERRA)
Garrett v. Circuit City Stores, Inc., 449 F.3d 672 (5th Circ. 2006)

Workers' Compensation
Melena v. Anheuser-Busch, 847 N.E.2d 99 (Ill. 2006)

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BINDING MANDATORY ARBITRATION OF EMPLOYMENT CLAIMS: THE STORY OF MARY KAY MORROW

Mary Kay Morrow
Kansas City, Missouri

Mary Kay Morrow shares this story:

Ms. Morrow worked at Hallmark Cards, Inc., creating, marketing, and distributing social expressions products for nearly 20 years. In January of 2002, Hallmark sent a letter to its employees stating that it was changing its terms of employment so that any legal disputes an employee had with Hallmark would have to be decided through a new involuntary "dispute resolution program," culminating in binding arbitration. The letter implied that simply showing up to work after the effective date would be deemed an agreement to this new policy. As the primary breadwinner for her household, Ms. Morrow, like most employees, was not in a position to walk away from her long-time employer. Also, like most employees, she thought that this new mandatory arbitration clause would never affect her. But she was wrong.

Throughout her 20 years of employment at Hallmark, Ms. Morrow had received good job reviews. But in 2003, things at Hallmark began to change for her. Despite Ms. Morrow's good history and loyalty to the company, Hallmark began holding Ms. Morrow and other older workers to higher performance standards than those applied to the younger workers in similar positions. Eventually Ms. Morrow was required to participate in a "Performance Improvement Plan" a program that was used to mark older employees for termination. When Ms. Morrow told the company that she thought they were discriminating against her based on her age, she was fired.

Ms. Morrow decided to take Hallmark to court on the grounds of discrimination and retaliation, and her lawyer filed the papers well within the time limit for such claims under Missouri law. Hallmark asked the court to move the case into arbitration, and the court granted its request. But when Ms. Morrow filed her complaint with the arbitrator, Hallmark asked the arbitrator to dismiss the claim altogether because it was not filed soon enough under Hallmark's own arbitration rules, despite Missouri's statute of limitations.

It turns out that Hallmark's arbitration clause had a rule that all claims must be filed within 30 days of the end of internal dispute resolution procedures, which Ms. Morrow had participated in before filing her lawsuit. The arbitration agreement put the employees at a disadvantage in other ways as well, for example, by significantly limiting discovery,

prohibiting class action claims, enforcing confidentiality and barring certain types of injunctive relief. Unlike a court that can order a business to stop discriminatory practices, these arbitrators do not have that ability. Even with this stacked-deck arbitration, the clause also stated that Hallmark, and Hallmark alone, could modify or terminate the "agreement" at any time.

As is frequently the case with big businesses and mandatory arbitration clauses, the arbitrators make a lot of money from repeat business from their corporate clients. Thus, they have a lot to lose by ruling against the employer in arbitration. So it is perhaps not that surprising that the arbitrator in Ms. Morrow's case dismissed the action because of the 30-day rule. The case was dismissed with prejudice, meaning that Ms. Morrow was barred from bringing any further action on the same claim. Amazingly, the arbitrator made this decision in spite of the fact that Missouri law specifically prohibits arbitration agreements from placing artificial time limits on legal claims.

Says Ms. Morrow: "It seems as if Hallmark has discovered that imposing stacked-deck mandatory arbitration programs on their employees means that they can act with virtual immunity from employment laws. At least, that's what happened in my case."

As of August, 2007, the Court of Appeals for the Western District of Missouri is considering Ms. Morrow's appeal of the order permanently dismissing her claims.

Ms. Morrow's case was reported in the Kansas City Business Journal on March 19, 2004. She can be reached through her attorney, Mark Jess, at (816) 474-4600.

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BINDING MANDATORY ARBITRATION OF EMPLOYMENT CLAIMS: THE STORY OF FONZA LUKE

Fonza Luke
Princeton, Alabama

Fonza Luke tells the following story:

Fonza Luke, a mother of four and a grandmother of four, started working as a licensed nurse practitioner for Baptist Health Systems (BHS) at its Medical Center in Princeton, Alabama, in 1971. For almost 30 years, she received the highest performance ratings from the doctors she worked with everyday. When the hospital needed her to work extra days and hours because of staffing shortages, she came to the call, including once working almost every day of the year to give them the help they needed. Whenever the hospital offered new training or skills development, she took advantage of it so she could do her job better.

In November 1997, Ms. Luke had to attend a meeting of hospital employees where she was given a copy of a new "Dispute Resolution Program." She, along with other hospital employees, was told that BHS was starting this new program, that they would have to give up their right to go to court if they have legal claims, that all claims would be brought to binding arbitration, and that this program would take effect in January for anyone working for the hospital. Ms. Luke refused to sign this agreement because she didn't want to give up her rights. She was twice told that if she didn't sign it she would be fired, but both times she refused.

Three years later, in early 2001, the hospital fired Ms. Luke after she returned from a continuing education class in Atlanta. The hospital's human resources director told her that she was being fired for "insubordination" after almost 30 years of working for BHS. Ms. Luke said she was devastated because she never thought that she would lose her job after all those years.

When Ms. Luke was terminated, she went to a lawyer because she believed that BHS fired her because of her race and age, as well as in retaliation for filing a complaint after she contracted tuberculosis on the job because of unsafe conditions. Ms. Luke is an African-American, she was 59 years old when she lost her job, and the only things she did that were "insubordinate" were things that younger, white employees did all the time without getting fired. She filed race and age discrimination claims with the U.S. Equal Employment Opportunity Commission, and then in federal court.

BHS asked the federal court to dismiss Ms. Luke's case because she had agreed to bring all of her claims to arbitration. Ms. Luke told the federal court that she never signed the arbitration agreement and never gave up her right to go to court. But the federal court said that BHS could force her to arbitrate because she kept working in her job after BHS showed her its arbitration agreement. When she appealed the federal court's decision, the appeals court ordered her into arbitration.

Ms. Luke said, "I did everything I could to keep my right to go to federal court, but the courthouse doors were closed when I got there."

At arbitration, she lost completely. The arbitrator, a defense counsel, was chosen by process of elimination from the arbitrators' list, which was composed heavily of defense counsel. The arbitrator didn't look at the other side. Indeed, according to her lawyer, it was impossible for Ms. Luke to get someone who was in the middle of the road, much less pro-employee. As a result, Ms. Luke's claims of discrimination and retaliation were denied, and she got no relief whatsoever.

Ms. Luke told her story at a press conference of the Give Me Back My Rights! campaign in February 2005. She can be reached through Donna Lenhoff at the National Employment Lawyers Association, 202-898-2880.

Contact: Donna R. Lenhoff
Legislative and Public Policy Director
dlenhoff@nelahq.org; 202-898-2880

BINDING MANDATORY ARBITRATION OF EMPLOYMENT CLAIMS: THE STORY OF DEBBIE DANTZ

Debbie Dantz
Tallmadge, Ohio

Debbie Dantz tells the following story:

In 2000, Ms. Dantz was a server at Applebee's in Tallmadge, Ohio. Within weeks of beginning her job, Ms. Dantz was made the victim of a brutally hostile work environment that included physical harassment, daily sexual insults, intense intimidation, and retaliation by her boss, the restaurant's manager. For example, the manager required the waitresses to wear skirts – and then he would lift them and look up them, which he did regularly, with crude commentary. At times, he would force Ms. Dantz to sit in a chair for over an hour and circle her like a predator, staring at her, saying nothing. After she complained of the various types of harassment, he and the kitchen staff (all male) flung food at her and held up her orders. He and the kitchen staff also hurled crude epithets at the women servers and mostly at Ms. Dantz, who had had the audacity to complain. The music in the kitchen was the worst variety of "gangsta rap," all about cutting up women with knives, raping them, and treating them as sexual objects. The manager also forced Ms. Dantz to work brutal schedules (12-14 hours, 6 days per week).

In 2001, Applebee's was bought out and the new ownership put a Mandatory Arbitration program into place. The program required the signatures of both the employer and the employee. When Ms. Dantz received the form, she consulted a lawyer who advised her not to sign. On the signature page of the agreement Ms. Dantz wrote: "I cannot sign this as I have been contacted by an attorney(s) in regard to certain strong issues that have happened at Applebee's." No one from the company ever executed the agreement either.

Her manager tried a number of times to get her to sign the form, and again she expressly wrote on the documents that she would not sign. In retaliation, he forced her to work only for tips by marking her as working zero hours – with the threat that if she complained, she would be fired.

The company gave up asking for her consent, and Ms. Dantz continued her employment, believing that she had preserved her right to her day in court. Meanwhile, the manager at Applebee's was still – unlawfully – making her work for nothing more than the tips she earned, even after she explained to him that she was taking care of two teenage daughters and a terminally-ill father and that she didn't even have enough money to afford a car or even a bed. In short, she was trapped – Applebee's was at least within walking distance to her house.

In January 2003, Ms. Dantz finally filed suit against Applebee's. By necessity, she was still working there, and continued there throughout the bulk of the litigation. The company asked the court to send the matter to arbitration. Ms. Dantz's lawyer asked the court to force the company

to produce the form that had Ms. Dantz's refusal to accept arbitration on it, but the court refused. In fact, even though Applebee's admitted that the form needed to be signed before it could be binding, and even though the company could not produce a signed form, the court still decided that Ms. Dantz had given up her rights to a trial simply because she had continued her employment with Applebee's.

Ms. Dantz appealed this ruling, and at around the same time was granted a second separate trial on a related cause of action. Her lawyer asked the second court to stay this new trial because its outcome could be impacted by the still undecided appeal from the first trial. But the second court would not put the case on hold, and so it proceeded. To make her case, Ms. Dantz had to spend thousands of dollars extracting evidence from Applebee's.

When the Sixth Circuit finally heard Ms. Dantz's appeal of the ruling compelling arbitration, the judges ignored the evidence about her specific refusal to agree to arbitration. Instead, the court ruled that Ms. Dantz was bound by the mandatory arbitration clause simply because she showed up to work on the day that the program took effect.

When this ruling was announced, the second court – the court which had refused to put a hold on the trial because it didn't think that the ruling in the appellate court would have any bearing on the outcome – reversed itself, and shut down Ms. Dantz's second trial.

After so many disheartening defeats in court, without ever having had the chance to have her case tried on its merits, Ms. Dantz's struggle was finally lost. She refused to take her case to Applebee's hand-selected arbitration company. Applebee's was never called to account for its violations of law, and Ms. Dantz never received the compensation she was owed for the humiliation and pain from the abusive and discriminatory treatment she suffered and for the all the time that she worked for tips only.

After her experiences, Ms. Dantz felt the courts treated her as badly as the employer. The courts put the final stamp on her perceived lack of control over her own life and circumstances. "I cannot go on any more. There is no justice," is her way of explaining how she felt.

In short – Ms. Dantz showed up to work for an employer who abused and cheated her, because she could not afford to walk away. The courts said that this action was a clear signal of agreement to waive her right to bring that employer to court – a clearer signal, in fact, than Ms. Dantz's own written statement on the arbitration form saying "I cannot sign this."

Ms. Dantz's cases are reported at N.D. Ohio, No. 5:03-00329 and N.D. Ohio, No. 5:04-CV-00060; Dantz v. Am. Apple Group, LLC, 123 Fed. Appx. 702 (6th Cir. 2005). She can be reached through her lawyers, Christy Bishop or Dennis Thompson, 330-753-6874, or Donna Lenhoff at the National Employment Lawyers Association, 202-898-2880.

Ms. SÁNCHEZ. Thank you very much for your testimony.

At this time, I would invite Professor Rutledge to give his testimony.

TESTIMONY OF PETER B. RUTLEDGE, ESQ., THE CATHOLIC UNIVERSITY OF AMERICA, COLUMBUS SCHOOL OF LAW, WASHINGTON, DC

Mr. RUTLEDGE. Thank you, Chairwoman Sánchez, Ranking Member Cannon, Representative Johnson and Members of the Subcommittee. I am an associate professor of law at the Columbus School of Law, coauthor of the book "International Civil Litigation in the United States," and author of several articles in the field of arbitration.

I appreciate the opportunity to participate in the hearing today, and would like to take you up on your invitation, Madam Chair, to elicit testimony to assess the accuracy of reports on exactly what is the state of the empirical data in arbitration to assist the Subcommittee in deciding whether legislation is necessary. I hope that both my written testimony and my oral testimony will assist you in that process.

Allow me to briefly summarize my points. First, the available data on arbitration is growing and in important respects is either inconsistent with or flatly contradicts some of the arguments that have been driving this debate so far. It is important to fill the gaps in the empirical record before knowing whether and to what extent legislation is necessary.

Second, several of the findings upon which H.R. 3010 rests either conflict with the available empirical evidence or rest on criticism not unique to arbitration.

Third, to the extent there are problems with arbitration, and let me speak personally here and stress I agree that there are some, several mechanisms already exist to regulate them. The question is not whether arbitration is perfect. Surely it is not. The question is whether the imperfections in the system justify jettisoning it altogether.

That leads me to my fourth point. Eliminating arbitration agreements may have significant negative economic effects. I am the first to admit that this is an area where we need more empirical research, but several bits of anecdotal evidence which are summarized in my written testimony indicate that arbitration has enabled companies to lower their dispute resolution costs and that those savings have been passed on to individuals in the form of higher wages, lower prices, and better share prices.

My own research, which I stress is a work in progress, indicates that eliminating the employment arbitration docket of a single organization, the AAA, would increase the cost of resolving those disputes by $88 million. If eliminating a single organization's docket increases costs that much, imagine what the increase in costs would be if arbitration were eliminated altogether. Basic economics teaches us that those increased costs have to be borne by someone, and they are going to be borne by the individuals, the same people whom H.R. 3010 is trying to protect.

And fifth and finally, the notion that post-dispute arbitration can somehow replace pre-dispute arbitration is something that is not a viable alternative.

Madam Chair, at bottom let me urge Congress to respond to the empirical proof here. The risk of legislating otherwise is that it would make worse-off the very individuals who Congress is trying to protect. In my remaining time, allow me to elaborate briefly on two examples.

One, arbitration is often criticized on the ground that it leaves the party with the weaker bargaining position, whether the employee, the consumer or otherwise, worse off. You have heard a few examples today of particular companies or instances where that is the case. But the aggregate measures indicate that by most measures, the party with the inferior bargaining position achieves superior or comparable results compared to what is the case is in litigation. One thing that I would encourage the Subcommittee to do is to consider exactly where are these people going to end up if arbitration is not available?

Two, arbitration is often criticized on the grounds—and it has been so criticized today—that it surrenders the employee's or the consumer's right to a jury trial. It is certainly true that arbitration does not involve a jury, but eliminating arbitration is not going to magically cause a jury to appear for all these cases. The available evidence indicates that if Congress eliminated arbitration, many of these individuals who it is trying to protect will not be able to find an attorney. If they can, few of their cases will reach a jury, and if they do, justice will come far later than it does for them in arbitration.

To paraphrase the words of one respected scholar in this field, in a world without arbitration, we would essentially have a Cadillac system of justice for the few, and a rickshaw system of justice for the many. Arbitration replaces that with a system of justice of Saturns for all. In other words, it enables citizens as a whole to have greater access to justice, even if a few individuals and their lawyers experience a marginal reduction in recoveries.

Madam Chairman, I have tried to keep underneath my time. Thank you for the opportunity to present my testimony. I would be happy to answer your questions.

[The prepared statement of Mr. Rutledge follows:]

PREPARED STATEMENT OF PETER B. RUTLEDGE

Chairwoman Sánchez, Ranking Member Cannon and Members of the Subcommittee. Thank you for the invitation to testify today. My name is Peter Rutledge, and I am an Associate Professor of Law at the Columbus School of Law at the Catholic University of America here in Washington, D.C. I am co-author of the book International Civil Litigation in the United States. I also have written several articles in the field of arbitration. I am pleased to offer my thoughts on H.R. 3010, the Arbitration Fairness Act.

SUMMARY

Allow me briefly to summarize the main points of my testimony:

- First, too much of the debate in this field has been dominated by anecdote, not data. The available empirical data on arbitration is growing, and, in important respects, either is inconsistent with or flatly contradicts, some of the anecdotes that appear to be driving the debate over arbitration reform. It is important to fill the gaps in the empirical record, before knowing whether and to what extent legislative action is necessary;

- Second, several of the findings upon which H.R. 3010 rests, found in Section 2 of the bill, are, based on the available empirical evidence, either erroneous or rest on criticisms not unique to arbitration;

- Third, to the extent there are problems with arbitration, several mechanisms already exist to regulate those problems;

- Fourth, eliminating predispute arbitration agreements may have significant negative economic effects and, ironically, make worse off the very parties whom defenders of H.R. 3010 are trying to protect;

- Fifth, post-dispute arbitration does not provide a viable alternative to the present system of enforceable predispute arbitration agreements.

With that summary, I will now elaborate on each of these points.

I. The State of the Empirical Research

The state of the empirical research in arbitration lags in comparison to that in other legal fields. The legal academy has been partly to blame for this. Many participants in the early debates brought preconceived notions about arbitration to the table. While they could argue about the proper direction of the legal doctrine, they were unprepared to engage in a systematic study of the empirical premises that underlay their positions.

More recently, the study of arbitration has begun to focus on those empirical premises, and researchers are slowly obtaining greater quantities of data about how arbitration operates.[1] For example, a series of studies by Lisa Bingham has helped to

[1] In addition, a number of governmental studies have looked at various aspects of arbitration. Some of these contain quite rich anecdotal information and policy perspectives, but the aggregate empirical analysis contained in these studies is limited. *See* GAO, Alternative Dispute Resolution: Employers' Experiences With ADR in the Workplace (1997); GAO, Employment Discrimination: Most Private Sector Employers Use ADR, 7 (1995); U.S. Commission on the Future of Worker-Management Relations, Final Report (1994); GAO, Securities Arbitration: How Investors Fare, 7-8 (May 1992). One government commissioned study did provide some valuable empirical evidence in the field of securities arbitration. *See*

assess whether there is a repeat player effect that benefits companies over employees.[2] Studies by scholars such as Elizabeth Hill, Theodore Eisenberg and Lewis Maltby have addressed the fundamental question whether arbitration leaves individuals better off or worse off than litigation.[3] Chris Drahozal at the University of Kansas recently edited a volume synthesizing the available empirical research in the field of international arbitration.[4] David Sherwyn at Cornell University is in the midst of seminal empirical research in employment arbitration,[5] and researchers at New York University have also made important contributions to the field.[6] In a forthcoming paper, I am attempting to measure the economic cost if Congress were to eliminate predispute arbitration.[7]

To be sure, there are gaps. The empirical record on employment arbitration is relatively more developed than that of consumer or franchise arbitration.[8] Moreover, the

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Michael Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* 32 (November 4, 2002);

[2] Lisa Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189, 208-09 (1997); Lisa Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303 (Estreicher & Sherwyn eds. 2004).; Lisa Bingham, *On Repeat Players, Adhesive Contracts and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 234 (1998).

[3] Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 814-16 (2003); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RES. J. 44, 44 (Nov. 2003-Jan. 2004); Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 107 (2003); Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 56-58 (1998); Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 William Mitchell L. Rev. 313 (2003).

[4] *Toward a Science of International Arbitration: Collected Empirical Research*, Chris Drahozal, ed. (2005).

[5] Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557 (2005).

[6] Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 567-68 (2001).

[7] Peter B. Rutledge, *Whither Arbitration?*, __ Geo. J. Law & Pub. Pol'y __ (2008). In the interest of full disclosure, I should note that the Institute for Legal Reform provided funding for this study.

[8] For some of the available research on franchise and consumer arbitration, see Keith Hylton & Chris Drahozal, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J

amount of available data varies with the arbitration provider. The American Arbitration Association has been especially willing to provide researchers access to their data; with respect to others the amount of publicly available data is more limited.

With the empirical record in this state, I would urge Congress to proceed cautiously. The risk is that the political rhetoric over arbitration will outpace the empirical reality, causing Congress to act on the basis of incomplete or, worse yet, erroneous information. Here is just one example. Arbitration is often criticized on the grounds that it leaves the party with the weaker bargaining position, whether the employee or the consumer, worse off.[9] In fact, nearly all of the available academic studies, most of which concern employment arbitration, demonstrate precisely the opposite outcome.[10] That is, by various measures, the party with the inferior bargaining

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Legal Stud 549 (2003); Linda Demaine & Deborah Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55 (Winter/Spring 2004).

[9] While I recognize that H.R. 3010 also covers franchise agreements, I take issue with the notion that franchisees, who are at bottom, businesspeople are properly equated with consumers or employees in terms of their information and bargaining position in an arms-length transaction.

[10] Researchers use various methodologies to determine whether arbitration leaves the party with the inferior bargaining position "better off." For studies looking at raw win rates – that is, comparing how often each side wins, see Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 108-11 (2003); Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 15 (2004), http://www.arb-forum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf; California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure*, Figure 4 (2004); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 Disp. Resol. J. 40, 44 (Oct.-Dec. 1995); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, 130-31 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author); GAO, Securities Arbitration: How Investors Fare, 7-8 (May 1992).

For studies using a comparative win rate methodology (that is, comparing how often a party recovers in arbitration as opposed to litigation), see Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. DISP. RES. 559, 564-65 (2001); Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 111-12 (2003); Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1569 (2005); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 130-31 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author).

For studies using a comparative recovery methodology (that is, comparing the amount of recovery in arbitration as opposed to litigation), see Michael Delikat & Morris Kleiner, *Comparing Litigation And*

position achieves better, or at least comparable, outcomes in arbitration compared to litigation.[11]

A recent report by the organization Public Citizen presents a counterpoint to the general trend in the academic research.[12] The main claim of the report is that one particular arbitral institution, the National Arbitration Forum, systematically favors businesses in credit card disputes that come before it. I have read the report. At one level, Public Citizen should be commended for trying to move the debate beyond anecdote and to the level of aggregate empirical analysis. But at another level, I cannot agree with the organization that the data support the view that arbitration is fundamentally flawed. The data present a skewed sample set upon which to base any decision about arbitration. Specifically, the bulk of the arbitrations evaluated by Public Citizen appear to be default collection actions – that is, relatively straightforward arbitrations commenced by a bank when someone does not pay their credit card bill.

Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?, American Bar Association Litigation Section Conflict Management, Vol. 6, Issue 3, 10 & Table 3 (2003); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 132 & Table 12 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 Disp. Resol. J. 40, 45 (Oct.-Dec. 1995); Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 791-92 (2003); Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 788-89 (2003).

For a good synthesis of the empirical record and a blueprint for future empirical research, see Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1567-68 (2005).

[11] There are two main exceptions to the dominant trend in the literature. First, the 1995 study by William Howard suggested that outcomes in arbitration were inferior to those in litigation, but subsequent scholarship has criticized the methodology that Howard employed. Second, more recent research by Hill and Eisenberg, cited above, suggested that arbitration may result in lower recoveries for employees earning less than $60,000. Yet as the authors themselves recognize, this study did not necessarily demonstrate that arbitration caused this outcome. Rather, given the well documented difficulties that this class of plaintiffs encounters in obtaining trial counsel, only very large meritorious suits ever actually reach court; by contrast, because arbitration is more cost-effective (or parties may elect to proceed pro se), a greater array of cases – both meritorious and non-meritorious – reach arbitration, creating the misimpression that arbitration is somehow responsible for these outcomes.

[12] Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* (September 2007).

That is a poor metric upon which to base any conclusion about the fairness of arbitration generally. It is the equivalent of my trying to convince you that a baseball pitcher has a near-perfect ability to throw "no-hitters" – at least where no batter is standing at the plate.

I will return to these issues in detail later in the testimony. For now, I just offer them to illustrate the point that there remain critical gaps in the systematic understanding about arbitration. Until those gaps are filled, something that the academy is actively pursuing, I would urge Congress not to let the anecdotes drive the debate.

II. The Findings of H.R. 3010 and the Empirical Research

Section 2 of H.R. 3010 sets forth a series of findings that purport to justify the reforms contained in the rest of the bill. I compared the assumptions in those findings with the actual empirical record. In several cases, I identified instances where the empirical record either did not support or, in some cases, directly contradicted the bill's findings. Allow me to summarize some of my key determinations:

- Right to a Jury Trial: A frequently heard complaint about arbitration is that it surrenders the employee's or consumer's right to a jury trial. H.R. 3010 echoes this complaint. It is certainly true that arbitration does not involve a jury. But eliminating arbitration would not suddenly cause all of those disputes to be decided by a jury. Numerous studies have documented how most civil litigation is resolved far before a case ever reaches a jury – whether through voluntary dismissal, settlement or dispositive rulings by the judge.[13] Others have documented how difficult it is for a plaintiff such as an employee to find an attorney willing to take her case unless the

[13] Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1566 (2005) (Vast majority of cases dismissed or resolved without court action undermines claim that arbitration will stagnate development of the law); Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 47(1998) (Cases never reach jury – of 3419 employment discrimination cases filed in 1994 that led to definitive judgment, 60% were disposed of by pretrial motion, with employers prevailing in 98% of those); Michael Delikat & Morris Kleiner, *Comparing Litigation And Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?*, American Bar Association Litigation Section Conflict Management, Vol. 6, Issue 3, 8 (2003).

amount in controversy is sufficiently high and the merits sufficiently strong.[14] Indeed, a founder of the National Employment Lawyers' Association, an organization dedicated to employee representation in employment disputes, testified a few years ago that employment attorneys turned away at least 95% of employees who sought representation.[15] Thus, it is erroneous to suggest that arbitration somehow strips a claimant of her right to a jury trial; without arbitration, she likely would never obtain such a trial or, even worse, may not even be able to find an advocate to take her case.

- "Take it or Leave it": H.R. 3010 criticizes the use of arbitration clauses in employment and other contracts on the ground that it gives employees (and other claimants) no meaningful option. In other words, they are forced to accept arbitration on a "take it or leave it" basis as part of the underlying agreement. The main problem with this argument is that it proves too much. Individuals are presented with a variety of terms on a take it or leave it basis.[16] For example, my employer presents me with only a single health insurer and a single 401(k) plan. Similarly, as a consumer, I may be presented with a variety of "take it or leave it" terms ranging from the interest rate at my bank to the price of the car that I rented last week. Yet no one would deny there are valid economic reasons, some of which directly benefit me as an employee or a consumer, why my counterparty does not dicker over those terms. In my view, the same economic rationale that justifies these sorts of "take it or leave it" policies applies to arbitration.

- Repeat Player Effect: H.R. 3010 posits that providers of dispute resolution services are pressured to design systems favoring the "repeat player" in the arbitration (i.e., the company which can offer it return business). I acknowledge that this claim has a theoretical appeal and previously have noted that appeal in my own theoretical writings.[17] Notwithstanding the theoretical appeal of the repeat player claim, the empirical picture is far more complex. Some studies have found evidence of a repeat player phenomenon while others have found no demonstrable effect.[18] Furthermore,

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[14] *See, e.g.*, David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1574 & n.88 (2005); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. DISP. RES. 559, 563 (2001); William M. Howard, *Arbitrating Claims of Employment Discrimination*, Dis. Resol. J., Oct.-Dec. 1995, at 40; William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes* (1995) (unpublished dissertation on file with author).

[15] Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 107 (2003).

[16] Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1563-64 (2005).

[17] *See* Peter B. Rutledge, *Toward a Contractual Theory of Arbitral Immunity*, 39 Ga. L. Rev. 151 (2004).

[18] *Compare* Lisa Bingham, *Is there a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Actual Cases and Outcomes*, 6 INT'L J. ON CONFLICT MGMT. 369, 380 (1995) and Lisa Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303, 323 & Table 2 (Estreicher & Sherwyn eds. 2004), *with* Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 816 (2003).

even where the repeat player effect exists, the cause is not clear. Most research suggests that the repeat player effect – if it exists – is not due to the arbitrator's financial incentives but, instead, to the "learning effects" from the repeat player's experiences.[19] That is, the repeat player learns what sorts of cases can be won and, therefore, is more likely to settle those, leaving for arbitration those where the repeat player is relatively confident it can win outright (or at least where the costs of taking the case through arbitration are lower than the minimum amount that the claimant is prepared to accept in settlement).

- Development of Public Law: H.R. 3010 criticizes arbitration for hindering the development of public law. This is only partly true and certainly is not unique to arbitration. It is only partly true because there remain avenues for public law to develop even through arbitration – whether through publication of the awards or judicial decisions in actions to confirm the awards. In any event, it would be unfair to single arbitration out for this criticism. A variety of other mechanisms have a far greater impact on the development of public law. The most obvious one is settlement, which I would safely suspect occurs far more frequently than arbitration. Settled cases generally do not result in the creation of binding precedent. While some academics have criticized settlement on this ground, I am unaware of any real suggestion in Congress to ban settlements. Settlements certainly yield benefits – reduced stress on the judicial system, speedier relief for plaintiffs and lower legal fees for both sides. In my view, the same logic supporting settlements – notwithstanding their retarding effect on the development of public law – also supports arbitration.

- Transparency: H.R. 3010 criticizes arbitration for not being adequately transparent. According to the criticism, decisions take place in secret, denying both the litigants and the public adequate opportunity to scrutinize the arbitrator's decision-making process. This criticism is mistaken for three reasons. First, it misapprehends arbitration: there are at least two junctures where the merits of arbitration are publicly aired: the enforcement of the agreement and the enforcement of the award. Second, like several of the other criticisms noted here, it unfairly singles out arbitration: a variety of other mechanisms, judicial or otherwise, are not transparent. Settlement again is the most obvious – a claim of threatened litigation may settle with even less public disclosure than arbitration. Even when claims are litigated, the opportunities for transparency are limited. The judge may enter an order on the record without elaboration, or an appellate court may summarily affirm a lower court judgment on some issue without elaborating on its reasoning. Third and finally, the criticism over transparency has a flipside – namely confidentiality. Parties may well prefer arbitration precisely because, relative to

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[19] Lisa Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303, 323 & Table 2 (Estreicher & Sherwyn eds. 2004). *See also* Sherwyn *et al., Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1570-71 (2005); Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 816 (2003).

civil litigation, the proceedings take place in a less public setting and, thereby, avoid the more open hostility that can be engendered when the parties stake out their position in public. Indeed, one of the great benefits of arbitration is a psychological one – it enables parties to sort out their differences before their dispute spills out into the court of public opinion and causes parties to dig into their positions.

III. Existing Mechanisms To Address Problems

My testimony should not be understood as an uncritical acceptance of the *status quo*. Surely there are instances of indefensible arbitration agreements.[20] But the question is not whether arbitration is perfect; like any system, it is not. Rather, the question is whether Congress should jettison the entire enterprise of predispute arbitration agreements in order to combat these difficulties. I would submit that it should not do so, and part of the reason is my trust in the existing mechanisms that have evolved to address this problem.

First, there has been a good deal of self-regulation in this area. In the securities industry, for example, the major arbitration services promulgate and revise their rules under the auspices of the Securities and Exchange Commission. On the commercial side, several of the major arbitration organizations have signed on to "Due Process Protocols". For example, the employment protocol sets forth a variety of rights including:

- the employee's right to be represented by a person of her own choosing;
- the employer is encouraged to pay at least a share of the employee's fees;
- employees should have access to all information reasonably relevant to their claims;
- before selecting an arbitrator, parties should have sufficient information to contact parties who previously have appeared before her;
- arbitrators should have sufficient skill and knowledge;

[20] *See, e.g., Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (refusing to enforce agreement with one-sided procedural rules).

- arbitrators should be drawn form a diverse background;
- arbitrators should be free of any relationships that would create an actual or apparent conflict of interest;
- the employee's entitlement to the same array of remedies in arbitration as she would be entitled to in a judicial proceeding

Subsequent protocols governing consumer disputes and health care disputes differ in some of the specifics but contain the same basic protections. Many of the major arbitration associations have committed to administering arbitrations in the consumer and employment areas only if the parties agreed to be bound by the protocols.[21]

To be clear, not all arbitral institutions have signed onto the protocols. But even where they do not bind the organizations, that does not mean they are wholly irrelevant. As I have explained elsewhere, some courts, including several justices on the Supreme Court, have looked to the protocols as a benchmark by which to assess the procedural fairness of a particular arbitral scheme.[22] In other words, while the protocols technically do not have the binding force of a legal rule, they nonetheless have exerted a persuasive influence on how some courts have interpreted existing doctrine governing the enforceability of arbitral agreements and awards.

Even where the protocols or the judicial reliance on them is inadequate, the FAA provides several mechanisms for regulating arbitration. Section 2 of the FAA, as

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[21] Am. Arbitration Ass'n, *Consumer Due Process Protocol* (1998), available at http://www.adr.org/sp.asp? id=22019; Am. Arbitration Ass'n, *Employment Due Process Protocol* (1995), available at http://www.adr.org/sp.asp? id=28535; JAMS, *JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness* (2007), available at http://www.jamsadr.com/rules/consumer_min_ std.asp; JAMS, JAMS Policy on Employment Arbitration: Minimum Standards of Procedural Fairness (2005), available at http://www.jamsadr.com/rules/employment_Arbitration_min_stds.asp

[22] *See* Peter B. Rutledge, *Is Arbitration State Action? Does It Matter?* (unpublished manuscript on file with author).

interpreted by the Supreme Court, authorizes courts to deny enforcement of arbitration agreements when, for example, the agreement is deemed to be substantively or procedurally unconscionable. Several courts have relied on these doctrines to invalidate agreements that, for example, cede too many of the claimant's procedural rights or impose too heavy a financial burden on arbitration.[23] Additionally, Section 10 of the FAA sets forth several grounds upon which courts can vacate awards, and the federal courts have articulated several other grounds, such as the manifest disregard of the law doctrine.

Finally, in certain contexts, administrative agencies perform an important role to check imperfections in the system. Agencies such as the Equal Employment Opportunity Commission have responsibility for the enforcement of federal laws such as the employment laws. Only recently, the Supreme Court made clear that these agencies retain the right to commence litigation against an alleged violator even where the claim is on behalf of individual or a group who, due to an arbitration clause, may be unable to pursue litigation themselves.[24]

IV. The Net Harm Wrought By Eliminating Pre-Dispute Arbitration

Let us assume that Congress enacts H.R. 3010. What would happen? In my view, it likely would increase the costs of dispute resolution, and a portion of these costs

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[23] *See, e.g., Walker v. Ryan's Family Steak Houses, Inc.*, 400 F.3d 370 (6th Cir. 2005) (refusing to enforce arbitration agreement where arbitral forum was nonneutral); *McMullen v. Meijer, Inc.*, 355 F.3d 485 (6th Cir. 2004) (refusing to enforce arbitration agreement which granted exclusive control over arbitrator selection to employer); *Murray v. United Food and Commercial Workers Intern. Union*, 289 F.3d 297 (4th Cir. 2002) (refusing to enforce arbitration agreement after finding agreement unconscionable). *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (refusing to enforce agreement with one-sided procedural rules). *See generally* Born & Rutledge, *International Civil Litigation in the United States* 1106-08 (4th ed. 2006).

[24] *See EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002).

would be passed onto employees (in the form of lower wages), consumers (in the form of higher prices) and investors (in the form of lower share prices). Ironically, then, eliminating predispute arbitration agreements may end up hurting some of the very groups that Congress is trying to protect. The only group who would come out ahead in this scenario is the lawyers, who would reap higher fees engaging in more protracted litigation.

Why exactly would that occur? Well begin by considering why parties agree to arbitrate. They do so in one of two circumstances. First, they will naturally agree to another form of dispute resolution when, for each party's preference ordering, that form provides the greatest marginal benefit over all other possible forms of dispute resolution (that is the expected payoff of a particular form of dispute resolution less the cost of that form). Second, parties will agree to an alternative form of dispute resolution where it is the preferred form for at least one party, and that party can make the economic equivalent of a side payment to the other party. In either case, eliminating arbitration reduces the marginal benefits – in the first case, it reduces the marginal benefits for both parties; in the second case, it eliminates marginal benefits for one party and the side payment to the other.

If that is the theory, how much evidence is there that arbitration actually functions this way? Let me stress here that this is probably the point in the debate where the empirical record is the thinnest. Nonetheless, there is some anecdotal evidence that arbitration improves welfare for both parties, including the sorts of parties whom H.R. 3010 seeks to protect. One early indication of the relationship between dispute resolution and individual wealth came in report of the Dunlop Commission, created by President

Clinton.[25] As part of its work, the Commission considered the impact of employment litigation and dispute resolution. It concluded:

> For every dollar paid to employees through litigation, at least another dollar is paid to attorneys involved in handling both meritorious and non-meritorious claims. Moreover, aside from the direct costs of litigation, employers often dedicate significant sums to designing defensive personnel practices (with the help of lawyers) to minimize their litigation exposure. *These costs tend to affect compensation. As the firm's employment law expenses grow, less resources are available to provide wage [sic] and benefits to workers.*[26]

This "dollar for dollar" statistic derives from a report of factual findings issued by the Secretaries of Labor and Commerce.[27] Those findings trace to a 1988 study of wrongful termination litigation in California conducted by the Rand Corporation's Institute for Civil Justice.[28] In that study, researchers reviewed a sample of jury trials over an eight-year period in California. The authors surveyed counsel in each case to gather information about litigation costs. Based on their analysis of counsel's answers and the final recovery by prevailing claimants, they determined that a claimant's legal fees were more than one-third of her final payment and that the sum of the claimants' legal fees and the defendant's legal fees represented over 75% of the final payment

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[25] U.S. Commission on the Future of Worker-Management Relations, Final Report (1994) (hereinafter "Dunlop Commission Report").

[26] *Id.* at 50.

[27] Factual Findings at 109-110 ("A conservative estimate is that for every dollar transferred in litigation to a deserving claimant, another dollar must be expended on attorney fees and other costs of handling both meritorious and non-meritorious claims under the legal program.") (footnote omitted).

[28] Dertouzos *et al.*, *The Legal Consequences of Wrongful Termination* (Rand Institute for Civil Justice 1988).

received by the claimant.[29] Thus, the Commission's findings provide some support of an inverse relationship between litigation costs and employee compensation.

More recent research confirms that the cost savings generated through arbitration result in benefits passed on to employees. One survey of thirty-six employers who had alternative dispute resolution programs found that several employers provided certain benefits such as the right to participate in a corporate profit sharing plan in return for the employees' willingness to participate in an ADR program that included arbitration. [30]

Finally, one case suggests that the distributive benefits of cost savings might extend to the credit industry as well.[31] In one case, a finance company varied the interest rate on its credit facility with a consumer's willingness to agree to arbitration.[32] If the borrower did not agree to arbitration, the APR was 18.96%; if the borrower agreed to arbitration, the interest rate dropped to 16.96%. In other words, arbitration generated some unspecified quantity of cost savings for the lender, a portion of which was passed on to the customer in the form of a 2-point drop in the interest rate.

Recognizing the limited explanatory value of such anecdotes, in my own research, I have endeavored to take the empirical record one step further. Employing a comparative cost recovery framework, I analyzed the data on arbitration caseloads, the costs of dispute resolution and the frequency with which alternatives to arbitration are used. Here, I wish to be very cautious because the data sets are incomplete, the analysis

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[29] *Id.* at 38. To clarify the terminology, the final payment is the amount actually received by the claimant (which may be lower than the verdict due to post-verdict negotiations between the parties). The net payment represents the difference between the final payment and the claimant's legal fees.

[30] Bickner *et al.*, *Developments in Employment Arbitration*, 52 DISPUTE RES. J. 10, 78 (1997).

[31] Christopher Drahozal, *Unfair Arbitration Clauses*, 2001 U. Ill. L. Rev. 695; Christopher Drahozal, *Privatizing Civil Justice: Commercial Arbitration and the Civil Justice System*, 9 KAN. J. L & PUB. POL'Y 578, 584-85 (2000). *See also* Stephen Ware, *Case for Enforcing Adhesive Arbitration Agreements*, 5 J. AM. ARB. 251, 256 n. 8 (2006).

[32] *Stiles v. Home Cable Concepts, Inc.*, 994 F. Supp. 1410 (M.D. Ala. 1998).

rests on several assumptions and the figures require further testing. But based on the data that I have been able to generate, I believe that eliminating the employment arbitration docket of just one of the nation's leading arbitration associations – the American Arbitration Association -- would increase aggregate dispute resolution costs approximately fourfold or approximately $88 million.

Let me be clear, this figure does not reflect any changes in recovery. I assume that recoveries remain constant. Rather, this estimate reflects simply the increase in how much it will cost society to resolve these disputes. This is why I say that the only people who come out ahead from the abolition of arbitration are the lawyers. Individuals will find it more difficult to obtain a lawyer, at least for smaller claims. Companies will have higher litigation costs, which they must pass on to individuals in the form of lower wages, higher prices or reduced share value.

As an academic, I am frankly reluctant to share this tentative conclusion in the public record. It is something that I am testing further and about which I am currently conferring with my colleagues at other universities. Yet, in the face of possible congressional action, I felt compelled to share this very tentative conclusion with the subcommittee both to give you a sense of the potential stakes and to emphasize the need for additional research and study in this area so Congress has a more complete and accurate picture of the economic impact.

Finally, for the lucky few who actually find a lawyer willing to take their case in a world without arbitration, justice will not come quickly. The comparative speed of recovery with respect arbitration and litigation is one area where we have especially good

data and where the import of the data is clear. Virtually every study considering the issue has concluded that results in arbitration are far swifter than those in litigation.[33]

V. Postdispute Arbitration Is Not a Viable Alternative.

Let me close by hopefully debunking one of the seductive arguments of those who would do away with predispute arbitration. Individuals opposing predispute arbitration often argue that they do not oppose arbitration, only agreements that bind a party to arbitration before a dispute has arisen; parties remain free to agree voluntarily to arbitrate after the dispute has arisen. The explanation for this proposal is deceptively simple: if defenders of arbitration are correct that arbitration offers so many advantages, then those advantages are equally likely to apply after a dispute has arisen; consequently, eliminating predispute arbitration agreements should not have much impact.

Postdispute arbitration has several problems, but let me focus on the central one: the parties' incentives in the postdispute context differ in the predispute context.[34] This enables them to make more strategic calculations about which form of dispute resolution better advances their interests (or more effectively hinders the individual's interests). If a company knows that an individual's claim is below a certain amount, it may calculate

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[33] California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the* CCP (August 2004); David Sherwyn *et al., In Defense of Mandatory Arbitration of Employment Disputes: Saving the Baby, Tossing out the Bath Water, and Constructing a New Sink in the Process*, 2 U. PA. J. LAB. & EMP. L. 73, 99 (1999); GAO, *Alternate Dispute Resolution: Employers' Experiences With ADR in the Workplace* 19 (1997); Garry Mathiason & Pavneet Singh Uppal, *Evaluating and Using Employer-Initiated Arbitration Policies and Agreements: Preparing the Workplace for the Twenty-First Century*, C902 A.L.I.-A.B.A. 875, 894 (1994) (citing Rand Corporation's Institute for Civil Justice study indicating that average processing time from complaint to decision in arbitration = 8.6 months plus 20% cost savings to parties); GAO: *How Investors Fare* (May 1992).

[34] Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 320 (2003); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 567-68 (2001);

that the individual could have difficulty obtaining a counsel willing to represent her. In those cases, a company may be *less* likely to agree to arbitration precisely because it knows that, effectively, its holdout will prevent the individual from pursuing her claim.[35]

Now contrast this state of affairs with those in the predispute context. In this setting, neither the company nor the individual knows in advance the terms or nature of a dispute.[36] Yet each has an incentive to enter into arbitration – from the individual's perspective, arbitration provides an affordable forum with superior chances for obtaining a favorable result; from the company's perspective, arbitration can lower the company's litigation costs. To be sure, both sides are engaging in some tradeoffs- the individual may be trading greater forum accessibility off against higher recoveries in litigation (assuming, of course, she can find a lawyer willing to take her case); the company is trading lower litigation costs off against a reduced likelihood of prevailing in the dispute. But that is the nature of any contractual bargain. The comparative advantage of arbitration is that it enables both parties to enter into an arrangement to manage some of the *ex ante* uncertainties about disputes before they arise, a possibility that is lost once the dispute arises and its terms are better known.[37]

Samuel Estreicher has used a very memorable metaphor to describe this essential bargain in predispute arbitration. According to Estreicher, "in a world without employment arbitration as an available option, we would essentially have a Cadillac

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[35] Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 58 (1998).

[36] They may be able to predict a likely dispute to a degree. They could base these predictions on their past experiences and the nature of the relationship between the parties.

[37] *See* Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 317 (2003).

system for the few and a rickshaw system for the many."[38] Cadillacs represent the high-level recoveries for those few individuals with high-value, meritorious claims who find representation; the rickshaws represent the majority of individuals who struggle to find counsel willing to take their lower-stakes or more questionable claim. In a world with predispute arbitration, people substitute their Cadillacs and rickshaws for Saturns. In other words, individuals as a whole achieve the greater access to justice afforded by arbitration, even if a few individuals with high-stakes claims experience a marginal reduction in recoveries.[39]

CONCLUSION

In sum, Madam Chair, thank you for the opportunity to offer these views on H.R. 3010. At bottom, it is my view that Congress should not prohibit predispute arbitration agreements in employment, consumer and franchise contracts. Rather, it should both encourage and await additional empirical research. That research may well show that minor additions to the existing regulatory repertoire are necessary. But eliminating predispute arbitration agreements would have a net negative effect on the economy, making worse off the very people whom Congress is seeking to protect.

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[38] Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 563 (2001) (internal quotations omitted) (noting that employers are willing to agree to predispute arbitration because they "are willing to create a risk of liability in many cases they could have otherwise ignored in order to decrease the risk of a ruinous punitive damages award.")

[39] *See also* Richard A. Bales, *Normative Consideration of Employment Arbitration at* Gilmer*'s Quinceanera*, 81 Tulane L. Rev. 331, 357-58 (2006).

Ms. SÁNCHEZ. I appreciate your testimony. Thank you.

I would now invite Mr. Eppenstein to present his oral testimony.

TESTIMONY OF THEODORE G. EPPENSTEIN, ESQ., EPPENSTEIN AND EPPENSTEIN, NEW YORK, NY

Mr. EPPENSTEIN. Thank you, Madam Chairwoman, and thank you, Mr. Johnson, for proposing this bill to the House.

I am going to talk to you today a little bit about securities arbitration. I have had various opportunities to view securities arbitration, first as an advocate for the investing public in the landmark securities case before the U.S. Supreme Court in 1987, *Shearson v. McMahon*.

Secondly, after that I testified in Congress twice, attempting to retroactively reverse the decision in that case, which in effect required mandatory arbitration, since it permitted the broker-dealers to require mandatory arbitration in their customer agreements.

Also, I have been a public member of the Securities Industry Conference on Arbitration, and we are a group that meets regularly involving not just the three public members, but a member from the industry, SIFMA today, and members from each of the securities regulatory organizations, the self-regulatory organizations like the NASD and the New York Stock Exchange. The SEC sits in regularly at our meetings. I have been a public member since 1998.

I can tell you through my experience from what I have observed, securities arbitration does not work for the investor. I request that you specifically include securities disputes and other investment malpractice disputes in your bill. My concern is that if it is not specifically laid out in your bill, we are going to be coming into court and finding out whether or not what is said here in the legislative process covers securities arbitration.

Now, let me tell you why I think you should do this. First of all, the Supreme Court in 1987, in a very close 5 to 4 decision, ruled that based on the SEC's position, which was presented in an amicus brief in support of the industry's view, and against the public, that pre-dispute arbitration clauses would be okay with them. This they did despite the fact that there was an SEC rule in place at the time—SEC rule 15(c)2-2, which prohibited the use by broker-dealers of arbitration clauses with regard to Federal statutory claims of fraud.

The SEC argued to the Court that they should permit mandatory arbitration, deem these contracts to be enforceable because they had oversight over the arbitration process. Well, they have oversight over the arbitration process, but it hasn't worked for the investor's protection. Let me tell you why. SRO arbitration, and that is self-regulatory organizations, and I am covering now all of the self-regulatory organizations, have arbitration panels of three people for claims over a minimal amount.

One person must come from the securities industry—must. There is no way the investor can get this person off. There are no investor advocates on the arbitration panels. Yes, there are people selected from a public pool of arbitrators. However, these people sometimes have conflicts of interest and are problematic to the investor.

Aside from that, the public pool is impure. They are very concerned about their own image and they want to work another day.

So they are not prone to come out with a large award because they think they are going to be stricken the next time their name comes up.

Let me tell you about a few other things, and I am not going to go into a description of war stories. There certainly are plenty. I am going to talk about statistics because that has been specifically challenged. In our area, it is clear—and I will lay it out to you in very summary fashion—that the investor has taken it on the chin ever since the McMahon decision came out.

The GAO did a study in 1992 taking a look at decisions that came out of arbitrations at the SROs from 1989 and 1990. They found the customer won about 60 percent of the time. They found that the customer got about 61 percent of what they claimed. After that, the Securities Arbitration Commentator, a private commentator looking at all SRO arbitration awards, took a look at the first 10,000 awards after the McMahon decision and found there was a downward trend in the results.

After that, you can see through the NASD's own statistics on how customers fare on their website the wins and the losses from 2000 to 2006. You can go there right now and you will see, back in 2002 the customer—just on a win-loss basis—was winning 53 percent of the time. I would like to correct my written statement at page 10. It had 50 percent. It was 53 percent in 2002. Every year after 2002, it went down.

Today, 2006 are the final figures that we have, it is down to a 42 percent win rate for customers. That means that 58 percent of the time, a customer goes home not only empty-handed, but they are going to have to pay their lawyers. They are going to have to pay the costs for the privilege of going to arbitration, and they have no faith in the system that the public believes is a stacked deck against them.

There has been a very recent study that has just come out, and this will be the last thing I will quote, and that is a 2007 study that came out looking at 14,000 arbitration awards from 1995 through 2004. That study is mentioned in my written materials. That study found not only the declining trend in arbitration of win rates, but they look at something called an "expected recovery rate," and that is not just the win-loss, but they took the probability of winning and they took the amount of recovery and they meshed it together, and they found that today—2004 was the last year that they covered—in 2004, the investor would get back approximately 22 percent in an arbitration.

I ask that you do three things. One, include us in your bill. Two, there is a place in some instances for arbitration, but it is not going to work at the industry-run forum, FINRA, which is where everything is now required to be held. We need an independently run arbitration system for those people who want to go to arbitration as opposed to court. If they have a $10,000 claim, they would rather go to arbitration. Give them that opportunity. Have the industry cosponsor it. Have them fund it.

The NASD paid their members each $35,000 in order to—some commentators have said—vote in favor of a consolidation of the arbitration forums and regulatory division at the NASD and the New York Stock Exchange. That equates to $175 million due to the costs

that the companies are going to save because after consolidation the arbitrations will be heard at one forum. But where is the benefit to the investor?

[The prepared statement of Mr. Eppenstein follows:]

PREPARED STATEMENT OF THEODORE G. EPPENSTEIN

Before the Subcommittee on Commercial and Administrative Law
U.S. House of Representatives Committee on the Judiciary

HEARING ON: H.R. 3010,
THE "ARBITRATION FAIRNESS ACT OF 2007"
October 25, 2007

Written Statement of Theodore G. Eppenstein, Esq.
Partner, Eppenstein and Eppenstein, New York, New York

IN SUPPORT OF PROHIBITING
MANDATORY ARBITRATION OF INVESTOR CLAIMS
IN SECURITIES ARBITRATION

Statement of Theodore G. Eppenstein In Support of Prohibiting Mandatory Arbitration of Investor Claims October 25, 2007

Written Statement of Theodore G. Eppenstein, Esq.
Partner, Eppenstein and Eppenstein, New York, New York

IN SUPPORT OF PROHIBITING MANDATORY ARBITRATION OF INVESTOR CLAIMS IN SECURITIES ARBITRATION

Before the Subcommittee on Commercial and Administrative Law
U.S. House of Representatives Committee on the Judiciary

HEARING ON: H.R. 3010,
THE "ARBITRATION FAIRNESS ACT OF 2007"
October 25, 2007

INTRODUCTION

I am honored to have been invited to participate in the Subcommittee's Hearing on H.R. 3010, the "Arbitration Fairness Act of 2007," and to recommend in connection with that Bill the prohibition of mandatory arbitration for the adjudication of securities fraud and other financial services misconduct, and to also recommend the establishment of an alternative forum independent from that industry for public investor disputes.

The Constitutional right to trial by jury for investors was rendered meaningless after the U.S. Supreme Court held, upon the urging of the SEC in the landmark arbitration case *Shearson/American Express v. McMahon* (which I argued for the customer), that predispute

arbitration clauses were enforceable [1] in the securities context. Investors have suffered for the last twenty years following the Court's narrow 5-4 decision in favor of the industry, when the brokerage industry made the arbitration clause mandatory.

A crisis exists today in self-regulatory organization (SRO) arbitration, which has replaced the American way -- trial in court by a jury of your peers. The securities industry customer contracts and their predispute arbitration clauses that require most if not all investors in the financial markets to submit to industry arbitration are not entered into at arm's length, and are almost always non-negotiable by the customer. The SRO arbitration system in which investors must file their disputes has failed to provide a fair forum for the public and tilts in favor of the brokerage firms. The Securities and Exchange Commission (SEC) has been of little help since its historic about-face in the *McMahon* case, when it submitted an amicus brief that supported the industry at the public's expense. Previously the SEC had taken a different view, upholding the rights of public investors to air their grievances in a court of law, and promulgating Rule 15c2-2[2], which prohibited mandatory predispute arbitration clauses for federal statutory claims of

securities fraud.

The dissenting Justices in the *McMahon* case maintained that predispute arbitration agreements for securities customers were unenforceable, pursuant to the statutory anti-waiver provisions, the policy of investor protection inherent in the securities laws, and the Court's own precedent, namely the seminal case of *Wilko v. Swan*, 326 U.S. 427 (1953) . The *McMahon* dissenters were seemingly astonished by the reversal of the previously long-held position of the SEC favoring non-arbitrability, and predicted that Congress was the last resort for the investing public to restore access to the courts. *McMahon*, 220 U.S. at 266-67. Now there is renewed hope with H.R. 3010 that Congress will return to investors the Seventh Amendment right to have all investment claims heard by a judge and jury and to prohibit mandatory arbitration.

THE CRISIS IN MANDATORY SECURITIES ARBITRATION

For sure, arbitration has served the securities industry well these past 20 years, where public scrutiny of all kinds of brokerage evils are hidden behind arbitration's closed doors and the firms' pocketbooks are sheltered from a jury's wrath. But the abrogation of basic fairness in

favor of the "black hole" into which most investor gripes fall should be evident even to the short sighted regulators. At the top of the list is the perception, and for many veterans of SRO arbitration the harsh reality, that there is a stacked deck against the public. That's because investor complaints in the SRO arbitration system, which is unlike any other, are typically decided by three individuals, one of whom must be reared, and usually is embedded, in the very industry on trial. That panelist is called a "non-public" or "securities industry arbitrator" by the forum. Yet there is no designated "investor arbitrator" to counterbalance the industry's representative on the panel, merely a pool of so-called "public" arbitrators who supposedly have no significant ties or sympathies with the industry. But the customer often faces panelists who are mis-classified and connected to the industry, administratively appointed by the SROs without any peremptory challenge available to the investor, trained to look for mitigating circumstances that will spare the brokerages big hits, and often financially reliant on being selected to adjudicate future cases. Because all arbitrators are aware that their final rulings are made public, this can cause concern even to the fairminded that issuing large awards to customers can put that

arbitrator on the industry's blacklist and on the sidelines for future assignments.

Securities arbitration has not been the fair, fast and economical path to recovery it was reputed to be. Higher fees, lack of disclosure of potential conflicts of interest by potential arbitrators, more "preliminary" hearings, endless motion practice, voluminous document demands, lengthy interrogatories, arbitrary evidentiary rulings by arbitrators precluding evidence of industry wrongdoing, and almost every type of delay imaginable just to get to the start of the trial can easily frustrate, overwhelm and exhaust the ordinary investor. And then, if the customer survives the blame the victim tactic that forms the bedrock of the defense, in a few years from filing there will be a decision, but with a limited ability for the parties to appeal it if the arbitrators got it wrong, or didn't compensate the victimized investor adequately.

Unfortunately for the investing public, the Supreme Court did not have at its disposal in 1987 the arsenal of statistics and studies which we now know demonstrate conclusively that customers fare poorly in SRO arbitration. Indeed, as shown in the materials supplied with this written statement, customers' chances of even winning anything in an SRO arbitration, much less

recovering a substantial portion of their losses, have declined precipitously since *McMahon* was decided. It's gotten so bad that not only do customers in SRO arbitration lose everything 58% of the time (in 2006, according to the NASD), but when they do win some recovery it's only a small fraction of their losses, and can be less than the expenses paid to the forum to hear their case.[3] Thus, in the intervening twenty years[4] since *McMahon*, when substantially all individual customer cases have been heard in arbitration, industry claims of the advantages of the system[5] is belied by the overwhelming evidence of the unfairness of mandatory arbitration, where even the SEC has long conceded that enforcement of the securities laws in SRO arbitration cannot be insured by its oversight.

Further complicating matters for investors is that until 2007 there were several SRO arbitration forums to choose from, with modest differences in the arbitration rules providing some competition and choice, even though they all were run by the industry. These SRO forums, through a steady process over the years of consolidation or attrition, have been reduced to only one: FINRA (the Financial Industry Regulatory Authority, created by the combination of the

regulatory and arbitration functions at the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD)). Now that there's no competition, the concern of customers is that they may be worse off than ever before.

STUDIES DEMONSTRATE MANDATORY
SRO SECURITIES ARBITRATION IS A FLAWED SYSTEM

But you don't need a PhD to understand what investors have been fuming about most: it's the poor results inappropriately labeled "awards" by the SROs. The analyses of these panel "awards" done by the U.S. Government Accountability Office (GAO) and others over the past 20 years graphically illustrate the exponential increase in detrimental outcomes for the public. These studies refer to customer "win rates" and the percentage of claimed amounts awarded, but count investors to be "winners" even if they don't get back enough to cover their costs to arbitrate.

The first GAO analysis in 1992 demonstrated that shortly after the McMahon case (1989-1990) investors received a favorable decision almost 60% of the time for cases arbitrated at the NASD and NYSE – and the winners recovered about 61% of their losses at the SROs. A

leading independent arbitration commentator (SAC) in 1996 issued its 1989-1995 survey of 10,000 SRO "awards" and found a "steady downward trend" in the "win rate" for cases in which customers prevailed.[6] This was followed by another GAO report at the request of the House of Representatives in 2000, which surveyed the awards from 1992-1998 and confirmed the downward curve of favorable SRO awards issued to investors in the 1992-1996 period, to an average of only about 51% for those years (although this "win rate" was on the up tick in 1997-1998).[7] Significantly, the government analysis also showed that the percentage of the amount awarded compared to the amount claimed had also slipped big time from the level of its earlier study – down from 61% in 1989-90 to 51% for the 1992-1998 period.

SAC published in February 2007 another survey of SRO arbitration results for the years 2000-2005 indicating the SRO "win rate" of all customer cases in 2000-2001 was 52-53%, where the customer won at least something.[8] But then the public's "win rate" fell further in successive years at the NASD, the largest SRO forum (2002 53%; 2003 49%; 2004 47%; 2005 43%). When the NASD published its results of "win rates" in customer cases decided in 2006, to the surprise

of absolutely no one who follows SRO arbitration, the grim results indicated the chance of investors winning at least $1 in arbitration at the NASD hit an all time low – a dismal 42%.[9] (The NYSE "win rate" was reportedly even lower!) And these diminishing "win rates" mean that at the NASD 58% of the time last year the brokerages, who often hire big gun outside law firms to doggedly protect their interests, shot down most public investors, sending John Q. Public home with a zero recovery for investment losses.

Looking back throughout the past two decades of SRO arbitration results invites comparison of the GAO's 60 percent win rate in 1989-90 to the NASD's paltry 42 percent in 2006, a decline that translates to about a 30 percent reduction in investor win rates over twenty years. The NASD's statistics also show a decline of around 20% in investors' chances from 2002 to 2006 levels.

The publication in June 2007 of the O'Neal/Solin Analysis (see endnote 3), based on almost 14,000 arbitration results from 1995 through 2004 (which overlaps the latest GAO and SAC surveys, and NASD statistics), should silence any doubters that SRO arbitration is a failed

system. The O'Neal/Solin study, using what the authors deem a "better measure for assessing the arbitration process" (of predicting outcomes for customers called the "Expected Recovery Percentage" which factors in the "win rates" with "award percentages"), found that the Expected Recovery Percentage for an investor during this 10 year period was at the high in 1998 of 38 cents to the dollar, and dropped to a low in 2004 (the last year analyzed) of 22 pennies on the dollar! And this decline does not take into account the customer's "share" of paying costs, expenses and fees.

It is almost twenty years since my last appearance and testimony at a different House Judiciary Committee hearing in December 1987, before the Subcommittee on Criminal Justice, in connection with efforts in Congress then to preserve a federal court option for the adjudication of RICO statute claims predicated on securities fraud.[10] That effort and others followed in the wake of the *McMahon* decision. In March 1988 I testified before the House Committee on Energy and Commerce, Subcommittee on Telecommunications and Finance[11] which was exploring securities law reform to restore to public customers the choice of federal court

adjudication of securities fraud claims instead of mandatory arbitration, and assisted the subcommittee in drafting such remedial legislation in order to retroactively reverse the *McMahon* decision, to restore to investors the right to a jury trial and to require certain SRO arbitration reforms.[12] Soon after *McMahon*, even the SEC recommended that investors be given contractual access to alternative arbitration forums outside of the industry.[13]

Yet sadly, the alternative forum never materialized, and nothing meaningful has changed since then except that SRO arbitration has become a trap for investors. Investors are still compelled to use an arbitration forum run by the industry's self-regulator under industry approved rules, where one member of every three-member arbitration panel is required to be from the industry itself, enforcing the perception (and in some cases the harsh reality) held by the public that the system is a stacked deck.

ALL THE PUBLIC MEMBERS OF SICA SUPPORT PROHIBITION OF MANDATORY SECURITIES ARBITRATION AND ESTABLISHMENT OF A NEW, INDEPENDENT SYSTEM OUTSIDE THE INDUSTRY

The Securities Industry Conference on Arbitration (SICA) was established in 1977 with the support of the SEC to create a Uniform Arbitration Code to harmonize the rules of the

various SRO arbitration forums then in existence. Since 1977, SICA has met on a regular basis to discuss SRO arbitration and to review and revise the Uniform Code. Besides three public members, all the SROs also have had voting membership in SICA along with the SIA (Securities Industry Association, now SIFMA), and the SEC has regularly attended quarterly meetings. SICA also drafted and revised the Arbitrator's Manual that was in use at the NASD and NYSE.

In January 2007, fully thirty years after the founding of SICA, all three Public Members[14] of SICA and all three Public Members Emeritus recognized that the crisis in the system required returning the court option to investors and creating a forum for securities arbitration totally independent from the industry to insure that the integrity of the process and the rights of customers were being fully protected. The Public and Emeritus Members of SICA signed a comprehensive letter[15] to the SEC in support of this initiative, with copies to NASAA (the North American Securities Administrators of America), and to members of the U.S. Congress, including the House Committee on the Judiciary Chairman. This effort was supported by NASAA, the umbrella organization of state securities administrators, in a letter from the

chairman of its Arbitration Project Group that advocated the elimination of the requirement for an industry arbitrator and barring public arbitrators with significant ties to the industry.[16]

CONCLUSION

The history of securities arbitration and the way in which customer disputes are litigated there makes abundantly clear why the system has become hopelessly flawed and harmful to the public. Further, the conceded inability of the SEC to insure that the federal securities laws are properly enforced in SRO arbitration decisions makes it all the more imperative that mandatory arbitration be eliminated and that other alternatives to the current process be made available to customers. Following are three practical recommendations for reform of the current process:

- Prohibit mandatory SRO arbitration and give investors the right to go to court;
- Mandate creation of a new arbitration system for those customers who, for various reasons, would prefer a faster and less costly resolution process by creating a new forum outside of the securities industry, but with SEC oversight, under a new set of rules that removes the requirement of an industry arbitrator; that prohibits motions to dismiss

entirely; that appoints arbitrators early on to oversee discovery issues; and where the parties agree on three neutrals without the appointment of an arbitrator experienced in the industry unless the parties agree. This forum should be funded and maintained by contributions from the industry to reduce costs to the investor.

- Until such a new independent forum is established, require FINRA to revise its rules and remove the industry arbitrator requirement at FINRA; cleanse the public pool of arbitrators to eliminate everyone who has ties to the industry; prohibit all motions to dismiss prior to the end of the case; and prohibit abusive discovery stonewalling by the industry, among other negative features of the current SRO arbitration process.

We ask that Congress fulfill the wishes of public investors and the hope of the late Justice Harry Blackmun – that Congress will give investors the relief that the highest Court denied them twenty years ago.

ENDNOTES

[1] 482 U.S. 220 (1987). Not long after, 1933 Act cases were also made subject to mandatory arbitration in *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989).

[2] Securities and Exchange Commission Rule 15c2-2, 17 C.F.R. Section 240.15c2-2(a). The rule provided in pertinent part: "It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer." Cited in *McMahon,* 482 U.S. at 264, n. 24.

[3] G. Morgenson, "When Winning Feels a Lot Like Losing," The New York Times, Business Section, December 10, 2006, p. 1. *See also* J. O'Neal and D. Solin, "Mandatory Arbitration of Securities Disputes, A Statistical Analysis of How Claimant's Fare" (2007) (the "O'Neal/Solin Analysis").

[4] On the tenth anniversary of the *McMahon* decision in 1997, The New York Times ran an Op Ed article critical of the SRO system and noting the same SRO arbitration problems that the public faces today. Theodore and Madelaine Eppenstein, "An Arbitration Albatross," The New York Times, June 8, 1997, Business Section 3 at p.12 (Exhibit Attached).

[5] *See* J. Pessin, "Out of Court Fight - Two Decades after Mandatory Arbitration Took Effect in Investor's Disputes, Debate over It Gains Momentum," Wall Street Journal (August 6, 2007), for a statement of the issues at stake in mandatory arbitration and the problems with the current system, giving the industry perspective in contrast to the investor's point of view. (Exhibit Attached).

[6] General Accounting [Government Accountability] Office, GAO/GGD-92-74, *"Securities Arbitration-How Investors Fare,"* at 35 (May 11, 1992). *See also* Sec. Arb. Commentator, *Public Customer Award Survey-The First 10,000 Awards* (May 1996))("A steady downward trend in the 'customer win' rate is revealed. . . . "), commenting on Awards in the 1989-1995 time period.

[7] GAO/GGD-00-115, "*Securities Arbitration: Actions Needed to Address the Problem of Unpaid Awards"* (June 15, 2000).

[8] Sec. Arb. Commentator, *Year(s) in Review II, A SAC Award Survey Comparing Results in 2005 to 2000-2004*, at 3 (February 2007) ("On the customer side Chart I discloses a downward trend that has been evident for some time in SAC's surveys and in the Award statistics that NASD publishes – a big decline in the "win" rate. We already know that this trend continues into 2006 Awards (likely, beyond the impact of Market 2000) and that it affects both Customer-Member

and Small Claims Awards.").

[9] *See* NASD Dispute Resolution Statistics-Results of Customer Complaint Arbitration Award Cases at p. 4 (Exhibit Attached).

[10] Written Testimony of Theodore G. Eppenstein, "Civil RICO Reform: Federal Court Adjudication of Broker-Dealer/Investor Fraud Claims," December 3, 1987.

[11] Written Testimony of Theodore G. Eppenstein, "Securities Law Reform: Restoring the Public Customer's Freedom of Choice of Federal Court Adjudication for Investor/Broker-Dealer Fraud Claims," March 31, 1988 (Exhibit Attached) for a full review of the Congressional, legal and regulatory history leading up to *McMahon*, and the arguments made then to restore investors' rights to choose court and a jury.

[12] H.R. 4960, otherwise known as the "Securities Arbitration Reform Act of 1988" (A Bill to amend the Securities Exchange Act of 1934 to provide for the fair, equitable and voluntary arbitration of customer-broker disputes, and for other purposes.).

[13] Letter of Richard G. Ketchum, Director, Division of Market Regulation, September 10, 1987 at p. 11.

[14] Theodore G. Eppenstein has been a Public Member since 1998.

[15] Letter of The Public Members of SICA to Hon. Christopher Cox, et. al, "The Public's Concerns about the Newly Combined NASD/NYSE Arbitration Forum and SICA's Mandate," (January 12, 2007) (Exhibit Attached).

[16] Letter of Bryan J. Lantagne to Hon. Christopher Cox, et. al, "Public Member[s] of SICA Regarding the Combined NASD/NYSE" (February 12, 2007) (Exhibit Attached).

ATTACHMENTS

Biographical Information for Theodore G. Eppenstein, Esq.

Theodore and Madelaine Eppenstein, "An Arbitration Albatross," The New York Times, June 8, 1997, Business Section 3 at p.12

J. Pessin, "Out of Court Fight - Two Decades after Mandatory Arbitration Took Effect in Investor's Disputes, Debate over It Gains Momentum," Wall Street Journal (August 6, 2007)

NASD Dispute Resolution Statistics-Results of Customer Complaint Arbitration Award Cases at p. 4

Written Testimony of Theodore G. Eppenstein, "Securities Law Reform: Restoring the Public Customer's Freedom of Choice of Federal Court Adjudication for Investor/Broker-Dealer Fraud Claims," March 31, 1988

Letter of The Public Members of SICA to Hon. Christopher Cox, et. al, "The Public's Concerns about the Newly Combined NASD/NYSE Arbitration Forum and SICA's Mandate," (January 12, 2007)

Letter of Bryan J. Lantagne to Hon. Christopher Cox, et. al, "Public Member[s] of SICA Regarding the Combined NASD/NYSE" (February 12, 2007)

Biographical Information for Theodore G. Eppenstein, Esq.

Theodore G. Eppenstein founded the law firm Eppenstein & Eppenstein which has an international practice representing investors and is widely known for their work in advocating the rights of the public for over two decades.

Mr. Eppenstein argued before the highest federal and state appellate courts including on behalf of investors before the U.S. Supreme Court in 1987 in *Shearson v. McMahon*, a landmark case which has been analyzed extensively and to this day continues to draw transnational attention. In the wake of *McMahon*, Mr. Eppenstein was asked to testify before two U.S. Congressional subcommittees.

The U.S. House of Representatives Subcommittee on Telecommunications and Finance invited Mr. Eppenstein to appear before it in 1988 and present his opinion of compulsory arbitration and arbitration reform. After testifying, along with his partner Madelaine Eppenstein Mr. Eppenstein assisted the Subcommittee in drafting remedial legislation (H.R. 4960). Mr. and Ms. Eppenstein were also asked to testify before the U.S. House of Representatives Subcommittee on Criminal Justice to present their opinions on civil RICO reform.

In 1998 Mr. Eppenstein was appointed to be one of three public members of the Securities Industry Conference on Arbitration ("SICA"), a think tank on arbitration including SRO and industry representatives, which meets regularly to discuss arbitration issues, drafted and revises the Uniform Code of Arbitration and the Arbitrator's Manual, and whose meetings are attended by representatives of the SEC. Mr. Eppenstein was reappointed to a second term in 2002.

The New York Stock Exchange (NYSE) invited Mr. Eppenstein in 1994 to express his views at the NYSE Symposium on Arbitration in the Securities Industry, where he appeared as a speaker and as a participant. The NASD's Arbitration Policy Task Force requested that Mr. Eppenstein present his opinion as a representative of investors at two sessions held in 1995. The NYSE and the Moscow Interbank Currency Exchange invited Mr. Eppenstein to participate in a two day symposium about arbitration in the United States held in Moscow in April 2000. In March 2003, the NYSE and the Cairo-Alexandria Stock Exchanges sponsored a two day symposium in Cairo covering arbitration topics at which Mr. Eppenstein was a principal speaker. From time to time, Mr. Eppenstein's opinions have been solicited by the General Counsel's office of the SEC and by the Directors of Arbitration at the NYSE and NASD, and several of his arbitration recommendations have been adopted by SICA and those self-regulatory organizations.

Mr. Eppenstein has argued on behalf of the investing public for over two decades. He also successfully litigated the "Amex Window" procedural mechanism for providing investors access to the American Arbitration Association (AAA) through the New York State appellate courts; his unanimous victory in *Cowen & Co. v. Anderson* in the New York Court of Appeals in

1990 established the law in New York State giving hundreds of thousands of investors the right to arbitrate at the independent AAA and not just within the confines of self-regulatory securities industry organizations. Mr. Eppenstein was also a member of the AAA's Securities Arbitration Rules Task Force, and a member of the AAA's Securities Advisory Committee. The Firm has also counseled attorneys transnationally on litigation, arbitration and mediation of investment fraud matters. The firm has prosecuted investment fraud claims for clients from coast to coast in the U.S. and for clients from England, France, Germany Spain, Belgium, Switzerland, Indonesia, Hong Kong, Ivory Coast, and the Middle East. The Wall Street Journal reported that the firm won the largest arbitration award ever for customers in 2001.

Mr. Eppenstein, along with Ms. Eppenstein, has co-authored many articles on securities arbitration and litigation, and they have both been on the faculty of professional seminars and conferences.

Mr. and Ms. Eppenstein's views have been quoted by many major national and international press. For example, The New York Times requested an opinion piece in 1997 about securities arbitration since the *McMahon* decision and published an article written by the Eppensteins. (The Times chose the title, "An Arbitration Albatross.") The New York Times (Front Page Sunday Business Section), The Wall Street Journal, The Washington Post, Barron's, Newsweek, Business Week, Smart Money, Forbes, Money Magazine, Investment Dealer's Digest, Investor's Daily, Bloomberg, The Chicago Tribune and The Los Angeles Times are among the publications that have interviewed Mr. Eppenstein on securities and commodities arbitration issues. Worth Magazine ran a profile of Madelaine and Theodore Eppenstein entitled "Two for the High Road, to the Eppensteins, Shareholders' Rights Are Sacred." Mr. Eppenstein also appeared on the cover of Investment Dealers' Digest and was prominently featured in the cover story "Taking Brokers to Court." The Wall Street Journal published a piece in August 2007 entitled "Out of Court Fight" which covered current arbitration issues featuring an e-mail exchange between Mr. Eppenstein and an attorney giving the opposing view.

Media coverage of Mr. Eppenstein and the firm Eppenstein and Eppenstein has also included numerous television shows such as the NBC Today Show on two occasions, CBS Business News, NBC Business News, ABC, PBS Wall Street Week, Court TV, CNN, CNBC, Financial News Network, Law Line and other cable shows.

A graduate of the State University of New York at Stony Brook (B.A. 1968) and St. John's Law School (J.D. 1973), Theodore G. Eppenstein was a recipient of Stony Brook's Distinguished Alumnus Award in 1991 for his work on behalf of the public investor. While attending Stony Brook, Mr. Eppenstein held 14 school basketball records, including most points in a game and in a career, and was inducted into the University's Athletic Hall of Fame in 1994. Mr. Eppenstein served as a member of the President's Intercollegiate Athletic Advisory Committee. In conjunction with Stony Brook's 40th Anniversary, Mr. Eppenstein was profiled as one of the University's finest 40 graduates in 1998 and served on the Board of Directors of the

Stony Brook Seawolves, which advised the Athletic Department. Mr. Eppenstein currently serves as a member of Stony Brook University's Business School MBA Advisory Board.

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VIEWPOINT

MADELAINE and THEODORE G. EPPENSTEIN

An Arbitration Albatross

Elliot Banfield

WHAT do you tell someone who says he lost his life savings to an unscrupulous stockbroker and now wants to sue in court and get a jury trial? There may be more than 10 million stock brokerage accounts out there, but the answer is, "Sorry, you can't go that route."

Ten years ago today, the Supreme Court, with the blessing of the Securities and Exchange Commission, locked the courthouse doors to such investors by granting the brokerage industry's wish that customer claims be limited to arbitrations conducted by industry tribunals.

In this landmark case, Shearson/American Express v. McMahon, the Justices in the narrow 5-to-4 majority found that the "bargained for" customer contract calling for mandatory arbitration of securities fraud disputes was enforceable. The decision proclaimed that the long-perceived mistrust of arbitration was, by 1987, a myth and that investors could get a fair deal in arbitration. In his dissent, Justice Harry A. Blackmun said the decision was "animated" by a desire to pare down the Federal court docket. And he asserted that investors should not lose their day in court at the whim of the industry and predicted that more litigation would ensue. This analysis has proved prophetic.

In the years that followed, the S.E.C., investor advocates, the Securities Industry Conference on Arbitration and the industry itself have been involved in a continuing effort to reform the process. There were some early and positive changes in the rules governing arbitration proceedings at the tribunals of the major self-regulatory organizations, the National Association of Securities Dealers and the New York Stock Exchange. For instance, all important information and documentation exchanges were once permitted to languish until the first day of a hearing; now the exchange of evidentiary material is slugged out by the lawyers before the arbitrator-referees well ahead of the hearings on the merits.

But substantive improvement has been slow, and a perception remains that arbitration is a stacked deck. Skepticism persists largely because the rules require a person affiliated with the industry to sit as an arbitrator on every three-member panel.

The industry asserts that it is better for the customer to have an individual knowledgeable about the workings of the market sitting in judgment of fraud claims. But the public suspects that an industry arbitrator will have difficulty determining impartially whether another firm engaged in fraudulent activity like unauthorized trading, unsuitable investing or churning. And will that industry arbitrator have the courage to render a multimillion-dollar award, including punitive damages, against another member of the Wall Street club? An industry arbiter who does that risks being blackballed by the industry in his career and in future cases.

But there is no need for the purported expertise of the industry "Solomon" on these panels because most disputes turn on the credibility of witnesses, not on technical trading issues. And our judicial system has generally functioned well over the centuries by leaving it up to lay jurors to understand even the most complex disputes.

The industry, which forced arbitration on investors — and which could stop forcing it anytime by removing the mandatory arbitration clauses from customer contracts — has tried in recent years to frustrate arbitration by going to the very courts it seeks to prevent its customers from using.

The most pernicious tactic has been to initiate litigation requesting state court judges in New York to dispose of customer claims before they reach arbitration, often regardless of the residence of the investor. Lawsuits by the hundreds were filed and temporary restraining orders were obtained stopping arbitration in its tracks while New York judges were asked to decide defense issues of statutes of limitations, redundant "eligibility" rules in arbitration and whether investors could proceed to argue for punitive damages. This wasteful and delaying tactic has continued, although it appears from recent decisions that New York's judges are tiring of it.

One legacy of Shearson v. McMahon is that arbitration for public investors has become more like court litigation, but without the safeguards built into the judicial system. As a result, the broker-dealers have devised strategies to frustrate the proceedings.

As early reform was to liberalize the discovery phase before the hearings. The industry has seized upon this as an opportunity to harass claimants and prolong the proceedings. Document requests are now a lengthy list that the broker-dealer churns out of its word processor. The most personal information is demanded, along with data about every investment the claimant ever made.

OFTEN, brokers also string out the discovery process when it comes to providing documents requested by investors. Despite repeated pre-hearing conferences, there are many cases in which the most important documents are not produced until the end of the process, and sometimes not even until the trial begins.

We are sure that one of our adversaries maintains an antique photocopier solely for use in providing illegible copies in response to customer requests. In one case, we fought for the right to see the original as well as the photocopy we had been furnished. When we finally got to look at it, it turned out to be the smoking gun. On the original, it could be seen that the word "not" had been erased at a crucial point. The erasure had not been apparent on the copy. The brokerage firm's settlement offer was ultimately doubled.

There are now two controversial proposals that the N.A.S.D. may send up for S.E.C. approval: a cap on punitive damage awards, and an opportunity for the industry, in claims based on activity more than six years old, to choose unilaterally to kick the claimant out of arbitration.

The punitive damage cap (the lesser of $750,000 or two times the compensatory loss), is perhaps the most disturbing of these proposals, especially when the most recent court decisions allow unrestricted punitive damages. Apparently, it is not enough to force customers to arbitrate rather than go to court. The N.A.S.D. also thinks that the industry should be able to impose what it views as a fair limit on what the arbitrators can award.

This is not the "justice" that the Supreme Court, in 1987, envisioned as a fair, fast, cost-effective alternative method of resolving disputes. Ideally, Congress should recognize that and undo the McMahon decision.

But if forced arbitration is to continue, changes are needed. There should be no six-year eligibility limit because brokers are fully protected by applicable statutes of limitations. The right to punitive damages should be made crystal clear, and arbitrary limits on them not allowed. The pool of arbitrators should include more of a cross-section of the investor's community, and the industry arbitrator should be removed unless the investor requests otherwise. And abuses to the discovery process should not be countenanced.

Given the power of the securities industry to fashion its own rules, and the inability of investors to have a real say in the administration of arbitration justice, there will no doubt be further erosion of public confidence in the system if the system is not improved. □

Madelaine and Theodore G. Eppenstein are the founding partners of the New York law firm of Eppenstein & Eppenstein; they represented the investors in Shearson/American Express v. McMahon and have testified before Congress on investor rights.

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Investing in Funds: A Monthly Analysis

***Out-of-Court Fight:** Two decades after mandatory arbitration took effect for investors' disputes, debate over it gains renewed momentum*

By James Levy Perry

The debate hasn't lost heat in two decades.

Twenty years ago, the Supreme Court ruled that securities brokerage firms could require their customers to take disputes to arbitration. Now, the critics of that ruling are at it again: Following a stream of statements and letters from legislators, lawyers and consumer groups urging the Securities and Exchange Commission and Congress to ban mandatory arbitration, Sen. Russell Feingold (D., Wis.) and Rep. Hank Johnson (D., Ga.) introduced legislation in mid-July that would make pre-dispute mandatory-arbitration agreements unenforceable.

Matt Farley

Motivating some critics is the consolidation of the industry's two primary arbitration forums, the National Association of Securities Dealers, with NYSE Regulation, a unit of NYSE Euronext. The merger, finalized last week, "raises the stakes for getting [arbitration] right" with a forum that is "independent and fair to investors," the head of the North American Securities Administrators Association testified before a Senate subcommittee in May.

Have any of the debating points changed? Will the latest push from arbitration's critics lead to an overhaul of the current arrangement?

The Wall Street Journal invited two lawyers to discuss the issue: Ted Eppenstein, who represented investors in the 1987 Shearson/American Express v. McMahon case and is currently a member of the Securities Industry Conference on Arbitration; and Matt Farley, a partner with the law firm Drinker Biddle & Reath, who defends brokerage firms in arbitration and litigation and is a member of the Securities Industry and Financial Markets Association Compliance and Legal Division. Here are excerpts from the email discussion:

The Wall Street Journal: Why has this topic heated up again?

Mr. Farley: Could it possibly be that, with the market not only fully recovered but seeming to hold steady these past few years, most if not all of the meritorious cases have already proceeded through the pipeline to an award? It isn't the "investors" who are seeking return to the pre-1987 option of going to court. It is the attorneys who don't have enough good cases to bring who are seeking new opportunities to "lock and load" with meritless claims that they know experienced arbitrators will likely dismiss.

Mr. Eppenstein: While the dark side is always quick to "blame the victim" or chastise their lawyers, here all the public wants is the right to choose the forum in which to fight financial fraud. The right of investors to a jury trial proceeding in a court of law was judicially usurped in the 5-4 McMahon decision. It's time for a sea change, to give back to public investors the American way: the choice to go to court if they desire.

WSJ: Why is Wall Street so adamant about mandatory arbitration? Even though arbitration takes longer than it has in the past, it is still faster and cheaper than taking a case through the legal system, suggesting that most investors would choose the arbitration route if they had a choice, right?

Mr. Farley: It is not a question of one or the other. Prior to McMahon, a case could – and many cases did – find themselves in both forums: the federal claim in a district court, all the other claims in arbitration.

A $25,000 case that would be "small claims" in most states [went] forward in a federal action, opening the door to every discovery mechanism afforded by [federal rules]. And a parallel arbitration was happening right alongside it, covering essentially the same facts and events. The situation was, logistically and economically, a nightmare. Securities firms rightly and naturally sought relief from the often recklessly wielded bludgeon of wide-ranging and all but limitless discovery.

Ted Eppenstein

Mr. Eppenstein: The [benefits of courts] over arbitration are discovery procedures which are monitored by the court, defined rules of evidence, legal precedents that are required to be followed, and most important, an impartial judge and a jury. There is the right to full appellate review. Court is an open forum, another plus for the public.

Because individual investors have not been permitted to bring their claims of securities fraud, unauthorized trading, unsuitable investments, churning [frequent trading to generate commissions], common-law claims, and the like into the courtroom, the public is also denied the ability to have the media fully and fairly report on the abuses on Wall Street that continue to befall the unwary investor. These get played out instead in a semi-secret arbitration proceeding.

Mr. Farley: Arbitration is cheaper, and faster. And more likely to have a measure of predictability than, say, a jury trial. And for those very reasons,

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like transactions in automobiles, credit cards, home improvements, garment production, construction of virtually all types, software disputes, and major-league athletics, the industry participants have generally opted for arbitration for the resolution of disputes.

Mr. Eppenstein: Matt, I agree with you that arbitration [run by self-regulatory organizations] is more likely to have a measure of predictability for the industry than a jury trial. That's because the [current] arbitration system can be viewed as a stacked deck against the investor. Thus, it is no surprise that arbitration would be cheaper, faster and a better way for the financial industry to trim its defense costs. Fast resolution at a cheap rate is what the industry seeks; the investor wants justice, even if it takes a little longer to achieve in court.

Even the NASD, the major provider of arbitration for customers in 2006, reports that its "win-loss" percentage of 42% is [lower than it has been since at least 2000].

WSJ: What role has the consolidation of regulatory functions of the NASD and NYSE Regulation, to form the Financial Industry Regulatory Authority, played in the renewed push for investors to have the option of going to court?

Mr. Farley: I see no connection between the merged arbitration facilities and whether the customer should have an ability to opt for a court proceeding. In recent years, [the NASD] has processed the vast majority of filed cases and aggressively served the investor community by making venues more local and convenient throughout the country. The attorneys who regularly represent customers have shown no lack of energy and imagination when it comes to urging and getting procedural rule changes that ease the prosecution of customer claims.

Mr. Eppenstein: When Wal-Mart and Costco are both in town, the consumer can decide where to shop for a better deal. The consolidation of the [NASD and NYSE] securities-arbitration forums effectively takes the last vestige of choice away from the public.

There are significant differences in arbitration at the NASD and the NYSE forums, such as the arbitrator selection process, different procedures to administer cases and different locations for the hearings.

I fully understand, Matt, that you don't perceive any difference. After all, the arbitrator pools are similar, and the win rates for investors are low at both [forums]. However, earlier this year all three current public members of the Securities Industry Conference on Arbitration and all public emeritus members joined together to complain to the SEC that consolidation would not be in the investor's best interest.

WSJ: Would it make sense for investors to have more choice in arbitration forums – like opening it up to the American Arbitration Association or Judicial Arbitration and Mediation Services?

Mr. Farley: Their fees are significantly higher than NASD/NYSE because they lack the subsidy that securities-industry member firms [pay as part of their regulatory fees]. In a pilot case some years back, several of the larger firms opened up their arbitration clauses to AAA, but there were few takers.

Mr. Eppenstein: The mini program you refer to was doomed from the start. Only a handful of [large brokerages] signed on for a few months, and then it was with certain conditions. What we need is an independent forum, funded by the industry, but independently run and operated with SEC oversight.

WSJ: Do you expect the SEC or Congress to make a change on this issue?

Mr. Farley: With the market up the past several years, the number of open arbitration cases has plummeted. While the trial bar always has its agenda, I don't see any broad constituency for legislation to alter the current situation or any obvious "injustice" crying out for relief. There is no empirical evidence at all that investors systematically fare worse in arbitration than they would in court with the same case. So I would say legislative or regulatory action is unlikely.

Mr. Eppenstein: Anyone with a sense of history can look at the declining, dismal results that [NASD and NYSE] arbitration has yielded to the investor over the past 20 years to see that the system is not a level playing field. NASD stats show the investor "win rate" has steadily declined. And when the customer does win something, the award is often only a small portion of the loss.

This information is well known to the SEC, but will they act? As predicted by [Supreme Court] Justice Harry Blackmun in the McMahon dissent, arbitration reform may ride on the seriousness of purpose of our elected members of Congress to right the wrong inflicted on the investing public 20 years ago. Congress must not only step up to the plate by writing letters and holding hearings -- it has to hit the ball over the fence and pass legislation to reverse the injustice. I think it will.

Mr. Farley: The decline in average recovery stats is misleading. The recovery rate has been fairly uniform until just the past few years, which included two new phenomena: claims involving self-directed Internet trading and alleged reliance on "tainted" research [by Wall Street analysts seeking to please their firms' investing-banking clients].

Whether in court or in arbitration, these are always tough sells and there is no study or any reasoned basis to argue that these cases would have done better in court. In fact, many of the so-called analyst cases [that were filed in court seeking class-action status] were summarily dismissed upon motion. [The fact that class members might have had individual accounts subject to an arbitration agreement doesn't preclude a class-action suit from going forward if the premise of the claim is viable.]

Mr. Eppenstein: However you want to argue it, the statistics are the knockout punch. Take your argument that there is no empirical study to show that investors would do better in court. Of course this is true, since there can be no case litigated both before a jury and then re- litigated before a securities arbitration panel. There will be no study done, but this is really just a red herring.

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How Arbitration Cases Close

Cases Decided by Arbitrators	2003	% of Cases	2004	% of Cases	2005	% of Cases	2006	% of Cases	Apr-2007	% of Cases
After Hearing	1,764	24%	1,915	21%	1,767	20%	1.265	18%	343	18%
After Review of Documents	313	4%	508	6%	355	4%	192	3%	42	2%
Total	2,077	29%	2,423	27%	2,122	24%	1,457	21%	385	21%
Cases Resolved by Other Means	2003	% of Cases	2004	% of Cases	2005	% of Cases	2006	% of Cases	Apr-2007	% of Cases
Direct Settlement by Parties	2,616	35%	3,700	41%	3,940	44%	3,503	50%	1,048	56%
Settled Via Mediation	1,182	16%	1,201	13%	910	10%	730	10%	148	8%
Withdrawn	647	9%	677	7%	806	9%	643	9%	150	8%
All Others*	679	9%	1,073	12%	1,127	13%	738	10%	130	7%
Total	5,124	71%	6,651	73%	6,783	76%	5,614	79%	1,476	79%

*All Other reasons for closed includes cases closed by: Stipulated Award, Bankruptcy of critical party; Uncured Deficient Claim; Forum Denied; Stayed by Court Action, etc. Note cases counted as closed in this report do not include those cases that closed and were then reopened.

Results of Customer Claimant Arbitration Award Cases

Year Decided	All Customer Claimant Cases Decided (Hearings & Paper)	All Customer Claimant Cases Where Customer Awarded Damages	*Percentage of Customer Award Cases
2000	1,196	635	53%
2001	1,172	637	54%
2002	1,330	702	53%
2003	1,513	742	49%
2004	1,894	888	47%
2005	1,610	687	43%
2006	1,011	425	42%

* Percentage of customer claimant award cases has been recalculated to reflect only instances in which investors as claimants recovered monetary damages or non-monetary relief.

Arbitrators by Type

This report lists all available arbitrators by Non-Public and Public Type.

Arbitrator Type **Total**

SECURITIES LAW REFORM: RESTORING THE PUBLIC CUSTOMERS' FREEDOM OF CHOICE OF FEDERAL COURT ADJUDICATION FOR INVESTOR/BROKER-DEALER FRAUD CLAIMS

Testimony of
Theodore G. Eppenstein, Esq.
Eppenstein & Eppenstein
Attorneys of Record for Investor Respondents in
Shearson/American Express v. McMahon

Before the
Subcommittee on Telecommunications and Finance
Committee on Energy and Commerce
U.S. House of Representatives

Wednesday, March 31 , 1988

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Before the
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Committee on Energy and Commerce
U.S. House of Representatives
Wednesday, March 16, 1988

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INTRODUCTION AND SUMMARY

I am honored to be asked to appear before you today to participate in the Subcommittee's hearings on the McMahon case and its aftermath, the disputed "voluntariness" of customer/brokerage agreements, the inadequacies of SRO arbitration systems and procedures and the need for amendments to the securities laws to ensure that the rights and claims of investors will be adequately protected in a forum consistent with our traditional American concepts of fairness, justice and due process.

The fundamental premise of this testimony is that the McMahon decision has erroded the confidence of the investing public in: the fairness and integrity of the customer/brokerage relationship; the customer/brokerage agreement which now almost universally contains a mandatory arbitration clause; and the arbitration procedures of the self-regulatory organizations for the adjudication of their claims.

At issue is the public's right to federal court adjudication and the ability to exercise a meaningful and voluntary choice as to a forum for the adjudication of securities law fraud claims. Surely Congress intended in its enactment of the 1933 and 1934 Acts, and in the amendments thereof in 1975, that public customers should not be permitted to prospectively waive the federal court forum. The core of

this legislative history and its underlying principle of the nonarbitrability of securities law claims had been adhered to for more than three decades at least, and was fully supported until the McMahon case by the overwhelming majority of federal Circuit Courts of Appeals and by the Securities and Exchange Commission. While the SEC has proposed significant changes to SRO arbitration systems which underscore the inherent lack of fairness to the public in SRO arbitration procedures, the Commission has yet to propose a meaningful mechanism such as that promoted by the Commodities Exchange Act and the CFTC to ensure the voluntariness of arbitration agreements.

The many significant rights, both substantive and procedural, that are unavailable in the arbitration process gives rise to the necessity of restoring to the investing public their choice of forum for the adjudication of investor claims arising under the securities laws. The public is awaiting the action of Congress to restore to investors the necessary protections that they are entitled to, consistent with the goals of the securities laws and traditional American principles of fair adjudication and due process. Reform of arbitration, while desirable for those customers who choose that alternative forum, is not a substitute for restoring the choice of jury trial to the American public.

BACKGROUND: THE PERVASIVENESS OF SECURITIES LAW FRAUD

As attorneys who represent defrauded investors in securities law litigation, our experience has shown that securities fraud is a pervasive and economically devastating problem for the public today. After the events of the last few months in the capital markets, no one can disagree that the confidence of the investing public is a very crucial factor in promoting stability and soundness in the financial marketplace, as well as prosperity for the brokerage industry. Yet the fraud that occurs in this area is so invasive that it has the potential to undermine this confidence and the integrity of the system.

Securities law fraud affects investors large and small, and does not distinguish between individuals and groups such as are represented by pension funds. As the attorneys who represented the McMahon plaintiffs in their federal court fraud case concerning arbitration-related securities fraud and RICO issues known as Shearson/American Express v. McMahon, __U.S.__, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), we can illustrate some of the facts underlying many of the more typical securities fraud complaints brought against the securities industry by public customers.

In the McMahon case, for example, it is alleged in the amended complaint that the broker: engaged in the fraudulent and wilful churning , or practice of trading excessively solely to maximize commissions, not only of the McMahons' individual accounts, but also of their fiduciary pension trust accounts, thereby violating Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. Section 78j(b) (the "1934 Act") and SEC Rule 10b-5, 17 C.F.R. Section 240.10b-5, promulgated thereunder, by making false statements and omitting material facts in the advice and financial projections given to the McMahons; by fraudulently dissipating the funds of Mrs. McMahon and those of numerous other investors representing the general public in a scheme known as the "Golden Apple" investment fund; and by violating the provisions of RICO. The amended complaint also alleges pendent common law claims of fraud, misrepresentation and breach of fiduciary duty.

The McMahons' claims include allegations of multiple acts of fraudulent, inappropriate and excessive trading on the part of their broker in connection with the joint account of the individual investors, in which, for example, over 400 options were allegedly traded with commissions totalling approximately $50,000. Also alleged are claims of securities fraud in relation to four trust accounts where over 3,500 options trades allegedly enabled the broker to reap overall more than $200,000 in excessive commissions. These options

trades were not in accordance with the investors' stated conservative investment objectives, and were not suited to secure either the McMahons' or their employees' retirement objectives.

As is fairly typical in these cases, the McMahon investors were unsophisticated in the securities field, having no college degrees nor financial market acumen and no prior investment experience in anything more risky then, e.g., short term municipal bonds, treasury bills and money market accounts. The broker, who actively sought and obtained complete discretion in the handling of these accounts, failed to disclose to these unsophisticated investors the volatility of the markets in which their personal investment funds and the funds of several pension trusts were at risk. Representations were allegedly made by the broker of a guarantee of appreciation through conservative investment policies which did not come to fruition; indeed, the gravamen of the investors' complaint is that the practices of the broker caused substantial losses.

The McMahon investors' complaint also alleges a scheme by the broker to defraud Mrs. McMahon and to utilize her good name in recruiting members of the general public to similarly invest in a so-called "Golden Apple" investment scheme, where the dissipation of substantial investments was caused by the injudicious trading of options by the broker. The complaint

also includes a RICO claim. It seeks treble damages for the underlying predicate offenses which comprise a pattern of illegal conduct allegedly aimed at defrauding the investors and the general public.

Over the past months since the market meltdown we have heard of many other striking events which all serve as indications of the pervasiveness of this type of fraud.

Surely, the debate over amending the regulations that govern the capital markets must take into serious account the enormity of this problem which injures not only the individual investors who are hurt economically, but commerce and society as a whole.

THE SECURITIES LAWS SHOULD BE AMENDED
TO PRESERVE THE PUBLIC'S RIGHT
TO FEDERAL COURT ADJUDICATION

Predispute arbitration clauses until this year were viewed virtually uniformly by Congress, the Courts and the Securities and Exchange Commission for over three decades as a particularly coercive and unfair trade practice. The fundamental philosophy of federal securities regulation that promotes full disclosure to investors and confidence of the investing public in the integrity of the capital marketplace underlies this long-settled policy, which for decades held

predispute arbitration clauses such as are routinely included in preprinted customer/brokerage agreements to be unenforceable.

Yet the Supreme Court's decision in McMahon in June 1987 held, unanimously on RICO and by a 5-4 vote for §10(b) violations, that valid predispute arbitration clauses are enforceable and that both RICO and 1934 Act claims are arbitrable, despite the contrary view of eight federal Circuit Courts of Appeals, prior SEC releases dating to 1951 and the high Court's own precedent. The Supreme Court's decision, many experts believe, may have been motivated by a desire to reduce the federal court caseload, even though less than 2% of the approximately 250,000 civil cases filed in fiscal year 1986 in the federal court system were securities law-related, and fewer than 1,000 civil RICO cases were filed with 40% of these based upon alleged securities fraud, according the Administrative Office of the U.S. Courts. See McMahon, 107 S.Ct. at 2359, 96 L.Ed.2d at 220 ("It is thus ironic that the Court's decision, no doubt animated by its desire to rid the federal courts of these suits, actually may increase litigation about arbitration.") (Blackmun, J. dissenting).

It is our view and that of many others familiar with this area of the law that the Supreme Court's decision in the McMahon case has effectively obliterated a long-revered policy of investor protection by limiting severely the defrauded

public investor's access to federal court adjudication of securities law fraud claims. Immediate remedial steps are now necessary to reinstate for public investors this important protection against an overreaching, coercive and unfair trade practice. These include: a) amendments of the securities laws to make explicit Congress' intent that the antiwaiver clauses thereof (§14 of the 1933 Securities Act and, analogously, §29(a) of the 1934 Exchange Act) prohibit the enforceability of predispute arbitration clauses because they effectively deprive investors of the statutory right to a judicial forum and promote broker-dealer deviation from compliance with the letter and spirit of the anti-fraud provisions of these laws; b) amendment of civil RICO provisions to preserve the right of the civil RICO plaintiff to federal court adjudication of these claims; and c) amendment of the Federal Arbitration Act, discussed infra.

The issues before this honorable body are being followed by and are of the utmost concern to members of the general public who participate in the financial markets, many of whom have already invested their savings, wages, and retirement funds in the stock market and have been defrauded by their stock brokers and their brokerage firms. We have had the opportunity to communicate with many defrauded individuals and pension participants who have almost uniformly pleaded ignorant of the fact that they have relinquished substantial statutory

and constitutional rights by virtue of having signed a printed agreement prepared by securities industry professionals containing a predispute choice of forum arbitration clause. At the heart of this problem is the complete absence of knowing waiver of the judicial forum, and the lack of meaningful voluntariness in surrendering these important rights on the part of the investor when the customer/broker agreement is placed in front of him or her by the brokerage firm or its representative.

The typical customer/broker agreement is a printed document containing standard industry "boilerplate" provisions. Typically, there is no negotiation between customer and broker over the terms of the agreement which has been carefully drawn by the legal counsel of the brokerage firm. The form which the customer/broker agreement takes, although it may differ from firm to firm, will now, in light of the McMahon decision, uniformly contain a predispute choice of forum clause mandating arbitration at the instance of the brokerage firm. There will be no choice at all for the public customer on this very uneven playing field where the securities professionals control the game. The brokerage firm even has the right to limit arbitration to whatever specific forum it chooses in its printed form (even though by doing so it may abrogate the constitution or rules of SRO's such as the NASD providing customer access), by using language which limits the choice of forum to a particular SRO, such as the NYSE. As has

been recently brought to the attention of the SEC by an attorney for a customer, in the aftermath of McMahon brokers have even resorted to arbitration clause language providing for a one-year time limitation on submission to an SRO, in clear derogation of the six year limitation found in §4 of SICA's Uniform Code of Arbitration. Shearson's multi-page form of agreement that the McMahons executed, which was presented to them unceremoniously by their broker as part of the "red-tape" necessary to open their accounts, is similar to many others we have seen. The arbitration clause can be found almost literally buried within the text on page 2 paragraph 13 where, without the benefit of even a subheading, in the middle of a paragraph concerning rights inuring to the benefit of heirs, we find those ominous words to the effect that any controversy between broker and customer will be determined by arbitration.

It should be a matter of grave concern that public customers are being coerced into choosing a forum in advance of a dispute, or even as a precondition of opening an account, in order to determine future disputes which have not yet arisen. Clearly, at the time the investor opens up a brokerage account, his or her trust in a broker and a brokerage firm is at its highest. After all, the investor is now willing to part with real money and deposit it with or borrow it on margin from the brokerage firm. In return he or she expects at a minimum total honesty in connection with the account. At this point

typically investors are neither represented by counsel nor are given the option of negotiating the terms of the pre-printed account forms. The "red tape" of opening up a brokerage account includes signing the customer agreement. We are told by investors that time and time again brokers advise them that the procedure is merely a "formality," the agreement does not have to be gone over with a fine tooth comb and that it is just like opening up a bank account. If investors seriously question the terms, including the arbitration clause, we are advised by our clients that they are quickly told by the broker that the provision is inviolable and an absolute requirement of the brokerage firm.

There is ample evidence to support the conclusion that the customer/broker agreement represents a clear contract of adhesion that should be deemed unenforceable especially in the aftermath of the Supreme Court's decision. Almost immediately after the Court's opinion in McMahon was published on June 8, 1987, the president of the Securities Industry Association ("SIA"), the powerful brokerage industry lobby, was quoted by reporters that henceforth brokerage firms will insist upon predispute arbitration clauses in their customer agreements; unless they sign on the dotted line, relinquishing their right to a day in Court, customers will not be able to do business in the marketplace. See New York Newsday, p. 49, col.3 (June 9, 1987); Barron's, p.38, cols. 4-5 (June 15, 1987).

While it may be argued that the investor might be inclined to shop around for a better deal, it is quite clear that the SIA and all of its approximately 500 members will act in unison and require public customers to sign an unequivocal arbitration agreement as a precondition to opening an account. Those few investors who actively read the small, fine print of the form, assuming they understand the significance of a predispute arbitration choice of forum, which is seriously in doubt, will most probably not be able to find another brokerage firm who will take them in without the clause. The only exception to this dilemma might be the institutional investor who has greater business and investment saavy and clout, and may have the ability to negotiate this issue. We know of no public customer who has been able to do this to date, including one customer who annually pays almost two million dollars in commissions, yet was unable to negotiate amendment to or removal of the mandatory arbitration clause.

Simply put, investors should not be permitted to, or more accurately stated, should not be coerced into waiving their right to a judicial forum, particularly in the predispute setting. To permit this to occur would undermine the policy of investor protection which places the investor on a different footing than the inherently superior position of the securities industry professional. See McMahon, 107 S.Ct. at 2350-2351 and n.9, 96 L.Ed. 2d at 210-211 and n.9 (Blackmun, J., dissenting).

LEGISLATIVE HISTORY

The fact that the antiwaiver provisions of the 1933 and 1934 Acts (Sections 14 and 29(a), respectively): a) protect investors against prospective waiver of their Section 22 and Section 27 rights to judicial resolution of their disputes; and b) act as a general limitation on the Federal Arbitration Act, 9 U.S.C. §1 et seq. ("FAA" or "Arbitration Act"), is confirmed not only in the text and legislative history of the 1934 Act particularly, but also in the legislative history of the Securities Act Amendments of 1975, Pub.L. 94-29, 89 Stat. 97 (the "1975 Amendments").

A discussion of the legislative history in Congress underlying the concept of the nonarbitrability of securities law claims, a principle that in most cases previously barred arbitration of RICO claims and their underlying securities fraud claims, would not be complete without reference to Justice Blackmun's cogent dissent in McMahon, which reviewed the evolution of the important public policy rationale forming the basis for the rule of nonarbitrability that was so long considered uncontroversial and widely adhered to since 1953:

> Both the Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted to protect investors from predatory behavior of securities industry personnel. In Wilko v. Swan, 346 U.S. 427 (1953), the Court recognized this basic purpose when it declined to enforce a predispute agreement to compel arbitration of claims under the

> Securities Act. Following that decision lower courts extended Wilko's reasoning to claims brought under §10(b) of the Exchange Act, and Congress approved of this extension.
>
> * * *
>
> If, however, there could have been any doubts about the extension of Wilko's holding to §10(b) claims, they were undermined by Congress in its 1975 amendments to the Exchange Act. . . . These amendments. . . are regarded as "the 'most substantial and significant revision of this country's Federal securities Laws since the passage of the Securities Exchange Act of 1934.'" Herman & MacLean v. Huddleston, 459 U.S. 375, 384-385 (1983), quoting Securities Acts Amendments of 1975: Hearings on S.249 before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., 1 (1975). More importantly, in enacting these amendments, Congress specifically was considering exceptions to §29(a), 15 U.S.C. §78cc, the nonwaiver provision of the Exchange Act, a provision primarily designed with the protection of investors in mind. The statement from the legislative history ["It was the clear understanding of the conferees that this amendment did not change existing law as articulated in Wilko v. Swan . . . H.R.Conf. Rep. No. 94-229, p. 111 (1975)"], on its face indicates that Congress did not want the amendments to overrule Wilko. Moreover, the fact that this statement was made in an amendment to the Exchange Act [Section 28(b)] suggests that Congress was aware of the extension of Wilko to §10(b) claims. . . . it implies that Congress was not concerned with arresting this trend. Such inaction during a wholesale revision of the securities laws, a revision designed to further investor protection, would argue in favor of Congress' approval of Wilko and its extension to §10(b) claims.

McMahon, 107 S.Ct. at 2346, 2347-2348, 96 L.Ed.2d at 204, 206-207 (footnotes omitted).

In a further remark underscoring the protective policy rationale behind Congress' major revision of the securities laws in 1975, Justice Blackmun stated:

> Common sense suggests that, when Congress states that it is not changing the law, while at the same time undertaking extensive amendments to a particular area of the law, one can assume that Congress is approving the law in existence.

McMahon, 107 S.Ct. at 2348 n.5, 96 L.Ed.2d at 207 n.5. (Blackmun, J., dissenting). Thus, Congress' ratification of existing law in 1975, that investors could not be compelled to waive, in advance of an actual dispute, their right to choose between the arbitral and judicial forums, arose clearly in the context of the 1975 amendments.

Yet the five-member majority opinion in McMahon, although apparently swayed by the Securities and Exchange Commission's amicus intervention, could not come to a firm conclusion as to the true import of the 1975 amendments' House Conference Report as an expression of congressional intent that section 29(a) and analogously, section 14, of the 1934 and 1933 Acts respectively, bar enforcement of predispute arbitration clauses. See McMahon, 107 S.Ct. at 2343, 96 L.Ed.2d 200-201. ("The committee may well have mentioned Wilko for a reason entirely different . . . . even assuming the conferees had an understanding of existing law that all agreed upon, they specifically disclaimed any intent to change it.").

Justice Stevens, in his terse two paragraph dissenting opinion as to Wilko's applicability to the 1934 Act, had no

such difficulty in discerning clear congressional policy and intent and the fact that the McMahon majority "changes a settled construction of the relevant statute":

> Gaps in the law must, of course, be filled by judicial construction. But after a statute has been construed, either by this Court or by a consistent course of decision by other federal judges and agencies, it acquires a meaning that should be as clear as if the judicial gloss had been drafted by the Congress itself. This position reflects both respect for Congress' role, see Boys Market, Inc. v. Retail Clerks, 398 U.S. 235, 257-258, 90 S.Ct. 1583, 1595-1596, 26 L.Ed.2d 199 (1970) (Black, J., dissenting), and the compelling need to preserve the courts' limited resources, see B. Cardozo, The Nature of the Judicial Process 149 (1921).
>
> During the 32 years immediately following this Court's decision in Wilko v. Swan, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed.168 (1953), each of the eight circuits that addressed the issue concluded that the holding of Wilko was fully applicable to claims arising under the Securities Exchange Act of 1934 . . . . This longstanding interpretation creates a strong presumption, in my view, that any mistake that the courts may have made in interpreting the statute is best remedied by the legislative, not the judicial, branch.

McMahon, 107 S.Ct. at 2359, and n.2, 96 L.Ed.2d at 220, and n.2. (Stevens, J., dissenting) (footnote omitted).

As part of the 1975 amendments Congress provided for arbitration involving disputes among securities industry

professionals under §28(b) of the 1934 Act. As several other defrauded investors who were supporting the McMahons pointed out in their brief amici curiae to the Supreme Court:

> Sections 28(b)(1) and (2) insure that no other provision of the Exchange Act will operate to bar disputes between members or participants of SROs [self-regulatory organizations such as the stock exchanges] where the SRO has established such a procedure. Neither Section 28(b)(1) nor Section 28(b)(2) requires a member or participant in the SRO to agree to compulsory arbitration in order to be subject to it. Section 28(b)(3) is different. In order for a person subject to Section 28(b)(3) to be bound to arbitrate a dispute in accordance with SRO arbitration rules governing SRO members or participants, that person must agree to be bound by those rules. Once agreeing to arbitrate, the person cannot be relieved of the contract by resort to any other provisions of the Exchange Act. However, unless there is some other provision of the Exchange Act to resort to avoid the agreement's consequences the general scope of the Arbitration Act would be sufficient to compel a person who agreed to arbitrate under SRO rules to honor this agreement. Thus, in the absence of such other provision, Section 28(b)(3) would be wholly unnecessary. At the very least, then, its inclusion expresses Congress' understanding and intent that some provision [the antiwaiver clause, Section 29(a)] of the Exchange Act operates as a general limitation on the Arbitration Act, necessitating the provisions of Section 28(b)(3).
>
> Also in 1975, Congress established and enumerated the rule making responsibilities of the Municipal Securities Rule Making Board (the "Board"). Pub.L. 94-29, §13, 89 Stat. 131. As a result Exchange Act Section 15B(b)(2)(D), 15 U.S.C. §78o-4(b)(2)(D), empowers the Board to provide for arbitration of "claims, disputes and controversies relating to transactions in municipal securities." Id. However, the Board's arbitration rules may not compel a municipal securities customer to submit to such arbitration "except at his instance and in accordance with" Section 29 of the Exchange Act. Id. By itself, the language "at his instance" might permit a pre-dispute agreement to arbitrate. But Section 15B(b)(2)(D) requires that the customer's "instance" also be in accordance with Section 29 of the Exchange Act. If Section 29 meant only that a customer cannot

waive a dealer's compliance with Exchange Act provisions, then requiring a customer's arbitration agreement to be "in accordance with" Section 29 is essentially meaningless because a dealer's compliance with Exchange Act obligations is not at issue in an arbitration agreement. "In accordance with Section 29" is meaningful, then, only if Section 29 means that a customer is protected from agreements which waive the customer's rights, including rights under Section 27 of the Exchange Act.

That Congress understands and intends that Section 29(a) operates to preclude waiver of a customer's rights under the Exchange Act, and not simply waiver of a defendant's obligations under the Act, is confirmed by the legislative history of the Securities Act Amendments of 1975, Pub.L. 94-29, 89 Stat. 97 (the "1975 Amendments"). In connection with amendments to Exchange Act Section 28(b), the Conference Report stressed: "It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in Wilko v. Swan, 346 U.S. 427 (1953), concerning the effect of arbitration proceedings provisions and agreements entered into by persons dealing with members and participants of self-regulatory organizations." H.R. Rep. No. 94-229, 94th Cong. 1st Sess., 111 (1975), U.S. Code Cong. & Admin. News, 1975, p. 342 (hereinafter, the "Conference Report").

In Wilko, the Court held that Section 14 of the Securities Act prohibited pre-dispute agreements to arbitrate because those agreements waived the customer's rights under Section 22. Wilko, 346 U.S., at 432-3, 434-5. Wilko's holding is predicated on interpretation of Section 14's "waive compliance" language to prohibit waiver of investors' rights, not just waiver of a seller's obligations under the Act. Wilko v. Swan, 346 U.S. at 434-35. The Conference Report confirms that with the 1975 Amendments Congress ratified Wilko's interpretation of Section 14. If Congress did not intend Section 14 of the Securities Act (or its equivalent, Section 29(a) of the Exchange Act) to bar the waiver of an investor's rights generally, and not just the waiver of the defendant's obligations under the Act, Congress could have rejected Wilko's interpretation of the "waive compliance with" language in Section 14. But, "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change . . . ." Lorillard v. Pons, 434 U.S.

> 575, 580 (1978). See also, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 381-2 (1982), Herman & MacLean v. Huddleston, 459 U.S. at 385-6. Here, one need not merely presume that Congress was aware of Wilko's interpretation of Section 14. The legislative history of Section 28(b) makes clear Congress' full awareness of Wilko and its acceptance of the law as articulated by Wilko. Necessarily, the equivalence of Section 14 of the Securities Act and Section 29 of the Exchange Act extends Wilko's interpretation to the Exchange Act as well.

Brief for Willie D. Chandler, et al., Amici Curiae, McMahon, at 11-13.

Congress has thus asserted its abiding interest in setting policy in this area. The important public policy rationale underlying the enactment of the securities laws and amendments of certain sections thereto in 1975 is unambiguous. It is to advance the protections afforded to investors under the federal statutory regime governing the securities marketplace. Rather than undermine these protections by reading the laws narrowly so as to deprive investors of their right to choose the forum in which to adjudicate their securities law claims, Congress in 1933, 1934 and 1975 explicitly enacted antiwaiver provisions and carved out exceptions to mandatory arbitration in order to protect public investors in the predispute setting from waiving their statutory right to the federal court forum.

It is obvious that an amendment to these laws is now necessary in order to preserve investor rights under the antiwaiver clauses of the securities laws and prevent further

erosion of the public's right to federal court adjudication of their federal statutory claims. With respect to amendment of RICO where securities fraud is often a predicate, any suggestion that the McMahon holding should somehow be codified is antithetical to the concept of investor protection and would be highly imprudent. Since the result of this current inquiry will have a significant impact on the effectiveness of investor protections and the level of investor confidence which is so compelling in this volatile economic climate, any action which would further restrict access of RICO plaintiffs to the federal courts is equally unwarranted.

The Arbitration Act was never meant to override these public policy considerations underlying federal court adjudication of statutory claims arising under the securities laws:

> The legislative history of the Arbitration Act shows if not that the Act "was to have a limited application to contracts between merchants for the interstate shipment of goods . . .", Prima Paint, 388 U.S. at 409 (Black, J. dissenting), then at least that Congress' attention was focused only on arbitration of such contracts and not the arbitration of statutory claims. Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration Before a Subcommittee of the Senate Committee on the Judiciary, 67th Cong. 4th Sess., 3, 5, 7, 9, 10 (1923) ("Hearing on S. 4213 and S. 4214"); Arbitration of Interstate Commercial Disputes, Hearing on H.R. 646 and S. 1005 before the Joint Committee of the Subcommittees on the Judiciary, 68th Cong., 1st Sess. 7, 27 (1924) ("Joint Hearings"). Indeed, one of [the] principal participants in the drafting of and Congressional hearings on the Arbitration Act

[footnote follows] [see Joint Hearings, 13 (Statement of Julius Cohen)] wrote one year after its enactment:

> Not all questions arising out of contracts ought to be arbitrated. It is a remedy peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of fact - quantity, quality, time of delivery, compliance with terms of payment, excuses for non performance, and the like. It has a place also in the determination of the simpler questions of law - the questions of law which arise out of these daily relations between merchants as to the passage of title, the existence of warranties, or the questions of law which are complementary to the questions of fact which we have just mentioned. It is not the proper method for deciding points of law of major importance involving constitutional questions or policy in the application of statutes. Speaking generally, it is a proper remedy for the determination of these classes of disputes which arise day by day in the common experience of the disputants and the individuals to whom the dispute is to be referred, where all meet upon a common ground.

Cohen and Dayton, The New Federal Arbitration Law, 12 Va. L. Rev. 265, 281 (1926), cited in Brief for Willie D. Chandler, et al., Amici Curiae, McMahon, 6-7.

REGULATORY POLICY AND OVERSIGHT

For over thirty years, in a policy predating the Wilko case in 1953, and prior to the McMahon case, the SEC not only supported the position of investors such as the McMahons who had unwittingly waived their statutory rights to go to Court by signing the arbitration clause, but the SEC actually opposed predispute agreements that might mislead a public customer into giving up statutory rights. In consistently rejecting the

validity of such clauses, which it deemed possibly actionable under the securities laws, the SEC time and again denounced the predispute arbitration clause which we are inquiring into here as a deceitful, unfair trade practice inimical to the rights of investors, which may in and of itself be a matter of fraud and violative of Rule 10b-5.

Through various releases and in the filing of an amicus brief in a Third Circuit case known as Ayers v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3d Cir.), cert. denied, 429 U.S. 1010 (1976), the SEC informed both the brokerage industry and the public of its belief in the inherent unfairness and unenforceability of the predispute arbitration agreement. The Commission did so based upon its independent analysis of both regulatory and public policy concerns, and not solely upon judicial interpretation of the law. See Securities Exchange Act Release No. 19813 (May 26, 1983), [1982-83 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 83,356, at p. 85,967 and n.6. See also SEC Securities Exchange Act Release No. 20397, [1983-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 83,452 (November 18, 1983); SEC Securities Exchange Act Release No. 15984, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 82,122 (July 2, 1979). The SEC, apparently frustrated by the fact that many brokerage firms did not heed this message, promulgated Rule 15c2-2, 17 C.F.R. Section 240.15c2-2, in 1983, which codified its prior position.

Former Rule 15c2-2, which was in place at the time of the SEC's amicus appearance in McMahon before the Supreme Court, is highly instructive. Enacted in November 1983, it mandated that brokerage firms, after finishing off their old inventory of customer agreement forms, use a new form of agreement which was required to provide that, despite any predispute arbitration clause which might be found elsewhere in the agreement, the customer nevertheless had the right to go to court for violations arising under the federal securities laws. The SEC required that then current inventories were to be modified by the use of a sticker with these terms clearly printed on it to be affixed to the old forms until they were used up. There was even a deadline set for the time in which brokers could use up old stock. The SEC also required, for the hundreds of thousands of customers who had agreements in place containing an arbitration clause, that the brokerage firms notify their customers in writing of the customers' right to maintain an action in court for claims arising under the federal securities laws.

In our practice we have reviewed many predispute arbitration clauses that were supposed to have complied with Rule 15c2-2 and have found that this is an area in which the brokerage firms' general counsel became quite creative. Because the exact terms of the required new notice to customers was left to the discretion of the industry, many amended

arbitration clauses were not in compliance with either the letter or the spirit of the rule. In any event, the SEC promulgated Rule 15c2-2 after hearing comment from the brokerage industry, and the rule was on the books when the McMahon case was pending before the Supreme Court.

Despite the Commission's laudable thirty year track record of unequivocal support for investors in this area, punctuated by the promulgation of Rule 15c2-2, to the great shock and chagrin of investors and the plaintiffs' securities law bar, the SEC did not support the public but filed an amicus brief and argued on behalf of the industry in the McMahon case, largely on the stated grounds that its oversight authority could "insure" the fairness of SRO arbitration. Curiously, the SEC did so without, to our knowledge, advising the Supreme Court of its then pending 18-month inquiry that would ultimately result on September 10, 1987 in sweeping proposals for SRO arbitration reform. In effect, the SEC's proposals underscore the lack of fairness to the public in the SRO arbitration system and the "limits inherent in the current arbitration rules." SEC Division of Market Regulation, Letter from Richard G. Ketchum, Director, to All Members of Securities Industry Conference on Arbitration, at 1 (September 10, 1987).

Our response to the SEC's proposals for changes in current arbitration practices, dated December 23, 1987, is annexed as an Exhibit hereto.

On October 15, 1987, just before the unprecedented events in the financial markets unfolded, the SEC unceremoniously repealed Rule 15c2-2. SEC Securities Exchange Act Release No. 34-25034 states summarily that the Rule "is no longer appropriate." Thus a regulation only recently considered necessary to correct a deceptive, pervasive and coercive trade practice has been wiped off the books of investor protection.

The public had previously enjoyed the right to choose between court or arbitration, since the securities laws as well as RICO provide for exclusive federal court jurisdiction (the 1933 Act provides for concurrent state-federal jurisdiction). The quantum-leap decision to authorize compelled arbitration and support the industry in this matter, which was essentially a choice of forum question in which the customer could by no stretch of the imagination gain to benefit from the deprivation of a previously vested 7th Amendment right to trial by jury, was justifiably disheartening for all investors around the country. It was our view then, as now, that the fundamental goals of investor protection of the 1933 and 1934 Acts as well as the deterrent goals of RICO are impermissibly undermined by prospective waivers of these statutorily provided rights to a judicial forum. Indeed, as we brought to the Supreme Court's attention in the McMahon respondents' brief:

Just last term, [the Supreme Court] revisited the legislative rationale underlying the protections with which public customers are vested under the 1934 Act:

> ". . . Congress' aim in enacting the 1934 Act was not confined solely to compensating defrauded investors. Congress intended to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions. Affiliated Ute Citizens, supra, at 151, 92 S.Ct. at 1471; see also Hermann & MacLean, 459 U.S., at 386-387, 103 S.Ct. at 1144-1145."

Randall v. Loftsgaarden, supra, _____ U.S. _____, 106 S.Ct. at 3154.

Consistent with these fundamental goals, the clear concern of the SEC, in addressing the pervasiveness of overreaching and manipulative practices in the securities industry in its dealings with public customers, has been the deterrence of fraud and ensuring the fullest possible disclosure. Thus, in 1979, the SEC acknowledged the self-same problem of non-disclosure and manipulation occurring at the time a customer opens an account that is at issue in the McMahon case:

> "It is the Commission's view that it is misleading to customers to require execution of any customer agreement which does not provide adequate disclosure about the meaning and effect of its terms, particularly any provision which might lead a customer to believe that he or she has waived prospectively rights under the federal securities laws . . . . Customers should be made aware prior to signing an agreement containing an arbitration clause that such a prior agreement does not bar a cause of action arising under the federal securities laws."

SEC Securities Exchange Act Release No. 15984, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶82,122, at 81,977-81,978 (July 2, 1979). See also SEC Securities Exchange Act Release No. 19813, [1982-83 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶83,356, at 85,967 n.6 (May 26, 1983).

Just three short years ago, the SEC enacted regulation 15c2-2, 17 C.F.R. Section 240.15c2-2, to correct the continuing industry-wide practice among brokers of failing to disclose to their public

customers that, by signing a boiler-plate form of customer agreement containing an arbitration clause, the customer had not necessarily prospectively waived vested rights to a judicial forum under the federal securities laws. SEC Securities Exchange Act Release No. 20397, supra, [1983-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶83,452. Although the SEC, as Amicus Curiae 18, has not explicitly asserted in this case a repeal of Rule 15c2-2, its argument in support of a repeal of Wilko (SEC as Amicus Curiae 20) effectively undermines its earlier effort in support of full disclosure to public customers of their rights and against overreaching by brokers.

The obvious inconsistencies of this position render its premise, that full disclosure is now somehow obviated by oversight, untenable, especially since the SEC as Amicus readily concedes that "[t]his Court noted in Mitsubishi Motors Corp., slip op. 12, that fraud and overreaching remain grounds for revoking an arbitration agreement." SEC as Amicus Curiae 19. But in Mitsubishi, the Court also stated that "the first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute," Mitsubishi, supra, 105 S.Ct. at 3354, and that "[o]f course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.'" Id. Clearly, petitioners' [Shearson's] efforts to abridge or abrogate altogether public customers' statutorily provided rights to full disclosure, by seeking to enforce all prospective waivers of such rights, represent an unwarranted, intolerable departure from congressional intent and prior SEC releases, as interpreted by almost all the Circuit Courts of Appeals, and would also conflict with the plain meaning of Mitsubishi.

Nor may petitioners [Shearson] reasonably claim that the SEC's position is strictly a result of its previous understanding of the application by the courts of the Wilko rule to Section 10(b) claims. As early as 1951, in a release that pre-dates Wilko, the SEC censured the brokerage industry for the use of analogous clauses which, lacking adequate disclosure, were deemed patently inconsistent with "just and equitable principles of trade and may raise serious questions of compliance with the anti-fraud provisions of the federal securities laws" including the 1934 Act. [footnote follows] SEC Securities Exchange Act

Release No. 58, (Apr. 10, 1951), quoted in SEC Securities Exchange Act Release No. 19813, [1982-83 Transfer Binder] Fed.Sec.L.Rep (CCH) ¶83,356, 85,967 n.6, states, in pertinent part:

> "This reasoning by the Commission was not novel. In 1951, the Commission released an opinion by its General Counsel concerning the use of 'hedge clauses' by brokers, dealers, investment advisers and others who sought thereby to avoid liability for a representation which they knew, or in the exercise of reasonable care could have discovered, to be false and misleading. The courts had repeatedly struck down such clauses. See Investment Advisers Act Release No. 58 (April 10, 1951). The position expressed in Release No. 58 was as follows:
>
> 'All the statutes administered by the Commission provide that any condition, stipulation or provision which binds any person to waive compliance with their requirements shall be void . . . . The question arises, therefore, whether the result, if not the purpose, of such a legend is to create in the mind of the investor a belief that he has given up legal rights and is foreclosed from a remedy which he might otherwise have . . . under the SEC statutes. . . .the antifraud provisions of the SEC statutes are violated by the employment of any . . . provision which is likely to lead an investor to believe that he has in any way waived any right of action he may have, ...[under] Section 10(b) of the Securities Exchange Act of 1934 and Rule [10b-5] thereunder, Section 15(c)(1) of that Act and Rule [15c1-2] thereunder. . . .'"

Id. at ¶83,356, 85,967 n.6.

The SEC's obvious and sustained concern over three decades has been that public customers, such as respondents [the McMahons], would be induced to either submit to arbitration, uninformed of their vested rights to a judicial forum under the securities laws, or possibly not pursue their claims at all. SEC Exchange Act Release No. 15984, supra, [1979 Transfer Binder] Fed.Sec.L.Rep.(CCH) ¶82,122 at 81,978. Yet SEC endorsement of disclosure is linked to the limitations of oversight. In response to an inquiry by Chairman Dingell of the House Subcommittee on Oversight and Investigations, the SEC recently conceded its total lack of oversight authority over

> actual SRO arbitration proceedings: "The Commission has no authority to review a specific arbitration to assure either compliance with the procedural requirements of the Code [Uniform Code of Arbitration] or accurate interpretations of underlying federal securities law or other claims by the arbitrators." [footnote follows] SEC Report of the Division of Market Regulation In Response to An Inquiry By the Honorable John D. Dingell, Chairman of the Committee on Energy and Commerce Concerning a Complaint by Joan Hunt Smith (August 28, 1986) (available from H.R. Committee on Energy & Commerce) (emphasis added).
>
> Since SEC oversight authority does not police the actual day to day broker-customer relationship, the intent if not the letter of SEC regulations now in place, which promote full disclosure, should not be unnecessarily curtailed by the judiciary at a time when customers need more, not fewer, protections.

Brief for Respondents, McMahon, at 35-37.

The controversial decision to eviscerate investor protection in the McMahon case, in these critical times of insider trading and financial market instability, bodes ill for the plight of millions of American investors. It is time for Congress to step in, to assert its role in the safeguarding of the investing public and the integrity of the capital markets by clarifying immediately its intent underlying investor protection written into the securities laws. In order to accomplish this end, Congress may of necessity have to amend these laws as well as the Arbitration Act. We are mindful that Congress has acted in this manner from time to time to correct not only misapplications and erroneous interpretations of Congressional intent but also usurpation of Congressional policy-making in a wide range of contexts. Most recently, for

example, the House passed H.R. 585 in order to bolster the rights of antitrust plaintiffs whose dilemma was no less threatening than the current plight of defrauded investors who, as a result of McMahon, may be thoroughly disenfranchised of their statutory remedies. See Report of the House Committee on the Judiciary, accompanying H.R. 585, H.Rep.No. 100-421, 100th Cong., 1st Sess. 25 (1987).

Unwittingly or not, Congressional intent with respect to the proscription against predispute waivers has been clouded by the McMahon decision. Only Congress can now restore to the investing public choice of forum and the important right to federal court adjudication of securities law grievances.

CHOICE OF FORUM IS NECESSARY IN ORDER
TO PROTECT STATUTORY RIGHTS WHICH CAN
ONLY BE FULLY VINDICATED BY JUDICIAL REVIEW

The risk that arbitration, lacking many of the fundamental safeguards built into federal and state court litigation procedures, may not vindicate the statutory rights at issue is at the center of this controversy. The vast differences between the judicial and arbitral forums makes such a risk a factor the public must reckon with. This is all the more significant when one considers the admission of the SEC to Chairman Dingell of the Committee on Energy and Commerce, House Subcommittee on Oversight and Investigations (cited above at p.29) conceding its total lack of oversight authority over

actual SRO, and by implication, all other arbitration proceedings: "The Commission has no authority to review a specific arbitration to assure either compliance with the procedural requirements of the Code [Uniform Code of Arbitration] or accurate interpretations of underlying federal securities law or other claims by the arbitrators." SEC Report of the Division of Market Regulation in Response to An Inquiry By the Honorable John D. Dingell, Chairman of the Committee on Energy and Commerce, supra, (August 28, 1986) (emphasis added).

The problems of oversight in this area are compounded by well-known budgetary constraints:

> In selecting matters for investigation, Commission managers consider not only specific characteristics, such as the potential dollar value and number of investors involved, but also intangible factors such as the deterrent value of a particular case.

SEC Enforcement Program: Information on Productivity; Statements and Cases Closed Without Action, GAO/GGD-86-106BR, at Appendix IV, 21 (Aug. 26, 1986) (Letter of George G. Kundahl, July 11, 1986).

In an amicus filing in a recent case, the SEC similarly advised the Supreme Court of the limits on oversight that affect enforcement:

> [the Commission] 'does not have the resources to police the industry sufficiently to ensure that false

> tipping does not occur or is consistently discovered,' and that '[w]ithout the tippees' assistance, the Commission could not effectively prosecute false tipping - a difficult practice to detect.'

Bateman Eichler v. Berner, ___U.S.___, 105 S.Ct. 2622, 2631 (1985), citing Brief for SEC as Amicus Curiae 25; H.R.Rep.No. 98-355, at 6 (1983). See also GAO Report, GAO/GGD-86-106BR, supra, App. IV at 21; H.R.Rep. 99-155, 99th Cong., 1st Sess. (1985) ("the SEC has limited resources and, understandably, must target its efforts on the largest, national threat to investor protection and market integrity.") Id. at 26 (Letter from President, North American Securities Administrators Assoc., Inc. to Hon. Timothy E. Wirth, Chairman, Subcommittee on Telecommunications, Consumer Protection and Finance).

These serious limitations of oversight and regulation extend to SRO arbitration, thus affecting the substantive and procedural rights of public investors. The Supreme Court itself has stated on many previous occasions that "the choice of forums inevitably affects the scope of the substantive right to be vindicated," Alexander v. Gardner-Denver Co., 415 U.S. 36, 57 (1974), citing U.S. Bulk Carriers v. Arguelles, 400 U.S. 351 (1971), and that "arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State. The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an arbitration panel may make a radical difference in ultimate result." Bernhardt v. Polygraphic Co. of America, Inc., 350 U.S. 198, 203 (1956).

Arbitration, while relatively shorter, inexpensive and informal when compared to a court proceeding, must be balanced against the loss of constitutional guarantees of due process, trial by jury, findings of fact and conclusions of law, federal pleading, discovery and evidentiary rules, and compulsory, orderly discovery; the risk that the law will be improperly applied to the facts at issue; the possible risk of collateral estoppel or inconsistent verdicts; and the unlikelihood, if not unavailability, under various rules of the industry's SROs, of the right to appeal. See, e.g., Sobel v. Hertz, Warner & Co., 469 F.2d 1211 (2d Cir. 1972), rev'g 338 F.Supp. 287 (S.D.N.Y. 1971). See generally Uniform Code of Arbitration, N.A.S.D. Manual (CCH) ¶¶ 3701-3743 (1986); Arbitration Rules of the American Stock Exchange, 2 Am. Stock Ex. Guide (CCH) ¶¶9540-9551J (1984); and Arbitration Rules of the New York Stock Exchange, Inc., 2 N.Y.S.E. Guide (CCH) ¶¶2600-2634 (1985).

The limited right to appeal is diminished still further because arbitrators are not required to state the basis for their decisions, thus eliminating any rational grounds for testing the legal sufficiency or remedial adequacy of awards. This is so in part because arbitration institutionalizes the practice of rendering decisions without giving reasons. According to the President of the American Arbitration Association, Robert Coulson: "Written opinions can be dangerous because they identify targets for the losing party to

attack." R. Coulson, Business Arbitration - What You Need to Know 26 (1980), cited in Note, Arbitrability of Claims Arising Under the Securities Exchange Act of 1934, 1986 Duke L.J. 548, 553 n.37. Under the Arbitration Act, 9 U.S.C. §10, and the various uniform rules at the stock exchanges and elsewhere governing arbitration, the only limited grounds to challenge an award are: undisclosed relationship affecting impartiality of panel; corruption of arbitrator; unfair conduct of hearing; and relief not authorized under contract. Erroneous findings of fact or misinterpretations of relevant laws are not usually grounds for a court to reverse an award, absent irrationality or manifest disregard of law. And arbitrators are not even bound to follow the precedent of prior awards. Note, supra, 1986 Duke L.J. at 553-54, n.38 and citations therein. See also J. Malcolm & E. Segall, The Arbitrability of Claims Arising Under §10(b) of the Securities Exchange Act: Should Wilko Be Extended?, 51 Albany L. Rev. 1 (Winter 1987). Under existing rules as well as SEC proposals, a designated member of the brokerage industry always sits on (and usually chairs) the arbitration panel. As one commentator has noted:

> Arbitration procedures have not changed sufficiently since Wilko was decided to eliminate the . . . fundamental objections to allowing adversaries to arbitrate Securities Act claims. Arbitration is not as effective as adjudication in federal court as a means of protecting investors' rights because the purposes underlying arbitration fundamentally conflict with the right to a federal forum granted under the Securities Act and the Exchange Act.

Note, supra, 1986 Duke L.J. at 552 and discussion with citations at 552-555. See also McMahon, (Blackmun, J., dissenting); SEC Securities Exchange Act Release No. 20397 [1983-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶83,452 at 86,357 and n.6. (Nov. 18, 1983), discussed above.

The overriding policy consideration involved in the McMahon case was the protection of the public investor against manipulation and deception in the financial markets, the same consideration which culminated in Congress' enactment of the securities laws in the first place. There are many significant rights, both substantive and procedural, that are literally unavailable in the arbitration process. Consequently, when a customer is not given the opportunity to make an informed choice, and prospectively forfeits the judicial forum, the result is not only to give unfair advantage to the brokerage industry, but to encroach upon the very substantive rights provided in the 1934 Act, among them full disclosure, fair dealing and judicial scrutiny.

The federal legislative policy underlying the securities laws can best be developed in the courts, where the private litigant has the procedural safeguards of judicial fact-finding, the rules of procedure and evidence that do not apply in the typical arbitration proceeding, the benefit of a complete record, additional safeguards of appellate review and

judicial expertise in interpreting and developing the law of a statutorily created cause of action. Such a course had been set by the Supreme Court previously, before McMahon, despite the general federal policy favoring arbitration, and even in the absence of statutory antiwaiver provisions. See generally McDonald v. City of West Branch, Michigan, 466 U.S. 284 (1984); Barrentine v. Arkansas-Best Freight System, Inc., 450 U.S. 728 (1981); Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974).

The importance to private RICO enforcement of judicial interpretation of the parameters of this relatively new law makes arbitration of RICO, in this context RICO based upon securities fraud predicate acts, an unacceptable mandatory forum. Arbitral panels are not trained in interpreting the complexities and ramifications of RICO, and lack the judicial mandate of issuing findings of fact and conclusions of law and following precedent. RICO thus cannot be fully and fairly evaluated and interpreted, not least because appellate review of arbitration awards is virtually nonexistent.

Since judicial review of both SRO and American Arbitration Association decisions is strictly limited, and there are no measures currently in place to ensure that customer agreements are executed voluntarily, the widespread use of mandatory predispute arbitration clauses may effectively insulate the securities industry from statutory liability and

judicial scrutiny of RICO and predicate securities fraud claims brought by public customers who have prospectively waived their rights arising under both the 1933 and 1934 Acts and, analogously, RICO.

Ultimately, there is the danger that compelled predispute waiver of the judicial forum, now the likely consequence of McMahon, may not only curtail but may eliminate altogether the Section 10(b) remedy.

This development is all the more ominous when one considers that enforcement and oversight by the Commission is significantly enhanced by the existence of the investing public's Section 10(b) remedy. See SEC Brief, Amicus Curiae, McMahon, at 26. Without Congress' speedy intervention, McMahon may signal the end of the judicial development of the law of securities fraud.

PUBLIC CUSTOMERS ARE RELYING UPON
CONGRESS TO RESTORE THEIR RIGHTS

The SEC's proposals illustrate the deplorable fact that for over ten years SRO arbitration has been a "stacked deck" favoring the industry to the detriment of the public investor. We are concerned that, as reported by the Division of Market Regulation to Chairman Dingell in August, 1986, the SEC lacks the resources and oversight capability to ensure that

the securities laws and the rights of investors are being successfully vindicated within any particular arbitration. While it is extremely important to amend SRO arbitration procedures in order to place the investor on a more equitable footing with the industry than now exists, adoption of the SEC amendments as proposed or as modified are, in our view, insufficient.

The voluntariness of arbitration agreements which were held enforceable by the Supreme Court in the McMahon case is of great concern to the investing public, especially since, in light of that decision, customers now are almost universally unable to open a brokerage account without signing such an agreement, thus effectively abrogating the investing public's right to a day in Court. The SEC, despite a thirty-year history of deeming this a deceptive and unfair trade practice, did not include in its arbitration reform proposals a revision to the customer/broker agreement which would ensure the voluntariness of the agreement of investors entering into predispute arbitration agreements. Compounding this omission to address the voluntariness issue in its proposals was the SEC's perfunctory rescission of Rule 15c2-2, enacted in 1983 to combat the abuse of mandatory arbitration clauses in the standard customer/broker agreement.

There is clearly no benefit to the public investor for him or her to choose prospectively, at the time of opening an account, a forum for the future adjudication of claims including securities law and RICO violations predicated upon securities fraud, and common law claims. There is, moreover, simply no valid rationale for requiring, in this coercive manner, a customer to sign an agreement with an arbitration clause as a precondition to do business in the marketplace, which is the common trade practice encouraged by the brokerage industry both before and since McMahon was decided. Shearson, in fact, now claims that the arbitration clause is a valid, enforceable contract of adhesion.

Ensuring the voluntariness of prospective agreements to arbitrate is a necessary concomittant of fairness and equitable practices of trade toward public investors. As we stated in the McMahon respondents' Petition for Rehearing to the Supreme Court:

> There is good reason for supporting such principles, as recognized by other regulatory agencies besides the Commission [the SEC]. In order to ensure the voluntariness of a customer's execution of an agreement to submit future disputes to arbitration, the Commodity Futures Trading Commission almost since its inception has enacted rules requiring that the signing of such an agreement, as a separate clause with its own signature line, by the customer "must not be made a condition for the customer to utilize the services" of the member firm. 41 Fed. Reg. 27, 520, §180.3(b)(6) (July 2, 1976). The Commodity Exchange Act itself requires commodity exchanges to "provide a fair and equitable procedure through arbitration or

> otherwise . . . for the settlement of customers' claims and grievances against any member or employee thereof: Provided that (i) the use of such procedure by a customer be voluntary . . . ." 7 U.S.C. §7a(11) (1922). No similar provisions are now being enforced by the Commission with respect to investors in the national securities markets.

Of additional concern is the fact that SICA has voiced major objections and apparently has not yet formally endorsed the SEC's proposals. According to Robert Love, counsel to the Division of Market Regulation, reforms may not be instituted until 1989, and then only after negotiation.

In light of the McMahon decision and the ongoing securities industry practice of requiring predispute arbitration agreements, we respectfully urge Congress to amend both the Securities Act of 1933 and the Securities Exchange Act of 1934, specifically the antiwaiver provisions found in Section 14 and 29(a) thereof, respectively, in order to clarify the intent of Congress that a) the antiwaiver clauses explicitly prohibit enforcement of predispute choice of forum clauses such as the arbitration agreements we have been discussing, and b) that these antiwaiver provisions explicitly mandate that the grant of federal court jurisdiction under Section 27 of the 1934 Act and Section 22(a) (concurrent state/federal court jurisdiction) of the 1933 Act may not be waived prospectively. The scope of the antiwaiver clauses should also embrace common law claims ancillary to securities law claims asserted pursuant to principles of pendent jurisdiction.

We believe that clarification and amendment of the 1933 Act is also necessary because the Supreme Court in McMahon, while holding 1934 Act claims arbitrable pursuant to valid, enforceable arbitration clauses, left the door open for a challenge to the still valid nonarbitrability rule that was first enunciated in Wilko v. Swan in 1953 with respect to 1933 Act claims.

We also suggest that in connection with such amendments, the Federal Arbitration Act should be amended in order to explicitly prohibit prospective waivers of federal court, or concurrent federal/state court, adjudication of federal statutory claims and common law claims pendent thereto, such as those arising under the securities laws and the RICO statute. We believe that Congress never intended the FAA to be used as a vehicle to frustrate the public's right to jury trial in appropriate cases.

Additionally, consideration should be given to amendment of the RICO statute, which is under consideration by the House Committee on the Judiciary, Subcommittee on Criminal Justice, to include a similar antiwaiver clause ensuring that the RICO statute's grant of federal court jurisdiction cannot be prospectively stipulated or contracted away. In this regard, we testified before the House Subcommittee on Criminal Justice, Committee on the Judiciary, chaired by the Honorable John Conyers, Jr., on December 3, 1987.

Finally, we and the public have been made aware, through the extensive media coverage of the hearings being conducted by the Subcommittee, that the protection of both the securities markets and the investing public is of utmost importance to Chairman Markey and the Subcommittee in order to ensure the integrity of the system, that the events connected with October 19, 1987 can never occur again and that past abuses rampant in the securities industry are rooted out.

Consistent with these goals and in order to effectuate the anti-fraud purposes of the securities laws embodied in the 1933 and 1934 Acts, we respectfully suggest that any amendments as discussed above must include a provision for retroactivity of these important protective measures. For example, any amendment to the securities laws should include a clause providing that such provisions shall be applied to any claims arising under the relevant statute and to any claims heretofore filed in federal district court (or state court as the case may be). Another way of stating this would be that, as of the effective date of any amendment, all compulsory arbitration agreements which do not comply with the statute as amended would be null and void, including those arbitration agreements heretofore signed by customers.

We recognize that questions might arise as to the applicability of such amendments to preexisting disputes on

constitutional grounds. We wish to point out that numerous courts have previously found that Congress does have the power to abrogate arbitration procedures that were previously contracted for, particularly where the clearly adequate remedy of court adjudication remains standing in place of arbitration. See Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 567 F.2d 1174 (2d Cir. 1977). A discussion of the voluntariness issue with respect to prospective, compulsory arbitration contracts is also part of the Circuit Court's opinion in the Ames case at page 1179.

It is our belief, as confirmed by the dissenting opinion of Justice Harry A. Blackmun in McMahon, 107 S.Ct. at 2359, that it is now up to Congress to restore rationality to this once settled area of law. The public eye is now focused intently on the current efforts of Congress to legislate the necessary protections that investors require in order to restore their confidence in the financial marketplace and to restore to the judiciary the role of interpreting and enforcing the federal securities laws and other anti-fraud federal statutes. For the investing public, Congress is the last hope for restoring an important measure of integrity and justice in the adjudication of investor claims arising under the securities laws.

- EXHIBIT TO EPPENSTEIN TESTIMONY -

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December 23, 1987

VIA FEDERAL EXPRESS

Richard G. Ketchum, Director
Division of Market Regulation
Securities & Exchange Commission
450 5th Street NW
Washington, D.C. 20549

Re: Letter sent to all SICA members dated September 10, 1987

Dear Mr. Ketchum:

We are the attorneys who represented the McMahon investors in Shearson/American Express v. McMahon, U.S. Supreme Court No. 86-44. We are writing at the recent invitation of Mark A. Fitterman, Associate Director, who also requested that we send copies of this letter to Chairman Ruder and Commissioner Fleischman, with respect to our comments on the letter sent by the Division of Market Regulation to all SICA members on September 10, 1987 regarding reform of self-regulatory organization - sponsored arbitration. The following is the substance of my testimony given on December 3, 1987 before the U.S. House of Representatives Subcommittee on Criminal Justice, Committee on the Judiciary.

The proposals to enhance the fairness of the SRO arbitration system advocated by the SEC in its 13 page letter to SICA members on September 10, 1987 (the "proposals"), should be embraced whole-heartedly by all concerned. Public confidence in the marketplace is at stake along with the American ideal that grievances between parties should be fairly adjudicated.

The proposals are a necessary if overdue step in the right direction. However, we believe that they fall short in many respects and would, even if adopted in their entirety, still leave the investor with a forum composed of a "stacked deck" in favor of the industry and fail to provide many safeguards to investors. Comprehensive suggestions for SRO

arbitration procedure reform which this firm presented recently before the 70th Annual Conference of the North American Securities Administrators Association in Snowmass, Colorado on August 31 through September 3, 1987, would further ensure that the public's right to a fairer hearing than is currently available in SRO arbitration would be available to investors choosing the arbitral forum in order to vindicate fully their federal statutory claims arising under the securities laws and RICO.

Among the most urgent of our recommendations is that the panel not contain any industry representatives or individuals related to the securities industry. This would allow the arbitration panelists who are the judges of both fact and law to more closely represent the cross-section of the lay community such as the juries we find in state and federal courts.

The adoption of rules of evidence are long overdue to ensure uniformity of decision-making and to clarify for both the customer and brokerage firm what standards will be applied at the arbitration. The proposals do not address this issue.

One of the proposals suggests that the results of the arbitration proceedings be made public. This falls short of permitting the sessions themselves to be open to the public; thus the deterrent effect of publicity will be restricted to the limited case summaries suggested instead of open sessions. In this regard, it should be remembered that the issues which will be brought before the SRO arbitrations concern broker fraud such as misrepresentation, unauthorized trading, churning, unsuitable investments, and violations of RICO. Such matters are extremely serious and the public should be fully informed as to the arbitration hearings. This can only be achieved through open sessions.

Additionally, we note that a spokeman for the SIA has expressed concern that the proposals could lead to the issuance of formal opinions and findings. Speaking from the investors' point of view, written opinions and findings of fact based upon the evidence and conclusions of law, not merely the proposed preservation of the record and summarization of legal issues resolved, are essential to the integrity of arbitral process and would be necessary elements to preserve the right of either party to appeal a decision which might not follow existing legal precedent. The SEC's Division of Market Regulation has previously stated that it has no authority to ensure that the federal securities laws are being correctly applied in arbitration and that they have no authority to overturn any particular result. See SEC Report of the Division of Market Regulation in Response to An Inquiry by the Honorable John D. Dingell, Chairman of the Committee on Energy and Commerce

(August 28, 1986). Thus, in the event an arbitration panel went astray of the law, a federal court would have a fully-documented record to review where reasons are given for the decision. Judges would also be in a better position to determine whether the award should stand or be vacated.

This problem inherent in SRO arbitration recently came to light in a case pending in the Southern District of New York before The Honorable Judge Shirley Wohl Kram, known as Tinaway v. Merrill Lynch, 658 F.Supp. 576, 579 (S.D.N.Y. 1987). Judge Kram found, on the basis of her review of an arbitration finding that reduced a claimant's loss by 95%, that there was evident partiality on the part of the arbitrators. The Judge vacated the award. Justice Blackmun in the McMahon dissent noted that the federal district courts will now be called upon to determine the correctness of awards more than ever before. Findings of fact and conclusions of law are necessary for this process to work efficiently.

Only one peremptory challenge is permitted under the Uniform Code of Arbitration which can be utilized by either side when challenging a panelist. This is insufficient. The number of challenges not for cause should be increased so that bias and prejudice can be weeded out in light of the expanded disclosure of the panelists' background provided for in the proposals. Providing for public access to full written opinions, findings and conclusions, not just summary results, is the only way to give investors a meaningful ability to evaluate the system.

In connection with the proposal concerning the purported need for industry expertise on the panels, we respectfully but strenuously object based upon the fact that the proposals also recommend that "arbitration panels include persons who are not so connected with the industry that it may hinder their ability to make independent judgments with respect to specific industry practices." Proposals at 2. It is proposed that the Uniform Code of Arbitration be amended to restrict those persons who may serve as public arbitrators to people wholly unconnected to the industry. We submit that if the list of so-called public arbitrators should not include persons who are connected with the industry in light of their potential bias, the exclusion should logically also apply to the industry representative serving as the panel chairman, whose opinions and expertise are often deferred to by the "public" arbitrators.

Investors are entitled to a panel whose members are totally objective. We agree with the SEC that fairness is of paramount importance with respect to SRO arbitrations. To ensure that the appearance of impropriety or bias does not exist, panels must be cleansed of industry representatives and

of the "public" arbitrators who currently have or have had ties to the securities industry in the past. The proposal that would still permit a person who has left the securities industry for a non-industry position to serve as a public arbitrator after the passage of three years is accordingly inappropriate, since the mere passage of time does not begin to address the potential for bias. The fact that these persons subsequently held non-industry positions does not necessarily eradicate from the process the "old boy" network that Wall Street breeds.

The proposals would permit partners of lawyers and accountants who regularly provide services to the securities industry to serve as public arbitrators. We object to this practice since it is obvious that legal and accounting partners share in fees generated by securities industry clients and thus may be biased by virtue of this association. Mere disclosure of this fact to the parties or a de minimus, 10% cap on billings/two year exception to the exclusion for attorneys and accountants who provide services to the industry does not in any way ameliorate the appearance of and potential for serious conflicts of interest.

The prospect that under the proposals three years may be permitted to expire before the new criteria for public arbitrators go into effect is subject to criticism. Despite the fact that the proposals seem to provide that in the interim public arbitrators will at least be subject to challenges for cause, this would merely delay rather than correct an inherent unfairness in the composition of the panel. The concern that the current pool of arbitrators would be substantially reduced if it were to take immediate effect is appropriate but not significant since the American Arbitration Association has a substantial pool of arbitrators without any securities industry ties who presumably would be readily available to step in and take up the slack. Moreover, it should not be too difficult for SROs to obtain other qualified non-industry arbitrators from bar association lists and by actively soliciting interest from the public sector. Unlike the juror who is paid a modest fee to serve, members of the general public empanelled as public securities arbitrators would receive a more remunerative stipend as an incentive to serve. The immediate result of enlisting truly impartial public panelists would be to infuse the system with the long-neglected objectivity to which the public investor is entitled.

The proposals imply that the brokerage firms who utilize the SRO arbitration process have historically kept extensive information on the voting patterns and awards rendered by the arbitrators, while the public's access is confined to the percentage of cases in which investors were awarded an unrevealed portion of their claims. All data

regarding claims and awards should be subject to pre-hearing disclosure so that the investors and their counsel will be on a more equal footing with the brokerage firm and its counsel. Challenges would thus become a meaningful concept.

Arbitrator evaluations should be kept by the SROs, but the concept should be expanded by requiring such evaluations to be filed independently with the SEC as a means of enhancing its oversight capability. In this age of the computer, data can be tabulated in connection with arbitrators the same way data can be tabulated in connection with brokers and their firms who have been found by arbitration panels to have commited fraudulent activities. Regulatory oversight over SRO arbitration would thereby be enhanced.

The proposal to make awards part of the public record would benefit investors and serve "to balance out the inherently unequal familiarity with the system of investors and member firms." Proposals at 8. However, the proposals would not require the arbitration panels in smaller disputes (for example, up to $15,000.00) to issue written findings of fact and conclusions of law. This would greatly serve to prejudice all but the largest claimants by denying most claimants and relatively small investors the ability to ascertain the rationale behind the arbitrators' decision.

The proposals with regard to discovery, historically one of the more deficient aspects of SRO arbitration, are somewhat limited in scope. There is a real need for pre-hearing conferences and preliminary hearings in all cases regardless of size of claim, and not just the complex ones the proposals mention. These conferences will not only serve to "delineate the issues in dispute, result in stipulations, and otherwise set the focus for the hearing on the merits," Proposals at 10, but may also be used to explore settlement. The problem arising at the hearing of arbitrators precluding evidence germane to proving a claim will thus be avoided. Any evidentiary problems or witness unavailability difficulties can be explored and resolved and depositions can be directed where appropriate at such conferences. They are a necessary addition to the SRO system.

We take issue with the limited use of the deposition process as proposed. Although we agree that in many court proceedings the discovery process is sometimes abused by counsel we find that it does serve to delineate the issues in controversy and to provide a record of each party's sworn testimony. Where the issues are sufficiently complex to require that such testimony be given, the depositions of parties involved in the dispute should be extended to necessary witnesses and other brokerage firm personnel such as compliance officers and branch managers.

The lingering problem of brokers stonewalling any meaningful document production prior to the hearing is serious and the proposals attempt to address it. From the start, however, the investor should be able to obtain a de minimus list of documents prior to commencing an arbitration. These documents would go a long way in assisting the defrauded investor and counsel and as to whether or not his or her claims are substantiated by documentation in the hands of the broker, and may also shed light on the prospects for ultimate success on the merits. A few of the documents which should be voluntarily disclosed are: a) the customer/broker agreement that was executed; b) account information forms; c) margin agreement, if any; d) correspondence between customer and the brokerage firm; e) disciplinary proceedings that are of record against the broker or branch office involved; f) market reports or evaluations upon which the brokerage firm's recommendations were based, if this is an issue, and other such basic documents depending upon the nature of the dispute.

Leaving aside for a moment the real necessity to reinstate investor rights abrogated by the McMahon decision by amendment to the securities laws, in the immediate future everyone envisions an increase in the number of arbitrations of securities fraud claims. Yet during this hopefully interim period of uncertainty, while the SROs are still thrashing out adoption of the SEC proposals for amendments to their rules and elimination of certain types of individuals from their panels, the brokerage firms should not be permitted to limit the choice of a panel to one of the SROs. The American Arbitration Association, as recommended by the proposals, should be a required alternative to be chosen by the customer at his or her option in the event SRO procedures are not deemed desirable by the customer.

Although reference to a replacement for former Rule 15c2-2 is notably absent from the proposals, we believe consideration should be given to adoption of a rule to ensure the voluntariness of a customer's execution of an agreement to submit future disputes to arbitration. The Commodity Futures Trading Commission rules provide a useful model. The CFTC almost since its inception has enacted rules requiring that the signing by the customer of such an agreement, as a separate clause within the customer/brokerage agreement with its own signature line, "must not be made a condition for the customer to utilize the services" of the member firm. 41 Fed.Reg. 27, 520, Section 180.3(b)(6) (July 2, 1976). The Commodity Exchange Act itself requires commodity exchanges to "provide a fair and equitable procedure through arbitration or otherwise. . . for the settlement of customers' claims and grievances against any member or employee thereof: Provided that (i) the use of such procedure by a customer be voluntary. . . ." 7 U.S.C. Section 7a(11) (1922) (emphasis

added). No similar provisions are in effect with respect to investors in the national securities markets.

With respect to fraudulent activity that is confirmed in an arbitration award, such findings should be sent to the SEC for its review and further action if needed.

We hope that you will consider our suggestions and comments on the proposals for reforming SRO arbitration in the spirit in which we have offerred them, which is to promote the dialogue regarding these issues in a fair and democratic manner.

Very truly yours,

Theodore G. Eppenstein

TGE/mo

cc: The Hon. David Ruder, Chairman
The Hon. Edward H. Fleischman, Commissioner
Mark A. Fitterman, Associate Director
Division of Market Regulation

PUBLIC MEMBERS OF SICA
SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

PUBLIC MEMBERS
THEODORE G. EPPENSTEIN
CONSTANTINE N. KATSORIS
J. PAT SADLER

EMERITUS PUBLIC MEMBERS
PETER R. CELLA
THOMAS R. GRADY
THOMAS J. STIPANOWICH

January 12, 2007

The Honorable Christopher Cox
Chairman
The U.S. Securities and Exchange Commission
100 F. Street NE
Washington, DC 20549

Re: The Public's Concerns about the Newly Combined NASD/NYSE Arbitration Forum and SICA's Mandate

Dear Chairman Cox:

The Public Members of the Securities Industry Conference on Arbitration are independently appointed, unaffiliated with the securities industry and serve to help protect the interests of public investors in securities arbitration. It is in this capacity that we communicate our concern regarding the recently announced proposed merger of the arbitration departments of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD") (collectively "the Consolidated SRO"), which will effectively create the only forum available for the resolution of disputes between public customers and the securities industry. All the Public Members (and the retired Emeritus Public Members) wish to address certain questions raised by the consolidation with respect to the future of securities arbitration. We suggest several measures that we believe would assist the investing public's perception of fairness as well as the process of arbitration.

SICA was established in April 1977 with the support of the Securities and Exchange Commission. It was tasked to create a comprehensive Uniform Code of Arbitration ("Uniform Code") to cover all claims by investors, in all self-regulatory organizations ("SRO's"). The Uniform Code that was developed harmonized the rules of the various SROs and codified procedures that previously had been informally utilized. The original Uniform Code was developed by SICA in the late 1970's, and since that time SICA has met on a regular basis to review and amend it as necessary.

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When in 1987 the U.S. Supreme Court decided that arbitration clauses would be enforced in 1934 Exchange Act securities cases,[1] investors became generally obligated to arbitrate their disputes with the industry, pursuant to predispute arbitration agreements. Two years later, the Supreme Court similarly upheld the arbitrability of claims under the Securities Act of 1933 pursuant to predispute arbitration agreements.[2] These two decisions transformed SRO arbitration from a voluntary process to a mandatory procedure for the resolution of most public investor disputes.

After 1987, brokerage firms utilized arbitration clauses in their customer agreements that required that all customer claims and controversies were to be tried in an arbitration forum operated by the various self-regulatory organizations. At the time there were multiple arbitration forums, including the NASD, NYSE, American Stock Exchange, Pacific Stock Exchange and Boston Stock Exchange, to name a few. Over the past decade, securities arbitration was principally administered by the NASD and the NYSE, the two major forums with the majority of the case filings. The remaining SRO's substantially reduced their caseload, while other exchanges were absorbed or gave up their arbitration programs entirely. According to a recent SICA subcommittee report, aside from the NASD and NYSE there were a bare handful of cases filed at all the other SRO forums in 2005. With the consolidation of the NASD and the NYSE arbitration departments there will be only one securities industry funded arbitration forum to which all investors must bring their claims and controversies.

The prospect of a single securities arbitration forum maintained and funded by the securities industry will only heighten the suspicion long held by many public investors that the system they are compelled to use is less than independent and hence less than fair. In the past SICA and particularly its Public Members have been able to exert some effect upon the uniform arbitration rules and their administration. The consolidation potentially creates a securities industry dispute resolution structure that will inherit all the present problems in the arbitration process in addition to a heightened degree of doubt as to its fairness. This is particularly so given the recent securities market abuses in which public investors were severely damaged while many, as the public observed, in the industry reaped substantial profits at the expense of their customers. The real issue is whether the Consolidated SRO should have the responsibility for providing the only arbitration forum to resolve investors' disputes, as opposed to having this critical function given to, or shared with, another forum totally independent of the securities industry?

We recall that the Commission had recommended in 1987 that an alternative to SRO arbitration should be made available for customers, and had asked SICA to encourage broker-dealers to include the option of a non-industry forum in future predispute arbitration clauses: "We recommend that SICA encourage broker-dealers to

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[1] *Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987).*

[2] *Rodriguez de Quijas v. Shearson/American Express, 490 U.S. 477 (1989).*

include in their arbitration clauses the option of using AAA arbitration as well as SRO arbitration forums."[3] At that time, SICA advised the SEC that the SIA's standard customer agreement included non-SRO alternative forums,[4] which is no longer the case. In fact, the SEC mandated in 1989 that the securities industry could no longer preclude access of investors to their choice of SRO forums. The SEC was clear that the SRO "rules are intended to effectuate an underlying policy of allowing the customer to choose the most appropriate forum for resolution of his or her particular claim."[5]

It has been reported by the NASD that the customers' chances of winning an award had substantially dwindled to around forty-three percent by 2006.[6] Yet historically, after McMahon (1989-90) the win rate at the NASD/NYSE was abont sixty percent, as reported by the GAO,[7] and when investor awards are granted, they are frequently only for a small percentage of the loss suffered by the investor, sometimes not even enough to pay their costs to arbitrate. Indeed, the public has been warned by a well-respected journalist that: "If you're an investor who has filed an arbitration case against your stockbroker, you would be wise to steel yourself for an irrational and unjust outcome."[8]

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[3] Letter of Richard G. Ketchum, Director, SEC Division of Market Regulation, September 10, 1987 at p. 11.

[4] *See* SICA Letter to Richard G. Ketchum, Director, SEC Division of Market Regulation, December 14, 1987 at p. 9.

[5] Litigation Release No. 12198, 44 S.E.C. Docket 461, 1989 WL 992090 (S.E.C. Release No.). *See also* SEC Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the New York Stock Exchange, Inc., National Association of Securities Dealers, Inc., and the American Stock Exchange, Inc., Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses, Release No. 34-26805, 43 S.E.C. Docket 1250, 54 FR21144, 1989 WL 991624(S.E.C. Release No.).

[6] *See* NASD Dispute Resolution Statistics-Results of Customer Complaint Arbitratiou Award Cases at www.nasd.com/ArbitrationMediation/NASDDisputeResolution/Statistics/index.htm NASD's statistics also show a drop of around 20% in the customer's chances from 2000 levels to 2005 levels. *Id.*

[7] General Accounting [Government Accountability] Office, GAO/GGD-92-74, Securities Arbitration-How Investors Fare (May 11, 1992). *See also* Sec. Arb. Commentator, Public Customer Award Survey-The First 10,000 Awards (May 1996))("A steady downward trend in the 'customer win' rate is revealed. . . ."), commenting on Awards in the 1989-1995 time period.

[8] Gretchen Morgenson, "FAIR GAME; When Winning Feels A Lot Like Losing," New York Times Business Section, December 10, 2006, p.1.

A single, independent securities arbitration forum, with SEC oversight and public investor and securities industry participation, would serve to contribute to the reduction of this negative perception.

Another alternative to compulsory SRO arbitration would be to again provide the public investor with the right to choose to bring grievances to court or to arbitration. While not all cases would be susceptible to resolution in court (for example, claims under $25,000), it would permit the public investor the choice as was their right prior to1987.

The creation of the Consolidated SRO underscores the continuing importance of maintaining SICA and the Public Members' role in attempting to ensure an arbitration process that protects public investors' rights in securities arbitration. The Public Members voice their concerns and make recommendations for reform. SICA's three voting Public Members are augmented by the experience of the Emeritus Public Members. No Public Member is affiliated with the securities industry. While the Emeritus Public Members do not have a vote, as the current Public Members do, they can also attend meetings, receive agenda books, submit agenda items, invite guests and participate in the discussions, all of which benefits public investors and aids the perception of integrity and fairness in monitoring the SRO arbitration system.

In light of the fact that there will now realistically be only one SRO arbitration forum, we must strengthen SICA's role as a watchdog over the arbitration process and, in addition, ensure that at least one-half of the future voting members of SICA be Public Members, for only then will public investors be persuaded that they have a real voice in a process they are being forced to participate in.

The continuation of the role of SICA and that of its independent Public Members is necessary in order to secure and maintain balance and fairness in securities arbitration.

Securities industry considerations have been the focus of the present consolidation, particularly the great savings achieved for the Consolidated SRO. It is not unreasonable to suggest that the public investors' interests be considered in order to ensure a truly level playing field for their claims in arbitration.

Respectfully,

The Public Members of SICA*

Current Public Members	Emeritus Public Members
Theodore G. Eppenstein	Peter R. Cella
Constantine N. Katsoris	Thomas R. Grady
J. Pat Sadler	Thomas J. Stipanowich

* *The Public Members and Emeritus over the long history of SICA have developed innovative ideas, vigorously represented the public investors' interests, and worked with industry and SRO representatives in order to revise and reform the securities arbitration system. Each of the current Public Members and Emeritus have extensive experience in preserving the rights of the investing public.*

The three public members are Theodore G. Eppenstein, Esq., Professor Constantine Katsoris, and J. Pat Sadler, Esq.

Theodore G. Eppenstein is a partner in the New York law firm Eppenstein & Eppenstein. He and his firm represented the investors in the McMahon case. He has testified before two Congressional subcommittees, assisted in drafting securities arbitration reform legislation, and has been a successful practitioner in this field, including winning a historic arbitration case against Refco, Inc. and succeeding in a precedent-setting case before the New York State Court of Appeals. Mr. Eppenstein has been a Public Member of SICA since 1998. He has worked on many subcommittees and has been chair of several subcommittees including Electronic Discovery, Special Procedures for the Elderly and Infirm Parties and Employment Disputes. Mr. Eppenstein and his partner Madelaine Eppenstein have co-authored many articles on securities arbitration and litigation, and he has regularly commented on matters that concern public investors, including before the Ruder Commission and the NYSE. Mr. Eppenstein was part of the NYSE's "Dream Team" which gave presentations on U.S. securities arbitration at the NYSE/MICEX Symposium in Moscow in 2000 along with Peter Cella, Esq., Professor Katsoris and Professor Thomas J. Stipanowich. He was also part of another NYSE delegation and was a principal speaker on arbitration at the Cairo and Alexandria Stock Exchanges in 2003 along with Professor Katsoris.

Professor Katsoris is Wilkinson Professor of Law at the Fordham University School of Law in New York where he has taught courses in taxation and other business related courses. He was one of the original Public Members when SICA was formed in 1977 and returned as a Public Member and Chair of SICA in January 2003. His service to the public has been well documented and includes co-chairing the NYSE Symposium on Arbitration, testifying before Congress on securities arbitration issues and speaking at various industry and arbitration related seminars. He is a well known commentator and has written numerous articles, some of which have been noted by the U.S. Supreme Court and the SEC. He is also a public arbitrator for the NASD and NYSE for over 35 years and an active mediator in securities disputes. At the suggestion of past SEC Chairman Arthur Levitt nearly ten years ago he was instrumental in establishing the securities arbitration clinic at Fordham and elsewhere.

J. Pat Sadler is a partner in Sadler & Houdesvan in Atlanta, Georgia, and represents the public's interest as a major part of his professional activity. Mr. Sadler is a former president of the Public Investor Arbitration Bar Association ("PIABA") and serves as a director of that organization. He is an experienced and active litigator and arbitrates before the various SRO's on behalf of claimants. He joined SICA as a Public

Member in 2005 and has assisted in many of SICA's subcommittees and projects, including as Chair of the subcommittee planning the survey on arbitration which will be shortly disseminated. Mr. Sadler also was a member of the NASD's NAMC.

The Emeritus Public Members are Peter R. Cella, Esq., Thomas R. Grady, Esq. and Professor Thomas J. Stipanowich. Mr. Cella was one of the original public members when SICA was formed in 1977. He served for about 18 years before taking Emeritus status. He is a renowned securities litigator representing public customers who have constituted a significant portion of his practice. He was part of the NYSE's "Dream Team" that went to Moscow in 2000. In 1984 Governor Mario Cuomo appointed Mr. Cella to the Citizen's Planning Committee Against Crime, an advisory group to the Governor of New York. Mr. Cella represents investors in his practice and is an arbitrator at the NASD and NYSE.

Thomas R. Grady is another Emeritus Public Member. Mr. Grady is Of Counsel to the firm of Ackerman, Link & Sartory and practices securities arbitration and litigation throughout the country from his offices in Naples and West Palm Beach, Florida. As a Public Member, Mr. Grady co-authored revisions to eligibility rules, helped to draft the Uniform Code into plain English with the coordination of representatives from the industry and fought against discovery and motion practice abuses in arbitration. Mr. Grady's insights over the years have been invaluable to the public.

Thomas J. Stipanowich, Emeritus Member, is Professor of Law at Pepperdine University School of Law and Academic Director of the Straus Institute for Dispute Resolution. He is the co-author of a five-volume treatise on the Federal Arbitration Act and many other works on arbitration and conflict resolution including a new law school book and materials Resolving Disputes: Theory, Practice and Law (Aspen 2005). From 2001-2006 he was President and CEO of the International Institute for Conflict Prevention and Resolution (CPR), a prominent international think tank based in New York City. He was also Academic Advisor for the revision of the Uniform Arbitration Act and was the Academic Reporter and primary drafter of the Consumer Due Process Protocol for arbitration. During his tenure as a SICA Public Member and Chair of SICA he was William L. Matthews Professor at the University of Kentucky.

cc: The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Kathleen L. Casey
The Honorable Annette L. Nazareth

The Honorable Max Baucus
The Honorable Christopher J. Dodd
The Honorable Daniel K. Inouye
The Honorable Chuck Grassley
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The Honorable Fred Upton

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The Honorable Melanie Senter Lubin
The Honorable Tanya Solov
The Honorable Patricia D. Struck
The Honorable Karen Tyler

Catherine McGuire, Esq., Chief Counsel, SEC Div. of Market Reg.
Mary L. Schapiro, Chairman and CEO, NASD
Linda D. Fienberg, President, NASD DR
George H. Friedman, Director of Arbitration, NASD DR
Richard G. Ketchum, CEO, NYSE Regulation
Dan Beyda, Chief Administrative Officer, NYSE Regulation
Karen Kupersmith, Director of Arbitration, NYSE Regulation

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SICA Members and Invitees

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February 12, 2007

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Public Member of SICA Regarding the Combined NASD/NYSE

Dear Chairman Cox:

I write in my capacity as Chair of the North American Securities Administrators, Inc. ("NASAA") Project Group on Arbitration (the "Project Group"). I was recently copied on a letter to you dated January 12, 2007 from the public members of the Securities Industry Conference on Arbitration ("SICA").[1] That letter highlighted a number of serious concerns raised by the consolidation of the arbitration departments of the New York Stock Exchange Regulation and the NASD. While the project group shares the concerns raised by the SICA public members, at this time I will focus on one particular concern raised by the public members in their letter. Specifically, that the average investor believes that, "the system they are compelled to use is less than independent and hence less than fair." This is the Achilles Heel of the current arbitration system and it can only be addressed by changing the composition of the arbitration panel.

NASAA shares the SEC's goal of creating an arbitration forum that is, both in perception and in fact, fair to all parties. NASAA applauds both the SEC and the NASD for the recent user-friendly revisions to the NASD Code of Arbitration Procedure. As Joseph Borg, President of NASAA, stated in his recent remarks setting out NASAA's legislative agenda, "[s]tate securities regulators believe Congress should review the manner in which arbitrations are conducted to determine: if there is sufficient disclosure of potential

[1] While NASAA is not a voting member of SICA, we are an invited attendee and an active participant in its meetings.

President: Joseph P. Borg Esq. (Alabama) • President-Elect: Karen Tyler (North Dakota) • Past-President: Patricia D. Struck (Wisconsin)
Secretary: James O. Nelson, II (Mississippi) • Treasurer: Fred J. Joseph (Colorado) • Director: Michael Johnson (Arkansas) • Director: Glenda Campbell (Alberta)
Director: Denise Voigt Crawford (Texas) • Director: James B. Rapp (Delaware)
Executive Director: Russel P. Immhoff
Ombudsman: Don B. Sutton (Florida)

conflicts by panel members; if selection, qualification, and composition of the panels is fair to the parties; whether the arbitrators receive adequate training; if explanations of awards are sufficient; if the system is fast and economical for investors; and if the entire arbitration process should be optional, not mandatory, for investors."

The purpose of this letter is to set forth the Project Group's position that arbitration panels must be unquestionably neutral. As long as arbitration panels remain comprised of a mandatory industry representative and public arbitrators who maintain significant ties to industry, the process is fundamentally unfair to investors.

Many have justified mandatory industry participation based on the industry representative role as an educator for the other panelists. This justification of an industry presence on the panel is spurious. First and foremost, expert witnesses ably serve the purpose of educating the arbitrators. The very notion of having a matter heard by a panel of independent arbitrators assumes that they come to the arbitration process with no preconceived opinion or interest in any party or issue at conflict. It stretches credulity to believe that arbitrators who are affiliated with industry can remain entirely impartial, but even if that were the case, the industry arbitrator creates a presumptive of bias that is poisonous to the principles of fair play and substantial justice. Do courts in complex medical malpractice cases insist that one physician be empanelled in order to "educate" the other members? Clearly, such a requirement in a judicial proceeding would be dismissed as creating a bias that would taint the final ruling and pervert the concept of a fair hearing. NASAA submits that intellectual honesty should not be discarded at the door of the arbitration forum.

Additionally, one could readily conclude that the assertion that arbitrators must be "educated" by an industry-affiliated panelist indicates that the current training of arbitrators is inadequate. While a pool of uneducated arbitrators is a serious problem, there are ways to correct this which will not taint the average investor's view of a currently mandatory process.

With the advent of a single forum for customer arbitration, any suggestion of bias must be removed from that forum with undue speed. Removing industry's role in the arbitration forum will instill confidence in the average investor that they will receive a fair and unbiased forum in arbitration. A goal, I am sure that all regulators wish to achieve. We urge you to address this matter and remove the requirement for the a mandatory industry representative and prohibit public arbitrators from having significant ties to industry

Please contact me if you have questions about this letter or if I can assist you in any way.

Sincerely,

Bryan J. Lantagne
Director
Massachusetts Securities Division and
Chair, NASAA Arbitration Project Group

cc: The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Kathleen L. Casey
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Karen Kupersmith, Director of Arbitration, NYSE Regulation

Rex A. Staples, General Counsel, NASAA
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Theodore G. Eppenstein, Esq.
Professor Constantine N. Katsoris
J. Pat Sadler
Peter R. Cella, Esq.
Thomas R. Grady, Esq.
Professor Thomas J. Stipanowich

Ms. SÁNCHEZ. Mr. Eppenstein, I apologize, but we are way over time and we do have questions we need to get to and we are expecting votes on the floor shortly. So I am going to have to cut your testimony off. Perhaps we can elicit some more information through the round of questions.

I am going to begin by recognizing myself for 5 minutes of questions. I will start with Ms. Ventrell-Monsees. One of the attachments to Mr. Naimark's testimony is the employment due process protocols. The president of your association, the National Employment Lawyers Association, at the time signed the protocols. Can you please explain the disconnect between the president of NELA approving the protocols, and your contrary testimony representing the NELA today?

Ms. VENTRELL-MONSEES. Yes, I can. The president of NELA did not sign the document, the employment due process protocol, as the president of NELA. The first paragraph of the employment due process protocol specifically states that the signatories were designated by their organizations, but the protocol reflects their personal views and should not be construed as representing the policy of the designating organizations.

I happened to be at the time working at AARP when the employment due process protocol and the consumer due process protocol were being developed. I was also a member of the American Bar Association's Labor and Employment Council at that time. You will see the other signatories on the due process protocol for employment were members of the American Bar Association's Labor and Employment Council, of which I was also.

All of those people acted in their individual capacities, bringing their knowledge and expertise to that process. The greatest flaw in the employment due process protocol is that, one, it did not bar pre-dispute mandatory arbitration. That is NELA's concern and it remains our position today.

Ms. SÁNCHEZ. I appreciate that answer.

Ms. Williams, I am sorry for your experience, because it sounds like it has been an absolutely terrible one. I am going to ask you some very simple questions, and then I am going to ask you a little bit tougher question. Do you feel like you got ripped off? Just real briefly, yes or no?

Ms. WILLIAMS. Absolutely. I feel like what was done to me was against the law.

Ms. SÁNCHEZ. Do you think that the option of going to court would have been more fair to you and perhaps less costly to you?

Ms. WILLIAMS. According to our franchise agreement, Maryland law would supersede the entire agreement, so that I should never have been in arbitration. We filed a civil suit. I was not to be in arbitration. I was forced in there.

Ms. SÁNCHEZ. How do you feel when you hear things like something that Professor Rutledge said, that, well, you know, most people can't hire attorneys to take their cases to court, so by virtue of the fact that they have mandatory arbitration, and you know, we are sorry that a few people are going to have bad experiences there, but you know, that is kind of the cost of doing business.

Ms. WILLIAMS. It is kind of incredible to me that the gentleman who spoke for the AAA and this gentleman here talk about, yes,

there are flaws and yes, there are things that need to be done. What are you going to do for me? That flaw cost me everything I have ever had. What is going to happen for me?

Ms. SÁNCHEZ. I am sure it is not just you, but I am sure that there are many others who find themselves in similar situations.

Ms. WILLIAMS. True.

Ms. SÁNCHEZ. Ms. Ventrell-Monsees, Professor Rutledge points out in his written testimony that a founder of NELA testified a few years ago that employment attorneys turned away at least 95 percent of employees who sought representation, and he suggested arbitration would allow those who have been turned away to have their disputes heard. I am interested in knowing what your response is to his observation and conclusions?

Ms. VENTRELL-MONSEES. Post-dispute voluntary arbitration or mediation would provide a forum for employees. That is absolutely clear. Attorneys also turn away many, many cases that would be forced into mandatory pre-dispute binding arbitration because the deck is stacked against the employees.

Ms. SÁNCHEZ. So in other words, a lot of employees who would normally consult with an attorney about bringing a case get turned away because of the very reason that there is a mandatory arbitration clause and they feel like it is not a worthwhile case to take because they have so many obstacles.

Ms. VENTRELL-MONSEES. The arbitrator doesn't have to follow the law. At least if you go to court, you are assured that the judge has a law guiding him or her and a right to appeal; that the jury should follow the law based on the instructions given by the judge; that you will get full discovery, not the limited discovery that you would be left with in arbitration; you will get full remedies stated by the Federal and State law, not the limited remedies that arbitrations take away from employees.

Ms. SÁNCHEZ. Thank you.

Professor Rutledge, if arbitration is more favorable to consumers and employees, according to the empirical studies that you cited in your written testimony, what rational business or employer would choose to arbitrate if it is in fact this wonderful system for employees and consumers who feel like they have been wronged?

Mr. RUTLEDGE. Thank you, Chairwoman Sánchez. That is an excellent question. The best way that I can answer it to you is by referring you to a 1997 study by the GAO entitled "Alternative Dispute Resolution: Employers' Experiences." I would just briefly highlight, recognizing that you are at the end of your time and you have votes going, two anecdotes that would explain why.

Ms. SÁNCHEZ. That study is more than 10 years old now. Correct?

Mr. RUTLEDGE. Absolutely, but I believe what it does, Madam Chairman—excuse me, Madam Chairwoman.

Ms. SÁNCHEZ. I have been called a lot worse, so "chairman" is not such a bad thing. [Laughter.]

Mr. RUTLEDGE. Me, too. [Laughter.]

Very briefly, the reason why I believe this study is relevant is because I believe it helps establish for you and the other Members of the Committee the context in which we came into a world where arbitration is much more prevalent. Ms. Ventrell-Monsees cited for

you studies which I agree with indicating that if you look back, there was a relatively lower frequency of arbitration, and that has grown.

Two anecdotes very quickly. The GAO study cites an instance in which the Rockwell Corporation spent over $1 million in attorneys fees winning a legal case. So I think the reason why a company might well choose to opt into an arbitration even if in the aggregate the individuals against whom they are arbitrating prevail more often is because it is lowering their attorneys fees.

Second example, the Brown and Root Company spent over $400,000 in legal fees defending an employment discrimination suit which it won. Following that experience, it put an ADR system in place which included an arbitration clause. According to GAO, the overall costs of dealing with employment conflicts were less than half of what the company used to spend, and legal fees were down 90 percent for the first 3 years following Brown and Root's adoption of the program. That is GAO's findings, not mine.

I am not a business person. I can't speak for the community. But responding to your initial invitation, Madam Chairman, I believe that the information such as what is contained in the GAO report will help you assess the empirical record to determine whether this legislation is necessary.

Ms. SÁNCHEZ. I thank you for your answer. I would only note that Mr. Eppenstein did say that statistically not only are consumers and employees going to mandatory binding arbitration—not only is their win-rate falling, but their recovery is also falling as well. And that may be one reason why businesses choose to go through the arbitration system as well.

My time has expired. I will recognize Mr. Cannon for 5 minutes for questions.

Mr. CANNON. It seems to me, before you run my time, that Mr. Rutledge wanted to respond to your last statement-question.

Mr. RUTLEDGE. Thank you very much.

Ms. SÁNCHEZ. I will grant him the opportunity if he so chooses.

Mr. RUTLEDGE. If I may, Madam Chairman. Thank you for the opportunity, and to Ranking Member Cannon. I would just make two points. I would not put words in Mr. Eppenstein's mouth, but I believe that his testimony was concerned with the declining win rates in the securities industry.

Ms. SÁNCHEZ. I stand corrected. You are correct. That was in one specific area. My apologies.

Mr. RUTLEDGE. The other point that I would make, Congressman Cannon, is this. There are a variety of studies in the securities industry, the 2007 one that Mr. Eppenstein cited being only one. Footnote—excuse me, congressman—a footnote in my written testimony cites several others, including the Tidwell study and the Perino study.

Very briefly, as to the 2007 study that Mr. Eppenstein kindly brought to our attention, there is one point that I would make, picking up on what Mr. Eppenstein said. Mr. Eppenstein indicated that—well, two points that I would make. One, Mr. Eppenstein indicated that win rates in securities arbitration were approximately 98 percent. Let us compare that for a moment with what William

Howard found in 1995 in looking at employment and consumer arbitrations.

In employment and consumer arbitrations, Mr. Howard found that in employment and consumer litigation only 8 percent of those claims went to trial, and when they went to trial, the employer's win rate was 72 percent. So if we are going to engage in a comparison of raw win rates, let's be clear that there are instances where the win rates at trial are more favorable to the business than the win rates in arbitration.

The other point that I would make——

Ms. SÁNCHEZ. Mr. Rutledge, I am going to just interrupt you to point out, though, the paradox that I think we have already stated with Ms. Ventrell-Monsees, which is many possibly meritorious employment claims never go to court by virtue of the fact that there is a mandatory binding arbitration clause in the employment context.

Mr. RUTLEDGE. Absolutely true, Chairwoman Sánchez. The other point that I would make is that many potentially meritorious employment claims would never go to trial because there would not be lawyers willing to take them. I cite in my written testimony a statistic indicating that if you don't have a meritorious claim of at least $60,000, that an employment lawyers is not going to be willing to take your case.

Ms. SÁNCHEZ. I hate to keep contradicting you, but if legal services were more available to people who needed access to them, I don't disagree that perhaps they would be able to bring their claims. But it seems to me that that is a whole other issue that we need to look at as Members of Congress, because there is a way that we can impact that as well.

Mr. RUTLEDGE. I agree with you, Madam Chairwoman, and that is precisely why I say I think it is so important to respond to your initial invitation, which is to ask: Does the empirical record justify the remedy that is being proposed here? There may be other remedies that are appropriate, but the question is whether jettisoning arbitration on balance is going to yield net benefit to the individuals whom Congress is trying to protect. The point that I am trying to make is based on my assessment of the empirical evidence, and I am not convinced that is the case.

Ms. SÁNCHEZ. I appreciate that.

Mr. Cannon?

Mr. EPPENSTEIN. Madam Chairperson, do I get to respond to inaccuracies about my testimony?

Mr. CANNON. I don't think we have any objection here.

Ms. SÁNCHEZ. Okay. If there is no objection, absolutely.

Mr. EPPENSTEIN. Thank you.

First of all, Professor Rutledge, the customer never won 98 percent of the time. In 2006, the customer is down to a 42 percent win rate; 58 percent of the time, the industry wins.

The other thing you mentioned was settlements, and the impact of settlements. I can tell you that settlements are impacted by arbitration. That is because—and I am not the only one to know these statistics, the broker-dealers do also—they feel in a settlement situation that they don't have the big risk if they go to arbitration and get a decision by the arbitrators, because they know that they are

not going to be hit for a big number, and they know 58 percent of the time they are going to win anyway.

So they give low-ball offers to the investor. The investor is there with the investor's attorney and the investor says, "Why are they so low?" And the attorney has to tell the investor what the deal is in terms of the stacked deck and what we have been talking about, how you can't get a fair trial. That pushes down the settlement offers. It pushes down the deals. It has a negative impact.

And you cannot compare a court decision to an arbitration decision because you don't have the same customer going to both forums at the same time.

Ms. SÁNCHEZ. That is very valid point.

Mr. EPPENSTEIN. That comparison is out the window.

Ms. SÁNCHEZ. I appreciate that.

I am now going to allow Mr. Cannon to ask questions.

Mr. CANNON. Thank you.

There are distinctions between sectors, and Mr. Eppenstein, you mentioned I think in your testimony that there is no public faith in the system. Doesn't that have the effect of moving people and customers out of the system? Isn't there a profound problem for stockbrokers who cheat their clients and then have the benefit of an arbitration system that is counterproductive for the industry and then perhaps for themselves individually?

Mr. EPPENSTEIN. I don't quite understand your question, Mr. Cannon. I am sorry.

Mr. CANNON. If stockbrokers cheat their customers, the customers won't come back.

Mr. EPPENSTEIN. They may not have any money to continue anyway.

Mr. CANNON. Of course not—well, perhaps. The point is there are other factors that affect how these things proceed and it is not just what happens in arbitration. Once burned, twice not there, I guess.

Let me shift to Ms. Ventrell-Monsees. We are looking actually at a bill here, and I wonder if you are familiar with it. There are basically three kinds of contracts, grossly speaking here. You have an at-will contract, you have a signed contract. You can't have an arbitration clause in an at-will contract. You can in a signed contract. And then you have union contracts. This bill excludes union contracts. Do you think that is appropriate? Are you familiar with that?

Ms. VENTRELL-MONSEES. Yes, I am familiar with it, and I have been dealing with it for many years. We have no concern with arbitration in collective bargaining agreements. The unions are there to represent their workers. They often do a very good job, and so there is no reason for Congress to address that issue.

The real problem that needs to be addressed is the contracts, and you can have mandatory arbitration in employment at-will. When you apply for the job, at the bottom of that application oftentimes there is a mandatory arbitration clause that people never see.

Mr. CANNON. Then it is a contract that is not an at-will. There may be few protections for the person at that point.

You pointed out that there are overtime problems. There are resolutions to overtime issues and those made a major story in Busi-

ness Week last week. There clearly are other protections in the system.

I had one other question for you, and that is that you cited two statistics, one I think was 85 percent win for the employer, and the other was 97 percent win for the employer. Did you look at the merits of those cases, or would it have been acceptable if it had been a 50-50 win?

Ms. VENTRELL-MONSEES. It is not possible to look at the merits because they are the results of the AAA decisions in California, so it is just the result itself.

Mr. CANNON. And that result you characterized as routinely discriminating against employees, as opposed to figuring out what the merits were. Let me just suggest that that is not very helpful to us because all kinds of things go into what is happening. From 1 year to the next, the employment world, whether we have a shortage of labor or a surplus, affects that sort of thing and companies have a fairly long-term interest in keeping their employees relatively happy. There are aberrations to that, but I don't think those statistics are very helpful in what we are looking at here.

Ms. Williams, my understanding is that in your case, there was a point at which the attorney general from the State actually got a settlement for you, and perhaps others—I am not sure if it included others in your franchise situation. Was that the case?

Ms. WILLIAMS. What do you mean by "settlement"?

Mr. CANNON. An offer to refund and take equipment back and things like that.

Ms. WILLIAMS. There is an open pending investigation still. We can talk about arbitration today if you like. I would love to talk about that with you, and I hope I get the opportunity at another point in time.

Mr. CANNON. I am just asking a question here. Did you have an opportunity to settle that was provided by the attorney general?

Ms. WILLIAMS. Mr. Cannon, Congressman Cannon, I should never have been in arbitration regardless.

Mr. CANNON. I understand that you don't like that. I am just wondering. Look, you ended up spending $1.5 million, and you told us that you didn't know at the time you made an investment which led to $1.5 million in expenditures that the average life of a coffee shop was 3 1/2 years.

Ms. WILLIAMS. That is correct. That would be the fraud.

Mr. CANNON. Was that fraud on the part of the company that sold you the equipment and the franchise, instead of telling you all the downsides?

Ms. WILLIAMS. Exactly. The information was not disclosed.

Mr. CANNON. You didn't have a reason to go look on the Internet—at the time, I am not sure that was available—to check out the kind of business you were getting in? In other words, you are a victim here, and I don't know this franchisor, but all the money you put out to vindicate your right to a trial, when you might have cut your losses and gone into some other kind of business, seems to me to be an unfair indictment of a franchisor.

Ms. WILLIAMS. That is correct, and we were given a UFOC, and according to the FTC guidelines there are 21 requirements by law that a franchisor needs to disclose. We did our due diligence based

on the information we were given. Your due diligence is only as good as the information that is being disclosed to you.

Mr. CANNON. With all due respect, we live in a world full of information, more full these days than before. It seems to me that it can't all be the franchisor's fault. This is not a case for the franchisor, but a case for the responsibility of the investor.

Thank you, Madam Chair. I yield back.

Ms. SÁNCHEZ. The gentleman yields back his time.

We have been called for votes, but we have just enough time, I think, to allow Mr. Johnson for his 5 minutes of questions, and then we will conclude our hearing.

Mr. Johnson?

Mr. JOHNSON. Well, I don't know if I will take 5 minutes. I will say that your testimony, Ms. Williams, has been very compelling.

Ms. WILLIAMS. Thank you.

Mr. JOHNSON. You purchased a franchise, and when you entered into that agreement, you really didn't have a choice as to whether or not to accept the pre-dispute binding mandatory arbitration clause that was in it. If you did not accept it, you simply would have been turned away from being able to purchase that franchise. Is that correct?

Ms. WILLIAMS. In our situation, the UFOC and the franchise agreement are amended to adhere to Maryland franchise registration disclosure laws. Under those laws, if there is a dispute as to whether or not fraud has been committed, it does not arbitrate. It goes to court.

Mr. JOHNSON. Well, my point is there was a mandatory binding arbitration clause in the franchise agreement that you signed. Correct?

Ms. WILLIAMS. I am finding out now that the amendment to the contract to adhere to Maryland law was useless. That is correct.

Mr. JOHNSON. And you didn't have a choice about whether or not to sign it or not. If you had not signed the agreement, then you would not have gotten a contract. I guess the point that I am trying to make is that when you go to purchase a cell phone, get cell phone service, a nursing home situation, you go to put your mother in a nursing home, you are confronted with a mandatory pre-dispute binding arbitration clause in the agreement.

If you don't sign it, then you won't be able to get mom into the nursing home. You won't be able to get the cell phone service. You won't be able to purchase the home from the builder. Every builder in town has a mandatory arbitration clause, pre-dispute, in their agreement. So if you want to purchase a home in that market, you are going to have to sign that agreement with that clause in there.

So it basically makes the consumer not have a choice as to whether or not to waive it or not. Of course, the consumer is not concerned about a dispute at that time. It is only when the dispute arises that you get caught up and you find that you have signed away, contracted away your right for a jury trial. A jury trial is important because it is in a public courtroom. The judge has either been elected or appointed. He or she has been subject to the will of the people and remains that way. Subject to judicial canons of ethics, he or she has to be fair and impartial, or else there is some recourse.

But there is no recourse available to help a person agree to buy an arbitrator or an unfair arbitration proceeding. So it is because of this imbalance that continues to take hold throughout the commercial industry throughout America that results in people not having an ability to engage in the public justice system that gives rise to this legislation.

So your testimony, Ms. Williams, is a clear example notwithstanding statistics and that kind of thing, but this is a clear example of why this kind of legislation is necessary, because of the nightmare that you have been through—no discovery, no choice of the arbitrator, exorbitant fees. You have spent $100,000 in costs, and did not have the ability to select the arbitrator. The arbitration process was held 500 miles away from your home. There are just so many costs involved.

Do you find, Ms. Ventrell-Monsees, that this is typical as far as this kind of nightmare is concerned?

Ms. VENTRELL-MONSEES. Yes. It is a very typical story in consumer cases and employment cases as well. Just as the consumer's life is devastated, so is the employee's.

Mr. JOHNSON. All right.

Mr. Eppenstein, you would agree that in terms of securities regulations and securities disputes that stockholders who have been burned by stockbrokers are subject to the same kind of nightmare?

Mr. EPPENSTEIN. Yes. And more than that, Mr. Johnson, the public isn't learning about the terrible frauds that are going on because the hearings are held behind closed doors. The decisions don't go into detail about what happened, and a lot of time the public never hears about it.

Mr. JOHNSON. Thank you.

Ms. SÁNCHEZ. The time of the gentleman has expired.

I want to thank all of the witnesses.

Mr. CANNON. Madam Chairman, may I just ask unanimous consent to submit a packet of documents for the record for the hearing?

Ms. SÁNCHEZ. Without objection, so ordered.

[The information referred to is available in the Appendix.]

Ms. SÁNCHEZ. I want to thank all of the witnesses for their testimony today. We actually got in both panels before the vote. Without objection, Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer as promptly as you can so that they can be made a part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any other additional materials.

Again, I want to thank everybody for their time, patience and effort in coming today to help us get to the bottom of this issue.

This hearing on the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 4:40 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

MATERIAL SUBMITTED BY THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH, AND RANKING MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

H.R. 3010, The Arbitration Fairness Act of 2007

Thursday, October 25, 2007

WRITTEN TESTIMONY OF

THE AMERICAN FINANCIAL SERVICES ASSOCIATION

The American Financial Services Association ("AFSA") commends Subcommittee Chair Sánchez and the Subcommittee on Commercial and Administrative Law for holding this hearing and is pleased to provide its views on how H.R. 3010, *The Arbitration Fairness Act of 2007*, will impact resolution of customer disputes in a fair and cost efficient way for all parties. Although the Act is portrayed as simply returning "fairness" to the arbitration process, it would effectively abolish all arbitration of consumer, employee, and franchise claims, and calls into doubt an even broader range of arbitration agreements.

AFSA, the national trade association for the consumer credit and finance industry, represents lenders that provide access to credit for millions of Americans. AFSA's 350 member companies include consumer and commercial finance companies, "captive" auto finance companies, credit card issuers, mortgage lenders, industrial banks, and other financial service firms that lend to consumers and small businesses.

Arbitration is beneficial due to its affordability, accessibility and efficiency. Mandatory arbitration is a key tool in resolving customer disputes in a way that is fair and cost efficient for both the customer and the company. Arbitration organizations such as the National Arbitration Forum, the American Arbitration Association, and JAMS all conduct their proceedings according to well recognized and detailed procedural rules that allow for fair and timely consideration of the claims by experienced and impartial arbitrators. We firmly believe, and it is our experience, that arbitrations are fair and beneficial to borrowers who have meritorious claims, and that arbitration clauses do not deter such borrowers from pursuing their claims.

A recent Ernst and Young study showed, for example, that 55% of arbitrations that went to hearing were resolved in the consumer's favor, that 79% of all arbitrations (including those that settled) were resolved in favor of the consumer, and that 69% of consumers surveyed indicated they were satisfied or very satisfied with the arbitration process. See "Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases" (Ernest & Young, 2004). Numerous other studies have confirmed these results. See "Arbitration: Simpler, Cheaper and Faster Than Litigation" (Harris Interactive, 2005)(finding that 75% of

arbitration participants are satisfied with the fairness of the process and 74% with the fairness of the outcome); Eric J. Mogilnicki and Kirk D. Jensen, "Arbitration and Unconscionability,", 19 Ga. St. L. Rev. 764(2003)(finding that 71% of individuals won claims against corporate entities before the NAF, compared to an individual winning less than 55% of claims brought against corporate entities in federal court).

Most Americans welcome arbitration as an alternative to suing to settle disputes, found a 1999 Roper Starch survey conducted for the Institute for Advanced Dispute Resolution and the National Arbitration Forum. The Roper poll found that 59% of Americans would choose arbitration over a lawsuit if the disputed amount of money were significant. When informed that arbitration would cost 75% less than a lawsuit, 82% of adults said they would opt for arbitration, according to the study.

Further, numerous courts have found arbitrations to be fair proceedings. See Walther v. Sovereign Bank, 386 Md. 412, 441-42 (Md. App. 2005)("The Court of Special Appeals noted that the arbitration would likely be more expedient and less procedurally cumbersome for petitioners than would a circuit court trial."); Green Tree Fin. v. Randolph, 531 U.S. 79, 95, n.2 (2000)("[N]ational arbitration organizations have developed similar models for fair cost and fee allocation. "); Marsh v. First USA Bank, 103 F.Supp.2d 909, 925 (N.D. Tex. 2000)("The Court is satisfied that NAF will provide a reasonable, fair, and impartial forum within which Plaintiffs may seek redress for their grievances.");Lewis v. Prudential -Bache Securities, Inc., 179 Cal. App. 3d 935, 945 (1986)(finding the American Arbitration Association to be impartial).

In 2000, AFSA's member companies adopted a voluntary standard setting out certain arbitration guidelines to use when resolving borrower-lender disputes. The intent of AFSA's voluntary standard is to ensure all involved parties receive fair treatment throughout the arbitration process. The standard establishes the minimum expected from our members. We have encouraged companies to develop and implement additional mechanisms that support the standard's goal of an arbitration process free and clear of any bias and unfairness.

The standard outlines 14 core principles for AFSA companies to apply to their arbitration programs (also known as Alternative Dispute Resolution or ADR programs), along with recommended procedures to implement each principle. Among the principles are: consumer access to full and accurate information about ADR programs; use of independent and impartial "neutrals" and independent ADR institutions; establishment of reasonable cost, location and time limits; and notification of participating parties about their right to representation and mediation. Also included is a call for lenders to provide "clear and adequate notice of the arbitration provision and its consequences, including a statement of its mandatory or optional character."

The federal law governing the nation's arbitration system is the Federal Arbitration Act (FAA), which recognizes arbitration and establishes the "validity, irrevocability and enforcement" of arbitration agreements. AFSA's voluntary standard goes far beyond what's required by law and fills in many gaps left by the FAA, since it does not mandate detailed standards for conducting arbitration proceedings.

There are several reasons why Congress should not pass this bill. First, the Act's overly broad and vague language and retroactive application are constitutionally suspect and will introduce widespread uncertainty into the economy and the courts. Second, the Act would largely dismantle the arbitration system, even though proponents have failed to establish the need for this drastic action. Third, if the Act becomes law, it will eliminate any possibility that consumers and employees will be able to obtain a remedy for the claims they are most likely to have—those involving individualized facts and damage less than $75,000. Last, the Act ignores the numerous existing protections against unfair arbitration provisions.

Amid the rhetoric and misleading assertions, the truth about arbitration has been obscured. But while opponents of arbitration are entitled to their opinions, they are not entitled to their own facts. Congress should not pass the proposed Arbitration Fairness Act (H.R. 3010) without considering the reality of how arbitration works.

Studies show that arbitrators are not biased, and safeguards, including strict disclosure requirements, protect against the risk of bias. Arbitration is usually less expensive than litigation for consumers and employees. Discovery limitations and the informal nature of arbitration make arbitration quicker and more accessible for consumers and employees. Arbitration agreements generally do not forbid a consumer or employee from retaining counsel. Many arbitration agreements do require that disputes be resolved on an individual basis. The vast majority of arbitration provisions do not require arbitration in an inconvenient location, and if forum-selection clauses are unfair, courts will refuse to enforce them.

The assumption that it is bad for arbitration to be confidential is flawed: many consumers and employees in fact do not want their personal disputes and private information to become part of the public record. In any event, many arbitration agreements do not mandate confidentiality.

The FAA does permit appeals from arbitration awards in certain, albeit limited, situations. After a dispute arises, a consumer and a company will rarely agree to seek arbitration if they have not already agreed to do so. The FAA was not intended to apply only to sophisticated business-to-business contracts. It was specifically designed to include consumer and employment contracts. Arbitration provisions are part of contracts that consumers and businesses freely enter into. Arbitration does not require consumers to give up the right to a trial by jury.

In conclusion, critics of arbitration assert that arbitration is broken—that is the premise that underlies the proposed Arbitration Fairness Act. Relying on anecdotes, the opponents of arbitration claim that arbitration is unfair, expensive, and biased in favor of companies. In light of the drastic changes that the Act would entail, the opponents of arbitration bear the burden of demonstrating that such changes are needed. When the data are examined, however, it is clear that arbitration's opponents have failed to make their case. Instead, studies show that arbitration is beneficial to consumers and employees. It is cheaper than litigation and more likely to result in positive outcomes for consumers and employees.

TESTIMONY OF
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

BEFORE THE
HOUSE SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON
"H.R. 3010, THE ARBITRATION FAIRNESS ACT OF 2007"

October 25, 2007

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to submit testimony on the Arbitration Fairness Act, H.R. 3010. This legislation would effectively abolish pre-dispute arbitration agreements as a way to quickly, efficiently and fairly resolve consumer disputes. This bill would also undermine arbitration generally as a dispute resolution forum. Moreover, this bill would undermine a unique and highly evolved forum with a proven track record of outstanding service to investors – the securities arbitration forum.

Securities arbitration is a system that works to resolve disputes between investors and securities firms. The system is fair to both investors and to securities firms and their employees. We know this from the weight of both anecdotal evidence and the most up-to-date empirical data. Yesterday, SIFMA, in conjunction with its Compliance and Legal Division, released a comprehensive white paper on arbitration in the securities industry that demonstrates the timely, cost-effective, and fair results that the forum has delivered to investors for over 30 years. The paper also explains the sound public policy that underpins pre-dispute agreements to arbitrate. A copy of our paper is attached to this testimony.[2]

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers locally and globally through offices in New York, Washington D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org.)

[2] *See* WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY: *The success story of an investor protection focused institution that has delivered timely, cost-effective, and fair results for over 30 years* (October 2007) (the "White Paper").

Securities arbitration allows parties to resolve disputes quickly, efficiently and fairly. Arbitration offers significant benefits to all parties – customers and securities firms alike – that may not be achieved through court-based litigation or in other forums.

Securities Arbitration is Faster and Less Expensive Than Court-Based Litigation

The data confirm that securities arbitration continues to be a far more efficient and cost-effective dispute resolution mechanism than traditional court-based litigation. On average, cases filed in securities arbitration are resolved 40 percent faster and at far less cost to customers than cases filed in court.[3] The most obvious benefit of the speedy resolution is that successful plaintiffs obtain the relief they seek -- usually money -- more quickly, and all parties are able to move on to more constructive endeavors. In addition, the significant reduction in time to judgment benefits all parties involved in the process: if parties spend less time litigating, they spend less money.

Securities Arbitration is Fair and Effective

Some critics of arbitration claim it delivers inequitable and unfair results to customers. These claims are belied by the facts. First, the percentage of securities arbitration claimants who recover—either by award or settlement—has held steady in recent years, and in 2006 was 66 percent.[4] Second, between 1995 and 2004, claimants' average inflation-adjusted recoveries in securities arbitration have followed a generally increasing trend.[5]

Nor is there evidence that the presence of a non-public or "industry" arbitrator on a three-member panel in securities arbitrations somehow infuses pro-industry bias into the process. A May 2005 study conducted by Securities Arbitration Commentator, Inc. ("SACI") on industry bias on arbitration panels found that the presence of non-public arbitrators yielded "no material impact on customer wins" when compared to "win" rates on awards which public arbitrators adjudicated alone.[6] In that study, SACI also considered 162 arbitrations where a dissent was

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[3] *See* White Paper, Appendix B (Arbitration is Faster Than Litigation).

[4] *See* White Paper, Appendix D (The Total Percentage of Claimants Who Recover Damages or Other Relief in Arbitration or by Settlement is Favorable).

[5] *See* White Paper, Appendix E (Investors' Inflation-Adjusted Recoveries in Arbitration Have Increased).

[6] *Industry Arbitrator Award Survey: Does the Securities Industry Arbitrator's Presence Create a Discernible Shift in Award Outcomes?*, Securities Arbitration Commentator, Inc. 8 (Vol. 2005, No. 4), *available at* http://sec.gov/rules/sro/nasd/nasd2005094/rpryder091905.pdf.

filed by an arbitrator.[7] Of those cases, claimants won 63 percent of the time, and more than 70 percent of the dissents were filed by *public* arbitrators.[8] SIFMA's own review of available decisions from 2005 and 2006 further supports the SACI study's findings: in 2005, arbitration panels, which include an "industry" arbitrator, found for claimants in 60 percent of cases whereas cases decided by a single arbitrator, which by rule must be a "public" arbitrator, found for claimants in 50 percent of cases. Similarly, in 2006 panels found for claimants in 55 percent of cases they heard.[9]

These studies confirm that a claimant's chances in an SRO-sponsored arbitration forum are as good, if not better, than his or her chances in court.

Securities Arbitration Provides Investors a Better Opportunity for a Hearing Than Court-Based Litigation

In addition to the efficiency and fairness benefits described above, significantly more cases brought in arbitration go to hearing and are ultimately heard on the merits than cases brought in court. In fact, 20 percent of all arbitration claims are decided by arbitrators, whereas only 1.5 percent of civil claims are decided by a judge or jury.[10]

Unlike in court cases, claimants in arbitration are not held to exacting pleading standards and thus, their claims are far less likely to be dismissed before a hearing. In court, however, a significant percentage of claims are dismissed on pre-hearing motions to dismiss or for summary judgment. Many of these dismissals are on what may be described as technical, or procedural, grounds. This includes dismissals for pleading failures and jurisdictional deficiencies.

A plaintiff in a court case may be faced with a daunting gauntlet of obstacles: a threshold motion attacking the sufficiency of pleading in a complaint; formal document requests with no presumption of anything being properly discoverable; written interrogatories; depositions of fact witnesses; discovery motions; written expert reports; depositions of expert witnesses; formal requests for admissions; a pretrial motion for summary judgment; interlocutory appeals of any decisions rendered before a trial; motions to preclude or allow certain evidence at trial; and

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[7] *Id.* at 5-6. The SACI study noted that of the 7,127 arbitration awards made from 2000-2004, only 186 awards (2.6 percent) included a dissent. *Id.* at 5.

[8] *Id.* at 6-7.

[9] *See* White Paper, Appendix G (The Presence of an "Industry" Arbitrator Has No Material Impact on Customer Wins).

[10] *See* White Paper, Appendix C (More Cases Are Heard Before a Decision-Maker in Arbitration Than in Court).

then, finally, for the few who make it that far, a trial followed by almost automatic appeals by the losing party. And, if a customer prevails in court after all of that, he or she may have to hurdle additional obstacles just to get that hard-earned judgment enforced. That is the reality facing those who need to resort to the court system.

In contrast, arbitration allows for a simple statement of claim, an answer, focused and limited discovery, and then a full merits hearing. While pre-hearing motions are permitted, they are disfavored and more limited in arbitration versus court. The costs to get to a hearing are a fraction of what they are in traditional litigation. As arbitration practitioners will readily acknowledge, many claims that would otherwise have been dismissed in court on legal grounds are nonetheless presented on the merits to arbitrators, allowing claimants a greater opportunity to be heard. And, as reflected in the significant percentage of cases that settle before a hearing, customers are able to use the leverage of a speedy hearing in negotiating favorable resolutions of disputes through mediation or other settlement negotiations.

Securities arbitration also provides a significant benefit to investors with small claims. Approximately 25 percent of all arbitrations involve claims of less than $10,000, and another 25 percent involve claims of less than $50,000, sums for which it may not be cost effective to litigate, whether in federal or state court.[11]

Multiple Regulators Oversee Securities Arbitration and Ensure It Remains an Investor Protection Focused Institution.

For over 30 years, securities arbitration has been closely regulated by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA). The tight regulation and strict oversight of securities arbitration has resulted in numerous procedural safeguards that protect investors and ensure fairness.[12] A few examples of such safeguards include: arbitrators must provide and update extensive biographical disclosures, including employment history, training, conflicts and associations with industry members, and arbitrators must disclose their awards in prior cases. Investors are involved in selecting arbitrators and arbitration panels. Sanctions are available against securities firms for failure to comply with the Code of Arbitration Procedure, and disciplinary referrals may be made to regulators for potential violations of federal securities laws. Investors are assured that a hearing will take place at a location close to their residence.

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[11] *See* White Paper, Appendix F (Many Cases are Small Claims, Which are Better-Suited for Arbitration Than Litigation).

[12] *See* White Paper, Appendix A (Chronology of Improvements to Securities Arbitration Procedures).

Pre-dispute Arbitration Agreements are Fair to Investors and Serve the Public Interest

Pre-dispute agreements to arbitrate securities disputes are not only fair to investors, but also serve the public interest. If both parties were free to choose their forum after a dispute had arisen, they would rarely reach agreement. As William Paul, former President of the American Bar Association, explained, "The odds of an agreement for binding arbitration being entered into after a dispute has arisen are not great. At that stage one party or the other will have a view that traditional litigation offers some advantage which the party does not choose to relinquish." Thus, if both parties had the choice, each would attempt to gain tactical advantage by picking one forum or the other. The evidence bears this out and shows that the odds of an agreement to arbitrate being entered into after a dispute has arisen are very low. Thus, the end result of this approach would be that most disputes would end up in the lengthier, costlier, litigation forum.

Moreover, eliminating pre-dispute arbitration would essentially create two separate justice systems – one for wealthy plaintiffs who may want to roll the dice with litigation (thereby driving up transaction costs for everyone), and one for the middle class who would continue to rely on arbitration for their best results. There is no sound public policy reason to eliminate pre-dispute agreements to arbitrate in the securities industry. The current system provides significant benefits that investors have enjoyed for over three decades: It resolves disputes faster and less expensively than litigation. It operates under rules tailored to investor claims. It provides predictability as to process, under rules that are uniform regardless of the state or county in which the case is brought. It is administered by a staff that is familiar with these types of disputes and often can provide greater attention to the cases than clerks in congested courts. It is closely overseen by multiple regulatory agencies, including the SEC and FINRA, and operates under rules designed to maximize protection of investor rights. Prohibiting pre-dispute arbitration agreements would simply produce more protracted, costly litigation. This result would not serve the best interests of investors or the U.S. capital markets.

Conclusion

In conclusion, numerous independent studies, and the most up-to-date statistical data demonstrate that the securities arbitration system has worked well for decades and continues to improve. It is not a perfect system, but nor is any alternative. Inevitably, any system that processes thousands of cases a year may produce the occasional anomalous result. But the point is not to compare securities arbitration to some idealized, utopian version of court-based litigation. Rather, the only useful exercise is to compare arbitration with the real-world court-based litigation as we know it. In that contest, arbitration wins hands-down. Securities arbitration allows investors to pursue small claims, provides a friendly forum for pro se investor claimants, lowers overall costs borne by investors and

securities firms, and secures the oversight of expert regulators, all within a framework that was specifically designed for investor claims and has demonstrated fairness for decades. Congress should not disturb a system that is working.

INTERNATIONAL FRANCHISE ASSOCIATION

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Samuel Wright
FedState Strategic Consulting, Inc.
George Zografos
Z Donut Co.

Matthew H. Shay
President

August 22, 2007

The Honorable Linda Sanchez
Chair
Subcommittee on Commercial and Administrative Law
U.S. House of Representatives
Washington, DC 20515

The Honorable Chris Cannon
Ranking Member
Subcommittee on Commercial and Administrative Law
U.S. House of Representatives
Washington, DC 20515

Dear Representatives Sanchez and Cannon:

I am writing on behalf of the International Franchise Association to urge your opposition to H.R. 3010, the Arbitration Fairness Act. This legislation, introduced in July by Congressman Hank Johnson (D-GA), would render pre-dispute binding arbitration clauses in franchise contracts unenforceable.

The mission of the International Franchise Association (IFA) is to safeguard the business environment for franchising worldwide. The IFA is the largest and oldest franchising trade group, representing franchise businesses in more than 85 industries, including more than 1,200 franchisor, 9,600 franchisee and 470 supplier members nationwide. America's more than 767,000 franchised businesses generate jobs for more than 18 million workers and account for $1.53 trillion in annual economic activity. One of the features of franchising is that it is a business model that can be successfully adopted to work in many different sectors of the economy. With hundreds of different franchise concepts in more than 85 different industries, there are a wide range of choices available for potential franchise investors.

H.R. 3010 amends the Federal Arbitration Act (FAA) to establish that agreements to arbitrate employment, consumer, or franchise disputes will not be enforceable if they are entered before the actual dispute arises. Many franchise agreements have mandatory arbitration provisions, and many do not. There are also many different types of mandatory arbitration provisions. For example, some franchise agreements give the *franchisee* sole discretion whether to invoke the process.

H.R. 3010 would have the effect of rendering an important provision in many franchise contracts void. This is a significant and unwarranted intrusion by Congress into existing contractual agreements between businesses.

Arbitration has always been a tool businesses use for addressing and resolving disputes. As you likely know, the original purpose of the FAA was to allow businesses "to settle their disputes expeditiously and economically." Unlike many of the examples of arbitration abuses in consumer contacts cited by the bill's sponsors, the purchase of a

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franchise is not a business to consumer transaction. It is a business to business transaction. Nor is it fair to assume that franchisors have disproportionate economic power. Not all franchisors are large. Not all franchisees are small and unsophisticated. In fact, roughly half of the IFA's *franchisor* members qualify as small businesses under federal standards. There are also a number of franchisee associations that represent their members in dealings with franchisors, thus ensuring a more "level playing field."

Moreover, franchising is already a business method with significant regulation on the state and federal level. Franchisors are legally obligated to provide potential franchise investors with a detailed prospectus before entering into substantive discussions. No matter how small a prospective franchisee may be in relation to its prospective franchisor, there is no doubt that the franchisee is made fully aware of the existence of any mandatory arbitration provision. The Federal Trade Commission's Rule on Franchising, as well as various comparable state laws and regulations, ensures that a prospective franchisee receives a detailed Franchise Offering Circular and that the existence of a mandatory arbitration provision, as well as various other terms of the potential franchise agreement, are fully disclosed and not hidden in "fine print" as the legislation presumes. The FTC recently completed a very thorough revision of the Franchise Rule. The proceedings took more than a decade, involving multiple public hearings and more than three hundred comments from interested parties. As part of the process, the agency specifically considered whether additional regulation of contract terms was necessary. The FTC ultimately concluded that such additional regulation was not justified, noting that the public record failed to show a pattern of unfairness in practices or acts in franchising.

The IFA believes that a vigorous approach to pre-sale disclosure of contract terms gives franchise investors the opportunity to make informed decisions about contractual obligations before signing agreements.

Thank you for your consideration, and please feel free to contact me if you have any questions regarding this legislation or franchising.

Sincerely,

Vice President
Government Relations

cc: Members of the Subcommittee

INTERNATIONAL FRANCHISE ASSOCIATION

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Larry Tate
Golden Corral Buffet & Grill
Samuel Wright
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Georgia Zagiatos
Z Donut Co.
Matthew R. Shay
President

October 24, 2007

The Honorable Linda Sanchez
Chair
Subcommittee on Commercial and Administrative Law
U.S. House of Representatives
Washington, DC 20515

The Honorable Chris Cannon
Ranking Member
Subcommittee on Commercial and Administrative Law
U.S. House of Representatives
Washington, DC 20515

Dear Representatives Sanchez and Cannon:

I am writing on behalf of the International Franchise Association to urge your opposition to H.R. 3010, the Arbitration Fairness Act. This legislation, which is the subject of a Subcommittee hearing tomorrow, would render unenforceable pre-dispute binding arbitration clauses in franchise contracts.

The mission of the International Franchise Association (IFA) is to safeguard the business environment for franchising worldwide. The IFA is the largest and oldest franchising trade group, representing franchise businesses in more than 85 industries, including more than 1,200 franchisor, 9,600 franchisee and 470 supplier members nationwide. America's more than 767,000 franchised businesses generate jobs for more than 18 million workers and account for $1.53 trillion in annual economic activity. One of the features of franchising is that it is a business model that can be successfully adopted to work in many different sectors of the economy. With hundreds of different franchise concepts in more than 85 different industries, there are a wide range of choices available for potential franchise investors.

H.R. 3010 amends the Federal Arbitration Act (FAA) to establish that agreements to arbitrate employment, consumer, or franchise disputes will not be enforceable if they are entered before the actual dispute arises. Many franchise agreements have mandatory arbitration provisions, and many do not. There are also many different types of mandatory arbitration provisions. For example, some franchise agreements give the *franchisee* sole discretion whether to invoke the process.

H.R. 3010 would effectively render an important provision in tens of thousands of existing franchise contracts void. This is a significant and unwarranted intrusion by Congress into contractual agreements between businesses.

Arbitration has always been a tool businesses use for addressing and resolving disputes. As you likely know, the original purpose of the FAA was to allow businesses "to settle their disputes expeditiously and economically." Unlike many of the examples of arbitration abuses in consumer contacts cited by the bill's sponsors, the purchase of a

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Telephone: 202/628-8000 Fax: 202/628-0812 E-Mail: ifa@franchise.org Internet: www.franchise.org

franchise is not a business to consumer transaction. The purchase of a franchise is a business to business transaction. Nor is it fair to assume that franchisors have disproportionate economic power. Not all franchisors are large. Not all franchisees are small and unsophisticated. In fact, roughly half of the IFA's *franchisor* members qualify as small businesses under federal standards. There are also a number of franchisee associations that represent their members in dealings with franchisors, thus ensuring a more "level playing field."

Moreover, franchising is already a business method with significant regulation on the state and federal level. Franchisors are legally obligated to provide potential franchise investors with a detailed prospectus before entering into substantive discussions. No matter how small a prospective franchisee may be in relation to its prospective franchisor, there is no doubt that the franchisee is made fully aware of the existence of any mandatory arbitration provision. The Federal Trade Commission's Rule on Franchising, as well as various comparable state laws and regulations, ensures that a prospective franchisee receives a detailed Franchise Offering Circular and that the existence of a mandatory arbitration provision, as well as various other terms of the potential franchise agreement, are fully disclosed and not hidden in "fine print" as the legislation presumes. The FTC recently completed a very thorough revision of the Franchise Rule. The proceedings took more than a decade, involving multiple public hearings and more than three hundred comments from interested parties. As part of the process, the agency specifically considered whether additional regulation of contract terms was necessary. **The FTC ultimately concluded that such additional regulation was not justified, noting that the public record failed to show a pattern of unfairness in practices or acts in franchising.**

The IFA believes that a vigorous approach to pre-sale disclosure of contract terms gives franchise investors the opportunity to make informed decisions about contractual obligations before signing agreements.

Thank you for your consideration, and please feel free to contact me if you have any questions regarding this legislation or franchising.

Sincerely,

Vice President
Government Relations

cc: Members of the Subcommittee

WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY:[2]

The success story of an investor protection focused institution that has delivered timely, cost-effective, and fair results for over 30 years.

OCTOBER 2007

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[1] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] This paper is the collective effort of SIFMA staff, SIFMA's Arbitration and Litigation Advisory Committees, and the Compliance and Legal Division of SIFMA, which consists of over 2,500 professionals either employed by the industry, outside counsel or other entities serving the securities industry, in collaboration with outside counsel, Paul, Weiss, Rifkind, Wharton & Garrison LLP.

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FOREWORD

In recent months, the use of predispute arbitration agreements in consumer contracts has come under attack from various critics, including members of the claimants' bar and the press. As part of this trend, legislators introduced the "Arbitration Fairness Act of 2007," H.R. 3010, in the United States House of Representatives on July 12, 2007. Along with its companion bill in the Senate, S. 1782, the legislation would ban predispute arbitration agreements in consumer contracts. The concerns that gave rise to these bills focus on unsupervised arbitration programs that use untrained arbitrators, conduct hearings far from the consumer's home, and involve hidden costs the consumer must bear.[3] Securities industry arbitration suffers none of these defects. Rather, securities arbitration affords investors the opportunity to have their claims heard close to home, before highly trained and experienced arbitrators, in a forum that has proven to resolve disputes at least as fairly as the judicial system, and much faster and less expensively.

This recent attack on predispute arbitration agreements is not the first. Congress considered and rejected similar legislation in 1988. That year, the "Securities Arbitration Reform Act" was introduced to amend the Securities Exchange Act of 1934

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[3] Sen. Feingold, Rep. Johnson Introduce Measure to Preserve Consumer Justice (July 12, 2007) *available at* http://feingold.senate.gov/~feingold/releases/07/07/20070712.html. On September 27, 2007 Senator Feingold released a statement regarding Public Citizen's recent report on arbitrations conducted by the National Arbitration Forum ("NAF") in California. The report asserts that private arbitration companies which receive millions of dollars in repeat business have a powerful incentive to rule in companies' favor and finds that NAF has, in fact, "ruled in favor of credit companies in 94 percent of the disputes it resolved." Statement of U.S. Senator Russ Feingold: At a Press Conference with Public Citizens on Protecting Consumers from Unfair Credit Card Contracts (September 27, 2007) *available at* http://feingold.senate.gov/~feingold/statements/07/09/20070927mb.htm. Securities arbitrators do not face a similar enticement: they are not employees of the self-regulatory organizations ("SROs") that conduct the arbitration and, no matter their decisions, will continue to be placed on neutral lists of potential arbitrators for a panel. Furthermore, as discussed *infra,* statistics cited by Public Citizen and Senator Feingold are simply not applicable to securities arbitration where two-thirds of all claimants recover damages or other non-monetary relief.

("1934 Act") to prohibit any broker or securities firm from entering into a predispute agreement to arbitrate so long as that agreement is a condition for establishing a customer account.[4] The House of Representatives held three hearings on the proposed legislation and heard testimony from, among others, the chairman of the Securities and Exchange Commission ("SEC"), legal scholars, investors, claimants' attorneys and members of the securities industry, and it chose not to pass the legislation. As Congress recognized approximately twenty years ago, securities industry arbitration serves the interests of both investors and the industry; it should not now disrupt a system that not only continues to work well, but also continues to provide an ever-expanding array of safeguards for investors.[5]

I. Executive Summary

For over three decades, applicable regulations have provided investors with an absolute right to have their disputes arbitrated.[6] Investment firms have gained the same right in return by entering into predispute arbitration agreements with their new customers. Such contracts ensure that both sides are treated fairly and effectuate the

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[4] *See* Securities Arbitration Reform Act of 1988, H.R. 4960, 100th Cong. (1988).

[5] Importantly, H.R. 4960 contained directives to the SEC that it shall, among other things, require that any "agreement to arbitrate future disputes... [be] clearly and prominently disclose[d] to the customer..." and to SROs that they "...specify the procedures for obtaining and enforcing, timely production of documents and witnesses..." as well as "provide the customer with reasonable biographical information and the right to challenge the selection of such arbitrators." As discussed *infra*, these measures have been adopted—and often expanded upon—by the SROs.

[6] *See* § 12200 of the National Association of Securities Dealers ("NASD") Code of Arbitration Procedure ("Code of Arbitration Procedure") and Rule 600A(a)(ii) New York Stock Exchange Arbitration Rules ("NYSE Rule") (directing that members of the securities industry must arbitrate upon demand of the customer). NASD's rules have required member firms to arbitrate at the investor's demand since March 1972. *See* NASD Manual (July 1, 1974) (noting that former Code of Arbitration Procedure ¶ 3702, § 2(a)(2) took effect on March 9, 1972).

public policy in favor of predispute arbitration agreements that has been recognized by both Congress and the United States Supreme Court.[7]

Opponents of predispute arbitration agreements, however, seek neither fairness nor equality; rather, they seek an unfair strategic advantage. They want investors to retain their right to arbitrate as they see fit, but to deprive investment firms of the same right. Equally importantly, they ignore the many unique and attractive features of securities arbitration, some of which include:

- **Securities arbitration is faster and less expensive than court-based litigation.**
  - A 1988 study found that average legal costs were $12,000 less in arbitration than in litigation. Adjusting solely for inflation, average legal costs today are at least $22,000 less in arbitration than in litigation. Given the significant increase in litigation costs since 1988, that gap is most likely substantially wider. More recent studies support this conclusion.
  - Cases filed in securities arbitration are resolved, on average, approximately 40 percent faster than cases filed in court.[8]
  - Arbitration saves time and money because motion practice and discovery—both of which may be used as expensive delaying tactics—are disfavored and more limited in arbitration versus litigation.
- **Securities arbitration is more accessible than court-based litigation.**
  - Relaxed pleading standards in securities arbitration encourage disputes to be filed. Recent Supreme Court decisions make certain that investors are far more likely to have their claims dismissed in court than in arbitration, where dismissals are rare. Thus, arbitration provides investors a much greater chance to have their "day in court."
  - The statistics bear out this fact. Whereas 20 percent of all arbitration claims are ultimately heard on the merits and decided by arbitrators, only about 1.5 percent of all civil claims in court are decided by a judge or jury.[9]

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[7] *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 225-226 (1987).

[8] *See* Appendix B (Arbitration is Faster Than Litigation).

[9] *See* Appendix C (More Cases Are Heard Before a Decision-Maker in Arbitration Than in Court).

- Approximately 25 percent of all arbitrations involve claims of less than $10,000, a sum for which it is often not cost effective to litigate, whether in federal or state court.[10]

- **Investors continue to fare well in securities arbitration.**
  - The percentage of securities arbitration claimants who recover—either by award or settlement—has held steady in recent years, and in 2006 was 66 percent.[11]
  - Between 1995 and 2004, investors' average inflation-adjusted recoveries in securities arbitration have followed a generally increasing trend.[12]

- **Securities arbitration is perceived to be fair, and is in fact fair.**
  - The most recent survey of securities arbitration participants found that approximately 93 percent of those surveyed—more than 50 percent of whom were investors—believed their case had been handled fairly and without bias.[13]
  - A 1992 GAO evaluation of the securities arbitration system found "no indication of a pro-industry bias in decisions at industry-sponsored forums."
  - A review of all 2005 and 2006 arbitration decisions found that the presence of an "industry" arbitrator has no material impact on customer wins.[14]
  - Securities arbitration is in fact fair because arbitrators understand the law and ensure it is properly followed and applied in each case.

- **Multiple regulators oversee the securities arbitration system and have ensured its development as an investor protection focused institution.**
  - For over 30 years, securities arbitration has been closely regulated by the SEC and by SEC-supervised SROs, such as the Financial Industry Regulatory Authority ("FINRA").[15]

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[10] *See* Appendix F (Many Cases are Small Claims, Which are Better-Suited for Arbitration Than Litigation).

[11] *See* Appendix D (The Total Percentage of Claimants Who Recover Damages or Other Relief in Arbitration or by Settlement is Favorable).

[12] *See* Appendix E (Investors' Inflation-Adjusted Recoveries in Arbitration Have Increased).

[13] *See* Gary Tidwell, Kevin Foster and Michael Hummel, *Party Evaluation of Arbitrations: An Analysis of Data Collected from NASD Regulation Arbitrations* 3 (Aug. 5, 1999), *available at* http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_009528.pdf.

[14] *See* Appendix G (The Presence of an "Industry" Arbitrator has No Material Impact on Customer Wins).

[15] FINRA was established on July 30, 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE. *See* FINRA News Release,

- Numerous procedural safeguards have evolved to protect investors and ensure fairness in securities arbitration, including:[16]
  - The requirement that arbitrators must provide and regularly update extensive biographical disclosures, including employment history, training, conflicts and associations with industry members;
  - Disclosure of prior awards of each proposed arbitrator;
  - Investor involvement in the selection process for arbitrators and arbitration panels;
  - Availability of sanctions against securities firms for failure to comply with the Code of Arbitration Procedure, including discovery obligations, and disciplinary referrals to SRO regulators for potential violations of federal securities laws or SRO rules;
  - Assurance that a hearing will take place at a location close to the customer's residence; and
  - Smaller fees for investors than for member firms.

- **Predispute arbitration agreements are fair to investors and serve the public interest.**
  - Predispute arbitration agreements contribute a valuable degree of predictability to the relationship between the parties.
  - Predispute arbitration agreements put the parties on equal footing once a dispute emerges and deter forum selection tactics.
  - In the absence of a predispute arbitration agreement, decisions whether to arbitrate an existing dispute will be governed by tactical advantage. The evidence shows that the odds of an agreement to arbitrate being entered into after a dispute has arisen are very low.

- In summary, the existing system serves the best interests of investors. Predispute arbitration agreements make it possible for investors to pursue small claims, provide a friendly forum for pro se investor claimants, lower overall costs borne by investors and securities firms, and secure the oversight of expert regulators, all within a framework that was specifically designed for investor claims and has demonstrated fairness for decades.

"NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority—FINRA"(July 30, 2007), *available at* http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P036329.

[16] *See* Appendix A (Chronology of Improvements to Securities Arbitration Procedures).

II. History of Arbitration in the Securities Industry

For over 130 years, arbitration has been used to resolve disputes between individual investors and members of the securities industry.[17] Since 1872, the securities exchanges and regulators have developed rules for the fair and effective administration of disputes so that today, FINRA, the securities industry's largest SRO, manages the resolution of over 4,000 disputes a year.[18]

Since the Federal Arbitration Act ("FAA") became law in 1925,[19] the legal system has had a "healthy regard for the federal policy favoring arbitration."[20] Based upon Congress' clear direction to place arbitration agreements "upon the same footing as other contracts,"[21] courts have consistently enforced agreements to arbitrate statutory claims.[22]

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[17] In 1817, NYSE allowed its members to arbitrate disputes that arose between them. In 1872, NYSE expanded the jurisdiction of its arbitral forum to hear disputes between individual investors and member firms. *See* Jill I. Gross, *Securities Mediation: Dispute Resolution for the Individual Investor,* 21 Ohio St. J. on Disp. Resol. 329, 336 (2006). NASD established its arbitral forum in 1968. *See* Testimony of Linda D. Fienberg, President NASD Dispute Resolution, Before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises Committee on Financial Services United States House of Representatives (March 17, 2005), *available at* http://www.finra.org/PressRoom/SpeechesTestimony/LindaFienberg/p013652 ("NASD has operated the forum since 1968, providing a fair process through arbitration and mediation for investors to settle disputes with their brokers.").

[18] Prior to the consolidation of NASD and NYSE, the NASD administered "over 94 percent of the investor-broker disputes filed every year." Letter from Linda D. Fienberg, NASD, dated January 26, 2007 (referencing the SICA 13th Report (2005)).

[19] 9 U.S.C. § 1 *et seq.* (2000).

[20] *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1, 24 (1983).

[21] H.R. Rep. 68-96, 1, 2 (1924).

[22] *See e.g., Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30 (1991) ("...generalized attacks on arbitration 'res[t] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants,' and as such they are 'far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.'" (citing *Rodriquez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477, 481 (1989)); *McMahon,* 482 U.S. 220; *Southland Corp.* v. *Keating,* 465 U.S. 1 (1984).

The validity of a predispute arbitration agreement in the setting of securities claims was considered and confirmed in the Supreme Court's 1987 decision in *Shearson/American Express, Inc. v. McMahon*. In *McMahon*, Justice O'Connor noted that securities arbitrators are "readily capable" of handling complex claims, that streamlined procedures are not inconsistent with the underlying substantive rights, and that judicial scrutiny of arbitration awards—while limited—is sufficient to ensure that arbitrators meet their statutory obligations.[23] The Court also found that any mistrust of arbitration as an efficient and fair means to resolve disputes is particularly unfounded in the context of securities arbitration, which is regulated by the SEC, which has "expansive power to ensure the adequacy of the arbitration procedures employed by the SROs."[24]

Two years later, the Court reinforced the importance of this unique aspect of securities arbitration when it held that claims brought pursuant to the Securities Act of 1933 ("1933 Act") may also be arbitrated pursuant to a predispute agreement made between the brokerage firm and the investor.[25] Since these rulings, members of the securities industry have generally included arbitration agreements in their contracts with investors to secure the benefits of arbitration first recognized by Congress more than 80 years ago.

III. For Over Thirty Years, the Public Has Had a Role in the Oversight of Securities Arbitration for the Benefit of Investors

Beginning in 1971, Congress undertook a "searching reexamination of the competitive, statutory, and economic issues facing the securities markets, the securities industry, and of course, public investors" in order to ensure that the regulatory structure

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[23] *McMahon*, 482 U.S. at 232 (citing *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633-34 (1985).

[24] *Id.* at 233.

[25] *Rodriquez de Quijas*, 490 U.S. at 481-483. The claim in *McMahon* was brought pursuant to the 1934 Act.

had kept pace with the economic growth and shift in public investment patterns since the early 1930s.[26] The result was that the SEC was granted "expansive power" to ensure the adequacy of the various exchanges and NASD's arbitration rules and procedures.[27] Since 1975, the SEC has used this authority to enhance the accessibility, neutrality, and fairness of the forum, all to the benefit of investors.

As recently as July 26, 2007, the SEC exercised its expansive oversight power when it approved NASD's proposal to consolidate the NASD and NYSE arbitration forums.[28] In so doing, the Commission addressed the argument that public investors be permitted to resolve their disputes either in court or in arbitration. The SEC concluded that in "light of the policy supporting arbitration evinced by the Federal Arbitration Act and the Supreme Court precedent upholding securities arbitration agreements, and the requirements of Section 19(b)(2) of the Exchange Act" that dictate the SEC act consistently with the requirements of the 1934 Act, consolidation of the two arbitral forums need not be "conditioned on providing customers with a choice of another dispute resolution forum."[29]

A. All Proposed SRO Arbitration Rules are Subject to Public Comment and SEC Approval

Each SRO, including FINRA, is required to file with the SEC any proposed rule or proposed change to its rules—including rules concerning the arbitration process—which the SEC, in turn, publishes for public comment.[30] Only after the public has had a meaningful opportunity to review and comment upon the proposed rule or rule

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[26] H.R. Conf. Rep. No. 94-229, 91 (1975).

[27] *See McMahon,* 482 U.S. at 233-234; *see also* 15 U.S.C. § 78s (2000).

[28] Securities and Exchange Commission, Release No. 34-56145, 77-78 (July 26, 2007), *available at* http://www.sec.gov/rules/sro/nasd/2007/34-56145.pdf.

[29] *Id.* at 78.

[30] 15 U.S.C. § 78s(b)(1) (2000).

change will the SEC either disapprove or approve a rule change.[31] The SEC will approve a rule change only if it finds the change to be "consistent with the requirements of [the 1934 Act] and the rules and regulations thereunder."[32] The rule must also be designed to "protect investors and the public interest" and cannot "permit unfair discrimination between customers, issuers, brokers, or dealers."[33]

The SEC and, in turn, the SROs, have been responsive to public comments concerning the effect of certain proposed rules upon investors: observations from interested parties have often resulted in an SRO amending or abandoning proposed rules. One example of this responsiveness is NASD's decision to abandon its proposed rule on the use of choice-of-law provisions in predispute arbitration agreements.[34] On November 29, 1999, the SEC published for comment a proposed rule change to amend NASD Rule 3110(f) to provide, among other things, that choice of law provisions are unenforceable "unless there is a significant contact or relationship between the law selected and either the transaction at issue or one or more of the parties."[35] The purpose of the rule was to protect investors from the use of arbitrary choice of law provisions in predispute arbitration agreements.[36]

After several amendments to the proposed rule change, notice of the proposal was again published in the *Federal Register* on September 12, 2003. The SEC

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[31] 15 U.S.C. § 78s(b)(2) (2000); *see also* 5 U.S.C. § 553 (2000).

[32] 15 U.S.C. § 78s(b)(2)(B) (2000).

[33] 15 U.S.C. § 78f (b)(5) (2000).

[34] *See* Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change as Amended and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 5 by the National Association of Securities Dealers, Inc., regarding NASD Rule 3110(f) Governing Predispute Arbitration Agreements with Customers, 69 Fed. Reg. 70,293 (Dec. 3, 2004).

[35] *Id.* at 70,294.

[36] *Id.*

received 24 comments on the proposal, the majority of which opposed the proposed provision relating to the use of choice-of-law provisions.[37] Commentators, including claimants' counsel, were concerned that "because relevant case law regarding choice-of-law provisions in predispute arbitration agreements has evolved considerably over the past five years....proposed paragraph (f)(4)(B) could be interpreted to endorse choice-of-law clauses that may not be enforceable under state law."[38] In response to these comments, NASD withdrew this proposed provision on January 9, 2004.[39]

Finally, two additional protections exist to ensure that substantive and procedural arbitral rules are consistent with the overarching goal of the 1933 Act and the 1934 Act to protect investors. First, SEC rulemaking is subject to judicial review under the Administrative Procedure Act ("APA").[40] Courts will review any alleged failure of the SEC to follow the "notice and comment" procedures provided for in § 553 of the APA. Second, 15 U.S.C. § 78s(c) grants the SEC the power, on its own initiative, to "abrogate, add to, and delete from" any SRO rule, including arbitration rules, to ensure that securities arbitration adequately protects the statutory rights guaranteed under the 1933 and 1934 Acts.[41]

B. Regulatory Oversight Extends Beyond the Rulemaking Process

The SEC oversight of securities arbitration extends beyond the rulemaking arena. For instance, the SEC engages in frequent review of SRO arbitration facilities to "identify areas where procedures should be strengthened, and to encourage

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[37] *Id.* at 70,293.

[38] *Id.* at 70,295.

[39] *Id.* at 70,293, 70,295.

[40] 5 U.S.C. § 702 (2000).

[41] 15 U.S.C. § 78s(c) (2000).

remedial steps either through changes in administration or through the development of rule changes."[42] Such proactive efforts have ensured that the rules governing securities arbitration provide the investor a fair, efficient and impartial forum.

In the late 1970's, for example, the SEC played a pivotal role in the establishment of the Securities Industry Conference on Arbitration ("SICA"). SICA's members consist of a majority of representatives of the investing public (including claimants' lawyers), a securities industry representative, and representatives of various securities regulators, among others. SICA was originally charged with developing, and did develop, a Uniform Code of Arbitration ("Uniform Code") which harmonized the various rules and procedures that SROs had been employing at the time and codified procedures that had been informally utilized.[43] Following the formation of FINRA, however, SICA no longer maintains or continues to amend the Uniform Code.

Notwithstanding the obsolescence of its original charter, SICA's diverse constituencies continue to meet on a regular basis to discuss specific rule proposals, and to discuss and debate current issues relating to arbitration, including, among others, arbitrator qualification and classification issues, electronic discovery issues, arbitrator disclosure and removal issues, and explained awards. Such meetings are another unique aspect related to securities arbitration: no other forum is the subject of conferences at which both investor and industry representatives, arbitrators, arbitration service providers and state and federal regulators convene to discuss pressing issues relating to the efficacy of the forum.

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[42] Self-Regulatory Organizations; National Association of Securities Dealers, Inc; Order Granting Approval to Proposed Rule Change Relating to the Arbitration of Employment Discrimination Claims, 63 Fed. Reg. 35,299, 35,303 n.53 (June 29, 1998).

[43] J. Kirkland Grant, SECURITIES ARBITRATION FOR BROKERS, ATTORNEYS, AND INVESTORS 94-95 (Quorum Books 1994).

Another example of SEC action includes the 1998 initiative to encourage SROs to use "plain English" in disclosure documents and other materials used by investors, including the Code of Arbitration Procedure.[44] NASD implemented the SEC's "plain English" guidelines, simplifying language, eliminating legalistic verbiage, and providing definitions to eliminate the potential for consumer confusion. But NASD then went several steps further: it reorganized the Code of Arbitration Procedure into a more user-friendly format, creating a separate arbitration code specific to customer disputes and reorganizing the sections of the Code of Arbitration Procedure to follow the chronology of a typical arbitration.[45] The SEC found that NASD's revisions "make the process of arbitration more transparent and more accessible to users of the forum, including those who may file arbitration claims *pro se*."[46]

Finally, the SEC has commissioned studies to investigate the adequacy of certain aspects of SRO arbitration. Such studies have led to enhancements of SRO arbitration procedures. For instance, in July 2002, the SEC retained Professor Michael Perino from St. John's University School of Law to assess the adequacy of arbitrator disclosure requirements at NASD and NYSE. Professor Perino concluded that, in his review of data from more than 30,000 SRO arbitrations, there was no evidence of

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[44] Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendments 1, 2, 3 and 4 to Amend NASD Arbitration Rules for Customer Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 thereto; Order Approving Proposed Rule Change and Amendments 1, 2, 3 and 4 to Amend NASD Arbitration Rules for Industry Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 thereto, 72 Fed. Reg. 4,574, 4,575 (Jan. 31, 2007); *see also* Code of Arbitration Procedure, *available at* http://www.finra.org/ArbitrationMediation/Arbitration/CodeofArbitrationProcedure/p009566. With the creation of FINRA, all securities arbitration claims filed after August 6, 2007 are administered under the Code of Arbitration Procedure. *See* NYSE Rule 600A(a)(i). A FINRA Code does not yet exist, but will "be melded from a harmonization of the NASD and NYSE Codes." *See 2006 Annual Award Survey: A SAC Award Survey Comparing Results in 2006 to 2000-20005*, Securities Arbitration Commentator, Inc. 12 (Vol. 2007, No. 2).

[45] 72 Fed. Reg. at 4,576.

[46] *Id.* at 4,601.

favoritism toward either industry members or customers, or undisclosed conflicts of interest, but he made a series of recommendations for strengthening the arbitrator disclosure requirements nonetheless.[47]

Professor Perino's recommendations led NASD to modify Sections 10308 and 10312 of the Code of Arbitration Procedure[48] to expand the types of relationships with the securities industry that would require an arbitrator to be classified as an industry arbitrator, delineate the standards for removing an arbitrator from hearing a dispute, and clarify that arbitrators have a mandatory duty to disclose and update conflict information, all to "provide additional assurance to investors that arbitrations are in fact neutral and fair."[49]

C. Legislative and SRO Oversight

Unlike other arbitral forums, securities industry SROs are subject to extensive Congressional oversight, principally through Congress' investigative arm, the Government Accountability Office, formerly known as the General Accounting Office ("GAO"). For example, in 1992, the GAO evaluated a "number of issues relating to the arbitration process sponsored by the securities industry self-regulatory organizations."[50] The review found that there was "no indication of a pro-industry bias in decisions at industry-sponsored forums."[51] The GAO nonetheless suggested that SROs implement

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[47] Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Arbitrations* 3-5, 48 (Nov. 4, 2002).

[48] The changes are now reflected in Code of Arbitration Procedure §§ 12100(p), 12408(a), and 12410.

[49] *See* NASD Notice to Members 04-49, Arbitrator Classification (effective July 19, 2004), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p002727.pdf.

[50] U.S. General Accounting Office, *Securities Arbitration: How Investors Fare* 1 (1992).

[51] *Id.* at 6.

"internal controls" related to arbitrator qualification and selection in order to further ensure the fairness of arbitral proceedings.[52]

In 2000, the GAO updated its 1992 study and found that the SROs had appropriately implemented the GAO's 1992 recommendations by "giving arbitration participants a larger role in selecting arbitrators, periodically surveying arbitrators to verify background information, and improving arbitrator training."[53]

Public oversight of securities arbitration is not limited to the executive and legislative branches of government. The SROs actively oversee the arbitration process, and obtain extensive public participation in so doing. For instance, FINRA's Board of Governors is composed of both public representatives, who hold a majority of seats, and industry members.[54]

The securities arbitration process is also overseen by the National Arbitration and Mediation Committee ("NAMC"). The Code of Arbitration Procedure provides that the NAMC has "the authority to recommend rules, regulations, procedures and amendments relating to arbitration, mediation and other dispute resolution matters to the Board" and "has such other power and authority as is necessary to carry out the purposes of the Code."[55] NAMC is also charged with the "recruitment, qualification,

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[52] *Id.* at 55-61.

[53] U.S. General Accounting Office, *Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards* 4 (2000).

[54] An Interim Board of Governors will serve until FINRA's three-year Transition Board of Governors is elected in October 2007. "Both Boards will include 11 public governors appointed from outside the securities industry and 10 governors from inside the securities industry." *See* FINRA Announces Interim Board of Governors to Serve Until Annual Meeting for Board Elections (August 2, 2007), *available at* http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P036351.

[55] Code of Arbitration Procedure § 12102(b). *See also* NASD Manual, Corporate Organization, Plan of Allocation and Delegation of Functions by NASD to Subsidiaries, NASD Dispute Resolution, Inc., National Arbitration and Mediation Committee, *available at* http://finra.complinet.com/finra/display/display.html?rbid=1189&element_id=1159000411.

training, and evaluation of arbitrators and mediators," and the "evaluation of existing rules, regulations, and procedures."[56] Like FINRA's Board of Governors, the NAMC is also composed of a majority of non-industry members.[57] Thus, non-industry participants have a significant role in shaping the procedures relating to securities arbitration.

FINRA also provides investors with many other tools to help understand and easily navigate the arbitration process. For instance, FINRA provides investors with numerous resources on its website, including "Frequently Used Forms," a "Questions and Feedback" forum, "Dispute Resolution Statistics," the "Neutral Corner" publication, [58] and "Resources for Parties," which provide, at one source, case-related guidance, the Code of Arbitration Procedure, and other helpful information for parties considering filing a claim or already in arbitration.[59]

In sum, having been subject to stringent oversight for over 30 years, and with the meaningful input and contributions of SICA and NAMC, among other groups, SRO arbitration has evolved into a forum that offers significant and ever-improving safeguards to its customers.

IV. Securities Arbitration Offers Strong Procedural Protections to Ensure Investors a Fair Process and an Impartial Forum

The rules and procedures employed by FINRA are designed to encourage and facilitate the filing of claims and the resolution of investor disputes by ensuring and improving the quality and fairness of the process. In short, claimants in

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[56] *See* National Arbitration and Mediation Committee, *available at* http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/WhatisDisputeResolution/NationalArbitrationMediationCommittee/index.htm.

[57] *See* Code of Arbitration Procedure § 12102(a)(1).

[58] *See* Arbitration and Mediation, *available at* http://www.finra.org/ArbitrationMediation/index.htm.

[59] *See* Resources for Parties, *available at* http://www.finra.org/ArbitrationMediation/ResourcesforParties/index.htm.

SRO arbitration enjoy significant control over the process and stronger procedural protections than they would have in other arbitral forums.

A. Procedural Safeguards Ensure Fairness in the Selection of an Arbitrator or Panel

The Code of Arbitration Procedure provides three major procedural safeguards to ensure investor participation in the selection of a fair and unbiased arbitrator or arbitral panel.

1. Potential arbitrators are required to provide detailed biographical information and to disclose potential conflicts of interest

FINRA Dispute Resolution, which oversees all securities industry arbitrations between member firms and their customers, carefully selects arbitrators from a broad cross-section of applicants, diverse in culture, profession and background. To qualify, applicants must have at least "five years of full-time, paid business or professional experience."[60] Applicants must also be recommended in writing by two persons who can personally attest to their integrity and skills. These letters are reviewed by FINRA staff and a subcommittee of the NAMC.[61] Once selected, arbitrators must provide and regularly update extensive biographical disclosures, including employment history, education, training, conflicts, and associations with industry members.[62] In addition, before being appointed to hear a dispute, arbitrators are required to make a

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[60] *See* Frequently Asked Questions About Becoming a FINRA Arbitrator, *available at* http://www.finra.org/ArbitrationMediation/ResourcesforArbitratorsandMediators/ArbitratorRecruitment/FrequentlyAskedQuestionsAboutBecomingaFINRAArbitrator/index.htm.

[61] Dispute Resolutions Forms, *available at* http://www.finra.org/ArbitrationMediation/ResourcesforArbitratorsandMediators/CaseRelatedInformationandForms/index.htm. *See also* NASD Dispute Resolution Arbitrator Application Booklet, May 2007, *available at,* http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p017271.pdf.

[62] *See* Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Proposal to Conduct Background Verification and Charge Application Fee for NASD Neutral Roster Applicants, 68 Fed. Reg. 5,6661-5,6662 (Oct. 1, 2003).

reasonable effort to learn of, and must disclose, any conflicts of interest related to hearing a particular case.[63] Finally, if during the course of a hearing a conflict arises, an arbitrator must disclose it so that a decision can be made as to whether he or she should be voluntarily removed from the case or whether the matter should be referred to the Director or President of FINRA Dispute Resolution.[64]

2. Either a sole public arbitrator or a panel composed of a majority of public, non-industry arbitrators will hear a dispute

Arbitration panels are composed of either a sole "public" arbitrator or a panel of three arbitrators, two of whom must be public, and one of whom is "non-public." As defined in Code of Arbitration Procedure § 12100(p), a non-public arbitrator is a person who was, within the past five years, associated with a broker or dealer, registered under the Commodity Exchange Act, a member of an exchange or a futures association or associated with a person or firm registered under the Commodity Exchange Act. Additionally, arbitrators are often defined as non-public or "industry" arbitrators if they spent a substantial part of their careers, including legal careers, engaging in, or working on behalf of, the above listed businesses. Finally, any person who is employed by a financial institution that effects transactions in securities or monitors compliance with securities laws also is classified as a non-public or "industry" arbitrator.

Under Code of Arbitration Procedure § 12100(u), the term "public arbitrator" refers to a person who is not engaged in any of the activities described in § 12100(p) and has not been engaged in those activities for over 20 years. Additionally, a public arbitrator cannot be an investment advisor, an attorney or accountant whose firm derives over 10 percent of its revenue from any persons or entities listed in

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[63] Code of Arbitration Procedure § 12408(a).

[64] *See* Code of Arbitration Procedure §§ 12408(b-c), 12410(b).

§ 12100(p);[65] an employee, a spouse or an immediate family member of any entity that controls or is controlled by a member of the securities industry; or a director or officer, or a spouse or an immediate family member of a person who is a director or officer of an entity that controls or is controlled by a member of the securities industry.

When a claim is $25,000 or less, it is heard by a single public arbitrator.[66] If the claim ranges between $25,000 and $50,000, the FINRA panel will consist of one public arbitrator, unless any party requests a panel of three arbitrators, which must include two public arbitrators.[67] If the investor's claim is more than $50,000, or if the claim does not specify damages, the panel will consist of three arbitrators, unless both parties agree in writing to one arbitrator.[68] A three-member arbitration panel must include two public arbitrators, one of whom serves as the chairperson.[69] To qualify as a chair, an arbitrator must either 1) have a law degree, be a member of the bar of at least one jurisdiction, and have served as an arbitrator on at least two prior SRO arbitrations in which hearings were held, or 2) have served as an arbitrator through award on at least three arbitrations administered by an SRO in which hearings were held.[70]

Before serving on an arbitral panel, a candidate must complete FINRA's comprehensive arbitrator training program which consists of an eight-hour online training

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[65] In order to further enhance investor confidence in the fairness and neutrality of its arbitration forum, on March 12, 2007, NASD filed a proposed rule change to amend the definition of public arbitrator so that a professional could not be classified as a "public" arbitrator if his or her firm derived over $50,000 or more in annual revenue in the past two years from any persons listed in § 12100(p). Self-Regulatory Organizations; National Association of Securities Dealers, Inc., Notice of Filing of Proposed Rule Change to Amend the Definition of Public Arbitrator, 72 Fed. Reg. 3,9110, 3,9111 (July 17, 2007).

[66] Code of Arbitration Procedure § 12401(a).

[67] Code of Arbitration Procedure §§ 12401(b), 12402(b).

[68] Code of Arbitration Procedure § 12401(c).

[69] Code of Arbitration Procedure § 12402(b).

[70] Code of Arbitration Procedure § 12400(c).

course and a four-hour onsite classroom session, which provides "practical guidance for resolving common issues that arise during arbitration."[71] FINRA also offers subject-specific online training modules on arbitrators' duty to disclose and parties' duties during the discovery process, among others. Arbitrators wishing to serve as chairperson must complete an additional nine-hour course to ensure that they are capable of assuming such significant responsibilities.[72]

3. Investors are able to choose the arbitrators to hear a dispute

Claimants in SRO arbitration, unlike plaintiffs in court, have significant input in the composition of an SRO arbitration panel. Once a claim has been filed, FINRA sends both parties a randomly generated list of eight public arbitrators, eight non-public arbitrators, and eight public chairperson-eligible arbitrators to hear the dispute.[73]

The parties receive extensive disclosures regarding each potential arbitrator, including employment history for the past 10 years and other background information. The parties also have access to potential arbitrators' prior awards on the FINRA website or by contacting FINRA directly. Each party may perform web-based searches for FINRA arbitration awards, free of charge, by simply entering the name of the potential arbitrator into the online database.74

After considering the relevant background information and prior awards of the list of potential arbitrators, each party may strike up to four arbitrators from each list

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[71] Arbitrator Training, *available at* http://www.finra.org/ArbitrationMediation/ResourcesforArbitratorsandMediators/ArbitratorTraining/ArbitratorTrainingPrograms/index.htm.

[72] *Id.*

[73] Code of Arbitration Procedure § 12403(a). If a panel consists of only one arbitrator, FINRA will send the parties a list of eight potential arbitrators from the chairperson roster. Code of Arbitration Procedure § 12403(a)(1).

[74] FINRA Dispute Resolution Homepage, *available at* http://www.finra.org/ArbitrationMediation/index.htm.

of eight arbitrators, and rank their preferences from the remaining arbitrators.[75] The ranked lists of both parties are then combined and the highest-ranked potential arbitrators are appointed by the Director of FINRA Dispute Resolution.[76]

The Supreme Court has recognized that these extensive requirements and procedures promote the fairness of the process in securities arbitrations. In *Gilmer* v. *Interstate/Johnson Lane Corp.*, the Court considered NYSE rules requiring arbitrators to disclose extensive background information (NYSE Rule 608) and conflicts of interest (NYSE Rule 610), the rule permitting parties to inquire further into arbitrators' backgrounds (NYSE Rule 608), and the rule permitting parties to challenge arbitrators (NYSE Rule 609).[77] The Court noted that these rules "provide protections against biased panels" and concluded that "[t]here has been no showing in this case that those provisions are inadequate to guard against potential bias."[78]

B. Procedural Safeguards in Favor of the Investor Exist Throughout the Entire Arbitration Process

Federal oversight and public input have ensured that procedural protections exist for the investor throughout dispute resolution proceedings. Examples of such protections are codified in several of FINRA's rules, including:

- Code of Arbitration Procedure § 3110(f) requires that "in any agreement containing a predispute arbitration agreement, there shall be a highlighted statement...that the agreement contains a predispute arbitration clause."[79]

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[75] Code of Arbitration Procedure § 12404.

[76] Code of Arbitration Procedure § 12406.

[77] *Gilmer*, 500 U.S. at 30. The Code of Arbitration Procedure provides investors the same procedural protections as the NYSE rules the Supreme Court considered in *Gilmer*. *See e.g.*, Code of Arbitration Procedure §§ 12403(b)(1), 12408(a), 12403(b)(2), 12404.

[78] *Id.* at 30-31.

[79] Code of Arbitration Procedure § 3110(f)(2)(A).

- FINRA also ensures that the substantive provisions of an agreement to arbitrate protect the investor: the arbitration clause cannot limit the ability of a party to file a claim or the ability of an arbitrator to make an award.[80] Thus, all of the remedies available to an investor in court are also available to an investor in arbitration. Should an arbitration clause be challenged, this rule facilitates judicial review of the agreement to determine its enforceability under the FAA.[81]
- Investors are not required to arbitrate disputes with members of FINRA whose memberships have been terminated, suspended, cancelled or revoked or against members who have been expelled.[82]
- Investors may represent themselves or may be represented by a person who is not an attorney in arbitration. This rule is particularly beneficial for investors with small claims who "may be unable to retain an attorney because the attorney may believe that the attorney's share of any award would be too small to justify the effort."[83]
- Sections 12204 and 12205 of the Code of Arbitration Procedure provide that class action claims and shareholder derivative actions may not be

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[80] Code of Arbitration Procedure §§ 3110(f)(4)(B-D). In some jurisdictions, claimants may have greater remedies available in arbitration than they would in court. For example, in New York, in the absence of a statute, punitive damages are available in a limited number of circumstances. *Garrity* v. *Lyle Stuart, Inc.*, 353 N.E.2d 793, 795 (N.Y. 1976). Similarly, in Massachusetts, the general rule is that punitive damages are not available absent specific statutory authority. *Santana* v. *Registrars of Voters of Worcester,* 398 Mass. 862, 867 (1986). Yet, in securities arbitration proceedings held in that state, claimants frequently seek punitive damages under the provision of the Code of Arbitration Procedure that allows arbitrators to award any damages they deem appropriate.

[81] 9 U.S.C. §§ 3, 4 (2000).

[82] Code of Arbitration Procedure § 12202.

[83] Securities and Exchange Commission, Release No. 34-56540, 3 (September 26, 2007), *available* at http://www.sec.gov/rules/sro/nasd/2007/34-56540.pdf.

arbitrated.[84] Under these provisions, members of the securities industry may not enforce arbitration agreements against any member of a certified or putative class unless the claimant has opted out of the class.[85] However, individual investors may, at their election, proceed to arbitrate disputes based upon the same facts and law underlying the class action if they opt out of the class action proceeding or otherwise provide notice that they will not participate in the class action or in any class recovery.[86] These rules regarding class actions must be disclosed in the text of an agreement to arbitrate.[87]

- Arbitration hearings are held at the location closest to the customer's residence at the time of the events giving rise to the dispute, or elsewhere as fairness to the customer may dictate.[88] FINRA has 73 hearing locations—including at least one in every state—and locations in Puerto Rico and London, England.[89] Therefore, the brokerage firm must be prepared to travel and arbitrate in any of the fifty states or abroad.
- Investors are subject to modest fees for filing a claim, and filing fees for investors are smaller than those for member firms.[90] For example, an

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[84] Code of Arbitration Procedure §§ 12204, 12205.

[85] Code of Arbitration Procedure § 12204(d).

[86] Code of Arbitration Procedure § 12204(b).

[87] Code of Arbitration Procedure § 3110(f)(6).

[88] Code of Arbitration Procedure § 12213(a).

[89] *See* FINRA Mediation Regional Offices and Hearing Locations, *available at* http://www.finra.org/ArbitrationMediation/Mediation/FINRAMediationRegionalOfficesandHearingLocations/index.htm.

[90] Code of Arbitration Procedure § 12900. It is important to note that broker-dealers bear 75 percent of the cost of administering SRO arbitrations. *The Arbitration Policy Task Force*

investor submitting a claim with damages in the amount of $2,501.00 to $5,000 must pay a $175.00 filing fee.[91] Furthermore, the SRO may defer an investor's payment of all or part of the filing fee on a showing of financial hardship,[92] and an investor's filing fee is partly refundable if the case is settled or withdrawn more than 10 days before a hearing, a frequent occurrence.[93]

- An arbitrator or arbitration panel may sanction a securities firm for failure to comply with the Code of Arbitration Procedure, including discovery violations.[94] An arbitrator or arbitration panel may also initiate a disciplinary referral to SRO regulators for perceived violations of federal securities laws or SRO rules.[95]
- Code of Arbitration Procedure §12904(i) requires payment of an award within 30 days unless a motion to vacate is filed. Penalties for non-compliance include monetary fines and suspension of a firm's membership license.[96]
- FINRA has implemented various measures to expedite arbitration proceedings in matters involving elderly or seriously ill investors. In such

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Report—A Report Card at 25 (July 27, 2007), *available at* http://www.finra.org/web/groups/rules_regs/documents/rules_regs/p036466.pdf.

[91] *Id.* In comparison, a FINRA member firm with a claim of the same amount must pay $525.00 to file its claim. Plaintiffs filing a civil suit in U.S. district court must currently pay a filing fee of $350.00. *See* Frequently Asked Questions, *available at* http://www.uscourts.gov/faq.html#filing.

[92] Code of Arbitration Procedure § 12900(a)(1).

[93] Code of Arbitration Procedure § 12900(c).

[94] Code of Arbitration Procedure § 12212(a). At the conclusion of the case, the arbitration panel may also refer firms and individuals to regulatory authorities for potential violations of federal securities laws or SRO rules. Code of Arbitration Procedure § 12212(b).

[95] *See* Code of Arbitration Procedure § 12212(b).

[96] *See* FINRA Sanction Guidelines at 20.

cases, FINRA staff begins the arbitrator selection process, schedules the initial pre-hearing conference and serves the final award as quickly as possible.[97]

Supplementing the Code of Arbitration Procedure are manuals, available to the parties and the arbitrators, that explain the arbitration rules. For example, FINRA has published a Discovery Guide that explains the discovery rules contained in the Code of Arbitration Procedure.[98] The Discovery Guide specifically identifies categories of documents that are discoverable in all customer cases and sets forth additional categories of documents that should be exchanged in cases with particular types of claims.[99] The lists serve as a guide to ensure that all relevant material is exchanged, but the parties and arbitrators retain the flexibility to make adjustments to the types of materials exchanged based upon the particular claims at issue.[100] The Discovery Guide thus facilitates the exchange of documents and information early on in the proceedings and ensures that customers are seeking and obtaining discovery that is relevant to their claims.

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[97] NASD Announcement, "Notice to Parties - Expedited Proceedings for Elderly or Seriously Ill Parties," (June 7, 2004), *available at* http://www.finra.org/ArbitrationMediation/ResourcesforParties/p009636. The expedition of proceedings for infirm or elderly parties is the result of just one of several pilot programs FINRA has undertaken in order to determine how to better serve investors. For instance, FINRA has also established the Discovery Arbitrator pilot program, which involves appointing one arbitrator to resolve all discovery disputes prior to the hearing. NASD Announcement, "Discovery Arbitrator Pilot" (July 27, 2005), *available at* http://www.finra.org/ArbitrationMediation/ResourcesforParties/p014765. In addition, the Mediation Settlement Month program, which offers reduced mediation rates, encourages more "parties to experience the benefits of mediation for the first time and to reinforce its value and effectiveness to those who have benefited from mediation before." FINRA Announcement, "October 2007 is FINRA Mediation Settlement Month," *available at* http://www.finra.org/ArbitrationMediation/Mediation/MediationSettlementEvents/p011328.

[98] *The Discovery Guide, available at* http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p018922.pdf.

[99] *Id.*

[100] *Id.*

To further assist arbitrators and to ensure that customers are receiving the protections of the Code of Arbitration Procedure, SICA compiled The Arbitrator's Manual (the "Manual") to supplement and explain the Uniform Code of Arbitration.[101] Among other things, the Manual attaches the Code of Ethics for Arbitrators in Commercial Disputes and explains the arbitrators' ethical responsibilities and duty to disclose conflicts.[102] The Manual also encourages arbitrators to "be sensitive to a party who is not represented by counsel," and to provide guidance to such a party by, among other things, explaining the purpose of the opening statement and ensuring "that the party has had an opportunity to present all evidence."[103] The Manual also explains the type of relief the panel may award, including compensatory damages, punitive damages, injunctive relief, interest and attorneys' fees.[104]

Thus, the procedural rules of the Code of Arbitration Procedure, which are supplemented by guides that discuss and explain them, are designed to assist investors seeking to pursue a claim and ensure that their substantive and procedural rights are adequately protected.

V. Securities Arbitration Is Faster and Less Costly Than Litigation

SRO arbitration is more efficient and cost effective than litigation. During the twelve-month period between March 2005 and March 2006, the median time interval for federal courts to reach a decision on the merits at a trial was 22.2 months.[105] By

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[101] *The Arbitrator's Manual*, January 2007, *available at* http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p009668.pdf.

[102] *Id.* at 40-51.

[103] *Id.* at 6-7.

[104] *Id.* at 30-31.

[105] Federal Judicial Caseload Statistic[sic], March 31, 2006, Table C-5, *available at* www.uscourts.gov/caseload2006/tables/C05Mar06.pdf.

contrast, in NASD arbitration, the average turnaround time for cases in 2006 was 13.7 months.[106] As these figures demonstrate, disputes submitted to SRO arbitrations are resolved approximately 40 percent faster than cases filed in federal court.[107]

The faster resolution of disputes in arbitration is largely due to a number of procedural practices that distinguish SRO arbitration from litigation. For example, while motion practice is almost a given in court, it is disfavored in arbitration.[108] Likewise, whereas expansive discovery is typical in court, focused discovery is mandated in arbitration.[109] As a result of these measures, parties' claims are resolved more expeditiously and at a lower cost in SRO arbitration than in litigation.

A. Motion Practice Is Limited in Arbitration

Whereas motion practice is standard in court, SRO arbitration generally discourages dispositive motions. Under the Federal Rules of Civil Procedure, a defendant may file a motion to dismiss and any party may file a motion for judgment on the pleadings or motion for summary judgment before trial.[110] While motions are permitted under the Code of Arbitration Procedure and have become more common in

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[106] Dispute Resolution Statistics August 2007, *available at* http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/Statistics/index.htm.

[107] Appendix B (Arbitration is Faster Than Litigation). Similarly, state courts' crowded dockets make it highly unlikely that claimants will have their dispute resolved more quickly in that forum than in arbitration.

[108] FINRA Announcement, "FINRA Board Approves Rule to Limit Motions to Dismiss in Arbitration" (September 26, 2007), *available at* http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P037048.

[109] *See The Discovery Guide, supra* note 98; *see also* Code of Arbitration Procedure § 12507(a)(1) ("Parties may also request additional documents or information from any party by serving a written request directly on the party. Requests for information are generally limited to identification of individuals, entities, and time periods related to the dispute; such requests should be reasonable in number and not require narrative answers or fact finding. Standard interrogatories are generally not permitted in arbitration.").

[110] Fed. R. Civ. P. 12, Fed R. Civ. P. 56.

SRO arbitrations in recent years,[111] their numbers are likely to decrease in the near future: FINRA announced on September 26, 2007 that its Board of Governors had approved rule amendments to significantly limit the number of dispositive motions filed in arbitration.[112]

In contrast, recent Supreme Court case law addressing pleading standards in federal court has lead to an increase in the frequency of motions to dismiss in that forum. Earlier this year, the Court found that a plaintiff in a securities fraud action must allege "with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." The Court held that an inference of fraudulent intent alleged in the complaint "must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."[113] Similarly, in 2005, the Supreme Court held that a plaintiff asserting a securities fraud claim must not only allege that he purchased a security at a price that was inflated because of the fraud but he must also plead loss causation—a causal connection between the economic loss suffered and the misrepresentation alleged.[114] The result of these decisions is that, for securities class action cases filed between 2005 and 2007, dismissals have accounted for 39.1 percent of dispositions.[115] While a claimant asserting a fraud claim in arbitration must ultimately prove loss causation, the issue is much less likely to be determinative at the pleading stage in arbitration than it is in court. The foregoing demonstrates an additional reason

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[111] *See* Code of Arbitration Procedure § 12503.

[112] *See supra* note 108.

[113] *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2504-05 (2007).

[114] *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336, 347 (2005).

[115] Todd Foster, Ronald I. Miller, Ph.D., Stephanie Planchich, Ph.D., Brian Saxton, and Svetlana Starykh, NERA Economic Consulting, *Recent Trends in Shareholder Class Action Litigation: Filings Stay Low and Average Settlements Stay High—But Are These Trends Reversing?*, 7 (September 2007), *available at* http://www.nera.com/image/PUB_RecentTrends_Sep2007-FINAL.pdf.

why arbitration is attractive to investors: it is highly unlikely that a claim will be dismissed solely on pleading grounds in arbitration, whereas in court the risk is much higher.

B. Discovery Is Narrowly Tailored and Less Costly in Arbitration

The time-consuming and costly discovery procedures available in court are generally not present in arbitration. Rule 26 of the Federal Rules of Civil Procedure permits a party to obtain, with certain enumerated exceptions, discovery "regarding any matter, not privileged, that is relevant to the claim or defense of any party."[116] Such discovery is guided by the parties, who are free to make broad requests for disclosure within the scope of Rule 26.[117] Under the Federal Rules, parties are also able to depose as many as ten witnesses without leave of the court (and more with leave of the court) in advance of trial.[118]

In contrast, the Code of Arbitration Procedure tailors the exchange of documents and information to presumptively discoverable material enumerated on specific discovery lists.[119] Parties may request additional documents or information, but requests for information are generally limited to "identification of individuals, entities, and time periods related to the dispute."[120] Interrogatories are generally not permitted in SRO arbitrations.[121] Similarly, depositions are strongly discouraged in SRO arbitrations, and are only permitted under very limited circumstances, such as where a witness is ill or dying.[122] Thus, the discovery process is more streamlined in arbitration and does not

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[116] Fed. R. Civ. P. 26(b).

[117] Fed. R. Civ. P. 26.

[118] Fed. R. Civ. P. 30.

[119] Code of Arbitration Procedure § 12506.

[120] Code of Arbitration Procedure § 12507(a)(1).

[121] *Id.*

[122] Code of Arbitration Procedure § 12510.

entail the significant costs associated with numerous depositions and expansive document production that are typical in court proceedings.

The discovery procedures in place in SRO arbitration enable the parties to obtain information relevant to their claims in a process that is streamlined, efficient, economical and specifically tailored to investor claims.

C. Faster Resolution of Disputes Benefits Both Parties

Shortened resolution times such as these come with a myriad of benefits to parties. First, faster resolution of the dispute reduces the costs incurred by both parties. Indeed, a study conducted by Deloitte Haskins found that for the period between October 1, 1987 and June 30, 1988, "the average legal costs are $12,000 less in arbitration than for litigation."[123] Thus, after adjusting solely for inflation, this disparity would have grown to at least $22,000 in 2007, but given that litigation costs have significantly out-paced inflation since 1988, that gap is most likely substantially wider. More recent studies support this conclusion. A former president of the American Bar Association found that a "ratio of 3 or 4 to one, litigation versus arbitration, is a fairly realistic estimate [of the cost savings from arbitration] and a reasonable expectation is that the cost of an arbitration will not be in excess of half the cost of litigating."[124] The cost effectiveness of the process serves as a "relative economic benefit favoring arbitration for the customer."[125] Thus, as the Supreme Court has noted, "it is typically a

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[123] Grant, *supra* note 43 at 96.

[124] William G. Paul, *Arbitration v. Litigation in Energy Cases*, First Annual Energy Litigation Program (Co-sponsored by the Center for American and International Law and by the ABA Section of Environment, Energy and Resources) (Nov. 2002), *available at* http://www.arb-forum.com/rcontrol/documents/ResearchStudiesAndStatistics/2002PaulArbitrationVLitigationInEnergyCases.pdf.

[125] *Securities Industry Ass'n* v. *Connolly*, 703 F. Supp. 146, 159 (D. Mass. 1988); *see also* Appendix F (Many Cases are Small Claims, Which are Better-Suited for Arbitration Than Litigation). Between 1995 and 2004, approximately 25 percent of arbitrations filed with NASD or NYSE involved claims of less than $10,000, a sum for which it is often not cost effective to litigate, whether in federal or state court.

desire to keep the effort and expense required to resolve a dispute within manageable bounds that prompts [parties] mutually to forgo access to judicial remedies."[126]

As discussed further below, the greater speed and lower cost of SRO arbitration also leads to the desirable result that more cases are resolved by decisionmakers on a full factual record in arbitration than in court.[127] Further, prompt resolution of the dispute improves the reliability of witness accounts and averts difficulties that may arise in locating witnesses, documents, and other evidence many years later.[128]

FINRA's mediation program is another aspect of its dispute resolution system that facilitates the efficient resolution of investor claims. FINRA Dispute Resolution developed the mediation program to provide additional dispute resolution options for parties.[129] Mediators are selected by NAMC and are required to have formal mediator training and prior experience serving as a mediator in order to be considered.[130] Mediation is a flexible, informal and voluntary process in which an impartial person, trained in negotiations, assists the parties in reaching a mutually acceptable resolution.[131] Mediation allows the parties to resolve disputes even more

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[126] *Mitsubishi Motors Corp.*, 473 U.S. at 633.

[127] *See* Appendix C (More Cases Are Heard Before a Decision-Maker in Arbitration Than in Court).

[128] Testimony of Marc E. Lackritz before the Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, U.S. House of Representatives, "A Review of the Securities Arbitration System," (March 17, 2005), *available at* http://www.sifma.org/legislative/testimony/archives/Lackritz3-17-05.html.

[129] *See* FINRA Mediation: An Alternative Path, *available at* http://www.finra.org/ArbitrationMediation/Mediation/ MediationAnAlternatePath/index.htm.

[130] *See* Mediator Recruitment Information, *available at* http://www.finra.org/ArbitrationMediation/ResourcesforArbitratorsandMediators/ArbitratorRecruitment/p011392.

[131] *Id.*

quickly than arbitration, saving them substantial time and expense. In 2005 and 2006, 10 percent of cases closed were resolved via mediation.[132]

VI. The Overwhelming Weight of the Evidence Illustrates that Securities Arbitration is Fair to Investors

The demonstrated efficiencies of SRO arbitration, as discussed above in Section V, do not come at the cost of fairness in the process or in the results. Parties in arbitration are far more likely than parties in court to have their disputes resolved by a decisionmaker on a full factual record. Also, SRO arbitration provides parties with all of the substantive rights (and then some) to which they would be entitled in litigation. Moreover, as discussed above in Section IV, SRO arbitration procedures include numerous safeguards against arbitrator bias, which, as the data show, lead to equitable outcomes. Finally, and not insignificantly, studies show that both sides have found SRO arbitrations to be fair.

A. Parties in Arbitration Are Far More Likely To Have Their Claims Decided Based on a Full Factual Record

Claims brought in court are subject to higher pleading standards than those brought in arbitration. The Federal Rules of Civil Procedure require a plaintiff claiming fraud to allege "with particularity" the specific facts upon which his claim is based,[133] and the Private Securities Litigation Reform Act of 1995 ("PSLRA") further heightens a securities plaintiff's burden under the already strict pleading standard. The PSLRA requires that any private plaintiff bringing an action under the 1934 Act (which provides remedies for fraud in connection with the purchase or sale of securities) must include in his complaint, "each statement alleged to have been misleading, the reason or

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[132] *Supra* note 106.

[133] Fed. R. Civ. P. 9(b).

reasons why the statement is misleading, and if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."[134]

Under the PSLRA, a plaintiff is also required to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind [scienter]."[135] As discussed previously, the significance of this heightened pleading requirement was recently clarified by the United States Supreme Court, which held that in the context of the PSLRA, "an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." [136]

In contrast, though arbitrators follow the substantive law, pleading standards in SRO arbitrations are relaxed in order to *encourage* claimants to file their disputes. Indeed, under Code of Arbitration Procedure § 12302(a)(1), a claimant is simply required to file a Statement of Claim, "specifying the relevant facts and remedies requested."[137] Consequently, the leeway given to SRO arbitrators "may result in arbitrators seeking to be 'fair' [by reaching the merits of an action] whereas such claims may have been dismissed by a court."[138] In other words, the lesser pleading

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[134] 15 U.S.C. § 78u-4(b)(1) (2000). A number of claims brought in arbitration are based upon state or common law claims and are not subject to the strict pleading requirements of the PSLRA.

[135] 15 U.S.C. § 78u-4(b)(2) (2000).

[136] *Tellabs Inc.*, 127 S. Ct. at 2505.

[137] Code of Arbitration Procedure § 12302(a)(1).

[138] Marc Steinberg, *Securities Arbitration: Better for Investors than the Courts?*, 62 Brook. L. Rev. 1503, 1506 (1996). The effect of the PSLRA on the number of securities cases dismissed at the pleading stage has been significant. While dismissals accounted for only 19.4 percent of dispositions for securities class actions filed between 1991and 1995, dismissals accounted for 39.1 percent of all dispositions for cases filed between 2001 and 2005. *Supra* note 115.

requirements available in arbitration are more likely to prevent dismissal of a claim in the early stages of the dispute resolution process and allow a party to have his claim heard by a decisionmaker after development of a full factual record.

The effect of these rules is evidenced by the number of claimants whose disputes are resolved by a decisionmaker in an SRO arbitration versus court.[139] In 2005, 20 percent of all NASD arbitrations closed were decided after a hearing. In 2006, 18 percent of NASD arbitrations were decided after a hearing.[140] In contrast, from March 31, 2005 through March 31, 2006, only 1.3 percent of all civil cases resolved in federal district courts were heard by a judge or jury.[141]

B. SRO Arbitration Provides Parties with All of the Substantive Rights Available to Them in Litigation

Parties participating in SRO arbitration are guaranteed all of the substantive rights to which they would have been entitled if the action had been brought in court. The Supreme Court, in upholding predispute arbitration agreements, has so noted, stating that "by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral rather than a judicial forum."[142]

Accordingly, an arbitrator may award punitive damages, attorneys' fees and any other award that a court of competent jurisdiction could make. Even though a court would likely uphold an agreement to limit punitive damages, member firms are prohibited by rule from including restrictions on punitive damages in their customer

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[139] *See* Appendix C (More Cases Are Heard Before a Decision-Maker in Arbitration Than in Court).

[140] *Supra* note 106.

[141] Federal Judicial Caseload Statistic[sic], March 31, 2006, Table C-4, *available at* http://www.uscourts.gov/caseload2006/tables/C04Mar06.pdf.

[142] *Rodriguez de Quijas*, 490 U.S. at 481 (citing *Mitsubishi Motor Corp.*, 473 U.S. at 628).

agreements.[143] This prohibition is enforced by disciplinary referrals. In this regard, investors in arbitration proceedings claimed punitive damages in "about 20 percent of the 1,552 total cases decided in 1998."[144] Investors also sought "reimbursement for attorney fees in about 10 percent of the 1,552 total cases decided in 1998."[145] Finally, in SRO arbitration, investors have an additional mechanism by which to ensure payment of an award that is not available to them in court: FINRA has the ability to suspend a member's license if it does not promptly pay an arbitration award.[146]

C. SRO Arbitration Is Unbiased

Opponents of arbitration sometimes assert that SRO arbitration is biased in favor of the financial services industry.[147] The evidence is to the contrary. The evidence confirms that SRO arbitration does not favor industry members over investors.

1. Statistical evidence shows that SRO arbitrations are not biased in favor of the industry

Studies show that customers fare better in SRO arbitration than in litigation. A 1992 GAO study, updated in 2000, concluded that there was "no indication of a pro-industry bias in decisions at industry-sponsored forums."[148] That study found no statistically significant difference between the results in SRO arbitrations and non-SRO arbitrations.[149] Likewise, data collected between 1980 and 2001 shows that 52.26

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[143] *See* NASD Conduct Rule 3110(f)(4).

[144] *Supra* note 53 at 29.

[145] *Id.*

[146] *Supra* notes 96 and 128.

[147] *See, e.g.*, Testimony of Joseph Borg before the United States Senate Committee on Banking, Housing and Urban Affairs, "Consolidation of NASD and the Regulatory Functions of the NYSE: Working Towards Improved Regulation," at 8 (May 17, 2007), *available at* http://banking.senate.gov/_files/ACF1D.pdf.

[148] *Supra* note 50 at 6.

[149] *Id.*

percent of securities arbitrations conducted by SROs resulted in awards for customers.[150]

Nor is there evidence that the presence of a non-public or "industry" arbitrator on a three-member panel in SRO arbitrations somehow infuses pro-industry bias into the process. A May 2005 study conducted by Securities Arbitration Commentator, Inc. ("SACI") on industry bias in SRO panels found that the presence of non-public arbitrators yielded "no material impact on customer wins" when compared to "win" rates on awards which public arbitrators adjudicated alone.[151] In that study, SACI also considered 162 arbitrations where a dissent was filed by an arbitrator.[152] Of those cases, claimants won 63 percent of the time, and more than 70 percent of the dissents were filed by *public* arbitrators.[153] SIFMA's own review of available decisions from 2005 and 2006 further supports the SACI study's findings: in 2005, arbitration panels, which include an "industry" arbitrator, found for claimants in 60 percent of cases whereas cases decided by a single arbitrator, which by rule must be a "public" arbitrator, found for claimants in 50 percent of cases. Similarly, in 2006 panels found for claimants in 55 percent of cases they heard.[154]

Nor have "industry" arbitrators objected disproportionately to large compensatory damage awards against securities firms or those involving punitive damages. In the five cases studied in which punitive damages were awarded against

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[150] Perino, *supra* note 47 at 32.

[151] *Industry Arbitrator Award Survey: Does the Securities Industry Arbitrator's Presence Create a Discernible Shift in Award Outcomes?*, Securities Arbitration Commentator, Inc. 8 (Vol. 2005, No. 4), *available at* http://sec.gov/rules/sro/nasd/nasd2005094/rpryder091905.pdf.

[152] *Id.* at 5-6. The SACI study noted that of the 7,127 arbitration awards made from 2000-2004, only 186 awards (2.6 percent) included a dissent. *Id.* at 5.

[153] *Id.* at 6-7.

[154] *See* Appendix G (The Presence of an "Industry" Arbitrator Has No Material Impact on Customer Wins).

securities firms, "industry" arbitrators filed not a single dissent.[155] Moreover, in cases granting large compensatory awards to investors, public arbitrators dissented from decisions granting large compensatory awards eighteen times compared to just five such dissents from "industry" arbitrators.[156] These figures led SACI to conclude that the data did not suggest that a non-public or "industry" arbitrator serves in a "less neutral role than his or her Public Counterparts."[157]

By virtue of his or her extensive experience and expertise, the inclusion of a non-public "industry" arbitrator benefits both parties to a dispute. As has been noted

> [o]ne of the benefits associated with the arbitration model...is decision making by those knowledgeable in the field, and the industry arbitrator provides that expertise. The SEC has not questioned the presence of an industry arbitrator, and at least one independent arbitration forum saw value in industry expertise.[158]

"Industry" arbitrators also benefit the public panelists as they can serve to educate them about financial products and services, industry customs and practices and other legal industry-related issues.[159] For this very reason, the presence of an industry arbitrator may also reduce costs: parties need not call expert witnesses in order to educate a

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[155] *Supra* note 151 at 6.

[156] *Id.*

[157] *Id.* at 8.

[158] Barbara Black, *Is Securities Arbitration Fair to Investors?* (The Eighth Annual James D. Hopkins Lecture), 25 Pace L. Rev. 1, 7 (2004). The author notes that before the AAA effectively ceased operating as a securities arbitration forum, it also classified arbitrators as neutral or industry parties. *See* Am. Arbitration Ass'n, Supplementary Procedures for Securities Arbitration, *available at* http://www.adr.org.

[159] "Industry" arbitrators are standard in other arbitration forums as well. For example, arbitration panels in the construction industry are typically composed of persons with experience in the construction field. *See* Am. Arbitration Ass'n, Construction Industry Arbitration Rules and Procedures, *available at* http://www.adr.org/sp.asp?id=22004. Similarly, arbitrators in reinsurance and insurance disputes are generally former officers or executives of insurance companies. *See, e.g., Reinsurance Arbitration—A Primer, available at* http://www.irmi.com/Expert/Articles/2006/Schiffer06.aspx.

panel about certain products or industry practices. As a result of their expertise and career in the industry, non-public arbitrators are more likely to be offended by, than protective of, misbehavior by other brokers or securities firms. His or her primary concern in deciding cases is to ensure the facts are weighed fairly, the law is applied correctly, and that justice is done, all of which serves to protect the reputation of the securities industry and the integrity of the arbitral forum.[160]

2. The Solin Study criticizing SRO arbitrations is fundamentally flawed

These well-documented facts notwithstanding, a recent study by Daniel Solin, a securities arbitration claimants' counsel, and Edward O'Neal, a professional expert witness who regularly testifies against brokers and their firms,[161] contends that investors do not fare well in securities arbitration. In particular, Solin and O'Neal conclude that:

1) between 1999 and 2004 investor-claimant win rates declined 15 percent;

2) claimants were less successful when they brought claims against large brokerage houses;

3) claimants who won at arbitration recovered a decreasing percentage of the amount claimed; and

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[160] Non-public arbitrators do not have any vested interest in the outcome of an arbitration. Although arbitrators receive an honorarium from FINRA, they are not employees of FINRA. *See* Code of Arbitration Procedure § 12214. As a result, FINRA arbitrators need not be concerned that a decision against the financial industry may result in termination of their employment. Likewise, a decision against a member firm will not preclude an arbitrator from being placed on a FINRA generated list of potential arbitrators for any particular panel. This independence—unlike elected judges or other arbitration forums where arbitrators are employed by the arbitration organization itself—ensures that FINRA arbitrators have no incentive to rule in favor of one party or another. The data demonstrates that this is the case: as shown above, the presence of an industry arbitrator does not adversely affect claimants.

[161] *See* Securities Litigation and Consulting Group, Testifying Experts, *available at* http://www.slcg.com/resumes.php?c=1b.

4) the average amount of expected recovery has decreased since 1998.[162]

The Solin Study, however, ignores the increasingly important role of settlements, the means by which the vast majority of securities arbitrations are resolved, in determining whether claimants achieved a favorable outcome. It also fails to account for or address a number of historically significant events that occurred during the time period covered by the study. Specifically, the Solin Study ignores the bursting of the stock "bubble" and the ensuing bear market of the early 2000s. The study also fails to address the particularly aggressive claimants' bar at that time, which filed an enormous number of arbitration cases, many with overstated losses and meritless claims—based on allegedly inaccurate stock research reports—which failed for many reasons, including the lack of a connection between their allegations and the losses they sought to recover. As a result, arbitrators decided against the claimant in more than two-thirds of analyst claims.[163]

These historical factors, as well as the circumstances discussed below—the evidentiary hurdles faced by investors in proving fraudulent research claims, the increase in the number of settlements and the 300 percent increase in the amount of damages requested during this time period—easily explain the study's findings of decreased win rates and diminished awards relative to the amount claimed. As a result, the Solin Study presents a fundamentally distorted picture of the fairness of SRO arbitration.

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[162] Edward S. O'Neal, Ph.D. and Daniel R. Solin, *Mandatory Arbitration of Securities Disputes-A Statistical Analysis of How Investors Fare* 17 (2007) ("Solin Study").

[163] *Supra* note 18 (regarding the proposed consolidation of the NASD and NYSE Regulation arbitration programs).

(a) The Solin Study's focus on "win rates" ignores that the period analyzed in the study was one in which many dubious securities claims were filed.

The rate at which claimants prevail over a specific period of time is not an empirically valid basis on which to judge the fairness of a dispute resolution forum. Perhaps this explains why not even the court system is evaluated in this manner. Although the Solin Study itself admits that win rates are "an inaccurate and misleading basis for determining the fairness of the mandatory arbitration system," it then proceeds to rely heavily on this concededly flawed metric to attack SRO arbitration.[164]

The effort to draw broad conclusions from claimant win rates during the period that the Solin Study focuses on is particularly suspect. Although the Solin Study reviews arbitration statistics for the period from 1995 through 2004, it predicates its condemnatory conclusions about the fairness of SRO arbitration almost entirely on reported results during 2002-2004. In particular, the Solin Study contends that during this period arbitration claimants prevailed less frequently than in years past and recovered a smaller percentage of their claimed damages.[165] Although the authors acknowledge that "[t]here may well be innocent explanations" for the decline in win and

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[164] Solin Study at 5. For the same reason, the Securities Arbitration Commentator Inc.'s survey of 2006 arbitrations, which highlights the gap in claimants' win rates when bringing "small claims" (i.e., those under $25,000) versus larger-dollar claims, does not impugn the fairness or efficacy of SRO arbitration. Furthermore, the rate at which investors win "small claims" has remained relatively constant when compared to the rate at which investors win larger-dollar claims: in 2000, there was a 9 percent difference in win rates between "small claims" and all other claims; in 2002, there was a 15 percent difference in win rates, and in 2005, there was, again, a 9 percent difference in win rates between larger-dollar claims and claims under $25,000. *See 2006 Annual Award Survey: A SAC Award Survey Comparing Results in 2006 to 2000-20005*, Securities Arbitration Commentator, Inc. 2-4, Chart 1 (Vol. 2007, No. 2).

[165] Solin Study at 11 ("The award percentages reached a high in 1998 of 68% and have steadily declined in the later years of the sample to stabilize at approximately 50% in the 2002-2004 time period. Note that this decline in the award percentage roughly corresponds to the decline in win rates over the same period. Toward the end of the sample period, investors were winning less frequently and, when they did win, they were being awarded a smaller percentage of their claim.").

recovery rates for arbitration claimants during that period, they quickly dismiss this possibility with the unsupported assertion that "the misconduct of [brokerage] firms reached its apex with the analyst fraud scandal" during this same period.[166] The Solin Study evidently considers this a sufficient evidentiary basis to indict SRO arbitration as a "'damage containment and control program masquerading as a juridical proceeding,' intended to protect the major brokerage firms from significant damages."[167]

The Solin Study, however, fails to give serious consideration to the fact that arbitration claims resolved during the 2002-2004 time period were qualitatively different from those decided in earlier periods—during which time investors secured unprecedented gains in the markets—and that those differences reduced their chances of prevailing at arbitration. As the Solin Study notes, the number of arbitration claims resolved markedly increased toward the end of their sample period. In fact, the number of arbitrations decided rose from 747 in 1999 to 2,021 in 2004.[168] And during the 2002-2004 time period, SROs resolved 47 percent more cases than during the prior three-year period.[169]

The Solin Study recognizes that the explosion in arbitration claims was likely driven by the collapse of the stock market and, more particularly, the implosion of the technology sector.[170] While it doubtless is true that investors are more likely to file claims when a bear market causes their investments to decline in value or to give back paper profits, it does not follow that investors have viable causes of action against their

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[166] *Id.* at 17.

[167] *Id.*

[168] *Id.* at Fig. 1.

[169] *See id.* at 6-7.

[170] *See id.* (attributing increase in number of arbitrations during period to "the bear market and resulting investor losses in the 2000 to 2002 period").

brokerage firms for such market losses.[171] The Solin Study offers no basis for its evident assumption that the incidence of broker misconduct would have increased proportionately with the number of claims during this period such that the claimant win rate should have been expected to remain constant.

Another distinctive feature of the arbitration claims resolved during the 2002-2004 time frame is the high percentage of claims premised on allegedly inaccurate analyst reports published by major brokerage firms.[172] As noted in the Solin Study, regulatory investigations and settlements concerning the integrity of analyst research reports further fueled the claimants' bar and prompted the filing of record numbers of arbitration claims.[173] In the months after the global research settlement with regulators, three claimants' firms alone "signed up" 10,000 potential arbitration claimants among them.[174] Several claimants' law firms advertised on television and the internet, posting estimates of potential recovery amounts and draft complaints containing boilerplate allegations. These advertisements encouraged the filing of claims by assuring investors there was no cost to filing a claim and therefore they had nothing to lose. Absent this extensive publicity from claimants' firms, promising recovery without costs, it is doubtful whether many of these claims would have been filed. The claimants' bar's aggressive solicitation of claimants thus undoubtedly resulted in a higher number of dubious claims.

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[171] *See, e.g.*, *Dura Pharmaceuticals, Inc.*, 544 U.S. at 345 (noting that securities laws make private securities fraud actions available not to "provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause").

[172] Brooke A. Masters & Ben White, *Wall St. Facing Legal Blitz; 'Global' Settlement Prompts Investor* [sic] *to File Claims*, THE WASHINGTON POST, Jul. 3, 2003, at E01.

[173] Solin Study at 13 ("The rise in award requests was likely driven by a combination of the technology bear market which began in 2000 and lasted through 2002 and the analyst fraud scandal..."). In some cases, analyst claims were brought by investors who did not even hold accounts at the firms against whom they filed their disputes.

[174] Masters & White, *supra* note 172.

Analyst claims, in particular, are difficult to win. To prevail on such claims, investors have to establish, among other things, that (1) specific research reports did not reflect the subjective views of the research analyst about a stock, (2) the investor reasonably relied on those reports for his decision to buy or sell the stock, and (3) the purportedly false research opinion itself, as opposed to an overall market collapse or some other reason, actually caused the investment to decline in value.[175] As Solin himself acknowledges in his book, *Does Your Broker Owe You Money?*, "[t]he primary hurdle that investors may find difficult to overcome is proving that they relied on the conflicted analyst reports in making their decision to invest."[176] In view of the substantial hurdles relating to analyst claims, it is hardly surprising that arbitrators awarded damages in fewer than one-third of analyst cases.[177] Indeed, when investors sued on these claims in court, they fared no better.[178]

(b) The Solin Study ignores the many claims resolved in mutually agreeable settlements

By narrowly focusing on claimant win rates at arbitration, the Solin Study also dramatically understates the percentage of arbitration claimants who receive some form of recovery in the arbitral process. The Solin Study ignores that the percentage of claims settled has increased markedly in recent years, including the very period during which the investor win rate has declined. For instance, in 2003, only 52 percent of cases

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[175] *See In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 273 F. Supp. 2d 351 (S.D.N.Y. 2003), *aff'd in part and rev'd in part sub nom., Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005); *cert. denied,* 126 S. Ct. 421 (Oct. 11, 2005).

[176] Daniel R. Solin, DOES YOUR BROKER OWE YOU MONEY? 203 (Penguin Books 2004).

[177] *Supra* note 18 (regarding the proposed consolidation of the NASD and NYSE Regulation arbitration programs).

[178] *See, e.g.*, *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 273 F. Supp. 2d 351; *Lentell,* 396 F.3d 161 (holding that plaintiffs failed to plead loss causation); *In re Initial Public Offering Secs. Litig.*, 2005 WL 1529659, at *4 (S.D.N.Y. June 28, 2005); *Joffee* v. *Lehman Bros., Inc.*, 2005 WL 1492101, at *14 (S.D.N.Y. June 23, 2005).

were settled directly by the parties or via mediation; by 2006, that number had grown to 60 percent of all arbitrations filed.[179] Currently, settlements are responsible for the resolution of "about 70% of closed cases."[180] Solin himself acknowledges in his book that he settles "somewhere over two-thirds of the claims" he brings and that he usually settles for damages of between 50-60 percent of the claim.[181]

Firms are more likely to settle meritorious claims since these are the claims that pose the greatest risk at arbitration. If a higher number of the claims with merit are being settled, then the claims that proceed to hearing are more likely to be weak or at least more difficult to prove, which would account for the declining win rate for those claims resolved at a hearing. In fact, over the past several years, because the percentage of cases that settle has increased at a greater rate than the decline in the win rate, the net effect is that an *increasing* percentage of claimants are receiving relief through the arbitral process. For example, whether through settlement or a decision on the merits, claimants recovered damages in two-thirds of the cases resolved in 2006, a fact that the Solin Study disregards.[182]

(c) The Solin Study's conclusions about the percentages of claimed damages recovered are misleading and, in all events, not meaningful.

The Solin Study also decries that in the period from 2002-2004 prevailing arbitration claimants recovered a smaller percentage of their claimed damages. Like "win" rates, however, the percentage of claimed damages recovered has never been

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[179] *Supra* note 106.

[180] *2006 Annual Award Survey: A SAC Award Survey Comparing Results in 2006 to 2000-20005*, Securities Arbitration Commentator, Inc. 2, (Vol. 2007, No. 2).

[181] *Supra* note 176 at 219. Solin's settlement range (50-60 percent of the claim amount) is on par with the historical percentage of requested damages awarded claimants in arbitration. Solin Study at 11, Fig. 7.

[182] *Supra* note 106; *see also* Appendix D (The Total Percentage of Claimants Who Recover Damages or Other Relief in Arbitration or by Settlement is Favorable).

accepted as a valid measure of the fairness of arbitration. Again, the court system certainly is not evaluated by this metric. Nor should it be, for it is widely known and well accepted that claimants tend to overstate the amount of damages requested in their statements of claim.[183]

Significantly, as even the Solin Study recognizes, arbitration claimants dramatically increased the amount of their claimed damages following the bear market and the bursting of the "internet bubble."[184] Indeed, it is likely that many claimants calculated their claimed damages as the difference between the value of their stock portfolios at the market's height during the late 1990s and their values following the market's decline. For example, in one securities arbitration that received media attention, Joseph Kenith, a Morgan Stanley client from 1996 to 2001, brought a $3.3 million dollar arbitration claim against Morgan Stanley alleging, among other things, negligence, breach of contract, breach of fiduciary duty, and failure to supervise.[185] According to his attorney, the $3.3 million that Kenith claimed as damages "represented the value of his account at the market's peak,"[186] but that is a measure of damages for which the law provides no support.[187] Significantly, Kenith had no out-of-pocket losses

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[183] The Neutral Corner—June 2006, Seth E. Lipner, *Study of Arbitration Recovery Statistics, available at* http://www.finra.org/ArbitrationMediation/ResourcesforArbitratorsandMediators/GeneralInformationandReference/TheNeutralCorner/p016939 ("In many cases, the amount a claimant demands in the arbitration statement of claim bears only a tenuous relationship to the damage incurred."); *id.* ("[C]laimants will generally overstate the amount of damages they request in the statement of claim.").

[184] *See* Solin Study at 13; *see also* Appendix E (Investors' Inflation-Adjusted Recoveries in Arbitration Have Increased).

[185] Gretchen Morgensen, *Market Place: Morgan Stanley Seeks to Change Basis for Award in Stock Case*, N.Y. TIMES, Aug. 21, 2003, at C1; *Arbitration Award Against Morgan Stanley Not Within Arbitrators' Jurisdiction to Alter*, BNA Corp. Law and Business Center, Aug. 25, 2003, *available at* http://corplawcenter.bna.com/pic2/clb.nsf/id/BNAP-5QMU3E?OpenDocument.

[186] Morgensen, *supra* note 185.

[187] *See Dura Pharmaceuticals, Inc.*, 544 U.S. at 343-344.

at all and even made $500,000 while a Morgan Stanley client.[188] The NASD arbitration panel nonetheless awarded Kenith $100,000.[189] As this case illustrates, because claimants and their counsel may claim almost any amount as damages, need not justify the amount claimed, and have an incentive to inflate their purported damages, the difference between a party's claimed damages and the amount a claimant recovers is meaningless.

As the Solin Study suggests, the significant change between 2002-2004 and earlier periods was not the amounts arbitration panels awarded to prevailing plaintiffs, but only the amounts that claimants and their counsel were requesting. Between 1998 and 2004, even after adjusting for inflation, SRO arbitration awards to prevailing claimants increased 6 percent.[190] Over the same period, however, the amounts claimants and their counsel claimed in damages increased 300 percent.[191] These figures suggest that it is not the arbitration panels that have changed in recent years, but only the assertiveness of the claimants' bar.

Notwithstanding the marked increase in claimed damages in recent years, recent and historical statistics show that arbitration claimants still recover a substantial percentage of claimed damages when they prevail in arbitration. Statistics included in the Solin Study show that even in recent years, investors receive about half

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[188] Morgensen, *supra* note 185. Damages are to be calculated to compensate a claimant only for what he lost because of the fraud, not to compensate him for what he might have gained. Restatement (Second) of Torts, § 549 cmt. b. ("[T]he recipient of a fraudulent misrepresentation is entitled to recover from its maker in all cases the actual out-of-pocket loss which, because of its falsity, he sustains through his action or inaction in reliance on it.").

[189] *Id.*

[190] *See* Solin Study at 13.

[191] *See id.*; *see also* Appendix E (Investors' Inflation-Adjusted Recoveries in Arbitration Have Increased).

of the amount they claim.[192] By contrast, investors who pursue similar claims in litigation do not fare nearly so well. For example, among all securities class action settlements in 2005, investors received 3.1 percent of their estimated damages. In 2006, that figure dropped to 2.4 percent.[193]

(d) The Solin Study's conclusions about win and recovery rates for large brokerage firms are misleading

The Solin Study further concludes that recovery rates in arbitration decline as the size of the claim increases and when claims are asserted against larger brokerage firms. The Solin Study suggests that this says something troubling about the fairness of the arbitration process. What this result actually suggests, however, is quite different.

First, large firms are generally subject to heightened regulatory scrutiny, and due to their greater resources and relatively greater reputational risk, they tend to invest more heavily in the training and procedures likely to detect and prevent securities-related employee misconduct. It therefore is not surprising that large firms might be expected to fare better in arbitration proceedings where claimants seek to recover for the alleged misdeeds of their employees.

Second, it is the larger brokerage firms that employ research analysts and that would be largely, if not exclusively, subject to claims of fraudulent research. As discussed above, due to the significant hurdles involved in such claims, panels have

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[192] *See* Solin Study at 11 & Fig. 7. Similarly, the Securities Arbitration Commentator Inc.'s recent survey found that investors recovered, on average, 54 percent of their claimed damages in 2006. *Supra* note 180 at 7.

[193] Laura E. Simmons and Ellen M. Ryan, Cornerstone Research, *Securities Class Action Settlements: 2006 Review and Analysis*, 6 & Figure 5, *available at* http://securities.stanford.edu/Settlements/REVIEW_1995-2006/Settlements_Through_12_2006.pdf.

awarded damages in fewer than one-third of analyst claims, which is significantly lower than average.[194]

Third, again, due to their greater resources, including very experienced legal staffs, larger brokerage firms are particularly likely to settle meritorious claims asserted against them prior to hearing.[195] Solin himself has acknowledged that "[o]nce the brokerage firm decides to take a case to hearing, it has determined that it has a reasonable prospect of winning. Otherwise, it would have settled the case."[196] For all these reasons, none of which provide any basis to question the fairness of the arbitral process, it is not surprising that recovery rates against larger firms will be lower than those against smaller firms.

D. Parties Believe SRO Arbitrations are Fair

Significantly, participants in SRO arbitrations—including claimants themselves—perceive the process as fair. In fact, a 1999 study analyzing the perception of fairness of NASD proceedings concluded that 93.49 percent of the individuals surveyed—54 percent of whom were claimants— found that their case was "handled fairly and without bias."[197] Similarly, in a 2001 study, 85 percent of those surveyed agreed that their cases were handled fairly and without bias.[198] No participants in that study strongly disagreed with the statement that their cases were handled fairly and

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[194] *Supra* note 18 (regarding the proposed consolidation of the NASD and NYSE Regulation arbitration programs).

[195] Tony Chapelle, *Advisors Score Big in Arbitration Study*, On Wall Street (June 1, 2007), *available at* http://www.onwallstreet.com/article.cfm?articleid=3635 ("[B]ig firms can afford to settle cases that have merit, and most times, they do. That leaves the relatively weaker cases. Smaller firms can ill afford to settle cases involving a couple of hundred thousand dollars.").

[196] *Supra* note 176 at 227.

[197] Tidwell, *supra* note 13 at 3-4.

[198] Perino, *supra* note 47, n119 (citing NASD-DR, *Customer Satisfaction Survey Results* 1 (May 2001)).

without bias.[199] Relying on this data, one commentator concluded that "[a]vailable empirical evidence suggests that SRO arbitrations are fair and that investors perceive them to be fair."[200]

That participants believe SRO arbitration to be fair and efficient is underscored by their continued use of SRO arbitration, even when alternative forums are available. In 2000, SICA commissioned a pilot program that permitted select customers to choose a non-SRO arbitration forum instead of standard SRO arbitration. Only 8 of the 277 participants chose to arbitrate their claim with a non-SRO entity.[201]

In short, there is no empirical data showing that SRO arbitrations are, or are thought by the parties to be, unfair. Rather, the data show that no industry bias exists in SRO arbitration and participants believe the SRO arbitration process is just.

VII. The Use of Predispute Securities Arbitration Agreements Is Fair to Investors and Serves the Public Interest

Given the fairness, speed and cost-effectiveness of arbitration, there is no sound public policy reason to preclude securities firms from providing for arbitration in customer agreements. Predispute arbitration agreements put the parties to a dispute on equal footing once a dispute emerges, and deter forum-selection tactics that serve no public purpose.

In addition, predispute arbitration agreements contribute a degree of predictability to the relationship between investors and members of the securities

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[199] *Id.*

[200] *Id.* at 48.

[201] Final Report, *Securities Industry Conference on Arbitration: Pilot Program for Non-SRO Sponsored Arbitration Alternatives, available at* http://www.lgesquire.com/SICA%20Pilot%20Report.pdf. The eight claimants selected either AAA or JAMS arbitration.

industry.[202] Such agreements provide both parties with the knowledge that they must resolve any dispute in SRO arbitration, mitigating the complex and often time-consuming and expensive process of examining other venues.[203] Investors are assured that firms must comply with the law or risk losing their licenses. Investment firms—both small introducing firms and larger clearing firms—are assured that they can avoid expensive litigation which encourages the settlement of frivolous claims. In effect, firms "accept the fact that a case with 'bad facts' will be adjudicated quickly so they will be forced to settle and they will accept having a very limited right of appeal in exchange for not having to extend the costs of a court defense or unpredictable jury damage awards."[204] This arrangement ensures the survival of small introducing firms, part of the fabric of American small business, who can serve their customers knowing that they will not be engulfed by defense costs in spurious court cases which could threaten their existence.

Those who would preclude the use of predispute arbitration agreements are not arguing for equal treatment. They are not arguing that arbitration should occur only when both parties agree to it after a dispute has arisen. Rather, they are arguing for an advantage not found elsewhere in dispute resolution: they want investors to have a unilateral right to choose whichever forum—arbitration or litigation—they think will benefit them in a particular case, giving securities firms no voice at all. It is not the norm in our judicial system that a plaintiff can unilaterally choose between litigation and arbitration; rather, the norm (absent agreement) is that a plaintiff is free to litigate, and can arbitrate only with the consent of the defendant.

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[202] *See* David Sherwyn, *Because It Takes Two: Why Post Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 1 Berkeley J. Emp & Labor L. 21-22, 67-68 (2003).

[203] *Id.* at 21-22.

[204] *Id.* at 67.

That norm, which would lead to litigation unless the parties agree otherwise, would be harmful to investors, and no one is seeking it here. Many investor claims—even ones involving substantial amounts—are not large enough to support the high cost of commencing and pursuing a lawsuit in court.[205] In cases involving amounts large enough to justify the costs of litigation, it is not uncommon for claimants (particularly elderly ones) to desire the expedition of arbitration, especially in an era of congested court dockets that give priority to criminal cases over civil cases and in consideration of the lengthy appellate process involved in civil litigation. It is for these reasons that FINRA requires securities firms to submit to arbitration at a customer's request.[206]

The use by securities firms of a predispute arbitration agreement thus does not give them an advantage—it provides them the same right as customers to choose arbitration. It places the parties on equal footing.

There is good reason to favor arbitration as the norm and therefore provide for it in customer agreements. While there is no evidence—and it is not the general experience of the industry—that arbitration leads to more favorable verdicts overall, the arbitration system provides significant benefits that have been enjoyed for more than three decades by both investors and the securities industry:

- It provides faster resolution of disputes.
- It reduces legal costs.
- It operates under rules tailored to investor claims.

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[205] *See* Appendix F (Many Cases are Small Claims, Which are Better-Suited for Arbitration Than Litigation).

[206] Code of Arbitration Procedure § 12200 (providing for arbitration when (1) it is required by written agreement or (2) it is requested by a customer).

- It provides predictability as to process, under rules that are uniform regardless of the state or county in which the case is brought.
- It is administered by a staff that is familiar with these types of disputes and often can provide greater attention to the cases than clerks in congested courts.
- It uses arbitrators who, by virtue of training and experience, often come to cases with an understanding of the rules and norms of the securities industry.

These are legitimate and sound reasons, all consistent with public policy, for the securities industry to secure for itself the same right as investors to seek arbitration in most cases.

In the absence of a predispute arbitration agreement, decisions whether to arbitrate an existing dispute will be governed by tactical advantage. As one commentator has noted,

> "the one overriding problem with post-dispute voluntary arbitration is that, according to the evidence... and a logical analysis of the economic, political, and legal incentives of the parties and their lawyers, it is extremely rare for both the plaintiff's and defense's attorneys in a case to select arbitration after the dispute has arisen."[207]

This dilemma has also been described by William Paul, former President of the American Bar Association,

> "The odds of an agreement for binding arbitration being entered into after a dispute has arisen are not great. At that stage one party or the other will have a view that traditional litigation offers some advantage which the party does not choose to relinquish... So if you prefer binding arbitration, put a provision for it in the contract, up front, when the deal is made, and before the dispute arises and then, and only then, will you have assured arbitration as the preferred dispute resolution mechanism."[208]

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[207] Sherwyn, *supra* note 202 *at* 7.

[208] *Supra* note 124.

Studies regarding the frequency of post-dispute voluntary arbitration bear this out. In a survey of AAA employment arbitrations conducted in 2001 and 2002, only 6 percent in 2001 and 2.6 percent in 2002 were the result of post-dispute arbitration agreements.[209] Likewise, a review of AAA business-to-business arbitrations revealed that only 1.8 percent of claims were brought pursuant to a post-dispute agreement to arbitrate.[210]

Parties wanting a prompt, fair, economical resolution will likely prefer arbitration, for the reasons described in the preceding pages. But litigation may, in a particular case, appeal to claimants' counsel seeking to drive up costs to induce a nuisance settlement; use a judicial forum to seek prejudicial publicity or solicit other clients; or hope for "jackpot justice;" or benefit from an anti-business jury pool in a carefully selected jurisdiction. Litigation may, by the same token, appeal to securities firms seeking to use their greater financial resources to the detriment of the small investor by engaging in extensive discovery or filing numerous motions. Precluding the use of binding predispute arbitration agreements will leave the choice between litigation and arbitration to be made on the basis of tactical considerations such as these. While a particular party in a particular case may benefit from these tactics, the public interest and the overall interests of market participants are poorly served by such gamesmanship. Predispute arbitration agreements strike the "right balance between investor protection and market competitiveness" by providing investors with a fair and impartial forum in

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[209] Lewis L. Maltby, *Out of the Frying Pan, into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, at 4 (May 2003), *available at* http://www.workrights.org/current/cd_adr.pdf.

[210] *Id.* at 6-7.

which to resolve disputes and protecting companies from meritless lawsuits which threaten their effectiveness in the market and even their very existence.[211]

In summary, the use of predispute arbitration agreements is fair—it provides no advantage to either side—and it brings about a result that serves the overall interests of both investors and the securities industry.

VIII. Conclusion

The current effort to make predispute securities arbitration agreements unenforceable is a solution in search of a problem. There is no credible evidence that SRO-regulated arbitration is unfair to investors or otherwise fails to protect their interests. Rather, objective and empirical evidence has proven that investors' claims are more likely to be heard on the merits, more quickly and with less cost, in arbitration than they are in federal or state court. Arbitration permits investors with claims too small to litigate a cost-effective opportunity to be heard, and provides those with larger claims a forum capable of bringing experience and knowledge to bear in resolving their disputes. Furthermore, securities arbitration has received high ratings for investor satisfaction, and it is unique among arbitration regimes in that it is closely supervised and regulated by independent regulators, including the SEC.

Prohibiting predispute arbitration agreements would simply produce more protracted, costly litigation. This result would not serve the best interests of investors or the U.S. capital markets. Congress should not disturb a system that is working.

* * *

[211] Opening Remarks by Treasury Secretary Henry M. Paulson, Jr. at Treasury's Capital Markets Competitiveness Conference (March 13, 2007), *available at* http://www.ustreas.gov/press/releases/hp306.htm.

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Appendix A
Chronology of Improvements to Securities Arbitration Procedures

Date	Initiative	Benefit to Investors
1994	NASD establishes a Blue Ribbon Task Force of experts, led by former SEC Chairman David Ruder, to conduct a comprehensive study of securities dispute resolution and recommend needed changes.[1]	Subjects the forum in which investor claims are heard to comprehensive review and improvement
January 1996	The Arbitration Policy Task Force releases its report, the most "wide-ranging examination of securities arbitration since the 1987 Supreme Court decision that holds predispute arbitration agreements enforceable…" containing more than 70 recommendations for change.[2]	Subjects the forum in which investor claims are heard to comprehensive review and improvement
October 1998	Neutral List Selection System is implemented whereby arbitrator lists are generated in a neutral fashion and available arbitrators are "rotated" through the system.[3]	Grants parties direct input into the arbitrator selection process

1. *See* NASD Dispute Resolution, *The Arbitration Policy Task Force Report—A Report Card* 5 (July 27, 2007), *available at* http://www.finra.org/web/groups/rules_regs/documents/rules_regs/p036466.pdf.
2. *Id.*
3. NASD NTM 98-90 (effective November 17, 1998), *available at* http://finra.complinet.com/file_store/pdf/rulebooks/nasd_98090.pdf.

1998	Initiative is begun to encourage the use of "plain English" in disclosure documents and other material used by investors, including the Code of Arbitration Procedure.[4]	Ensures that the arbitration process is more transparent and accessible to users of the forum
September 1999	NASD announces the implementation of the *Discovery Guide*, which requires parties to produce specific categories of documents at the outset of arbitration, provides that certain categories of documents are presumptively discoverable, and directs arbitrators to sanction parties for violating written discovery orders.[5]	Aids parties and arbitrators in discovery by streamlining the process
1999	Annual focus groups are launched to gather feedback from constituents on targeted areas of the process.[6]	Helps ensure that constituents have input into the arbitration process

4. Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendments 1, 2, 3, and 4 to Amend NASD Arbitration Rules for Customer Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 thereto; Order Approving Proposed Rule Change and Amendments 1, 2, 3, and 4 to Amend NASD Arbitration Rules for Industry Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 thereto, 72 Fed. Reg. 4,574, 4,575 (Jan. 31, 2007).
5. NASD NTM 99-90, *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p004058.pdf.
6. *See* FINRA Dispute Resolution Fact Sheet, August 23, 2007, *available at* http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/FINRADisputeResolutionFactSheet/index.htm.

August 2000	NASD requires firms to certify in writing that they have paid arbitration awards within 30 days of a decision.[7]	Helps ensure prompt payment of awards to investors
February 2001	Code of Arbitration Procedure is amended to allow the Director of Arbitration to remove arbitrators for cause once a hearing has begun.[8]	Helps ensure arbitrator impartiality
May 2001	Code of Arbitration Procedure is amended to prohibit a firm that has been terminated, suspended, or expelled from NASD, or that is otherwise defunct, from enforcing a predispute arbitration agreement against a customer in the SRO arbitration forum.[9]	Provides customers an avenue in which to seek relief against firms no longer subject to SRO jurisdiction and regulatory oversight
September 2002	Arbitration process is streamlined for claimants filing against defaulting, suspended, or terminated industry respondents.[10]	Makes it faster and cheaper for investors to get default judgments in arbitration against members not in good standing with the securities industry SRO

7. NASD NTM 00-55 (effective September 18, 2000), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003993.pdf.
8. NASD NTM 01-13 (effective March 8, 2001), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003916.pdf.
9. NASD NTM 01-29 (effective June 11, 2001), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003875.pdf.
10. NASD NTM 02-58 (effective October 14, 2002), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003483.pdf.

2002	SEC commissions study to assess the adequacy of arbitrator disclosure requirements.[11]	Helps ensure impartiality of decision makers in the arbitration process
October 2003	Systematic arbitrator background check system is enhanced to include criminal checks, employment verification, and professional license verification.[12]	Helps to ensure the accuracy and reliability of information parties use in selecting arbitrators
2003-2004	A series of steps to control discovery abuse is announced and implemented. NASD reminds member firms of their obligations under the rules to cooperate in the voluntary exchange of documents and information at the outset of arbitration.[13]	Requires industry members to be more responsive to their discovery obligations
2003-2004	Customer, Industry, and Mediation Codes of Procedure are simplified and filed with SEC.[14]	Allows investors to more easily navigate the arbitration process

11. Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Arbitrations* 2 (Nov. 4, 2002).
12. NASD NTM 03-64 (effective October 1, 2003), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003097.pdf.
13. NASD NTM 03-70 (effective November 6, 2003), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003073.pdf.
14. *See* FINRA Dispute Resolution Fact Sheet, August 23, 2007, *available at* http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/FINRADisputeResolutionFactSheet/index.htm.

June 2004	Procedures to reduce case processing time for matters involving elderly or infirm parties are implemented.[15]	Allows faster resolution of certain investors' claims
June 2004	Code of Arbitration Procedure is amended to expand the definition of "industry arbitrator" to exclude individuals with minor or even indirect ties to the securities industry from serving as public arbitrators in NASD arbitrations.[16]	Reduces the perception of a pro-industry bias in the roster of those eligible to sit as public arbitrators in NASD arbitrations
June 2004	Code of Arbitration Procedure is amended to grant parties' requests to challenge arbitrators for cause "where it is reasonable to infer an absence of impartiality, the presence of bias, or the existence of some interest on the part of the arbitrator in the outcome of arbitration." Close questions involving challenges brought by investors are resolved in favor of the customer.[17]	Helps ensure arbitrator impartiality and resolve close questions involving partiality and bias in favor of investors
August 2004	NASD implements on-line filing of claims.[18]	Improves the efficiency of securities arbitration by allowing claimants to file their claims faster and with greater assistance from the SRO

15. NASD Announcement, "Notice to Parties - Expedited Proceedings for Elderly or Seriously Ill Parties," June 7, 2004, *available at* http://www.finra.org/ArbitrationMediation/ResourcesforParties/p009636.
16. *See* NASD Notice to Members 04-49, Arbitrator Classification (effective July 19, 2004), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p002727.pdf.
17. *Id.*
18. NASD NTM 04-56 (effective August 5, 2004), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p009899.pdf.

August 2004	NASD amends its by-laws to allow it to institute suspension proceedings against a formerly associated person for failing to pay an award or settlement for a period of two years after the award was entered or the settlement was entered into; the amendments also grant NASD the authority to suspend a broker's ability to associate with a member in any capacity until an award or settlement is paid.[19]	Prevents formerly associated brokers who fail to pay awards or settlements from re-entering the securities industry
August 2004	NASD amends Code of Arbitration Procedure to allow parties and arbitrators, at the first pre-hearing conference, to establish guidelines for direct contact with arbitrators.[20]	Allows parties to streamline the process for filing pleadings and corresponding with the arbitrators
January 2005	NASD amends rule governing predispute arbitration agreements with customers to require delivery and customer acknowledgment of the agreement at the place and time of signing.[21]	Ensures that customers fully understand and acknowledge that they agree to arbitrate their disputes

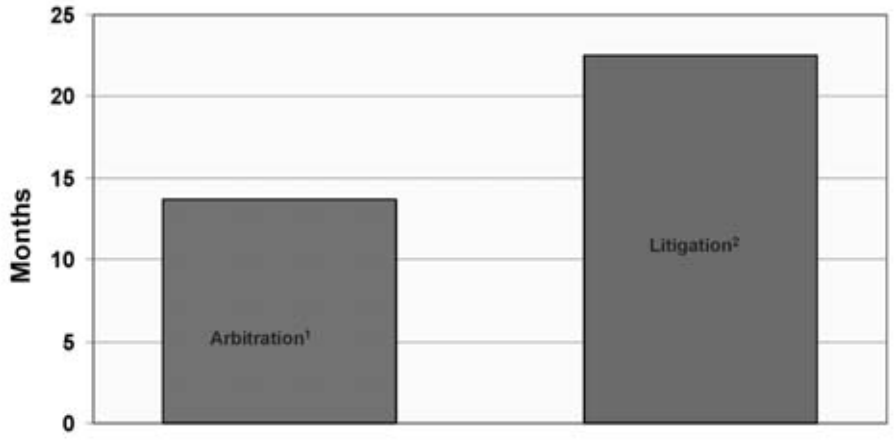
19. NASD 04-57 (effective September 9, 2004), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p009798.pdf.
20. NAST NTM 04-62 (effective September 30, 2004), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p009904.pdf.
21. NASD NTM 05-09 (effective June 1, 2005), *available at* http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p013203.pdf.

2005-2006	NASD conducts extensive business process reviews to streamline case processing.[22]	Improves efficiency of arbitration process
July 2007	NASD Dispute Resolution issues "The Arbitration Policy Task Force Report—A Report Card." The Report card states in pertinent part that "NASD has implemented nearly every key recommendation" made in the 1996 report and concluded that ten years after the Blue Ribbon Task Force was established NASD arbitration is more "fair to participants, and offers investors procedures for dispute resolution with broker-dealers that are equal to and frequently superior to actions in courts."[23]	Reviews and reports on tangible steps taken by the securities arbitration forum to ensure that investor claims are heard in a forum that is fair

22. *See* FINRA Dispute Resolution Fact Sheet, August 23, 2007, *available at* http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/FINRADisputeResolutionFactSheet/index.htm.
23. *See* NASD Dispute Resolution, *The Arbitration Policy Task Force Report—A Report Card* 1, 5 (July 27, 2007), *available at* http://www.finra.org/web/groups/rules_regs/documents/rules_regs/p036466.pdf.

Arbitration Is Faster Than Litigation

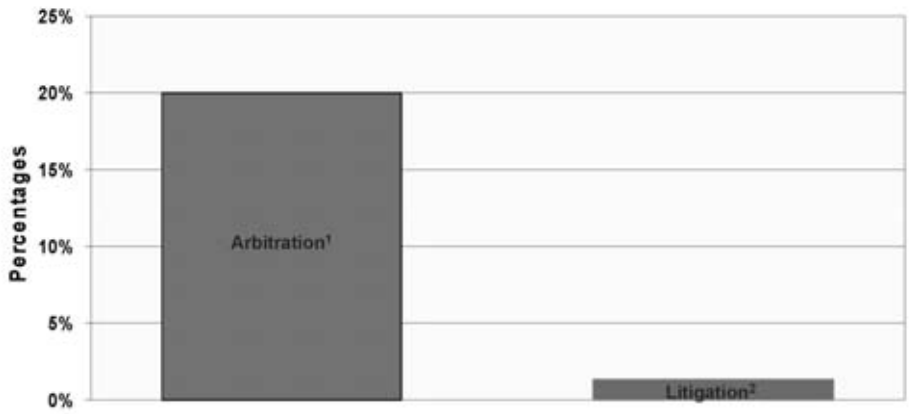
Duration of Cases in Arbitration vs. Litigation



1. Arbitration statistics are based on data for a 12-month period ending August 2007 and reflect the average duration of an arbitration proceeding from the filing of the complaint to completion of the case. *See* Dispute Resolution Statistics *available at* http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/Statistics/index.htm.

2. Litigation statistics reflect median time intervals from filing to disposition of civil cases filed in U.S. district courts during the 12-month period ending March 31, 2006. *See* Federal Judicial Caseload Statistic[sic], March 31, 2006, Table C-5, *available at* www.uscourts.gov/caseload2006/tables/C05Mar06.pdf.

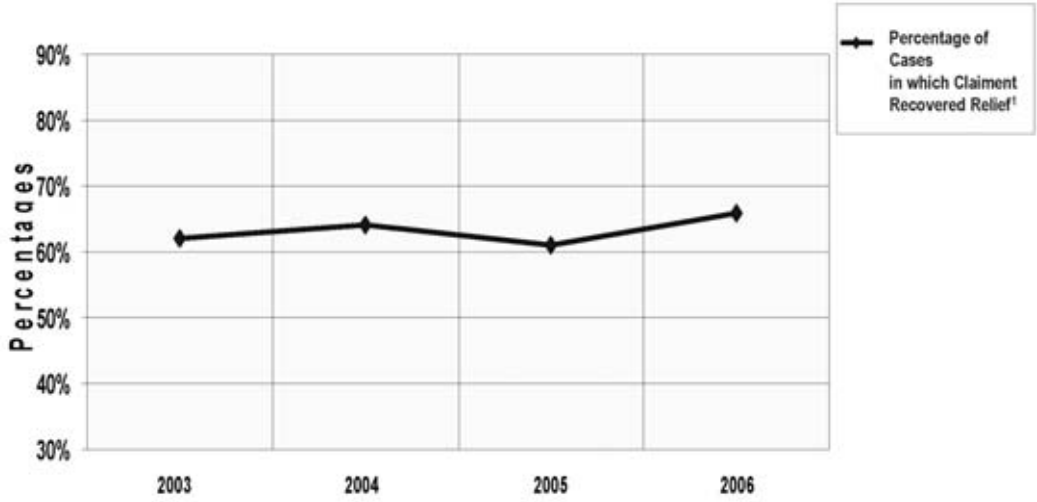
More Cases Are Heard Before a Decision-Maker in Arbitration Than in Court



1. Source: Dispute Resolution statistics, *available at* http://www.finra.org/ArbitrationMediation/FINRADisputeResolution/Statistics/Index.htm. Data reflect percentage of arbitration cases heard on the merits in 2005.

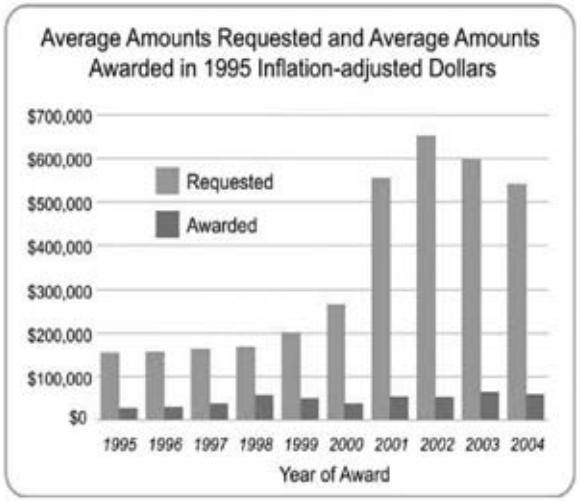
2. Source: Federal Judicial Caseload Statistic [sic], March 31, 2006, Table C-4, *available at* http://www.uscourts.gov/caseload2006/tables/C04Mar06.pdf. Data reflect percentage of cases that reached trial in U.S. district courts for the 12-month period ending March 31, 2006.

The Total Percentage of Claimants Who Recover Damages or Other Relief in Arbitration or By Settlement is Favorable



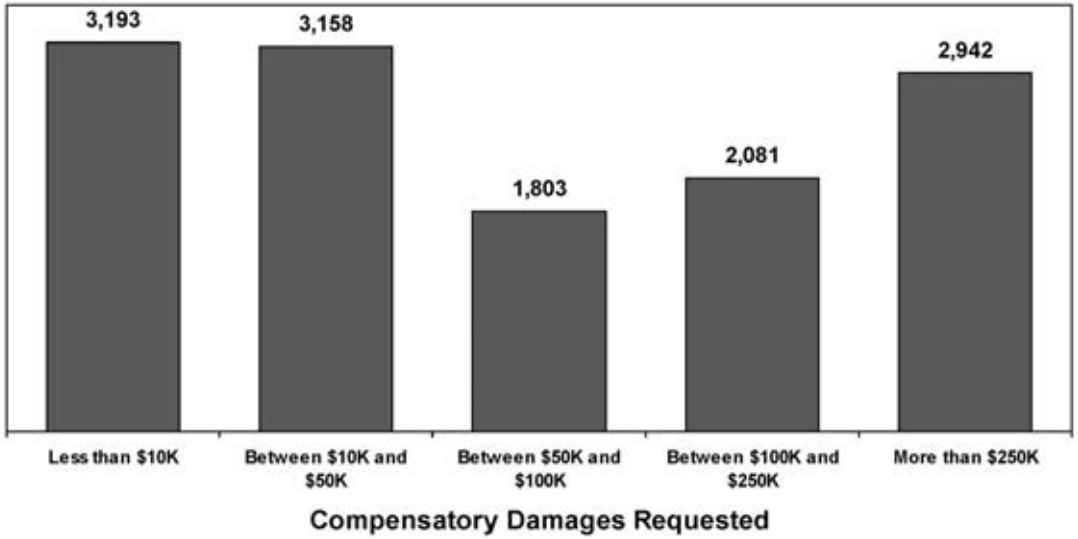
1. Source: Dispute Resolution Statistics *available at* http://www.finra.org/AbitrationMediation/FINRADisputeResolution/Statistics/Index.htm. Data shows percentage of cases in which claimants, including claimants other than customers, recovered damages or other relief either in arbitration or by settlement.

Investors' Inflation-Adjusted Recoveries in Arbitration Have Increased[1]



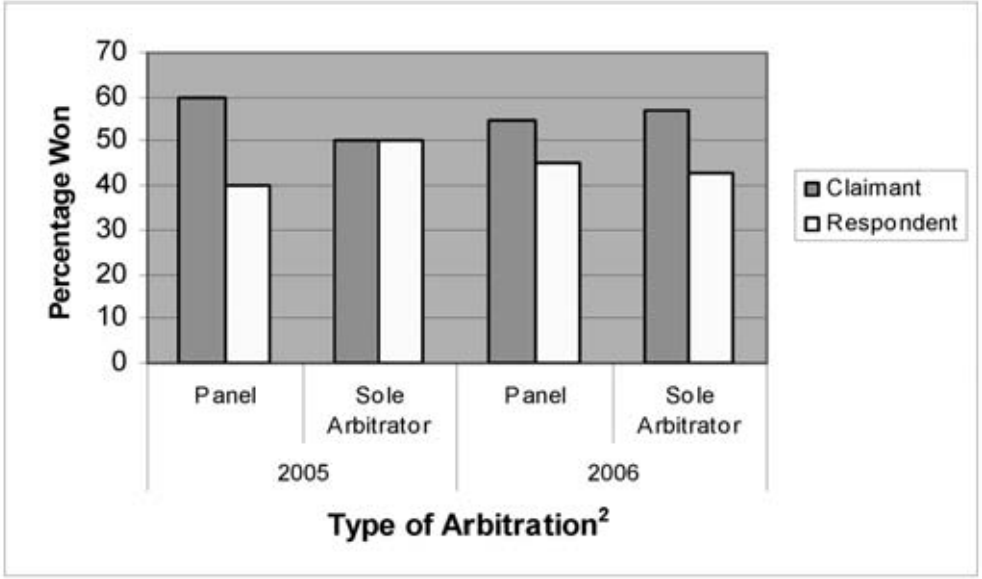
1. Source: Edward S. O'Neal, Ph.D. and Daniel R. Solin, *Mandatory Arbitration of Securities Disputes: A Statistical Analysis of How Claimants Fare* (2007) at 14, Figs. 10 & 11.

Many Cases are Small Claims, Which are Better-Suited for Arbitration Than Litigation[1]



1. Source: Edward S. O'Neal, Ph.D. and Daniel R. Solin, *Mandatory Arbitration of Securities Disputes: A Statistical Analysis of How Claimants Fare* (2007) at p. 8, Fig. 3. The statistics reflected are based on data regarding NASD and NYSE arbitrations occurring between January 1995 and December 2004. Solin Study at 5.

The Presence of an "Industry" Arbitrator Has No Material Impact on Customer Wins [1]



1. Source: September 2007 review of all 2005 and 2006 arbitration decisions available on the FINRA website. *See* http://www.finra.org/ArbitrationMediation/ResourcesforParties/FINRAArbitrationAwardsOnline/index.htm. Any arbitration decision in which the Claimant received some form of requested relief is included among the "Percentage Won" above.

2. Arbitrations are decided by panel or sole arbitrator. A panel consists of three arbitrators, two of whom must be public, and one of whom is non-public or "industry." A sole arbitrator is always a public arbitrator.

RESPONSE TO POST-HEARING QUESTIONS FROM LAURA MACCLEERY, ESQ., DIRECTOR, PUBLIC CITIZEN'S CONGRESS WATCH DIVISION, WASHINGTON, DC

Auto Safety Group • Congress Watch • Energy Program • Global Trade Watch • Health Research Group • Litigation Group
Joan Claybrook, President

February 9, 2009

The Honorable Linda T. Sanchez, Chairman
The Honorable Chris Cannon, Ranking Member
Subcommittee on Commercial and Administrative Law
U.S. House of Representatives Committee on the Judiciary
362 Ford House Office Building Washington, DC XXXX

Re: Written Responses by Laura MacCleery, Director Congress Watch Division of Public Citizen, to Questions for the Record from Chairman Linda T. Sanchez, Subcommittee on Commercial and Administrative Law, Hearing on H.R. 3010, "The Arbitration Fairness Act of 2007," Oct. 25, 2007.

Dear Chairman Sanchez and Ranking Member Cannon,

Please find attached my written responses to your questions submitted for the record from the Subcommittee on Commercial and Administrative Law hearing on H.R. 3010, "The Arbitration Fairness Act of 2007," held on October 25, 2007. Also attached are copies of Public Citizen's 2008 report, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration*, and a recent Business Week article by Robert Berner and Brian Grow on consumer arbitration titled *Banks vs. Consumers (Guess Who Wins)*. I respectfully request that these be submitted for the record along with my testimony.

Sincerely,

Laura MacCleery
Director
Congress Watch Division
Public Citizen

Responses by Laura MacCleery, Director Congress Watch Division of Public Citizen, to Questions for the Record from Chairman Linda T. Sauchez, Subcommittee on Commercial and Administrative Law, Hearing on H.R. 3010, "The Arbitration Fairness Act of 2007," Oct. 25, 2007.

1. Are there alternatives to mandatory binding arbitration that you would find fair for consumers and businesses?

We do not object to arbitration in general. But it is inherently unfair to require a commitment on the part of consumers to arbitrate future disputes as a condition of obtaining a service or employment, long before any dispute has arisen. We support the Arbitration Fairness Act, because it would provide consumers with a meaningful choice between going to arbitration or court.

Currently, arbitration firms favor the companies that hire them to conduct arbitrations. Some even market themselves as being business-friendly. It is unrealistic to expect that there will be a fair outcome before a decisionmaker with a clear financial incentive to favor one party – the business that is a repeat customer – over another.

Simply prohibiting corporations from forcing consumers into arbitration is both a just and market-based solution. By giving consumers a choice of whether or not to arbitrate a dispute, arbitration companies must compete on fairness grounds for business. That is, when parties may choose to agree to binding arbitration only after a dispute arises – and therefore when the consumer or employee has a meaningful choice in the matter – then arbitration firms will be required to offer a fair process that both parties would find appealing.

2. How do you respond to the argument that mandatory arbitration is less costly than going to court?

The argument that arbitration is cheaper than court is disingenuous. Arbitration service providers charge substantial up-front fees, which can run into the thousands of dollars, and procedural steps such as filing a motion, holding a hearing, or receiving a written opinion generally requires payment of an additional fee. In one case, a three-page decision "written findings of fact/ conclusions of law and reasons for award," cost $1,500. *See* Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* (2007), at 34.

These fees are a barrier to individuals filing suit or attempting to use procedures that would otherwise be available to them in court. Individuals are also taxed in other ways, including having fees assessed against them in the guise of an award, being unable to recover for fees when they prevail in arbitration, and having their awards substantially reduced. *See, e.g.*, Public Citizen, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration* (2008), at 15. These practices make arbitration even more costly for the individual.

As an example of the costs of arbitration, Appendix B of my testimony describes the costs associated with an arbitration proceeding compared to a court case involving the same issues and

the same termite company. As the chart indicates, the young couple incurred $24,000 in arbitration costs, excluding attorney fees, compared to $563, excluding attorney fees, incurred by the widow who was able to take her claim to court.

3. A fair arbitration process includes neutral arbitrators. Who are generally the arbitrators hearing disputes? Are they equally representative of plaintiff's and defendant's attorneys? Are there some arbitrators that seem to rule favorably for consumers or businesses all of the time?

In addition to helping companies manipulate the arbitration process to their advantage, the service providers also pressure their so-called "neutrals" to find in favor of business.

Arbitrators are routinely "blackballed" for finding against corporations. In our *Arbitration Trap* report, we document the case of Harvard Law School professor and veteran arbitrator Elizabeth Bartholet. Bartholet was recruited by National Arbitration Forum (NAF) in 2003 and handled about 19 cases involving one credit card company. She ruled for the company 18 times and the 19th case was dismissed. In the 20th case, however, the debtor asserted a counterclaim and she awarded the debtor about $48,000. Subsequently, NAF removed her from seven credit card cases she was scheduled to handle, and told the debtors Bartholet could not handle them because she had a scheduling conflict, an assertion she denied. In addition, credit card companies voluntarily dismissed another four cases that had been on her agenda.

Because the arbitration providers rely on their cases for income, they cannot afford to lose business. It is no surprise that this system results in decisions that heavily favor corporations.

Arbitration firms also have an incentive to favor their clients – the business parties to a dispute – and favoring them does not require bias on the part of individual arbitrators.

4. In your written testimony, you refer to your organization's recent report on how the credit card industry uses arbitration to its advantage. Why did you focus on credit card companies and consumers?

We would be happy to examine the outcomes of arbitrations that do not involve consumers as parties or credit cards as a subject matter, but the secrecy of arbitration prevents us from having the data on which to base those analyses.

Our research included all of the data that was released pursuant to California law. We focused on the NAF data presented in our report because most other arbitration service providers' data was simply too poorly or confusingly presented for analysis. American Arbitration Association (AAA) and JAMS, for example, only marginally complied with the disclosure provisions of the law, making it very difficult to discern anything conclusive from their data. NAF presented its arbitration outcomes in a manner that was confusing at first blush; however, we were eventually able to collect and analyze the data through a special computer program.

The report focuses mainly on credit card outcomes because that is the overwhelming majority of NAF's California caseload. As documented in our report as well as a recent Business Week

article, "Banks vs. Consumers (Guess Who Wins)," NAF is the preferred collection mill used by banks like Bank of America, which now owns the credit card company MBNA America, to collect credit card debts. *See* Robert Berner & Brian Grow, "Banks vs. Consumers (Guess Who Wins)," BUS. WK., Jun. 5, 2008.

Another reason for our focus on cases between banks and consumers is that large corporations appear to engage in binding mandatory arbitration in disputes against consumers and employees far more than they do in disputes against other businesses. A recent study by Professors Theodore Eisenberg and Geoffrey Miller found that only 11 percent of contracts between large, sophisticated actors contained arbitration clauses. *See* Theodore Eisenberg & Geoffrey P. Miller, *The Flight From Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 350 (2007)

This is in stark contrast to another study that Professors Eisenberg and Miller conducted with Emily Sherwin in which they concluded that more than 75 percent of consumer contracts contained arbitration clauses. *See* Eisenberg Geoffrey Miller & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Agreements in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 882-83 (2008).

5. Please discuss an example of how a pre-dispute binding mandatory arbitration clause may harm an identity theft victim.

There are many powerful examples of how identity theft victims are harmed by binding mandatory arbitration. The first case that we cite in our *Arbitration Trap* report is Troy Cornock, whose wife, unbeknownst to him, opened an MBNA credit card in his name. Troy learned of this card for the first time four years after his wife had opened it, when an MBNA employee called him and demanded payment. Troy was unaware of the card and accompanying bills because he and his wife were separated when she opened the card and the bils had been going to her residence. Ignoring Troy's explanation of the situation, MBNA filed a case against Troy with NAF, but the papers were sent to his wife's address. Even when Troy corrected both MNBA and NAF about his address, mail continuously went to his wife instead of him. MBNA also lacked proper documentation, such as a credit card application or purchase receipt with Troy's signature, but the NAF arbitrator still found in MBNA's favor and awarded them almost $10,000. MBNA secured a court judgment against Troy based upon the arbitrator's decision. Troy never responded to the judgment because, again, the papers were sent to his ex-wife's house.

In a case of mistaken identity, Anastasiya Komarova was notified by a debt purchasing company called National Credit Acceptance that they had secured an $11,214.33 arbitration decision against her from NAF. In fact, the MBNA credit card that had given rise to the arbitration had been belonged to Christopher S. Propper and Anastasia Komarova. Despite confirmation from MBNA that she was not responsible for the debt, Anastasiya later received notice from National Credit that they were seeking to confirm the award. National Credit continued to pursue their claim against the wrong Komarova. Anastasiya filed a court action against MBNA and National Credit for damages and sought an injunction to prevent them from further collection activity against her.

Responses by Laura MacCleery, Director Congress Watch Division of Public Citizen, to Questions for the Record from Ranking Member Chris Cannon, Subcommittee on Commercial and Administrative Law, Hearing on H.R. 3010, "The Arbitration Fairness Act of 2007," Oct. 25, 2007.

1. Justice Ruth Bader Ginsburg praises arbitration. What do you think the Supreme Court justice fails to understand?

We have conducted a wide-ranging search and were unable to locate a source for the statement that Justice Ginsburg "praises arbitration."

There was an arbitration case, *Hall Street Associates v. Mattel, Inc.*, 552 U.S. --, 128 S.Ct. 1396 (2008), recently argued in the Supreme Court. Following the oral argument in that case on Nov. 7, 2007, Justice Ginsburg was quoted as having suggested that "the property owner is seeking more latitude than the law allows for judicial review of arbitration cases." *Mattel* is not an example of binding mandatory arbitration forced upon a consumer, a defining hallmark of binding mandatory arbitration that the Arbitration Fairness Act would prohibit. In the *Mattel* case, two sophisticated parties agreed to arbitrate an ongoing dispute that was pending in litigation before the United States District Court for the District of Oregon.

We raise no objections to any dispute resolution alternative that the parties agree to after a dispute between the parties has arisen. However, binding mandatory arbitration (BMA) is wholly distinct from post-dispute agreements, such as the one outlined in *Mattel*. BMA requires consumers and employees to agree up-front, before any dispute arises, to accept BMA as the only method for resolving any potential, future disputes. Because entire industries have adopted BMA clauses, consumers have no choice but to accept them. They are required to give up their legal rights as a condition of retaining a job, receiving medical care, renting a car, opening a bank account, or obtaining a credit card, to name just a few of the situations in which BMA clauses are being used.

Another Supreme Court case, *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000), has often been misleadingly cited by the National Arbitration Forum (NAF) in support of their proposition that their cost and fee schedules are fair and reasonable. Justice Ginsburg's concurring opinion in that case endorsed a fee schedule in NAF's procedural rules "that limit small-claims consumer costs to between $49 and $175." *See Randolph*, 531 U.S. at 95 n.2.. When citing to this case, the NAF generally neglects to mention that it subsequently increased those fees. It is also important to note that in addition to these fees, consumers could also get stuck paying for the other side's expenses, including its lawyers, which could cost hundreds of thousands of dollars.

2. In Public Citizen's study of credit card arbitration, why did you not include settlements as consumer wins in your study? I can assure you that the government counts the settlements it achieves as wins.

We limited our study to cases in which an arbitrator was assigned. Cases that were resolved before assignment of an arbitrator likely consisted of facts that overwhelmingly favored one of

the parties. For example, a credit card company might have sought payment from a wrongly identified individual. While the company should drop the case once the error was discovered, such an action could not be accurately characterized as an arbitration "win" for the consumer. Indeed, because arbitrations are not dismissed with prejudice, dismissed cases can, and often are, re-filed by the business at a later date.

The universe of cases studied in our report consisted of 33,948 consumer BMA cases processed by NAF in California. Many of the 33,948 cases were not completed. An arbitrator was not selected and apparently, based on the available information, did not take any action either for or against the consumer. So those 14,654 uncompleted cases were excluded from our study because they did not provide any information on our main issue of whether arbitrators were ruling primarily on behalf of business interests.

The remaining 19,294 cases in which an arbitrator was selected were the main focus of our analysis. Of those, businesses won 18,091 (93.8 percent), consumers won 781 (4 percent) and 422 (2.2 percent) were settled. *See* Public Citizen, *The Arbitration Trap*, at 15. The 422 cases that were settled were not counted as consumer victories for the purposes of our study because we were unable to determine from the information available whether the settlement occurred as the result of any act by the arbitrator. Nor could we determine from the information presented whether the consumer considered the settlement a victory.

The 94 percent victory rate for businesses showed that secrecy, arbitrators' conflicts-of-interest and the absence of due process combine to rig the results of BMA against the consumer.

3. In Public Citizen's study why did you exclude data concerning cases before the AAA and other arbitration forums, which would have given a fairer picture of consumer success rates in arbitration?

The AAA's disclosures are insufficient to permit even basic research on case outcome, a fact that underscores the excessive secrecy and lack of accountability in arbitration generally. Still, evidence suggests that our findings regarding NAF cases in California were not unusual. Data provided in a court case revealed that First USA Bank managed a 99.6 percent success rate in 19,705 cases in Alabama. *See* Public Citizen, *The Arbitration Trap* at 13-14. In short, our study was limited in scope because of the lack of availability of information due to shoddy reporting by arbitration companies.

Only in California are the outcomes of binding mandatory arbitration cases a matter of public record, and even there, the method of disclosure leaves much to be desired.The firms choose how to post their data and typically do so through static, Adobe-format documents. These are not searchable, sortable databases. The data submitted by NAF were presented in a relatively consistent format that allowed us to put it into a spreadsheet and analyze it.

In contrast, the data submitted by AAA and JAMS could not be downloaded into a spreadsheet. As we document in our *Arbitration Debate Trap* report, when we attempted to duplicate AAA's findings by analyzing reports it published as required under California law, we could discern the victorious party only in approximately 7 percent of the cases. Public Citizen, *The Arbitration*

Debate Trap, at 12. AAA left the "prevailing party" field – a required disclosure – blank in more than 90 percent of the cases it has reported. We contacted AAA to inquire about the discrepancy, and AAA Senior Vice President Richard Naimark explained that AAA created its fact sheet by combing case files and counting any award as a victory for the claimant. Naimark acknowledged that because AAA's public disclosures do not reveal which party brought the case, the public cannot verify AAA's conclusions.

4. How can we possibly make the leap from skewed data in a flawed study of credit card collection arbitrations to the assertion that mandatory binding arbitration should be outlawed in *any* consumer, franchise or employee contract, or, indeed, in *any* contract between parties of equal bargaining power? Isn't that the equivalent of playing Russian roulette with the arbitration system?

Credit card providers constitute a minor industry whose record should not taint the reputation of binding mandatory arbitration. More than 100 million Americans have credits cards and they hold more than 800 million accounts combined. Most are forced into binding mandatory arbitration. This is one of the most pervasive industries in America. Moreover, we strongly disagree with the assertion that the parties in consumer contracts or "of equal bargaining power." The consumer has no leeway to negotiate the terms of the contract. True, the consumer can refuse to sign the contract and forgo the purchase or and/or use of the product.

Further, while we would welcome the opportunity to study other industries, we are constricted by one of mandatory binding arbitration's most damning characteristics: its notorious secrecy. We have subsequently analyzed nine classes of employment arbitration outcomes that were reported in academic studies. This analysis demonstrates that individuals' win rates, average awards, and median awards are all lower in arbitration than they are in court. *See* Public Citizen, *The Arbitration Debate Trap*, at 15, Figure 2.

Finally, please note that neither the cases evaluated in our study nor the types of arbitration that H.R. 3010 have anything to do with involve contracts negotiated between businesses or parties of equal bargaining power. The intent of the bill is to prevent contracts from being forced upon consumers who have no real choice but to accept contracts containing an arbitration clause. These are "contracts of adhesion" – pacts in which one side is so dominant that the other party has no real ability to bargain. *See* Public Citizen, *The Arbitration Trap*, at 6.

The credit card industry is a perfect example. Virtually the entire industry requires BMA as part of their credit card contract with the consumer. Other industries also require BMA. For example, cell phone companies, home builders, auto insurance firms, nursing homes, cable TV providers, computer companies, employers and many other businesses force customers and employees to accept BMA as a condition of the purchase or the job. The Chamber of Commerce claims that "BMA clauses are in millions of consumer contracts across the United States." *See* Public Citizen, *The Arbitration Trap*, at 4. In these transactions, no bargaining on whether an arbitration clause will be part of the contract ever takes place. The contract document is prepared by business and the consumer, employee or franchisee has no choice in the matter.

5. How many new class actions does Public Citizen and organizations like it stand to bring if this arbitration option is wiped out for consumers, franchisees, non-union employees and any parties with unequal bargaining power?

Public Citizen's attorneys who are involved with class actions do not believe that passage of H.R. 3010 will have any impact on the number of class actions in which they are involved.

From 80 to 90 percent of the class actions in which Public Citizen has been involved over the years have been cases in which Public Citizen has intervened to object to settlements that were considered unfair to the class members either because the plaintiffs' attorneys were taking a share that was too large, the coupons to be awarded were unfair to the plaintiffs or for other similar reasons. As for the few class action cases filed by Public Citizen, our lawyers have not been involved in contracts with mandatory arbitration clauses; in fact, these cases have not generally involved consumer contracts at all.

Public Citizen's role in class action litigation will not be affected whatsoever by the passage of H.R. 3010.

6. In your report you mention that companies won 94% of cases brought against consumers. Do you have any reason to believe results would be better in court? My understanding is that the results tend to be similar or worse – just more costly.

There can be little doubt that secrecy, arbitrator selection methods, arbitrator financial conflict of interest, repeat player bias, absence of procedural fairness and right of appeal and other factors operate to skew the BMA system against the consumer, employee and franchisee. Since our courts protect parties from all of those problems, results in court cases are necessarily better than those obtained via BMA.

Because of arbitration's hallmark secrecy, there is little empirical data available by which to compare arbitration results with those from similar proceedings in court. A study cited by NAF, while not truly comparable, suggested a win rate for "business sellers" against individuals of 77 percent. (This represents a marked difference from our findings.) *See* Mark Fellows, *The Same Result As In Court, More Efficiently: Comparing Arbitration And Court Litigation Outcomes*, METRO. CORPORATE COUNSEL 32 (July 2006) Unfortunately, the study did not identify the types of transactions involved in these lawsuits.

A better comparison, however, would be the level of satisfaction, win or lose, of consumers, employees or franchisees who voluntarily agreed to submit their dispute to arbitration after the dispute arose compared with those who were forced to accept BMA as a condition precedent to purchasing the good or service or obtaining the job.

Although it is often claimed that arbitration is less costly than going to court, there is little empirical evidence to back up that claim. In court, the parties do not have to pay the judges for their time. Our courts are funded by the taxpayers and are open to all citizens.

Arbitration, in contrast, is a private system and the parties using the system have to shoulder all of its costs. The arbitration process includes a menu of pay-as-you-go fees. Costs include significant filing fees and fees can also be imposed for issuance of a subpoena; for filing a motion; for a written explanation of an arbitrator's rationale for making a decision and several other stages in the process. The fee structures are frequently on a sliding scale – the higher the amount sought, the higher the costs – creating increased obstacles for those seeking or facing significant damages.

Appendix B of my testimony describes an example of the costs associated with an arbitration proceeding, when compared to a court case involving the same issues and the same termite company. The young couple in that case incurred $24,000 in arbitration costs, excluding attorney fees, a far greater sum than the $563, excluding attorney fees, incurred by the widow who was able to take her claim to court. This apples-to-apples comparison clearly shows that the cost of arbitration is far greater than the cost of pursuing a claim in court.

Attachment 1

The Arbitration Debate Trap

How Opponents of Corporate Accountability
Distort the Debate on Arbitration

Public Citizen

Acknowledgments
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About Public Citizen
Public Citizen is a national non-profit membership organization based in Washington, D.C. We represent consumer interests through lobbying, litigation, research and public education. Founded in 1971, Public Citizen fights for consumer rights in the marketplace, safe and affordable health care, campaign finance reform, fair trade, clean and safe energy sources, and corporate and government accountability. Public Citizen has five divisions and is active in every public forum: Congress, the courts, governmental agencies and the media. Congress Watch is one of the five divisions.

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APPENDIX

INTRODUCTION

Public Citizen has long opposed the use of pre-dispute binding mandatory arbitration, a method by which businesses force individuals to submit all disputes to private arbitration companies instead of litigating in court.[1] These arrangements, which are increasingly common, set up a severe conflict of interest by enabling businesses to choose the arbitration firms that resolve their disputes with customers or employees.

In September 2007, Public Citizen published a study showing that individual consumers had lost approximately 94 percent of arbitrations administered by the National Arbitration Forum.[2] The study also highlights several injustices wrought by binding mandatory arbitration.[3]

Six months later, the U.S. Chamber Institute for Legal Reform ("Chamber Institute") issued a response authored by Catholic University law professor Peter B. Rutledge entitled *Arbitration – A Good Deal for Consumers: A Response to Public Citizen*.[4] "There is only one little problem with the Public Citizen Report," the *Response* argues. "[I]t is wrong, both on the facts and in its ultimate conclusions."[5]

With financial support from the Chamber Institute,[6] Rutledge also drafted a law review article entitled *Whither Arbitration?* that purports to review the academic literature on arbitration. "It is imperative to take an honest assessment of this empirical picture," Rutledge states in *Whither*. "This paper takes up that charge."[7] We refer to these two papers collectively as the *Chamber Papers*.

Rutledge explains in *Whither* that he reaches "some surprising conclusions," chiefly that "most of the methodologically sound empirical research does not validate the criticisms of arbitration."[8] The *Chamber Response* charges that Public Citizen's 2007 report "ignores almost all of the existing literature" on how individuals fare in arbitration.[9]

This paper answers the Chamber's challenge. We review the research cited in the *Chamber Papers* as well as studies that the *Chamber Papers* fail to address. We reach significant conclusions of our own. Most important, the literature overwhelmingly shows that individuals fare far worse in arbitration than court. The vast majority of available data show individuals winning at lower rates, receiving lower average awards, and

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[1] For ease of discussion, we use the term "arbitration" to refer to pre-dispute binding mandatory arbitration unless otherwise noted.
[2] John O'Donnell, Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 15 (2007) [hereinafter *Arbitration Trap*].
[3] *Id.* at 6-10.
[4] Peter B. Rutledge, Chamber of Commerce Institute for Legal Reform, *Arbitration – A Good Deal for Consumers: A Response to Public Citizen* (2008) [hereinafter *Chamber Response* or *Response*].
[5] *Chamber Response* at 2.
[6] Peter B. Rutledge, *Whither Arbitration?* 6 GEO. J. L. PUB. POL'Y 549, 549 (2008) [hereinafter *Whither*].
[7] *Id.* at 551.
[8] *Id.*
[9] *Chamber Response* at 6.

receiving lower median awards in arbitration than court. Perhaps most surprising, this conclusion holds firm even if one looks only at the studies *Whither* cites to contrast arbitration with court. In short, the Chamber Institute is promoting a deeply erroneous picture of the "empirical evidence."

Rutledge concludes *Whither* with the warning that congressional scrutiny of arbitration "can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study."[10] We agree. This paper aims to assist Congress in heeding the Chamber's call.

[10] *Id.* at 589.

SUMMARY OF KEY FINDINGS

Empirical evidence shows individuals do better in court than arbitration.

- Despite the *Chamber Papers*' claims that the "empirical research" shows that individuals achieve "superior" results in arbitration, every comparative study they cite in fact shows individuals receiving lower average payments in arbitration than court. Further, most of the studies show individuals winning at a higher rate in court than in arbitration and receiving larger median payments. The studies allow for a total of 27 discrete comparisons of win rates, average awards and median awards. Twenty-two of these comparisons favor court over arbitration.

The Chamber's literature review fails to mention unfavorable studies and findings.

- *Whither* fails to address several studies that distinguish between the arbitration success rates of employees who negotiated their own contracts and those who were subject to nonnegotiable arbitration terms detailed in employee handbooks. These studies report a success rate of 57 percent to 69 percent for employees who negotiated their own contracts compared to a success rate of only 20 percent to 40 percent for employees who were subject to employee-handbook terms.

The *Chamber Papers* characterize a study that found serious concerns with arbitration clauses as concluding that arbitration clauses put consumers on equal footing with businesses.

- The *Chamber Response* states that one study "concluded that 'few of the fifty-two [arbitration clauses studied] reflect the type of egregious self-dealing that has been identified in publicized cases. Most of the clauses appear in many respects to put the consumer on equal terms with the businesses that drafted them . . . .'"[11]

  In fact, the study's authors were discussing only the superficial appearance of fairness in arbitration clauses. "These terms suggest *prima facie* that businesses are placing consumers on equal footing with themselves in resolving any future disputes," the authors wrote. "A closer look at the clauses sampled, however, suggests that there are grounds for concern," the authors continued, launching into a three-paragraph litany of criticisms of binding mandatory arbitration, all of which Rutledge ignores.[12] "In

[11] *Chamber Response* at 8 (citing Linda J. Demaine & Deborah R. Hensler, *'Volunteering' to Arbitrate Through Predispute Arbitration Clauses: the Average Consumer's Experience*, 67 L. & CONTEMP. PROBS. 55, 72 (2004)).
[12] Demaine & Hensler, 67 L. & CONTEMP. PROBS. at 72-73.

sum, the appearance of a level playing field may be deceptive," the paper concludes.[13]

The *Chamber Papers* selectively cite favorable portions of studies that in fact flatly contradict the Chamber's arguments.

- The *Chamber Papers* argue that "arbitration makes it easier for individuals to find an attorney willing to take their case [sic],"[14] citing a study's finding that lawyers will take a case only if they expect sufficiently high damages.[15] The *Papers* neglect to mention that the same study reported that lawyers on average required *higher* provable damages to take a case to arbitration ($65,000) than court ($61,000).[16]

- *Whither* asserts that "the only reported data showing a win-rate of less than 50%" for claimants in arbitration was a study of securities arbitrations in the early 1990s.[17] But at least five studies have shown win rates of less than 50 percent – and portions of four of these studies are cited in the *Chamber Papers*.[18]

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[13] *Id.* at 73.

[14] *Chamber Response* at 6.

[15] *Id.* ("[P]laintiffs' attorneys turn away most cases unless a case offers a high rate of success and sufficiently high potential damages.") (citing William M. Howard, *Arbitrating Claims of Employment Discrimination: What Really Does Happen? What Really Should Happen?* 50 DISP. RESOL. J. 40 (1995) [hereinafter *Employment Discrimination*]); Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 570 ("According to one oft-cited estimate, plaintiffs' counsel will require a meritorious case with damages of at least $60,000 to $75,000.") (citing Howard, *Employment Discrimination* at 40; William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served?* (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with Public Citizen) [hereinafter *Can Justice Be Served*]).

[16] Howard, *Can Justice be Served* at 150. Moreover, the median response was $50,000 for both arbitrations and court cases. *Id.*

[17] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 557 n.36.

[18] American Arbitration Association, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload* (undated), at http://www.adr.org/si.asp?id=5027 [hereinafter *AAA One-Pager*]; Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?* 11 EMPLOYEE RTS. & EMPLOYMENT POL'Y J. 405, 418 (2007); Michael Delikat & Morris Kleiner, *Comparing Litigation and Arbitration of Employment Disputes; Do Claimants Better Vindicate Their Rights in Litigation?* 6 A.B.A. LITIG. SEC. CONFLICT MGMT. 1, 10 (2003); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RESOL. J. 44, 48 (Nov. 2003-Jan. 2004); Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. DISP. RESOL. 777, 806 (2003).

The *Chamber Papers* Cite Surveys on Voluntary Arbitration as Evidence of Satisfaction with Pre-Dispute Binding Mandatory Arbitration.

- The *Chamber Papers* cite five surveys that discuss consumers' or lawyers' views on arbitration,[19] but fail to mention that three of the five concern the use of *voluntary* arbitration.[20] The surveys are hardly unclear on this point. One repeated the phrase "voluntary arbitration" in twelve of sixteen inquiries,[21] asking questions such as, "how would you rate the quality of the outcome . . . resulting from voluntary arbitration proceedings?"[22] Of course, one expects a vast difference regarding views of "voluntary arbitration" and arbitration that is forced on individuals.

The *Chamber Papers* Wrongly State That a Key Survey Did Not Originate from the Arbitration Industry.

- *Whither* states that a survey by the "Roper Organization" showing favorable attitudes about arbitration was *not* "underwritten by industry associations."[23] But the survey was commissioned by a pro-arbitration advocacy organization called the Institute for Advanced Dispute Resolution, which described its mission as "promot[ing] the use of arbitration, mediation, and other dispute resolution methods throughout America and the world."[24] The Institute's president was Roger Haydock, a founder of the National Arbitration Forum (NAF)[25] and a director of NAF dating back to at least 1996.[26] (He is now NAF's managing director.[27]) The Institute's most recent address placed it in NAF's offices,[28] and its

[19] *See* ROPER ASW, 2003 LEGAL DISPUTE STUDY; INSTITUTE FOR ADVANCED DISPUTE RESOLUTION (2003) [hereinafter ROPER]; A.B.A., SECTION OF LITIGATION TASK FORCE ON ADR EFFECTIVENESS, SURVEY ON ARBITRATION (2003) [hereinafter A.B.A. SURVEY ON ARBITRATION]; HARRIS INTERACTIVE SURVEY CONDUCTED FOR U.S. CHAMBER'S INSTITUTE OF LEGAL REFORM, ARBITRATION: SIMPLER, FASTER, CHEAPER THAN LITIGATION (2005) [hereinafter HARRIS INTERACTIVE SURVEY]; Gary Tidwell, Kevin Foster & Michael Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulatory Arbitrations* (1999); ERNST & YOUNG , OUTCOMES OF ARBITRATION: AN EMPIRICAL STUDY OF CONSUMER LENDING CASES (2004).

[20] *See, e.g.*, ROPER at 27; A.B.A. SURVEY ON ARBITRATION at 24; HARRIS INTERACTIVE SURVEY at 9.

[21] *See* A.B.A. SURVEY ON ARBITRATION at 9-29.

[22] *Id.* at 24.

[23] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 561 (citing ROPER at 6).

[24] Institute for Advanced Dispute Resolution, Form 990, Statement 4 (2003).

[25] Website of William Mitchell College of Law, http://www.wmitchell.edu/faculty/Roger-Haydock+ADR+leave.html.

[26] *See, e.g.*, Ed Anderson & Roger Haydock, *History of Arbitration as an Alternative to U.S. Litigation*, WEST'S LEGAL NEWS, Aug. 12, 1996.

[27] *See, e.g.*, Roger Haydock, *Arbitration Is a Solution That's Fair to Everyone*, MINNEAPOLIS STAR-TRIBUNE, May 15, 2008.

[28] Institute for Advanced Dispute Resolution, Form 990 (2005); Website of National Arbitration Forum, http://domains.adrforum.com/main.aspx?itemID=766.

website listed NAF as "our sponsor."[29] When we dialed its most recently listed phone number, we got Haydock's voice mail.

The *Chamber Papers* contradict several of the positions Rutledge took in previous writings.

In previous work, Rutledge voiced many of the criticisms of arbitration that he now disputes in the *Chamber Papers*. Perhaps most surprising, Rutledge devoted two full academic papers to arguing that parties in arbitration should have the ability to sue arbitrators – in court – because binding mandatory arbitration affords participants so little opportunity to appeal or otherwise protect themselves from arbitrators who are biased or ignore the law. Below are examples of statements in the *Chamber Papers* that contradict Rutledge's past writings:

- The *Chamber Response* says that "judicial review of the award fills the gap" of policing unfair arbitration rulings and assures readers that "courts can vacate awards (and have done so) when, among other things, there is evidence that the arbitrators were not impartial."[30] But Rutledge previously wrote that "the argument that aggrieved parties can always seek vacatur of the award is an inadequate response. Vacatur does not provide the parties the return of the costs that they bore as a result of the flawed institutional arbitration, nor does it compensate the parties for the lost time prior to the entry of an enforceable award."[31]

- The *Chamber Response* labels a "myth" the argument that "arbitrators have financial incentives to favor firms that hire them."[32] But Rutledge previously wrote that arbitrators "who may seek to develop reputations for being friendly to particular parties or particular industries may actually have incentives that cut against independence."[33]

- The *Chamber Response* states that "parties to arbitration are not bound to any confidentiality obligation."[34] But Rutledge previously wrote that "many arbitration rules and some arbitration laws specifically provide for the confidentiality of proceedings and, in addition, the confidentiality of any award."[35]

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[29] Archived website of Institute for Advanced Dispute Resolution, http://web.archive.org/web/20070322202435/www.adrinstitute.org/nationalarbitrationforum.htm.
[30] *Chamber Response* at 16.
[31] Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 180 (2004) [hereinafter *Arbitral Immunity*].
[32] *Chamber Response* at 3 (quoting *Arbitration Trap* at 7-8, 29).
[33] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 194.
[34] *Chamber Response* at 15.
[35] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 163.

- The *Chamber Response* says that "to the extent individuals may not know the details of the particular candidates for nomination as arbitrator, they or their lawyers can investigate (just as they do with a judge)."[36] But Rutledge previously wrote that "arbitrations often take place under the guise of confidentiality, so even assuming that a party were willing to undertake the investment, the party may be stymied in its efforts to learn much about an arbitrator's or an institution's reputation."[37]

- The *Chamber Response* argues that Public Citizen's *Arbitration Trap* makes "the misplaced assumption that arbitrators somehow do not follow the governing law."[38] But Rutledge previously promoted stripping arbitrators of immunity from lawsuits as a remedy for their failures to follow the law.[39] In doing so, he argued, "Arbitrators do not have to follow precedent. Arbitrators also are not bound by the same rules of evidence and procedure as courts. Often there is no transcript, and arbitrators are not obligated to provide detailed findings of fact and conclusion of law in their awards."[40]

- The *Chamber Response* provides many assurances that "arbitral rules" protect individuals from unfairness.[41] But Rutledge previously argued that individuals should be given freedom to sue arbitrators partly because "the current regime of legal immunity protects arbitrators and arbitral institutions even when they have violated their own rules (*and a surprising number of reported opinions raise this problem*)."[42]

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[36] *Chamber Response* at 16.
[37] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 195.
[38] *Chamber Response* at 29.
[39] *See generally* Rutledge, *Arbitral Immunity*, 39 GA. L. REV. 151.
[40] *Id.* at 167.
[41] *See Chamber Response* at 3, 4, 7, 15-16, 22, 27.
[42] Peter B. Rutledge, *Market Solutions to Market Problems: Re-examining Arbitral Immunity as a Solution to Unfairness in Securities Arbitration*, 26 PACE L. REV. 113, 125 (2005) (emphasis added) [hereinafter *Market Solutions*].

I. THE EVIDENCE DEMONSTRATES THAT INDIVIDUALS FARE WORSE IN ARBITRATION THAN COURT.

The *Chamber Response* purports to rebut allegations of injustice in arbitration by bringing the broad sweep of empirical research to bear on the issue. The *Chamber Response* claims that the empirical evidence shows that "individuals generally achieve superior results in arbitration than litigation."[43]

In fact, the available empirical research almost universally demonstrates that individuals fare worse in arbitration than in court.

A. Studies Cited in the *Chamber Response* Do Not Support the Conclusion That Individuals Fare Better in Arbitration.

1. The Comparative Studies Cited in the Chamber Response *Do Not Support the Chamber's Conclusion That Individuals Fare Better in Arbitration than Court.*

The *Chamber Response* cites just two comparative studies to support its sweeping claim that individuals fare better in binding mandatory arbitration than court. One study is of limited value because it compares arbitration recoveries of highly paid securities industry employees with court recoveries of employees from a cross-section of society. The other was written by an arbitration firm executive and suffers from a severe methodological error. We discuss each below:

Michael Delikat and Morris M. Kleiner (2003). This study compared results of jury trials in federal court with those of arbitrations involving NASD securities employees. It found that victorious individuals received an average court award of $377,030 compared to $236,292 in arbitration, and a median award of $95,554 in court compared to $100,000 in arbitration. Claimants prevailed at a higher rate in arbitration than court (46.2 percent to 33.6 percent). The average award for all claimants – including those who did not receive an award – was $127,704 in court compared to $110,500 in arbitration.[44]

In addition to Delikat and Kleiner's finding that individuals received significantly smaller average awards in arbitration than court, there are several other reasons why their study fails to show that individuals "generally achieve superior results in arbitration":

Employees in the arbitration side of the study were almost certainly better paid than those on the litigation side. Critics of this study have pointed out that securities industry employment arbitration cases almost universally concern highly paid members of that industry. These individuals would be expected to receive higher average awards than those of the broader socio-economic cross-section of employees who litigated in court.[45]

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[43] *Chamber Response* at 6.

[44] Delikat & Kleiner, 6 A.B.A. LITIG. SEC. CONFLICT MGMT. at 10-11.

[45] *See, e.g.*, Hill, 18 OHIO ST. J. DISP. RESOL. at 792 (securities industry arbitration "is largely limited to the highly compensated members of that industry"); Colvin, 11 EMPLOYEE RTS. & EMPLOYMENT POL'Y J. at

Because the study was limited to cases that reached a verdict, employees' success rate in court was probably understated. The only court cases the researchers included in their results were those in which a judge or jury verdict was reached. Only 3.8 percent of the cases in the study reached this stage.[46] Therefore, the study omitted more than 96 percent of cases brought. Moreover, the average outcomes of the omitted cases might have been more positive for employees than those of the cases included. A 1995 study that proponents of arbitration often cite for other purposes found that 71 percent of all individuals filing employment cases in federal court received a favorable outcome (mostly through settlements) compared with only 28 percent of individuals whose cases reached a judge or jury verdict.[47]

Securities arbitrations appear to provide more procedural protections for individuals than typical arbitration proceedings. The rules of securities arbitration are regulated by the Securities and Exchange Commission.[48] No other form of binding mandatory arbitration is subject to such regulatory oversight.[49] Also, securities industry arbitration rules require disclosure of information about arbitrators and provide individual claimants an equal say in choosing them.[50]

Mark Fellows (July 2006). This article by an in-house attorney at the National Arbitration Forum argues that businesses' success rate in NAF-administered arbitrations is roughly the same as in business-initiated cases that go to a bench trial in federal court.[51] But the article counts as a loss any arbitration claim that a business withdrew before the arbitrator was appointed. These claims are not comparable to judicial decisions after bench trials. As Figure 1 shows, when one includes only cases actually decided by an arbitrator – a closer approximation of cases in which a bench trial was held – businesses' success rate in arbitration soars.

416-17 ("It is likely that there are differences in the types of cases brought in these forums, with many securities arbitration cases involving contractual claims and relatively highly paid employees.").

[46] Delikat & Kleiner 6 A.B.A. LITIG. SEC. CONFLICT MGMT. at 8.

[47] Howard, *Can Justice be Served*, at 107.

[48] *See, e.g.*, Jill I. Gross, *McMahon Turns Twenty: The Regulation of Fairness in Securities' Arbitration*, 76 U. CINC. L. REV. 101, 119 (2008) ("SEC regulation makes securities arbitration different in a meaningful way from other forms of consumer arbitration, which are not regulated by a federal administrative agency.").

[49] *Id.*

[50] *See, e.g.*, Barbara Black & Jill I. Gross, *Making It up as They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1003 (2002); MICHAEL A. PERINO, REPORT TO THE SECURITIES AND EXCHANGE COMMISSION REGARDING ARBITRATOR CONFLICT DISCLOSURE REQUIREMENTS IN NASD AND NYSE SECURITIES ARBITRATIONS 11-12, 24-25 (2002).

[51] Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, 07/06 METRO. CORP. COUNS. 32 (2006).

Figure 1: Businesses Success in Business-Initiated Arbitrations Versus Court Cases
(arbitration statistics include only cases in which an arbitrator was actually appointed)

Type of Case	Percentage of Time Business Prevailed
Arbitration: Business-initiated contract cases handled by the National Arbitration Forum in which an arbitrator was appointed	96.8%[52]
Courts: Business-initiated contract cases in federal courts reaching a bench trial	78.9%[53]

The Fellows article also discussed consumer-initiated arbitrations, claiming that consumers prevailed in 65.5 percent of cases that reached a decision. This rate, the article claims, compares favorably with a 60.9 percent success rate for "buyer plaintiffs" litigating contract cases that culminated in a bench trial.[54] We were unable to duplicate these results. We analyzed NAF data disclosed under California law and found that consumers prevailed in only 37.2 percent of consumer-initiated cases that reached a decision.[55] Regardless of the discrepancy between NAF's and Public Citizen's analyses, consumer-initiated cases account for a minuscule percentage of NAF arbitrations and therefore are not representative of NAF arbitrations. Public Citizen's review of NAF's California caseload from 2003 to 2007 shows that consumers initiated only 118 out of 33,948 cases filed, or 0.35 percent.[56]

2. *The Chamber Institute's Memorandum Dated July 11, 2008, Is Meaningless Because of Its Selective Use of Data.*

The Chamber Institute for Legal Reform recently commissioned an analysis of data on NAF that uses a methodology similar to that employed by NAF's counsel. The analysis claims that consumers prevailed in 32.1 percent of cases that did not end in settlements – either by "winning their arbitration hearing outright or having the claims against them dismissed."[57] But 99.6 percent of these cases in which consumers purportedly "prevailed" (8,534 out of 8,558) were dismissals, not victories after a hearing. Of those dismissals, 91.2 percent (7,783) occurred before an arbitrator was even appointed.[58] These cases can hardly be used as evidence of the fairness of NAF arbitration. They scarcely involved arbitration at all.

[52] Public Citizen analysis of National Arbitration Forum reports posted pursuant to § 1281.96 of the California Code of Civil Procedure [hereinafter Public Citizen Analysis of NAF Reports].
[53] Fellows, 07/06 METRO. CORP. COUNS. 32.
[54] *Id.*
[55] Public Citizen Analysis of NAF Reports.
[56] *Arbitration Trap* at 15.
[57] U.S. Chamber Institute for Legal Reform press release, *Arbitration Better than Court for Consumer Debtors, Study Shows Consumers Four Times More Likely to Lose When Credit Cases Go to Court* (July 15, 2008), at http://www.instituteforlegalreform.com/media/pressreleases/20080715.cfm; Jeff Nielsen, Garrett Rush & Jordan Hartley, Navigant Consulting, Memorandum dated July 11, 2008 [hereinafter *Chamber Memorandum*], at http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1212. The Chamber Institute's analysis used a dataset posted to the Internet by Public Citizen.
[58] Public Citizen Analysis of NAF Reports.

There is also reason to doubt NAF's characterization of the roughly 700 other dismissals it coded as consumer wins (instances in which an arbitrator was appointed before the dismissal). The business party might have dismissed for any number of manipulative reasons – practices that NAF actually encourages, according to recent press accounts:

> A current NAF arbitrator speaking on condition of anonymity explains that the [marketing] presentation reflects the firm's effort to attract companies, or "claimants," by pointing out that they can use delays and dismissals to manipulate arbitration cases. "It allows the [creditor] to file an action even if they are not prepared," the arbitrator says. "There doesn't have to be much due diligence put into the complaint. If there is no response [from the debtor], you're golden. If you get a problematic [debtor], then you can request a stay or dismissal." When some creditors fear an arbitrator isn't sympathetic, they drop the case and refile it, hoping to get one they like better, the arbitrator says.[59]

Given these practices, it is possible that the consumers who "won" the cases discussed above lost the very same cases later. NAF's secrecy prevents us from knowing.

In the end, the Chamber Institute's memorandum only confirms that consumers fare abysmally in NAF arbitrations. Of the 2,019 cases that had a hearing in which the consumer participated in some manner,[60] the Chamber Institute recognizes that consumers won only 28 cases, or 1.4 percent.[61] Of the 18,075 total cases that went to a hearing, consumers won just 30, or *0.17 percent*.

3. *The Non-Comparative Studies Cited by the* Chamber Response *Do Not Show Success for Individuals in Arbitration.*

The *Chamber Response* cites two other analyses as showing reasonable success for individuals in arbitration, although these studies do not compare results in arbitration to those in court. Like the comparative studies discussed above in section I.A.1, these studies also fail to support the Chamber's argument:

The California Dispute Resolution Institute (2004). This study attempted to analyze results of consumer arbitrations between January 2003 and February 2004 using data disclosed under California law. Researchers were unable to draw meaningful conclusions because the available data were grossly incomplete.

The *Chamber Response* states that "[w]hile the Institute noted that data limitations prevented broad conclusions, it did find that arbitration produced positive results for consumers."[62] But the Institute made no such finding. Although the *Chamber Response*

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[59] *See* Robert Berner & Brian Grow, *Banks vs. Consumers (Guess Who Wins?)*, BUSINESS WEEK, June 5, 2008.

[60] Consumers could have participated in person or by submitting documents. The NAF data do not specify the means of participation for a given case.

[61] *Chamber Memorandum* at 2.

[62] *Chamber Response* at 7-8 (citing CALIFORNIA DISPUTE RESOLUTION INSTITUTE, CONSUMER AND EMPLOYMENT ARBITRATION IN CALIFORNIA: A REVIEW OF WEBSITE DATA POSTED PURSUANT TO SECTION 1281.96 OF THE CCP (2004)).

notes that the Institute's researchers reviewed 2,175 cases,[63] it fails to mention that the Institute could not determine the prevailing party in 1,873 of them (86.1 percent).[64] Indeed, the Institute's principal finding was that the public disclosures from arbitration firms were of limited value:

> This report concludes that – owing to a number of factors, including problems with the statute's requirements – there are inconsistencies, ambiguities, and gaps in the data and that these limit the utility of the information in presenting a clear picture of consumer arbitration in California.[65]

In 2007, Public Citizen wrote software to help analyze the results of NAF cases from 2003 to 2007. In contrast to many providers, NAF identifies the prevailing parties in its disclosures[66] although, as discussed above, there is reason to doubt some of its characterizations.

American Arbitration Association (2007). The *Chamber Response* also cites a one-page American Arbitration Association (AAA) fact sheet stating that individuals prevailed in 48 percent of consumer-initiated arbitrations in which AAA issued an award in the first eight months of 2007.[67] This finding is unreliable because any arbitrator award was counted as a win, regardless of its relation to the amount sought. This means for example that AAA would deem victorious a claimant who sought $50,000 and received only $5. Additionally, the *Chamber Response* fails to mention the fact sheet's finding that businesses prevailed in 74 percent of the cases in which they were the claimants.[68]

We attempted to duplicate AAA's findings by analyzing reports it published as required under California law, but we could discern the victorious party only in approximately 7 percent of the cases. AAA left the "prevailing party" field – a required disclosure[69] – blank in more than 90 percent of the cases it has reported. We contacted AAA to inquire about the discrepancy, and AAA Senior Vice President Richard Naimark explained that AAA created its fact sheet by combing case files and counting any award as a victory for the claimant. Naimark acknowledged that because AAA's public disclosures do not reveal which party brought the case, the public cannot verify AAA's conclusions.[70]

That AAA's disclosures are insufficient to permit even basic research on case outcomes only underscores the excessive secrecy and lack of accountability in arbitration generally.

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[63] *Id.* at n.11.
[64] CALIFORNIA DISPUTE RESOLUTION INSTITUTE at 25.
[65] *Id.* at 5; *see also id.* at 18 ("Because arbitration as it is currently practiced in California is more complicated than the variables of this study can analyze, this data might not yield adequate information upon which definitive conclusions about the efficacy of private arbitration in California can be reached.").
[66] *Arbitration Trap* at 15.
[67] *Chamber Response* at 9 (citing *AAA One-Pager*, at http://www.adr.org/si.asp?id=5027).
[68] *AAA One-Pager*, at http://www.adr.org/si.asp?id=5027.
[69] C.C.P. § 1281.96(a)(3).
[70] Taylor Lincoln, research director of the Congress Watch division of Public Citizen, interview with AAA Senior Vice President Richard Naimark, July 11, 2008.

The *Response* also refers to *Whither*, Rutledge's literature review, which cites several other comparative studies. But the studies cited in *Whither* almost universally support the conclusion that individuals fare *worse* in arbitration that court.

B. The Studies That *Whither* Cites Contradict Its Claim That Individuals Enjoy Superior Results in Arbitration Versus Court.

1. The Studies That Whither *Cites to Compare Arbitration with Court Support the Conclusion That Individuals Fare Far Better in Court.*

The introduction of *Whither* promises that the paper "takes up [the] charge" of providing "an honest assessment of [the] empirical picture" on arbitration, and it touts "some surprising conclusions," including a finding that "arbitration generally results in higher win rates and higher awards for employees than litigation."[71]

But the evidence presented in *Whither* fails to support these conclusions. To the contrary, the studies cited in *Whither* that compare arbitration and court results overwhelmingly demonstrate that employees fare worse in arbitration than court.

Whither isolates three categories of comparison between arbitration and court.[72] In two of the three (comparative awards and award amounts relative to demands), the preponderance of the studies *Whither* cites show that individuals fare worse in arbitration. *Whither* scores the other category, "comparative win rates," a tie. (This review will demonstrate that the studies *Whither* cites actually show that judicial outcomes are better for individuals in the comparative win rates category as well.) Thus, in the categories Rutledge selects, the record for individuals on arbitration versus court is 0-3 if one uses Public Citizen's analysis or 0-2-1 if one accepts Rutledge's. Neither result justifies the conclusion that "individuals as a whole achieve superior results in arbitration than litigation."[73] Here is a breakdown:

Comparative win rates. Two of the three studies *Whither* cites on comparative win rates show individuals faring better in court than arbitration. These studies offer a total of nine indices of comparison between court and arbitration,[74] and individuals fare better in court

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[71] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 551.

[72] *Id.* at 557-60. *Whither*'s discussion comparing success rates in arbitration versus courts also discusses "raw win rates" in arbitration, *i.e.*, studies that determined the percentage of times individuals won arbitration cases but did not attempt to compare such results to court results. We discuss *Whither*'s portrayal of individuals' raw win rates below in section I.B.2.

[73] *Chamber Response* at 6 (citing *Whither*).

[74] Eisenberg & Hill, 58 DISP. RESOL. J. at 48; Delikat & Kleiner, 6 A.B.A. LITIG. SEC. CONFLICT MGMT. at 10; Howard, *Can Justice be Served*, at 107, 122, 124. In discussing comparative win rates, *Whither* mentions in passing other articles that *Whither* states confirm the conclusion that "choice of forum" has "relatively little effect on a claimant's win rate." *Whither*, 6 GEO. J. L. PUB. POL'Y at 557 & n.39 (citing David Sherwyn, Samuel Estreicher & Michael Heise, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1574 (2005); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. DISP. RESOL. 559 (2001); Lewis L. Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 114 (2003) [hereinafter *Workplace Justice*]). We omit these articles here because they are

in six of the nine. Of the three in which individuals fare better in arbitration, two concern employees who negotiated their own contracts. By definition, these individuals have a greater opportunity to influence the terms of arbitration clauses than do employees who are subject to nonnegotiable, employee-handbook terms. The third study concerns individuals in securities arbitration, which, as discussed above, provides greater safeguards for individuals than other forms of arbitration.

Comparative awards. All three of the studies *Whither* cites on comparative awards show individuals receiving higher average (mean) awards in court, and two of the three show individuals receiving higher median awards.[75] These studies offer a total of nine indices of comparison. Individuals fare better in court in all nine mean-award comparisons and seven of nine median-award comparisons. The two median-award comparisons in which individuals fare worse in court concern securities industry arbitrations or cases involving employees who negotiated their own contracts.

Of twenty-seven total comparisons of win rates and awards, twenty-two favor court and five favor arbitration. Figure 2 provides individuals' win rates, average awards, and median awards in the comparative studies *Whither* cites.[76]

literature reviews discussing prior research, much of which is addressed in this section and some of which is irrelevant. One of the articles contains a section of original analysis, but it primarily compares outcomes between EEOC proceedings and a single employer's in-house alternative dispute resolution program, not win rates between court and arbitration. *See Sherwyn, Estreicher & Heise*, 57 STAN. L. REV. at 1581-91.

[75] Eisenberg & Hill, 58 DISP. RESOL. J. 44 at 49; Delikat & Kleiner, 6; A.B.A. LITIG. SEC. CONFLICT MGMT. at 10; Howard, *Can Justice be Served*, at 109, 125-26.

[76] These are the sources consulted in Figure 2: Howard, *Can Justice be Served*, at 107, 109, 122, 124-26; Eisenberg & Hill 58 DISP. RESOL. J. 44 at 48-49; Delikat & Kleiner, 6 A.B.A. LITIG. SEC. CONFLICT MGMT. at 10. Figure 2 does not include results from Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 48 (1998), which *Whither* cites for insight into comparative recoveries in relation to amount sought. Its results are not included here because it did not use original data. It finds individuals achieving dramatically higher win rates in arbitration (63 percent to 14.9 percent) and dramatically higher awards in court ($530,611 to $49,030).

Figure 2: Studies Comparing Individuals' Success in Arbitration Versus Court
(favorable results in bold)

Study	Court Win Rate	Arbitration Win Rate	Court Mean Award	Arbitration Mean Award	Court Median Award	Arbitration Median Award
Howard (1995) (Arbitration versus federal court for employment disputes)	**71%** (all cases)	68%	**$330,277** (verdicts only)	$114,905	**$75,000** (verdicts only)	$32,950
Howard (1995) (Arbitration versus federal court for securities industry employees)	**71%** (all cases)	48%	**$330,277** (verdicts only)	$83,518	**$75,000** (verdicts only)	$41,700
Eisenberg and Hill (2004) (Arbitration versus state court for civil rights disputes brought by employees who had individually negotiated contracts)	**43.8%**	40% (n=5)	**$206,976**	$32,500 (n=2)	**$206,976**	$32,500 (n=2)
Eisenberg and Hill (2004) (Arbitration versus federal court for civil rights disputes brought by employees who had individually negotiated contracts)	36.4%	**40%** (n=5)	**$336,291**	$32,500 (n=2)	**$150,500**	$32,500 (n=2)
Eisenberg and Hill (2004) (Arbitration versus state court for civil rights disputes brought by employees who had employee-handbook arbitration clauses)	**43.8%**	24.3%	**$206,976**	$56,096	**$206,976**	56,096
Eisenberg and Hill (2004) (Arbitration versus federal court for civil rights disputes brought by employees who had employee-handbook arbitration clauses)	**36.4%**	24.3%	**$336,291**	259,795	**$150,500**	56,096
Eisenberg and Hill (2004) (Arbitration versus state court for non-civil-rights disputes brought by employees who had individually negotiated contracts)	56.6%	**64.9%**	**$462,307**	$211,720	68,737	**94,984**
Eisenberg and Hill (2004) (Arbitration versus state court for non-civil-rights disputes brought by employees who had employee-handbook arbitration clauses)	**56.6%**	39.6%	**$462,307**	$30,732	**$68,737**	13,450
Delikat and Kleiner (2003) (Arbitration versus federal court for securities industry employees)	33.6%	**46.2%**	**$377,030**	$236,292	$95,554	**$100,000**
Total favorable results	**6**	3	**9**	0	**7**	2

Comparative awards relative to demands. The lone study *Whither* cites for insight into award amounts relative to demands states that individuals fare significantly better in court. It reports that mean awards in court were 70 percent of the amount demanded

while mean awards in arbitration were only 25 percent of the amount demanded.[77] *Whither* criticizes the study's methodology on several grounds, most significantly because it compares "arbitration disputes *not* dominated by discrimination claims with litigated disputes that were dominated by discrimination claims."[78] Irrespective of the merit of that criticism, one can safely conclude that this study's finding on award amounts relative to demands does nothing to bolster *Whither's* argument that individuals do better in arbitration than court.

2. *Studies Cited in* Whither *Also Contradict the Chamber's Conclusions on "Raw Win Rates" in Arbitration.*

In addition to comparing courts and arbitration on the three measures mentioned above (win rates, awards, and awards relative to demands), *Whither* also discusses studies that report winning percentages in arbitration without comparing them to outcomes in similar court cases – a measure that Rutledge calls "raw win rates." Here, *Whither* makes a stunningly erroneous claim, asserting that "the only reported data showing a win-rate of less than 50 percent [for claimants in arbitration] is William Howard's study of securities arbitration."[79]

In fact, at least five other studies have found win rates of less than 50 percent for individual claimants – and four of these are cited in the *Chamber Papers*. Among them is the study on which the *Chamber Response* relies most heavily to support its claim that "[i]ndividuals generally achieve superior results in arbitration than litigation."[80] These are the studies:

- Delikat and Kleiner (2003) found an employee win rate of 46.2 percent in arbitration.[81] (Cited in both the *Chamber Response* and *Whither*.[82])
- An AAA fact sheet reviewing AAA-administered consumer arbitrations for the first eight months of 2007 reports that individuals prevailed in 48 percent of cases they initiated and 26 percent of cases initiated by businesses.[83] (Cited in *Chamber Response*.[84])
- Eisenberg and Hill (2004) found a 46 percent win rate for employees in arbitrations generally and a 26.2 percent win rate for employees in arbitrations of civil rights claims.[85] (Cited in *Whither*.[86])

[77] Maltby, 30 COLUM. HUM. RTS. L. REV. at 48.
[78] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 559-60.
[79] *Id.* at 557 n.36.
[80] *Chamber Response* at 6.
[81] Delikat & Kleiner, 6 A.B.A. LITIG. SEC. CONFLICT MGMT. at 10.
[82] *See Chamber Response* at 6 n.6; Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y, 570-71 & n.106.
[83] *AAA One-Pager* at http://www.adr.org/si.asp?id=5027.
[84] *See Chamber Response* at 9 n.17.
[85] Eisenberg & Hill, 58 DISP. RESOL. J. at 48. Public Citizen used Eisenberg and Hill's data to calculate the percentages provided in the text of this paper. Eisenberg and Hill report wins and losses separately for

- Hill (2003) found an employee win rate of 43 percent in arbitration.[87] (Cited in both the *Chamber Response* and *Whither*.[88])

- Colvin (2007) found a 19.7 percent win rate for individuals whose employment disputes were arbitrated by AAA.[89] (Not cited in the *Chamber Papers*.)

C. Evidence Not Cited by the Chamber Papers Shows That Employees Who Do Not Negotiate Their Contracts Individually Fare Dismally in Arbitration.

In addition to the deep flaws in the *Chamber Papers*' interpretations of the evidence they cite, they also fail to discuss important empirical evidence – for example other studies on comparative success rates in arbitration for employees who negotiated their own contracts versus those who were forced into arbitration under employee-handbook terms. The distinction is important because employees who negotiate their own contracts are able to influence the terms under which future arbitration proceedings will be administered – meaning that the arbitrations are at least in part voluntary. Employees subject to handbook terms enjoy no power to shape the rules.

A 2007 study by Penn State University professor Alexander J.S. Colvin found that employees subject to employee-handbook cases won fewer than 20 percent of their cases before AAA from 2003 to 2006.[90] Colvin notes that his findings conflict with some earlier studies on employment arbitration, but that this was probably because those studies involved employees who had individually negotiated contracts.[91] His finding was more consistent with studies that examined arbitrations for employees subject to nonnegotiable handbook arbitration terms:[92]

- In a 1998 study of employment cases administered by AAA between 1993 and 1995, Indiana University professor Lisa B. Bingham found that 68.8 percent of employees who had individually negotiated contracts received an award, compared to 21.3 percent of employees subject to employee-handbook terms.[93]

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higher-paid and lower-paid employees and for civil-rights and non-civil-rights claims. We added their numbers to determine total win rates.

[86] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 558 n.25, 558 n.45, 559 n.46, 560 n.50.

[87] Hill, 18 OHIO ST. J. DISP. RESOL. at 806. This study appears to use data that overlaps with the data analyzed in Eisenberg and Hill's 2004 paper.

[88] *See Chamber Response* at 7 n.9, 20 n.54, 21 n.59, 22 n.63, 23 n.70, 27 n.93; *Whither*, 6 GEO. J. L. PUB. POL'Y at 555 n.25.

[89] Colvin, 11 EMPLOYEE RTS. & EMPLOYMENT POL'Y J. at 418.

[90] *Id.*

[91] *Id.* at 413, 418.

[92] *Id.*

[93] Lisa B. Bingham, *An Overview of Employment Arbitration in the United States: Law, Public Policy and Data*, 23 N.Z. J. INDUS. REL. 5, 16 (1998).

- Bingham and Shimon Sarraf in 2000 published a similar study reviewing AAA results in 1996 and 1997. Employees who negotiated their own contracts won 61.3 percent of the time; those subject to personnel manual agreements won 27.6 percent of the time.[94]

- Eisenberg and Hill in 2003 distinguished between employees who negotiated their own contracts and those subject to employee-handbook terms, and also broke out discrimination and non-discrimination cases. The study reviewed a random selection of AAA employment arbitrations in 1999 and 2000 and found that employees subject to employee-handbook terms fared significantly worse than those who negotiated their own contracts in both civil rights and non-civil rights cases. They also fared worse than employees who litigated in court for both types of cases.[95]

"It is not clear that the types of cases represented in these AAA awards of the early 1990s are representative of the employment arbitration system that has arisen in more recent years," Colvin writes. "In particular, a majority of these awards [in the early 1990s] appear to have involved claims by employees, typically managers and executives, under individually negotiated contracts, rather than claims brought under arbitration provisions from employment manuals or handbooks."[96] Colvin's study and others like it "raise[] the concern that overall employee win rates may be much lower under the employer promulgated mandatory arbitration procedures that have expanded in recent years than suggested by some of the early studies in this area," he explains.[97]

Figure 3 compares the success rate in arbitration of employees who negotiated their own contracts to those who were subject to arbitration terms dictated by employment manuals.

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[94] Colvin 11 EMPLOYEE RTS. & EMPLOYMENT POL'Y J. at 414 (Lisa B. Bingham & Shimon Sarraf, *Employment Arbitrations Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising out of Employment: Preliminary Evidence That Self-Regulation Makes a Difference*, *in* ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF NEW YORK UNIVERSITY 53RD ANNUAL CONFERENCE ON LABOR 303, 320-28 (Samuel Estreicher & David Sherwyn eds., 2004)).
[95] Eisenberg & Hill 58 DISP. RESOL. J. 44 at 48.
[96] Colvin, 11 EMPLOYEE RTS. & EMPLOYMENT POL'Y J. at 413.
[97] *Id.*

Figure 3: Studies Assessing Arbitration Win Rates of Employees Subject to Employee-Handbook Terms

Study (Year published)	Success rate in arbitrated disputes for employees who individually negotiated their contracts	Success rate in arbitrated disputes for employees subject to employment manual terms
Bingham (1998)	68.8%	21.3 %
Bingham and Sarraf (2000)	61.3%	27.6 %
Eisenberg and Hill (2004) (Non-civil rights cases)	64.9%	39.6 %
Eisenberg and Hill (2004) (Civil rights cases)	40.0% (n=5)	24.3 %
Eisenberg and Hill (2004) (Total)	63.4%	35.3%
Hill (2003)	57%	34%
Colvin (2007)	n/a	19.7%

D. Surveys Show Satisfaction with Voluntary Arbitration, But Provide Little Insight into Pre-Dispute Binding Mandatory Arbitration.

The *Chamber Papers* refer to various surveys that "suggest that individuals are pleased with the process and outcomes in arbitration."[98] Significantly, four of the five surveys that the *Papers* cite were produced on behalf of arbitration industry organizations or the Chamber Institute for Legal Reform itself. (The *Chamber Papers* purport to cite six surveys, but one merely quotes the findings of an already-cited survey.[99])

More important, the Chamber's papers leave out a vital detail: Most of the surveys they cite concern satisfaction with arbitration entered into *voluntarily after a dispute arises*. This distinction is vital for two reasons. First, inquiries into consumer satisfaction with voluntary arbitration are irrelevant to the Chamber's attempt to demonstrate the fairness of arbitration regimes that are forced on consumers or employees. Second, these studies actually serve to rebut the Chamber's core argument: that it is necessary to retain the legality of pre-dispute binding mandatory arbitration because no one will choose arbitration willingly after a dispute arises. These are the surveys:

1. Harris Interactive

A Harris Interactive study financed by the Chamber Institute concluded that 66 percent of respondents who had used arbitration would choose it again. *Whither* neglects to inform

[98] *Chamber Response* at 29.

[99] *See* Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 561 n.61 (quoting PERINO at 34-36); PERINO at 36 n.124 (citing Gary Tidwell, Kevin Foster & Michael Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulatory Arbitrations* 38 (1999)).

readers that 81 percent of the survey's subjects had voluntarily chosen to enter into arbitration after a dispute arose.[100]

2. *Ernst & Young / National Arbitration Forum*

The *Chamber Papers* report that a 2005 Ernst & Young / National Arbitration Forum survey of participants in consumer lending cases found that 69 percent of consumers were at least "satisfied" with the resolution of disputes handled by NAF.[101] While these survey subjects were subject to pre-dispute mandatory arbitration, they were selected from the minuscule fraction of NAF cases brought by consumers – just 226 cases between January 2000 and January 2003, according to the survey.[102] (The survey does not provide a total number of cases for the period. But Public Citizen found that, of 33,948 California cases NAF handled from 2003 to 2007, only 118 (0.35 percent) were initiated by consumers.[103]) Neither paper informs readers that such a selective pool was used, nor that the results were based on responses from just 29 of the 175 individuals chosen for the survey.[104] The *Chamber Papers* also neglect to mention that NAF assisted Ernst & Young by contacting the subjects.[105]

3. *Roper Organization / Institute for Advanced Dispute Resolution / Roger Haydock*

Setting up a contrast to the Harris Interactive and Ernst & Young projects, *Whither* singles out a 2003 survey by the "Roper Organization" as one that was not "underwritten by arbitration industry associations."[106] This claim turns out to be wildly inaccurate. The organization that commissioned and published the survey was in fact a self-proclaimed arbitration advocacy organization led by the managing director of the National Arbitration Forum and operated out of NAF's offices.

The survey was published by the Institute for Advanced Dispute Resolution, a 501(c)(3) nonprofit.[107] The Institute's filings with the Internal Revenue Service (IRS) list Roger Haydock as its president.[108] Haydock was a founder of the National Arbitration Forum[109]

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[100] HARRIS INTERACTIVE SURVEY at 9; Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 561.

[101] *Id.*; *Chamber Response* at 5.

[102] ERNST & YOUNG, OUTCOMES OF ARBITRATION: AN EMPIRICAL STUDY OF CONSUMER LENDING CASES 7 (2004).

[103] *See Arbitration Trap* at 15.

[104] ERNST & YOUNG at 7, 11. Ernst and Young attempted to contact a random sample of 175 individuals and obtained 29 responses. *Id.* at 11. The survey does not explain why researchers did not attempt to contact all 226 individuals.

[105] *Id.* at 19.

[106] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 561 ("While the Harris and the Ernst & Young study generated similar results, both studies might be criticized on the ground that the studies were underwritten by industry associations. However, other reports have largely validated these studies' conclusions. For example, a 2003 study by the Roper Organization surveyed a random cross section of 1036 adults . . . .").

[107] ROPER at 1; Institute for Advanced Dispute Resolution, Form 990 (2003); Public Citizen Researcher Peter Gosselar phone interview with principal from GfK Custom Research, the successor company of Roper ASW (July 11, 2008).

[108] Institute for Advanced Dispute Resolution, Form 990, Statement 7 (2003).

[109] Website of William Mitchell College of Law,

and by 2003 a longtime director of NAF.[110] He is now NAF's managing director.[111] In its most recent filing with the IRS, the Institute listed its address as 6465 Wayzata Blvd., Suite 500, in St. Louis Park, MN,[112] which is NAF's address.[113] The now-defunct Institute's phone number was 952-516-6410,[114] one digit different from NAF's main line.[115] When we dialed the "6410" extension, we reached Haydock's voice mail.

The Institute reported to the IRS that its primary purpose was "[t]o promote the use of arbitration, mediation, and other dispute resolution methods throughout America and the world."[116] A now-defunct Web page of the Institute (retained by an Internet archiving service) contains a page titled "About Our Sponsor." The sponsor listed is the National Arbitration Forum.[117]

Moreover, a separate report published by the Institute (which listed the National Arbitration Forum as its sponsor) indicates that the Institute resided "at William Mitchell College of Law,"[118] where Haydock is a professor.[119] Public Citizen contacted a vice dean at the college who explained that Haydock had proposed creating the Institute at William Mitchell but that the idea was tabled because Haydock took a leave of absence. "We haven't done anything with it," he said.[120]

Whither's claim that the Institute survey was not "underwritten by industry associations" is only the first of several problems with its use of the study.

Whither also uses this survey (like most others it cites) as evidence on binding mandatory arbitration, but the survey examined attitudes about *voluntary* arbitration. Survey respondents were asked, "If you had a legal dispute over [money] which one of the following statements best describes the likelihood of your taking it to arbitration versus filing a lawsuit?"[121] The question makes clear that respondents were asked to consider arbitration chosen voluntarily after a dispute arose. Sixty-four percent said they either

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http://www.wmitchell.edu/faculty/Roger-Haydock+ADR+leave.html.

[110] *See, e.g.*, Ed Anderson & Roger Haydock, *History of Arbitration as an Alternative to U.S. Litigation*, WEST'S LEGAL NEWS, Aug. 12. 1996 ("Roger Haydock is director of the National Arbitration Forum and Advanced Dispute Resolution.").

[111] *See, e.g.*, Roger Haydock, *Arbitration Is a Solution That's Fair to Everyone*, MINNEAPOLIS STAR-TRIBUNE, May 15, 2008.

[112] Institute for Advanced Dispute Resolution, Form 990 (2005).

[113] Website of National Arbitration Forum, http://domains.adrforum.com/main.aspx?itemID=766.

[114] Institute for Advanced Dispute Resolution, Form 990 (2005).

[115] Website of National Arbitration Forum, http://www.adrforum.com/main.aspx?itemID=218.

[116] Institute for Advanced Dispute Resolution, Form 990, Statement 4 (2003).

[117] Archived website of Institute for Advanced Dispute Resolution, http://web.archive.org/web/20070322202435/www.adrinstitute.org/nationalarbitrationforum.htm.

[118] INSTITUTE FOR ADVANCED DISPUTE RESOLUTION, JUDICIAL BENCHBOOK: ARBITRATION AND MEDIATION PRACTICE AND PROCEDURE (2003).

[119] Website of William Mitchell College of Law, http://www.wmitchell.edu/academics/faculty/Haydock.asp.

[120] Taylor Lincoln, research director of the Congress Watch division of Public Citizen, interview with William Mitchell College of Law Vice Dean for Faculty Niels B. Schaumann (July 17, 2008).

[121] ROPER at 27.

"definitely" or "probably" would choose arbitration.[122] *Whither* characterized the survey as finding that "64% said they would prefer arbitration over litigation,"[123] failing to note that this "preference" might not hold if arbitration were required rather than chosen.[124]

Whither also indicates these respondents "had not necessarily participated in arbitration."[125] This is a profound understatement. In fact, just 6 percent of the survey's respondents had ever been involved in an arbitration proceeding,[126] and only 9 percent even mentioned arbitration when asked to name alternatives to court.[127]

4. American Bar Association

The *Chamber Papers* note that 75 percent of respondents to a 2003 survey of lawyers conducted by the American Bar Association said that outcomes in arbitration were comparable to or better than the outcomes in litigation.[128] Both papers fail to inform readers that respondents' answers addressed their experience with voluntary arbitration. Specifically, survey subjects were asked questions such as, "In general, how would you rate the quality of the outcome (the fairness, validity, client satisfaction etc. associated with final awards) resulting from voluntary arbitration proceedings?"[129] It would be difficult to misapprehend the survey as focusing on binding mandatory arbitration; it uses the phrase "voluntary arbitration" in twelve of sixteen questions.[130]

5. NASD

Whither cites two surveys as evidence of satisfaction among participants in securities arbitrations. The first was a 1999 study led by Gary Tidwell, director of neutral training and development of the NASD Regulation Office of Dispute Resolution. "Of those surveyed, 93.49% felt that the arbitration was handled fairly and without bias," *Whither* reports, accurately paraphrasing Tidwell's finding.[131] This result may indicate that securities industry arbitration systems include enough protections to give participants a sense of fairness. But *Whither* still overstates the support for its position by suggesting that different, newer evidence corroborated Tidwell's findings. It continues, "In a more recent paper, Michael Perino reported similar results. He also reported that 91% of surveyed investors who had participated in NASD arbitrations found that the arbitrators demonstrated either an excellent or a good level of fairness."[132] In fact, this "more recent paper" merely restated the results of different questions from Tidwell's 1999 study.[133]

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[122] *Id.*
[123] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 561.
[124] *Id.*
[125] *Id.*
[126] ROPER at 25.
[127] *Id.* at 20. Another page of the same survey indicates that 12 percent mentioned arbitration. *Id.* at 18. The survey does not explain this discrepancy.
[128] *Chamber Response* at 5; Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 561.
[129] A.B.A. SURVEY ON ARBITRATION at 24.
[130] *See id.* at 9-29.
[131] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 561.
[132] *Id.*
[133] PERINO at 36 n.124.

E. Conclusions About Empirical Data on Arbitration Results

The empirical data on binding mandatory arbitration support the following conclusions:

- Data on arbitration are scarce and skewed toward favorable results. Virtually the only credible data obtained and analyzed by independent researchers concerns securities industry arbitrations regulated by the federal government or employment arbitration cases administered by the American Arbitration Association, which is often suggested to be fairer than other arbitration companies.[134] Colvin aptly voiced this concern regarding potential biases in the available data: "I have always been enormously grateful to organizations that have allowed me access to them to conduct research in this area, but have often worried that this leads one to follow the trail from one best case scenario to another while missing the darker cases that are hidden from public scrutiny."[135]

- Notwithstanding the bias in the data sets, most studies show that individuals fare worse in arbitration than court.

- Employees who are required by terms of nonnegotiable personnel manuals to settle disputes in arbitration have experienced particularly low success rates. Most studies have placed their success rates in AAA-administered arbitrations at under 30 percent, and one recent study found a success rate of only 19.7 percent.

- Most surveys showing satisfaction with arbitration among individuals or lawyers are irrelevant to the debate on binding mandatory arbitration because they concern only voluntary arbitration or the hypothetical use of arbitration as described by interviewers – or both.

[134] *See, e.g.*, Maltby, *Employment Arbitration*, 38 U.S.F. L. REV. at 114 ("[I]t is almost inconceivable that all of the hundreds of providers in this unregulated field meet AAA's high standards."); Richard A. Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceañera*, 81 TUL. L. REV. 331, 349 ("The AAA is a reputable arbitral provider that frequently has refused to arbitrate cases under rules it considers unfair. Other arbitral service providers have demonstrated considerably fewer scruples.").
[135] Colvin, 11 EMPLOYEE RTS. & EMPLOYMENT POL'Y J. at 446-47.

II. THE *CHAMBER PAPERS* FAIL TO REFUTE CRITICISMS OF BINDING MANDATORY ARBITRATION, AND RUTLEDGE HIMSELF HAS VOICED MANY OF THESE CRITICISMS.

The *Chamber Papers* purport to dispel numerous criticisms of arbitration's processes that we outlined in our 2007 report. Several of these criticisms – for example, that arbitration is largely conducted in secret, lacks meaningful appeal mechanisms, and strips individuals of their right to a jury trial – usually receive only passing reference in the academic literature because they are generally accepted. Part II of this paper demonstrates that Rutledge himself has acknowledged many of these criticisms in his previous scholarship. Allegations that arbitrators have incentives to favor businesses, that arbitration rules are often stacked against individuals, and that arbitrators freely stray from the law are more controversial and have been the subject of somewhat more academic research. Part II discusses this research as well.

A. Arbitrators and Arbitration Providers Have Incentives to Favor Businesses Over Individuals.

1. Individual Arbitrators Have Incentives to Favor Business.

The *Chamber Response* says that it is a "myth" that "arbitrators have financial incentives to favor firms that hire them."[136]

But Rutledge has acknowledged in previous writings that these incentives exist. In 2004, he wrote that "[t]hose [arbitrators] who may seek to develop reputations for being friendly to particular parties or particular industries may actually have incentives that cut against independence."[137] He also stated:

> [Arbitrators] may also develop reputations with particular types of parties. For example, an arbitrator may be perceived as 'industry friendly' in securities law disputes or being 'contractor friendly' in construction disputes. Through these activities designed to enhance their reputations, arbitrators generate business in the form of fees and, hopefully, future appointments.[138]

This previous view of Rutledge's finds support in anecdotal evidence, such as the notorious case of Harvard law professor Elizabeth Bartholet, who evidently was blacklisted by a NAF after she ruled for a consumer and against the credit card company in one case.[139] NAF removed Bartholet from subsequent cases, saying she had a "scheduling conflict," a claim she asserts is false.[140] Other arbitrators also have expressed concern that their rulings could affect future appointments. In the words of California

[136] *Chamber Response* at 3 (quoting *Arbitration Trap* at 7-8, 29).
[137] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 194.
[138] *Id.* at 165.
[139] Testimony of Elizabeth Bartholet before the Senate Judiciary Committee, July 23, 2008.
[140] *Id.*

arbitrator Richard Hodge, "You would have to be unconscious not to be aware that if you rule a certain way, you can compromise your future business."[141]

The view that individual arbitrators favor business parties also finds support in empirical studies. Several researchers have sought to answer whether "repeat players" – businesses trying multiple cases before the same arbitration firm, or before the same arbitrator – enjoy better success than first-timers. The *Chamber Response* states that such studies have yielded "mixed" results.[142] Researchers generally have found that businesses enjoy atypically favorable results in repeat-player scenarios, disagreeing for the most part only on how to explain this phenomenon.[143] For its part, *Whither* acknowledges the existence of a repeat-player "effect," arguing only that there is insufficient evidence that this advantage for business is caused by arbitrator bias.[144]

2. *Arbitration Firms Have Incentives to Favor Business.*

The incentives of *arbitration companies* are far more important than those of individual arbitrators. These companies have the strongest of incentives to favor business: Their very existence depends on whether businesses choose them.

The use of pre-dispute binding mandatory arbitration clauses enables a business to choose its arbitration firm (or to create the appearance of consumer choice by permitting consumers to select one of two firms chosen by the business). Professor Jean Sternlight aptly summarized the problem this creates:

> Arbitration organizations, such as the American Arbitration Association (AAA) and the National Arbitration Forum (NAF), are now competing to provide arbitration services for particular companies that require their consumers to arbitrate future disputes. Companies and providers often sign agreements to the effect that a particular company will be named as the provider in arbitration clauses involving certain kinds of disputes. Obviously, once an entity is named as the provider, financial benefits accrue to that provider.[145]

In short, binding mandatory arbitration creates market competition to favor business – which of course means disastrous results for other parties. This is nothing short of a market for injustice.

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[141] Eric Berkowitz, *Is Justice Served?* L.A. TIMES, Oct. 22, 2006.
[142] *Chamber Response* at 3.
[143] *See, e.g.*, Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223 (1998); Hill, 18 OHIO ST. J. DISP. RESOL. at 777.
[144] Rutledge, *Whither*, 6 GEO. J. L. PUB. POL'Y at 573 ("Empirical research has documented a repeat player effect but does not *necessarily* link that effect to any nonneutrality on the arbitrator's part.") (emphasis added).
[145] Jean Sternlight, *Creeping Mandatory Arbitration: Is It Just*, 57 STAN. L. REV. 1631, 1650 (2005).

3. Rutledge Agrees That the Way to Fix Unfairness in Arbitration Is to Align Market Incentives Properly, Not to Create New Arbitration Rules.

In another irony, Rutledge agrees that "if we accept the oft-heard premise that the arbitral system favors the industry," then "regulatory reforms" – meaning procedural fixes – "are unlikely to be an effective long-term solution" to unfairness in arbitration:[146]

> Basic economics suggests that, over time, both the industry and the agencies will adapt their behavior to the new legal regime, which is perhaps precisely why each new wave of reforms is met with academic criticism claiming that the reforms did not go far enough. Rather than simply imposing a rule on arbitrators and institutions in an effort to reach a desirable result, wouldn't it be better if we designed the market in a way to give the players an incentive to reach those results on their own?[147]

We could hardly agree more. We just think Rutledge's solution is complicated and unrealistic. He proposes stripping arbitrators and arbitration institutions of immunity from lawsuits,[148] and he apparently would hold them liable not just for intentional or reckless misconduct, but also for mistakes of law, under a negligence standard.[149] At first blush, negligence liability for legal errors seems harsh and unworkable. And this change in the legal regime would likely be extremely disruptive. It would require arbitration providers and users alike to determine their options and prices for contracting around the new liability and would send insurers scrambling to offer coverage for it.

There is a much simpler and more sensible solution: Rather than force arbitration on consumers and employees when they have a dispute with a company, give them a choice in the matter. This will require arbitration providers to compete to satisfy these individuals too – and not just businesses.

B. Arbitration Lacks Adequate Appeal Rights.

The *Chamber Response* calls it a "myth" that "only the rare appeal succeeds with high costs for consumers" in arbitration.[150] It argues that "[a] court may vacate (or refuse to confirm the award) on various grounds specified in Section 10 of the FAA along with various nonstatutory grounds, including manifest disregard of the law"[151] and that "[c]ourts can vacate awards (and have done so) when, among other things, there is

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[146] Rutledge, *Market Solutions*, 26 PACE L. REV. at 120.

[147] *Id. See also id.* at 116 ("Calls for reform rest on a basic premise – that securities arbitration is unfair because the system is "captured" by the industry. If we accept that premise, then regulatory reforms are unlikely to be an effective long-term solution. Such reforms may yield ephemeral results as arbitrators and broker-dealers need time to react to shifting norms. Over the long run, however, economic analysis suggests that they will simply adapt their behavior to the new legal regime and, eventually, new norms will develop that continue to give favored treatment to the repeat players, namely the industry.").

[148] *See generally* Rutledge, *Arbitral Immunity*, 39 GA. L. REV. 151; Rutledge, *Market Solutions*, 26 PACE L. REV. 113.

[149] Rutledge, *Market Solutions*, 26 PACE L. REV. at 130-31.

[150] *Chamber Response* at 4 (quoting *Arbitration Trap* at 9, 39).

[151] *Id.* at 29.

evidence that the arbitrators were not impartial."[152] But Rutledge's own past writings offer a starkly contrasting view.

1. Rutledge Has Argued That Judicial Review of Arbitrations Is "Inadequate."

Rutledge himself has argued that it is virtually impossible to obtain meaningful judicial review of an arbitration ruling. In 2005, for example, he wrote that "the grounds for vacatur are themselves extremely narrow, and the opportunity for judicial review of the award's substance virtually non-existent (apart from the toothless 'manifest disregard of the law' doctrine.)"[153]

Even in the rare cases in which a party manages to convince a judge to vacate an arbitration award, Rutledge has argued, this redress is "inadequate."[154] This is because, in Rutledge's words from 2004, "Vacatur does not provide the parties the return of costs that they bore as a result of the flawed institutional arbitration, nor does it compensate the parties for the lost time prior to the entry of an enforceable award."[155]

Finally, Rutledge wrote, "Even if the party convinces a court to vacate the award, the party must then return to arbitration to relitigate the matter at substantial expense, on top of the already substantial expense of bringing the vacatur action in court."[156]

We hardly could have said it better.

2. The Chamber Response *Touts a Standard of Review for Arbitrations That Rutledge Has Deemed "Toothless" and Illegitimate.*

In the *Chamber Response*, Rutledge writes that parties can seek dismissal of bad decisions based on "manifest disregard of the law."[157] But Rutledge has called this doctrine "toothless" or "practically toothless" multiple times, in articles published before and after the *Chamber Response*,[158] and he has advocated abolishing the doctrine:

> Court-based expansions of judicial review of arbitration awards suffer from a legitimacy problem. Apologists for the "manifest disregard of the law" standard

[152] *Id.* at 16.
[153] Rutledge, *Market Solutions*, 26 PACE L. REV. at 131-32.
[154] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 180 ("The argument that aggrieved parties can always seek vacatur of the award is an inadequate response."). *See also* Rutledge, *Market Solutions*, 26 PACE L. REV. at 123.
[155] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 180.
[156] *Id.* at 194.
[157] *Chamber Response* at 29.
[158] Rutledge, *Market Solutions*, 26 PACE L. REV. at 131 ("[T]he 'manifest disregard of the law' standard is toothless and, as a consequence, 'there is no meaningful review of arbitrator awards to assure arbitrators are applying the law.'"); *id.* at 131-32 ("'[T]he grounds for vacatur are themselves extremely narrow, and the opportunity for judicial review of the award's substance virtually non-existent (apart from the toothless 'manifest disregard of the law' doctrine.'"); Peter B. Rutledge, *Arbitration and Article III*, 61 VAND. L. REV. 1189, 1200 (2008) ("Whatever review of the merits exists is practically toothless."); *id.* at 1210 ("[A]t most, federal courts only review arbitral awards for manifest disregard of the law – a highly deferential, perhaps toothless, standard on which few awards have been set aside.").

> have sought to anchor it either in the text of the [Federal Arbitration Act] itself or in Supreme Court precedent. Contrary to their arguments, neither statute nor precedent supports a judicially created "manifest disregard of the law" standard.[159]

In addition, Rutledge's previous scholarship argued that the lack of a paper trail in arbitration is an obstacle to winning an appeal even when a legal basis exists:

> Unless required by the parties' agreement or the applicable institutional rules, arbitrators in the United States are not required to give reasons for their decision. This norm complicates application of the 'manifest disregard of the law' standard. As described above, the standard generally requires proof that the arbitrators consciously disregarded the applicable legal principle. Evidence of this conscious disregard, however, will be hard to come by in situations where arbitrators have not given reasons for their decisions.[160]

We must add a caveat to this narrative of unsuccessful arbitration appeals: In state courts, the narrative apparently applies more to employees than employers. University of Illinois professor Michael LeRoy, who reviewed court rulings on appeals of arbitration rulings from 1975 to 2005, found that state appeals courts upheld 87 percent of employers' arbitration victories but only 56 percent of employees' wins. The discrepancy was smaller in lower state courts, but the trend still held. They upheld 87 percent of employer wins compared to 78 percent of employee wins. There was no meaningful discrepancy in federal courts, which backed arbitration rulings 85 to 93 percent of the time, and showed no significant discrepancy between success rates of employees or employers.[161]

Thus, at least in the employment context, individuals who are forced into arbitration cannot even count on the one purported benefit of a system that provides few opportunities for successful appeal: the ability to rely on the finality of a favorable decision.

C. Arbitration Proceedings Are Shrouded in Excessive Secrecy.

The *Chamber Response* states that "parties to arbitration are not bound to any confidentiality obligation."[162]

This, too, is contradicted by Rutledge himself. He wrote in 2004, "Many arbitration rules and some arbitration laws specifically provide for the confidentiality of proceedings and, in addition, the confidentiality of any award."[163] The *Chamber Response*'s claims also flatly contradict direct evidence from arbitration firms and the businesses that use them. For example, the National Arbitration Forum's rules state: "Arbitration proceedings are

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[159] Peter B. Rutledge, *On the Importance of Institutions: Review of Arbitral Awards for Legal Errors*, 19 J. INT'L ARB. 81, 89 (2002). *See also id.* at 82 ("[C]ourts should not review arbitral awards for manifest disregard of the law.").
[160] *Id.* at 99-100.
[161] Joseph A. Slobodzian, *Arbitration Awards Studied*, HUMAN RESOURCES EXECUTIVE, May 28, 2008.
[162] *Chamber Response* at 15.
[163] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. 163.

confidential unless all Parties agree or the law requires arbitration information to be made public."[164] And researchers have found arbitration clauses that bar individuals from disclosing even the *existence* of a dispute without the consent of all parties.[165]

Rutledge also discussed the confidentiality of arbitration when describing the challenge of researching the backgrounds of arbitrators and arbitration firms:

> Acquiring information about arbitrators is costly, and parties may not have substantial resources to invest in learning about the reputations of arbitrators or arbitral institutions. Moreover, arbitrations often take place under the guise of confidentiality, so even assuming that a party were willing to undertake the investment, the party may be stymied in its efforts to learn much about an arbitrator's or an institution's reputation.[166]

The *Chamber Response* proposes that two factors mitigate the secrecy of arbitration: First, arbitration is "potentially subject to public scrutiny"[167] at its start and finish. This is because "a party resisting arbitration can refuse to commence proceedings, thereby forcing the other party to seek an order compelling arbitration" and because "the losing party in the arbitration can resist enforcement of the award, either by bringing an action to vacate the award or forcing the prevailing party to file a petition to confirm the award."[168]

This argument inadvertently highlights that arbitration can encourage more, not fewer, court proceedings. The Chamber contemplates that parties will litigate, then arbitrate, then litigate again – hardly a model of efficiency or cost-saving.

But the Chamber's argument is also wrong. Litigation over the enforceability of an arbitration provision in a contract or the enforceability of an arbitration rarely focuses on the merits of a dispute. Instead, it focuses on separate issues such as the validity of the contract or whether arbitrators abused their authority. Therefore, it need not address, much less reveal, many of the facts or legal issues in the underlying dispute.

Second, the *Response* argues that the "indicia of secrecy" cited by critics of arbitration "can likewise occur in our civil justice system. For example, information may be subject to a protective order, prohibiting its public dissemination."[169] Thus, "the confidentiality about which Public Citizen complains is not unique to arbitration."[170]

This argument fails because, as Rutledge himself has recognized, court proceedings are usually public, while arbitration proceedings are usually private. In noting that many arbitration rules call for proceedings and awards to remain confidential, Rutledge wrote,

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[164] National Arbitration Forum Code of Proc. Rule 4.
[165] Demaine & Hensler, 67 L. & CONTEMP. PROBS. 69.
[166] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 195.
[167] *Chamber Response* at 15.
[168] *Id.* at 15-16.
[169] *Id.* at 16.
[170] *Id.* at 17.

"By contrast, parties cannot guarantee that judicial proceedings will remain confidential, and the court's opinion almost certainly will become public."[171]

Finally, although the Chamber Institute funded and published Rutledge's report calling it a "myth" that "arbitration proceedings are secret"[172] and claiming that "parties to arbitration are not bound to any confidentiality obligation,"[173] the Institute's own website contradicts these statements. It states: "The outcome [of arbitration] is made public only if the parties want it to be."[174]

D. The Rules of Arbitrations Protect Businesses More than Individuals.

The *Chamber Response* repeatedly attempts to deflect criticism of unfair practices in arbitration by arguing that consumers are protected by "arbitral rules."[175] According to the *Chamber Response*, these rules entitle individuals to written opinions, restrict the share of costs that can be imposed on individuals, and guarantee that arbitration does not restrict available remedies.

But aside from SEC oversight of securities arbitrations, nothing requires any arbitration provider to establish rules to protect individuals. And many arbitration clauses include rules stacked against individuals.

Kansas University law professor Christopher R. Drahozal studied 34 arbitration clauses governing franchise contracts and found a trend of franchisors permitting themselves to pursue cases in court while foreclosing that option for franchisees. For example, some claims or remedies were excluded from arbitration in 32 of 34 cases (94 percent), "either categorically or at the option (almost always) of the franchisor."[176] One clause granted the franchisor the right to choose arbitration or litigation for any claim,[177] and two permitted the franchisee to opt for court but only if the franchisee expressly waived "the right to a trial by jury and any and all claim(s) for punitive, multiple, exemplary and/or consequential damages."[178]

Demaine and Hensler's study of 52 arbitration clauses is illuminating and worth quoting at length. Although the researchers found arbitration terms that "suggest *prima facie* that businesses are placing consumers on equal footing with themselves," a "closer look at the clauses sampled" gave them several "grounds for concern":[179]

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[171] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 163.
[172] *Chamber Response* at 3 (quoting *Arbitration Trap* at 7, 28).
[173] *Id.* at 15.
[174] Website of the Institute for Legal Reform, http://www.instituteforlegalreform.com/issues/issuedetail.cfm?issue=ADR.
[175] *See Chamber Response* at 3-4, 7, 15, 16, 22, 27.
[176] Christopher R. Drahozal, *'Unfair' Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 739 (2001).
[177] *Id.*
[178] *Id.* at 740.
[179] Demaine & Hensler 67 L. & CONTEMP. PROBS. at 72.

> For example, if consumers challenge business practices, limitations on discovery will disadvantage them more than the business, as the businesses will hold most of the relevant information. If filing, administrative, and hearing fees add significantly to transactions costs, this burden will fall disproportionately on the (ordinarily less financially able) consumer, even when such fees are split equally. Class actions, which are almost always exclusively used by consumers against businesses, are often precluded. The nature of interim relief provided for is more suited to the business than the consumer. And the types of claims exempted from arbitration tend to be those brought by businesses against consumers. *In sum, the appearance of a level playing field between the parties may be deceptive*.[180]

> Moreover, this study provides little basis for believing that consumers are making informed decisions when they "agree" to arbitrate in predispute arbitration clauses. More than a third of the clauses obtained fail to inform consumers that they are waiving their right to litigate disputes in court. A fifth of the clauses do not explicitly state that the outcome of arbitration is final and binding. More than a third do not provide consumers with any information regarding the expenses they should expect to incur in an arbitration proceeding. Many clauses are silent on key aspects of arbitration, such as arbitrator qualifications and selection or the rules of discovery and evidence. And almost a third of clauses fail to state what organization will provide the arbitration. Moreover, to be fully informed of the features of the arbitration to which they are "agreeing," consumers would need to review the applicable provider rules, a daunting task (made impossible when the arbitration provider is not named in the clause).[181]

Rutledge's characterization of this discussion in the *Chamber Response* is perhaps just as illuminating as the discussion itself – not about arbitration, but about the business lobby's selective use of the "empirical evidence." Rutledge characterizes Demaine and Hensler's article as follows:

> While recognizing that further research was necessary, *they concluded that* "[f]ew of the fifty-two clauses reflect the type of egregious self dealing that has been identified in publicized cases. Most of the clauses appear in many respects to put the consumer on equal terms with the businesses that drafted them . . . ."[182]

The *Response* neglects to discuss any portion of the next two paragraphs of Demaine and Hensler's article, quoted above, which detail serious concerns about the fairness of arbitration clauses. And the *Response* ignores Demaine and Hensler's last words – the conclusion of their conclusion, as it were:

> The prevalence of arbitration rules that subtly or more strongly tilt the playing field in the business's favor provides grounds for concern about how consumers

[180] *Id.* at 72-73 (emphasis added).
[181] *Id.* at 73.
[182] *Chamber Response* at 8 (emphasis added; ellipses in original). *See also* Testimony of Peter B. Rutledge before the Senate Judiciary Committee, Subcommittee on the Constitution, Dec. 12, 2007 ("This led the authors to conclude that 'few of the 52 clauses reflect the type of egregious self-dealing that has been identified in publicized cases. Most of the clauses appear in many respects to put consumers on equal terms with the businesses that drafted them . . . .'").

> actually fare in arbitration. In summary, the evidence to date suggests that there is little reason to believe consumer arbitration is – in the conjecture of the [Supreme] Court – only another forum.[183]

E. Arbitrators Are Not Required to Follow the Law, or Even Their Own Rules.

The *Chamber Response* asserts that Public Citizen's complaint about limitations on individuals' rights to appeal in arbitration "rests on the misplaced assumption that arbitrators somehow do not follow the governing law,"[184] and it labels a "myth" the statement that "while arbitration firms make the rules, they do not always follow them."[185]

1. Rutledge Voiced Public Citizen's View in Prior Writings.

In a 2004 paper, Rutledge himself agreed with our view that arbitrators are *not* required to follow the law, stating, "Arbitrators do not have to follow precedent. Arbitrators also are not bound by the same rules of evidence and procedure as courts. Often there is no transcript, and arbitrators are not obligated to provide detailed findings of fact and conclusion of law in their awards."[186]

Rutledge proposes that the law should permit individuals to sue arbitrators – in real courts, no less – to provide "a greater incentive for arbitrators and arbitral institutions to ensure that they observe the governing law and rules."[187] He explains that "the current regime of legal immunity protects arbitrators and arbitral institutions even when they have violated their own rules (and a surprising number of reported opinions raise this problem)."[188]

2. Other Research Supports Public Citizen's View as Well.

Other research also supports the view that arbitrators are not required to follow the law. For example, Pace University law professors Barbara Black and Jill Gross in 2001 studied arbitrators' adherence to the law in securities cases. Although they speculated that arbitrators' deviations from the law might at times help individuals, they left no doubt that that the practice is common:

> Little attention has been paid to the issue of whether, as a result of *McMahon*, arbitrators, in fact, do apply the law to decide disputes. While the Supreme Court assumed that arbitrators could and did apply the law, there is now considerable evidence that they do not.
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[183] Demaine & Hensler, 67 L. & CONTEMP. PROBS. at 74.
[184] *Chamber Response* at 29.
[185] *Id.* at 5 (quoting *Arbitration Trap* at 41).
[186] Rutledge, *Arbitral Immunity*, 39 GA. L. REV. at 167.
[187] Rutledge, *Market Solutions*, 26 PACE L. REV. at 125.
[188] *Id.* at 125.

> Indeed, in recent years it has become evident that there are areas where the "law is clear," but arbitrators are regularly arriving at results that appear contrary to the law.[189]

F. Arbitration Limits the Remedies Available to Claimants.

The *Chamber Response* contends that "[a] variety of rules entitle claimants [in arbitration] to the same panoply of remedies available to them in civil litigation."[190]

But no rules, much less a "variety of rules," require arbitration firms to provide particular types of remedies. The firms set their own rules. Moreover, even if an arbitration institution's guidelines make available all remedies that an individual could receive in court, businesses often limit these remedies in the customized arbitration clauses they insert in contracts.

For example, the *Chamber Response* touts a rule in AAA's protocol that says "[t]he arbitrator should be empowered to grant whatever relief would be available in court under law or in equity."[191] But Drahozal's study of 34 franchise arbitration clauses found that, although "virtually all" the clauses required arbitrations to be administered by AAA, 74 percent "sought to preclude recovery of punitive damages."[192]

Aside from prohibiting awards of punitive damages, some arbitration clauses limit compensatory awards. Demaine and Hensler found four clauses that "explicitly limit consumers' substantive rights by placing limits on damages."[193] One tour operator's contract limited damages to just $500.[194] Drahozal found that the franchise agreement of the Doctor's Associates Inc., which licenses Subway sandwich shops, placed an $80,000 cap on "total liability for Disputes."[195]

G. Many Arbitration Clauses Prohibit Class Actions, Which Harms Consumers by Blocking the Only Realistic Avenue for Bringing Many Small Claims.

The *Chamber Response* calls it a myth that "arbitration agreements typically prohibit class action lawsuits."[196] Aside from this statement, however, the *Response* fails to include any argument actually contesting the allegation.

Instead the *Chamber Response* advances several irrelevant and unsupported arguments. It argues that most consumer and employment disputes "would not qualify for class

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[189] Black & Gross, 23 CARDOZO L. REV. at 991.
[190] *Chamber Response* at 28.
[191] *Id.*
[192] Drahozal, 2001 U. ILL. L. REV. at 737.
[193] Demaine & Hensler 67 L. & CONTEMP. PROBS. at 71.
[194] *Id.* at 71.
[195] Drahozal, 2001 U. ILL. L. REV. at 738-39.
[196] *Chamber Response* at 5 (quoting *Arbitration Trap* at 3, 49).

treatment anyway."[197] Setting aside the validity of this sweeping and unsupported assertion, it offers no help to individuals whose claims would in fact "qualify for class treatment." The *Chamber Response* also advances a weak argument against the value of class actions, stating that "it is far from clear that class actions substantially benefit the individual consumer."[198] And it offers that courts sometimes "regulate the enforceability of class action waivers,"[199] which we take as an oblique acknowledgement that some courts have invalidated class action bans as violating fundamental state public policy.[200] None of these arguments has anything to do with the frequency of class action bans in arbitration provisions.

Moreover, Rutledge has indicated at least implicitly that there is a significant relationship between class action bans and arbitration provisions. He recently wrote that if the Arbitration Fairness Act became law, plaintiffs' lawyers "would unquestionably find it far easier to bring certain class action lawsuits in court."[201] Similarly, he told the *Legal Times* that eliminating pre-dispute binding mandatory arbitration would burden court dockets by smoothing the path for class actions.[202]

And in both *Whither* and the *Chamber Response*, Rutledge rightly hedges against the argument that class actions do not benefit individuals, which he advances only tepidly in the first place.[203] He admits that the argument "presupposes that class actions serve as [sic] compensatory purpose" and that, "[t]o the extent class actions serve a deterrent purpose, this argument loses some force."[204]

Finally, the *Chamber Response* argues that arbitrations involving consumer defendants are irrelevant to the dispute over class action bans because, "as defendants in any litigation, [these consumers] would not be entitled to class treatment anyway."[205] This argument is mistaken because many consumer defendants might have class-worthy claims against their creditors under, for example, state consumer-protection or federal lending and debt-collection laws. And it is possible that the consumers' inability to bring those claims is precisely what leaves them with no option but to play defense, alone, in a forum firm picked by the creditor, with little chance of defeating meritless claims against them.

Moreover, given reports that NAF awards typically add legal fees of 15 percent to 20 percent of debts owed and that NAF processes many arbitrations with extreme haste,

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[197] *Id.*
[198] *Id. See also id.* at 25. The Chamber does not explain what it means by the phrase "substantially benefit."
[199] *Chamber Response* at 25-26.
[200] *See, e.g.*, *Scott v. Cingular Wireless*, 160 Wash. 2d 843, 161 P.3d 1000 (2007).
[201] Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against The Arbitration Fairness Act*, 9 CARDOZO J. CONFLICT RESOL. 267, 268 (2008).
[202] *Arbitration Goes to the Mat*, BLOG OF THE LEGAL TIMES (April 2, 2008).
[203] *See, e.g.*, *Chamber Response* at 25 (arguing merely that "research on class actions calls . . . into question" whether class actions "necessarily are a better deal for the consumer").
[204] *Whither*, 6 GEO. J. L. PUB. POL'Y at 572 n.116. *See also Chamber Response* at 25 n.80.
[205] *Chamber Response* at 25.

requiring little effort on the part of corporate claimants,[206] consumers might have class claims against creditors or NAF for charging unjust or falsely inflated legal fees.

H. Arbitrations Harms Consumers by Limiting Access to Jury Trials.

The *Chamber Response* argues it is a "myth" that "the constitutional right to a jury trial . . . suffer[s]" under binding mandatory arbitration.[207] This claim appears to hinge on the definition of "suffer," for Rutledge has acknowledged that participants in arbitration lose the right to a jury trial. He wrote in Senate testimony that "as to the waiver of the right to a jury trial, it is certainly true that arbitration does not involve a jury."[208]

Similar to its argument on class action bans, the *Chamber Response* answers not by disputing whether binding mandatory arbitration strips people of the right to jury trial, but instead by arguing that this right has little value. The *Response* cites the "reality of our civil justice system . . . that, even without arbitration, in most instances a jury never hears the case."[209]

But the right to a jury trial can play a significant role even in cases that never go before a jury. This is of course because the threat of a jury trial can give individuals leverage against corporations in settlement discussions.

Moreover, actual arbitration provisions belie the *Chamber Response*'s disparagement of the significance of jury trials. Several arbitration agreements reviewed by Public Citizen deprive customers of the right to jury trial even if a future dispute should find its way into court. For example, a Verizon Wireless contract states, "Further, if for any reason a claim proceeds in court rather than through arbitration, we each waive any trial by jury."[210] There would be little reason for companies to strip consumers of the right to jury trial if that right did not benefit consumers in litigation against the companies.

Finally, the Chamber Institute itself recently published a survey in which corporate lawyers were asked to list their top complaints about the judicial system, and five of the top 15 issues concerned juries.[211]

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[206] Robert Berner & Brian Grow, *Banks vs. Consumers (Guess Who Wins?)*, BUSINESS WEEK, (June 5, 2008).
[207] *Chamber Response* at 3 (quoting *Arbitration Trap* at 7, 38).
[208] Testimony of Professor Peter B. Rutledge before the Senate Judiciary Committee, Subcommittee on the Constitution, Dec. 12, 2007.
[209] *Chamber Response* at 24.
[210] Customer Agreement Terms & Conditions Your Verizon Wireless Customer Agreement (on file with Public Citizen).
[211] U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, LAWSUIT CLIMATE 2007: RATING THE STATES 10.

I. Arbitration Makes It Harder, Not Easier for Individuals to Find Counsel, and Some Evidence Suggests That Consumers Do Not Represent Themselves Adequately in Arbitration.

The *Chamber Response* argues that arbitration benefits individuals because, "By streamlining the dispute resolution process and reducing the costs associated with it, arbitration makes it easier for individuals to find an attorney willing to take their case or, alternatively, to represent themselves."[212] The data contradict these claims.

1. Consumers Subject to Binding Mandatory Arbitration Have More Difficulty Finding Counsel, Not Less.

The argument that arbitration makes it easier for individuals to obtain a lawyer flows largely from an unscientific survey of employment lawyers in an unpublished, 1995 Ph.D. dissertation by William M. Howard.[213] And that survey supports the opposite conclusion.

Howard's dissertation reported that lawyers responding to his survey required average provable damages of $61,000 to pursue an employment case in court. Myriad arbitration studies have cited Howard's findings to argue that high court costs lock out people of modest means.[214] But these proponents – including Rutledge and the Chamber – invariably neglect to mention a key detail: Survey respondents reported requiring *higher* provable damages on average – $65,000 – to take an arbitration case.[215] Additionally, the survey found that attorneys

- were more likely to require at least some minimum damages for arbitration cases (90 percent) than court cases (78 percent);

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[212] *Chamber Response* at 6.

[213] Howard, *Can Justice be Served*, at 150. Howard's dissertation was later summarized in Howard, *Employment Discrimination*, 50 DISP. RESOL. J. 40.

[214] *See* Eisenberg & Hill, 58 DISP. RESOL. J. at 45 ("lower-paid employees seem to lack ready access to court, as other researchers have reported."); *id.* n.15 (citing Howard, *Employment Discrimination*, 50 DISP. RESOL. J. at 45); Hill, 18 OHIO ST. J. DISP. RESOL. at 782-83 ("A recent survey by William Howard of plaintiff's lawyers' standards for accepting employment discrimination cases shows that it is probable that only highly-compensated employees pursue employment discrimination claims in court."); *id.* n.21 (citing Howard 50 DISP. RESOL. J. at 43-44); David Sherwyn, Samuel Estreicher & Michael Heise, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1574 (2005) ("Similarly, Maltby reports a 1995 study of plaintiffs' lawyers that found that lawyers would not take a case unless the employee had at least $60,000 in back pay damages."); *id.* n.91 (citing Lewis L. Maltby, *Out of the Frying Pan, into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 317 (2003) (citing Howard, *Employment Discrimination*, 50 DISP. RESOL. J. at 40, 44)); Maltby, *Employment Arbitration*, 38 U.S.F. L. REV. at 106-07 ("In order for a member of the private bar to accept a civil case against an employer, there must be provable economic damages (not including punitive damages) of at least $75,000."); *id.* n.1 (citing Howard, *Employment Discrimination*, 50 DISP. RESOL. J. at 40, 44); *id.* ("Howard's data from 1995 showed a minimum level of provable damages of $60,000. Lewis Maltby estimated this figure to have increased to at least $75,000.").

[215] Howard, *Can Justice be Served*, at 150. The median minimum-damages requirement was $50,000 in each forum. *Id.*

- were more likely to require retainers for arbitration cases (90 percent) than court cases (77 percent), although the average retainer was higher for court;[216] and

- required slightly higher contingent fees for arbitration cases (36 percent) than for court cases (35 percent).[217]

Howard's survey respondents also reported that they passed up 95 percent of potential cases,[218] a figure arbitration proponents have used to argue that court is too expensive for all but the highest dollar cases. But proponents fail to inform their audience that the most frequently cited reason for rejecting a claim, listed by 84 percent of respondents, was that there was "no provable case."[219] This problem of course prevents lawyers from taking cases regardless of whether they are headed to arbitration or court. Another factor equally relevant to arbitration and court, "Unable to pay retainer," was cited by 24 percent of respondents. "Inadequate damages" was cited by only 18 percent.[220]

Colvin offered the opposite view from those who argue arbitration makes it easier to obtain a lawyer for an arbitration case. He speculated that the lower average awards in arbitration could make the challenge more difficult than for court cases: "The differences in mean outcomes between arbitration and litigation discussed above are likely to have a major impact on the ability of employees to obtain representation by counsel."[221]

2. *Although Little Empirical Data Exists, Some Evidence Suggests That Individuals Are Harmed by the Lack of Counsel in Arbitration.*

In his recent review of 836 AAA-administered employment arbitrations, Colvin found that employees with counsel enjoyed a success rate 65 percent higher than that of self-represented employees (22.6 percent to 13.7 percent). Average awards for employees with counsel were more than double those for self-represented employees ($28,009 to $13,222).[222] However, as Colvin suggests, it could be that the unrepresented plaintiffs could not secure counsel because they had weak cases, in which case their lower win rate is appropriate.[223]

But another of Colvin's comparisons gives stronger reason to believe that having counsel is critical. Colvin reports that represented employees won 23.4 percent of cases in which

[216] The average retainer was $3,600 for court and $3,000 for arbitration, while the medians were $3,000 and $2,000, respectively. *See id.*
[217] *Id.* at 150.
[218] *Id.* at 151.
[219] *Id.* at 152
[220] *Id.* at 150.
[221] Colvin, 11 EMPLOYEE RTS. & EMPLOYMENT POL.'Y J. at 432-3.
[222] *Id.* at 433.
[223] Somewhat similarly, Elizabeth Hill found that pro se and represented employees had comparable win rates, but that the unrepresented claimants were less likely to receive monetary relief. *See* Hill, 18 OHIO ST. J. DISP. RESOL. at 820. Of course, it could be that the unrepresented claimants had no counsel precisely because they were likely only to win equitable rather than monetary relief and could have paid attorneys only through contingency fees.

the employer appeared for the first time before a particular arbitrator (*i.e.*, not a "repeat" arbitrator), while winning 17.3 percent in cases before repeat arbitrators. This difference was not statistically significant. Self-represented employees, however, won 16.3 percent of cases before non-repeat arbitrators and only *2.0 percent* (1 win in 49 cases) before repeat arbitrators. Colvin found the latter win rate "strikingly low," noting that it "raises particular concerns about the danger of repeat player bias for the more vulnerable employee who does not have representation by counsel."[224]

J. Arbitration Reduces Individuals' Ability to Obtain Relevant Evidence.

The *Chamber Response* labels as a "myth" the assertion that "parties have reduced discovery rights" in arbitration."[225] But arbitration firms themselves *advertise* that they limit discovery – and the Chamber itself has touted this feature of arbitration.

The National Arbitration Forum has promised clients: "Little discovery. Very little, if any, discovery and pre-hearing maneuvering."[226] The Chamber Institute for Legal Reform's website states: "Time consuming and expensive pre-trial discovery is avoided."[227]

Indeed, the *Chamber Response* scarcely defends its assertion that arbitration does not limit discovery. The strongest claim it makes is that "arbitration clauses virtually never *preclude* discovery, and all the major arbitral associations entitle the parties to *some degree* of discovery."[228] Elsewhere, the *Chamber Response* cites a finding "that only about five percent [of arbitration clauses] affirmatively barred discovery."[229] The *Response* neglects to inform readers that those same researchers concluded that 54 percent of arbitration clauses discussed discovery or evidentiary standards, in most instances to "alert consumers that discovery may be limited and evidentiary standards may be relaxed by comparison to litigation."[230]

K. Arbitration Is Often More Expensive than Court for Individuals.

There is little doubt that the costs of pursuing a case in arbitration (excluding attorney's fess) are typically higher for individuals than those to pursue a case in court unless lenient arbitrators shift costs to the business party.

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[224] Colvin, 11 EMPLOYEE RTS. & EMPLOYMENT POL.'Y J. at 434.
[225] *Chamber Response* at 4.
[226] National Arbitration Forum document soliciting business, submitted under subpoena in *Toppings v. Meritech Mortgage Inc.*, 569 S.E.2d 149 (W. Va. 2002) (on file with Public Citizen). In addition, NAF director Roger Haydock has written that "discovery is limited" in arbitration. Roger S. Haydock, *Civil Justice and Dispute Resolution in the Twenty-First Century: Mediation and Arbitration Now and for the Future*, 27 WM. MITCHELL L. REV. 745, 765 (2000). *See also* Roger S. Haydock, *The Supreme Court Creates Real Civil Justice Reform*, 11/01 METRO. CORP. COUNS. 45 (2001) ("In arbitration . . . the discovery process is limited . . . .").
[227] Website of the Institute for Legal Reform, http:///www.instituteforlegalreform.com/issues/issuedetail.cfm?issue=ADR.
[228] *Chamber Response* at 4 (emphasis added).
[229] *Id.* at 26.
[230] Demaine & Hensler, 67 L. & CONTEMP. PROBS. 68.

At times, arbitration fees are dramatically higher than court costs and undoubtedly hinder individuals' ability to pursue cases. Indeed, arbitration firms sometimes use "loser pays" rules, which effectively threaten individuals with thousands of dollars of liability if their case is unsuccessful.[231]

Public Citizen's 2007 report on NAF arbitrations showed that an individual seeking damages of $50,000 to $74,999 would face $1,730 in initial costs to pursue a case. This compared with average costs of less than $200 for three state courts (Maryland, Michigan and California) and $350 in federal court. But initial filing fees were just the beginning. The cost of a participatory hearing session would be $950, and requesting written findings on an award would run another $1,500.[232]

These fees appear to serve two functions: discouraging individuals from pursuing cases and enriching arbitration firms. A National Arbitration Forum financial a statement showed that it had income in 2006 of $10.7 million on revenue of $39.4 million – a 27 percent profit margin on top of the fees received by arbitrators.[233]

The *Chamber Response* attempts to minimize the cost issue by arguing that overall costs of arbitration – including attorney's fees – are lower "at the end of the day" compared to costs of proceeding in court.[234] But advocates for arbitration argue that it enables individuals to cut legal fees by representing themselves – a perilous endeavor.[235] Also, other costs of arbitration can be prohibitively high on their own. For example, Public Citizen examined two cases homeowners brought against a termite company. One case was adjudicated in court, the other in arbitration. Both homeowners received substantial awards ($435,000 in court; $431,000 in arbitration). But while court fees totaled only $600, arbitration costs were $42,000 – and half of that fee was assessed to the victorious homeowner.[236]

Second, the *Chamber Response* argues that arbitrators have the discretion to assess costs to the business party and that costs assessed to individuals are usually modest: "In contrast to civil litigation, arbitration also affords arbitrators greater discretion to shift fees and costs to the business litigant."[237] Of course, the greatest difference in arbitrators' discretion is their freedom to shift fees to the individual consumer or employee in any case – something a court would do only as a sanction for severe misconduct.

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[231] National Arbitration Forum document soliciting business, submitted under subpoena in *Toppings v. Meritech Mortgage Inc.*, 569 S.E.2d 149 (W. Va. 2002) ("Loser pays. Prevailing party may be awarded costs.") (on file with Public Citizen).
[232] *Arbitration Trap* at 36.
[233] National Arbitration Forum, *Statements of Cash Flows Years ended Dec. 31, 2006 and 2005* (on file with Public Citizen).
[234] *Chamber Response* at 22.
[235] *See, e.g.*, Colvin, 11 EMPLOYEE RTS. & EMPLOYMENT POL'Y J. at 434. ("Among self-represented employees, the employees won only one out of forty-nine cases (a 2.0 percent win rate) where there was a repeat employer-arbitrator pairing.").
[236] Laura MacCleery, Testimony before the House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, Oct. 25, 2007.
[237] *Chamber Response* at 23.

The *Response* takes issue with Public Citizen's report of the National Arbitration Forum shifting costs to individuals by arguing "the actual research suggests that, generally, when arbitrators shift fees, they generally do so for the benefit of the individual."[238] But the "actual research" cited in the *Response* consists of one study that reviewed employment cases administered by the American Arbitration Association.[239] The findings of that study would provide little reassurance to someone forced to arbitrate under a different firm. A system in which the rules require individuals to pay steep fees but grant arbitrators discretion to shift or relax the fees – and also grant arbitrators discretion to saddle individuals with even higher costs – can hardly be viewed as better than court, which does not require steep fees in the first place and does not threaten ordinary individuals with the possibility of paying for their opponents' corporate lawyers.

Third, the *Chamber Response* cites the possibility of protection from courts. "Section 2 of the Federal Arbitration Act, as construed by the Supreme Court, helps to ensure that a particular arbitration clause cannot impose costs that place arbitration beyond an individual's ability to pay."[240] But the Supreme Court has held that individuals bear the burden of proving this inability to pay in court – a result that even *Whither* deems "debatable"[241] and deems a potential issue for reform.[242] It is unclear how individuals who cannot afford arbitration will find the money to prove in court that they cannot afford arbitration.

Whither also provides a telling acknowledgement of the significance in administrative fees in arbitration cases. It states: "Additionally, depending on the arbitral forum, fees may depend on the amount in controversy (unlike American litigation, which does not vary fees with amount demanded), giving lawyers an incentive to claim lower damages in arbitration relative to litigation."[243] If fees were truly insubstantial in relation to the overall costs of a case, they would not influence the amount a claimant requests – particularly in a system such as NAF's, which specifies that arbitrators may not award more than the request.[244]

L. Banning Pre-Dispute Binding Mandatory Arbitration Would Not End All Arbitrations.

Finally, *Whither* argues that banning pre-dispute binding mandatory arbitration would effectively end the use of arbitration as a method for resolving disputes because one party will invariably choose to litigate in court after a dispute arises. In the employment

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[238] *Id.*
[239] *Id.* (citing Hill, 18 OHIO ST. J. DISP. RESOL. at 777).
[240] *Id.* at 24.
[241] *Whither*, 6 GEO. J. L. PUB. POL'Y at 569; *see also id.* ("*Green Tree*'s holding on that point has been the subject of some academic criticism.").
[242] *Id.* at 590.
[243] *Id.* at 560.
[244] National Arbitration Forum Code of Proc. Rule 37B ("An Award shall not exceed the money or relief requested in a Claim or amended Claim and any amount awarded under Rule 37C."); Rule 37C (providing for the award of fees and costs).

context, for example, employees with higher-stakes claims would choose court, where there are "higher mean recoveries."[245] And in lower stakes cases, if one accepts the argument that pursuing a case in court is more expensive, then the "employer may be *less* likely to agree to arbitration precisely because it knows that its holdout will effectively prevent the employee from pursuing her claim."[246]

The claim that post-dispute arbitration is not viable is severely undercut by surveys touted in the *Chamber Papers* themselves. The *Papers* cite three surveys of lawyers or consumers that report favorable attitudes toward voluntary, post-dispute arbitration, belying the Chamber's claim that no one would choose arbitration if offered voluntarily.

To the contrary, making arbitration voluntary is the only way to ensure that arbitration providers offer something that individuals *would* choose.

[245] *Id.* at 586.
[246] *Id.* (emphasis in original).

APPENDIX

A STUDY IN CONTRADICTION: A REVIEW OF PROFESSOR RUTLEDGE'S STATEMENTS ON ARBITRATION

On Whether Arbitrators Have Financial Incentives to Favor Businesses (Part I)

Rutledge	Rutledge
It is a "myth" that "[a]rbitrators have financial incentives to favor firms that hire them." – Peter B. Rutledge, *Chamber Response* at 3.	"[Arbitrators] may also develop reputations with particular types of parties. For example, an arbitrator may be perceived as 'industry friendly' in securities law disputes or being 'contractor friendly' in construction disputes. Through these activities designed to enhance their reputations, arbitrators generate business in the form of fees and, hopefully, future appointments." – Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 165 (2004).

On Whether Arbitrators Have Financial Incentives to Favor Businesses (Part II)

Rutledge	Rutledge
"Public Citizen study ignores the academic research finding that, to the extent that a repeat player phenomenon exists, it has nothing to do with the arbitrator's incentives at all and instead is most likely attributable to a business's settlement behavior." – Peter B. Rutledge, *Chamber Response* at 21.	Arbitrators "who may seek to develop reputations for being friendly to particular parties or particular industries may actually have incentives that cut against independence." – Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 194 (2004).

On Whether Arbitration Provides Sufficient Appeal Provisions (Part I)

Rutledge	Rutledge
"Parties to arbitration do have the right to appeal an award. A court may vacate (or refuse to confirm the award) on various grounds specified in Section 10 of the FAA along with various nonstatutory grounds, including manifest disregard of the law." – Peter B. Rutledge, *Chamber Response* at 29.	"[T]he grounds for vacatur are themselves extremely narrow, and the opportunity for judicial review of the award's substance virtually non-existent (apart from the toothless 'manifest disregard of the law' doctrine)." – Peter B. Rutledge, *Market Solutions to Market Problems: Re-examining Arbitral Immunity as a Solution to Unfairness in Securities Arbitration*, 26 PACE L. REV. 113, 131-32 (2005)

On Whether Arbitration Provides Sufficient Appeal Provisions (Part II)

Rutledge	Rutledge
"To the extent those [protections] are inadequate, judicial review of the award fills the gap. Courts can vacate awards (and have done so) when, among other things, there is evidence that the arbitrators were not impartial." – Peter B. Rutledge, *Chamber Response* at 16.	"The argument that aggrieved parties can always seek vacatur of the award is an inadequate response. Vacatur does not provide the parties the return of costs that they bore as a result of the flawed institutional arbitration, nor does it compensate the parties for the lost time prior to the entry of an enforceable award." – Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 180 (2004).

On Whether Arbitration Is Confidential

Rutledge	Rutledge
"Parties to arbitration are not bound to any confidentiality obligation." – Peter B. Rutledge, *Chamber Response* at 15.	"Many arbitration rules and some arbitration laws specifically provide for the confidentiality of proceedings and, in addition, the confidentiality of any award." – Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 163 (2004).

On Whether Court Is Less Confidential than Arbitration

Rutledge	Rutledge
"Public Citizen ignores the fact that many of the indicia of secrecy about which it complains [in arbitration] can likewise occur in our civil justice system. For example, information may be subject to a protective order, prohibiting its public dissemination. Certain judicial proceedings may be nonpublic, either by nature of the court's jurisdiction or based on the judge's decision in a given case. Judges may not always give reasons for their rulings, instead entering a minute order or ruling from the bench. Juries likewise may render verdicts without giving reasons for their decision, particularly when they are using a general verdict form. Thus, the confidentiality about which Public Citizen complains is not unique to arbitration." – Peter B. Rutledge, *Chamber Response* at 15.	"By contrast [to arbitration], parties cannot guarantee that judicial proceedings will remain confidential, and the court's opinion almost certainly will become public." – Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 163 (2004).

On Whether Individuals Can Reasonably Research the Background of Arbitrators and Arbitration Firms

Rutledge	Rutledge
"To the extent individuals may not know the details of the particular candidates for nomination as arbitrator, they or their lawyers can investigate (just as they do with a judge)." – Peter B. Rutledge, *Chamber Response* at 16	"Acquiring information about arbitrators is costly, and parties may not have substantial resources to invest in learning about the reputations of arbitrators or arbitral institutions. Moreover, arbitrations often take place under the guise of confidentiality, so even assuming that a party were willing to undertake the investment, the party may be stymied in its efforts to learn much about an arbitrator's or an institution's reputation." – Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 195 (2004).

On Whether Arbitrators Adhere to the Law and Governing Principles

Rutledge	Rutledge
"[Public Citizen's] complaint rests on the misplaced assumption that arbitrators somehow do not follow the governing law." – Peter B. Rutledge, *Chamber Response* at 29	"Arbitrators do not have to follow precedent. Arbitrators are not bound by the same rules of evidence and procedure as courts. Often there is no transcript, and arbitrators are not obligated to provide detailed findings of fact and conclusion of law in their awards." – Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 167 (2004). "The current regime of legal immunity protects arbitrators and arbitral institutions even when they have violated their own rules (and a surprising number of reported opinions raise this problem)." – Peter B. Rutledge, *Market Solutions to Market Problems: Re-examining Arbitral Immunity as a Solution to Unfairness in Securities Arbitration*, 26 PACE L. REV. 113,125 (2005)

On the Importance of Class Action Bans in Pre-Dispute Arbitration Clauses

Rutledge	Rutledge
"Requirements to qualify for class certification in federal litigation are demanding, so many disputes between individuals and companies (such as an employment discrimination suit) likely would not qualify for class treatment anyway." – Peter B. Rutledge, *Chamber Response* at 5.	"Lastly, [Rutledge] noted, the prohibition of pre-dispute arbitration agreements would lead to a greater burden on judges' dockets by smoothing the path for class actions." – Jeff Horwitz, *Arbitration Goes to the Mat*, BLOG OF THE LEGAL TIMES (April 2, 2008).

Attachment 2

BusinessWeek

COVER STORY June 5, 2008, 5:00PM EST

Banks vs. Consumers (Guess Who Wins)

The business of resolving credit-card disputes is booming. But critics say the dominant firm favors creditors that are trying to collect from unsophisticated debtors

by Robert Berner and Brian Grow

What if a judge solicited cases from big corporations by offering them a business-friendly venue in which to pursue consumers who are behind on their bills? What if the judge tried to make this pitch more appealing by teaming up with the corporations' outside lawyers? And what if the same corporations helped pay the judge's salary?

It would, of course, amount to a conflict of interest and cast doubt on the fairness of proceedings before the judge.

Yet that's essentially how one of the country's largest private arbitration firms operates. The National Arbitration Forum (NAF), a for-profit company based in Minneapolis, specializes in resolving claims by banks, credit-card companies, and major retailers that contend consumers owe them money. Often without knowing it, individuals agree in the fine print of their credit-card applications to arbitrate any disputes over bills rather than have the cases go to court. What consumers also don't know is that NAF, which dominates credit-card arbitration, operates a system in which it is exceedingly difficult for individuals to prevail.

Some current and former NAF arbitrators say they make decisions in haste—sometimes in just a few minutes—based on scant information and rarely with debtor participation. Consumers who have been through the process complain that NAF spews baffling paperwork and fails to provide the hearings that it promises. Corporations seldom lose. In California, the one state where arbitration results are made public, creditors win 99.8% of the time in NAF cases that are decided by arbitrators on the merits, according to a lawsuit filed by the San Francisco city attorney against NAF.

"NAF is nothing more than an arm of the collection industry hiding behind a veneer of impartiality," says Richard Neely, a former justice of the West Virginia supreme court who as part of his private practice arbitrated several cases for NAF in 2004 and 2005.

A DIFFERENT REALITY

NAF presents its service in print and online advertising as quicker and less expensive than litigation but every bit as unbiased. Its Web site promotes "a fair, efficient, and effective system for the resolution of commercial and civil disputes in America and worldwide."

But internal NAF documents and interviews with people familiar with the firm reveal a different reality. Behind closed doors, NAF sells itself to lenders as an effective tool for collecting debts. The point of these pitches is to persuade the companies to use the firm to resolve clashes over delinquent accounts. JPMorgan Chase (JPM) and Bank of America (BAC) are among the large institutions that do so. A September, 2007, NAF PowerPoint presentation aimed at creditors and labeled "confidential" promises "marked increase in recovery rates over existing collection methods." At times, NAF does this kind of marketing with the aid of law firms representing the very creditors it's trying to sign up as clients.

NAF, which is privately held, employs about 1,700 freelance arbitrators—mostly moonlighting lawyers and retired judges—who handle some 200,000 cases a year, most of them concerning consumer debt. Millions of credit-card accounts mandate the use of arbitration by NAF or one of its rivals. NAF also resolves disputes involving Internet domain names, auto insurance, and other matters. In 2006 it had net income of $10 million, a robust margin of 26% on revenue of $39 million, according to company documents.

NAF's success is part of a broader boom in arbitration dating back to the 1980s, when companies began introducing language into employment contracts requiring that disputes with workers be resolved out of court. Mandatory arbitration spread to other kinds of agreements, including those involving credit cards.

NUMEROUS LOYAL PATRONS

Now, with the economy stumbling, NAF's focus on consumer credit could prove even more lucrative. U.S. credit-card debt hit a record high of $957 billion in the first quarter of 2008, up 8% from the previous year, according to Federal Reserve data. People who had relied on home-equity loans are seeing that money evaporate in the mortgage crisis and are running up card balances. Card providers, meanwhile, are increasingly turning to arbitration to collect on delinquent accounts.

Even consumer advocates concede that most people accused of falling behind do owe money. But the amounts are often in dispute because of shifting interest rates, fees, and penalties. Sometimes billing mistakes or identity fraud lead to confusion. Plenty of acrimony surrounds the traditional collections process in which lenders' representatives or companies that buy debt at a discount pressure consumers to pay up. Arbitration is supposed to be different. Endorsed by federal law, it purports to offer something akin to the evenhanded justice of the court system. That's why state and federal judges overwhelmingly uphold arbitration awards challenged in their courtrooms. This confidence may be misplaced, however, at least in many cases that come before NAF. (Its main competitors—the nonprofit American Arbitration Assn. in New York and JAMS, a for-profit firm in Irvine, Calif.—tend to affract employment disputes and contractual fights between companies.)

NAF has numerous loyal patrons among the country's financial titans. Chase says in a statement that it "uses NAF almost exclusively in its collection-arbitration proceedings due to NAF's lower cost structure." Companies pay from $50 to several hundred dollars a case, depending on its complexity. "Many legal commentators have found arbitration to be fair, efficient, more consumer friendly, and faster than the court system," Chase adds. Roger Haydock, NAF's managing director, says: "This is like the *Field of Dreams*: Build a ballpark, and they will come."

Others argue that NAF umpires make calls that put debtors at a disadvantage. In March, Dennis J. Herrera, San Francisco's city affomey, sued the firm in California state court, accusing it of churning out awards for creditors without sufficient justification. The lawsuit cites state records showing that NAF handled 33,933 collection arbitrations in California from January, 2003, through March, 2007. Of the 18,075 that weren't dropped by creditors, otherwise dismissed, or settled, consumers won just 30, or 0.2%, the suit alleges. "NAF has done an end run around the law to strip consumers of their right to a fair collection process," Herrera says in an interview.

The firm counters in court papers that federal law intended to encourage arbitration precludes the suit. NAF's "neutral decision-makers constitute a system that satisfies or exceeds objective standards of fairness," the firm says in a press release. NAF adds in an e-mail that the suit obscures thousands of cases in which consumers prevail because creditors abandon their claims or the disputes are "otherwise terminated."

So far, the San Francisco litigation relies mostly on publicly available information about NAF. Internal documents and interviews provide a more detailed picture of the firm.

The September, 2007, marketing presentation, which NAF left with a prospective customer, boasts that creditors may request procedural maneuvers that can tilt arbitration in their favor. "Stays and dismissals of action requests available without fee when requested by Claimant—allows Claimant to control process and timeline," the talking points state.

A current NAF arbitrator speaking on condition of anonymity explains that the presentation reflects the firm's effort to attract companies, or "claimants," by pointing out that they can use delays and dismissals to manipulate arbitration cases. "It allows the [creditor] to file an action even if they are not prepared," the arbitrator says. "There doesn't have to be much due diligence put into the complaint. If there is no response [from the debtor], you're golden. If you get a problematic [debtor], then you can request a stay or dismissal." When some creditors fear an arbitrator isn't sympathetic, they drop the

case and refile it, hoping to get one they like better, the arbitrator says.

The firm goes out of its way to tell creditors they probably won't have to tussle with debtors in arbitration. The September, 2007, NAF presentation informs companies that in cases in which an award or order is granted, 93.7% are decided without consumers ever responding. Only 0.3% of consumers ask for a hearing; 6% participate by mail.

NAF says in a statement that it legitimately markets its services. As for the evenhandedness of the process, it adds: "Arbitration procedures are quite flexible and make stays and adjournments available to both claimants and respondents."

Many arbitrators praise NAF. In response to *BusinessWeek*'s (MHP) inquiries, the firm sent an e-mail to a group of arbitrators asking for statements "demonstrating that you provide an invaluable service to the public by acting as a fair, independent, and unbiased Neutral." NAF passed along 10 testimonials. In one, Michael Doland, an arbitrator and attorney in Los Angeles, says: "The cynical view that arbitrators favor businesses over consumers is not correct with regards to the NAF. No communication, direct or indirect, from the NAF to myself as an arbitrator ever suggested such an approach." In an interview, Doland says: "If I ever thought this process was corrupt, that would be the day, the hour, that I would resign."

But other arbitrators have quit NAF for just that reason. Elizabeth Bartholet, a Harvard Law School professor and advocate for the poor, worked as an NAF arbitrator in 2003 and 2004 but resigned after handling 24 cases. NAF ran "an unfair, biased process," she said in a deposition in September, 2006, in an Illinois state court lawsuit. NAF isn't named as a defendant in the pending case, which challenges a computer maker's use of an NAF arbitration clause. Bartholet said that after she awarded a consumer $48,000 in damages in a collections case, the firm removed her from 11 other cases. "NAF ran a process that systematically serviced the interests of credit-card companies," she says in an interview.

In response, the firm says that both sides in each case have the right to object to one arbitrator suggested by NAF, based on the arbitrator's professional biography, which is provided to the parties. Creditors had simply exercised that option with the Harvard professor, NAF says.

SWIFT DECISIONS

Even arbitrators who speak highly of NAF say that the decision-making process often takes very little time. Anita Shapiro, a former Los Angeles superior court judge, says she has handled thousands of cases for the company over the past seven years. Creditors' lawyers have always assured her that consumers are informed by mail when they are targeted in arbitration, as NAF rules require, she says. But in the majority of cases consumers don't respond. She assumes this is the consumers' choice. Shapiro says she usually takes only "four to five minutes per arbitration" and completes "10 to 12 an hour." She is paid $300 an hour by NAF. If she worked more slowly, she suspects the company would assign her fewer cases.

Asked about Shapiro's account, NAF says: "Arbiters alone determine the amount of time required to make their decisions." It adds that collections cases tried in court are often decided swiftly when consumers don't respond. NAF says its "arbitrators provide much greater access to justice for nonappearing consumer parties by ensuring that the [corporate] claimant submits sufficient evidence."

But some consumers, including those on whose behalf the city of San Francisco is suing, complain that they don't have a real opportunity to contest NAF arbitration cases. By design, arbitration rules are less formal than those of lawsuits. The target of an arbitration can be informed by mail rather than being served papers in person. Evidence can be introduced without authentication.

In March the law firm Wolpoff & Abramson settled a class action in federal court in Richmond, Va., alleging unfairness by the firm in NAF arbitrations. The suit, filed on behalf of 1,400 Virginia residents pursued by the credit-card giant MBNA, claimed that Wolpoff & Abramson, which represented the company, promised them in writing that they could appear at hearings before an NAF arbitrator but then failed to arrange for the hearings. NAF wasn't named as a defendant in the

suit. Denying wrongdoing, Wolpoff & Abramson agreed to pay a total of $60,000 in damages. The firm, based in Rockville, Md., declines to comment. NAF denies that consumers were falsely promised hearings.

TROUBLING FORMS

Diane McIntyre, a 52-year-old legal assistant and one of two lead plaintiffs in the Virginia class action, says she was gradually paying down $9,000 she owed MBNA. She had reduced her debt to about $6,000 when she got word in May, 2005, from Wolpoff & Abramson of an arbitration award against her for $6,519, plus $977 in legal fees. She intended to contest the amount of the award and the fees at a hearing but never had a chance. "I wanted to pay the debt" but not all at once, she explains. As part of the class action sefflement, Wolpoff & Abramson agreed to accept $4,000 from McIntyre.

A number of other NAF arbitrators *BusinessWeek* contacted independently say that even apart from the absence of debtors contesting most cases, NAF's procedures tend to favor creditors. What most troubled Neely, the former West Virginia supreme court justice, was that NAF provided him with an award form with the amount sought by the creditor already filled in. This encourages the arbitrator to "give creditors everything they wanted without having to think about it," says Neely.

In the three NAF cases he decided, Neely says he granted the credit-card companies the balances and interest they claimed but denied them administrative fees, which totaled about $300 per case. Neely says such fees wouldn't be available to creditors who filed suit in court. "It's a system set up to squeeze small sums of money out of desperately poor people," he asserts. Neely stopped receiving NAF assignments in 2006 after he published an article in a legal publication accusing the firm of favoring creditors.

NAF says that Neely's accusations lack "any shred of truth." The independence of its arbitrators ensures they will decide cases diligently, NAF adds. "Arbitrators are in no way discouraged from deviating from the [creditor's] requested relief."

Lewis Maltby, a lawyer in Princeton, N.J., decided six credit-card cases for NAF in 2005 and 2006 but says he stopped because, like Neely, he became "uncomfortable" with the process. Maltby runs a nonprofit group promoting employee rights and has served as a director of the American Arbitration Assn. (AAA). Working for NAF, he was surprised at how little information he received to make his decisions. Files contained printouts purporting to summarize a consumer's debt and an unsigned, generic arbitration agreement, he says. "If you wanted free money, you could do [each case] in five minutes."

Maltby says the most difficult cases to decide were three claims by MBNA to which consumers did not respond. The files lacked any evidence that the consumer had been notified, he says. He ruled in MBNA's favor, having assumed that the debts were "probably" genuine. But he adds: "I would have liked to have been more confident that was the case." He did slice the fees requested by creditors' lawyers, because he thought they had expended little effort. He decided one other case for MBNA after the debtor conceded in writing that he owed money but couldn't afford to pay. MBNA withdrew another claim after the consumer said he had been the victim of identity theft, Maltby says.

In a statement, NAF says that *BusinessWeek* misrepresented Maltby's views. But Maltby later said he stands by all his comments. In a statement, Bank of America, which acquired MBNA in January, 2006, declines to comment because of the suit filed by San Francisco against NAF.

William A. Gould Jr., a Sacramento lawyer with a general private practice, says he stopped handling arbitrations for the company after doing several in 2003 and 2004 because the process "just seemed to be prefty one-sided." He says he didn't observe specific instances of bias but became concerned about the imbalance between creditors and their law firms—which were highly sophisticated about NAF procedures—and most consumers, who were naive and lacked legal representation. "The whole organizational mechanism was set up to effect collections," Gould says. Asked to respond, NAF says creditors and their attorneys are "no more sophisticated" about arbitration than they are about court procedures, and consumers are "no more naive."

Founded in 1986, NAF at first depended heavily on one customer, ITT Consumer Financial, the now-defunct lending arm of conglomerate ITT. (ITT) Milton Schober, then the general counsel of ITT Consumer Financial, says he opposed the relationship, fearing it could deny individuals the broader rights they enjoyed in court, such as greater latitude to appeal. Top officials of ITT Consumer Financial, which like NAF was based in Minneapolis, felt otherwise. "Management thought [NAF's] rules for arbitration favored creditors more," says Schober, who is now retired. "Shopping for justice: That's what it was." Neither NAF nor ITT, now a defense electronics manufacturer, would comment on Schober's assertions.

BUSINESS STRATEGY

Haydock, NAF's managing director, says that from the outset, it tried to familiarize corporations and their attorneys with the benefits of arbitration over court cases. NAF isn't alone in doing this. AAA and JAMS also place ads in legal publications and sponsor events at bar association meetings.

But NAF goes further. On some occasions, it tries to drum up business with the aid of law firms that represent creditors. Summaries of weekly NAF business development meetings from 2004 and 2005, which are labeled "confidential," show it enlisted Wolpoff & Abramson and another prominent debt collection law firm, Mann Bracken, to help win the business of companies such as GE's (GE) credit-card arm. When creditors succeed, the law firms seek fees of 15% or 20% of awards, which are added to judgments and billed to debtors. Atlanta-based Mann Bracken surfaces in a November, 2004, NAF document that states: "Work with Mann to begin its taking lead on GE as it relates to Mann running the program for it."

The same NAF document describes efforts to collaborate with Mann Bracken and Wolpoff & Abramson to recruit Sherman Financial Group as an arbitration customer. Sherman, based in Charleston, S.C., buys delinquent debt from major credit-card companies at a discount and then tries to collect on it. Under the heading "Last Week's Single Sales Objective," the NAF document notes that Wolpoff & Abramson and Mann Bracken partner James D. Branton are to host a panel discussion with attorneys for Sherman Financial. "Follow-up w/ Branton and Wolpoff after conference," the document adds.

The strategy appears to have worked. Sherman confirms that Mann Bracken has represented it in collections cases before NAF. But Sherman denies that either law firm solicited its business on behalf of the arbitration firm.

A former NAF staff employee familiar with its business development efforts says: "It was well understood within NAF that working through established collection law firms was an effective way to develop business with creditors." Insisting on anonymity, the ex-employee explains that, since Wolpoff & Abramson and Mann Bracken had strong ties to major credit-card companies, the law firms could boost NAF's chances of getting creditors to use its services. All told, documents from four NAF business development meetings from October, 2004, through August, 2005, refer 36 times to Wolpoff & Abramson, Mann Bracken, and their attorneys in connection with pitches to credit-card providers and debt buyers.

An arbitration company collaborating with law firms to land business troubles some legal scholars. "Most people would be shocked," says Jean Sternlight, an arbitration expert at the University of Nevada, Las Vegas. "Our adversarial system has this idea built into it that the judge is supposed to be neutral, and NAF claims that it is," she adds. "But this certainly creates a great appearance, at a minimum, of impropriety, where the purportedly neutral entity is working closely with one of the adversaries to develop its business."

"STREAMLINING" THE PROCESS

Mann Bracken's Branton declines to discuss specific clients, citing confidentiality agreements. In an e-mail, he adds: "Mann Bracken frequently and openly works with arbitration administrators (including the National Arbitration Forum and the American Arbitration Assn.) to assist our clients in developing legal solutions tailored to their needs. This is very similar to the work we do with court clerks across the country in streamlining the litigation process for our clients."

NAF's rivals, AAA and JAMS, say they don't cooperate with debt collection law firms in this manner. "Those who inquire about filing cases with us, which include individuals, governmental entities, and businesses, often reach out to understand how to use our online filing process, which is available to all parties," says AAA spokesman Wayne Kessler. The firm says

it handled 8,358 consumer arbitration cases in 2007, far fewer than NAF. JAMS says it doesn't handle such cases.

NAF arbitrators say they aren't familiar with all the ways the company markets itself. When told about the internal documents, however, several expressed concern. "Using a law firm to actually solicit business for [NAF] raises a question of the appearance, at least, of potential impropriety," says Edwin S. Kahn, a lawyer in Denver who advocates for low-income families and, as a sideline, has handled about 30 NAF cases and 50 AAA cases. Kahn says he is considering recusing himself from cases involving Mann Bracken and Wolpoff & Abramson: "I have learned something that might affect my objectivity."

NAF interprets Kahn's comments as showing that "he is very aware of his professional responsibility to remain entirely neutral." It adds that it has "been successful in completely isolating the independent arbitrators from educational and marketing efforts used to encourage the use of arbitration."

Edward C. Anderson, an NAF founder and past CEO, confirms that the company does "educate" creditors' lawyers on the benefits of arbitration in hopes that the lawyers' clients will purchase NAF's services. He sees no conflict of interest. "The documents that you have apparently relate to meetings with particular lawyers," he says. "It looks to me like we pitched these lawyers on the efficacy of arbitration for their clients, and they have to decide what works for them." Mann Bracken and Wolpoff & Abramson decline to comment.

GE confirms that it employs Mann Bracken and says consumers may resolve disputes before NAF or AAA. Consumers also may opt out of GE's arbitration clause, although relatively few do. In a statement, GE spokeswoman Cristy F. Williams says that when the company initiates collection actions, "it has historically always filed in a court of appropriate jurisdiction." She adds that GE's arbitration clause referring to NAF was in place before the 2004 and 2005 references to Mann Bracken in the NAF documents. GE declines to respond to questions about the overall fairness of NAF arbitration or on Mann Bracken's role in aiding NAF to gain arbitration business.

EASING THE COURT'S LOAD

Most judges are favorably disposed toward arbitration as a way of alleviating the courts' litigation load. In one case in which customers questioned the use of an arbitration clause by credit-card issuer First USA Bank, a federal judge in Dallas ruled in 2000: "The court is satisfied that NAF will provide a reasonable, fair, impartial forum."

But some courts have found reason to question NAF awards. In May, 2005, a state judge in Oregon threw out a $16,642 arbitration judgment favoring MBNA. Judge Donald B. Bowerman didn't explain his reasoning, but the consumer in the case, Laurie A. Raymond, had appealed the award, saying she had been complaining to MBNA since 1990 that the charges attributed to her were the result of fraud or a mistake. Raymond, a 54-year-old family-law attorney in Portland, also told the court that she had never signed an arbitration agreement. Unlike most alleged debtors, Raymond energetically disputed NAF's jurisdiction. The credit-card company at certain points in the past had conceded that she didn't have to pay, she says. Nevertheless, in July, 2004, the arbitrator entered the award for the bank without holding the hearing Raymond says she had requested.

After Raymond got the award canceled, she sued MBNA for violations of debt collection and credit reporting laws. MBNA settled the suit on confidential terms. MBNA parent Bank of America declines to comment specifically, citing privacy obligations. "The referral to arbitration was consistent with the practices in place at the time," the bank says. "We believe arbitration can be an efficient and fair method of resolving disputes between our customers and the company."

NAF declines to comment on the Raymond case. But generally, the company adds: "Litigants, on either side, do not always see the facts, the law, or the process through an unbiased eye."

Raymond felt equipped to take on NAF and MBNA because of her legal training, she says. "One reason I went on with the process was that if [NAF] can do this to someone who understands this stuff, what are they doing to the little grandma next door?"

Cheryl C. Betts of Cary, N.C., was one layperson who felt overwhelmed. She learned that she'd been taken to arbitration in May, 2007, when Mann Bracken sent her a letter about $6,027 she owed on a Chase credit card. The letter informed her that she'd have to pay an additional $602 in legal fees related to arbitration but offered to settle for 75% of the total, or $4,972. Betts, a 55-year-old former administrative assistant for an energy company, says she always intended to pay her debt but didn't want to cough up nearly $5,000 at once. "I'm not a deadbeat," she says.

Betts says her troubles began after she was late with one $128 minimum payment in August, 2005. Chase lowered her credit limit from $6,000 to $4,900. Fees and penalty interest soon pushed her over that limit, setting off a spiral of rising minimum- payment demands that she says she couldn't afford. Betts says she repeatedly contacted the bank to try to work out a payment plan. "This should never have happened," she says.

Chase declines to comment on particular credit disputes, citing customer privacy. The bank points to a 2000 opinion by U.S. Supreme Court Justice Ruth Bader Ginsburg saying that "national arbitration organizations have developed similar models for fair cost and fee allocation.... They include National Arbitration Forum provisions that limit small-claims consumer costs."

The May, 2007, letter to Betts from Mann Bracken announcing its intention to arbitrate set off a nine-month flurry of paperwork. In August, after she filed an 11-page response to the arbitration claim, Mann Bracken requested an adjournment, which was granted. Four months later, Betts fired off a long fax further disputing the case, and the law firm responded by seeking a 45-day extension. Betts thought she would have another opportunity to contest the case.

But on Feb. 15, 2008, the day after the extension expired, an NAF arbitrator issued a ruling ordering her to pay $5,575 to Chase. She has taken the case to a state court in Raleigh. "Many people," she says, "would have thrown in the towel because they don't have the time to pursue this, or they are just totally confused.... The only thing that kept me going was that I knew that I hadn't done anything wrong."

NAF declines to comment on the Betts case but reiterates that its procedures are fair. It adds that "parties can become confused about court procedures or about arbitration procedures.... "

Join a debate about regulating credit card rates.

Berner is a correspondent for BusinessWeek in Chicago. Grow is a correspondent in BusinessWeek's Atlanta bureau.

With Susann Rutledge

Xerox Color. It makes business sense.

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RESPONSE TO POST-HEARING QUESTIONS FROM RICHARD NAIMARK, SENIOR VICE PRESIDENT, AMERICAN ARBITRATION ASSOCIATION, WASHINGTON, DC

Answers to questions for Richard Naimark from Chairwoman Linda T. Sanchez:

Response to Question #1

The Due Process Protocols were developed by a diverse group of people representing highly divergent points of view. Their work product represents the best consensus thinking about what constitutes due process, fair play and a level playing field in the areas of consumer-business disputes and employee-employer disputes. There was no limitation of subject matter for discussion. The issue of pre-dispute clauses was thoroughly discussed by the group with the conclusion that the law in this area was unsettled and agreement within the group unlikely. For the participants, the Protocols represented a principled and balanced hearing, regardless of the genesis of the process.

The National Consumer Disputes Advisory Committee, which developed the Consumer Due Process Protocol, included individuals designated by the National Association of Attorneys General and the National Association of Consumer Agency Administrators, as well as individuals from the FTC, Consumers Union, Consumer Action, and the AARP:

Hon. Winslow Christian, Co-Chair,
Justice (Retired), California Court of Appeal

William N. Miller, Co-Chair,
Director of ADR Unit, Office of Consumer Affairs
Virginia Division of Consumer Protection (Designated by National Association of Consumer Agency Administrators)

David B. Adcock
Office of the University Counsel
Duke University

Steven G. Gallagher
Senior Vice President
American Arbitration Association

Michael F. Hoellering
General Counsel
American Arbitration Association

J. Clark Kelso
Director, Institute of Legislative Practice
University of the Pacific, McGeorge School of Law

Elaine Kolish
Associate Director, Division of Enforcement, Bureau of Consumer Protection
Federal Trade Commission

Robert Marotta
Wolcott, Rivers, Wheary, Basnight & Kelly, P.C.
Formerly Office of the General Counsel, General Motors Corporation

Robert E. Meade
Senior Vice President
American Arbitration Association

Ken McEldowney
Executive Director
Consumer Action

Michelle Meier
Former Counsel for Government Affairs
Consumers Union

Anita B. Metzen
Executive Director
American Council on Consumer Interests

James A. Newell
Associate General Counsel
Freddie Mac

Shirley F. Sarna
Associate Attorney General-In-Charge, Consumer Frauds and Protection Bureau
Office of the Attorney General, State of New York
(Designated by the National Association of Attorneys General)

Daniel C. Smith
Vice President and Deputy General Counsel
Fannie Mae

Terry L. Trantina
Member, Ravin, Sarasohn, Cook, Baumgarten, Fisch & Rosen, P.C.
Formerly General Attorney, AT&T

Deborah M. Zuckerman
Staff Attorney, Litigation Unit
American Association of Retired Persons

Thomas Stipanowich, Academic Reporter
W.L. Matthews Professor of Law
University of Kentucky College of Law

The Task Force on Alternative Dispute Resolution in Employment, which developed the *Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship*, included individuals from the Federal Mediation and Conciliation Service, the ACLU, the ABA, and the National Employment Lawyers Association:

Christopher A. Barreca, Co-Chair
Partner, Paul, Hastings, Janofsky & Walker
Rep., Council of Labor & Employment Section of the American Bar Association

Max Zimny, Co-Chair
General Counsel, International Ladies' Garment Workers' Union
Rep., Council of Labor and Employment Section of the American Bar Association

Arnold Zack, Co-Chair
President, National Academy of Arbitrators

Carl E. VerBeek
Partner, Management Co-Chair
Arbitration Committee of Labor & Employment Section of the American Bar Association

Robert D. Manning
Angoff, Goldman, Manning, Payle, Wagner Varnum Riddering Schmidt & Howlett & Hiatt, P.C.
Union Co-Chair, Arbitration Committee of the Labor & Employment Section of the American Bar Association

Charles F. Ipavec
Arbitrator
Neutral Co-Chair, Arbitration Committee of the Labor & Employment Section of the American Bar Association

George H. Friedman
Senior Vice President, American Arbitration Association

Michael F. Hoellering
General Counsel, American Arbitration Association

W. Bruce Newman
Rep., Society of Professionals in Dispute Resolution

Wilma Liebman
Special Assistant to the Director, Federal Mediation & Conciliation Service

Joseph Garrison
President, National Employment Lawyers Association

Lewis Maltby
Director, Workplace Rights Project
American Civil Liberties Union

Response to Question #2

All cases conducted under the Consumer or Employment Due Process Protocols have reasonable fees for the individual. For consumers the total fee is either $125 (for claims up to $10,000) or $375 (for claims up to $75,000). In some instances, opponents of arbitration compare these fees only with initial court filing fees, resulting in claims that submitting a claim to arbitration can cost two to three times as much as filing in court. While technically correct, this does not take into account the likelihood of a smaller total

out-of-pocket cost for the ADR option. Typically, claims for home construction involving hundreds of thousands or millions of dollars have been handled as commercial claims, with a completely different fee schedule. Fees for employees filing under a blanket employer arbitration policy are $150. Claims for individually negotiated employment contracts, typically at the executive level, have a different fee schedule based on the size of the claim.

More important, however, is that the overall cost to the employee or consumer of arbitration can be significantly lower.

Response to Question #3

The arbitration process is not secretive. Rather, it is a *private* process, owned by the parties to the contract. The parties are free to be as public about the arbitration as they choose. The arbitrator and the arbitration organization must maintain the privacy of the process in the sense that they do not have the legal right to divulge information about the arbitration – the parties do. Under California law, arbitration organizations and the arbitrators are now required to disclose private information regarding the parties and arbitral decisions, which previously would have been considered as a violation of the parties' right of privacy. An additional consideration was that the reporting requirement was in essence an unfunded mandate, with cost implications that could have a significant impact on us as a not-for-profit organization. Once the law passed, the AAA complied fully with the reporting requirement, including reporting of consumer and employment arbitrations for the entire United States, rather than just California. Therefore a similar law nationally would have negligible effect on the American Arbitration Association.

Answers to questions for Richard Naimark from Ranking Member Chris Cannon:

Response to Question #1
Removing contractual freedom by limiting pre-dispute arbitration clauses is a disturbing concept that will effectively harm consumers and employees.

Response to Question #2
Most individuals and, until fairly recently, most businesses are not sufficiently aware of arbitration and its attributes to seek such clauses in their contracts. In fact, most contract terms are suggested by the business (payment terms, rates of interest, warranty provisions, etc.), just as are arbitration clauses. Arbitration offers the individual significantly better access to justice than would normally be available.

Response to Question #3
Most consumers are interested in their individual case, not a class-wide remedy. Disputes that may ultimately best be resolved by providing the consumer with a nominal coupon or refund on a future purchase may best be resolved through class action (either through an ADR provider or the courts), whereas disputes that may result in a more significant settlement for the individual employee or consumer would likely be better served by arbitration. With arbitration they can have a cost-effective, easily accessed opportunity to seek justice in their individual case, something that would not otherwise be available. Even with a voluntary opt out for small claims court, many consumers chose to file arbitration instead of going to court.

Response to Question #4
The use of arbitration in the consumer and employment context is relatively new. In a short period of time the courts, up to and including the United States Supreme Court, have done a great deal of definition of the proper scope and parameters of the arbitration process. The Due Process Protocols were implemented and made available. Much of corporate America has continually refined its arbitration clauses for conformity with the rulings of the court and the standards available. The field is clearly rapidly moving toward a point of balance and maturity.

Response to Question #5
Making the Due Process Protocols mandatory on all companies and arbitration providers would effectively remove most questions about the process. Such a move would ensure fair play for all in the arbitrations, whether individuals or companies.

Response to Question #6
The so-called "repeat player effect" is widely misinterpreted. Companies that have repeated exposure to any form of dispute resolution, whether the courts or arbitration, learn how to better handle matters at which they are likely to be found at fault. It is a form of organizational learning. As a result they tend to settle more of the cases in which they are unlikely to prevail, and to establish systems to address consumer or employee complaints. They become more responsive to the "little guy". Rather than representing a problem, the "repeat player effect" is often an example of the individual being better

served – overall – by the company through access to a fast, efficient, and fair dispute resolution mechanism. The case statistics of American Arbitration Association show the majority of consumer and employment arbitrations are settle before they get to a decision by an arbitrator.

Response to Question #7
The courts are continually refining the parameters and standards appropriate for consumer and employee arbitration. Courts strike clauses, including arbitration provisions, that are considered unconscionable. Arbitral decisions which exceed the contractual authority of the arbitrator or wander beyond the bounds of arbitral law are nullified, though this is a rare occurrence. The empirical evidence shows good results in arbitration, and compares favorably with court experience.

Response to Question #8
When companies level the playing field by implementing an ADR program (including sometimes covering some of the individual's costs and/or providing for telephone or document submission hearings), they are making justice accessible to a huge part of the population that would otherwise not seek or achieve redress. (Some companies even provide employees a stipend for fees for their lawyers when they file a case in arbitration). Losing this would be a distinctly anti-consumer development. This is with the caveat that the arbitration process has balance and fairness standards, such as those provided by the Due Process Protocols.

Response to Question #9
Arbitration is a time honored, court validated process that can provide tremendous opportunities for access to justice. It must be balanced and principled in form. It must result in awards that are consistent with the developing law of the land. It is as American as apple pie, having been used in this country since colonial days, even by George Washington. Arbitration, properly done, is a form of community self-regulation and is to be encouraged and promoted as an important lubricant in our society.

POST-HEARING QUESTIONS* SUBMITTED TO THE HONORABLE ROY E. BARNES, THE BARNES LAW GROUP, LLC, MARIETTA, GA

QUESTIONS FOR GOV. ROY BARNES

From Linda T. Sánchez, Chair

1. The Supreme Court reviewed arbitration in the last term in the Cardegna case. Please explain how this affects your area of the law and contracts in general.

2. Have you ever had an experience where you felt that a corporation had unduly influenced the arbitration process by exerting economic pressure on an arbitration association that survives by virtue of its being named by corporations in their arbitration clauses?

The intent of the FAA was to put arbitration agreements and clauses on equal footing with other contracts. In your experience, is this still the case?

*At the time of the printing of this hearing, the Subcommittee on Commercial and Administrative Law had not received a response to these questions from the witness.

Questions for the Record from Ranking Member Chris Cannon,
Subcommittee on Commercial and Administrative Law,
"Hearing on: H.R. 3010, The Arbitration Fairness Act of 2007,"
October 25, 2007, 2:00 a.m., Room 2141 RHOB

Questions for the Hon. Roy Barnes, the Barnes Law Group:

1. How many new class actions do your law practice and practices like it stand to bring if this arbitration option is wiped out for consumers, franchisees, non-union employees, and any parties with unequal bargaining power? Rather than advocating a bill that takes options off the table and leaves these plaintiffs looking only for the trial lawyers, why doesn't your firm and others like it diversify into the arbitration area?

2. If you think the fees generated by individual arbitration claims would be too small to justify your firms' involvement, why shouldn't we wait for or prod the market to produce the Hyatt Legal Services of the arbitration world, and foster competition? Why should we sacrifice the interest in diversified legal services and diversified dispute resolution options to the narrow interests of trial lawyers?

3. If arbitration options were reduced, wouldn't that tend to hurt consumers, franchisees and employees by driving up the costs of litigation and the costs of products and services, under the classic laws of supply and demand? Don't your firm and firms like it stand to benefit from that? Why should that be allowed?

4. Under that same logic, who would be more likely to benefit from reduced alternative dispute resolution options for consumers, franchisees and employees – the consumers, franchisees and employees themselves, or the trial lawyers and public interest litigation firms who bring the litigation that competes with arbitration?

5. Some argue that companies are able to use their repeat experience and expertise in arbitration to abuse and manipulate the arbitration process, to consumers', franchisees' and employees' detriment. Isn't a company that's savvy enough to do that likely to be savvy enough to abuse and manipulate the litigation process to consumers', franchisees' and employees' detriment?

6. Courts have ruled that arbitration is a procedural right, not a substantive one. It is also a faster and cheaper procedure. Don't both parties to a transaction stand to benefit from the procedures afforded by arbitration? If so, why should an arbitration option be taken away from consumers and companies?

RESPONSE TO POST-HEARING QUESTIONS FROM KENNETH L. CONNOR, ESQ., WILKES AND MCHUGH, P.A., WASHINGTON, DC

Responses of Kenneth L. Connor
To Questions for the Record from Linda T. Sanchez, Chair
Subcommittee on Commercial and Administrative Law
"Hearing on: H.R. 3010, The Arbitration Fairness Act of 2007,"
October 25, 2007, 2:00 p.m., Room 2141 RHOB

Question 1. Do arbitration clauses in nursing home contracts affect the quality of care in nursing homes?

Response. I believe that arbitration clauses in nursing home contracts adversely affect the quality of care in nursing homes.

Common sense and human experience tell us that accountability and responsibility run hand in hand. When wrongdoers are not held fully accountable for the consequences of their misconduct, their wrongdoing multiplies. Pre-dispute binding mandatory agreements are designed to minimize accountability by nursing homes for their wrongdoing. Such agreements often impose limitations on discovery, caps on damages, waiver of punitive damages and attorney fees, and other provisions that limit the accountability of nursing homes that have abused or neglected their residents. Additionally, the arbitral forum required by the agreements is often industry friendly and adverse to residents. The industry gets a "repeat player" advantage by using the same arbitrators over and over. The net result is that awards arising out of these arbitral forums are dramatically lower than those that are awarded by juries in civil trials. This means that, by requiring pre-suit binding mandatory arbitration, nursing homes avoid full accountability for the harms they inflict on innocent residents and they are more likely to repeat their wrongdoing.

When nursing homes are held fully accountable for the harms and damages they cause, they are less likely to repeat the behavior that gave rise to the accounting. Misconduct is less likely to occur when nursing homes realize that it costs more to do business the wrong way than it does the right way.

Question 2. Do arbitration clauses in nursing home contracts impact the public's ability to learn about any problems in certain nursing homes?

Response. Yes, and in a negative way. Arbitration proceedings, unlike jury trials, are typically conducted in a setting that is not open to the public. Additionally, unlike civil trials, these proceedings are not typically a matter of public record. Consequently, the public is much less likely to learn of problems that exist in nursing homes whose liability is determined by arbitration rather than in a trial.

When it comes to selecting a nursing home, knowledge is power. Jury verdicts, in contrast to arbitration awards, are often publicized in newspapers or on television, thus giving the public additional means of learning about problems that exist in nursing homes in their communities. The knowledge acquired enables the members of the public to make a more informed judgment about the nursing home the will select for their loved one.

Question 3. How do arbitration agreements affect your ability to conduct discovery in nursing home cases?

Response. In a civil case filed in court, parties are typically entitled to obtain discovery of any information relevant to the subject matter of the action and which is not otherwise privileged from disclosure. Discovery is typically much more limited in arbitration settings. Frequently, the rules of the arbitral forum will limit discovery. Often there are draconian limits on the number of witnesses who can be deposed and the number of documents which will be required to be produced. Sometimes, discovery is limited just to matters involving the care and treatment of the resident whose claim is being arbitrated. Such limitations prevent residents from learning that the problems they suffered from were problems which were pervasive throughout the facility and ones the nursing home had notice of. This kind of information is highly relevant to proving liability of the nursing home. Further, these discovery limitations often prevent the resident from finding out who was really in charge of operation and managing the nursing home during their residency. The effect will be that the real culprits will often escape liability and accountability for their actions.

Question 4. How important are the use of experts in the type of cases you litigate? How does mandatory binding arbitration affect that?

Response. Experts are critical in proving liability in nursing home cases. Often, state law requires expert testimony as a condition of proving liability in a nursing home case. Many times, a variety of medical and financial experts are required to meet the plaintiff's burden of proof. In an arbitration setting, the rules often limit the number of experts may

call, thereby prejudicing the ability of a resident to prove his or her case against the facility.

Respectfully submitted this 22nd day of July, 2008 by

Kenneth L. Connor,

In his individual capacity and not on behalf of any organization

Responses of Kenneth L. Connor
To Questions for the Record from Ranking Member Chris Cannon
Subcommittee on Commercial and Administrative Law
"Hearing ou: H.R. 3010, The Arbitration Fairuess Act of 2007,"
October 25, 2007, 2:00 p.m., Room 2141 RHOB

Question 1. Why isn't outreach, education, and continuing improvement of arbitration options the right course here, rather than removing whole fields of arbitration from the economy and sacrificing consumers, franchisees, and employees to trial lawyers?

Response. Education, outreach and continuing improvement of arbitration options all have merit. Fundamentally, however, the problem with pre-dispute binding mandatory arbitration in nursing home cases (the area I was asked to testify about) is that it is unconscionable for residents from both a procedural and substantive point of view.

When the frail elderly present for admission at a nursing home, the last thing they are expecting is to be confronted with a document that asks them to waive important legal rights. These people typically suffer from a variety of problems associated with advanced age. They often are incompetent or of questionable competence. They usually are on multiple medications which may impair their judgment and they commonly suffer from deficits of hearing and vision. The agreement for pre-dispute binding mandatory arbitration is often sandwiched toward the end of a 50-60 page admission agreement. The admissions coordinator charged with the responsibility of explaining the agreement frequently don't understand it themselves. Very often, the elderly person, who is already terrified about being left in the care of an institution but who is in desperate need of nursing care, is told that if they don't sign the agreement, admission will denied. This only ratchets up the anxiety for the prospective resident since the next available nursing

home may be miles away from their family. Under these circumstances, there can be little doubt as to why the elderly person signs the agreement.

There is no parity of bargaining power between the facility and the resident who is being pressured into waiving important legal rights which may include substantial sums of money if they suffer abuse or neglect at the hands of the nursing home. In virtually any other setting, people who preyed on an elderly person and conned them out of important legal rights would be prosecuted. The only satisfactory solution is to prohibit this insidious practice which preys on the weakest and most vulnerable of our citizens.

By the way, I can't help but notice, Mr. Cannon, that the premise of your question shows great antipathy toward America's trial lawyers. You may not be aware that some of America's greatest leaders were trial lawyers, including John Adams, John Quincy Adams and Abraham Lincoln. I don't know what the origin of your hard feelings are, but I would respectfully suggest that it would be more helpful if you directed your energies toward reining in nursing homes that are abusing America's frail elderly rather than disparaging the members of the legal profession who are trying to protect them.

Question 2. Are you aware that many franchisors are small, inventive intellectual property owners, with few resources, time-limited patents, and licenses with large companies as the way their inventions get to market? These franchisors gain an immense amount of parity by insisting that their disputes with major corporations go to mandatory, binding arbitration. Would it be just to take that option away from them?

Response. This question should be directed to another member of the panel. I was asked to address pre-dispute binding mandatory arbitration in the context of nursing home cases.

Question 3. Would it be just to allow unions to continue to insist on mandatory arbitration in disputes between them and their members, but not anyone else?

Response. This question should be directed to another member of the panel. I was asked to address pre-dispute binding mandatory arbitration in the context of nursing home cases.

Question 4. Would it be just to treat union members and non-union members equally in this bill?

Response. This question should be directed to another member of the panel. I was asked to address pre-dispute binding mandatory arbitration in the context of nursing home cases.

Respectfully submitted this 22nd day of July, 2008 by

Kenneth L. Connor,
In his individual capacity and not on behalf of any organization

RESPONSE TO POST-HEARING QUESTIONS FROM DEBORAH WILLIAMS, ANNAPOLIS, MD

Answers for Congressman Chris Cannon

1. I am not sure how requirements from the FTC, Maryland Franchise Registration and Disclosure Law and Michigan Franchise Law can be viewed as someone's " version". Our case was not based on one persons "version" as opposed to another. Our case was very simple: 1) the FTC requirements on disclosure, 2) Maryland Law, and 3) Michigan Law. We gave our UFOC to the arbitrator along with documents and third party contracts that we received in Discovery from The Coffee Beanery's Corporate Office. We presented all of this into evidence, along with the UFOC from 2000 which showed that our UFOC was the first that no longer disclosed the legally required information. These are facts, not someone's version of what happened. In regards to the petitioners' witnesses, The Coffee Beanery had two expert witnesses. The first was the Arbitrators accountant, who also happens to be the accountant for The Coffee Beanery. The second testified about disclosure requirements and agreed that The Coffee Beanery was required to disclose the information that was presented into evidence. Given Mr. Naimark's testimony that validated the impossibility of overturning an arbitrator's decision, it would explain the Judge's err in not completely reviewing the proceedings. Being forced into Binding Mandatory Arbitration strips away your ability to question or appeal the outcome of your case. Only an arbitrator would be so arrogant as to show such complete disrespect and disregard for our Judicial System. This arbitrator put a whole new spin on the law: If you are shot and crippled, but do not die, then there is no crime. A Judge would have known that a decision like ours would be subject to public scrutiny.

2. It is not true that we pursued arbitration. I have enclosed a facsimile from the American Arbitration Association that clearly discloses it was the Respondents who made the decision to proceed to arbitration. Our arbitration contract called for mandatory mediation before arbitration or litigation. This was a breach of the contract. We continued to try and schedule mediation for 4 months after the Respondents decision to proceed to arbitration. While in the process of scheduling mediation the Respondents had the AAA send us a list of arbitrators to choose from. At this point we filed for a Jury Trial. Our arbitration contract clearly discloses that we do not waive our right to a trial by Jury for any violations of Maryland Franchise Law. The AAA not only refused to respond to our attorneys demand for a review of this breach, but they informed us that an arbitrator had been appointed six months ago! Why were we sent a list of arbitrators if they had already made a selection? I fail to see how any actions taken by the Maryland Attorney General can change the fact that we were forced into Binding Mandatory Arbitration.
We would have been more then willing to accept a "fair" result. When an arbitrator is appointed 6 months prior to filing a motion compelling arbitration, without allowing us to have a voice in who this person is, we would not consider this fair. Anything short of a trial is unacceptable. It is my right as a citizen of The United States of America to exercise my Constitutional right to a trial by jury. This right was stolen from me by Binding Mandatory Arbitration.

3. Again you are misinformed. The Order obtained by the Maryland Attorney General did not release us from our obligations. The Order would have enabled the franchisee to collect around $100,000. We would still be obligated to a ten year lease and our loan for the business. Early termination of our lease would have equated to about $900,000, plus our loan balance. The franchisee who accepted the State settlement is now close to bankruptcy caused by the early termination of his lease. On the other hand, future royalties are about $475,000. I'm sure that you see why this was not an acceptable solution. This settlement did cost us. We were asked to waive our right of private action as a condition of the settlement, should we take it. Looking at the numbers you can see this was a no win situation. The only solution was to file a case in court based on the Attorney General's findings and conclusions of law. Our arbitration agreement was amended to accommodate our right to a trial by jury for any violations of Maryland Franchise Registration and Disclosure Laws. Instead we were forced into Binding Mandatory Arbitration.

4.You ask me why you should "undo the whole swaths" of the arbitration system?
Again you seem to be misinformed. The Arbitration Fairness Act of 2007 would only put arbitration on equal footing with our Constitutional right to a trial by jury. People would be able to choose arbitration or court.

My experience shows the following:
The Facts of our case should send up a Red Flag to everyone.
Our Contract was Breached.
The amendment that was signed by both parties was not honored.
Our Contract was for mediation to take place within 60 days of the filing.
We filed for mediation in January 2005. Eleven months later there was still no date to mediate.
A list of arbitrators was sent November 17, 2005 , for us to choose.
A motion to compel arbitration was not filed until January 31, 2006.
We were then informed that the arbitrator was appointed in August of 2005. This is six months prior to the filing.
I have also included a list of close to 100 Coffee Beanery victims of this flawed concept.
As you can see from this list, I'm not the only one to suffer the effects of this predatory franchisor. This list was entered into evidence and was not disputed.
The list is pretty impressive when you consider that the concept was first offered in 1997.

The arbitrators decision has given this franchisor the license to continue selling this failed concept to unsuspecting victims.

As for the Maryland Attorney Generals actions against The Coffee Beanery, well that was all for naught. The Coffee Beanery is in violation of that Consent Order, and is the subject of yet another investigation in Maryland. These are the actions of a fearless corporation.

This is my experience with arbitration. I think even you would have to agree that this is hardly a good alternative to a public forum in which these questionable actions could at least be reviewed.

These are the facts of our case. These facts went undisputed. This is my experience.
This is Binding Mandatory Arbitration.

I am not a pioneer in my experience with arbitration. The fact that this hearing is being held, tells me that.

Answers to Questions From Chair Sanchez

1. Our cost to arbitrate far exceeded what we would have paid in the traditional court system.
In a traditional court our filing fee would have been between $500 - $1000.
Filing fee for arbitration was $8,500.
There is no fee paid to a Judge.
Our half of the arbitrator's fee was $8,500. This does not include charges prior to the actual arbitration. You also have to pay for study time and conference calls.
There is no fee for a transcriber in court.
Our half of the transcriber fee was $18,000.
In court if you lose you can appeal.
In arbitration you have to pay any fee that the arbitrator wants to impose. It cost us $150,000 to lose. There is no appeal.
This includes an hourly rate of $250. for two of The Coffee Beanery officers to attend arbitration. We were also charged mileage for these two officers to and from arbitration.
We were forced to fly from Maryland to Michigan four times.
There is an additional charge of $18,000. for the other half of the transcriber fee.
The transcriber alone ended up costing us $36,000.

2. I have a hard time trying to figure out how we could make arbitration fair . It scares me to think that as a society we have abandoned our right of access to the courts. As a Nation is this the direction we want to go. I can't be the only one wondering why we are trying to make a privatized justice system fair. We already have a Judicial System that works pretty well. It may not be perfect, but it has been in place for over two hundred years.

Arbitration is not policed, second guessed and worst of all is secret. These three facts pretty much make up the arbitration system. Arbitration has more power then you, me, or all the Court Judges. This kind of power breeds corruption and abuse. It has become justice for those who employ and have the ability to guarantee repeat business.

There are only two options I can think of that may help level the playing field:
1) Arbitration should be an option for either party, not mandatory.
2) There has to be a review process in place to keep everyone honest. Arbitrators should be held to same scrutiny as our courts.
There can be no secrets in Justice.

I would also like to express my concern as to where we as a Country are going in relation to our Judicial System. When looking at all of the contracts we sign everyday, it's the people who are authoring these contracts that include "the arbitration clause". As long as Binding Mandatory Arbitration is allowed, it seems obvious that our Judicial System will be controlled by the authors of those contracts. This is our chance to give people a choice, which is ours by birthright. My experience alone should be the red flag needed to change the course we are now on.

RESPONSE TO POST-HEARING QUESTIONS FROM CATHY VENTRELL-MONSEES, ESQ., LAW OFFICES OF CATHY VENTRELL-MONSEES, CHEVY CHASE, MD, ON BEHALF OF THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION

QUESTIONS FOR CATHY VENTRELL-MONSEES
From Linda T. Sanchez, Chair

Responses by Cathy Ventrell-Monsees, National Employment Lawyers Association:

1. Would this legislation, H.R. 3010, sufficiently protect the rights of workers?

Response: H.R. 3010 would adequately protect workers' rights by making mandatory, pre-dispute arbitration provisions unlawful. The only way to protect workers rights is to insure that arbitration agreements are truly voluntary and entered into after a dispute arises.

2. In your written testimony, you indicate that some military and reserve personnel returning from Iraq and Afghanistan are not getting their jobs back. This is troubling. Please explain how arbitration agreements can prevent our returning soldiers and marines from returning to their jobs.

Response: Two cases in which reservists lost their jobs due to their military service illustrate this point. In *Garrett v. Circuit City Stores*, 449 F.3d 672 (5th Cir. 2006), a military reservist sued under the Uniformed Services Employment and Reemployment Act (USERRA), 38 U.S.C. § 4302(b), claiming Circuit City did not preserve his job when he was returned from Iraq. The court held that he had lost his right to bring his claim in court and was forced into arbitration. In upholding the arbitration agreement, the court expressly ignored language in the House Committee Report that stated that arbitration of a USERRA claim would not be required or binding. 449 F.3d at 679.

The other case is *Landis v. Pinnacle Eye Care*, 2007 WL 2668519 (W.D.Ky.2007), in which the plaintiff claimed that the company demoted him upon his honorable discharge from the military. Landis claimed that his employer made it clear that his deployment had caused his demotion and any further involvement with the military would deprive Landis of further career opportunities. The district court ordered the case to proceed through arbitration.

I would also like to add to the record information about a question you posed during the hearing. You asked me to comment on the suggestion by Professor Rutledge that arbitration provided a hearing for all employees, most of whom would not find an attorney to take their case. As support for his argument, Professor Rutledge cites to the testimony of a NELA founder that "employment attorneys turned away at least 95% of employees who sought representation." (Rutledge testimony page 8, note 15, Oct. 25, 2007).

The NELA founder, Paul Tobias, did not make such a statement and there is no support in his testimony to the Dunlop Commission or its proceedings for that statement. The 2003 law review article upon which Professor Rutledge relies was based on Mr. Tobias' testimony to the Dunlop Commission in 1994. A review of Mr. Tobias' testimony and the minutes of the Dunlop Commission reveal no such number.

In his testimony, Mr. Tobias stated that attorneys turn away of a lot employment cases because most people have no rights or claims, or because of costs, but he never gave a percentage or number. (See page 6 of testimony at: http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1433&context=key_workplace.) The minutes from that day's proceedings of the Dunlop commission make no mention of lawyers turning away 95% of employment cases. What Mr. Tobias did say was that 95% of employees don't want their jobs back (See, p 2 of the transcript at: http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1425&context=key_workplace.)

Thus, there is no support underlying the assertion in the 2003 law review article and Professor Rutledge's reliance upon it that employment attorneys purportedly turn away 95% of employees seeking representation.

The main reason people can't get lawyers for employment cases is because of the at-will doctrine. Most people have no rights relating to termination. They are getting good advice when attorneys tell them they do not have a legal claim and cannot bring a case.

People have no trouble getting lawyers for meritorious statutory claims because of the provision of attorneys' fees. This is particularly true for wage and hour cases where the damages can be minimal. The combination of having rights and an attorney's fee provision makes it possible for attorneys to take the cases. Similarly, many sex harassment cases have low or no economic damages but attorneys take such cases to stop harassment in the workplace. The Supreme Court case of *Faragher v. City of Boca Raton*, 524 U.S. 775 (1998) is a perfect example. In that case, the court awarded $1 in nominal damages to the plaintiff. But the case set significant precedent by establishing the legal standards employers must follow in responding to harassment claims. Had Ms. Faragher been forced to arbitrate her claim, we would not have the important legal standards we have today.

Moreover, people *need* to be represented by counsel in arbitration; otherwise they get run over. For example, recently there has been a proliferation of pretrial motions in arbitrations. Without legal representation in arbitrations, employees are not able to respond to such motions and thus are having their cases thrown out of arbitration without even a hearing. Indeed, pretrial motions are especially inappropriate where discovery is limited. Unrepresented workers have a far lower win percentage and are routinely dismissed on summary judgment or some other prehearing device.

The fact is indisputable that mandatory arbitration does not create access to justice (nor do companies actually want to implement a system that permits more rather than fewer claims). In fact, arbitration provisions are a deterrent to lawyers taking cases. Companies don't implement mandatory arbitration systems to provide a forum for employees with complaints. They know it is a deterrent to bringing claims and leading management attorneys, such as Paul Cane, urge their employer clients to use mandatory arbitration for its deterrent effect. (June 19, 1996 BNA article attached). Companies also use mandatory arbitration systems to reduce the damages in the cases that are brought. (See Wall Street Journal article, "When Suing Your Boss Is Not an Option" by Nathan Koppel, quoting Connie Bertram, a Washington-based employment defense lawyer at Winston & Strawn LLP.) The high fees, the lower possibility of winning, the smaller damages, the repeat player problem and the possibility of being hit with fees deter people from pursing claims at all.

Questions for the Record from Ranking Member Chris Cannon,
Subcommittee on Commercial and Administrative Law,
"Hearing on: H.R. 3010, The Arbitration Fairness Act of 2007"
October 25, 2007, 2:00 p.m. Room 2141 RHOB

Responses by Cathy Ventrell-Monsees, Esq., National Employment Lawyers Association

1. H.R. 3010 would leave undisturbed mandatory binding arbitration clauses in collective bargaining agreements. Many seem to suggest that binding arbitration leads to collusion between companies and arbitrators against the ordinary individual. Assuming for the sake of argument that that's true, why do you think it's ok for unions and companies and arbitrators to collude against the individual employee under H.R. 3010?
2. If you don't think that's ok, I assume that must then think that mandatory binding arbitration is a good thing for union employees. Why do you want to shut the non-union employees out of it, while the union employee gets in on the deal?

Responses to Questions 1 and 2:
Your questions contain mistaken assumptions about arbitrations under collective bargaining agreements (CBA). First, the arbitration of union employees' employment claims that fall outside of the terms of the CBA is not mandatory. Union members are not required to arbitrate claims under federal, state or local statutes or common law employment claims. They must only arbitrate claims arising from rights granted by the CBA. When employers have tried to use arbitrations under CBAs to preclude union employees from going to court for statutory discrimination claims, the courts have routinely allowed union employees to go to court on their claims. See Lindemann & Grossman, *Employment Discrimination* Law 805 (Supp. 2000).

Second, while an employee can pursue discrimination claims through arbitration under a collective bargaining agreement when the CBA prohibits discrimination, the arbitrator's decision is not binding and has no effect on the employee's right to pursue a discrimination claim in court under federal, state or local law. *See Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974); *Bell v. Conopco, Inc.*, 186 F.3d 1099 (8th Cir. 1999) (voluntary submission of claim to arbitration under collective bargaining agreement does not preclude later discrimination suit in court).

Third, labor arbitration is generally recognized as the result of negotiation between parties of relatively equal bargaining power. This contrasts sharply with "adhesive arbitration contracts --- those drafted and imposed by the party of superior bargaining strength on a take-it-or-leave-it basis…." Lindemann & Grossman, *Employment Discrimination* Law 1414 (1996).

Fourth, unions act as prosecutors on behalf of employees in arbitrations of claims made under a collective bargaining agreement. Therefore, your premise that "unions and companies and arbitrators collude against the individual employee" is mistaken. Fifth, both the union and the employer are recognized as "repeat users" of the labor arbitration system. Therefore, arbitrators are less likely to demonstrate repeat bias for one side, which is a common and serious problem in employer-imposed mandatory, pre-dispute arbitration provisions.

3. What about when the collective bargaining agreement requires arbitration between the union itself and its employees? If you think mandatory binding arbitration is a bad deal, why do you think it's ok for the union to proceed against or defend itself from its members through mandatory binding arbitration?

4. What about when unions bosses conspire to deprive civil rights? It looks like in the end the newer cause of civil rights gets sacrificed to the older cause of unions in H.R. 3010. Why is that a good thing?

Responses to Questions 3 and 4:
NELA opposes predispute mandatory arbitration provisions imposed by any employer, including unions who act as employers. Unions are covered by the federal employment discrimination laws as employers and are subject to the same legal standards as employers. I am not aware of a union that imposes predispute mandatory arbitrations on their employees. If you can provide us with a specific case or union, we might be able to provide a more detailed response.

5. It seems kind of odd that H.R. 3010 favors both unions and trial lawyers, without there being proof that everyone else should get the short end of the stick. Can you reconcile why, on the one hand, non-union folks should be left to the trial lawyers, while union personnel would get to benefit from the availability of arbitration?

Response to Question 5:
Union employees typically have some form of representation in their arbitrations under a CBA. As previously stated, union employees are not bound by an arbitration decision and can file their statutory or common law employment claims in court. H.R. 3010 would give to individual employees the same right to go to court or to voluntarily choose another form of alternative dispute resolution after a dispute arises, such as arbitration. Lawyers who represent individual employees are entitled to their attorneys' fees for their services, whether provided in an arbitration or in a court proceeding. Since many arbitrations consume as much time as court proceedings, there is often little difference in the amount of the attorneys' fees in an arbitration proceeding versus a court proceeding. Thus, your premise that H.R. 3010 benefits attorneys (as well as unions) is mistaken.

6. In your testimony, you seem to refer to *Walker v. Ryan's Family Steak Houses, Inc.*, in which "almost half of an arbitration provider's annual income came from just one employer's fee," and *Breletic v. CACI Federal, Inc.*, in which "an employee returning from active military service was required to go to Virginia to arbitrate his claims for reinstatement and retaliation -- even though he lived and worked in Georgia." If I'm correct, though, in both of those cases, courts refused to enforce the arbitration agreements. How can those cases be evidence that we need to radically change the arbitration system, if they show the courts adequately policing arbitration under the existing system?

Response to Question 6:
First, the cases to which you refer, *Walker* and *Breletic*, are the exception, not the rule. The majority of courts ruling on challenges to mandatory arbitration clauses have upheld shockingly unfair and even unlawful clauses, such as *E.E.O.C. v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742, 745 (9th Cir. 2003) (employee lost a job offer when he refused to agree to arbitrate); *Tinder v. Pinker Security*, 305 F.3d 728, 730-733 (7th Cir. 2002) (employee was bound by an agreement to arbitrate she claimed she never even saw); *Luke v. Baptist Medical Center-Princeton*, No. 03-14342 (11th Cir. March 11, 2004) (court held employee had to arbitrate her race and age discrimination claims even though she twice refused to agree to the arbitration clause imposed on her after more than 25 years of employment).

The *Breletic* case actually illustrates *not* that courts are "adequately policing arbitration under the existing system," as you claim, but rather the opposite. It is true that the mandatory arbitration clause at issue in *Breletic* was struck down as inconsistent with the Uniformed Services

Employment and Reemployment Rights Act (USERRA) by a federal district court in Georgia. But more recently, the Fifth Circuit Court of Appeals -- a more authoritative court than the district court that decided *Breletic* -- held the opposite. In *Garrett v. Circuit City Stories*, 449 F.3d 672 (5th Cir. 2006), a military reservist sued under USERRA claiming Circuit City did not preserve his job when he was returned from Iraq. The court held that he had lost his right to bring his claim in court and was forced into arbitration. In upholding the arbitration agreement, the court expressly ignored language in the House Committee Report that stated that arbitration of a USERRA claim would not be required or binding. 449 F.3d at 679. (Time Magazine reported the injustice suffered by Marine Captain Garrett on June 14, 2007 in an article entitled "The Veterans' Enemy at Home" by Reynolds Holding.)

Since *Garrett*, we are aware of only one case involving the same issue, *Landis v. Pinnacle Eye Care*, 2007 WL 2668519 (W.D. Ky. 2007), in which the plaintiff claimed that the company demoted him upon his honorable discharge from the military. Landis claimed that his employer made it clear that his deployment had caused his demotion and any further involvement with the military would deprive Landis of further career opportunities. The district court ordered the case to proceed through arbitration, based primarily on the Fifth Circuit's decision in *Garrett*.

If I were representing a veteran returning from Iraq or Afghanistan today who has not received her or his job back from an employer and there was a mandatory arbitration clause, I would say that the courts are (wrongly) more likely to follow the *Garrett* case than the *Breletic* case, and thus advise him or her that it's not worth the time and money to challenge the arbitration clause.

Second, and more important, even when employers *know* that a mandatory arbitration clause is likely to be struck down, it makes economic sense for them to continue to impose MA clauses on employees — because their inclusion deters prospective plaintiffs and their attorneys from pursuing their claims in the first place. Case in point: Circuit City, which has continued to require its employees to sign an arbitration clause since 1995, despite the fact that the clause has been struck down as often as 15 to 20 times. *See, e.g., Circuit City Stores v. Adams*, 279 F.3d 889 (9th Cir. 2001), *on remand from Circuit City Stores v Adams*, 532 U.S. 105 (2001) (striking down clause's unlawful limitations on available remedies).

It should also be noted that there is a huge cost born by employees by mandatory arbitration provisions. It is enormously expensive to challenge an arbitration provision. It can cost more than $20,000 just to undo an adhesive arbitration provision on behalf of an employee who seeks to exercise her statutory and constitutional right to go to court. Even if the employee succeeds in getting a district court to overturn an arbitration provision, the employer can still appeal and drag out the time before an employee can get to a court to actually hear her employment claim.

Thus, there are thousands of unlawful mandatory arbitration clauses that are never challenged or examined by a court in any way. People challenging unfair treatment on the job are left with two choices: to pursue their claims in arbitration, giving up their rights to an impartial judge and a jury trial; or to simply drop their case. This result is entirely contrary to Congress's purpose in enacting statutes to protect employees from discrimination or other exploitation. In a discrimination case under Title VII of the 1964 Civil Rights Act, for example, Judge Coar invalidated an attorney's fee restriction in the employer's MA clause, explaining:

> Title VII's attorney's fees provision is valuable not only because it permits the grant of the actual fees, but also because it promotes the understanding among the legal community that those fees, barring some rare exceptions, will be available to plaintiffs who prevail in their Title VII claims. Forcing employees to arbitrate the issue of attorney's fees chips

> away at the sense of financial security that Congress sought to provide attorneys who represented meritorious Title VII plaintiffs. That, in turn, effectively keeps plaintiffs from vindicating their rights under the federal statute and does not serve the remedial and deterrent purposes of the statute.

Safranek v. Copart, Inc., 379 F. Supp. 2d 927, 934 (N.D. Ill. 2005). This analysis applies with equal force if an employee is forced to challenge the lawfulness of the arbitration clause.

RESPONSE TO POST-HEARING QUESTIONS FROM PETER B. RUTLEDGE, ESQ., THE CATHOLIC UNIVERSITY OF AMERICA, COLUMBUS SCHOOL OF LAW, WASHINGTON, DC

CUA

THE CATHOLIC UNIVERSITY OF AMERICA
Columbus School of Law
Washington, DC 20064

December 19, 2007

The Honorable Linda Sánchez
Chairwoman, Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
2138 Rayburn House Office Building
Washington, D.C. 20515-6216

Dear Chairwoman Sánchez:

Thank you again for the opportunity to testify at the October 25, 2007 hearing on the Arbitration Fairness Act. I hope that you and the other members of the subcommittee found my testimony helpful to your deliberations. This letter responds to your letter of November 20 which enclosed the draft transcript and additional written questions.

As to the draft transcript, I do not have any corrections but do have one clarification which I would request be inserted via amendment at the end of the record and insertion of a footnote in the transcript. It concerns page 86 of the transcript, lines 1871-1881. Those lines of my testimony create the misimpression that Mr. Eppenstein represented the win rate in securities arbitration to be 98 percent. That was not my intention. Rather, my intention was to note that according to William Howard's 1995 study of employment cases (cited on lines 1872-73 of the transcript) 60% of those cases were resolved by pretrial motion and, of those cases, the employer prevailed in 98% of them. Thus, the point that I was trying to make is that – if "win rates" are the optimal measure of the fairness of a dispute resolution system (as the study cited by Mr. Eppenstein presumes) – then the Howard study suggests that the civil litigation system is far more worrisome than arbitration: in terms of outcomes, about the worst place an individual can be is on the receiving end of an employer's summary judgment motion.

As to the written questions, I have attached to this letter my answers. The numbering of the answers tracks the numbering of each set of questions

If you have any questions, please do not hesitate to contact me at (202) 319-5726. Wishing you the best for the holidays, I remain

Sincerely yours,

Peter B. Rutledge
Associate Professor of Law

ANSWERS TO QUESTIONS FROM CHAIRWOMAN SÁNCHEZ

1. This question really has two subparts so let me answer them in order. The first concerns the original intent of the Federal Arbitration Act ("FAA"). As you know, the legislative history on the FAA is sparse. While some of that history suggests that the bill was designed primarily to cover business-to-business disputes, other bits suggest that the bill, more generally, was designed to benefit individuals. *See* S. Rep. No. 536, 68th Cong., 1st Sess. 3 (1924) (FAA will appeal "to big business and little business alike, ... corporate interests [and] ... individuals"). In that latter regard, I believe a legal system supportive of arbitration is consistent with that original intent.

   The second subpart of the question concerns balancing the need for consumer protection and the desire to keep down the costs of dispute resolution. I believe that the answer to this question rests on three pillars. The first is the availability of adequate data – such data will provide an opportunity to assess outcomes and economic impact. The second is industry self-regulation, as exemplified by the Due Process protocols about which Mr. Naimark testified. The third is the judicial oversight envisioned by the FAA, both at the front-end of the process (whether to enforce the agreement) and the back end (whether to enforce the award). A wholesale prohibition of predispute resolution, as the Arbitration Fairness Act proposes, would not achieve those two goals identified in your question.

2. The cost point is an important one. Here, it's important to note that you can use two different baselines. *See generally* Leroy & Feuille, *When is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Gree Tree of Mandatory Employment Arbitration*, 50 U.C.L.A. L. Rev. 143 (2002). One baseline compares "forum costs" (that is, things like filing fees, hearing fees, etc.). Based on this measure, some arbitrations might seem more expensive than litigation (though some clauses and some associations eliminate this problem through caps on the individual's share of fees). The other baseline compares dispute resolution costs as a whole (that is both forum fees and attorney's fees). Based on this measure, arbitration might well be cheaper than litigation – particularly if the amount saved on attorney's fees (through arbitration's more streamlined process) exceeds the higher forum fees.

   Accepting, though, that arbitration is sometimes more costly, then I think the proper mechanism to regulate that matter is through Section 2 of the FAA as interpreted by the Supreme Court in *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000). At bottom, a court can decline to enforce an arbitration agreement on the basis of its unconscionability, and the burdensomeness of the forum fees, *Randolph* makes clear, can serve as the basis for such a finding. To be clear, though, the Arbitration Fairness Act does not address the issue of costs; it would dispense with predispute arbitration agreements altogether, a result that, as I mentioned in my testimony, may well worsen the access to justice for some of the same individuals whom its supporters are trying to protect.

3. The Arbitration Fairness Act covers wide swaths of arbitrations, and the need for data varies with the sector. As to topics like employment arbitration or securities arbitration, we generally have pretty good data except on two points: (1) we are only beginning to grasp the net economic cost of eliminating arbitration and (2) it is difficult to measure the effect of these systems on settlement dynamics (since settlements, unlike arbitration awards, may be difficult to measure).

   As to consumer arbitration, we would need the answer to these two questions; in addition, we would want much more extensive data on matters like win rates, recovery rates, cost sharing, and survey results.

   As to franchise arbitration, we would need the answer to all of the foregoing questions and, additionally, would want to know more about the contracting patterns.

4. The relationship between arbitration and class actions is an important one. But opponents of arbitration who criticize its effects on class actions are overstating their case. First, we only have a limited sense of the prevalence of class action waivers. The 2004 study by Demaine and Hensler, discussed in my written testimony, noted that class action waivers only appears in about one-third of the arbitration clauses that they reviewed. *See* Demaine & Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 L. & Contemp. Probs. 55 (Winter/Spring 2004). Second, class actions are not necessarily inconsistent with arbitration. The Supreme Court in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), implicitly approved of class-action arbitrations. So if Demaine and Hensler are right that class action waivers are not so prevalent, then the question is not over the use of class actions but simply the forum in which they are pursued. Third, the statement from Mr. Levin's testimony begs the question whether these cases even would qualify for class-action status. If a product malfunctions or an employee is the victim of harassment, those cases are not going to qualify for class action status in civil litigation because they likely will not satisfy the typicality requirement. Finally, class actions are not the only mechanism by which a legal system can achieve deterrence, even as to small value claims. Government agencies and attorneys general, who are not parties to the underlying arbitration agreements, maintain the authority to prosecute court actions on behalf of aggrieved individuals, thereby achieving the desired marginal deterrence.

5. I must quibble a bit with the premise of the question that consumer and employment arbitration entails intractable problems. But to the question of non-binding mediation, I do not believe that Congress is presented with a mutually exclusive choice between the two systems of alternative dispute resolution. Indeed, the 1997 GAO report cited in my testimony, among others, illustrates how arbitration and mediation can work hand-in-hand as part of a company's dispute resolution system. A mediation system can resolve some disputes before they ever reach arbitration. To be sure, arbitration is an essential piece of that dispute resolution system – it provides the backstop when the other dispute resolution steps have failed. But, to your question, Congress should certainly encourage

mediation as part of a broader dispute resolution scheme, but one that should include arbitration as well.

6. I am not entirely sure that I understand the question. The point, I believe, is that it's entirely possible for business to support a system that saves money but also makes the individual better off. Even if individuals recover more frequently in arbitration or if arbitration lowers the access to justice barriers that individuals encounter in our civil litigation system, a company might still support it if it enables the company to realize net savings in its dispute resolution costs. I believe the GAO report cited in my testimony makes that point particularly vividly.

7. This is a complex question. At one time, some other countries, notably in South America and Europe, prohibited certain predispute arbitration agreements in consumer and employment disputes. In some cases, both in Europe and Canada, some jurisdictions are backing away from that rule and allowing predispute arbitration agreements in certain circumstances in disputes between an individual and a company. *See* Gary Born, *International Commercial Arbitration* (forthcoming 2008). More importantly, I think two critical features differentiate those foreign systems from our own – (a) the rules governing attorneys' fees and (b) the limits on procedural devices such as discovery and class actions. Most foreign systems prohibit contingency fee arrangements and require the losing party to pay at least a portion of the prevailing party's attorney's fees. These rules discourage marginal or frivolous actions that might be brought here purely for settlement or harassment value. Most foreign systems also do not permit extensive party-drive discovery. The effect of this rule is to limit the crippling effects on a company of having to comply with extensive discovery requests (which may be propounded simply to extract a settlement in an amount below the legal costs of complying with the discovery). Frankly, these two differences reduce the strain on the judicial system and the costs of dispute resolution, thus reducing the need for a system of alternative dispute resolution for these sorts of claims.

ANSWERS TO QUESTIONS FROM RANKING MEMBER CANNON

1. Generally speaking, yes, arbitration is able to deliver justice to individuals and to companies. It resolves cases more expeditiously than the civil justice system. By most measures, individuals achieve superior, or at least comparable, results in arbitration compared to civil litigation. Finally, by lowering the costs of dispute resolution, arbitration overcomes some of the access-to-justice problems that plague our civil justice system.

2. Yes, arbitration should be encouraged precisely because each party is at the head of the line for the arbitrator (rather than having to take a number at the courthouse and wait in line). Some might argue that speedy results are not just if they are not the product of a fair process. But by and large arbitration providers have done a decent job of ensuring that their processes are fair and, as I noted in my testimony, existing mechanisms are in place to weed out the unfair ones.

3. I think you have identified a very important point in placing this debate over arbitration in the context of contractual freedom more generally. Encouraging people to read the fine print of their agreements is a good lesson in sound consumer practices. Eliminating the enforceability of contracts does not help anyone. The logic of those who oppose arbitration would be to eliminate the ability of parties to contract freely, even when those contractual agreements are in their interest. Arbitration clauses would not provide a logical stopping point. Forum selection clauses and choice-of-law clauses also would be on the chopping block.

4. You are right. One apparent lesson from the hearing is that supporters of the Arbitration Fairness Act worry about the individual's ability to afford counsel and thereby obtain access to justice. But eliminating arbitration would undercut this very objective – it would put lawyers out of reach for all except the big-ticket plaintiffs who could hold out the promise of high fees through settlement or verdict. Encouraging alternative dispute resolution lowers the costs of the dispute, thereby enabling attorneys to provide services efficiently and economically. Perhaps one way to accomplish this would be to encourage the creation of arbitration litigation clinics (such as the one at Pace University) where law students operating under the guidance of clinical faculty could help to represent individuals in such proceedings.

5. You are right to pick up on the ability of the market to develop best practices tailored to the exigencies of a particular problem. The due process protocols, developed by several arbitration associations in conjunction with various stakeholders, supply a perfect illustration. Those protocols, which cover employment, consumer and health care disputes, contain a certain common core of procedural protections. At the same time, they vary slightly in their details, variations explained by the nature of the dispute. Thus, this market-based regulation helped the stakeholders to tailor rules appropriate to the types of cases before them. Moreover, where adjustments became necessary (such as the rules governing the individual's share of the fees in a consumer dispute), the providers could react nimbly. By contrast, a regulation or law proscribed by Congress

would be neither tailored to the type of case nor easily adaptable based on changing circumstances.

6. Yes, arbitration did not evolve in a vacuum. As the 1997 GAO study cited in my testimony makes clear, it came about because of failures in our civil justice system – overcrowded dockets, slow results and high costs. Removing that alternative does not solve the problems with the civil litigation system but, rather, exacerbates them.

7. Until I read the September 2007 Public Citizen report, I was unaware of allegations that an arbitrator had been "blackballed." While the report does contain an allegation about one arbitrator to that effect, I am unaware of anything suggesting that this is a pervasive problem. As to the point regarding forum shopping, you are exactly right – forum shopping occurs in our civil litigation system, as evidenced, for example, by the frequency with which major pieces of class action litigation are filed in certain counties in the country or major pieces of civil litigation are filed in districts with relatively more favorable precedent on a particular issue.

8. The "unequal bargaining power" language in H.R. 3010 is incredibly vague and, if the bill were enacted, would almost certainly invite satellite litigation over its applicability.

9. The bill's proposal to invalidate predispute arbitration agreements in franchise relationships is one of its most puzzling aspects. No one is compelled to be a franchisee; it is a voluntary economic investment like any other. Parties can (or should) make those investment decisions circumspectly, not rashly. To suggest, therefore, that franchisees are some unsuspecting class requiring paternalistic legislation strikes me as untenable. More importantly, to invalidate clauses in preexisting contracts between businesses sends a very dangerous message about the integrity and enforceability of commercial relationships.

10. Absolutely. Defenders of H.R. 3010 who cite the right to jury trial as a reason to abolish predispute arbitration agreements are mistaken. Most studies, which are cited in my written testimony, indicate that only a very small fraction of cases filed in civil court ever are decided by a jury. Either a judge dismisses them, or they settle.

11. I am not as familiar with demographics of intellectual property holders and franchise agreements. Regardless, though, as I indicated above, I agree with you that Congress should not presume to know what is best for these industries or to upset the stability and enforceability of contractual agreements.

12. I addressed the study cited by Mr. Eppenstein in a letter to Chairwoman Sánchez following the hearing. I reproduce here the relevant passage from that letter:

    "I wanted to supplement the record to make three points about the methodology in that study. First, it should be noted that this study used a methodology that focused on actual recovery relative to amount claimed. There are some merits to

this approach, but one drawback is what economists call the "moral hazard" problem. The plaintiff's attorney may have a strong incentive (and little disincentive) to claim a high amount of damages in her complaint. While this may be a sensible settlement strategy, it skews the data by suggesting that claimants recover less than the amount that they were seeking (even if that amount bears little resemblance to their actual damages).

Second, it should be noted that the decline in favorable outcomes for investors appeared to coincide with the popping of the technology bubble in late 2001 and 2002. Given the losses that investors experienced during this period, it perhaps is unsurprising that the amount claimed increased while recoveries remained constant or dipped slightly. That simply means that people had a lot to fight about; it does not necessarily demonstrate that the securities arbitration system was inherently flawed.

Third, as with any time series data set, the baselines are important. The baselines used in this study suggest a decline over the particular time period chosen by the authors. But the data could easily be sliced along different time axes to suggest a smaller dip in win rates or even a relative constancy.

To be clear, I do not mean to suggest that the study is fundamentally flawed. It is an important contribution to the empirical literature in this area. Rather, these comments simply are designed to help put the study and the methodological choices embedded in it into perspective."

RESPONSE TO POST-HEARING QUESTIONS FROM THEODORE G. EPPENSTEIN, ESQ., EPPENSTEIN AND EPPENSTEIN, NEW YORK, NY

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February 9, 2009

Via Fax (202) 225-3746
Mr. Norberto Salinas, Counsel
U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Commercial Administrative Law
2426 Rayburn House Office Building
Washington, DC 20515

Re: Hearing on H.R. 3010, The Arbitration Fairness Act of 2007

Dear Norberto:

The following are answers to questions from Linda T. Sanchez, Chair and Chris Cannon, Ranking Member:

Questions from Linda T. Sanchez, Chair

1. You have spoken about the declining prospects of investor recoveries in SRO arbitrations. Is it possible to compare how investors would have done if they had brought these claims to court?

Answer: Because of mandatory pre-dispute arbitration agreements I do not believe it is possible to conduct a statistically viable study of how, hypothetically, investors would fare before a judge and jury as opposed to being forced to have a panel of arbitrators hear their cases. Investors typically do not bring the same exact claim to a court and arbitration because it is either one or the other that has jurisdiction to adjudicate these investment cases.

The key to this inquiry is the perception of investors that they would do better before a court with a jury rather than in an arbitration proceeding. In February 2008 SICA (the Securities Industry Conference on Arbitration, whose members include representatives of FINRA, an industry lobbying group, SIFMA, and public members such as myself) published a useful study of the perceptions of securities arbitration participants entitled: "Perceptions of Fairness of Securities Arbitration: An Empirical Study"*. One of the questions concerned investors who, during the past five years, had experiences in court and also in a securities arbitration proceeding.

The results were significant. Seventy six percent of the investors who responded found arbitration to be "unfair" compared with their court experience.

2. The industry says that most cases that are filed in SRO arbitrations settle and customers get funds paid to them without having to go through a trial. Does that not show that the SRO system is working well if the majority of customers settle their claims without even having to put on their case?

Answer: Settlements do not show that the SRO system is working. If anything, settlements indicate the opposite. The statistics on how customers fare in SRO arbitrations are not a secret. FINRA has published its customer results for arbitrations conducted in 2007 that show an all time low win rate for customers of 37%. This means customers lost 63% of the time that their cases went to decision by an arbitration panel. For purposes of comparison, the statistics assembled by the GAO just after the McMahon case show that in 1988 to 1990 customers were winning approximately 60% of the time. As I testified, there has been a sliding scale downward of customer victories from 2002 to 2007 (there was slight improvement in 2008). The industry also is aware that when the customer does win, the customer does not recover anywhere near his losses. In another recent study published in 2007, "Mandatory Arbitration of Securities Disputes, A Statistical Analysis of How Claimants Fare" [E. O'Neal and D. Solin], the authors analyzed 14,000 arbitration awards rendered from 1995 to 2004. They examined not just the win rates but also the recovery rates, and they factored these together to get an "expected recovery rate" for investors. The study showed that investors could expect to recover 22 cents on the dollar and, if the cases involved the largest brokerage firms, the customers expected recovery rate dropped to about 12 cents. Customers and the broker/dealers and their attorneys are aware of these studies and statistics. Public recognition of the consequences that Claimants may face if they go the hearings on the merits often results in low offers and low settlements. If investors had access to a judge and jury, it would be expeeted that the cases that should settle would do so at a much higher level.

3. At times we have heard that the federal judiciary is over burdened with cases and that has given rise to alternative dispute resolution systems to take up the overload. If we propose a bill to give back to securities customers the constitutional right to go to court, how will that affect the federal docket?

Answer: The effect on the federal docket will not be significant. Commodities cases can go to the reparations program and securities claimants can choose, especially in the smaller cases, to stay in arbitration. Many cases might also be filed in state courts under state statutes. Those that are filed in federal court might total a few thousand cases, per annum, but this would only comprise one to two percent of the entire federal docket and would not disturb case administration.

4. You advocate for an arbitration system which is independent of the security (sic) system. Is that not what the American Arbitration Association and JAMS and others are? Are they not alternative forums suited for the securities industry? If not, then why?

Answer: Many critics of the SRO arbitration system have asked Congress for an independent forum in which customers can bring their disputes. The current alternative arbitration forums, which hear other types of disputes such as employment and consumer disputes, are not subsidized by the securities industry as FINRA is. As a result, the cost of the filing fees can be quite high and in some instances over $10,000; the arbitrators are paid by the hour instead of by the session which almost always results in a significantly higher sum that is paid by the parties to arbitrate their case; and previously, we have seen some alternative providers attempt to structure their rules to disadvantage Claimant investors. For example, the American Arbitration Association in the 1990s devised a special set of securities arbitration rules which would have required an individual from inside the securities industry to sit as one of three arbitrators in each case. This "industry arbitrator" is one of the biggest complaints which I have brought to your attention and a problem that other investor right groups complain about. Indeed, the states' securities administrators organization, NASAA (North American Securities Administrators Association), has supplied a written statement to you asking for the elimination of the industry arbitrator. Furthermore, these independent providers do not have the oversight of the SEC and are not answerable to any higher authority (other than in very limited court proceedings to confirm or vacate an award, and then, usually only after the plaintiff loses).

I have asked that you mandate development, by the SEC with the assistance of investor and industry participants, of an independent arbitration forum outside of the securities industry so that investors may obtain a fair hearing at a forum where only true neutrals serve as arbitrators. This should be funded and sponsored by the securities industry as they currently do at FINRA. I have suggested that, since the NASD paid $175 million to its members (broker/dealers) to vote in favor of the consolidation of the arbitration and regulatory divisions of the NYSE and NASD into FINRA, ostensibly as part of the cost savings that consolidation would reap, a portion of this sum or future cost savings should be passed onto the investor by way of the creation of this independent forum. In the interim, during the formulation of this independent forum, I have also asked that you mandate specific changes to the FINRA system, including: (a) the elimination of the "industry arbitrator"; (b) "puring" the public pool of arbitrators to weed out anyone with ties either directly or indirectly to the securities industry; and (c) take steps to end the abusive discovery tactics which FINRA and its arbitrators have countenanced.

5. One of the assertive benefits of arbitration is that an arbitrator is an expert in the field. And yet you argue in your written testimony that something is wrong with having someone experience in the industry on every panel? Why?

Answer: The so-called "asserted" benefits of an industry arbitrator is a myth created by

the industry and its advocates. While it sounds good to have someone with prior knowledge of the rules and regulations to sit in judgment, this is not a necessity in a court case and our jury system has worked well for many centuries without any such requirement. Certainly if and when there are matters which require an expert in the field, the parties will bring in their own experts who will advise an independent panel of industry rules, regulations, policies and procedures and whether they have been complied with or not. This regularly occurs in our current SRO system of arbitration. Furthermore, the investor has a continuing concern as long as there is "an industry arbitrator" on each panel that this individual has the appearance if not the potential of being biased. This perception was reported by almost one-half of all the investors who participated in arbitrations that went to award in 2005 and 2006 according to the SICA Empirical Study. Indeed, only 19% of the other participants believed that arbitrators are not biased. Another study was finalized and published in 2009 called "The Attorney as Arbitrator." This study shows that the awards rendered by the attorneys who represent industry participants, who act as arbitrators, tend to be lower for the investor than awards rendered by other arbitrators. Lastly, I would point out that the arbitrator selection process at FINRA does not function to pair specific industry arbitrators who match up with the issues present in the case they are asked to sit on. So whatever experience the industry arbitrator may have, it would not necessarily be useful to the issues at hand. The customer's perceptions and concerns, that these industry arbitrators are beholden to the very industry on trial; that many of them are still employed in the securities industry and fear being black-listed if they participate in an unfavorable award to the industry; and that there exist undisclosed conflicts of interest, all strongly support the necessity of dispensing with the industry arbitrator.

6. How will HR 3010 help protect investors?

Answer: The legislation will provide investors with the ability to choose to have a court and jury trial, a choice that investors have not been able to utilize since the Supreme Court decided the McMahon case in 1987. While arbitration does have a place as an alternative, not mandatory dispute resolution arena, the current system run by FINRA fails in many respects. The public has no confidence in the industry sponsored SRO system and it should be eliminated. If investors do not believe they will get a fair hearing, the integrity of the marketplace is diminished. The American system of justice, to afford an aggrieved party due process in a jury trial, should not be usurped by an industry "agreement" that is not entered into by the public at arms length. For investors, Congress is indeed their last hope to change this inequality.

Mr. Norberto Salinas, Counsel
February 9 2009
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Questions for the Record from Ranking Member Chris Cannon,
Subcommittee on Commercial and Administrative Law,
"Hearing on: H.R. 3010, The Arbitration Fairness Act of2007,"
October 25, 2007, 2:00 a.m., Room 2141 RHOB

Questions for Theodore Eppenstein, Esq., Eppeustein & Eppenstein

1. By banning pre-dispute arbitration agreements, this bill would essentially eliminate or severely limit the use of arbitration in consumer, employment and other types of contracts. There is always an incentive for at least one party to use the courts to their advantage. So don't you believe many more disputes would have to be decided in court?

Answer: From the securities industry perspective, I don't agree with your premise. The Bill would not eliminate mandatory arbitration at FINRA which is where the cases against its member firms are currently heard. The Bill would effectively give the choice to the customer to go to court. Some cases would be filed in court and others would not.

2. How many of these cases do you think there would be -- thousands? hundreds of thousands? millions?

Answer: According to FINRA's records, new case filings fluctuated the last three years between just over 3,000 to under 5,000 total filings a year nationwide. While many customers might opt to remain in an arbitration process that is independent of the industry and run under a new set of rules as I proposed, the filings in our court system might increase by only a few thousand a year which is a very small percentage of the total filings currently.

3. Arbitration costs are paid by the parties to the dispute. Wouldn't these costs be shifted to the courts and ultimately to taxpayers? This could mean literally millions of dollars in extra costs piled upon taxpayers.

Answer: I don't agree that millions of dollars in extra costs would be created and paid for by taxpayers. There are fees which are charged by the courts in order to file and prosecute a case. The fact is that arbitration costs to the public investor is part of the problem created by mandatory arbitration. Gretchen Morgensen of the New York Times wrote about this problem in her piece entitled "When Winning Feels a Lot like Losing." Here, she reported how, although a public investor "won" an arbitration award, the expenses were higher than the award.

4. Who would handle the cases? It is doubtful that lawyers would handle many of these since they are mostly small dollar claims. So who would do it?

Answer: Typically, lawyers don't handle small dollar claims in arbitration in the securities area. Again, under the procedures I mentioned in my testimony, an independently run

arbitration forum should be created, subsidized by the securities industry but administered outside of it with new rules which include the right to process smaller claims without the necessity of an attorney's assistance. FINRA currently has a procedure for claimants to file their own small claims by letter.

5. If it is the consumer, the franchisee or the employee, he or she often would probably go to small claims court. That can be done now, so what does H.R. 3010 accomplish?

Answer: Currently, if there was a small claim for an investor, he or she is barred by the industry arbitration agreement from bringing that case to small claims court. H.R 3010 would rectify that problem and permit investors to go to court.

6. Our court system already has a significant backlog of cases with people waiting for resolution of their disputes. By throwing away arbitration won't we be further choking the court system and unnecessarily delaying the resolution of these disputes?

Answer: No. The additional cases will not be substantial; many will settle and the rest will not add a strain to the court system.

7. If arbitration options were reduced, wouldn't that tend to hurt consumers, franchisees and employees by driving up the costs of litigation and the costs of products and services, under the classic laws of supply and demand? Doesn't your firm and firms like it stand to benefit from that? Why should that be allowed?

Answer: I don't agree with your premise. H.R. 3010 would give to the investor the right to choose to have a judicial proceeding in order to obtain justice. Currently, the securities arbitration forum has been called a "stacked deck" in favor of the industry since one member on each three person panel needs to be affiliated with the industry. My testimony tracked the steep decline in the win/loss ratios and the small expected recovery rate when customers are successful. Customers are being hurt by being forced into mandatory arbitration.

8. Under that same logic, who would be more likely to benefit from reduced alternative dispute resolution options for consumers, franchisees and employees the consumers, franchisees and employees themselves, or the trial lawyers and public interest litigation firms who bring the litigation that competes with arbitration?

Answer: I don't see the logic here. If you compare the small chance of winning and of significant recovery in securities arbitration against potential for the public to win a court jury verdict, the stark fact of the benefits which court litigation provides outweighs the detrimental treatment often occurring in securities arbitration. The prospect of court litigation with the unmasking of the mistreatment of investors by their brokers and brokerage firms would provide more than enough incentive for significant settlements to be offered by the industry to settle

claims filed in court. Since most cases in the securities area are handled on a contingency basis, your logic fails.

9. Some argue that companies are able to use their repeat experience and expertise in arbitration to abuse and manipulate the arbitration process, to consumers', franchisees' and employees' detriment. Isn't a company that's savvy enough to do that likely to be savvy enough to abuse and manipulate the litigation process to consumers', franchisees' and employees' detriment?

Answer: You missed the point here. Securities industry defendants have shown to be successful in arbitration proceedings due to the inherent abuse of the current arbitration process. Not only is the composition of the panel unfair to the investor, but it is discovery abuse, prolonged delays and postponements, and the inability to choose from a fair pool of arbitrators that are the main problems, not how "savvy" the defendants are. Judges and magistrates monitor the court process. Arbitrators don't answer to the forum, nor can the SEC or FINRA guarantee that the arbitrators are following the law.

10. Courts have ruled that arbitration is a procedural right, not a substantive one. It is also a faster and cheaper procedure. Don't both parties to a transaction stand to benefit from the procedures afforded by arbitration? If so, why should an arbitration option be taken away from consumers, franchisees, employees and companies?

Answer: Arbitration clauses in securities customers' agreements have become contracts of adhesion. The public investor is not given the right to opt out of the printed forms that they are given. Firms refuse to handle investments unless arbitration within the industry is agreed to. It is also highly debatable whether the SRO process is faster or cheaper. As mentioned above, the public investor does not benefit from the arbitration procedures at FINRA. As I testified, the investor should be given the right to choose to file a case in court. A new arbitration forum should be established should the customer wish to go there.

***SICA Study: Highlights of Findings**

On February 6, 2008, SICA released "Perceptions of Fairness of Securities Arbitration: An Empirical Study." The results, obtained through the work of two law professors from Pace University School of Law (Jill Gross) and University of Cincinnati College of Law (Barbara Black) with the assistance of the Survey Research Institute from Cornell University, demonstrate:

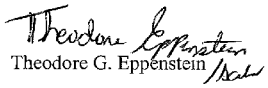
- 63 percent of the customers who responded either disagreed or strongly disagreed that the arbitration process was fair;
- Almost 50 percent of customers disagreed that arbitration was without bias for all parties, compared to only 19 percent who agreed that there was no bias for all parties;

- In comparing securities arbitration to recent court experiences, 76 percent of customers responding found arbitration to be unfair;
- When asked whether arbitration was economical for all parties, 37 percent of customers responding disagreed;
- As for whether customers found arbitration was "simple" for all parties, more customers disagreed than agreed.

A full copy of SICA's Empirical Study dated February 6, 2008 appears on the Pace website at www.law.pace.edu/files/finalreporttosica.pdf.

My thanks to the Subcommittee for giving me the opportunity to address H.R. 3010.

Best regards,



Theodore G. Eppenstein

TGE:salw