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# S. 1782, THE ARBITRATION FAIRNESS ACT OF 2007

## HEARING

BEFORE THE

SUBCOMMITTEE ON THE CONSTITUTION

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

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# S. 1782, THE ARBITRATION FAIRNESS ACT OF 2007

**WEDNESDAY, DECEMBER 12, 2007**

U.S. SENATE,
SUBCOMMITTEE ON THE CONSTITUTION,
COMMITTEE ON THE JUDICIARY,
*Washington, D.C.*

The Subcommittee met, pursuant to notice, at 9:32 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Russell D. Feingold, Chairman of the Subcommittee, presiding.

Present: Senators Feingold and Brownback.

## OPENING STATEMENT OF HON. RUSSELL D. FEINGOLD, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Chairman FEINGOLD. I call the Committee to order, and good morning, everybody. Welcome to this hearing of the Subcommittee on the Constitution on S. 1782, the Arbitration Fairness Act of 2007.

I want to welcome our witnesses and thank them for taking the time to join us this morning and give us the benefit of their expertise on this very important topic. I look forward to hearing your testimony.

One of the most fundamental principles of our justice system is the right to take a dispute to court. Indeed, all Americans have the constitutional right in civil and criminal cases to a trial by jury. The right to a jury trial in civil cases in Federal court is contained in the Seventh Amendment to the Constitution. Many States provide a similar right to a jury trial in civil matters filed in State courts.

Now, I have been concerned for many years that mandatory arbitration clauses are slowly eroding the legal protections that should be available to all Americans. A large and growing number of corporations now require millions of consumers and employees to sign contracts that include mandatory arbitration clauses. Most of these individuals have little or no meaningful opportunity to negotiate the terms of their contracts, and so they find themselves, if they even realize that the provision is in the contract, having to choose either to accept a mandatory arbitration clause or to forgo securing employment or needed goods and services. Perhaps most disturbingly, mandatory arbitration clauses are being used to prevent individuals from trying to vindicate their civil rights under statutes specifically passed by Congress to protect them.

There is a range of ways in which mandatory arbitration can be particularly hostile to individuals attempting to assert their rights.



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For example, the administrative fees—both to gain access to the arbitration forum and to pay for the ongoing services of the arbitrator or arbitrators—can be so high as to act as a de facto bar for many individuals who have a claim that requires resolution. In addition, arbitration generally lacks discovery proceedings and other civil due process protections. Furthermore, under a developing body of case law, there is no meaningful judicial review of arbitrators' decisions.

Unfortunately, in a variety of contexts—employment agreements, credit card agreements, HMO contracts, securities broker contracts, and other consumer and franchise agreements—mandatory arbitration is fast becoming the rule rather than the exception. The practice of forcing employees to use arbitration has been on the rise since the Supreme Court's Circuit City decision in 2001. Unless Congress acts, the protections it has provided through law for American workers, investors, and consumers will slowly, but surely, become irrelevant.

Just as its name suggests, the Arbitration Fairness Act is designed to return fairness to the arbitration system. Arbitration can be a fair and efficient way to settle disputes. I strongly support voluntary alternative dispute resolution methods, and we ought to encourage their use. What this bill does, though, is ensure that citizens once again have a true choice between arbitration and the traditional civil court system by making unenforceable any predispute agreement that requires arbitration of a consumer, employment, or franchise dispute. The bill does not apply to mandatory arbitration systems agreed to in collective bargaining, and it certainly does not prohibit arbitration if all parties agree to it after a dispute arises.

Let me quickly address two questions that have arisen about the bill. First, it is intended to cover disputes between investors and securities brokers. I believe that such disputes are covered by the definition of consumer disputes, but to clear up any uncertainty, we will make the intent even clearer when we mark up the bill in committee.

Second, as I mentioned, the bill covers consumer, employment, and franchise disputes, each of which is a defined term. In addition, it covers disputes that arise under civil rights statutes or "any statute intended...to regulate contracts or transactions between parties of unequal bargaining power." Now, some opponents of the bill have seized on that language and misstated it, saying that the bill covers any contract between parties with unequal bargaining power. They then say that such a provision is overbroad and very vague. I actually agree that such a provision would be problematic, but, of course, that is not what the bill says. The provision in question is essentially a savings clause so that a cause of action under a civil rights statute or a statute that is specifically designed to address disparities of bargaining power can be brought in court, even if the dispute does not meet the definition of a consumer or employment or franchise dispute. So I hope this helps to clear up any misunderstanding about the scope of the bill.

In our system of Government, Congress and State legislatures pass laws and the courts are available to citizens to make sure those laws are enforced. But the rule of law means little if the only forum available to those who believe they have been wronged is an

alternative, unaccountable system where the law passed by the legislature does not necessarily even apply. This legislation both protects Americans from exploitation and strengthens a valuable alternative method of dispute resolution. So I look forward to exploring the implications and the details of this bill with our witnesses.

[The prepared statement of Senator Feingold appears as a submission for the record.]

Let me now turn to my friend and Ranking Member, Senator Brownback, for any opening remarks he would like to make, and I want to thank him and his staff for cooperation in putting this hearing together. Senator Brownback?

**STATEMENT OF HON. SAM BROWNBACK, A U.S. SENATOR FROM THE STATE OF KANSAS**

Senator BROWNBACK. Thank you very much, Senator Feingold. I appreciate that, and I would like to—I have a series of items I want to enter into the record about this topic. I would ask that they be placed in the record at the end of my statement, if that would be possible.

I want to thank my colleague for holding the hearing. I appreciate the witnesses for being here. It is an important topic. It is one that I believe that the statute that is being proposed is overly broad and will be subject to an interpretation that goes far beyond the intent that has been stated here by the author of the bill.

In 1925, Congress passed the Federal Arbitration Act. The Act embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts. It was intended to overcome judicial resistance to arbitration.

The bill before us today, S. 1782, would decimate many provisions of this and over eight decades of Federal policy favoring arbitration. It would invalidate countless contracts, clogging our court system, I believe, with claims and depriving consumers and other people with less access to the courts, the so-called, in often cases, little guys have their only real chance of meaningful recovery. I am hopeful that the author of this legislation can persuade me differently, but I think that is what this will lead us toward.

Let me develop that. The bill's supporters claim that it is intended to help people with less influence in the system—powerless employees, consumers—avoid contracts of adhesion. Its sweeping scope belies, I believe, that purported goal. The bill would render unenforceable all—this is a quote—"pre-dispute arbitration agreements in employment, consumer, and franchise contracts." The bill does not distinguish between, on the one hand, the so-called fine print arbitration agreements that supporters attack as unfair and, on the other hand, fully negotiated contracts between sophisticated parties. The bill would apply not only to the teenager working at a fast-food joint, but to the CEO who brought in his own attorney to negotiate a generous employment contract.

The fact of the matter is that in our system the person, the so-called little guy, is by and large better off in arbitration than trying to get to court. Arbitration is cheaper than litigation, and it leads to faster results for plaintiffs. Numerous studies also show that arbitration is more favorable to consumers and employees than litigation.

For example, the National Work Rights Institute found that employees were almost 20 percent more likely to win employment cases in arbitration than they were to win in court. A California study showed that consumers won 65.5 percent of their arbitration claims against businesses as opposed to between 60, 61 percent of lawsuits nationwide. When you add settlements into the equation, the vast majority of consumers who arbitrate against businesses resolve their disputes satisfactorily.

Moreover, the settlements or awards that plaintiffs receive in arbitration are typically the same as or even larger than court awards. Arbitration is also far more accessible to the little guy than is the court system. First of all, it generally is not costly, a 2006 article citing average arbitration fees of only $46.63. Under the American Arbitration Association's consumer procedures, for example, consumers cannot be asked to pay more than $125 in arbitration costs. Business defendants shoulder all the remaining fees. Second, and more importantly, arbitration doors are always open to consumers and employees with small individualized claims.

Indeed, Justice Breyer has explained that low-value disputes, like the typical consumer dispute, are particularly well suited for arbitration. Without enforceable arbitration agreements, "the typical consumer who has only a small damage claim would be left without any remedy but a court remedy, the cost and delay of which could eat up the value of any eventual small recovery."

Cost and fees make the courts inaccessible to most small claims, but an even bigger problem for plaintiffs with low-value claims is trying to secure the legal representation needed to approach the courthouse doors.

Under the contingency fee systems, plaintiffs' trial lawyers will not look twice at disputes that are too small to net sizable attorneys' fees and too unique to bundle into a class action. One survey of plaintiffs' attorneys revealed that they agree to represent only 5 percent of the individuals who seek out their help, and they require a minimum of $60,000 in provable damages, ask for a retainer, and require payment of a 35-percent contingency fee.

Another report found that a consumer or employee would need to have a claim of at least $75,000 before litigation became cost-effective for an attorney.

Now, the trial bar may point to class actions as a solution for small-value disputes. But most consumers and employees will not be able to obtain redress in class actions. The vast majority of their claims are individualized. My toaster did not work, or my account was charged twice, or I was wrongfully denied a promotion. These kinds of claims do not meet the Rule 23 Federal standard for class actions because common issues of law, in fact, do not predominate.

Even where claims can be bundled together into a class action, though, class members generally receive no real benefit. Congress recognized in passing the Class Action Fairness Act of 2005 that, "Class members often receive little or no benefit, and they are sometimes harmed."

The reality in most class actions is that counsel are awarded large fees while too often class members with coupons or other awards get little or no value. And at times, unjustified awards are made to certain plaintiffs at the expense of other class members.

I believe S. 1782 trades a system that works fairly well for the vast majority of claimants for a system that leaves more consumers and employees without any meaningful chance at recovery. I do not think this is the route we want to go. I am certain that is not the route that my colleague wants to go.

I stand open to discussion and dialog of how we can improve the current system, but I think both of us in our background and our practice would look at if there are ways and places that you can take things to arbitration, that is generally a better way to go. It gets things done faster. It gets things done with less cost. And it gets people a resolution to items.

So I think this is overly broad. I am willing to look at and to listen to it, but I think we ought to continue with the favor that we have put on arbitration since 1925 and not really throw that system out. I look forward to the testimony of the witnesses to further illuminate the topic.

Thanks for holding the hearing.

Chairman FEINGOLD. Thank you, Senator Brownback, and you have well stated the opposite view. But let us be very clear: This bill is about mandatory arbitration. So whatever statements you use from 1925 about arbitration in general or whatever studies you use about arbitration in general does not necessarily relate to this bill. And we will be fly specking that as we go through this to make sure that the general value of arbitration is not questioned. This is only about mandatory arbitration. But I thank the Senator, and, of course, he very eloquently articulated a different view.

Will the witnesses please stand and raise your right hand to be sworn in? Do you swear or affirm that the testimony you are about to give before the Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mrs. LUKE. I do.

Mr. RUTLEDGE. I do.

Mr. ALDERMAN. I do.

Mr. NAIMARK. I do.

Ms. SOLOV. I do.

Mr. DE BERNARDO. I do.

Mr. BLAND. I do.

Chairman FEINGOLD. Thank you, and you may be seated at this point.

We will proceed in the order that you are seated from my left to my right. I would ask each of you to limit your oral presentation to 5 minutes so we have ample time for questions and discussion.

Our first witness is Mrs. Fonza Luke, and I am so glad that she is here to tell her story about her experience with mandatory arbitration. Mrs. Luke was a licensed nurse for more than 30 years at Baptist Medical Center-Princeton in Birmingham, Alabama, the last 5 years of which she spent in the gastrointestinal lab. She was trained at Birmingham School of Nursing. Currently, she works two jobs—full-time as a night supervisor in an assisted living community, and part-time in the emergency room at Birmingham's Cooper Green Hospital. Mrs. Luke also serves on the board of Blessed Sacrament Catholic Church in Birmingham. She has four children and six grandchildren, including two under the age of one,

whom she cares for frequently. She has been happily married for 42 years.

Thank you for coming here to testify, and you may proceed.

**STATEMENT OF FONZA LUKE, BIRMINGHAM, ALABAMA**

Mrs. LUKE. Chairman Feingold and distinguished members of the Subcommittee, thank you for the invitation to testify at this hearing about my experience with mandatory arbitration as an employee. I would also like to acknowledge my attorney, Mark Elovitz, without whom I would not have the opportunity to be here today.

I started working as a licensed nurse for BMC Princeton in 1971. For almost 30 years, I was a dedicated employee, and I received the highest performance ratings from the doctors I worked with every day. When the hospital needed me to work extra days and hours because of staffing shortages, I came in. Once I worked almost every day of the year to give them the help they needed. Whenever the hospital offered new training or skills development, I took advantage of it so I could do my job better.

In November 1997, I was required to attend a meeting of hospital employees where I was given a copy of a new "Dispute Resolution Program." The other employees and I were told we would have to give up our right to go to court that if we had legal claims against BMC, they would have to go to binding arbitration. If we did not sign the so-called agreement describing this program, we were told we would lose our jobs. I refused to sign this agreement because I did not want to give up my rights. I thought it was not right to make employees give up their right. I talked to my husband, also to my priest about it, and they both agreed that I should not sign. About a year later, the hospital again asked me to sign the agreement. Again I refused. In spite of what the hospital said, I was not fired for refusing.

About 3 years later, in early 2001, when I returned from a continuing education class in Atlanta, the hospital's human resources director told me that I was being fired for "insubordination." I was devastated because I never thought I would lose my job after almost 30 years of working at BMC, always with good evaluations.

I do not think I was insubordinate at all. The only things I did they called "insubordinate" were things that younger, white employees did all the time without being fired. At that time, I went to see Mr. Elovitz. I believed that BMC fired me because of my race and my age. I was 59 years old. I believe that the explanation of insubordination was just an excuse.

With the help of my lawyer, I filed race and age discrimination claims with the EEOC, which, after a long investigation, ruled in my favor.

The next step was to file a discrimination case in Federal court, which I did. But BMC asked the Federal court to dismiss my case because, they said, I had agreed to bring all claims to arbitration. I told the Federal court I never signed the arbitration agreement and never gave up my right to go to court. But the Federal court said that BMC could force me to arbitrate because I kept working in my job. I thought this was unfair that I appealed the Federal court's decision, but the Federal court agreed with the lower courts

and ordered me into arbitration. The fact that I specifically refused to agree to arbitration twice meant nothing.

The arbitrator was chosen by process of elimination from a list that was composed heavily of defense lawyers. According to my lawyer, with that list of arbitrators, it was impossible for me to get someone who was even in the middle of the road, much less someone who would be sympathetic with employees. I find it hard to believe this arbitrator, whose time was paid for by BMC, could make a fair decision in my case. In the end, my claims of discrimination and retaliation were denied. I got nothing, no relief whatsoever. I don't think the arbitrator even looked at my side of the story.

Today, I have to work two jobs to make as much as I did at BMC. I did everything I could to keep my right to go to court, but the court doors were closed when I got there. I was not allowed to bring the evidence of discrimination before a fair and impartial judge or a jury of my peers. Before a judge and jury instead of an arbitrator, I believe I would have gotten at least a fair hearing.

Thank you for listening to my story.

[The prepared statement of Mrs. Luke appears as a submission for the record.]

Chairman FEINGOLD. Thank you so much, Mrs. Luke.

Our next witness is Professor Peter B. Rutledge. Professor Rutledge is an Associate Professor of Law at the Columbus School of Law, Catholic University of America. He is co-author of the book "International Civil Litigation in the United States" and the author of several articles in the area of arbitration law.

Thank you for joining us, Professor Rutledge, and you may proceed.

**STATEMENT OF PETER B. RUTLEDGE, ASSOCIATE PROFESSOR OF LAW, COLUMBUS SCHOOL OF LAW, CATHOLIC UNIVERSITY OF AMERICA, WASHINGTON, D.C.**

Mr. RUTLEDGE. Thank you, Chairman Feingold and Senator Brownback, for the opportunity to testify. I could not agree with both of you more that the issues raised by this bill are important, and, therefore, my urge to the Subcommittee would be to pay careful attention to the underlying data and to the underlying impact of the bill if it were enacted. Allow me briefly to summarize the main points of my written testimony.

First, a thorough understanding of the available data and the gaps in the data should drive this policy debate over the future of arbitration as a whole. In important respects, that data are inconsistent with several of the premises underlining calls to abolish predispute arbitration agreements.

Second, to the extent that there are particular instances of problematic arbitrations, existing mechanisms are available to filter out the unfair ones.

Third, if Congress were to eliminate predispute arbitration agreements, individuals would find it more difficult to obtain a lawyer; they would achieve smaller recoveries; and all of this would occur at a slower pace due to our overburdened court system. Companies' legal costs would rise, and those higher costs ultimately would be borne by the very individuals whom this bill is trying to

protect. The only people who, with certainty, are going to benefit from this bill are the lawyers.

Fourth, postdispute arbitration does not present a viable alternative to a system of predispute enforceable agreements.

In my remaining time, Mr. Chairman, allow me to elaborate please on two of these points.

First, eliminating predispute arbitration agreements would not make individuals as a whole better off. Arbitration is often criticized on the grounds that it leaves the party with the inferior bargaining position worse off. In fact, nearly all of the available academic studies, many of which I concede concern employment arbitration, demonstrate precisely the opposite; that is, by various measures, individuals achieve either superior or at least comparable outcomes in arbitration compared to litigation. A variety of studies have also indicated the difficulty that individuals, particularly low-income ones, encounter in their efforts to find an attorney willing to take their case due to the higher expense and greater delay in our court system. Ranking Member Brownback has already referred to some of these studies. And, moreover, for those individuals who do find a lawyer, studies consistently document that it takes far longer for our litigation system to deliver them justice than for arbitration.

For example, a 2004 study of employment disputes found that the median time between the filing and the judgment was approximately three times as long in litigation as opposed to arbitration.

The second point on which I wish to elaborate, Mr. Chairman, is this issue of postdispute arbitration, and I understand the appeal of the argument that says if arbitration is such a good deal and parties are willing to agree to it predispute, surely they would agree to it postdispute. And what I would refer to you and your staff, Mr. Chairman, is a 2004 study by David Sherwyn, which is one of the only studies that I am aware of that is an empirical study of postdispute arbitration, looking specifically at the Illinois Human Rights Commission's postdispute arbitration option. Professor Sherwyn surveyed 1,300 cases that were submitted before the Illinois Human Rights Commission, and he could not identify a single one in which the parties agreed to postdispute arbitration.

As you know, Mr. Chairman, recently the Congress enacted a bill which carved out arbitration agreements between automobile dealers and manufacturers, and I cite in my testimony a recent decision by the Seventh Circuit in which the dealer attempted to propose postdispute arbitration, and the manufacturer resisted it. My point is this: I think we should not delude ourselves that post- dispute arbitration is somehow going to capture all the benefits of predispute arbitration while eliminating the unfairnesses. I think at the end of the day, if Congress were to enact this bill, it would be effectively gutting arbitration as an effective system of dispute resolution, with deleterious benefits for the very people whom this bill is trying to protect.

Thank you.

[The prepared statement of Mr. Rutledge appears as a submission for the record.]

Chairman FEINGOLD. Thank you, Professor.

Our next witness is Richard M. Alderman, who is Associate Dean for Academic Affairs and Director of the Center for Consumer Law at the University of Houston Law Center. The author of 19 books and numerous articles, Dean Alderman is a national and international leader in the field of consumer law. Dean Alderman also serves as the editor in chief of the Journal of Consumer and Commercial Law, the official publication of the Consumer and Commercial Law Section of the State Bar of Texas.

Dean, thank you for agreeing to testify today and for making the trip up from Texas, and the floor is yours.

**STATEMENT OF RICHARD M. ALDERMAN, ASSOCIATE DEAN FOR ACADEMIC AFFAIRS, DIRECTOR, CENTER FOR CONSUMER LAW, UNIVERSITY OF HOUSTON LAW CENTER, HOUSTON, TEXAS**

Mr. ALDERMAN. Thank you, Chairman Feingold, Ranking Member Brownback. Thank you for the opportunity to discuss the Arbitration Fairness Act of 2007. I appear before you—I did not say anything important before.

[Laughter.]

Mr. ALDERMAN. I appear before you as someone who has served as an arbitrator and who supports arbitration and ADR, but who supports our court system more.

Not long ago, automobile dealers came to Congress to ask for help. They asserted they were being denied access to the courts through the manufacturers' use of predispute arbitration provisions. The dealers believed it was unfair for the stronger party to unilaterally force the weaker party to give up the right to sue as a condition of doing business. In 2002 Congress, with the support of 50 cosponsors in the Senate and 252 in the House, passed the Motor Vehicle Franchise Fairness Act. I am asking you to provide similar protections for consumers.

As some who has taught consumer law for 35 years, in my opinion this is the most important piece of consumer legislation of the last three decades. I say this for one simple reason: Excessive predispute mandatory binding arbitration frustrates our system of Government by denying courts the ability to play the vital role that the founders of this country envisioned.

You have heard already and will continue to hear about whether consumer arbitration is good or bad, whether it is expensive or inexpensive. But no one disputes one issue. It is imposed by the stronger party, not voluntarily agreed to.

Ask any school child and he or she will tell you about our system of Government, checks and balances, legislative, judicial, and executive branches of Government. And it is the judicial branch that is a uniquely American institution and its role is essential. Our civil justice system provides an open, public forum to resolve disputes. It interprets and applies the laws that the legislature enacts, and it creates or modifies the laws through our common law system. The current system of arbitration has allowed business to effectively "opt out" of our civil justice system and replace it with a system of private justice that it controls. Even the supporters of consumer arbitration recognize this.

In a recent article written by supporters of consumer arbitration, the authors note that the auto and home industry has "divorced" themselves from the Alabama justice system because of the fear of unfair awards. Instead of working through the legislative process to enact change, instead of electing different decisionmakers, car dealers and home builders simply included a few sentences in their contracts to enact major substantive changes in the application of the law.

And our courts do more than just resolve disputes; they interpret statutes and create common law. Through stare decisis and precedent, decisions of higher courts are binding on lower courts, and it ensures uniformity of results. For example, in 1995, Congress amended the Truth in Lending Act. Unfortunately, the language chosen was not the most precise, and courts gave differing interpretations to how the damage cap should be applied. In 2004, the U.S. Supreme Court held the damage cap should be applied. That decision is binding on all lower courts, ensuring a uniformity and consistency of application.

Today, most consumer credit contracts contain an arbitration provision. It is unlikely that courts will be given the opportunity to review a statute. Instead, we have arbitrators who are not bound by precedent, who are not bound by the decisions of other arbitrators, and who have to decide individually how the law will be interpreted and applied. The widespread use of consumer arbitration ensures that consumers with identical claims in identical circumstances may be treated differently by arbitrators who have no way of establishing the consistency that our system mandates.

And finally, the common law tradition of this country empowers our courts to create and modify legal doctrine. Consumer doctrines such as unconscionability, strict products liability, habitability, good and workmanlike performance have all been created, modified, extended, and limited by our courts to protect consumers and ensure a fair bargain. Arbitrators cannot create the common law; arbitrators cannot modify the common law. They are bound by existing legal doctrine. Essentially, we have frozen the law by submitting everything to arbitration, denying the courts the ability to develop and adapt the law as society and business changes.

To me the question is simple. It is not whether arbitration is fair; it is not whether it benefits consumers. It is whether the powerful party to a bargain should be able to deny the other person access to the courts. The answer, as Congress recognized in the case of automobile dealers, is clearly no. I encourage you to enact the Arbitration Fairness Act and recognize that sellers and buyers of automobile deals have the same rights.

Thank you.

[The prepared statement of Mr. Alderman appears as a submission for the record.]

Chairman FEINGOLD. Thank you so much, Dean.

Our next witness is Richard Naimark, Senior Vice President of the American Arbitration Association and of the International Center for Dispute Resolution. Mr. Naimark is the founder and former Executive Director of the Global Center for Dispute Resolution Research, which conducted research in arbitration and ADR for business disputes in cross-border transactions. Mr. Naimark is an expe-

rienced mediator and facilitator, having served as an arbitrator in a wide variety of business and organizational settings. His experience includes work with the United Nations, government, universities, corporate, construction, computer, real estate, land use, insurance, and nonprofit subject areas.

Thank you for joining us, Mr. Naimark, and you may proceed.

**STATEMENT OF RICHARD NAIMARK, SENIOR VICE PRESIDENT, THE AMERICAN ARBITRATION ASSOCIATION, WASHINGTON, D.C.**

Mr. NAIMARK. Thank you, Chairman Feingold, Senator Brownback. Thank you for the invitation and the opportunity to participate in the hearing today.

I would like to say at the outset that I am here on behalf of the American Arbitration Association, which has over the years pioneered the development of arbitration rules and standards, standards in the form of what we call due process protocols and codes of ethics for arbitrators.

The AAA is a not-for-profit public service organization. We have been around for 81 years, shortly after the formation of the Federal Arbitration Act, actually. Arbitrators who hear cases that are administered by the AAA are not employees of the AAA. Typically, they are practicing attorneys with outside practices, and they will from time to time serve as arbitrators. The AAA, I want to say, does not represent an industry, does not represent the ADR or arbitration industry, so we are really only speaking out of our own position and out of our own experience.

I would like to say that we should make no mistake about the focus of this particular subject matter. The primary issue at hand, I believe, is access to justice.

The reality in this country is that our legal system is very difficult to navigate for most Americans. We have heard before and will continue to hear claims with a dollar value somewhere below $50,000 to $65,000 have a very difficult time obtaining legal representation, regardless of the validity of the claim. Litigation is an exceedingly difficult process for pro se individuals to pursue. Arbitration can, and does, provide ready access to justice if—and I would say "if" with capital letters—due process protections are built into the process. Otherwise, litigation frequently, unfortunately, is a big money endeavor.

Arbitration can provide a fair, efficient, and cost—effective mechanism for resolving disputes.

Recognizing about a decade ago that these issues in the context of consumer and employment disputes were going to arise, I am going to say the fairly heavy use of consumer and employment arbitration really began to trickle in about 10 years ago. And recognizing that it presented some unique challenges, the AAA organized some work groups, widely diverse groups of advisers from all sides of the issue, to try to establish standards of fair play for the process that could be applied so that there would be essentially a level playing field. The result is what we call the due process protocol. There is one for consumer disputes, there is one for employment disputes, there is one for health care disputes.

Now, the AAA and a few other organizations have implemented this protocol, but others have not. In the employment area, as I mentioned, also, there is a similar protocol.

Arbitration between a consumer and a business, or an employee and a business, must incorporate these safeguards to ensure a level playing field and maintain basic procedural fairness. And we have had good results, and the courts have repeatedly referred to the protocols as a standard of fair play in this area.

The protocols do common-sense things. I will give you a little sampling.

For instance, consumers and businesses have a right to independent and impartial neutral administration of their dispute.

Consumers and employees always have a right to representation.

Costs of the process must be reasonable.

Location of the proceeding must be reasonable.

No party may have a unilateral choice of the arbitrator.

There shall be—and I think this is very important—full disclosure by arbitrators of any potential conflict or appearance of conflict so that the parties can be assured of having a neutral, independent, and impartial arbitrator.

Perhaps most important, there shall be no limitation of remedy that would otherwise be available in court or administrative proceeding.

And there are a number of other aspects of the protocols. As I say, they are common-sense types of protections that need to be built into every arbitration in this context.

I would say to this Committee and I would say to Congress, you have it in your hands to assure access to justice and a level playing field for all participants in our legal process, and you can do so by passing a requirement that the due process protocols, or something very much like them, and codes of ethics for arbitrators are applied to all consumer and employment arbitrations in this country. And in that way, fairness in consumer and employment arbitration would no longer be voluntary.

Thank you.

[The prepared statement of Mr. Naimark appears as a submission for the record.]

Chairman FEINGOLD. Thank you so much, Mr. Naimark.

Our next witness is Tanya Solov, the Director of the Illinois Securities Department. Ms. Solov began her career with the Securities Department in 1994 as the senior enforcement attorney and later served as the Assistant Director for Enforcement until 1999, when she was appointed Director by Secretary of State Jesse White. Tanya serves on the Corporation, Securities, and Business Law Section of the Illinois State Bar Association. She is also actively involved in the North American Securities Administrators Association, having served as the past Chair and now a current member of the Broker-Dealer Section and a participant in the Arbitration Legal Services and Financial Intermediaries Project Group.

So, Ms. Solov, thank you for coming all this way to testify, and the floor is yours.

**STATEMENT OF TANYA SOLOV, DIRECTOR, ILLINOIS SECURITIES DEPARTMENT, ILLINOIS SECRETARY OF STATE, CHICAGO, ILLINOIS**

Ms. SOLOV. Thank you. Chairman Feingold and Ranking Member Brownback, I am Tanya Solov, and I am honored to convey NASAA's support for the Arbitration Fairness Act of 2007. This is an important issue for investors and State securities regulators.

The constitutional right of investors to have their day in court was rendered meaningless after the U.S. Supreme Court in McMahon held that predispute arbitration clauses were enforceable in the securities context. The impact of that decision is more profound today because roughly half of all U.S. households rely on securities markets to plan and prepare for their financial futures, and that number is growing.

Twenty years ago, investors had a choice of investing with a firm that required arbitration or one that recognized a judicial forum. Today, almost every broker-dealer includes in their customer agreements a predispute arbitration provision that forces investors to submit all disputes to a single securities arbitration forum run by the securities industry.

It is not surprising that many investors view industry arbitration as biased and unfair. An investor's chance of winning an arbitration award has declined from approximately 60 percent in 1989–90 to about 43 percent by 2006. It is also noteworthy that a "win" in arbitration often amounts to recovery of only a fraction of the losses incurred by the investor. Sometimes the sum awarded is less than the costs and fees the investor paid to obtain some reimbursement for the broker's wrongdoing.

When arbitration is inadequate to protect the substantive rights of investors, an independent judicial forum must be an option. Arbitration may be desirable and appropriate if both parties knowingly and voluntarily agree to arbitrate at the time the dispute arises. If arbitration really is fair, inexpensive, and quick, then these benefits will prompt investors to choose arbitration.

However, even if arbitration is cheaper and faster, in many cases, especially where investors lose their life savings, a fair forum with appellate review is more important than cheap, fast, and unfair.

In the securities context, the investor and the brokerage firms are not on equal footing. Brokerage firms have significantly more resources to fight investor claims, and they currently have the benefit of arbitrating in their own industry forum with an industry member hearing the case. The option to litigate in an independent judicial forum would go a long way toward bringing balance to the process.

Until mandatory securities arbitration is a thing of the past, NASAA will continue to work to eliminate the inherent industry bias in the existing system. The consolidation of the NASD and the NYSE into FINRA has effectively resulted in a single industry forum run by the industry.

Securities arbitration cases are heard by a three-member panel that includes one securities member. Many have justified mandatory industry participation based on the industry's role as an educator of the other panelists. The industry arbitrator is acceptable

only if all parties in the case voluntarily agree that an industry expert is needed. Otherwise, expert witnesses ably serve the purpose of educating the arbitrators.

Industry arbitrators bring their particular experiences, based on their firm's training, policies, and procedures, to the decision-making process. As evidenced by industry scandals and regulatory enforcement actions, the industry's way of doing things is not always in conformance with the law. Even if the industry arbitrator has no preconceived notions, the industry arbitrator creates a presumption of bias that is contrary to the principles of fair play and substantial justice.

It is also disconcerting that the industry believes that the public arbitrators are not capable of understanding a case and rendering a decision without industry influence. If that is indeed true, investors should not be forced to bring their case in such a forum.

NASAA believes that the securities arbitration system should be truly voluntary; arbitration panels should be unbiased; arbitrators should be better screened and trained; and meaningful and accurate statistics concerning arbitration outcomes should be compiled and disseminated.

As long as securities arbitration remains mandatory, investors will continue to face a system that is not fair and transparent to all. For this reason, NASAA supports the passage of the Arbitration Fairness Act of 2007.

Thank you.

[The prepared statement of Ms. Solov appears as a submission for the record.]

Chairman FEINGOLD. Thank you very much, Ms. Solov.

Our next witness is Mark A. de Bernardo. Mr. de Bernardo is a partner in the Washington, D.C., regional office of Jackson Lewis, where he concentrates his practice on employment litigation in counseling and workplace drug- testing issues. He is the author of four State drug-testing laws and 18 books on employment and labor law topics and has testified more than 40 times before Congress and various Federal and State regulatory committees on employment and labor law issues. Mr. de Bernardo is a graduate of the Georgetown University Law Center and Marquette University, which we, of course, approve of.

Mr. de Bernardo. In Wisconsin, yes.

Chairman FEINGOLD. Thank you for joining us today, sir, and you may proceed.

## STATEMENT OF MARK A. DE BERNARDO, EXECUTIVE DIRECTOR AND PRESIDENT, COUNCIL FOR EMPLOYMENT LAW EQUITY, JACKSON LEWIS LLP, VIENNA, VIRGINIA

Mr. DE BERNARDO. It was quite a win over the University of Wisconsin on Saturday, was it not?

[Laughter.]

Senator BROWNBACK. Hear, hear.

Chairman FEINGOLD. Out of order.

[Laughter.]

Mr. DE BERNARDO. Can I have my 8 seconds back, Mr. Chairman?

Chairman Feingold, Mr. Brownback, Senator Brownback, I appreciate this opportunity on behalf of the Council for Employment Law Equity to testify in support of ADR, in support of mediation and arbitration as an alternative to litigation, and in opposition to S. 1782.

I have been a labor lawyer for nearly 30 years. If you want justice, I firmly believe you are more likely to get justice in arbitration than you are in litigation. Arbitration is going to be much more predictably balanced, neutral, and fair. It is quicker. And as we have seen and as is included in my statement and statements of some of the other witnesses, all of the empirical evidence, all of the evidence that is out there shows that, in fact, individuals that are going to arbitration, mandatory binding arbitration, fare better. They are more likely to prevail, 63 percent to 43 percent over litigation. They do not have their cases dismissed, which 60 percent of the employment cases—if we look at just employment cases, we prevail, we, the management community, prevail on 60 percent of those cases on dismissals—motions to dismiss, motions for summary judgment. So only 40 percent of those cases go on.

There is much more access to our judicial system through arbitration than there is through litigation. A survey of plaintiffs bar found that only 5 percent of plaintiffs' attorneys agreed to provide representation—I am sorry. They provide representation of only 5 percent of the individuals who seek out their help.

In addition, plaintiffs' attorneys require a minimum of $60,000 provable damages. They commonly request a retainer up front. They typically require a payment of a contingency fee of between 33 and 40 percent.

In fact, when you take a look at the studies, the average award—the median award provided to individuals in arbitration is, according to Lewis Maltby of the National Work Rights Institute in Princeton, formerly of the American Civil Liberties Union, higher for individuals who are pressing their claims in arbitration than it is for litigation. In another study, the difference was de minimis. It was between $68,000 and $64,000. But when you factor in attorneys' fees and costs, the people pressing this claim in arbitration are actually faring better financially.

So you have more access to the judicial system. You have more likelihood of redress of the complaints. And, frankly, arbitration in America makes employers better employers because more issues are addressed, they are address earlier, there is a quicker fix.

You mentioned, Chairman Feingold, my background in terms of drug-testing issues. One of the things we know in drug testing is earlier intervention in substance abuse is going to be more successful. Well, you know, that is true in workplace problems of all kinds—earlier intervention. And what arbitration provides is a mechanism by which problems are identified early. There is intervention early. Things are corrected. There are many, many, many more employee concerns and complaints that are addressed.

If you just take a look at the plaintiffs' bar and the survey that I talked about, only 5 percent of those people seeking help from the plaintiffs' bar, representation from the plaintiffs' bar in employment matters; 95 percent of them have the door slammed on them. And if we do not have arbitration as an alternative, 95 percent of

those people that—some high portion of them will have no other legal recourse.

I do believe that this bill would be a death blow to arbitration in America. As a practical matter, there are hundreds of thousands of arbitrations every year. The vast, overwhelming majority are what is referred to in the legislation as "predispute" and what I refer to as "mandatory binding arbitration." There are very, very few postdispute arbitrations in America. In fact, an American Bar Association survey found that 86 percent of lawyers, both plaintiff and defense lawyers, said that they would not recommend postdispute arbitration to their clients. So as a practical matter, this bill, if it were enacted, would impose a death sentence in terms of ADR in America.

I do not know how we can do that. I do not know how, when there are hundreds of thousands of arbitrations per year, when there are hundreds of thousands of individuals who have access and recourse, legal recourse to our system to redress their concerns, how we can cast those people out and close the door in terms of their pressing their claims forward.

In terms of the advantages for employees, I will just mention briefly they get a faster resolution of the problems; a simpler, more focused, more confidential, and more dignified process; less disruption to career. Arbitration is a job saver. Litigation is a job destroyer. Once we are in litigation, the employee does not want to work for us; we do not want them in our workplace. With arbitration, you have that possibility of preserving the job. You have peace of mind because it diffuses employee issues and concerns; they do not come to a boil on the stove; it is not simmering, you know, these issues that are of concern to the employees.

You have the same range of remedies. As I mentioned earlier, you have higher awards. You have the same decisionmaking process, and you have a better chance of prevailing.

I appreciate this opportunity to testify, and I pledge my cooperation as we move forward.

[The prepared statement of Mr. de Bernardo appears as a submission for the record.]

Chairman FEINGOLD. Thank you very much, sir.

Our final witness, F. Paul Bland, Jr., is a staff attorney for Public Justice, which was formerly Trial Lawyers for Public Justice, where he handles precedent-setting, complex civil litigation. He is the co-author of the book entitled "Consumer Arbitration Agreements: Enforceability and Other Issues" and numerous articles. For 3 years, he was the co-chair of the National Association of Consumer Advocates. He was named the San Francisco Trial Lawyer of the Year in 2002 and the Maryland Trial Lawyer of the Year in 2001 for his role in two cases challenging abuse of mandatory arbitration clauses. In the late 1980's, he was chief nominations counsel to the U.S. Senate Judiciary Committee under then-Chairman Biden. He graduated from Harvard Law School in 1986 and Georgetown University in 1983, and we welcome you back to the Judiciary Committee, Mr. Bland. Thank you for joining us today. The floor is yours.

**STATEMENT OF F. PAUL BLAND, JR., STAFF ATTORNEY, PUBLIC JUSTICE, WASHINGTON, D.C.**

Mr. BLAND. Thank you so much for the invitation to come here, Senator Feingold, Mr. Chairman, and also thank you, Senator Brownback.

Senator Feingold, you are a hero to a lot of people in the consumer and the civil rights community for your work on this issue, and it has been incredibly important. We are really grateful for it.

Rather than trying to summarize my lengthy written statement, I would like to sort of respond to some of the things that have been going on here, because there are some just outlandish comments being made, frankly.

Rather than looking at the principles here, is it a better system to let the stronger party to a dispute pick who the judge is? Is it a better system to have human beings who make decisions have their decisions be essentially unreviewable, where errors of law, errors of fact cannot be looked at? Is it a better system to have a secret system?

Rather than looking at the big picture and the principles here, what we get from the professor and what we get from Mr. de Bernardo is let's look at studies, let's look at data, let's break this down into which side has been able to pay for studies that will be more on their side. And let's look at what that data is. The data is unbelievably handpicked and selective, and the reason is because arbitration is so secretive in every place in the United States except for the State of California. Everywhere else there are secrecy provisions; there are rules—AAA's rules, there are rules in the National Arbitration Forum rules that keep all the data secret.

So the studies that have been done have been very careful about what samples they use. For example, the Bankers' Association paid Ernst & Young to do a study, which Professor Rutledge likes to talk about. The Ernst & Young study selected one case out of every 1,000 consumer cases that have been handled by the National Arbitration Forum in order to come up with the results that supposedly show that consumers win more often. And when they decided how a consumer wins, if a consumer lost their home due to a predatory practice or deceptive practice, and they brought a case for $100,000 and they got $1, Ernst & Young, paid for by the Bankers Association, said, "well, that is a win for the consumer, they got $1". That kind of study does not get you very far.

There has been a lot of talk about the National Work Rights Institute. What is the institute? The institute is one guy—it is Mr. Maltby—and a secretary. It is not a big institute in a broader sense. Mr. Maltby is generously funded by the American Arbitration Association. That is where he gets most of his money. He is on their board. He does a huge amount of AAA arbitration work. And there are real selection samples with his studies. What he does is he tends not to consider cases in which people were forced into arbitration by a court or ordered in. He takes all those cases and puts those to the side when he selects what his sample is.

So what is the one place in the country where there is data that is not hand-picked, that is not cherry-picked by one side? That is California, because California passed a statute that said in consumer and employment arbitrations, the arbitration companies

have to post all the data—all the data, not just the data that Ernst & Young and the Bankers Association have picked, but all the data on their websites.

Now, this was passed over the strong lobbying opposition of the American Arbitration Association, but it went through. What does that data show?

Now, we just heard a statement from Mr. de Bernardo that every study shows that individuals do better in arbitration. That statement is outlandishly untrue. In my statement, at page 16, I quote from Alexander Colvin, a professor at Penn State, who just did a study of the California data, which is not cherry-picked. And what he finds is that employee win rates and damage awards are much worse for the individual in arbitration.

There is another study that came out in California in the HMO setting where arbitrators were handling HMO cases. And what the HMO study found was that, first of all, every single time that an arbitrator gave a large award to an individual, the arbitrator was blackballed and they never heard another arbitration involving an HMO. They also found worse win rates and much lower awards.

I can tell you what my own experience is, and from talking to tons of consumer lawyers and employment lawyers around the country, is where you go into litigation, if you beat the arbitration clause—there is a drafting error, there is a flaw, there is something they did wrong, and you are able to knock it out—the settlement value of the case doubles. I have had a series of cases where my client has gotten past the arbitration clause and the value of the case goes way up. So the idea that arbitration is a great thing that employees and consumers are loving is crazy.

With respect to the American Arbitration Association, do their due process protocols solve everything? Well, first of all, the American Arbitration Association is being undersold by the National Arbitration Forum, which sends out these advertisements to banks and gives speeches at bankers associations conferences and so forth, where they basically say, look, the AAA in States in which it is illegal to have a ban on class actions, the AAA will actually allow a class action to go forward and follow State law. We at the NAF have never had a class action in front of our organization.

The NAF advertises that there are some settings in which the AAA will give consumers discovery. We do not allow discovery except in rare circumstances with us.

What is the result? I follow a lot of arbitration clauses, particularly for big companies. I collect them for the book that I write. The AAA is being written out of more and more clauses, and the National Arbitration Forum is being written in. Since the stronger party gets the right to draft the contract, it is a race to the bottom.

But even with the AAA, there are a lot of times that they have broken promises. For example, they talked about the due process protocols, and Mr. Naimark talked about how AAA said, well, you cannot strip people of remedies, corporations cannot say "not only does the consumer have to go from court to arbitration, but she also loses her rights under various consumer protection statutes".

Prior to 2001, AAA had never enforced that. There was case after case in which a company would have an arbitration clause that stripped people of remedies and they would not enforce that. It was

only when we brought this to the attention of a Federal judge in San Francisco, who threw out an AAA arbitration clause as unconscionable, that we finally got a change that went the other way where AAA finally started to enforce their protocols in some cases.

But, similarly, the AAA has as one of the due protocols that says we will only have a reasonable cost, we will not have very expensive arbitration clauses. But there are more than half a dozen Federal court cases that are reported in which courts have found that their costs of arbitration are so high as to be unconscionable under the law.

AAA says that one of the due process protocols is you will always get a neutral arbitrator. But when you get a list of who is going to be on your panel, there are seven names on the list. The vast majority of the time, every one of those names is a lawyer who specializes in defending that industry. So, for example, right now there is someone who has got a case against Duke Hospital. Well, AAA promised in press releases all over their website that they would not handle mandatory arbitration of health cases, but they are doing them for Duke Hospital. But who shows up on the list? They are all medical malpractice defense lawyers.

This is what happened to Mrs. Luke. Mrs. Luke has an employment discrimination claim. Does she get a jury? Does she get people who are just out of the community? No. She gets a lawyer whose job it is to defend similar companies, and if the lawyer rules against the corporation and gives a big award to the employee or the consumer, they are never going to get another job as an arbitrator. That is a lousy system.

[The prepared statement of Mr. Bland appears as a submission for the record.]

Chairman FEINGOLD. Thank you, Mr. Bland, very much for your testimony. I want to thank the entire panel. It was a very good panel, and I look forward to our chance, Senator Brownback and I, to ask some questions.

First, though, at this time, without objection, I will place in the record the statement of Laurence Schultz, President of Public Investors Arbitration Bar Association.

I understand that Mr. Schultz is here today. Would you please stand? Thank you very much, sir. Without objection, that is entered into the record.

Without objection, I will put in the record a copy of the letter Chairman Leahy and I sent to SEC Chairman Christopher Cox requesting that the SEC promulgate rules prohibiting broker-dealers from requiring investors to accept mandatory arbitration clauses.

I will also put in the record a copy of the letter to the SEC from seven consumer, homeowners, and civil rights groups supporting our request. And, without objection, I will put in the record a copy of Chairman Cox's reply.

Without objection, I will place in the record a letter from 36 consumer, civil rights, homeowners, and employees rights groups in support of the Arbitration Fairness Act.

All right. We will start the questions, do a 7-minute round to begin with. I will kick it off by asking Mrs. Luke some things.

I want to thank you again for being here and telling your story. One of the most amazing things to me is that you actually refused

to sign a mandatory arbitration agreement when your employer was telling you you had to sign it. I think it is fair to say that most people would not be able to withstand that kind of pressure in that situation.

Can you tell us more about why you did not want to sign the arbitration agreement?

Mrs. LUKE. Well, I did not want to sign it because, first of all, the way they explained it, I would be signing away my rights. I would not be able to go to court if anything happened. I had been with Baptist Medical Center Princeton for 30-plus years, and I was looking forward to retiring from the company. And I did not want to sign that because I felt like if I did sign it and something did come up, they could terminate me and I would not have a leg to stand on.

Chairman FEINGOLD. And you had been working for your employer for many years already when you were asked to sign the arbitration agreement. Did the employer offer you anything in return for giving up your rights to go to court?

Mrs. LUKE. They offered me nothing for giving up my rights, but they offered to terminate my position if I did not sign it.

Chairman FEINGOLD. Some offer. You said you thought you would have had a fairer hearing on your case in a court of law than you did in arbitration. Why do you think that?

Mrs. LUKE. Well, because the arbitrator was paid by Baptist Medical Center Princeton, and I was not allowed to bring any of the evidence I had. I first went to the EEOC, who investigated for months and ruled in my favor. The arbitrator told me I could not bring this up, nor could I bring any evidence from this. And I felt that that was unfair, that if I had gone to court, I would have been able to use all of this information, and that they would have looked at it objectively and possibly ruled in my favor.

Chairman FEINGOLD. Thank you so much.

Mr. Bland, thank you for your extensive written testimony. It will be very helpful to the Committee.

There was a shocking report on the ABC News website yesterday about a Houston woman employed by Halliburton KBR in Baghdad who alleged she was raped by coworkers. She said that she was placed under guard by her employer for 24 hours without food and water and told not to leave Iraq for medical treatment or she would be fired. She has filed suit against Halliburton in Federal court. The company is saying that under her employment contract she must go to arbitration.

I have a copy of the ABC News story that I will put in the record at this time, without objection.

What is wrong with deciding a case like this in arbitration, if that is what the contract provides?

Mr. BLAND. Senator, there is an unbelievable irony that we have someone who is overseas fighting to defend our freedoms, fighting to defend our system, and when she comes back here she is told "you have no constitutional rights, you have to go into a secret, privatized tribunal that is picked by the company". I mean, that irony is amazing.

You spoke in your opening statement about the Seventh Amendment of the Constitution. You know, the right to a jury trial is not

just in the Constitution. It is the central reason why this country became independent. In the Declaration of Independence, they not only talk about the jury trial, but there is actually a clause in which one of the colonists' principal complaints is that the King was picking the judges and that the judges depended for their job and their salary upon the King picking them. Well, does that sound familiar? Because the arbitrators depend on the King, being Halliburton, to get the work and to get paid.

Now, first of all, it is obvious why Halliburton wants this. It is a secret system. They can cover up the facts. There is a gag order there. None of the facts about what is going on in that situation will come out if it is done in arbitration as opposed to the open court system.

The second obvious problem is that what she is likely to end up with is an arbitrator who is a lawyer whose principal job is defending companies like Halliburton against employment claims instead of having a jury. And that is an incredibly unfair thing particularly to do to someone who is so horribly, grievously injured. It is an extremely unfair system to have an arbitrator who knows that they are going to be blackballed if they rule for the employee.

And if you look at the data under the California disclosure rules at AAA, Halliburton wins the vast majority of the employment cases that they face. It is something like 85% of the cases have gone for Halliburton. Only a handful of cases have gone for the employee.

And then the final thing is suppose you have an arbitrator who is still doing their best but they make a mistake and they get it wrong and they rule against this woman where the law, in fact, would have favored the woman? She will have no appeal.

Now, in court, she would have an appeal. But in arbitration the Seventh Circuit said last year that a wacky decision of law by an arbitrator is not grounds for overturning a decision. The Third Circuit said 2 years ago that a glaring error of law by an arbitrator is not grounds for overturning a decision. The U.S. Supreme Court said in a case which Justice O'Connor wrote that even if the arbitrator's decisions are silly—involve silly fact finding, that is not grounds for overturning it.

So the arbitrator has a motive to rule for Halliburton, so that they will keep getting the work, and they have the opportunity to do it because there is no review at all. The review is meaningless. Mr. Naimark in a House hearing a couple of weeks ago agreed that the judicial review of arbitrators' decisions is meaningless.

Chairman FEINGOLD. Thank you very much, Mr. Bland.

Professor Alderman, some of my colleagues on the Republican side argue that we should not get rid of mandatory arbitration but develop legislation to reform arbitration in order to ensure its fairness. Of course, they never pushed these kinds of ideas during the long period that they controlled the Senate. Perhaps if significant reforms had been made a decade ago, we would not be in the place we are now. But at this point, do you think procedural reforms such as ensuring that there is a neutral arbitrator, better discovery, a written decision, et cetera, will actually fix the problem of mandatory binding arbitration?

Mr. ALDERMAN. I think that will guarantee we have the worst of both worlds, and let me emphasize one point that I think is really important. You are considering this because of the fact that arbitration is imposed unilaterally by one side that can do whatever it wants, and that is just absolutely inconsistent with ADR and arbitration.

I support arbitration, I favor ADR, and it works because of its informality, because of its simplicity, because different people can serve as arbitrators, because it is not a court. To try and make arbitration more like a court will not work, and the question is very simply: Should consumers be forced into arbitration? Should consumers be forced to forfeit their right to sue as a condition of obtaining the necessities of life?

Chairman FEINGOLD. Thank you, sir.

Ms. Solov, thank you for coming today. I found your testimony very useful because the State agencies that NASAA represents are charged with protecting the investing public. Does NASAA have a position on whether the SEC can and should act by regulation on this question?

Ms. SOLOV. The SEC does have oversight responsibility over the arbitration process and certainly should exercise that oversight. NASAA does support the letter, Chairman Feingold, that you sent to SEC Chairman Cox where you noted the problems of arbitration and the responsibility for oversight. So we do think that the SEC should exercise oversight.

However, our position is that investors must be given a choice. They should not be forced to sign a mandatory arbitration agreement when they open a brokerage account. As you indicated in that letter, there are many problems with arbitration. State law is often not followed. And we at NASAA reviewed many years of awards and found that often investors are getting just a small percentage of their losses. And I know much has been said today about data and statistics and comparisons, but since the McMahon decision, really, investors have not been able to pursue their cases in court. They have not been able to bring a case where a broker has churned their accounts or there was unsuitable trading. So, really, there are no meaningful numbers, statistics, or data to draw a comparison. All we know is from hearing the stories of investors and from actually looking at arbitration awards that investors are not getting a fair shake in the system.

Chairman FEINGOLD. Thank you, Ms. Solov.

Now I will turn to Senator Brownback for his first round.

Senator BROWNBACK. Thanks, Mr. Chairman.

This to me—and I appreciate the hearing and I appreciate the panel—is kind of one of these "where the rubber meets the road" hearing because this is a lot of issues and where people finally get some access to redress on something that has really been problematic and difficult for them. I see what the Chairman is trying to drive at. I appreciate it. We both practiced law before coming here. Mine was a much more pedestrian law practice than Mr. Feingold's was, and I am the Kansas—

Chairman FEINGOLD. I am not sure you know what my law practice was.

[Laughter.]

Senator BROWNBACK. Well, I know you do not know what mine is, and I was the Kansas expert on fence law, so you can go—I guess you could Google "fence law in Kansas," and my name will show up. That is not why I won my seat to the U.S. Senate, but my point in saying that is that we had this arbitration provision in Kansas fence law, and we did it because these are really low-value cases by the most part. Now, sometimes you get a prize bull into a great cow's pasture, and Russ and I being from agricultural States, we know things happen then, and things of value sometimes happen then. So we would have these series of cases, and even cases where a guy would loosen his fence wire so the prize bull could get over into the next pasture.

My point in saying this is you would involve—the county commissioners would come out and would appraise whose fence—who needs to build the fence up. And this was binding in the system, and these articles I would write on fence law would get read by a lot of people because the cases just had low value. They could not get settled. And the only way for one to really get settled would be the county commissioners were coming out as people were paid $7 a day as arbitrators to come out and arbitrate the fence law case and justice was served rather than in the past people pulled guns on each other and said this is the way justice will be served. And it is an old, historic legacy, but it tended to work, and the areas of law did not mature.

Maybe, Mr. Alderman, as to your point—which I think is an interesting point that you bring forward on that, and that is why I say this is one of those cases where the rubber meets the road. This is where people really live and they have real disputes, and a lot of times they cannot get access to courts because it is just too expensive for them to get access to courts or lawyers hired in this type of case.

I would note for the record, Mr. Chairman—and you can correct me, and I hope your lawyers will. But according to the Supreme Court case—I want to cite this—in the case of *EEOC* v. *Waffle House*, it is a 2002 case. The Supreme Court has ruled that the EEOC can bring claims on behalf of employees, despite any arbitration agreement. Now, if that proves to be different, then I want that corrected. but I just want to say when you have that category of case, then the EEOC can say arbitration is out on this, and so there is access here.

Mr. Naimark, you mentioned, I thought, some interesting points about you like arbitration, but you would like more due process built into it, if I am hearing you correctly. How would you do that?

Mr. NAIMARK. Well, you might easily start with the existing models. The due process protocols were not developed by the AAA per se. They were developed by a diverse committee of people representing interests typical of people on this panel, widely divergent. And the search was for common ground. What are principles we can agree on that provide due process for everybody, that are unarguably——

Senator BROWNBACK. Would you build that into a statute? Would you pass that? Would you amend the Federal Arbitration Act? How would you do that?

Mr. NAIMARK. I would not amend the Federal Arbitration Act for other reasons. I would build a piece of companion legislation and require that all arbitrations in this area where you are trying to protect the little guy, so-called, that the due process protocols, or something like them, be applied, yes.

Senator BROWNBACK. Because the Federal Arbitration Act has had a number of judicial reviews, and so it has had—it is refined by the courts to a point that people feel like it is working better than if you went in and tried to really gut the law itself?

Mr. NAIMARK. Yes. The arbitration activity in this country and around the world is much, much bigger than the area we are talking about here. There is a lot of business- to-business. There is actually a lot of Government access of arbitration process, both in this country and abroad. And the FAA has become a foundation really built by the judiciary over the years. If you look at the FAA, it is very brief. But over the last 82 years, the courts have defined the contours of the arbitration process. So I think the danger of monkeying with that and perhaps dismantling some of the 82 years of judicial wisdom is not worth it, and I would have a companion piece of legislation.

Senator BROWNBACK. Mr. Rutledge, you view this proposed piece of legislation—I am sure put forward with all good intents—as overly broad and gutting the Federal Arbitration Act?

Mr. RUTLEDGE. Yes, Senator, I do. And I guess I would like to pick up on something that I believe the representative—well, I would like to make two points. One goes back to my earlier testimony.

One of my concerns about this legislation, Senator, and Chairman Feingold, with respect, is that it lumps together employment, consumer, franchise, and now apparently securities arbitration. What I can say to you is that the state of the data as to how those different arbitration systems function is very different.

And that takes me to my second point. The representative from the securities enforcers indicated that one of the things that she would like to see is more data, and I would encourage you to make sure that you have the data that you need before you decide what to do rather than adopt a piece of legislation that is going to throw this whole system overboard. And if I could just—

Senator BROWNBACK. That is an interesting thought about trying to get more data, because there seems to be some dispute about data issues here.

Mr. RUTLEDGE. And one other thought that I would like to respond to, Senator Brownback, in response to Mr. Bland, Mr. Bland—and I do not mean to quote him inaccurately—I believe accused a professor on this panel of making outlandish comments. And Professor Alderman and I were sort of sitting here and conferring exactly whom he was referring to, but I am going to venture a guess that it probably was not Professor Alderman.

And lest my sort of outlandish comments and the studies that I am referring to be taken out of context, let me be perfectly clear with your staff. As to employment arbitration, I believe that the best, most accurate data that you can look at at this point are the Hill and Eisenberg studies cited in my testimony. As to consumer arbitration, I believe that the best and most accurate studies that

you can look at are the Demaine and Hensler study and the California Dispute Resolution Institute's study cited in my testimony. And as to franchise arbitration, as to which, admittedly, we probably have the least data, the best and most accurate study to which I can refer you are the Drahozal and Hylton studies.

I simply offer those to you, Chairman Feingold and Senator Brownback, both to respond to the claim that I made—or apparently I made an outlandish remark and to ensure that you have access to the best, most available accurate data before you make your decision and determine whether you need more data before you decide what to do.

Thank you.

Senator BROWNBACK. Chairman, if I could, I have a series of eight items I would like to enter into the record, and there are various statements and testimony and articles.

Chairman FEINGOLD. Without objection.

I will start the second round. Mr. Bland, I believe Senator Brownback is correct that the EEOC can bring a case in court despite a mandatory arbitration provision. But the EEOC, of course, can only bring a small number of cases itself. Can you clarify this for us? And Mrs. Luke said that the EEOC had found in her favor, but that did not allow her to bring her case in court, did it?

Mr. BLAND. No. The *EEOC* v. *Waffle House* case was described correctly by Senator Brownback. It is a case where a guy was hired as a short-order cook. He had an epileptic fit. They fired him. He said under the Americans with Disabilities Act a company is supposed to do something before it just fires someone for having epilepsy. They stood by their position.

The arbitration clause blocked the individual from bringing a case on his own behalf for money to cover himself. The EEOC was allowed to go forward. The EEOC principally pursues injunctive relief, like an order saying to Waffle House the next time you have someone with epilepsy, see if you can get medicine or something before you fire them. But the EEOC handles, less than 1 percent of all cases that are brought in front of it. EEOC's staff has remained fairly constant for 25 years, but the number of claims going into it is gigantic.

So I do think Senator Brownback described the case correctly. It was a 6–3 decision written by Justice Stevens. My firm filed an amicus brief, and they followed the side that we supported. So I am a big fan of the case.

Chairman FEINGOLD. Thank you.

Ms. Solov, I mentioned the testimony from Mr. Schultz from PIABA. When you hear that the group that represents claimants in security arbitrations believes that the system is stacked against investors, does that give you any concern that this issue could end up affecting investor confidence in the securities markets and in the brokers they must use to invest?

Ms. SOLOV. Yes, Chairman Feingold. It can and it has. And as a State securities regulator, I am hearing more and more from investors who have had bad experiences in arbitration. And, in fact, I think that as word gets out—for example, this hearing and this proposed bill—investors will start taking a stronger stance because they do not want to risk their life savings and then have to arbi-

trate in an industry forum with an industry arbitrator on industry terms.

I also would like to just respond briefly with regard to the data. The data has shown that since the McMahon decision in the securities industry, investors' wins have gone down significantly. The data that NASAA was referring to that we would like FINRA to provide is what, in fact, constitutes a win, because we know from looking at arbitration statistics that investors are winning just small percentages of their claims currently, and those are, in fact, counted as wins.

So, to clarify, that is what we are referring to. But I think that there is enough data and there is enough hard evidence out there to currently change this system.

Chairman FEINGOLD. Thank you. I have to say, you know, that I have been working on this issue for 13 years, but I have been amazed in the last few months at the number of people all over Wisconsin and all over the country who come up to me and just mention this legislation. And, Professor Alderman, those of us concerned by the growing prevalence of mandatory arbitration clauses often focus on the fairness of the proceedings to individual claimants. But I was struck by your testimony concerning the effect of this growing private system of justice on the law as a whole and, therefore, on society at large. I would like you to say a little more about that. What do we lose as a Nation when disputes are resolved in secret proceedings where the law is not necessarily applied consistently?

Mr. ALDERMAN. First, I think it is important to emphasize consumer law is different. Consumer law is not a statute. It does not have the various agencies enforcing it to the extent of the other areas. It is Federal and State legislation. It is common law. It is complex.

More importantly, I have been doing a lot internationally. I taught in half a dozen countries in the last few years. I host a conference on international consumer law every other year that we have 60 or 70 professors at. The United States is different in how we regulate, protect consumers, and deal with the marketplace. We use private litigation. Our statutes are enacted on the assumption that lawyers will bring the lawsuits. Most of them provide for attorneys' fees so you do not need a minimum of $60,000 to obtain an attorney. And it is this public resolution of disputes that keeps the marketplace, I think, on guard. It keeps consumers informed. And when you take that secret, you are losing one of the biggest benefits of our open court system. I noticed many members—and I did not check all, but all that I checked, many members of this Committee very clearly somewhere on their website, you see reference to the importance of an open court system. And we are talking about completely closing and privatizing that court system when it comes to consumers—consumers again, who, in my opinion, comparing car dealers—and let me point out I did not follow all of the hearings, but I do not recall any discussion of the need for all of the data to see whether car dealers were being treated fairly by manufacturers or not. The issue was they were being forced to do something by manufacturers. And I think with consumers it is so much more important. These are the necessities of life. This is your

house. This is the nursing home. This is the automobile. If you do not have a way to publicly access what is going on, to know what is going on, you cannot protect yourself.

Chairman FEINGOLD. Thank you.

Mr. Bland, in his testimony Mr. de Bernardo calls S. 1782 a "mandatory litigation bill" and says that it would effectively end arbitration in America. I assume that he realizes that S. 1782 would not prohibit arbitration if both parties agree to it after a dispute arises. Much of his argument deals with employment arbitration, so I will ask you first, but I would also like to hear from Professor Alderman: Do you agree that this argument seems to assume that no rational employee would ever choose arbitration voluntarily or that, when they do, employers would refuse to agree to arbitration? And if that is so, isn't that a pretty scathing indictment of the fairness of the current arbitration system?

Mr. BLAND. It certainly is. I mean, it is a pretty grim idea that the only way you can have arbitration is if you force people into it and that they would never choose it on their own.

But, you know, another thing is that the idea that this bill is a dramatic change in the landscape in consumer cases is a little crazy because the idea of mandatory arbitration in consumer cases is very recent.

In 1995, almost no banks in America had arbitration clauses. In 2000, almost no car dealers had arbitration clauses. All of these clauses have been adopted just in the last couple of years. It is a very recent phenomenon that they have happened.

But, also, there are almost no consumers choosing arbitration today. If you looked at the Public Citizen report that came out a few weeks ago, they looked at 34,000 cases that arbitrators decided in California. Of those cases, only 118 were brought by the consumer. All the other cases were cases brought by businesses against consumers for collections cases.

There was some data that came out of a lawsuit in Alabama that involved First USA Bank. They found that there were 20,000 cases that had been resolved in arbitration. Of the 20,000 cases, 4—only 4—were brought by consumers. The idea that, well, this is this really valuable alternative, that consumers are out there rushing to join and thriving in arbitration and that if this bill passes, consumers will lose these things that all these people value—it is 118 people in California in 3 years chose to do this. No one else. This is not something consumers are seeking. There are not consumers out there who are going to be going home at night crying if they lose this opportunity. It is not something they use. It is something that is forced on them.

Chairman FEINGOLD. Thank you, Mr. Bland.

Now it is Senator Brownback's turn for a second round.

Senator BROWNBACK. The fence law expert is back here.

Mr. de—

Mr. DE BERNARDO. De Bernardo.

Senator BROWNBACK. Excuse me. Thank you. And congratulations on the Marquette win.

[Laughter.]

Senator BROWNBACK. As somebody from a State where basketball is serious business, this is important when that happens.

Mr. DE BERNARDO. It was no surprise, Senator.

Senator BROWNBACK. There was no arbitrator there.

Why is it that there are so few post-arbitration dispute resolutions? You mentioned that in your statement, that if you do not do it on a required basis, on a post basis, it is like 95 percent, I believe is your number, don't go with a post-arbitration dispute mechanism?

Mr. DE BERNARDO. Well, the 95 percent was referring to the plaintiffs' bar and that only 5 percent of those who seek representation from the plaintiffs' bar on employment issues are actually represented by the plaintiffs' bar. So they are going to say no to 95 percent of the people who feel they have a grievance in the employment area. For those people, without arbitration there is no legal recourse. So my point is that arbitration—and when you have an arbitration system at a company, which a growing number of companies have—

Senator BROWNBACK. You actually have a recourse.

Mr. DE BERNARDO. Yes.

Senator BROWNBACK. Whereas there is not a recourse otherwise.

Mr. DE BERNARDO. Sure.

Senator BROWNBACK. Why is there not more postdispute arbitration taking place?

Mr. DE BERNARDO. Well, because once you have the dispute, what you have is representation by the plaintiffs' bar, you know, the cases—the individual fact patterns that could have been resolved or were earlier—I talked earlier about early intervention into a problem. So, you know, my secretary feels—is offended because I use the "F" word in the office, OK? I do not know. It is careless on my part. It is bad. It is a bad idea. But, you know, I do not know that. If somebody came to me and said, "You know what? Your secretary feels offended by the fact that you"—gee, I would apologize. I would say I will try never to use it again. I did not realize that. That is a small adjustment.

But, you know, what happens is we are employment lawyers, we have 425 employment lawyers representing management. Most of these cases, it is cumulative. It is not one incident. It is over the years, a series of things, a series of petty grievances, maybe not so petty grievances that grow. And what you have is this hostile and offensive environment.

And so what happens is what you have with arbitration is this intervention so that you are correcting the action, making for better workplaces. So now once you get to the point where litigation has been filed, you have the plaintiffs' bar involved. They seek recovery. They want attorneys' fees. They have identified this case from among the 5 percent that they accept that are coming to them. It is a declaration of war.

At that point, it is very, very unlikely—as I pointed out, this ABA survey found that 86 percent of lawyers would not—both defense and plaintiffs' lawyers said that they would not recommend postdispute arbitration to their clients. And, frankly, I would not either.

Senator BROWNBACK. Mr. Alderman, I appreciate your testimony, and I appreciate your expertise in this area. It is very good. A couple of quick things for you, though, if I could.

One point that you made is that we have frozen consumer law, if I hear you, and that kind of intrigued me from the standpoint of I can see what you are pointing to with that. And then you talk about the secretiveness of this.

Is there another way to get at those desires on your part where you represent a broad desire to have a better set of consumer laws for the United States that you work on here and with other countries than what I perceive as really going at the heart of the Federal Arbitration Act and changing a fundamental basis of law? Is there a different way to go at that?

Mr. ALDERMAN. I do not see a way that you can deal with the consumer law in this country and take the courts out of the picture, and I will use Texas as an example.

In the 1970's, Texas enacted—and this is in one of the articles of mine that I cite. The Texas Supreme Court established a doctrine of good and workmanlike performance. It was a time in the heyday of consumerism. It was a court that was considered very liberal. Between 1973 or 1974 and 1995, the Texas Supreme Court and lower courts dealt with that doctrine about 180 times. By the early 1990's, the Texas Supreme Court had decided we went too far. We gave consumers too many rights. We actually have to back off a little bit. And they modified it.

There have not been any cases in the last 5 or 6 years dealing with this doctrine. In my opinion, had arbitration occurred to the same extent it does now 8 years ago, arbitrators would be applying a law that, had the Texas Supreme Court been given an opportunity to review it, they actually would have made it more favorable to businesses.

But to me, the common law is the value of this country. It is the court's ability to modify the law.

Senator BROWNBACK. And that is where you see we are not getting the common law development.

Mr. ALDERMAN. And we do not get the interpretation of statutes. I wish that I could say every statute passed was perfectly worded and had no ambiguities, but it does not. And arbitrators cannot resolve that, except individually in the case before them.

Senator BROWNBACK. Just it would be much more interesting to me, as one that looks at arbitration—and I think you do have to go at it in various categories—as being something that makes the system much more accessible to a lot more people. And that is something I am interested in, but I am also interested in the development of consumer law, and—

Mr. ALDERMAN. If I may make one more—

Senator BROWNBACK. Let me just finish this point, and I would be happy to hear back from you. I do not want to just throw out something that makes the system somewhat work. I mean, maybe we could have more TV shows that have these disputes go on. That is one way we could get more access to it. But this is a way that can get things resolved for most people—not everybody, but I am sympathetic to your point of further development of the law. It is just I would like to look at it in some other setting other than going right at this Federal Arbitration Act statute.

Mr. ALDERMAN. I simply do not believe that the increases use of arbitration, that these entities are looking out for my rights and

they are trying to force me into something that is better for me. This is substance. And let me give you one quick example, and I think your example is something that I would favor, and I would tell everybody to take advantage of: a county commissioner that heard disputes. I do not have problems with bias, I do not have problems with cost. I think that is a wonderful idea. And the Better Business Bureau had something like that.

Senator BROWNBACK. May I go on to your point just real quickly in my remaining time. So yours is really the selection of the arbitrator.

Mr. ALDERMAN. It is the fact that only one side, and nothing will change it, controls the entire process. In Texas, if you are a member of the Better Business Bureau, you must use Better Business Bureau arbitration, regardless of what entity your contract says. Many consumers—and I advise them to use Better Business Bureau arbitration. It was inexpensive. It was held at reasonable times. It was very fair. After they ruled against one of the home builders in Houston, the home builder and other home builders withdrew from the Better Business Bureau, imposing arbitration under one of the national associations. I think this is being done for one reason. It gives business control, and there is nothing we can do with the procedures that will eliminate that control, and it is about substance, not procedure.

Senator BROWNBACK. Thank you.

Chairman FEINGOLD. Thank you. I appreciate the Ranking Member's comments about the way in which arbitration provides access. But access inherently is about something you choose to access. It is not about something you are forced to access. It is like saying jails give access to prisoners. They do not have a choice. So we have to, again, make sure that this topic is about mandatory arbitration, not arbitration in general.

Mr. Bland, do you want to say something about Mr. de Bernardo's claim that employment lawyers accept only 5 percent of the cases that come to them?

Mr. BLAND. Yes. When I saw this testimony last night—I got it at about 9 o'clock—and I read this Footnote 14, I was really curious about it because I had never heard that before. And I contacted a number of civil rights lawyers and said this guy is saying essentially that 95 percent of plaintiffs' lawyers would turn down employment cases, but that a much higher percentage of them would take them if they could do them in arbitration. And that is not the comparison. It is not even—

Mr. DE BERNARDO. That is not what I said.

Chairman FEINGOLD. You will get a chance to respond.

Mr. BLAND. It is not even apples and oranges. It is more like frogs and ball bearings, they are so far apart.

What the study says is that if people come in and say, "I think I was fired wrongly and I want to be able to sue my employer," because of the at-will doctrine in America, generally most people in America can be fired at the employer's choice unless there is something like racism or sexism going on, that 95 percent of plaintiffs' lawyers will advise the person not to sue. An employee comes in and says, "I want to sue," and the lawyer says, "You don't have a suit." That is good advice. For most people, you don't have a suit.

Most people who are fired, there is nothing they can do about it. The courts do not go around reinstating everybody who is fired in America. Nineteen out of 20 times, the good advice is just go away, there is nothing you can do about it, move on with your life.

The comparison that is relevant here is are people more likely to go into arbitration when they do have a valid claim, they do have a race discrimination claim that is real or a gender discrimination claim that is real, or are they more likely to go into court? And the data that I have seen—and also what virtually every civil rights lawyer I know says—is that they are more likely to go to court than arbitration because in arbitration it is very common to have a "loser pays" rule.

The U.S. Supreme Court said in the *Christiansburg Garment* case that if a civil rights claim, like a Title VII case, like Mrs. Luke's case, saying I have been fired because of my age or because of my race, that you cannot be hit with the other side's attorneys' fees unless your claim is frivolous.

In arbitration, it is very different. It is very common for arbitrations to have "loser pays" rules. I have seen a number of cases in which arbitrators have given the complete attorneys' fees to the defendant, even bankrupted people bringing sexual harassment cases.

One of the arbitration firms, the National Arbitration Forum, advertises in speeches and articles written for banking audiences that they have a "loser pays" rule to discourage cases—not just frivolous cases. A "loser pays" rule for anyone who loses a case.

For my clients, that is a deal breaker. No one walks in my door and says, "I was cheated. I was fired improperly." And I said, "I will tell you what. We will take your case. If you win, you will get your back pay. If you lose, you will bankrupted." OK? People walk from that.

Chairman FEINGOLD. I want to give Mr. de Bernardo a quick chance to respond.

Mr. DE BERNARDO. I am sorry?

Chairman FEINGOLD. I want to give you a quick chance to respond if you would like. You looked like you wanted to.

Mr. DE BERNARDO. Well, that is simply a misstatement of what is in the testimony, and I would urge you, Mr. Chairman, to read the testimony in that regard.

Chairman FEINGOLD. Thank you. Sam, did you want to ask anything else?

Senator BROWNBACK. No. We just would note the citation here that he has got at the bottom, so I would ask that be noted for the record. I think it is well noted.

Chairman FEINGOLD. Without objection.

I want to thank—

Mr. RUTLEDGE. Senator?

Chairman FEINGOLD. Very quickly.

Mr. RUTLEDGE. Very quickly, Senator, just to Mr. Bland's point about "loser pays" rules, if I could refer your staff to the 2003 study by Elizabeth Hill and to the 2004 study by Demaine and Hensler, both of those show that as an empirical matter, this notion that loser pays is being applied as a routine matter just is not correct.

Chairman FEINGOLD. Thank you, sir. Well, I want to thank everybody. I think this is exactly what a hearing should be, a fair

hearing of the issue. From my point of view, the more I hear about this, the more I am stunned by how central this issue is to our economy, to our consumers, and to our society. This is a big deal. And listening to you today, I am even more motivated to try to do something fundamental about this mandatory arbitration issue.

So I want to thank Senator Brownback for his participation and thank our witnesses. The record will remain open for 1 week for any further written materials that you or anyone else wants to submit. In addition, Senators may submit followup written questions for you during that same 1-week period, and I would ask that you attempt to send in your answers to those questions as soon as you can so we can complete the record.

The hearing is adjourned.

[Whereupon, at 11:10 a.m., the Subcommittee was adjourned.]

[Questions and answers and submissions for the record follow.]

# QUESTIONS AND ANSWERS

Response of Richard Naimark to a question submitted by Senator Brownback

**Question: A number of witnesses who testified in support of the bill claim that arbitrators and arbitration organization are fundamentally biased against consumers and employees. They also say that lists from which the parties choose an arbitrator are routinely composed of only biased individuals. How can we make sure that arbitrators will be neutral and treat all parties to a dispute fairly?**

**Answer**:

A critical element of a fair and impartial ADR mechanism is a disclosure requirement on the arbitrator. The AAA's rules require the disclosure of

> "...any circumstance likely to give rise to justifiable doubt as to the arbitrator's impartiality or independence, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives. Such obligation shall remain in effect throughout the arbitration."

A mechanism for disqualification/removal of an arbitrator is a second critical element. The AAA's rules require the arbitrator to be impartial and independent and to perform his or her duties with diligence and in good faith. Arbitrators are subject to disqualification for failure to meet these criteria or under "...any grounds for disqualification provided by applicable law."

Additionally, the AAA makes available through its website all information on consumer case decisions as required under California law, but has voluntarily extended this to all cases in the U.S. Information published by the AAA for consumer cases include the following data when available:

- Name of Non-Consumer Party
- Type of Dispute
- Salary Range (reported only on employment cases)
- Prevailing Party (as reported by arbitrator)
- Consumer Self Represented (indicates whether the consumer represented himself or herself in the arbitration procceding)
- Filing Date
- Disposition Date
- Type of Disposition (Awarded, Settled, Withdrawn)
- Amount of Claim
- Total Fee (total amount of arbitrator's fees and expenses charged on the case)
- Fee Allocation (percentage of the Total Fee borne by the consumer and non-consumer parties)
- Name of Arbitrator
- Award Amount (monetary amount awarded on the claim, if any)
- Other Relief

The AAA, a not-for-profit, public service organization, took a leading role, in conjunction with the American Bar Association, in the development of *The Code of Ethics for Arbitrators in Commercial Disputes*, which was most recently revised in 2004. This Code has canons requiring impartiality, integrity, fairness, and other key elements of alternative dispute resolution.



42605.001

**ANSWERS TO POST-HEARING WRITTEN QUESTIONS FROM SENATOR BROWNBACK**

**Prepared by Professor Peter B. Rutledge**

(Hearing on S. 1782, December 2007)

1. *Given that so little of the money recovered in class action settlements actually goes to class members, can you conceive of any way that this bill would not simply result in transferring money directly into the bank accounts of the trial lawyers both bringing and defending those class actions? Wouldn't consumers and employees be likely to receive more money directly through arbitration than waiting for the scraps that they would receive from a class action settlement?*

   It is reasonable to expect that the trial lawyers likely will benefit from the Arbitration Fairness Act, both for the reasons you mention and because litigation is more expensive than arbitration. With one exception, the available empirical evidence, summarized in my written testimony, suggests that by most measures the average individual will be worse off in litigation compared to arbitration. As to the exception, one study of employment arbitration suggests that individuals below a certain income threshold actually recover less money in arbitration than litigation. But, as the authors of this study acknowledge, this aberration likely is due to the fact that most individuals in this income bracket could not find a lawyer willing to litigate their case (unless they had a sufficiently high-stakes claim) whereas arbitration, due to its lower costs, actually improves the chances of obtaining an affordable resolution of a dispute.

2. *The vast majority of members of a settlement class who are eligible to file claims never do so - most people receive claims forms in the mail, and never return them because the forms are too complicated, or they don't have the right information to prove they have a claim, or they are turned off by the idea that the lawyers running the class action are going to get millions while each individual gets a few dollars. Do you know of any class actions involving consumers where even 10 percent of the eligible class members actually applied for and shared in the class settlement?*

   I am generally aware of the research on class actions, which suggests that the "take rate" (i.e., the rate at which eligible class members seek compensation from a settlement fund) can be quite low.

3. *A number of the witnesses cited studies that show that consumers and employees will have difficulty finding an attorney if they do not have a claim for at least $65,000. Most consumer and employment disputes are individualized - and therefore, not susceptible to being part of a class action under Federal Rule of Civil Procedure 23 and the analogous state rules. If this law is passed, will those consumers with individualized claims, who cannot join a class action, be better off in court than in arbitration?*



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No, the individuals described by your question will not be better off in litigation than arbitration. The stakes of their claim coupled with the access-to-justice problems in our civil litigation system mean that these individuals likely will never have a day in court (much less the jury trial touted by defenders of the Arbitration Fairness Act).

4. *Proponents of this bill assure us that the bill will not eliminate arbitration because consumers and employees will still be free to choose arbitration after a dispute arises. But studies have shown that only a miniscule number of arbitrations are the result of post-dispute agreements to arbitrate. Isn't it likely that this bill will eliminate 99 percent (or more) of consumer and employment arbitrations in this country?*

Yes, there is virtually no empirical evidence demonstrating the viability of post dispute arbitration. The available empirical evidence, cited in my written testimony, suggests precisely the opposite – that postdispute arbitration does not occur. This may be for psychological reasons – that the parties become dug in once their positions are public. Or it may be for strategic reasons – because parties know more information about their adversaries' position after a dispute arises than in the predispute veil of ignorance. Whatever the cause, and more research can be done in this area, the record suggests that postdispute arbitration is not a meaningful alternative. Consequently, the likely effects of the Arbitration Fairness Act should be unmistakable – it will kill arbitration for these types of disputes.

5. *A number of the witnesses who testified in support of the bill claim that arbitrators and arbitration organizations are fundamentally biased against consumers and employees. They also say that the lists from which the parties choose an arbitrator are routinely composed of only biased individuals. How can we make sure that arbitrators will be neutral and treat all parties to a dispute fairly?*

This question contains both an empirical component and a prescriptive component. As to the empirical component, the claim of arbitrator bias simply does not withstand scrutiny. Research into the so-called "repeat player" effect, detailed in my written testimony, offers at best a mixed conclusion on whether that effect exists. Moreover, even those scholars who have documented the repeat player effect have concluded that the effect is not due to any systemic bias in arbitration but rather factors unrelated to the arbitrator. As to the prescriptive component, existing mechanisms can ensure the neutrality of arbitrators – many arbitral institutions such as the American Arbitration Association employ strict requirements of independence and impartiality in their arbitrators. Even where the arbitral association does not screen out nonneutral arbitrators, evidence of bias provides a ground for vacatur of an arbitral award under Section 10 of the Federal Arbitration Act.



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6. *Professor Aldermon says that the main reason why arbitration should be eliminated is that courts perform the impartant function af interpreting the law and laying down precedents for future courts to follow. But it seems to be an exaggeration to say that every case filed in court results in a ground-breaking decision. Over 90 percent of all cases get dismissed, or are settled, well before judgment. Then, of the remaining cases that actually get decided by a court, a full 80 percent of them result in unpublished opinions that don't result in precedent. Can you explain whether, at the end of the doy, concerns obout the death of precedent are theoreticol rather than procticol?*

In some respects, concerns about the death of precedent are unfairly attributed to arbitration; in other respects, these concerns are overblown. As a general mater, a vast array of legal conventions such as mediations, settlements, unappealed judgments, and unpublished opinions (all fully endorse by our legal system) reduces the opportunity to create precedent. Seen in this light, arbitration is simply another form of extrajudicial dispute resolution. Moreover, even as to arbitration, the complaint is overblown. Most centrally, administrative agencies (the EEOC, SEC, FTC, *et al.*) or other parties who are not signatories to arbitration agreements can still commence litigation and, thereby, have the opportunity to create precedent.

7. *What would be the likely impact on the backlogs that courts currently experience if S. 1782 wos enacted?*

Adoption of the Arbitration Fairness Act likely will increase already congested court dockets, at both the federal and the state level. To take just one example, a recent report by the group Public Citizen criticized arbitration of consumer debt collection actions, citing recent data gathered by the State of California. If those actions were not arbitrable under the Arbitration Fairness Act, it would inject thousands new cases into the California court system. Not only would these parties have to "take a number" in the California courts, but they would naturally push other litigants to the back of the line, slowing down the machinery of justice for everyone.

8. *Mr. Bland told us thot we should not credit the fact that the Equal Employment Opportunity Commission is not bound by arbitration agreements between the employee ond employer, because the EEOC almost always obtains only injunctive relief, and not monetary relief for employees. Can you explain why it is significant that the EEOC can still go to court on behalf of employees, and whether the EEOC con in fact recover monetary relief for those employees?*

As I've already mentioned, the ability of the EEOC (and other agencies) to litigate a case enables those agencies to influence the development of caselaw. I do not profess to be an expert on remedies in employment discrimination law, but my research in preparation of answers to these questions does indicate that, contrary to Mr. Bland's testimony, federal courts



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have upheld the authority of the EEOC to obtain monetary relief for employees subject to arbitration agreements.



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SUBMISSIONS FOR THE RECORD

# Victim: Gang-Rape Cover-Up by U.S., Halliburton/KBR

**KBR Told Victim She Could Lose Her Job If She Sought Help After Being Raped, She Says**

**By BRIAN ROSS, MADDY SAUER & JUSTIN ROOD**

**Dec. 10, 2007—**

A Houston, Texas woman says she was gang-raped by Halliburton/KBR coworkers in Baghdad, and the company and the U.S. government are covering up the incident.

Jamie Leigh Jones, now 22, says that after she was raped by multiple men at a KBR camp in the Green Zone, the company put her under guard in a shipping container with a bed and warned her that if she left Iraq for medical treatment, she'd be out of a job.

"Don't plan on working back in Iraq. There won't be a position here, and there won't be a position in Houston," Jones says she was told.

In a lawsuit filed in federal court against Halliburton and its then-subsidiary KBR, Jones says she was held in the shipping container for at least 24 hours without food or water by KBR, which posted armed security guards outside her door, who would not let her leave.

"It felt like prison," says Jones, who told her story to ABC News as part of an upcoming "20/20" investigation. "I was upset; I was curled up in a ball on the bed; I just could not believe what had happened."

Finally, Jones says, she convinced a sympathetic guard to loan her a cell phone so she could call her father in Texas.

"I said, 'Dad, I've been raped. I don't know what to do. I'm in this container, and I'm not able to leave,'" she said. Her father called their congressman, Rep. Ted Poe, R-Texas.

"We contacted the State Department first," Poe told ABCNews.com, "and told them of the urgency of rescuing an American citizen" -- from her American employer.

Poe says his office contacted the State Department, which quickly dispatched agents from the U.S. Embassy in Baghdad to Jones' camp, where they rescued her from the container.

According to her lawsuit, Jones was raped by "several attackers who first drugged her, then repeatedly raped and injured her, both physically and emotionally."

Jones told ABCNews.com that an examination by Army doctors showed she had been raped "both vaginally and anally," but that the rape kit disappeared after it was handed over to KBR security officers.

A spokesperson for the State Department's Bureau of Diplomatic Security told ABCNews.com he could



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not comment on the matter.

Over two years later, the Justice Department has brought no criminal charges in the matter. In fact, ABC News could not confirm any federal agency was investigating the case.

Legal experts say Jones' alleged assailants will likely never face a judge and jury, due to an enormous loophole that has effectively left contractors in Iraq beyond the reach of United States law.

"It's very troubling," said Dean John Hutson of the Franklin Pierce Law Center. "The way the law presently stands, I would say that they don't have, at least in the criminal system, the opportunity for justice."

Congressman Poe says neither the departments of State nor Justice will give him answers on the status of the Jones investigation.

**Click Here for Full Blotter Coverage.**

Asked what reasons the departments gave for the apparent slowness of the probes, Poe sounded frustrated.

"There are several, I think, their excuses, why the perpetrators haven't been prosecuted," Poe told ABC News. "But I think it is the responsibility of our government, the Justice Department and the State Department, when crimes occur against American citizens overseas in Iraq, contractors that are paid by the American public, that we pursue the criminal cases as best as we possibly can and that people are prosecuted."

Since no criminal charges have been filed, the only other option, according to Hutson, is the civil system, which is the approach that Jones is trying now. But Jones' former employer doesn't want this case to see the inside of a civil courtroom.

KBR has moved for Jones' claim to be heard in private arbitration, instead of a public courtroom. It says her employment contract requires it.

In arbitration, there is no public record nor transcript of the proceedings, meaning that Jones' claims would not be heard before a judge and jury. Rather, a private arbitrator would decide Jones' case. In recent testimony before Congress, employment lawyer Cathy Ventrell-Monsees said that Halliburton won more than 80 percent of arbitration proceedings brought against it.

In his interview with ABC News, Rep. Poe said he sided with Jones.

"Air things out in a public forum of a courtroom," said Rep. Poe. "That's why we have courts in the United States."

In her lawsuit, Jones' lawyer, Todd Kelly, says KBR and Halliburton created a "boys will be boys" atmosphere at the company barracks which put her and other female employees at great risk.

"I think that men who are there believe that they live without laws," said Kelly. "The last thing she should have expected was for her own people to turn on her."

Halliburton, which has since divested itself of KBR, says it "is improperly named" in the suit.



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In a statement, KBR said it was "instructed to cease" its own investigation by U.S. government authorities "because they were assuming sole responsibility for the criminal investigations."

"The safety and security of all employees remains KBR's top priority," it said in a statement. "Our commitment in this regard is unwavering."

Since the attacks, Jones has started a nonprofit foundation called the Jamie Leigh Foundation, which is dedicated to helping victims who were raped or sexually assaulted overseas while working for government contractors or other corporations.

"I want other women to know that it's not their fault," said Jones. "They can go against corporations that have treated them this way." Jones said that any proceeds from the civil suit will go to her foundation.

"There needs to be a voice out there that really pushed for change," she said. "I'd like to be that voice."

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## VII. ADDITIONAL VIEWS OF SENATORS FEINGOLD, DURBIN, AND KENNEDY

We fully support S. 221 and the committee report. We provide these additional views to respond to the minority views filed by Senators Kyl, Specter, and Brownback, which primarily include criticism of a bill that the committee has not yet considered, the Arbitration Fairness Act, S. 1782. We are cosponsors of that legislation, which would render unenforceable pre-dispute arbitration agreements in consumer, employment, and franchise contracts.

The primary assertion of the minority views is that both S. 221 and S. 1782 will eliminate the option of arbitration, which will cause great economic hardship to defendant companies. They assert, for example, that S. 1782 would mean that "every dispute would have to go to court," and that:

> [O]nce arbitration agreements are rendered null and void by this Act [S. 221], there will be nothing "voluntary" about the litigation that parties will be forced to endure. The bill's assault on "mandatory" arbitration is more clearly and accurately described as the creation of mandatory and unavoidable litigation.

Reading these pronouncements, one might think that the bills actually prohibit arbitration. They do not. Under both S. 221 and S. 1782, parties to a dispute remain free to choose arbitration rather than litigation. And we are confident that many will. But the very fact that the minority views assume that arbitration will never take place if corporations cannot force farmers, or consumers, or employees to go to arbitration by putting an arbitration clause into a take-it-or-leave-it contract speaks volumes. If arbitration is such a wonderfully fair and efficient alternative to litigation, why wouldn't a consumer or a worker choose it voluntarily?

The point of S. 221, and of S. 1782, which we hope the committee will consider at some point in the future, is to give parties who have a dispute a choice, after the dispute arises, of how they want to resolve it. If arbitration is as fair and cost-efficient as the defenders of mandatory arbitration argue, then surely farmers, consumers, and employees will choose it when they have the freedom to make a real choice. The problem with the current system, as years of experience have shown in the area of agricultural contracts, is that arbitration has proven very beneficial and efficient for the large repeat player, but not so for the individual farmer, grower, consumer or employee. Indeed, one effect of S. 221 may be that once the farmer has a real choice, arbitration programs will have a much greater incentive to make their systems fair if they want to stay in business.



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The amendment offered by Senator Kyl during the committee's markup of S. 221 to give the parties the right to discovery and to a written decision in arbitration was not a serious effort to repair an arbitration system that farmers have come to see as stacked against them. A bill similar to S. 221 passed the Senate by a wide margin as an amendment to the farm bill in 2002. Between that time and the date of the committee action, defenders of the current system made no effort to move legislation to improve the arbitration process. Farmers have waited long enough for Congress to respond to their grievances. Alternative half-measures hastily concocted only when legislation designed to help them is finally moving are not enough.

We say half-measures because Senator Kyl's amendment did not even come close to rectifying the problems with the current arbitration system. For example, there is generally extremely limited judicial review of arbitration decisions. Individuals who find themselves in mandatory binding arbitration are often unable even to challenge the format and procedures that may generate an unjust result.

In addition, farmers have no way of knowing how often the arbitrators they must use under the contract have ruled in favor of agribusiness in similar cases. Some arbitration systems do not even require that the arbitrators follow applicable law. Another issue that the amendment did not address is the availability and cost of transcripts of the arbitration proceedings. The list goes on and on. The defeat of Senator Kyl's amendment was not a result of a partisan unwillingness to recognize a good faith effort to "fix" mandatory arbitration. (As the committee report correctly notes, a bipartisan majority of the committee voted against each of the Kyl amendments.) It was defeated because it was too little, too late.

The minority views reserve their greatest scorn for S. 1782, which has not yet been considered by the committee. We see no reason to respond in detail to the one-sided discussion of a supposedly typical employment discrimination case that now often must go to arbitration, but could be filed in court under that bill. We could easily describe actual employment discrimination complaints rejected without analysis or legal basis by arbitrators handpicked by employers, and would note that Congress passed the Civil Rights Act of 1964 and other civil rights statutes to give workers the ability to take their grievances to court, not to a biased arbitration panel. In any event, we look forward to the committee's future work on our bill because mandatory arbitration is just as much of a problem for consumers and employees as it is for farmers. We are confident that a record will be developed to support our bill, and we reject the portrait of exploding, extortionist employment litigation that the minority views paint.

The Federal Arbitration Act of 1925 was passed to allow the courts to recognize and enforce alternative dispute resolution. But with the help of a few mistaken court decisions, it has become a weapon in the hands of big business to avoid the laws that Congress and state legislatures pass to protect consumers and employees, and yes, farmers. Big companies are making use of a parallel but very different legal system and forcing those they do business with to participate in it. We make no apologies for wanting to re-

verse the alarming trend of mandatory pre-dispute arbitration agreements, and look forward to Congress enacting S. 221 and other similar legislation to restore the primacy of the rule of law.

RUSSELL D. FEINGOLD.
RICHARD DURBIN.
EDWARD M. KENNEDY.

Testimony of

Richard M. Alderman
Associate Dean for Academic Affairs
Dwight Olds Chair in Law
Director, Center for Consumer Law
University of Houston Law Center

Before the United States Senate Committee on the Judiciary
Subcommittee on the Constitution

**"S. 1782, The Arbitration Fairness Act of 2007"**

December 12, 2007

Chairman Feingold, members of the Committee, thank you for the opportunity to join the discussion of the Arbitration Fairness Act of 2007. I appear before you as someone who has served as an arbitrator and supports arbitration, but who values our courts more.[1]

Not long ago, automobile dealers came to Congress to ask for help. They asserted they were being denied access to the courts through the manufacturers' use of a pre-dispute arbitration provision. The dealers believed it was unfair for the stronger party to the bargain to have the right to unilaterally force the weaker party to forfeit the right to sue as a condition of doing business. In 2002 Congress passed the Motor Vehicle Franchise Fairness Act, with 50 co-sponsors in the Senate and 252 in the House. Today, I am asking that you provide similar protections for consumers.

As some who has taught consumer law for 35 years, and who has worked as a consumer advocate for even longer, I truly believe that the Arbitration Fairness Act is the most important piece of consumer legislation of the past three decades. I say this for one simple reason, excessive pre-dispute mandatory binding arbitration frustrates our system of government by denying courts the ability to perform the vital role the founders of this country envisioned.

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1. See generally Richard M. Alderman, *Consumer Arbitration: The Destruction of the Common Law*, 2 J. OF AMERICAN ARBITRATION 1 (2003); Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUSTON L. REV. 1237 (2001); and Richard M. Alderman, *The Future of Consumer Law in the United States—Hello Arbitration, Bye-bye Courts, So-long Consumer Protection*, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1015517



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You have heard and will continue to hear the debate about whether consumer arbitration is good or bad for consumers. Questions have been raised about the true cost of arbitration, and its fairness. But no one disputes that consumer arbitration is imposed by the stronger party, not voluntarily agreed to.[2]

Ask any school child and he or she will tell you about our system of government, checks and balances, legislative, executive and judicial branches of government.[3] It is the judicial branch that is uniquely American and its role is essential. Our civil justice system provides an open, public forum for juries to resolve disputes. It interprets and applies the laws enacted by the legislature, and it often creates or modifies law through our common law system. The increasing use of consumer arbitration denies the courts the ability to play this vital role. Our current system of arbitration has allowed business to effectively "opt-out" of our civil justice system and replace it with a system of private justice, it controls. Even supporters of consumer arbitration recognize that substance not form is the reason for pre-dispute arbitration provisions.

For example, in a recent law review article the authors note that the auto and home industries have "divorced" themselves from the Alabama justice system, because of the fear of unfair awards.[4] Instead of working through the legislative process to enact change, or using the political process to elect different decision makers, car dealers and home builders simply included a short phrase in their contracts, to enact major substantive changes in the application of the law.[5] [I assume that if a "friendlier"

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2. The validity of arbitration clauses is based on the premise that they are a voluntarily chosen alternative forum of dispute resolution. Consumer arbitration is anything but voluntary. It is placed in boiler-plate form contracts, presented on a take it or leave it basis. Perhaps more importantly, it is fast becoming anything but an "alternative." Consumer arbitration is quickly becoming universal. For example, nearly all credit card agreements, bank contacts, home builder agreements and car purchase orders, contain a binding arbitration clause. Consumer arbitration is not an alternative to our courts, it is designed to replace them when it comes to consumer disputes. Today very few consumer disputes may be presented in court, soon there may be none.

3. For example, a popular children's book states:

> There are three branches of federal government, charged with different responsibilities. The legislative branch (the House of Representatives and the Senate) creates laws for the nation. The executive branch (headed by the president of the United States) executes, or carries out, the laws. The judicial branch (The Supreme Court and other lower courts) interprets the law and can overrule them.
>
> In addition to separating powers, the Constitution also provides for numerous ways in which these bodies of government overlap. This is so they can check up on one another in case one body does something that isn't good for the country.

Mark Friedman, GOVERNMENT, at 12 (2005).

4. W. Scott Simpson, Stephen J. Ware, and Vickie M. Willard, *The Source of Alabama's Abundance of Arbitration Cases: Alabama's Bizarre Law of Damages for Mental Anguish*, 28 AM. J. TRIAL ADVOC. 135, 177 (2004). As the authors of the article note:

> The auto and home industries, fearing catastrophic verdicts before Alabama juries, now require customers, nearly across-the-board, to enter into pre-dispute binding arbitration agreements as a condition of doing business. These industries have effectively divorced themselves from the Alabama civil justice system in hopes of obtaining fairer and more just awards before arbitrators.

5. A recent study of commercial arbitration clauses supports the proposition that the widespread use of arbitration in consumer cases may be in fact based on something other than the efficiency benefits of an alternative forum:



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judiciary were elected, the auto and home industries would stop using arbitration to take advantage of the friendlier forum.]

And our courts do more than just resolve disputes; they interpret statutes and create common law.[6] Through stare decisis and precedent, decisions of higher courts are binding on lower courts, insuring uniformity of results. For example, in 1995, Congress amended the remedy provisions of the Truth-in-Lending Act. Unfortunately, the language used was not the most precise, and courts gave differing interpretations to a significant issue—whether damages were capped at $1,000. In 2004 the United States Supreme Court held the cap applied. [7] Its decision is now binding on all other courts to consider this issue, insuring consistency and a uniform application of the statute.

Today, most consumer credit contracts contain an arbitration provision, and it is unlikely a court will be given the opportunity to resolve ambiguities. Instead, we have arbitrators, not bound by the decisions of any other arbitrators, each deciding the issue of how the law should be interpreted and applied. The widespread use of consumer arbitration means consumers with identical claims and circumstances may all be treated differently, by arbitrators unable to create precedent or establish consistent legal doctrine.

---

> We present evidence that large corporate actors do not systematically embrace arbitration. International contracts include arbitration clauses more than domestic contracts, but also at a surprisingly low rate. Our results have implications for the justifications for the widespread use of arbitration clauses in consumer contracts. If the reasons that some have advanced to support the use of arbitration in the consumer context - that it is simpler and cheaper than litigation - are correct, it is surprising that public companies do not seek these advantages in disputes among themselves. In the simple economic view, our results suggest that corporate representatives believe that litigation can add value over arbitration.

Theodore Eisenberg and 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, 373-74 (2007).

6. The need for a common law supplement to legislation has been described as follows:

> Our society has an enormous demand for legal rules that actors can live, plan, and settle by. The legislature cannot adequately satisfy this demand. The capacity of a legislature to generate legal rules is limited, and much of that capacity must be allocated to the production of rules concerning governmental matters, such as spending, taxes, and administration; rules that are regarded as beyond the courts' competence, such as the definition of crimes; and rules that are best administered by a bureaucratic machinery, such as the principles for setting the rates charged by regulated industries. Furthermore, our legislatures are normally not staffed in a manner that would enable them to perform comprehensively the function of establishing law to govern action in the private sector. Finally, in many areas the flexible form of a judicial rule is preferable to the canonical form of a legislative rule. Accordingly, it is socially desirable that the courts should act to enrich that supply of legal rules that govern . . . [business] conduct-not by taking on lawmaking as a free-standing function, but by attaching much greater emphasis to the establishment of legal rules than would be necessary if the courts' sole function was the resolution of disputes.

Chris A. Carr and Michael R. Jenks, *The Privatization of Business and Commercial Dispute Resolution: A Misguided Policy Decision,* 88 KY. L. J. 183, 193 (1999). *See generally,* Jay M. Feinman, *Un-Making Law: The Classical Revival in the Common Law,* 28 SEATTLE UNIV. L. R. 1 (2004) (discussing changes and trends in the development of the common law).

7. *Koons Buick GMC, Inc. v. Nigh,* 543 U.S. 50 (2004).



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And finally, the common law tradition of this country empowers the courts to create and modify legal doctrine.[8] Consumer doctrines such as unconscionability, strict products liability, habitability and good and workmanlike performance have been created, modified, limited and extended by our courts to protect consumers and insure a fair bargain. But arbitrators cannot create or modify the common law.[9] They are bound by existing legal doctrine, essentially freezing the common law of consumer transactions, denying courts the ability to develop and adapt the law.[10]

To me the question is simple, it is not whether arbitration is fair or benefits consumers, it is whether the more powerful party to a bargain should be able to deny the other access to the courts. The answer, as Congress recognized in the case of automobile dealers is clearly no. I encourage you to enact the Arbitration Fairness Act and recognize that automobile dealers and consumers should have the right to sue.

I thank you for the opportunity to discuss this important issue, and welcome any questions you may have.

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8. The common law is the system that America has adopted and developed over the centuries for ensuring the law stays current with rapidly changing social and economic conditions. As Justice Harlan F. Stone noted, "If one were to attempt to write a history of the law in the United States, it would largely be an account of the means by which the common-law system has been able to make progress through a period of rapid social and economic change." Harlan F. Stone, *The Common Law in the United States,* 50 HARV. L. REV. 4 at 11 (1936).

9. Unlike court opinions, most of which are published, most decisions of arbitrators are secret, and are often not even accompanied by a written opinion. Even when published and made available to the public, the decision of one arbitrator or panel of arbitrators, is in no way binding on any other arbitrator or panel. In fact, arbitrators generally are not compelled to follow the law and their decisions may not be appealed.

10. As every first year student at an American law school is taught, precedent and stare decisis are the foundations of the common law. Courts are bound by precedent and must follow decisions of higher courts, and all courts should give serious consideration to the rationale of others. As Justice Stone noted almost seventy years ago, the common law's,

> [D]istinguishing characteristics are its development of law by a system of judicial precedent, its use of the jury to decide issues of fact, and its all-pervading doctrine of supremacy of the law—that the agencies of government are no more free than the private individual to act according to their own arbitrary will or whim, but must conform to legal rules developed and applied by courts.

Harlan F. Stone, *The Common Law in the United States,* 50 HARV. L. REV. 4, at 5 (1936).Through this process of judicial precedent, courts create and mold legal rights, co-existent with, and supplemental to, those created by statute



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**Alliance for Justice**
**Center for Responsible Lending**
**Consumer Federation of America**
**Consumers Union**
**HomeOwners for Better Building**
**Public Citizen's Congress Watch**
**U.S. Public Interest Research Group**

25 June 2007

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Dear Chairman Cox and SEC Commissioners:

The undersigned organizations write in strong support of Senators Feingold's and Leahy's call for the SEC to protect the investing public by prohibiting mandatory arbitration.

True investor protection requires that investors not be stripped of their legal and constitutional rights as a condition of entering into our securities markets. The very best solution is the one originally intended by the exchanges and Securities and Exchange Commission (SEC) when the Constitution of the New York Stock Exchange (NYSE) and bylaws of NASD were approved.

Those rules provide that industry members are required to arbitrate at the request of the customer. In that scheme, any investor wishing to take advantage of the industry-subsidized system could do so. None of the alleged benefits of the system would be lost. But investors who would prefer to avail themselves of the rule of law in a public court would also retain that option. Permitting the industry to require the forfeiture of that option as a condition of opening an account forecloses on the freedom of investors contrary to the original intent of the law.

If arbitration were voluntary, the marketplace would encourage the NASD to improve its system and the public perception of the fairness of its program. It cannot reasonably be disputed that the securities arbitration system does not enjoy the perception of fairness required to fulfill its purpose.

There is no precedent in present-day America for allowing an industry to create its own justice system and to act in concert to impose it on the public. Some of the unfair procedures that have been permitted to exist include:

- A refusal to allow depositions in most cases;
- An "eligibility" rule imposing an industry-created statute of limitations;
- The common failure to explain awards, which frustrates appeals;



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- A requirement that industry arbitrators be present on every panel;
- An explicit instruction to the arbitrators that they are not required to follow the law; and
- The misclassification of industry-affiliated attorneys as "neutrals".

American investors are entitled to the rule of law when it comes to protecting their pensions and life savings. Please protect investors by giving them back an option to have their rights enforced in a public court of law.

Thank you for your consideration,

**Marya Torrez**
**Alliance for Justice**

**Sally Greenberg**
**Consumers Union**

**Jillian Aldebron**
**Center for Responsible Lending**

**Janet Ahmad**
**HomeOwners for Better Building**

**Barbara Roper**
**Consumer Federation of America**

**Laura MacCleery**
**Public Citizen's Congress Watch**

**Edmund Mierzwinski**
**U.S. Public Interest Research Group**

cc:
The Honorable Paul S. Atkins, SEC Commissioner
The Honorable Roel C. Campos, SEC Commissioner
The Honorable Annette L. Nazareth, SEC Commissioner
The Honorable Kathleen L. Casey, SEC Commissioner

The Honorable Russell Feingold, U.S. Senate
The Honorable Patrick Leahy, U.S. Senate
The Honorable Barney Frank, U.S. House of Representatives, Committee on Financial Services
The Honorable Spencer Bachus, U.S. House of Representatives, Committee on Financial Services



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**TESTIMONY TO THE SUBCOMMITTEE ON THE CONSTITUTION OF THE UNITED STATES SENATE JUDICIARY COMMITTEE**

# S. 1782, THE ARBITRATION FAIRNESS ACT OF 2007

**December 12, 2007**

**by F. Paul Bland, Jr.**

**Staff Attorney**

**Public Justice (Formerly Trial Lawyers for Public Justice)**[1]

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[1] F. Paul Bland, Jr., is a Staff Attorney for Public Justice, where he handles precedent-setting complex civil litigation. He has argued or co-argued and won nearly twenty reported decisions from federal and state courts across the nation, including cases in the four different U.S. Courts of Appeal and in the high courts of five different states. He is a co-author of a book entitled *Consumer Arbitration Agreements: Enforceability and Other Issues*, and numerous articles. For three years, he was a co-chair of the National Association of Consumer Advocates. He was named the "Vern Countryman" Award winner in 2006 by the National Consumer Law Center, which "honors the accomplishments of an exceptional consumer attorney who, through the practice of consumer law, has contributed significantly to the well being of vulnerable consumers." He also has won the San Francisco Trial Lawyer of the Year in 2002 and Maryland Trial Lawyer of the Year in 2001 for his role in two cases challenging abusive mandatory arbitration clauses. Prior to coming to Public Justice, he was in private practice in Baltimore. In the late 1980s, he was Chief Nominations Counsel to the U.S. Senate Judiciary Committee. He graduated from Harvard Law School in 1986, and Georgetown University in 1983. Alexis Rickham also contributed research and insights to this testimony.

## INTRODUCTION AND SUMMARY

This testimony will make the following points:

- A large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their rights to a trial by jury and to bring cases in the U.S. public civil justice system, and instead submit all of their legal claims to binding mandatory arbitration.[2]
- Most consumers have little or no meaningful choice about submitting to arbitration. Few people notice or realize the importance of the fine print that strips them of rights; and because all the corporations in entire industries are adopting these clauses, people have no choice. They must give up their rights as a condition of buying a car, opening a bank account, or getting credit card, etc.
- Private arbitration companies are under great pressure to devise systems that favor the corporate repeat players who draft the arbitration clauses (and thus decide which arbitration companies will receive their lucrative business). For example, arbitrators who rule against corporations and in favor of individuals are often blackballed from serving as arbitrators in future cases. Also, some arbitration companies have undertaken advertising campaigns aimed at prospective corporate clients which make a number of inappropriate promises of favorable treatment.
- There is no meaningful judicial review of arbitrators' decisions. Under current law,

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[2] The concerns addressed in this testimony all relate to "pre-dispute arbitration agreements," meaning contract provisions agreed to in advance of any dispute or claim that require a party to take any claims that may later arise to arbitration instead of to court. The concerns discussed here do not relate to post-dispute arbitration, in which two parties to an existing dispute agree after the dispute arises to submit that dispute to arbitration.



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arbitrators enjoy near complete freedom to ignore their own rules, the facts and even the law in any given case, without fear that their rulings will be seriously examined by any later court – and without fear of personal or professional consequences.

- Many corporations tack on lots of unfair provisions to their arbitration clauses that are not inherent to the idea of arbitration, but that further rig the systems against individuals. For example, some corporations impose "loser pays rules" to discourage individuals from bringing claims; some corporations insert provisions into arbitration clauses that strip individuals of substantive statutory rights; some corporations require people to arbitrate their claims across the country (knowing that they'll be forced to drop the cases); and some corporations use arbitration clauses to ban class actions even where it is clear for class actions are the only way for individuals to have any remedy. While some courts have been protective of individuals, striking down some of these unfair contract terms, too many other courts have either left the issue of whether the arbitration clauses violate the law to be decided by arbitrators rather than courts or uphold even egregiously unfair clauses. This is particularly disturbing because arbitrators have a significant financial incentive to rule that the clauses are legal, so they can continue to bill the file on the case.
- A number of corporations are using arbitration for debt collection, but abusing the process so that the arbitration process just becomes a "mill" that nearly always rules for the lender regardless of the underlying facts.



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**CAN THE PROBLEMS AND ABUSES OF MANDATORY ARBITRATION BE FIXED BY MAKING THE SYSTEM A LITTLE MORE FAIR THROUGH STANDARDS?**

As some corporations have imposed increasingly draconian and outrageous contract terms on their customers and employees, and tried to slip these provisions past courts by including them in a paragraph of the contract labeled "arbitration" and then argued that even if the terms would otherwise be illegal that a corporation can do anything it wants without limits in a contract if the term is in an arbitration clause, some "reform" efforts have focused on the idea that all that is needed is to make arbitration somewhat more fair. "The system is really o.k. at its core," the argument runs, "we just need to eliminate some of the worst abuses." The premise behind this kind of reform is that so long as some of the most egregious abuses are banned – corporations can't make Florida residents arbitrate small claims in Alaska, for example, or there is a vague promise to make sure that arbitrators are neutral – that the rest of the system can be left alone.

In our view, this kind of palliative does not address the real problem. The real problem with mandatory pre-dispute arbitration between parties of vastly differing bargaining power stems from the nature of incentives and power. So long as the stronger party to a contract is designing a system that will resolve disputes between both parties (and, in particular, is picking which company will decide those disputes), so long as it is predictable and certain that the vast majority of consumers and employees do not and will not read through the fine print legalese of standard form contracts, so long as courts will not meaningfully review the decisions made by the private judges picked by the corporation, the system will not work well. The arbitration companies can adopt vague and unenforceable "due process protocols," or the Congress could pass some vague "rules" that arbitration must be "fair" and "neutral" and so forth, but clever



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parties will find many ways to take advantage of the system. In our view, vague promises to reform the very worst abuses of mandatory arbitration will do very little to solve the very real problems that our clients have encountered and continue to encounter every day.

**BACKGROUND ON PUBLIC JUSTICE.**

Public Justice (formerly Trial Lawyers for Public Justice) is a national public interest law firm dedicated to using trial lawyers' skills and resources to advance the public good. We specialize in precedent-setting and socially significant litigation, carrying a wide-ranging docket of cases designed to advance the rights of consumers and injury victims, environmental protection and safety, civil rights and civil liberties, occupational health and employee rights, protection of the poor and the powerless, and overall preservation and improvement of the civil justice system.

Public Justice was founded in 1982 and is currently supported by more than 3,000 members around the country. More information on Public Justice and its activities is available on our web site at www.publicjustice.net. Public Justice does not lobby and generally takes no position in favor of or against specific proposed legislation. We do, however, respond to informational requests from legislators and persons interested in legislation, and have occasionally been invited to testify before legislative and administrative bodies on issues within our expertise. In keeping with that practice, we are grateful for the opportunity to share our experience with respect to the important issues this Committee is considering today. In this connection, we have extensive experience with respect to abuses of mandatory arbitration, having litigated (often successfully) a large number of challenges to abuses of mandatory arbitration in state and federal courts around the nation.



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**I. Many Corporations' Standard Form Contracts Require Customers And/Or Employees to Give Up Their Constitutional Rights to a Jury Trial, And Instead Submit Legal Disputes to Binding Arbitration As A Condition of Getting Services Or Having a Job.**

In just the last generation, there has been a largely unnoticed but very important revolution in the way many corporations do business. Fifteen years ago, only a handful of corporations required consumers or non-unionized employees to submit their claims to binding arbitration. Now, these mandatory arbitration clauses are in tens of millions of form contracts. Here are just a few examples:

- All of the largest credit card companies in the U.S. have binding arbitration clauses, and it is very hard to find any credit card issuer that does not have such a clause. Similarly, it is very hard to get a checking account or most loans or other financial services products without submitting to an arbitration clause.[3]
- The vast majority of cell phone and residential phone companies require their customers to accept binding arbitration clauses on a take-it-or-leave-it basis. Cingular, Sprint, T-Mobile, Verizon, Working Assets Long Distance, Qwest, and many other companies have such clauses. It would be hard for a customer to get a cell phone without giving up her or his right to a jury trial.
- Millions of persons are required by their employers to submit all claims – wage and hour claims, civil rights claims, everything – to binding arbitration. Employers such as

[3] There is one important exception. Last fall, Congress made it a misdemeanor for a lender to put an arbitration clause into many loan agreements with members of the military or their dependent family members. 10 U.S.C. § 987 (e)(2)-(4); (f)(1). There is a serious policy question as to how mandatory arbitration could be so unfair when it is imposed upon a member of the military that it is a crime, yet it is supposed fair and proper to impose it on other citizens.



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Anheuser-Busch, Cheesecake Factor, Circuit City, Ford Motor Co., Hooters, Hughes Electronics, Kentucky Fried Chicken, Lenscrafters, Marriott International, Pfizer, Rockwell, Ralph's Grocery/Albertsons, Waffle House and General Electric (among thousands of others) all require their employees to agree to mandatory arbitration clauses as a condition of getting or keeping a job.[4]

- From talking to hundreds of consumer lawyers and consumers, it appears that in the last four years the vast majority (if not nearly all) car dealers in the U.S. have inserted binding arbitration clauses into their car sales contracts. (Only a few car dealers in the entire nation had such clauses seven or eight years ago.)[5]
- It is hard to buy a computer without submitting to a binding arbitration clause. Dell, Gateway, and other major companies insist upon them.
- Mandatory arbitration is growing rapidly as a requirement for patients to receive necessary medical services. Many HMOs have arbitration clauses; more and more doctors have such clauses; most nursing homes require patients (or family members) to

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[4] As one example of how courts often do not protect employees from mandatory arbitration, *see Garrett v. Circuit City Stores*, 449 F.3d 672 (5th Cir. 2006). In that case, a company allegedly did not preserve the job of a military reservist who was sent to Iraq. When he sued under the Uniformed Services Employment and Reemployment Rights Act (USERRA), 38 U.S.C. § 4302(b), the Court held that he had lost his right to bring this claim in court and had to bring his claim to a private arbitrator. There is no little irony that someone who has risked his life protecting our freedoms would be forced to lose a number of his own constitutional freedoms as a result of a fine print contract. 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. *Id.* at 679.

[5] By contrast, back in 2002, automobile dealerships lobbied strenuously for and won a federal statute that bars car manufacturers from insisting that car dealers arbitrate disputes. 15 U.S.C. § 122 6 (a)(2). The Congress has only protected car dealers, however, and not car buying consumers.



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sign such clauses; I have seen such a clause in a contract providing for an organ transplant.

- Mandatory arbitration clauses are in contracts for a wide range of other consumer goods and services – home sales contracts, insurance companies, rental car companies, mortuaries, pest control companies, securities broker services, pet boarding companies, etc., all regularly require customers to sign them as a condition of service.

## II. Consumers and Employees Have Little Choice But to Agree to Mandatory Arbitration Clauses.

Literally millions of Americans have unknowingly received mandatory arbitration clauses in a manner that ensures that the clauses would not be read or understood by all but a very few of their recipients. We have seen dozens of arbitration clauses, including clauses used by some of the largest and richest corporations in the United States, that are (a) cast in dense and cryptic legalese incomprehensible to lay persons (and even many lawyers); (b) set forth in minuscule print, often on the back side of a document; and (c) buried in the center of a mailing that contained a variety of other pieces, most of which were solicitations and advertisements unlikely to be read by most recipients. Many on-line contracts bury the arbitration clauses hundreds of lines deep in the fine print; the corporations know that most normal people will just click "agree" rather than scroll down so far. Even when consumers are asked to sign or initial below or at the arbitration clause, it is often in the context of a transaction where the consumer is asked to quickly flip through a large body of "standard" documents or contract provisions, which rarely include an explanation of the arbitration clause.[6]

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[6] In one case in which we were counsel, the first sentence of a lender's arbitration clause was 256 words long!



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In light of these sorts of common practices, it should not be surprising that most people first learn that a company says that they have lost the right to sue -- and have "waived" their constitutional right to trial by jury – only after a dispute rises. In most cases, an individual's first awareness of an arbitration clause comes as a bitter surprise. We have spoken to literally hundreds of persons on this topic over the past few years, including homeowners, farm operators, consumer and civil rights attorney's, consumers, employees, journalists and arbitrators. Again and again in those conversations, we have heard from people – often very angry and very dissatisfied people – who were utterly unaware that they had been sent an arbitration clause, and who believed that they had never agreed to such a clause. *See also* Fannie Mae Announcement 04-06, Sept. 28, 2004 ("We also recognize, however, that borrowers who would prefer to present their grievances in court may unknowingly agree to mandatory arbitration at the time they sign their mortgage documents."); Linda J. Demain and Deborah Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 Law & contemp. Problems 55, 73-74 (Winter/Spring 2004) ("Given the lack of information available to consumers in predispute arbitration clauses, and the difficulty of obtaining and deciphering these clauses, it is likely that most consumers only become aware of what rights they retain and what rights they have waived after disputes arise."); Christine Reilly, *Achieving Knowing and Voluntary Consent in Pre-Dispute Mandatory Arbitration Agreements at the Contracting Stage of Employment*, 90 Cal. L. Rev. 1203, 1225 (2002) (empirical research demonstrates that employees "do not understand the remedial and procedural consequences of consenting to arbitration" and that "[v]ery few are aware of what they are waiving.").

Unfortunately, many courts do little to require that individuals actually receive



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meaningful notice that they are supposedly "agreeing" to give up their constitutional rights and submit to arbitration.

- In one case, where a consumer bought a computer over the phone, the arbitration clause was sent to consumers inside the box with a computer. For a consumer to reject the clause, she would have to pack up and send back the computer in the box (at her own expense) within 30 days. While anyone familiar with human nature and consumer behavior can predict that few consumers would take such a step, courts have upheld such clauses. *E.g., Hill v. Gateway 2000 Inc.*, 105 F.3d 1147 (7th Cir. 1997).
- Alabama's highest court upheld an arbitration agreement that was not even in the contract that the consumers signed. Public Justice represented a husband and wife who purchased title insurance when they bought a farm. When they later found out that there were serious defects in the title, the title insurance company attempted to force them to arbitrate their claim despite the fact that the original contract they signed had not contained the arbitration clause. Instead of including the arbitration agreement in the contract, the insurance company had sent it to the consumers in the mail weeks later, arriving after the parties were already enmeshed in their legal dispute. Yet the court held it was enforceable. *McDougle v. Silvernell*, 738 So. 2d 806 (1999).
- And in an unusual case where one of our clients did know her employer gave her an arbitration clause and refused to sign it, the U.S. Court of Appeals for the Eleventh Circuit held that she was still bound by it because she failed to quit her job as a nurse at Baptist Medical Center-Princeton in Alabama, after having worked there as a nurse for almost 30 years. *Luke v. Baptist Medical Center-Princeton*, No. 03-14342 (11th Cir.



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March 11, 2004).

- In another case, a court compelled arbitration against the estate of a woman who died in a nursing home. Although the woman was legally blind and could not understand the contents of the papers she signed, the court said that no one can defend against the enforcement of a contract just because they signed it without reading it. *Estate of Etting v. Regent's Park at Aventura, Inc.*, 891 So.2d 558 (Fla. Dist. Ct. App. 2004).

**III. Private Arbitration Companies Have Powerful Incentives to Favor the Corporations that Select Them Through Their Standard Form Contracts.**

There are a number of different private arbitration companies who compete to be selected by corporations in their standard form contracts with consumers and employees. Arbitration work is often very lucrative, and arbitrators know that if they rule against a corporate defendant too frequently or too generously (from the standpoint of that corporation), they will lose the work. Companies imposing arbitration clauses on their employees and consumers through standard form contracts of adhesion sometimes justify their actions with rhetoric about arbitration being cheaper and faster and fairer than litigation in court. From numerous conversations with lawyers both for corporations and advocates for individuals generally, and participation in multiple mediations and settlement negotiations, I can unequivocally testify that the nearly universal perception among both plaintiff-side and defense-side lawyers is that arbitrators are more likely to have a pro-defense attitude than are judges or juries. As one indication of the truth of this point, for each of the past five years, state and federal courts around the country have published more than 200 reported cases a year involving challenges to mandatory arbitration clauses where individual consumers or employees were attempting to



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maintain their rights to pursue their cases in court while the corporations were attempting to force the cases into arbitration. One by product of this widespread (and rational) perception is that arbitration clauses deter attorneys from agreeing to present individuals, and deter individuals from exercising their rights.

There is some empirical evidence and a good deal of academic analysis showing that arbitrators have a tendency to favor "repeat player" clients.[7] In the consumer law context, the repeat player will generally be the corporate defendant. *See* James L. Guill & Edward A. Slavin, Jr., *Rush Unfairness: The Downside of ADR*, Judges' J., Summer 1989, at 8, 11 (1989)("[A]n arbitrator's decision might be influenced by the desire for future employment by the parties.... Some arbitrators openly solicit work. They write to parties noting their availability, sometimes enclosing samples of their awards.") (citations omitted); Kirby Behre, *Arbitration: A Permissible Or Desirable Method for Resolving Disputes Involving Federal Acquisition and Assistance Contracts?*, 16 Pub. Cont. L.J. 66 (1986) (discussing possibility "that an arbitrator will make a decision with an eye toward his role in future disputes involving one or both of the parties–that is, an arbitrator's decision might be influenced by the desire for future employment by the parties.").

### A. Corporations Often Blackball Arbitrators Who Rule In Favor of Individuals, and the Rosters of Potential Arbitrators Tend to Be Heavily Tilted In Favor of Corporate Defendants.

One particularly troubling aspect of the repeat-player syndrome is the tendency of

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[7] *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1476 (D.C. Cir. 1997); Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 Employee Rts. & Emp. Pol'y J. 189 (1997) (study finding that employees recover a lower percentage of their claims in repeat player cases than in non-repeat player cases); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637, 684-85 (1996).



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corporate repeat-players to blackball arbitrators who might rule against them. This tendency was revealed by a study of mandatory arbitration in managed care cases in California, which found a small number of cases in which an arbitrator awarded a plaintiff more than one million dollars against a health maintenance organization (HMO). Marcus Nieto & Margaret Hosel, *Arbitration in California Managed Health Care Systems* 22-23 (2000). In each instance, that was the only HMO case that the arbitrator ever handled, *id.*, suggesting that every time an arbitrator entered a substantial verdict against an HMO, the arbitrator was unable to get any further work from an HMO in the state. That same study also found that arbitrators were far more likely than judges to enter summary judgment for defendant HMOs.

In the last few months, there have also been two publicly disclosed episodes of arbitrators who were handling cases for the National Arbitration Forum ("NAF") being blackballed after ruling for consumers against NAF's most prominent client, MBNA Bank. The first episode of an NAF arbitrator being blackballed is described in the deposition of Harvard Law Professor Elizabeth Bartholet, taken on September 26, 2006, by a lawyer challenging NAF as being biased in a consumer case against Gateway Computers.[8] Professor Bartholet had also served as an independent contractor arbitrator for NAF, until she resigned. Her deposition describes how she was also blackballed by a credit card company after she ruled against it in a single arbitration. At the time that the credit card company decided to block her from hearing any more cases involving itself, she was scheduled to hear a number of other consumer cases. NAF sent out

[8] This deposition transcript is well over 100 pages in length. If any member of the Subcommittee or her or his staff would like, Public Justice would be happy to provide the Subcommittee with a copy of this deposition transcript. Similarly, this testimony will describe a number of other documents that we have encountered in our work, and we would be happy to supply the Subcommittee with those documents as well.



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letters to the consumers falsely stating that she would no longer be the arbitrator in their cases, because she had a scheduling conflict. The professor, however, did not have a scheduling conflict; instead, NAF had sent out this explanation to conceal the fact that in reality she had been blackballed by a lender who did not like how she ruled in a past case.

The second recent disclosure came in an article written by Richard Neely, a former justice of the West Virginia Supreme Court in the 2006 September/October issue of The West Virginia Lawyer. After retiring from the bench, Justice Neely was approached by NAF to serve as one of its independent-contractor arbitrators, and he agreed to do so. He reported that when he did not award a bank the full amount of attorneys' fees it asked for, that he found himself barred from handling anymore cases involving that bank. He explained that banks, as "professional litigants," can make use of their superior knowledge of arbitrators past decisions to help ensure that their cases are heard by NAF arbitrators who will rule for them.

In addition to the possibility that individual arbitrators may be blackballed, there are many indications that private arbitration companies are subject to financial pressures if they irritate corporate defendants. *See* Eric Berkowitz, *Is Justice Served*, LA Times Magazine, October 22, 2006:

> Declaring that contractual restrictions on class suits are 'inappropriate,' JAMS announced in 2004 that it would start to 'ensure fairness' by ignoring such prohibitions and letting class arbitrations go forward. But then Citibank, Discover Card and American Express fought back, writing JAMS out of their arbitration accords. Within months, JAMS reversed itself. . . .

*See also* Justin Scheck, *JAMS reverses class action policy; Under corporate pressure, it agrees to enforce exclusion clauses*, The Recorder 1 (March 11, 2005).

While many arbitration service providers are very secretive about the identity and



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background of their arbitrators, a good deal of anecdotal evidence indicates that they are heavily disproportionately drawn from lawyers who specialize in representing corporate defendants. Consider the following illustrations, which Public Justice respectfully suggests are illustrative of much broader patterns:

- We recently received an exemplar of a medical group's mandatory arbitration clause that provides that all patients of this medical group must submit to arbitration before an organization entitled "The National Insurance Arbitration Promotion Association." This organization, which was selected by the doctors' insurance company, explicitly has the goal of "help[ing] the company stay in business," stresses to patients that most lawsuits against doctors are allegedly baseless, and pledges that patients' recoveries will be limited (without respect to the law in a state), and that limitations periods will be shortened, as well as providing other terms that favor doctors.
- In a number of cases, parties in insurance cases being handled by the American Arbitration Association ("AAA"), have received a short list of potential arbitrators, where every name on the list is someone who works directly or indirectly for the insurance industry. We have a "strike sheet" in one case, for example, where the plaintiff's lawyer went through and annotated how each prospective arbitrator was connected to the insurance industry.
- Public Justice was involved in a case in Alabama, involving a lawsuit against a title insurance company for fraud and breach of contract. Our client was offered a list of potential arbitrators from AAA, and every potential arbitrator on the list either worked directly for a title insurance company or was an attorney at a law firm that did substantial



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work defending insurance companies.

- One NAF advertisement labeled "Professionals and the National Arbitration Forum," consists of a list of favorable quotes, all of which come from attorneys or officials affiliated with corporations, and none of whom principally represents individual plaintiffs. Another NAF News Release includes a list of persons who endorse its work, and every one of those 21 persons specializes in representing financial institutions and banks. It is clear that the NAF targets its advertising at lenders.
- In one case filed by a consumer against ITT Capital Finance Corp., NAF chose as an arbitrator a lawyer whose law firm represented a host of other ITT entities.
- From material taken from NAF's website disclosures pursuant to California's disclosure requirement, the results from a single quarter's worth of decisions by just one NAF arbitrator reveal that the person handled 80 cases brought by banks against individuals, and ruled for the bank in all 80 cases. In 78 of the 80 cases, she gave the bank 100% of the amount it claimed, in two cases, she gave slightly less. She also ruled on one claim brought by a consumer against a bank, and dismissed it.
- Several consumer attorneys have told Public Justice that they sought to become AAA arbitrators, only to be told that the AAA lists in their state are filled. They later learned that more corporate defense lawyers were subsequently been added to the list.

There is also evidence that even when arbitrators do find for plaintiffs, they tend to make smaller awards to individuals with employment and civil rights claims, *Armendariz v. Foundation Health Psychare Servs.*, 6 P.3d 669 (Cal. 2000), or to individual medical malpractice plaintiffs, Marcus Nieto and Margaret Hosel, *Arbitration in California Managed Health Care*



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*System*, 21 (2000), than do courts or juries.

Corporate supporters of mandatory arbitration routinely point to "studies" claiming that consumers and employees do well in mandatory arbitration. Some of these studies, like the American Bankers Association-funded Ernst & Young report praising the National Arbitration Forum, suffer from grave methodological files. (That study, for example, literally ignores 1,000 consumer cases handled by NAF for every case it considers, and considers a $1 award to a consumer claiming losses of $100,000 to be a victory.") Other studies compare apples and oranges, cherry-picking limited data that show that high-ranking corporate employees who have individually-negotiated contracts do well in arbitration, and then projecting that equally positive results would apply to cases involving far less powerful employees with no control over the arbitrator. This flaw is evident in the work of Lew Maltby, a member of the American Arbitration Association's Board of Directors and Executive Committee, who regularly works as a paid arbitrator in AAA cases, and who relies at least in part on help from the AAA to raise money for his small "National Workrights Institute." In fact, the best and most recent data reflects that the corporate funded studies paint an overly rosy picture. See Alexander J.S. Colvin, Assoc. Prof., Penn. State, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury*, presented at the National Academy of Arbitrators 26 (April 14, 2007) ("the most recent data on cases deriving from employer-promulgated agreements in the [AAA California disclosures] suggest that employee win rates and damage awards are lower than indicated by the earlier studies and lower than those in litigation.")

Sometimes, arbitration company representatives appear to be not only aware of, but cavalier about, consumers' perceptions of pro-corporate bias. I am familiar with a case where



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West Virginia consumer lawyer Dan Hedges learned that an arbitrator proposed by the AAA previously served as defense counsel in cases similar to the one he was then handling. Mr. Hedges expressed to the arbitration company, AAA, that this was not fair to his client. Instead of taking the complaint seriously, the AAA representative laughed and said, "Yeah, I thought you would like that."

**B. Some Arbitrators' Advertisements and Solicitations to Potential Corporate Clients Confirm the Dependency of Arbitrators Upon Corporate Goodwill.**

Perhaps as the most blatant proof that some arbitration companies see their role as aiding corporate defendants against consumer plaintiffs comes in some of the advertising material aimed at potential corporate clients of NAF. (This is one of the largest arbitration firms in the U.S., handling hundreds of thousands of consumer cases each year.) NAF makes promises that sharply favor the interests of corporate defendants and place individual plaintiffs at an obvious disadvantage. Consider the following examples:

- One NAF solicitation sent generically to multiple potential corporate clients states in huge print that NAF is "The alternative to the million dollar lawsuit."
- In a letter dated April 16, 1998, from NAF's Director of Arbitration to Alan Kaplinsky, NAF warns Mr. Kaplinsky that the "class action bar" is threatening to bring lawsuits involving the Y2K issue, and states that the "*only* thing" that will "prevent" such suits is the adoption of an NAF arbitration clause "in every contract, note and security agreement."[9] The approach in this letter is not that of an even-handed neutral arbitration

[9] Mr. Kaplinsky is a prominent corporate defense lawyer who represents banks. According to his firm's website, its "Consumer Financial Services Group has developed one of the pre-eminent and largest consumer financial services litigation defense practices in the country, defending banks and other financial institutions throughout the United States in class



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forum, but of an advocate advising defense counsel how to defeat a mutual adversary ("the class action bar").

- A January 14, 1999 letter from an NAF official to a prospective client states in the very first sentence that "A number of courts around the country have held that a properly-drafted arbitration clause in credit applications and agreements *eliminates class actions . . . .*" (Emphasis in original.) This letter also promises that NAF arbitration "*will make a positive impact on the bottom line.*" (Emphasis in original.)[10]
- Another advertisement distributed to corporate in-house counsel on NAF letterhead states that its rules provide for "[v]ery little, if any, discovery."

NAF is not alone in its approach, AAA also actively solicits business from its corporate contacts. Paul Van Loon, a Regional Vice President of AAA, sent a memo to AAA's Northern California panelists asking for their help. "Part of our marketing effort for 2000 will be to

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actions and other complex litigation." http://www.ballardspahr.com/home.htm. In an article entitled "Excuse me, but who's the predator: Banks can use arbitration clauses as a defense," *Bus. Law.* 24 (May/June 1998), Kaplinsky wrote that "Consumers have been ganging up on banks. But now the institutions have found a way to defend themselves." *Id.* at 24. The article makes clear that mandatory arbitration is this "defense" for financial institutions against consumer claims, and notes that "Arbitration is a powerful deterrent to class action lawsuits. . . ." *Id.* 24-26.

[10] Additional inappropriate remarks appear in NAF's own newsletter. In addition to handling consumer disputes, NAF handles quite a few cases involving internet "Domain Name" disputes. In that connection, NAF produces a publication entitled "Domain News." Many of these periodicals run chatty articles that actually boast of the decisions that NAF arbitrators issue in favor of famous persons in these domain name disputes. *E.g., Johnny Unitas Wins Another One,* 2 Domain News Vol 4, at 2; *Master of Domains: metallica.org,* 1 Domain News Vol 7 at 1; *Hey You, Get Off of My Domain!: MickJagger.com,* 1 Domain News Vol. 6 at 2. While Public Justice takes no position on these particular domain disputes, this type of article surely places NAF in a very different position than any court in the United States. Imagine any state or federal court issuing a ruling in favor of one party over another, and then publishing an article – from the court – boasting of the fact and mocking the party who lost the case.



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develop business contacts with corporations headquartered in Northern California," wrote Loon, who wanted the panelist to "make the introduction for us" to any corporate contacts they might have.

These sort of solicitations and promises show what is inherently unfair and wrong with a system where companies can hand pick private judging services to replace publicly accountable courts. These arbitration companies wish to supplant the publicly accountable system of courts and juries, but they have not held themselves to the same ethical standards as those imposed on courts and juries. NAF is effectively promising corporate defendants that its procedures will insulate them from a broad category of potential liabilities by preventing consumers with small claims from having any meaningful means of relief. If a judge were to solicit business from a party that might come before it with strong *ex parte* hints that the solicited party would get a good deal in the judge's courtroom, there is no doubt that this would be improper or sanctionable behavior.

**C. Most Courts Do Little to Protect Individuals Against Biased Arbitrators.**

Some courts have struck down arbitration clauses that required individuals to submit their claims to particularly extreme and egregious arbitration systems; perhaps a dozen courts have struck down arbitration systems such as ones where one party could pick the individual arbitrator. Unfortunately, many other courts have been reluctant to protect individuals against arbitrators biased towards industry.

First, the most common problem – that the arbitrator is a lawyer who principally represents parties just like the defendant in a case – is generally not grounds for challenging an arbitration clause or an arbitrators' decision. This is a fairly well established and widely



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recognized day-to-day reality, and courts accept generally such arrangements without question.

Even for more egregious illustrations of bias, however, a number of courts have said that they will only consider issues relating to whether an arbitrator is biased after the arbitration is complete. Consider what this would mean to an individual – you might have to go through a process with a decision maker who can charge you tens of thousands of dollars in fees, could order you to pay the other sides' attorneys' fees, might take years to decide the case, and only then could you go to court to argue that the arbitrator was unfairly biased towards the other side.

And for some courts, it seems as though nothing short of a videotape of an arbitrator stuffing wads of cash into their pockets would be grounds for challenging an arbitration clause on the basis of bias. In one particularly extreme case, an arbitration clause was enforced by a state's high court even though an employer required an employee to submit his claims to arbitration before an arbitration panel *composed of partners of the accounting firm he was suing. See Dean Hottle v. BDO Seidman, LLP*, 846 A.2d 862 (Conn. 2004). In another case, Judge Posner of the U.S. Court of Appeals for the Seventh Circuit stated, "the standard due process entitlement to an impartial tribunal is relaxed when the tribunal is an arbitral tribunal rather than a court." *United Transp. Union v. Gateway Western Railway Co.*, 284 F.3d 710, 712 (7th Cir. 2002) (citing to four other federal appellate decisions). Judge Posner made this comment in the course of holding that it was of no concern to the court that an arbitrator had been convicted of violating the criminal tax laws.

**IV. Arbitrators Are Immune From Any Meaningful Judicial Review.**

Judicial review of arbitration is less than minimal; it approaches non-existent. The general rule is that judicial review of arbitrators' decisions "is very narrow; one of the narrowest



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standards of judicial review in all of American jurisprudence." *Lattimer-Stevens Co. v. United Steelworkers of Am. Dis. 27*, 913 F.2d 1166, 1169 (6th Cir. 1990).[11] Consider a few illustrations:

- The U.S. Court of Appeals for the Seventh Circuit remarked in a decision issued last year that courts should not review arbitrators' interpretations of contracts even if they are "wacky," so long as the arbitrator attempted to "interpret the contract at all." *See Wise v. Wachovia Securities, Inc.*, 450 F.3d 265, 269 (7th Cir. 2006).
- The U.S. Court of Appeals for the Third Circuit considered an arbitrator's decision that "inexplicably" cited and relied upon language that was not included in a key document. The court held, though, that "such a mistake, while glaring, does not fatally taint the balance of the arbitrator's decision in this case. . . ." *Brentwood Medical Associates v. United Mine Workers of America*, 396 F.3d 237, 238 (3d Cir. 2005). This vividly demonstrates how narrow the review of arbitration decisions is – they are upheld even when they are based upon "glaring mistakes" of law.
- In a case involving baseball player Steve Garvey, the U.S. Supreme Court held that

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[11] *See also First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) ("the court will set aside [an arbitrator's] decision only in very unusual circumstances."); *Baravati v. Josephthal, Lyon & Ross*, 28 F.3d 704, 706 (7th Cir. 1994) ("[J]udicial review of arbitration awards is tightly limited."); *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998) ("judges follow the law . . ., while arbitrators, who often . . . are not lawyers and cannot be compelled to follow the law and their errors cannot be corrected on appeal (there are no appeals in arbitration), although there are some limitations on the power of arbitrators to flout the law."); *Di Russa v. Dean Witter Reynolds Inc.*, 121 F.3d 818, 821 (2d Cir. 1997) (to modify or vacate an arbitration award, a court must find both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case), *cert. denied*, 118 S. Ct. 695 (1998); *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998) (arbitrator's decision may only be overturned for manifest disregard of the law in "severely limited" circumstances, where a court finds that "the arbitrators knew of a governing legal principle yet refused to apply it . . .").



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"courts are not authorized to review the arbitrator's decision on the merits" even if the arbitrator's fact finding was "silly." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2002).

- In another case, the California Supreme Court held that even when an arbitrator's decision would "cause substantial injustice" on its face, that it was not subject to judicial review. *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992).
- In a case decided a few months ago by the U.S. Court of Appeals for the Eleventh Circuit, the court angrily decried persons who try to "convert arbitration losses into court victories," and noted that the only basis for challenging an incorrect arbitration decision is where a party can prove with "clear evidence" that the arbitrator was conscious of the law and deliberately ignored it; "showing that the arbitrator merely misinterpreted, misstated or misapplied the law is insufficient." *B.L. Harbert International, LLC v. Hercules Steel Co.*, 441 F.3d 905, 910 (11th Cir. 2006). The court went on to state that parties who challenge arbitration awards should be sanctioned more often for asking for judicial review, and that this would be "an idea worth considering" in order to discourage future challenges to arbitration.

The law governing judicial review of arbitration also encourages arbitrators not to give any reasons for their decisions because then it is entirely impossible to attack their decisions. *See Fellus v. AB Whatley, Inc.*, 2005 WL 9756090 (N.Y. Sup. Ct. Apr. 15, 2005) (in the absence of a reasoned decision supporting an arbitration award, there was no basis for court to decide whether arbitrator manifestly disregarded the law.); *H&S Homes v. McDonald*, 2004 WL 291491 (Ala. Dec.17, 2004) (in the absence of an explanation of damages awarded by arbitrator, the court had



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no basis to determine whether arbitrator manifestly disregarded the law; arbitrator's failure to give reasons for the award did not itself constitute manifest disregard of the law). As a result, many arbitrators have told me that they are discouraged by the major arbitration firms from producing written decisions in most cases because doing so basically gives arbitrators a means of putting themselves beyond any scrutiny. The upshot of all this is clear – arbitration is largely a system above and beyond the law.

This lack of judicial review undermines the public function of litigation. "By closing off access to proceedings, eliminating judicial precedent, and allowing parties to write their own laws, we compromise society's role in setting the terms of justice." *See* Jean Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637, 695 (citations omitted). *See also* Mike Ward, *Texas' chief justice calls for overhaul of state courts,* American-Statesman, February 21, 2007 ("'A privately litigated matter may well affect public rights,' [Chief Justice Wallace] Jefferson said. 'Its resolution may ultimately harm the public good or, because those decisions are secret, impede an innovation to a recurring problem, much to the detriment of Texas citizens.'")

**V. Many Companies Add Other Unfair Terms to Mandatory Arbitration Clauses**

It is remarkably common for corporations to draft standard form contracts that not only require individuals to take their claims to arbitration instead of court, but also strip individuals of substantive rights that they would have under civil rights or consumer protection statutes. Many courts have struck down such provisions, or sometimes entire arbitration clauses containing several such provisions, as being so unfair as to be unenforceable. In other words, the rule in those courts is that while corporations may insist that individuals submit their claims to



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arbitration, they cannot add on extraneous terms that are not inherent to arbitration and that would otherwise be illegal.

Unfortunately, a number of other courts have not taken such a tack. Some courts have concluded that current federal law favors arbitration so much that even if a contract term would otherwise be illegal, it should be enforced if it is embedded in an arbitration clause. Other courts have concluded that arbitrators (rather than courts) should decide all challenges to terms stripping individuals of basic legal rights included in an arbitration clause. (The arbitrator has a strong financial incentive not to find that such terms, contained in the contract that gives the arbitrator power to hear a case – and bill for her or his time on a case – are illegal.)

One court has gone so far as to say that even a challenge to the unconscionability under normal state contract law of the arbitration provision itself is for the arbitrator to decide. *See Hawkins v. Aid Association for Lutherans*, 338 F.3d 801, 807 (7th Cir. 2003). Under this approach, a challenge that an arbitrator was biased or charged excessive fees for arbitration would be decided by the arbitrator!

**A. Arbitration Is Often Cloaked In Secrecy, Which Disadvantages Consumers and Employees Against Corporations Who Are "Repeat Players" in Arbitration.**

Arbitration is all-too-often secretive, with strict confidentiality rules sometimes limiting what can be publicly revealed either about the underlying facts of a dispute or about the arbitrators' rulings. Reporters are generally not allowed to be present in arbitrations, and proceedings are closed to the public. These characteristics are not inherent to arbitration, but too often become part of the process.

In addition, some arbitration clauses and the rules of some arbitration providers require



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that all parties to a dispute keep all facts about both the dispute and the arbitrator's resolution of the dispute "confidential." Furthermore, "[a]rbitrators have no obligation to the court to give their reasons for an award," *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 976 n.8 (1960), and it is common for arbitrators to provide no written explanation for their decisions. *See* Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 Sup. Ct. Rev. 331, 397-98 (1996). Even when arbitrators do produce written decisions, "arbitrators' decisions are not intended to have precedential effect even in arbitration (unless given that effect by contract), let alone in the courts." *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998). Professor Richard Reuben, a proponent of alternative dispute resolution, has cautioned that arbitration can sacrifice important public values of transparency and accountability. Richard C. Reuben, *Democracy and Dispute Resolution: The Problem of Arbitration*, 67 Law & contemp. Probs. 279, 298-302 (Winter/Spring 2004).

This secrecy tends to reduce the ability of consumer attorneys to effectively represent their clients. *See* Marcus Nieto & Margaret Hosel, *Arbitration in California Managed Health Care Systems* 22 (2000) ("[P]laintiffs in California health care claims generally do not have information about arbitrators' decision records before selecting a neutral arbitrator. In contrast, health care plans do have information about the win-lose decisions of arbitrators. This information gap may favor health care plans."); Jean Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637, 683-84 (1996) ("[A] consumer's attorney often relies on public information gained from other lawsuits to build her own claims of negligent or intentional misconduct. Repeat-player companies can gain similar information through private channels. Thus, by requiring private



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arbitration the company may again deprive the consumer of certain relief she might have obtained through litigation." (citations omitted)).

A federal court has acknowledged that a non-transparent system of arbitration may be unfair to consumers because it perpetuates a disparity in knowledge between consumers and business. If a business repeatedly has cases before a particular set of arbitrators, it will know much more than consumers about which arbitrators to select. This knowledge is important. When a situation is created where only corporate repeat players have ready access to information about arbitration decisions, consumers are disadvantaged. Such a system puts the corporate repeat player "in a vastly superior legal posture since as a party to every arbitration it will know every result and be able to guide itself and take legal positions accordingly, while each [consumer] will have to operate in isolation and largely in the dark." *Ting v. AT&T*, 182 F.Supp.2d 902, 933 (N.D. Cal. 2002) (footnote omitted), *aff'd in relevant part and reversed in part on other grounds*, 319 F.3d 1126 (9th Cir. 2003), *cert. denied*, 319 S.Ct. 53 (2003).

**B. Arbitration Is Often Extremely Expensive for Individuals.**

In paying taxes, American citizens cover the costs of operating the court system, so they are only required to pay a nominal filing fee to initiate a lawsuit. People forced into arbitration frequently pay far greater fees to file their case, and to have the decision maker hear their case and to hear various motions that go with the case, than the fees consumers must pay to file a case in court. We have seen a number of arbitration clauses that require individual consumers to pay fees that exceed the amount of money they would stand to gain if they won their cases. A number of consumers and consumer attorneys have told us that they (or their clients) would abandon their cases if forced into arbitration, because they could not afford the fees likely to be



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charged by the arbitrators. This problem is exacerbated by the widespread practice of hidden or uncertain fees, where an arbitration service provider loudly touts a small "filing fee," but then adds on a variety of subsequent fees for handling disputes over discovery, motions and the like. In one recent employment case, a person was required to pay arbitration fees of more than $60,000 to pursue civil rights claims.

While many courts have refused to enforce arbitration clauses that require individuals to pay significant fees to have their claims heard, some courts seem unconcerned with the possibility that a consumer or employee would be saddled with enormous fees to have their claims heard. In one case, for example, the Supreme Court of Alabama upheld an arbitration agreement despite the consumers having to pay between $12,000 to $14,000 to arbitrate claims that were likely worth between $20,000 and $30,000. *Leeman v. Cook's Pest Control, Inc.*, 902 So. 2d 641 (2004). In another case, a federal court of appeals enforced an arbitration clause even though it (a) imposed arbitration costs upon an impoverished individual of between $27,500 and $29,000 in order for her to vindicate her claims; and (b) expressly waived all of the individuals claims for exemplary, punitive and consequential damages (even though they otherwise would have been available under the law). *Overstreet v. Contigroup Co.*, 462 F.3d 409 (5th Cir. 2006).

**C. Arbitration Clauses Are Often Used As A Means to Avoid Class Action Suits.**

Many corporations add to their arbitration clauses terms that ban individuals from bringing or participating in class action cases, either in court or in arbitration. While many courts have struck down these types of contract terms as being unconscionable and unenforceable, other courts have upheld them, citing in several cases that there is a strong presumption in favor of enforcing arbitration clauses. (From a legal perspective, this argument is puzzling, because the



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U.S. Supreme Court has held that parties can bring class actions in arbitration, so a federal policy favoring arbitration should say nothing about bans on class actions. Nonetheless, these provisions are often enforced.)

These class action bans often insulate corporations from legal accountability, since many Americans cannot feasibly pursue certain types of claims, particularly cases where individual claims are too small and complex to be litigated by a private attorney. Class action suits allow consumers to pool their individual resources, which is crucial when going up against well-funded corporations. As Congress stated, "Class action lawsuits are an important and valuable part of the legal system when they permit the fair and efficient resolution of legitimate claims of numerous parties by allowing the claims to be aggregated into a single action against a defendant that has allegedly caused harm." Class Action Fairness Act of 2005, 28 U.S.C. §1711 (2005). Stopping individuals from bringing class action suits effectively immunizes corporations from any legal accountability for certain categories of illegal acts they might commit, even when it is very clear that they have broken the law.

Some courts have recognized the importance of preserving consumers' access to class action proceedings. In *Ting v. AT&T*, 182 F. Supp. 2d 902 (N.D. Cal. 2002), *aff'd in relevant part*, 319 F.3d 1126 (9th Cir. 2003), the federal district court held that AT&T's arbitration clause for long distance telephone customers was unconscionable in part because it deprived consumers of the right to bring or participate in class action proceedings. The *Ting* court held that the ban on class actions amounted to an exculpatory clause because it would have been economically infeasible to prosecute each claim on an individual basis. *Id.* at 918. *See also West Virginia ex rel. Dunlap v. Berger*, 567 S.E.2d 265 (W. Va. 2002) ("[P]ermitting the proponent of such a



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contract to include a provision that prevents an aggrieved party from pursuing class action relief would go a long way toward allowing those who commit illegal activity to go unpunished, undeterred, and unaccountable."); *Powertel, Inc. v. Bexley*, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999) ("Class litigation provides the most economically feasible remedy for the kind of claim asserted here. The potential claims are too small to litigate individually, but collectively they might amount to a large sum of money. . . By requiring arbitration of all claims Powertel has precluded the possibility that a group of its customers might join together to seek relief that would be impractical for any of them to obtain alone.") Many other courts have refused to protect consumers from such provisions, however. *See, e.g.*, *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Edelist v. MBNA Am. Bank*, 790 A.2d 1249 (Del. Super. Ct. 2001) ("The surrender of that class action right was clearly articulated in the arbitration amendment. The court finds nothing unconscionable about it and finds the bar on class actions enforceable.").

In my experience, arbitration clauses that ban class action proceedings prevent many consumers who have been harmed by corporate wrongdoings from seeking relief. These class action bans also shield corporations from liability for these illegal activities. This shield not only hurts the consumers who have already been harmed and are being stopped from vindicate their rights, but also hurts future consumers because the prospect of an expensive class litigation normally operates as an important deterrent that makes abusing consumer rights too expensive to be profitable. At its core, allowing corporations to use arbitration clauses to ban class action proceedings injures consumers.



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**D. Many Arbitration Clauses Include "Loser Pays Rules" to Discourage Individuals from Bringing Claims; Plaintiff's Fear Being Bankrupted By Huge Defense Fees If They Do Not Win Their Case.**

For many consumers and employees pursuing their claim through arbitration is too risky because of the Loser Pays Rule that arbitration companies impose. In one case, for example, an AAA arbitrator entered a loser pays award of more than $200,000 against a woman who brought a sexual harassment suit against her employer. If this kind of award is made more frequently, few if any women will ever be willing to pursue their civil rights claims in court.

NAF's advertisements and solicitations aimed at businesses stress that it has a Loser Pays Rule. In an interview with a glossy magazine targeted to in-house corporate counsel, NAF's Executive Director openly explained that this Loser Pays Rule extends to attorneys' fees and is aimed at making it more risky for individuals to bring claims against businesses, as a means of achieving tort reform:

> Editor: Another goal of Civil Justice Reform is to impose a penalty on commencing litigation as a way to extort a settlement of a frivolous claim. Civil Justice Reform advocates have proposed a "loser pays" rule to counter such tactics.
>
> Anderson: The rules of the National Arbitration Forum allow the arbitrator to award the prevailing party the cost of the arbitration including attorneys' fees. The rules of the other major arbitration administrators have similar provisions. The economics of dispute resolution by arbitration are entirely different from the economics of bringing lawsuits. There is no such thing as a "no risk" arbitration for either side.

*Do an LRA: Implement Your Own Civil Justice Reform Program NOW*, Metropolitan Corp. Couns., Aug. 2001. Given that most individual consumer claims are relatively modest in size, the prospect of potentially paying enormous fees to a corporate defendant's high priced law firm (fees that could easily exceed $400 per hour for a partner in a D.C. firm) will discourage most consumers from going forward with even the strongest claim.



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It should be noted that Loser Pays Rules in civil rights and consumer cases are contrary to the substantive law in many jurisdictions, as the U.S. Supreme Court noted in *Christiansburg Garment Co. v. EEOC*, 434 U.S. 412, 418 (1978). One state Supreme Court has held that a similar Loser Pays Rule in an arbitration agreement rendered the agreement substantively unconscionable. *See Sosa v. Paulos*, 924 P.2d 357, 362 (Utah 1996) (an arbitration provision requiring a medical malpractice plaintiff to pay the litigation costs of the doctor if the patient "wins less than half the amount of damages sought in arbitration" was unconscionable). Nonetheless, other courts have enforced Loser Pays Rules when they were imposed in arbitration clauses, so this problem has not been solved by judicial oversight of arbitration abuses.

**VIII. There Is A Growing Trend Towards the Abuse of Mandatory Arbitration by Debt Collectors.**

A rapidly growing number of debts are being collected through mandatory arbitration – nearly all with the National Arbitration Forum ("NAF") – rather than through the court system. While it is difficult to determine the exact magnitude of this secretive organization's debt collection activity, a number of bits of information (such as some discovery documents that have emerged in litigation and reports from consumer lawyers in a number of states about skyrocketing numbers of cases filed to confirm arbitration awards for creditors on court dockets) indicate that the NAF is resolving hundreds of thousands of debt collection cases each year.

This is a troubling trend for consumer advocates. The NAF is a notoriously lender-friendly organization who openly advertises its services as being favorable to and more profitable for lenders and debt collectors than other arbitration companies, and a very large body of anecdotal data indicates that the NAF's arbitrators nearly always rule for lenders in the full



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amount that they demand in cases. I recommend to the Subcommittee a report issued by Public Citizen in September 2007 entitled "How Credit Card Companies Ensnare Consumers." From communicating with literally hundreds of consumers and lawyers representing consumers who are caught up in NAF debt collection cases, I can unequivocally state that I have seen a very large number of cases that support the core conclusions reached by Public Citizen in its report.

As evidence supporting (and sometimes in addition to) these obvious and overarching concerns, there are a number of extremely troubling facts and concerns about the manner in which the NAF conducts debt collection arbitrations:

- NAF appears to funnel a very large number of cases to a few carefully picked arbitrators who nearly always rule for lenders. As one illustration, one NAF arbitrator in California has decided more than 500 cases where MBNA bank sued customers, ruling for the bank in all but a handful of cases. NAF likes to boast that it has a huge roster of arbitrators, consisting of more than 1,500 lawyers and former judges. Public Citizen found that almost 90% of more than 34,000 cases decided by NAF in California were handled by only 28 arbitrators. This is consistent with other studies that have concluded that NAF funnels the vast majority of cases to a small number of "reliable" arbitrators.
- In 1998 First USA Bank gave sworn interrogatory answers in an Alabama case where consumers were challenging an arbitration clause. The court required the defendant to produce statistics about its experience in arbitration. The statistics showed that where the credit card issuer had sued its customers more than 50,000 times in arbitration, only four customers had brought cases against the company in arbitration! The statistics also showed that out of almost 20,000 arbitration cases that were completed, the bank had won



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all but 87, for a win/loss rate of 99.6%.

- Instead of filing normal complaints with supporting documents to start a case, certain debt collectors file claims with the NAF in the form of pure digital data streams, that the NAF then formats into documents that are sent to the NAF arbitrators with pre-printed orders. The arbitrators are not sent any original documents establishing that the consumers actually agreed to either the arbitration clauses or the credit contracts, but simply receive digital information with a blanket assertion from the lenders that all consumers agreed to arbitration and owed the asserted amounts listed for the accounts.
- Many NAF arbitrators decide very large numbers of cases, often 40 or more, in a single day. In the overwhelming majority of cases, NAF arbitrators simply sign the pre-printed orders generated by the home office, that award the lender the full sums that the lender has requested for the loans, any fees related to the loans, attorneys' fees and arbitration fees.
- A large number of cases have been documented establishing that the NAF has entered awards in favor of MBNA and other lenders against persons who were identity theft victims who did not, in fact, owe any debts. Our office regularly receives calls and letters from consumers who report that this has happened to them.
- It appears that there are thousands, if not tens or hundreds of thousands, of cases where NAF arbitrators have awarded sums to lenders (and particularly MBNA) for debts that were past (and sometimes quite far past) the relevant statute of limitations.
- MBNA Bank and its attorneys boast publicly about a provision of MBNA's contract that purportedly permits consumers to "opt out" of MBNA's arbitration provision if they



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choose, and argue that this provision means that MBNA's arbitration provision is not mandatory. Nonetheless, there are several documented cases where the NAF entered awards against consumers in favor of MBNA even though particular consumers opted out of MBNA's arbitration system – who have registered mail receipts to prove this fact, and who notified NAF of this fact.

- NAF regularly awards large sums for attorneys' fees to lenders against consumers in cases, but it is not evident from the records in these cases that the creditors' attorneys did anything other than forward information from the lender's records to NAF in an e-mail with digital data.
- We have received a substantial number of allegations from consumers who report that NAF officials failed to send notices of debt collection arbitrations to consumers at their actual address, and it appears that NAF makes little effort to ascertain the correct addresses for consumers. Nonetheless, my office has had conversations with literally hundreds of consumers and consumer attorneys that suggests that NAF rarely (if ever) overturns default awards against consumers who report to it that they did not receive timely notices of claims.
- Under the laws of many states, attorneys appearing in arbitrations that take place in those states must either be admitted to practice in those states, or must receive permission to appear in those arbitrations on a pro hac vice basis. (Most states only permit out-of-state attorneys to appear in a small number of cases in a state on a pro hac vice basis, and require that fees be paid for pro hac vice admissions to state bar authorities.) In hundreds of cases, if not far more, NAF arbitrators have permitted attorneys for creditors to appear



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in cases without requiring them to seek pro hac vice basis.

- o A substantial body of anecdotal experience from consumers and consumer lawyers across the U.S. indicates that NAF rarely if ever grants any kinds of extensions to consumer debtors, and regularly enters default awards against consumers who were as little as one day late in responding to arbitration notices.
- o By contrast, numerous consumers and consumer attorneys report that NAF regularly grants extensions to its lender clients, particularly MBNA Bank, when the lenders request extensions or miss deadlines.
- o Although documents from NAF cases in many states establish that NAF arbitrators regularly include significant sums in their awards for lenders for the lenders' attorneys' fees and both parties' arbitrators' fees, NAF consistently does not include sums for these items in the disclosures it makes on its website related to arbitrations that are conducted in California. It appears that in reporting on California arbitrations, NAF just rolls the attorneys' fees and arbitration fees into the lender's overall claim, so that consumers looking at NAF's website cannot determine the size of these fees in consumer cases.

In short, the NAF appears to be an extremely unfair and untrustworthy substitute for the civil justice system for debt collection cases. The NAF appears to operate as part of a debt collection mill, regularly generating substantial awards for lenders that greatly exceed the sums to which the lenders are legally entitled. The NAF system is geared towards quickly awarding lenders the full amount the lenders claim a consumer owes, without performing much scrutiny of the magnitude or appropriateness of these awards.



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## CONCLUSION

In all too many cases, the promise of fair and inexpensive arbitration is not kept for American consumers. The current system suffers from a lack of transparency, which permits and even encourages these abuses.



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September 21, 2007

To Members of the United States Senate:

The undersigned members of the Coalition to Preserve Arbitration strongly oppose to S. 1782, the "Arbitration Fairness Act." This legislation would effectively abolish pre-dispute arbitration agreements as a way to fairly, quickly and easily resolve consumer, employment, and franchise related contractual disputes, as well as disrupt commercial arbitration well beyond the bill's advertised scope. We urge you to oppose S. 1782.

S. 1782 not only eliminates the use of pre-dispute arbitration clauses in future consumer, employment, and franchise contracts, it also nullifies pre-dispute arbitration clauses in existing contracts if a dispute arises under that contract after enactment of the legislation. This bill undermines what has been a long-standing and effective form of alternative dispute resolution since at least 1925, when Congress enacted the Federal Arbitration Act. In developing and passing the Federal Arbitration Act, Congress rightly recognized that arbitration can be a more efficient, more effective, and less expensive way to resolve disputes than further flooding the courts with litigation. A significant outcome of this legislation will be to turn what could be easily resolved disputes into huge class action lawsuits. In many circumstances, these lawsuits will ultimately provide little justice to allegedly aggrieved consumers, employees and franchisees.

The changes made by this legislation are unwarranted. For example, a RoperASW survey found that 64% of participants would prefer to take a dispute to arbitration instead of filing a lawsuit. It should also be noted that research shows that arbitration may provide a greater likelihood of an award to a consumer, and in the employment context it can be about one-third times faster than litigation. According to American Bar Association statistics, even trial lawyers understand arbitration works: 78% say it is faster than going to court, and 56% say it is more cost effective.

This legislation is also constructed on faulty premises. Arbitrators cannot ignore the law—courts will overturn awards made in "manifest disregard" of the law. Nor does arbitration deprive parties of their rights; it merely shifts the forum in which claims are heard, and the courts have been vigilant in refusing to enforce agreements that would deprive a party of his or her statutory rights.

Also of great concern is the fact that the legislation would likely disrupt commercial arbitration as it is currently practiced among corporations and other commercial entities—including arbitration over antitrust matters allowed by the Supreme Court's *Mitsubishi* case decided in 1985. Furthermore, the broad application of the legislation to "transactions between parties of unequal bargaining power" would put the enforceability of almost every arbitration clause in doubt. This resulting uncertainty would cause a significant problem for American businesses, especially in their international transactions, where the foreign party would be likely to insist that all



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contractual and legal proceedings be conducted outside the United States in order to avoid the effects of this legislation.

Enactment of S. 1782 would severely damage an alternative dispute resolution system that consumers and businesses have relied on for decades. Adopting such a measure would only serve to increase litigation and undermine a system that has provided tremendous benefit to all involved—including consumers, employees and franchisees. Accordingly, we strongly oppose S. 1782 and urge you to do so as well.

Sincerely,

American Bankers Association
American Financial Services Association
American Health Care Association/National Center for Assisted Living
American Insurance Association
American Meat Institute
AT&T
Business Roundtable
Coors Brewing Company
Council for Employment Law Equity
CTIA – The Wireless Association®
International Franchise Association
Johnson & Johnson
National Association of Home Builders
National Association of Manufacturers
Securities Industry and Financial Markets Association
T-Mobile USA
The Financial Services Roundtable
U.S. Chamber of Commerce
U.S. Chamber Institute for Legal Reform



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CHRISTOPHER COX
CHAIRMAN

HEADQUARTERS
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WASHINGTON, DC 20549

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

REGIONAL OFFICES
ATLANTA, BOSTON, CHICAGO,
DENVER, FORT WORTH,
LOS ANGELES, MIAMI, NEW YORK,
PHILADELPHIA, SALT LAKE CITY,
SAN FRANCISCO

July 9, 2007

The Honorable Russell D. Feingold
Committee on the Judiciary
United States Senate
506 Hart Senate Office Building
Washington, DC 20510

Dear Senator Feingold:

Thank you for your May 4, 2007 letter regarding mandatory arbitration clauses in securities brokerage contracts.

Your letter raises important issues in an area that has a long history. The Federal Arbitration Act, enacted in 1925, established a strong federal policy favoring arbitration. Nonetheless, from 1983 until 1987, the Commission had a rule that prohibited broker-dealers from using predispute arbitration clauses in agreements with retail customers to cover claims arising under the federal securities laws. The rule was rescinded after the U.S. Supreme Court held in Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987), that predispute agreements to arbitrate claims arising under the Securities Exchange Act of 1934 are enforceable.

The Commission oversees the securities arbitration process of the self-regulatory organizations (SROs) through inspections of the SROs and review of their arbitration rules. Our oversight is directed at ensuring that the arbitration process is fair and efficient. The SEC and the SROs regularly and rigorously monitor and review the arbitration process to ensure that it is meeting the needs of investors. In 2002, the SEC commissioned a study by Professor Michael Perino on the adequacy of arbitrator conflict disclosure requirements at NASD and NYSE. Professor Perino's report also touched on user perceptions of fairness, finding that "[a]vailable empirical evidence suggests that SRO arbitrations are fair and that investors perceive them to be fair." The Perino report also suggested that, to resolve any doubts about investor perceptions regarding the fairness of SRO arbitration programs, the SROs should sponsor an independent user survey. This survey is currently being conducted under the auspices of the Securities Industry Conference on Arbitration by the Pace Investor Rights Project.

Because your letter raises serious questions about the use of pre-dispute arbitration clauses that I believe are deserving of further consideration, and because the Commission takes seriously its responsibility to oversee the actions of the securities self-regulatory organizations, I have asked the agency's professional staff to look carefully at the issues you raise, to collect

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WWW.SEC.GOV



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Hon. Russell D. Feingold
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additional empirical information on these matters, and to evaluate whether existing protections for brokerage customers are adequate. Once we have had the opportunity to do that, we would be happy to set up a briefing with you or your staff to discuss these issues more thoroughly.

Thank you again for taking the time to share with us your thoughts and concerns about this topic. Please call me at (202) 551-2100 or have your staff call Jonathan Burks, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010 if you have any questions or comments.

Sincerely,

Christopher Cox
Chairman



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# TESTIMONY

**in support of**

**ALTERNATIVE DISPUTE RESOLUTION PROGRAMS IN EMPLOYMENT**

**and in opposition to**

**S. 1782, "THE ARBITRATION FAIRNESS ACT"**

**before the**

**SUBCOMMITTEE ON THE CONSTITUTION**

**of the**

**JUDICIARY COMMITTEE**

**of the**

**UNITED STATES SENATE**

**on behalf of**

**THE COUNCIL FOR EMPLOYMENT LAW EQUITY**

**by**

**Mark A. de Bernardo**
**Executive Director and President**

**December 12, 2007**

## I. Statement of Interest

Good morning Chairman Feingold, Ranking Minority Member Brownback, and members of the Subcommittee on the Constitution of the Senate Judiciary Committee. Thank you for this opportunity to testify *in strong support of* the use of Alternative Dispute Resolution ("ADR") in employment, and of the use of mediation and arbitration generally as effective alternatives to litigation, and *in opposition to* S. 1782, "The Arbitration Fairness Act."

My name is Mark A. de Bernardo, and I am the Executive Director and President of the Council for Employment Law Equity ("CELE"), as well as a senior Partner at the law firm of Jackson Lewis. Among other activities on the ADR issue, I have authored four *amicus curiae* briefs in support of ADR, and have drafted ADR policies, conducted audits of ADR programs, and/or advised employers on ADR issues for nearly 20 years. It is my firm and unequivocal belief that the use of ADR is both pro-employer *and* pro-employee and – when implemented appropriately – is a tremendous asset to both employee relations and our jurisprudence system.

The Council for Employment Law Equity is a non-profit coalition of major employers committed to the highest standards of fair, effective, and appropriate employment practices. The CELE advocates such employment practices to the employer community; before the judicial, legislative, and executive branches of government; and to the public at-large.

Among other activities, the Council for Employment Law Equity has filed *amicus curiae* briefs on numerous occasions to the U.S. Supreme Court, including twice on ADR issues, and to other federal and state courts and the National Labor Relations Board; has filed comments during rule-making to the Department of Labor, the Department of Health and Human Services, the Office of Management and Budget, and the Government Services Administration; and has been active on policy-making issues before the American Bar Association's House of Delegates.

The CELE regularly attempts to positively and constructively influence the consideration of national policy issues of importance to the employer community. ADR is one such issue.

Jackson Lewis also has a long and proud record of support for effective and equitable ADR programs as an alternative to costly, time-consuming, deleterious, and relationship-destructive litigation. Like organized labor, which has long embraced binding arbitration as a foundation of union representation, my law firm is highly supportive of ADR – and its impacts of less litigation and less legal fees – *because* it is what is best for many of our clients, *and their employees*, and because it is the right thing to do.

Jackson Lewis is a national law firm of more than 425 lawyers in 33 offices, *all* of whom are dedicated exclusively to the representation of management on labor and employment issues. No law firm has had as extensive or prominent a labor practice as has Jackson Lewis over the past 50 years, and it is highly unlikely that any firm has as much experience or expertise on ADR issues. In addition, Jackson Lewis has the highest concentration of employment lawyers in such major markets as the New York, Washington, and Los Angeles metropolitan areas.



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Clearly, the CELE in particular, and the employer community in general, has a *very* strong interest in any initiative, such as S. 1782, which would so drastically undermine the use of Alternative Dispute Resolution programs in employment. I am here today to provide real-world context, and to underscore the message that, "it ain't broke," so "don't fix it." ADR in employment – and in other contexts – does *not* need a "fix."

On behalf of the CELE, I can assure you that we are equally committed to helping ensure fairness in our arbitration and ADR systems for employees and employers alike.

## II. Summary of Position

The seminal question is: Should employers and employees be able to engage in mediation and mandatory binding arbitration of employment disputes as an alternative to litigation?

The seminal answer is: Absolutely. ADR in employment programs are flourishing, and when implemented appropriately, are decisively in *employees'* best interests... and yet S. 1782 would effectively *deny* this option to employers and employees.

It is hard to imagine a more sweeping – and devastating – blow to mandatory binding arbitration that S. 1782's language:

> (b) No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of –
>
> (1) an employment, consumer, or franchise dispute...[1]

S. 1782 would effectively *end* arbitration in America.

ADR – a common, useful, positive, pro-active, timely, cost-effective *and* effective tool for making employers *better* employers and giving employees favorable resolution of their workplace problems – would essentially be eliminated from the American employment landscape after more than 80 years of sustained growth and success.[2] *Many* would lose if S. 1782 were enacted; *very few* would gain.

Why is preservation of ADR in employment critically important?

The use of Alternative Dispute Resolution in employment is common and increasing as a means of avoiding litigation, addressing *more* employee issues, and resolving *more* amicably

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[1] Section (4)(b)(1) of S. 1782 – "Validity and enforceability."

[2] The Federal Arbitration Act (Chapter 1, Title 9, United States Code) was enacted by Congress in 1925 to promote arbitration as an alternative to litigation, and to "avoid the expense and delay of litigation" S. Rep. No. 68-536, at 3 (1924).

these concerns. Given the costs, delays, and divisiveness of employment litigation, a more sensible and conciliatory option is preferable for employers *and their employees.* The net result of the use of ADR is:

(1) More employee complaints received *and* resolved;

(2) Employee complaints resolved sooner and with less tension;

(3) Less turnover/more likely and more favorable preservation of employment relationships;

(4) Improved morale;

(5) More effective communication, and enhanced constructive input by employees into their companies; and

(6) Better workplaces.

Frankly, I firmly believe that appropriate ADR in employment programs – as they are *currently* in use – *are* fair, *do* have the requisite safeguards, and *are not* commonly subject to abuse.

However, *if* there are reforms which are necessary and appropriate, certainly they should be considered, and the CELE would support and welcome such reforms.

What is *not* needed is the wholesale and retroactive dismantling of common, effective, and widespread ADR programs that work... and work well. The cost to employees and employers, and to the interests of justice and sound employee relations, would be enormous *and* extremely destructive.

## III. Summary of Advantages of ADR for Employees

The most effective – and utilized – Alternative Dispute Resolution programs are the ones in which employees "buy into" the program and recognize the distinct advantages to the individual. The advantages of ADR – for employees – include:

**(1)** **A faster resolution of problems** – Justice delayed *is* justice denied, and employment-related litigation now takes, on average, more than two years to resolve;[3]

[3] For example, the average time to resolve civil cases in *state* courts was 24.2 months in 2001, according to the U.S. Department of Justice, *Civil Trial Cases and Verdicts in Large Counties,2001* at 8, available at http://www.ojp.usdoj.gov/bjs/pub/pdf/ctcvlcoi.pdf. The backlog and delay in the *federal* courts for civil cases is even greater. In fiscal year 2006 alone, 259,000 civil cases were filed in U.S. District Courts, continuing the dramatic trend upwards. *Fiscal Year 2006 Caseloads Remain at High Levels,* THE THIRD BRANCH:

(2) **A simpler, more focused, more confidential, and more dignified process** – Litigation is war, and who wants to go to war, particularly with the outcome so uncertain?;

(3) **Less disruption to career and personal life** – One of the advantages of ADR is the vastly increased chances for amicable resolution of an employment problem – the goal is to keep the employee in his or her job, and to do so in a way that the employee is happier and more productive. Litigation is destructive of the employment relationship; ADR is constructive;

(4) **Peace of mind** – ADR helps "diffuse" employee issues and concerns – *before* they heat up and "come to a boil." With earlier intervention and correction, small problems do not build into big problems, and there is less psychological "wear and tear " all the way around;

(5) **The same range of remedies and higher awards** – ADR provides the very same remedies to an aggrieved employee as litigation, and monetary damages are not only awarded to the employee faster than in litigation, they are awarded on just as broad a basis and at higher levels as in litigation.[4] No financial remedy is waived by participation in the ADR process;

(6) **The same decision-making process** – Formal arbitration under an ADR program has essentially the same decision-making process as traditional litigation. The arbitrator is neutral, trained, and experienced, unaffiliated with either party, and acts very much like a judge.[5] Moreover, the decisions of the arbitrator are final and binding on *both* parties;

(7) **A better chance of prevailing** – Employees have a 63 percent chance of prevailing in employment arbitration, but only a 43 percent chance of prevailing in employment litigation.[6] Thus, employees have nearly a 50-percent *better* chance in arbitration than in court. This includes employment cases dismissed on

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NEWSLETTER OF THE FEDERAL COURTS (March 2007), available at http://www.uscourts.gov/ttb/2007-03/fiscal/index/html.

[4] The median award for employees who prevail in arbitration and in court are very similar – $63,120 for arbitrations and $68,737 for trials. *See* Theodore Eisenberg and Elizabeth Hill, *Employment Arbitration and Litigation: An Empirical Comparison*, 2003 Pub. H. & Legal Theory Res. Paper Series 1, 14 available at http://papers.ssrn.com/co13/papers.crm? abstract_id=389780. In fact, given that in all but the relatively few *pro se* cases, the employee must subtract attorneys' fees and costs from his or her award in litigation, *most* employees in employment arbitrations actually fare *much* better financially than in court.

[5] In fact, based on my legal practice of 28 years and experience as a senior Partner at a major law firm, I have absolutely no doubt that arbitrators are, in general, much *more* consistently and predictably neutral and balanced than judges are. Is there a difference between a Reagan-appointed judge and a Clinton-appointed judge? Yes, there is. The range of judicial philosophies is even greater at the state level. Going to court is the real crap shoot; going to arbitration is much more likely to achieve a fair and unbiased resolution.

[6] *See* Theodore Eisenberg, *supra, note 4.*

Motions for Summary Judgment. Even excluding those cases dismissed, employees are more likely to prevail in arbitration than trials that are litigated to decision – 63-to-57 percent.[7] Furthermore, nearly one-quarter (24.9 percent) of the employment cases arbitrated by the American Arbitration Association would not survive Motions for Summary Judgment, based on those arbitrators which do go to trial and are dismissed.[8] Thus, if you are an employee with a grievance, you have a better chance of winning, virtually no chance of being dismissed, and a higher median award[9] if you go to binding arbitration than litigation – and, in most cases, you do not have to split that award with a plaintiffs' lawyer; and

(8) **More problems raised and resolved** – An effective ADR program significantly *increases* the number of employee complaints, and that is better for everyone. More problems raised, more problems addressed, more problems resolved – quickly, efficiently, and cost-effectively – means better employer-employee relations, better morale, better employee retention, and a more productive and enthusiastic workforce.

## IV. Summary of Advantages of ADR Programs Overall

Alternative Dispute Resolution programs in employment have multiple, substantial benefits to *both* employers and employees:

- **Issues are resolved sooner** – The delays of litigation – motions, discovery, appeals, and an overall backlogged and cumbersome legal process – are avoided in favor of a short, simple, streamlined process which yields final determinations with a quick turnaround;

- **More grievances are addressed** – Given the option of an easily accessible, less confrontational, less time-consuming, and relatively cost-free means of raising workplace grievances, employees are *more* likely to raise issues at a company with an ADR program than they would in litigation – if they even *could* (the overwhelming majority of employment issues addressed in arbitration would *never* be litigated because of the relative inaccessibility of the legal process, the reluctance of plaintiffs' attorneys[10] to take on cases for which only modest

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[7] *See id.*

[8] *See id.*

[9] This is further confirmed by research by the National Workrights Institute which found that, consistent with the Eisenberg study *supra, note 4*, employment arbitration provides *higher* median awards than employment litigation - $100,000for arbitration; $95,554 for litigation. *Employment Arbitration: What Does the Data Show?* The National Workrights Institute, available at http://www.workrights.org/current/cd-arbitration.html.

[10] The minimum damages required to sustain employment litigation is $75,000, according to the National Workrights Institute. *See id.* In fact, the NWI found that in those cases with a stated demand, the majority (54 percent) were for a stated demand that was less than $75,000. More than a quarter involved demands for less than $25,000. Lewis L. Maltby, *Arbitrating Employment Disputes: The Promise and the Peril in Arbitration and Employment Disputes*, 530. (Daniel P. O'Meara ed., 2005). The bottom line is that more than *twice* as many

recovery would be "best-case" foreseeable, courts' procedural rules disqualifying matters of relatively minor controversy, and/or employers' high success rate for prevailing on Motions to Dismiss and Motions for Summary Judgment;

- **Inappropriate workplace practices are more likely to be corrected** – With issue determinations being made by credible and objective third parties who are trained in arbitration, knowledgeable about the legal process, and carefully selected because of their expertise in the issues and their lack of bias, intervention into – and correction of – employment practices and/or manager misconduct which may be inappropriate is achieved more frequently, more effectively, and more expeditiously;

- **ADR is less disruptive and distractive than litigation** – Since issues get resolved in a timely and decisive manner,[11] with a minimum commitment of time and resources, and ADR process is infinitely less disruptive and distracting vis-à-vis the more formal, costly, protracted, and combative legal process in our courts;

- **ADR is more cost-effective than litigation** – The most effective Alternative Dispute Resolution programs are mandatory and are binding on all parties. No long, drawn-out legal battles. No litigation. No appeals. No excessive litigation costs and legal fees.[12] By achieving a fair, final, and early resolution, ADR is cost-effective; and

- **ADR is adjudicated by qualified and objective professionals** – Arbitrators certified by the American Arbitration Association ("AAA"), the Judicial Arbitration & Mediation Services ("JAMS"), and the National Arbitration Forum are highly qualified professionals experienced in the legal process, with an established record of objectivity, and subject-matter expertise. They are reliable,

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employees can access the arbitration system than can access the court system because of the dollar threshold of their claims alone.

[11] One study found that arbitrations lasted an average of 116 days, with a median of 104 days. Kirk D. Jensen, *Summaries of Empirical Studies and Survey Regarding How Individuals Fare in Arbitration*, 60 CONSUMER FIN. L. Q. REP. 631 (2006), citing California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review o Website Posted Data Pursuant to Section 1281.96 of the Code of Civil Procedure*, (August 2004), available at http://www.mediate.com/cdrii/cdri_print_Aug_6.pdf. By contrast, the lifespan of an average employment case, according to the Federal Judiciary Center, is almost two years (679.5 days) from the time of filing until the date of resolution. Evan J. Spelfogel, *Pre-Dispute ADR Agreements Can Protect Rights of Parties and Reduce Burden on Judicial System*, 71 New York State Bar Journal No. 7, 22 (1999).

[12] One study found that civil cases lasted between two-and-a-half and eight years to resolve depending on the nature of the case and the jurisdiction involved. *Evaluating and Using Employer Instituted Arbitration Rules and Agreements in Employment Discrimination and Civil Rights Actions in Federal and State Courts* (ADLI-ABA Course of Study, April 28-30) 875, 894 (1994). The backlog in the federal courts is significant – 23,000 cases had been pending in U.S. District Courts for two-to-three years in 2006, and another 50,000 had been pending between one and two years, and this does not, of course, include appeals and remands. *U.S. District Courts: Civil Cases Pending by Length of Time Pending* tbl.4.11, available at http://www.uscourts.gov/judicialfactsfigures/2006/Table411.pdf.

credible, committed, and readily available through a highly developed and highly respected existing network. These organizations have the capacity to create, and experience in creating, specialized panels to address specific forms of arbitration – in this case neutral arbitrators with specific knowledge and/or expertise in employment issues.

## V. Elements of an Effective ADR Program

The CELE, and the employer community as a whole, hope that Congress recognizes and fully appreciates what we believe is undeniable: Arbitration is a vital and necessary component of our civil justice system.

If S. 1782 is enacted, that civil justice system will be catapulted into chaos: hundreds of thousands of arbitrations a year will be replaced by tens of thousands of new court cases;[13] *any* redress by the vast majority of individuals currently using the arbitration process will be rendered impossible as their claims will be abandoned and left homeless in the new judicial order;[14] the already overburdened and significantly backlogged court system will be swamped by a tidal wave of new cases; and millions of employees (and consumers) and thousands of companies now subject to contracts they voluntary entered into that call for mediation and arbitration of disputes will have those contracts *retroactively* voided – a legal nightmare!

To the extent there are any *valid* concerns about ADR and the use of mandatory binding arbitration to address and resolve employment (and other) disputes, and should these concerns warrant Congress taking action, the most appropriate course of legislative action would be to require procedural reforms, *not* to recklessly dictate that "predispute arbitration" will not be "valid or enforceable."

One option is to look at what CELE, and many other informed professionals in the field, commonly consider the elements of an effective ADR program, and incorporate these concepts, as appropriate, into a bill as ADR "safeguards."

The following are common components of model Alternative Dispute Resolution in employment programs. With ADR – like most employment policies – "one size" does *not* fit all.

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[13] In 2002, the American Arbitration Association *alone* handled more than 200,000 arbitrations. Deborah R. Hensler, *Our Courts, Ourselves: How the Alternative Dispute Resolution Movement is Re-Shaping Our Legal System*, 108 PENN. ST. L. REV. 165, 167 n. 11 (2003) (citing data from 2002). If S.1782 becomes law, the overwhelming majority of arbitrations currently being conducted in the United States would not occur. Many of these would be foisted on our court system. Just the AAA arbitrations – 200,000 – represent nearly 80 percent of the 259,000 cases filed in U.S. District Courts in 2006. If only 20 percent of these were litigated, that's 40,000 *more* civil court cases (and 160,000 individuals left out in the cold with no legal recourse).

[14] A survey of the plaintiffs' bar found that they agree to provide representation to only five percent of the individuals who seek out their help. In addition, plaintiffs' attorneys require a minimum of $60,000 provable damages, commonly request a retainer up front, and typically require a payment of a contingency fee of between 33 and 40 percent. Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777 (2003). Therefore, the door is slammed shut on 95 percent of potential plaintiffs in litigation. In arbitration, that number is virtually zero.

Employers typically and appropriately tailor their ADR programs to their own company's needs, priorities, and employee relations culture.

Nonetheless, some common elements of ADR-in-employment programs are:

(1) **An "open door" policy** for employees to bring concerns to their supervisors and managers;

(2) **Designation of a company executive** to serve as a confidential advisor – or "ombudsman" – should employees not want to bring a concern to their direct supervisors or managers. Ideally, the designated advisor should have some background and training in human resources and/or dispute resolution, should be available at a designated "employee hotline" telephone number, and should have credibility with employees as a fair and reasonable person;

(3) **Informal mediations** should be used to address concerns *before* they grow into problems;

(4) **Peer review panels** also can be effective because the participation of co-workers in the process adds credibility to the evaluation and suggested resolution of employee problems;

(5) **Management review boards** sometimes serve as a "check and balance" to ensure that employees are being treated fairly and consistently;

(6) **Binding arbitration** is the seminal component of a successful ADR program. The parties avoid litigation – with its inaccessibility, delays, costs, divisiveness, and unpredictability – by achieving internal resolution by a neutral arbitrator which is *binding* on both parties;

(7) **Legal assistance** sometimes is offered by employers to their employees as well. If an employee wants legal representation at a mediation or arbitration, employers should permit it. Employers also should consider paying for the employee's legal representation – up to, for example, a $2,500 limit per employee per year;

(8) **The use of qualified arbitrators** is vital. Typically, ADR programs use independent, professional arbitrators from the American Arbitration Association, Judicial Arbitration & Mediation Services, and/or the National Arbitration Forum;

(9) **The maintenance of employee confidentiality**, when requested by the employee, is critically important. Employees have to trust the ADR program to use it, and company misuse undermines the program's credibility, decreases its use, and thereby helps defeat its purpose; and

(10) **A "no-retaliation" policy** is helpful in this regard. Employees should know and expect that their forwarding of a complaint will *not* result in retaliation, and that managers who do retaliate will be disciplined.

These are the types of safeguards which the CELE, and Jackson Lewis, recommend to employers to enhance their ADR programs and to ensure employee acceptance and cooperation.

What would be *most* appropriate would be legislation that would provide incentives (such as tax credits) to employers to voluntarily implement ADR programs with the type of safeguards and "best practices" listed above.

What would be *least* appropriate would be legislation, such as S. 1782, that would impose a death penalty on ADR as an employment practice.

## VI. Who Loses If S. 1782 Is Enacted

If the "Arbitration Fairness Act of 2007" were enacted, the sun would still come up.

However, for *millions* of Americans, their lives would be worse:

(1) **Consumers** – There would be more legal costs, more frivolous and marginal litigation,[15] a greater potential for legal extortion of employers who terminate even the most deserving employees, and credit deadbeats who intentionally leave 1K balances on multiple credit cards because they believe they are unlikely to be pursued for 1K because it would be irrational and cost-prohibitive. As a consequence, the costs of products and services will be higher. Consumers would *lose* because companies would have much higher costs and be forced into more litigation;

(2) **Consumers** (again) – Consumers would be less likely to get their grievances addressed once they are denied the option of arbitration because *most* plaintiffs' attorneys are unlikely to accept litigation with only a modest expectation of damages;

(3) **Employees** – Due to the increased level of costly litigation, and the increased "surrender" of some employers to frivolous or marginal claims in the name of litigation-cost avoidance,[16] S. 1782 would cost money and detract from employers' profitability, cost jobs, negatively affect stock prices and profit-sharing, detract from possible salary and benefit increases, and/or curtail expansion/capital investment. For some companies, especially smaller businesses, enough increased litigation – the abolition of arbitration of employment disputes *would* substantially increase litigation – could impact their viability as a business entity (i.e., cause bankruptcies);

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[15] For example, would companies, facing credit card defaults, litigate $500 claims? $1,500 claims? $3,000 claims? Would not the costs of litigation make contesting such credit defaults prohibitive? Would not *some* plaintiffs' attorneys file assembly-line complaints for every aggrieved individual who had his or her employment terminated? Why not? – Let's collect my "good-bye present" – $5,000 or $10,000 or $15,000 going out the door because some small business cannot afford the costs and time of litigation, or the potential exposure.

[16] Given the costs of litigation, many times a "win" is not a win. Typically, it can cost an employer $250,000 to litigate an employment claim to decision.

(4) **Employees** (again) – No mediation or arbitration means *less* accessibility to the legal process, *fewer* issues being addressed, *less* likelihood of meaningful redress/correction/improvement, *more* likelihood of the employment relationship being terminated, *less* communication/input into workplace policies and practices, *more* confrontations if they do pursue their claims in litigation; and – bottom line – *worse* workplaces;

(5) **Employers** – More cost, more litigation, more confrontation, less timely identification of workplace problems, less opportunity for early intervention, more turnover, worse employee relations, destruction of ADR systems that have been long-standing and well-accepted – *and that work well*. The costs – both in human and financial resources – would be enormous;

(6) **The Court System** – More litigation, more backlog, more delays, less resolution, dismemberment of an alternative legal process that promotes timely and less acrimonious resolution and reduces the ever-growing pressure on our judicial system. If arbitration were effectively banned, *most* of those claims would never be addressed, but *many* would shift to the court system – a burden which no one, save the plaintiffs' bar, could afford or would appreciate;

(7) **Deserving Plaintiffs** – Nothing prevents an individual from pursuing his or her claims of employment discrimination with the Equal Employment Opportunity Commission, comparable state or local agencies, or in court. Even when subject to mandatory binding arbitration agreements, that right cannot be waived before *or* after the ADR process has been exhausted. However, without the possibility of mediation and arbitration, the courts would get further clogged, the delays would increase, the period from time of filing to time of decision would be lengthened, and the entire process would work less efficiently, less effectively, and fairly – even for the most deserving plaintiffs;

(8) **Taxpayers** – Substantially more of a burden on our court system would require more judges, more staff, more facilities, more cost. From where? From us; and

(9) **The Interests of Justice** – As mentioned above, the maxim "justice delayed is justice denied" would be underscored. No quick and painless resolutions in ADR programs. No resolution at all in most cases. Resolution in a much longer time period through litigation, no matter how deserving, and more delays, confrontation, disruption of the employment relationship, uncertainty, and investment of time and resources. Is the destruction of ADR really in employees' interests? No, it is not.

## VII. Who Wins If S. 1782 Is Enacted?

The obvious answer is: the plaintiffs' bar.

The American Association for Justice, formerly the American Trial Lawyers Association, *hates* arbitration – less litigation, less confrontation, less likelihood of runaway juries (multi-million-dollar verdicts for hot-coffee cases – resulting in a country full of people drinking luke-

warm coffee), less of a weapon with which to intimidate the employer community, less damages, and – most of all – less attorneys' fees.

They claim everyone deserves "their day in court." Do they? I am not so sure (those who misuse and abuse the judicial process, those who use it for legal extortion, those who take a "lotto" mentality to litigation) – but I am sure that, in the employment context, individuals retain that option regardless, and no ADR program can abridge those rights.

So the "trial lawyers" (plaintiffs' lawyers) would win if S. 1782 became law – a bigger pool of potential plaintiffs, less harmony in the workplace, more *former* employees (rather than *current* employees) with issues, more opportunities for one-third-plus-expenses of the verdict or settlement.

Who else wins? Undeserving employees. Undeserving consumers. People whose cases would be undeserving in the context of a fair, relatively quick, relatively inexpensive, and more predictable forum (certified arbitrators are more rational, more familiar with the law, and more experiences than any jury), but whose cases – thrust upon the court system – may be worth a "nuisance settlement."

All the rest of us? We lose. S. 1782 – and the betrayal and abandonment of ADR it represents – would be bad public policy and harmful to American justice and American society.

## VIII. Supporters of ADR

### (A) The Judiciary Favors ADR

There can be no doubt that employment cases create an unnecessary strain on the limited resources of our judicial system.

Private employment suits grew at an astronomical rate in the 1990s. In January of 1999, the Bureau of Justice Statistic published a study showing that from 1990 through 1998, private employment-related civil rights cases nearly tripled.[17] Private employment-related complaints accounted for approximately 65 percent of the overall increase in cases that flooded the U.S. District Courts in this period.[18]

The torrent of employment-related lawsuits coupled with the delays in case processing evinced a need for more effective case management. Arbitration is well-suited to meet this need.

The federal judiciary and Congress agreed. In response to this explosive growth in employment litigation, the Alternative Dispute Resolution Act of 1998[19] was passed and signed into law in October 1999 to promote the use of ADR in the federal court system. This law

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[17] Marika F.X. Litras, "Civil Rights Complaints in U.S. District Court, 1990-98" (NCJ-173427). Employment discrimination cases increased from 8,413 filings in 1990 to 23,735 in 1998.

[18] *See id.*

[19] Pub. L. No. 105-315.

mandates U.S. District Courts to establish their own ADR programs and authorizes the use of at least one form of ADR.

Additionally, Recommendation 39 of the *Long Range Plan for the Federal Courts*[20] encourages U.S. District Courts to "make available a variety of alternative dispute resolution techniques, procedures, and resources to assist in achieving a just, speedy, and inexpensive determination of civil litigation."[21] Clearly, the intent of promoting ADR methods within the court system is to lighten the federal court docket.

S. 1782 stands in opposition to this worthwhile goal. S. 1782 would prohibit hundreds of thousands of arbitrations of employment and consumer disputes and transfer many of them to our courts, leaving litigation as the only resort – if obtainable – and exacerbating an already clogged and overburdened court system.

**(B) Practicing Lawyers Favor ADR**

A 2006 survey by the American Bar Association ("ABA") of the membership of the General Practice and Solo and Small Firm Division of the ABA found that 86.2 percent felt that "their clients' best interests are sometimes best served by offering ADR solutions," and nearly two-thirds (63.2 percent) thought that "offering clients ADR solutions is an ethical obligation as a practitioner."[22] Nearly two-thirds (66.2 percent) also predicted that "ADR use will increase in the future."[23]

**(C) Employees Favor ADR**

It is hard to recognize just who needs to be "protected" when it comes to ADR in employment... *not* employers, who increasingly are using ADR programs, and enthusiastically so[24]... and *not* employees – a public opinion poll found that 83 percent of employees *favor* arbitration.[25]

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[20] See *New Law Authorizes ADR in All District Courts*, THE THIRD BRANCH, published and available at http://www.uscourts.gov/ttb/feb99ttb/newlaw.html.

[21] *See id.*

[22] *ADR Preference and Wage Report*, National Arbitration Forum, 2006 (data collected by Surveys and Ballots Inc. Available at http://www.adrforum.com/users/naf/resources/GPSoloADRPreferenceandusage report.pdf).

[23] *See id.*

[24] In a survey of more than 530 corporations in the Fortune 1000, more than 23 percent of respondents reported that they use ADR for non-union dispute resolution. Lipsky, Dawd and R. Seeber, *The Use of ADR in U.S. Corporations: Executive Summary* (1997). The survey was conducted by Price Waterhouse and Cornell University's PERC Institute on Conflict Resolution. Obviously, the percentage has gone up since then.

[25] See Princeton Survey Research Associates, *Worker Representation and Participation Survey Focus Group Report*, Princeton, NJ (April 1994).

**(D) Parties to Arbitration Favor ADR**

In a survey of more than 600 adults who had participated in binding arbitration, more than 70 percent were satisfied with the fairness of the process and the outcome, including many who had lost their arbitrations. Arbitration was viewed as faster (74 percent), simpler (63 percent), and cheaper (51 percent) than going to court, and two-thirds (66 percent) said they would be likely to use arbitration again (48 percent said they were *extremely* likely to use arbitration again).[26]

In addition, as discussed in the next section of this testimony, the *Federal Government* favors ADR as well.

## IX. Our Well-Established National Labor Policy Strongly Supports the Use of Arbitration Agreements in Employee Relations

It is clear that Congress's intent in enacting the Federal Arbitration Act was to encourage the use of arbitration.[27] Since its enactment in 1925,[28] and codification in 1947,[29] the use of arbitration in the private and public sectors has flourished.

A number of recent legislative and executive branch initiatives have reaffirmed our nation's commitment to, and acceptance of, ADR. Such measures include the Civil Rights Act of 1991 ("CRA"),[30] in which Congress specifically endorsed the arbitration of Title VII[31] cases. Section 118 of the CRA provides that "where appropriate and to the extent authorized by law, the use of alternative dispute resolution, including... arbitration, is encouraged to resolve disputes arising under [Title VII]."[32] Additionally, the Administrative Dispute Resolution Act ("ADRA") – passed in 1990 and subsequently amended and permanently reauthorized in 1996, and amended again in 1998 – mandates that federal agencies create internal ADR programs. The 1998 amended ADRA[33] requires each U.S. District Court to adopt local rules regarding the use of ADR. The ADRA's Findings and Declaration of Policy notes that:

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[26] *Arbitration: Simpler, Cheaper, and Faster than Litigation*, U.S. Chamber Institute for Legal Reform (2005) (survey conducted by Harris Interactive) (www.instituteforlegalreform.org/resources/arbitrationstudy/final.pdf).

[27] *See, e.g., Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20,24 (1991) ("[the FAA's] purpose was to reverse the long-standing judicial hostility to arbitration agreements... and to place arbitration agreements upon the same footing as other contracts."

[28] 43 Stat. 883.

[29] 9 U.S.A. §1 (1994).

[30] Pub. L. No. 102-166.

[31] 42 U.S.C. §§2000e *et seq.*

[32] 105 Stat. at 1081, *reprinted in* notes to 42 U.S.C. § 1981.

[33] Pub. L. No. 105-315.

> Alternative dispute resolution, when supported by the bench and bar, and utilizing properly trained neutrals in a program adequately administered by the court, has the potential to provide a variety of benefits, including greater satisfaction of the parties, innovative methods of resolving disputes, and greater efficiency in achieving settlements.[34]

Additionally, many government agencies have implemented ADR programs governing their own employees. The United States Department of Agriculture's ADR program, for example, has an overall resolution rate of 82 percent, and the time from request for ADR to actual mediation averages 24 days.[35] The Federal Election Commission resolved all 26 employee complaints brought to the agency's Equal Employment Opportunity director in a recent three-year period.[36] Other government agencies to benefit from ADR programs include the Department of Labor, Department of Treasury, United States Mint, Army Corps of Engineers, Navy, Air Force, Postal Service, Department of State, and Department of Veterans Affairs.

That the federal government is so widely committed to the use of ADR for its own employees emphatically underscores the appropriateness of ADR use in private-sector employment.

## X. Conclusion

Alternative Dispute Resolution is a positive, necessary, and highly appropriate component of our judicial system. ADR is increasing in use, and the *need* for ADR is increasing as well. Mandatory binding arbitration in employment is entrenched as a useful, fair, and productive fixture on our American employment landscape. It is both pro-employer *and* pro-employee. As discussed earlier, employees are more likely to have their employment issues addressed by their increased accessibility to arbitration vis-à-vis litigation, and are more likely to prevail and to receive higher median awards in employment arbitration than in employment litigation.

To abandon this practice, to suddenly and retroactively render its use void and unenforceable, as S. 1782 would do, would have far-reaching and disastrous impacts on American jurisprudence and American society.

S. 1782 is a mandatory litigation bill. *That* is not the way to go.

On behalf of the Council for Employment Law Equity, and the employer community at-large, I respectfully urge you to preserve the rights of employers and employees to engage in Alternative Dispute Resolution, and to support the necessary and appropriate practice of mandatory binding arbitration in employment.

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[34] Pub. L. No. 105-315, §2(1).

[35] John Ford, *Workplace ADR: Facts and Figures from the Federal Sector*, published at http://www.conflict-resolution.net/articles/Ford3.cfm.

[36] *See id.*

I thank you for the opportunity to express our view here today, and I would welcome any questions which you may have and the opportunity to work together to help ensure that there is – and continues to be – *fairness* in arbitration in America.

Statement of
**The Honorable Russ Feingold**
United States Senator
Wisconsin

December 12, 2007

Opening Statement of U.S. Senator Russ Feingold
Senate Judiciary Subcommittee on the Constitution
Hearing On "The Arbitration Fairness Act of 2007"

As Prepared for Delivery

One of the most fundamental principles of our justice system is the right to take a dispute to court. Indeed, all Americans have the constitutional right in civil and criminal cases to a trial by jury. The right to a jury trial in civil cases in Federal court is contained in the Seventh Amendment to the Constitution. Many States provide a similar right to a jury trial in civil matters filed in state court.

I have been concerned for many years that mandatory arbitration clauses are slowly eroding the legal protections that should be available to all Americans. A large and growing number of corporations now require millions of consumers and employees to sign contracts that include mandatory arbitration clauses. Most of these individuals have little or no meaningful opportunity to negotiate the terms of their contracts and so find themselves, if they even realize that the provision is in the contract, having to choose either to accept a mandatory arbitration clause or to forgo securing employment or needed goods and services. Perhaps most disturbingly, mandatory arbitration clauses are being used to prevent individuals from trying to vindicate their civil rights under statutes specifically passed by Congress to protect them.

There is a range of ways in which mandatory arbitration can be particularly hostile to individuals attempting to assert their rights. For example, the administrative fees—both to gain access to the arbitration forum and to pay for the ongoing services of the arbitrator or arbitrator—can be so high as to act as a de facto bar for many individuals who have a claim that requires resolution. In addition, arbitration generally lacks discovery proceedings and other civil due process protections. Furthermore, under a developing body of case law, there is no meaningful judicial review of arbitrators' decisions.

Unfortunately, in a variety of contexts--employment agreements, credit card agreements, HMO contracts, securities broker contracts, and other consumer and franchise agreements--mandatory arbitration is fast becoming the rule, rather than the exception. The practice of forcing employees to use arbitration has been on the rise since the



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Supreme Court's Circuit City decision in 2001. Unless Congress acts, the protections it has provided through law for American workers, investors, and consumers, will slowly, but surely, become irrelevant.

Just as its name suggests, the Arbitration Fairness Act is designed to return fairness to the arbitration system. Arbitration can be a fair and efficient way to settle disputes. I strongly support voluntary, alternative dispute resolution methods, and we ought to encourage their use. What this bill does is ensure that citizens once again have a true choice between arbitration and the traditional civil court system by making unenforceable any predispute agreement that requires arbitration of a consumer, employment, or franchise dispute. The bill does not apply to mandatory arbitration systems agreed to in collective bargaining, and it certainly does not prohibit arbitration if all parties agree to it after a dispute arises.

Let me quickly address two questions that have arisen about the bill. First, it is intended to cover disputes between investors and securities brokers. I believe that such disputes are covered by the definition of consumer disputes, but to clear up any uncertainty, we will make the intent even clearer when we mark up the bill in committee.

Second, as I mentioned, the bill covers consumer, employment, and franchise disputes, each of which is a defined term. In addition it covers disputes that arise under civil rights statutes or "any statute intended . . . to regulate contracts or transactions between parties of unequal bargaining power." Some opponents of the bill have seized on that language and misstated it, saying that the bill covers any contract between parties with unequal bargaining power. They then say that such a provision is overbroad and very vague. I actually agree that such a provision would be problematic, but of course, that's not what the bill says. The provision in question is essentially a savings clause, so that a cause of action under a civil rights statute or a statute that is specifically designed to address disparities of bargaining power can be brought in court, even if the dispute does not meet the definition of a consumer or employment or franchise dispute. I hope this helps to clear up any misunderstanding about the scope of the bill.

In our system of government, Congress and state legislatures pass laws and the courts are available to citizens to make sure those laws are enforced. But the rule of law means little if the only forum available to those who believe they have been wronged is an alternative, unaccountable system where the law passed by the legislature does not necessarily apply. This legislation both protects Americans from exploitation and strengthens a valuable alternative method of dispute resolution. I look forward to exploring the implications and details of this bill with our witnesses.

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United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510–6275

May 4, 2007

The Honorable Christopher Cox
Chairman
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Cox:

We write regarding the prevalence of mandatory arbitration clauses in securities brokerage contracts. While arbitration can offer investors a valuable alternative to the courts as a means of resolving disputes, the increasing trend of stronger parties to a contract forcing weaker parties to waive their rights to judicial process is reason for serious concern. Although the Securities and Exchange Commission ("SEC") has done a good job regulating some other aspects of securities arbitration, we are troubled that the SEC has not adequately addressed the problem of mandatory arbitration clauses.

When Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934, it provided investors with an enhanced judicial remedy intended to serve as the foundation for vigorous private enforcement of the Acts' new comprehensive protections. The threat of public prosecution by individual investor-litigants gave teeth to the enforcement of securities laws, and Congress intended that this special judicial remedy be widely available to investors. Because securities firms today almost uniformly present prospective customers with contracts that include "take-it-or-leave-it" mandatory arbitration clauses, most investors are no longer able to invoke the courts to assert their rights either under the Acts or state laws. Accordingly, we request that the SEC, in fulfillment of its statutory duty to protect individual investors, promulgate a rule that will prohibit broker-dealers from requiring investors to accept mandatory arbitration clauses.

In its 2000 *Report on Securities Arbitration* (GAO/GGD-00-115), the General Accounting Office noted that the number of securities cases processed in the courts was "too small to make meaningful comparisons" to those processed through arbitration and later explained that all nine of the largest twelve brokerage firms that replied to its survey "require individual investors to agree to resolve their disputes through SRO-sponsored arbitration as a condition of opening most types of accounts." *Id.* at 5, 30. Since then, this situation has only worsened. On its own website, the SEC tacitly recognizes that the

judicial remedy has been virtually extinguished for investors when it states: "[I]f you have a brokerage account, you probably signed an agreement that requires you to settle any disputes with your broker through arbitration rather than the courts."
Where investors face a stark choice between signing a mandatory arbitration agreement and forgoing investment-related services, we cannot say honestly that arbitration has been voluntarily selected. Instead, we must admit that arbitration has been imposed on investors—regardless of their wishes—by the brokers, which hold much greater bargaining power. In the SEC Office of Inspector General's ("OIG") 1999 audit titled *Oversight of Self-Regulatory Arbitration*, the OIG conceded that "to the extent investors are unable to open accounts without signing mandatory arbitration agreements, they perceive that their participation in securities arbitration is involuntary." *Id.* at 4.

Thus far, the SEC has not responded to this specific problem with regulations. Instead, the Commission has declined to act beyond imposing stricter disclosure requirements, explaining that so long as the terms of any contract were fully disclosed, further regulation was unnecessary. *Id.* at 5. This policy may have been sufficient in the past when investors could, through their own initiative, identify and select brokers that did not include mandatory arbitration clauses in their standard contracts. With the prevalence of such clauses in today's brokerage contracts, however, the Commission must step in on behalf of the individual investors and restore their ability to choose judicial process.

The SEC's mission is, first and foremost, to protect investors, and simply relying on investors' ability to exercise informed choice when no choice is actually offered is clearly insufficient. Arbitration can be a fair and efficient way to settle disputes, but only when it is entered into knowingly and voluntarily by both parties to the dispute. We call on the Commission to consider the best mechanisms to address this problem, giving particular attention to the following alternatives: (1) a rule banning all pre-dispute mandatory arbitration clauses; or (2) if pre-dispute agreements are to be allowed, a rule requiring broker-dealers to provide their customers with a "check-the-box" choice between traditional judicial process and Self-Regulatory Organization ("SRO") arbitration.

Two Supreme Court cases from the 1980s, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987), and *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), paved the way for the expansive judicial enforcement of mandatory arbitration clauses under the Securities Acts. In both cases, the assumptions and rationale underlying the Supreme Court's rulings are clear: that arbitration increases rather than limits options and that the SEC will actively monitor arbitration to ensure it offers adequate investor protections. Promulgation of either of the aforementioned rules would be consistent with the Supreme Court's rulings on this issue.

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First, arbitration agreements were presumed by the Court to "advance the objective of allowing buyers of securities a *broader* right to *select* the forum for resolving disputes." *Rodriguez de Quijas* at 483 (emphasis added). This rationale that arbitration is valid on the grounds that it broadens the choices for claimants to select their forum is echoed in decisions upholding arbitration agreements in other contexts. *See, e.g., Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 29 (1991). When the Supreme Court decided *McMahon* and *Rodriguez de Quijas*, it was not standard practice across the brokerage industry to include mandatory arbitration clauses in customer contracts, and many investors were free to select among brokers on the basis of whether they did or did not permit judicial process. That mandatory arbitration clauses are now an industry norm—and thus a de facto requirement imposed upon investors—is a significant shift from one of the presumptions essential to the Court's decisions. The SEC should act to require that brokers allow investors to have an actual choice between the courts and arbitration, thereby restoring the element of voluntariness assumed by the Court.

Second, the SEC was presumed by the Court to be exercising its "authority to oversee and to regulate those arbitration procedures." *Rodriguez de Quijas* at 483. As noted in *McMahon*, the Commission has "expansive power" to regulate in this area. *Id.* at 233. Thus, issuing an appropriate rule is consistent with the second presumption of the Court as well. In an amicus brief filed by the SEC in the 2002 case, *NASD Dispute Resolution, Inc. and New York Stock Exchange, Inc., v. Judicial Council of California, et al*, the Commission correctly asserted that it "has full supervisory authority over the rules adopted by SROs, including the power to mandate the adoption of additional rules." Indeed, this power has been both contemplated and exercised with regard to mandatory arbitration clauses in the past. *See, e.g.*, Current Rule 10301(d) of NASD Code of Arbitration. It is the SEC's charge to protect the interests of the American investor and to regulate in furtherance of this duty. Promulgation of a rule concerning mandatory arbitration is clearly within the power of the Commission and is consistent with its charter.

Investors must have the opportunity to meaningfully weigh arbitration's benefits against a set of significant trade-offs. Notwithstanding the SEC's efforts to ameliorate some of the most troubling aspects of arbitration, agreeing to arbitration is still a waiver of constitutional rights that are protected in the judicial system. For instance, arbitration (1) lacks the formal court-supervised discovery process often necessary to learn facts and gain documents; (2) does not require that arbitrators follow the rules of evidence laid out for state and federal courts; (3) imposes no obligation on arbitrators to provide factual or legal discussion of the decision in a written opinion; and (4) severely limits judicial review. Arbitration is structured to create a more streamlined proceeding in order to provide faster and less expensive decisions, though at the cost of reduced legal certainty.



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The appeal of arbitration and mediation for disputes that are relatively straightforward or that involve modest damages will ensure that such alternative dispute resolution processes can continue to be the primary means for resolving disputes even after implementation of a rule that is more protective of investors. At the same time, restoring investors' access to the courts would enable some investors to assert their rights more effectively than in arbitration. Thus, an investor who requires significant discovery to show that she was the victim of coordinated misconduct by a firm will be much better able to substantiate this kind of complex claim with the more extensive discovery procedures of state or federal court. Although citizens are permitted to waive certain constitutional rights, it is important to remember that implicit in the constitutional foundation of our civil justice system is the basic principle that individuals should not be coerced or mislead into waiving such fundamental rights.

SEC promulgation of either of the mandatory arbitration rules suggested above would not indicate any disapproval of arbitration, nor would it lessen the benefits that arbitration can bring to the securities field. Rather, by insisting on the element of voluntary participation in the arbitration process, the SEC would strengthen the validity of arbitration as a forum for resolving disputes. According to the SEC's Office of Inspector General, "virtually all of the officials" surveyed by OIG during the audit believed that even if the SEC were to eliminate mandatory arbitration agreements altogether, the more sweeping of the two proposals we have made, such regulation would not result in a significant decrease in the number of disputes handled through arbitration. *Oversight of Self-Regulatory Arbitration* at 4. The OIG continued that if—instead of being bound by mandatory arbitration agreements—investors were given the *choice*, those investors "would perceive the securities arbitration process more favorably." *Id.*

We believe we should encourage arbitration and mediation in cases where they can be helpful. Should the SEC act as suggested in this letter, the quality of the securities arbitration process will be improved. As the SEC's Division of Market Regulation stated when it recommended in 1988 that brokers be prohibited from requiring mandatory arbitration clauses, reintroducing the element of competition between SROs and the courts for the investor dispute resolution business "should increase incentives to SROs and their members to ensure that the arbitration forum remains fair and efficient." *Id.* at 5. Arbitration will remain as a vital option for investors; at the same time, in those circumstances where an investor with a complex or particularly sensitive claim might be better protected by traditional judicial process, the SEC will have ensured that that protection is available.



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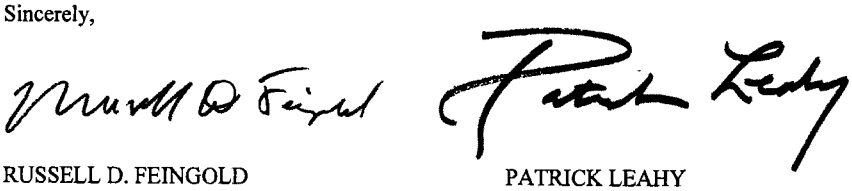
May 4, 2007
Page 5

One of the most important pillars of our justice system, enshrined in the Seventh Amendment, is the right to take a dispute to court. Crowded court dockets and the expense of litigation lead many litigants in civil cases appropriately to seek alternative ways to resolve their disputes. It may well be that arbitration is the best way of resolving many of these matters and that most investors, when given the choice, will select arbitration. It is vital, however, for the SEC to ensure that American investors are given a meaningful opportunity to make the choice between arbitration and traditional judicial process. There can be no doubt that investors would be better off with a choice between the court remedy provided by Congress and SRO arbitration than they are currently with no option but SRO arbitration.

Thank you for your attention to this important matter. We look forward to your response.

Sincerely,



RUSSELL D. FEINGOLD
United States Senator

PATRICK LEAHY
Chairman



42605.081

THE FINANCIAL SERVICES ROUNDTABLE
*Impacting Policy. Impacting People.*

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December 11, 2007

The Honorable Sam Brownback
Ranking Member,
Subcommittee on The Constitution
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Ranking Member Brownback:

On behalf of the Financial Services Roundtable, I am writing to express our opposition to S. 1782, *the Arbitration Fairness Act of 2007*. The Roundtable opposes this legislation because it would curtail the use of arbitration with no consideration of its fairness or efficiency, and negatively impact both companies and consumers creating additional costs by pushing thousands of cases being handled each year through arbitration into our overburdened court system.

S. 1782 would ban the inclusion of a provision in a consumer, employment or franchisee contract that would require the use of arbitration to settle a dispute should one arise between the parties to the contract. While purported to create "fairness" in the arbitration system, in reality it would effectively eliminate the use of arbitration for dispute settlement.

Claims made by some groups with respect to the unfairness of arbitration are not generally shared by individuals who have actually used arbitration to settle disputes. A 2004 Ernst & Young Study that looked at consumer lending cases found that 69 percent of individuals that used arbitration to settle a dispute were satisfied or very satisfied with the process.[1] A survey of participants in securities arbitration cases, found that individuals in 93 percent of the cases reviewed felt their arbitration was handled fairly and without bias.[2]

An analysis of data, including outcomes, also helps to demonstrate that arbitration is fair and unbiased. An article published in the Georgia State University Law Review indicates that 71 percent of individuals won claims against corporate entities before the National Arbitration Forum, compared to an individual winning less than 55 percent of claims brought against corporate entities in federal court.[3] While there has been attempts to

[1] Ernest & Young LLP, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* (2004)
[2] Gary Tidwell, Kevin Foster, and Michael Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations* (2002)
[3] Eric J. Mogilnicki, and Kirk D. Jensen, *Arbitration and Unconscionability*, 19 Ga. St. U. L. Rev. 764 (2003)



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paint arbitration as unfair or bias by looking at certain types of cases, such as debt collection cases, when compared to available data the outcome of court cases is similar. An examination of security cases shows a similar conclusion, finding that "available data on arbitration outcomes do not suggest that industry members fare better than investors."[4]

Arbitration is also considered to be more efficient in terms of both time and costs. A 2003 American Bar Association survey indicates that 78 percent of trial attorneys said arbitration is faster than lawsuits, and 56 percent said it was more cost effective.[5]

By essentially eliminating arbitration, S. 1782 would create additional costs for consumers and companies. The costs, along with potential obstacles of bringing a claim in court can deny a consumer the ability to have their individual dispute heard. In addition, requiring our courts to hear more cases will only increase the cost of the judicial system to all taxpayers.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $65.8 trillion in managed assets, $1 trillion in revenue, and 2.4 million jobs.

Roundtable member companies take their obligations to comply with consumer protection laws very seriously and always strive for full and complete compliance. However, errors sometimes occur. A dispute resolution process such as arbitration is better at protecting all stakeholders - companies, consumers and shareholders - than traditional, slow-paced litigation.

Thank you for considering the views of the Roundtable.

Best regards,

Steve Bartlett
President and CEO

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[4] Michael Perino, *Report To The Securities And Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements In NASD And NYSE Securities Arbitrations* (Nov. 4, 2002).
[5] ABA Section of Litigation Task Force on ADR Effectiveness, American Bar Assoc. , *Survey on Arbitration* (2003)



42605.083

INTERNATIONAL FRANCHISE ASSOCIATION

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Z Donut Co.

Matthew R. Shay
President

December 11, 2007

The Honorable Russ Feingold
Chairman
Subcommittee on Constitution, Civil Rights and Property Rights
U.S. Senate
Washington, DC 20510

The Honorable Sam Brownback
Ranking Member
Subcommittee on Constitution, Civil Rights and Property Rights
U.S. Senate
Washington, DC 20510

Dear Senators Feingold and Brownback:

I am writing on behalf of the International Franchise Association to express serious reservations regarding S. 1782, the Arbitration Fairness Act. This legislation is unwarranted and would harm franchisees and franchisors by making it significantly more costly and difficult to resolve franchise business disputes.

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, there are a wide range of choices available for potential franchise investors.

S. 1782 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. S. 1782 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." The purchase of a 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*

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Senators Feingold and Brownback
December 11, 2007
Page two

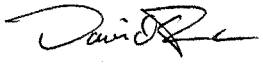
members qualify as small businesses under federal standards. There are also a number of franchisee associations that represent their members in dealings with franchisors, thus ensuring a more "level playing field." Finally, it is important to keep in mind that franchising involves sustaining a relationship between franchisor and franchisee. Both parties must cooperate in order to be successful, and both parties have a stake in swiftly and amicably resolving their disputes whenever possible. Enactment of S. 1782 will seriously impede the ability of both parties to address disputes by eliminating a low-cost alternative to litigation.

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 franchise investor 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 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 including franchisees and franchisors. 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.

S. 1782 is a flawed policy. By eliminating arbitration as a tool, it will force most disputes into litigation. This will delay resolution of disputes and significantly increase the costs for both parties. The IFA believes that a vigorous approach to pre-sale disclosure of contract terms protects franchise investors by giving them 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,



David French
Vice President, Government Relations

cc: Members of the Subcommittee



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Statement of
**The Honorable Patrick Leahy**
United States Senator
Vermont

December 12, 2007

Statement of Senator Patrick Leahy,
Chairman, Senate Judiciary Committee

Hearing Before the Subcommittee on the Constitution on
"S. 1782, The Arbitration Fairness Act of 2007"
December 12, 2007

Today's hearing addresses an issue that I have been concerned about for many years - Binding Mandatory Arbitration (BMA) provisions that require consumers to give up their right to have disputes resolved by a judge or jury. Companies are unilaterally inserting mandatory, binding arbitration clauses in their agreements that consumers and employees must sign as a condition of employment, or for receiving medical care, buying a car, opening a bank account or getting a credit card. Few people understand that the fine print of these clauses strips them of their constitutional right to have disputes resolved in court.

Arbitration is credible and effective only when consumers enter into it knowingly, intelligently and voluntarily. Unfortunately, many individuals are unaware that they are even entering into a mandatory binding arbitration agreement. That is why I have joined with Senator Feingold to cosponsor the Arbitration Fairness Act of 2007, S. 1782. This bill would protect consumers against BMA provisions by requiring that agreements to arbitrate employment, consumer, franchise, or civil rights disputes be made after the dispute has arisen. Such timing would ensure the voluntariness of the decision to waive the constitutional right to a jury trial and go to arbitration.

Every American should have meaningful legal recourse to resolve disputes, and I believe that this legislation is a step in the right direction. I thank the Chairman of the Subcommittee on the Constitution for calling this hearing and for introducing legislation to address this growing and pervasive problem.

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**Testimony of Mrs. Fonza Luke**
**of Birmingham, Alabama**

**On the Arbitration Fairness Act of 2007 (S. 1782)**
**Before the Subcommittee on the Constitution**
**Committee on the Judiciary**
**United States Senate**

**December 12, 2007**

Chairman Feingold and distinguished Members of the Subcommittee, thank you for the invitation to testify at this hearing about my experience with mandatory arbitration as an employee. I would also like to acknowledge my attorney, Mark Elovitz, without whom I would not have the opportunity to be here today.

I started working as a licensed nurse for Baptist Health Systems (BHS) Medical Center Princeton in 1971. For almost 30 years, I was a dedicated employee who received the highest performance ratings from the doctors I worked with every day. When the hospital needed me to work extra days and hours because of staffing shortages, I came in, including once when I worked almost every day of the year to give them the help they needed. Whenever the hospital offered new training or skills development, I took advantage of it so I could do my job better.

In November 1997, I was required to attend a meeting of hospital employees where I was given a copy of a new "Dispute Resolution Program." The other employees and I were told that BHS was starting this new program, that we would have to give up our right to go to court if we had legal claims, that all claims would be brought to binding arbitration, and that this program would take effect the following January. I refused to sign this agreement, because I did not want to give up my rights. I was told twice that if I didn't sign, I would be fired, but both times I refused. And I was not fired at that time.

About three years later, in early 2001, the hospital did fire me, after I returned from a continuing education class in Atlanta. The hospital's human resources director told me that I was being fired for "insubordination" after almost 30 years of working for BHS. I was devastated because I never thought that I would lose my job after all those years.

At that time, I went to see Mr. Elovitz. I believed that BHS fired me because of my race and age. I was 59 years old when I was terminated. The only things I did that were "insubordinate" were things that younger, white employees did all the time without getting fired. With the help of my lawyer, I filed race and age discrimination claims with the U.S. Equal Employment Opportunity Commission, and then in federal court.



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But BHS asked the federal court to dismiss my case because, they said, I had agreed to bring all such claims to arbitration. I told the federal court that I never did sign the arbitration agreement and never gave up my right to go to court. But the federal court said that BHS could force me to arbitrate, just because I had kept working in my job after simply BHS *showed* me the arbitration agreement. When I appealed the federal court's decision, the appeals court ordered me into arbitration.

The arbitrator was chosen by process of elimination from a list that was composed heavily of defense lawyers. According to my lawyer, with that list of arbitrators, it was impossible for me to get someone who was even in the middle of the road, much less someone who might be sympathetic to employees. As a result, my claims of discrimination and retaliation were denied, and I got no relief whatsoever. I don't think the arbitrator even looked at my side of the story.

The result? I have received no relief or settlement from BHS for having discriminated against me. Today, I have to work two jobs to make as much as I did at BHS.

I wasn't even allowed to bring the evidence of discrimination before a fair and impartial judge or a jury of my peers. I did everything I could to keep my right to go to federal court, but the courthouse doors were closed when I got there.

Thank you again for listening to my story.



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## VIII. MINORITY VIEWS OF SENATORS KYL, SPECTER, AND BROWNBACK

With this Act, the Senate Judiciary Committee starts the process of repealing the Federal Arbitration Act of 1925. Without holding a single hearing on the subject, the committee begins to turn back the clock on over 80 years of alternative dispute resolution in this country.

It is bad enough that American families will be forced by this legislation to pay more for poultry and other produce so that the trial lawyers can get their cut. Unfortunately, however, the new Congress's assault on the arbitration system is not limited to contracts involving poultry and livestock. Already, two majority members of this committee have introduced the so-called "Arbitration Fairness Act of 2007," S. 1782, which would gut arbitration agreements that cover "employment, consumer, or franchise disputes" or that involve parties with "unequal bargaining power." That's pretty much everything, folks. No longer would American businesses be able to avoid going to court over garden-variety disputes whose amount in controversy is overwhelmed by the costs of paying for a lawyer and going to trial—the types of disputes whose only reasonable method of resolution is arbitration. Instead, every dispute would have to go to court—or, more realistically, would be settled for a nuisance payment, regardless of the merits of the complaint. And to top it all off, the bill's "unequal bargaining power" exception should ensure enough litigation over its meaning to put many a lawyer's children through college.

Allow us to explain why arbitration is necessary—why Congress endorsed its use over 80 years ago, and why all of the intervening Congresses, mostly under the control of Democratic majorities, have been content to preserve this system. The best reason for arbitration is that for many disputes, the cost of litigating the matter in court grossly exceeds the amount at issue. For example, in an employment dispute, if the plaintiff raises *McDonnell-Douglass* "inference of discrimination" claims, the defendant will be required to produce papers and defend depositions regarding not only the work history of the plaintiff employee, but also of all similarly situated employees. Even if the plaintiff's claims are utterly devoid of merit, simply hiring the lawyers and going through discovery, depositions, and summary judgment motions can easily cost the defendant over $250,000. And of course, most jobs in this country pay only a fraction of that amount.

Think about the position in which Congress would be placing a small employer—one whose resources do not permit retention of in-house counsel and who lacks a bottomless litigation budget. Imagine that this employer has an employee whose performance and work habits are substandard, and so he fires that employee. The employee then turns around and sues the employer, alleging var-



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ious forms of unlawful discrimination. The annual pay for the job in question is only $40,000. But the employer must now retain an attorney, and that attorney explains to the employer that litigating the case through its conclusion will cost over $250,000.

What do the proponents of this legislation expect such an employer to do? Do they think that every employer—regardless of its size—should be forced to pay a quarter of a million dollars for the privilege of firing a nonperforming employee? Surely even U.S. Senators cannot be so unfamiliar with the reality of the private economy that they believe that every fired employee's legal complaint is meritorious. Do they think that fired employees, and especially their lawyers—who will need no time at all to appreciate the economic dynamics of this new system—will not take advantage of their leverage in such a situation?

What *will* happen if Congress guts arbitration is this: every employer, regardless of its size, will begin to settle employment discrimination suits for their nuisance value. Private employers are not in business to win employment lawsuits. They are in business to make money. And if confronted with the alternatives of "winning" a lawsuit for $250,000, or paying $15,000 and attorney's fees to a nonperforming employee in order to make him go away, employers will simply pay the ransom. It is the only economically reasonable thing to do. And Congress will have been a party to this extortion.

Allow us to also dispel the notion that this Act is intended to "fix" arbitration. This Act is not designed to fix the system, but to gut it. One of the majority report's complaints about poultry-contract arbitration—one of the supposed causes for this legislation—is that "under the current system, there is no right to receive a written explanation of the arbitrator's decision." Yet during the mark up of this bill, an amendment was offered on behalf of Sen. Kyl that would have done just that—that would have preserved arbitration while creating a right to demand that an arbitrator explain his decision in writing. The Kyl amendment also would have empowered the arbitrator to order the discovery of documents. Yet that amendment was defeated on a party-line vote. For all of the alleged problems with arbitration that are described in the majority report—problems, by the way, that were never identified in any hearing before the committee with jurisdiction over this bill—the purpose of this bill is not to address those problems. The purpose of this bill is to gut arbitration.

Two other aspects of this legislation highlight just how extreme the bill is. First, the Act applies retroactively—it not only prevents parties from entering into enforceable arbitration agreements in the future, it also guts arbitration agreements that were made years before this legislation was even proposed. It simply takes pre-existing contracts and tears them up.

Second, this bill's violence against private contracts is not limited to agreements enforceable under federal law. The Act also reaches into state jurisdiction, gutting contracts voluntarily entered into between parties who are operating in the same state and whose agreements would be enforceable in state courts as a matter of state law. This Act preempts the laws of all 50 states, preventing any state from preserving enforceable arbitration as an alternative

to courtroom litigation. Again, an amendment was offered in the committee that would have limited the damage done by this Act to agreements sought to be enforced under federal law, and that would have preserved agreements that are enforceable in state court pursuant to state law. Again, the amendment was defeated on a party-line vote.

The majority report also cites the high up-front fees sometimes charged for poultry arbitrations as a justifying cause for this legislation. Again, had this problem even been identified in a hearing before this committee prior to the mark up of the legislation, surely some agreement could have been reached on a standard for limiting such fees. Obviously, it is not necessary to retroactively gut both federal and state arbitration in order to regulate such fees. Moreover, we find it somewhat ironic that the majority expresses such concern over a $20,000 fee for conducting an arbitration. If arbitration is no longer an enforceable option, the costs imposed on defendants both large and small by courtroom litigation can be expected to exceed arbitration fees by an order of magnitude.

The majority report and proponents of the bill complain of "mandatory" arbitration. What they really object to is enforceable arbitration. The Act prevents private parties from entering into *any* enforceable agreement to arbitrate these disputes—even if such an agreement is entirely voluntary. It is the bill's ban on arbitration agreements that is properly characterized as mandatory. And once arbitration agreements are rendered null and void by this Act, there will be nothing "voluntary" about the litigation that parties will be forced to endure. The bill's assault on "mandatory" arbitration is more clearly and accurately described as the creation of mandatory and unavoidable litigation.

Harnessing the ancient political power of farmers to the legislative agenda of the Association of Trial Lawyers of America, this committee turns back the clock on over 80 years of the development of the arbitration system in this country; it drives up the costs that Americans will be forced to pay to feed their families; and it ensures that the legal system will be used to extract nuisance settlements from small businesses that will now have no enforceable alternative to the expense of courtroom litigation. With regard to this last effect, it is a shame that this committee, in particular, would be a party to facilitating such abuses. We should never knowingly permit the legal system to be used as a vehicle for litigation extortion.

This is a terrible bill. And it is a bad omen of things to come.

JON KYL.
ARLEN SPECTER.
SAM BROWNBACK.

**Statement of the American Arbitration Association**
**Submitted to the**

**Subcommittee on the Constitution**
**Committee on the Judiciary**
**United States Senate**
**Wednesday, December 12, 2007**

Good morning, Chairman Feingold, Senator Brownback, and members of the Subcommittee. I am Richard Naimark, Senior Vice President of The American Arbitration Association (AAA). 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.

The 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 longstanding work in the field of alternative dispute resolution, we believe we have an important contribution to make to the subject matter of the hearing taking place today.

We must make no mistake in our focus on this subject, the primary issue at hand is access to justice. The reality in this country is that our legal system is difficult to navigate for most Americans. Claims with a dollar value below $50,000 - $65,000 have a difficult time obtaining legal representation, regardless of the validity of the claim. The litigation process is exceedingly difficult for pro se individuals to pursue. Arbitration can, and does, provide ready access to justice **IF** due process protections are built in.

Arbitration provides a fair, efficient, and cost-effective mechanism for the resolution of disputes when implemented fairly and impartially, in accordance with due process protocols:

- **A recent analysis of 2006 AAA consumer cases, in which the consumer is the claimant, yielded an 81% favorable outcome for the consumer (58% voluntary settlement; 48% outright win, per award of arbitrator of the remaining cases going to an award).**
- **A similar analysis of 2006 employment cases administered by the AAA found that the employee had a favorable outcome 77% of the time.**

These figures may seem astonishing to you (additional information and methodology described in Annex D). How can this data be reconciled with other data and anecdotal information being offered? One key factor, the most important one for you as lawmakers, is that these statistics are based on cases that went through arbitration that conforms to the *Due Process Protocol for Mediation and Arbitration of Consumer Disputes* and the *Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship.*

The AAA, recognizing that the use of arbitration in consumer agreements presented some unique issues, a decade ago convened a group of representatives of consumer, academic, government, and industry



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groups to examine these issues. This National Consumer Disputes Advisory Committee (Annex A) ultimately issued the Consumer Due Process Protocol (the full Protocol is attached as 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 Employment Due Process Protocol (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 nearly a decade and have proven effective and reliable. Courts have repeatedly referred to the Protocols as a standard of fair play in this context.

Key Provisions of the 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.
- 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 over 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.



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**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
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David B. Adcock
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Michael F. Hoellering
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Michelle Meier
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Consumers Union

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Daniel C. Smith
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Fannie Mae

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



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**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

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

2. *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.*

3. *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.*



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

5. *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

1. *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 mey require the Provider to subsidize the process.*

2. *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 end 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:*

a. *clear and adequate notice of the arbitration provision and its consequences, including a statement of its mandatory or optional character;*
b. *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;*
c. *notice of the option to make use of applicable small claims court procedures as an alternative to binding arbitration in appropriate cases; and,*
d. *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

1. *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 heve discretionary authority to require a face-to-face hearing upon the request of a party.*

2. *Confidentiality in Arbitration. Consistent with general expectations of privacy in arbitration hearings, the arbitrator should maka 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 evidentiery 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 exchenge 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

1. *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.*

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

3. *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.*

For further detail and commentary please see WWW.ADR.ORG , Consumer Arbitration Rules

## Annex C

***Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship***

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.



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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.



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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.



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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.

Dated: May 9, 1995

Signatories

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**Annex D**

**ADDITIONAL INFORMATION AND COMMENTS ON STATISTICS AND DATA**

EMPLOYMENT

In 2006 there were 1,235 AAA employment arbitrations resolved. Employees received a favorable outcome in 77% of these cases. Seventy-one percent (71%) of these cases were resolved by settlement or withdrawl prior to an award. The remaining 29% or 354 cases proceeded to an award. Employees received a monetary award in 22% of the cases that proceeded to an award. The employee was self-represented in 100 of the cases that proceeded to an award (28% of the 354 awarded cases). On average, employment cases that were awarded in 2006 were resolved in less than one year (11.7 months). Pursuant to AAA rules, AAA fees are paid by the employer, and arbitrator compensation paid by the employee is capped at $125.

Notes:

1. AAA employment statistics and information presented in this testimony are based on employment cases determined by the AAA to arise out of employer-promulgated plans and do not include case statistics that involve individually-negotiated employment agreements.

2. When an employment arbitration is filed, the AAA makes an initial administrative determination as to whether the dispute arises from an employer-promulgated plan or an individually-negotiated employment agreement or contract. This determination is made by reviewing the documentation provided to the AAA by the parties, including, but not limited to, the demand for arbitration, the parties' arbitration program or agreement, and any employment agreements or contracts between the parties. The AAA's review is focused on two primary issues. The first component of the review focuses on whether the arbitration program and/or agreement between the individual employee and the employer is one in which it appears that the employer has drafted a standardized arbitration clause with its employees. The second aspect of the review focuses on the ability of the parties to negotiate the terms and conditions of the parties' agreement. If a party disagrees with the AAA's initial determination, the parties may bring the issue to the attention of the arbitrator for a final determination.

CONSUMER

In 2006 there were 987 AAA consumer arbitrations resolved in which the consumer initiated the case. Fifty-eight percent were resolved prior to an award. The remaining 42% (414 cases) proceeded to an award. Consumers received a monetary award in 48% of the cases that proceeded to an award. On average, consumer cases are resolved in 3.8 months for cases proceeding on documents alone (34% of awarded cases) and in 7.4 months for cases with an in-person hearing (66% of awarded cases). Pursuant to AAA rules, AAA fees are to be paid by the business and arbitrator compensation is capped for consumers at $125 for claims up to $10K and $375 for claims up to $75K.

Notes:

1. AAA consumer statistics presented in this testimony are based on cases that were administered under the AAA's Supplementary Procedures for Consumer-Related Disputes and initiated by the consumer.
2. In 2006, 1,294 consumer arbitration cases were filed with the AAA and 77% of these cases were filed by consumers.
3. AAA applies Supplementary Procedures for Consumer-Related Disputes when an arbitration clauses exist in an agreement between an individual consumer and a business where the business has a standardized, systematic application of arbitration clauses with customers and where the terms and conditions of the purchase of standardized, consumable goods or services are non-negotiable or primarily non-negotiable in most or all of its terms, conditions, features or choices. The product or service must be for personal or household use. Consumers are not prohibited from seeking relief in a small claims court for disputes or claims within the scope of its jurisdiction.



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**An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?**

Delikat, Michael

The authors compared the results of jury trials in federal court in the Southern District of New York with the results in NASD securities arbitrations. Their findings contradict charges that private arbitration programs are "structurally biased" against employees who have civil rights claims. The authors found that in arbitrated and litigated employment cases completed during the same period, claimants had a higher success rate in the arbitrations than they did in litigated cases in federal court.

In an effort to provide some modest additional empirical research to assist the policy debate over mandatory employment arbitration1 and give parties an additional basis for evaluating the selection of a dispute resolution forum, our firm, Orrick, Herrington & Sutcliffe LLP, studied the outcomes of employment cases in three different fora. For each group studied, we determined the average jury award for all verdicts, the percentage of verdicts in which the employee-plaintiffs prevailed, the average verdict size in favor of employees, and the median verdict (i.e., the number above and below which there is an equal number) for the plaintiff.2 Because the cases did not all fall within the same time period, we were unable to compare the results in all three groups. Thus, for purposes of this article, we are presenting the results for two groups of cases for which we have comparable information. The first group is made up of employment discrimination disputes resolved in the U. S. District Court for the Southern District of New York (S.D.N.Y.) between April 1, 1997 to July 31, 2001 (the N.Y. Federal Court Trials). The second group includes securities arbitrations between January 1989 through February 2002 in proceedings administered by the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE) (collectively, the Securities Arbitrations).

The N.Y. Federal Court Trials

Number of Cases. To identify the N.Y. Federal Court Trials, we reviewed the docket sheets of 3,000 employment discrimination cases filed in the S.D.N.Y. from April 1, 1997, to July 31, 2001. As the focus was only on trial outcomes and not pretrial or post-trial settlements, modifications of verdicts or appeals, our statistics reflect trial results, but not necessarily the actual final case result.

We found that of the 3,000 discrimination cases filed during a four-and-one-quarter-year period, only 125 cases (3.8% of the total) were tried to conclusion, 115 by juries, 10 by judges. This finding is extremely important and provides a highly significant counter-point to arguments by those who say that mandatory predispute arbitration agreements deprive potential discrimination claimants of a jury trial. The reality is that only a tiny percentage of employment discrimination claimants who file their cases in court ever have their claims resolved by a jury or even by a judge.

Win Rates. Award Data and Timing. After determining how many trials actually took place, we gathered information about the win rate of the employment discrimination plaintiffs, the median and average damages awarded, and the time it took to conclude the trial.

We found that employment discrimination plaintiffs prevailed in about one-third of the trials (33.6%) while the employers prevailed in the rest. When the employee prevailed, the median amount of damages award was $95,554 while the average award was much higher-$377,030. The large disparity between the median and average awards is due to the fact that there were several relatively high verdicts that skewed the average upward. Because the average verdict is very sensitive to extremely high or low jury awards in the sample as a whole, it is possible to end up with averages that are not terribly meaningful.



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In the cases where employment discrimination plaintiffs prevailed at trial, the median award of attorney's fee was $69,388 and the average attorney fee award was $149,756.

The median time from filing to verdict or judgment was 25 months. Additional data from this study is in table 1.

The Securities Arbitrations

Number of Cases. Based on available data from the NASD and the NYSE, we identified 572 securities arbitrations during the period January 1989 through February 2002. In order to be able to draw a more relevant comparison with the outcomes in the N.Y. Federal Court Trials, we isolated the securities arbitration awards that were issued between April 1, 1997 through July 31, 2001. In this time frame, there were 186 awards.

Win Rates, Award Data and Timing. In the relevant subset of our sample we found that the claimants received an award of monetary relief approximately 46% of the time. This was significantly higher than the success rate for the N.Y. Federal Court Trials.

The median award for prevailing claimants in the subset of arbitrations was $100,000, nearly $5,000 more than the median award in the N.Y. Federal Court Trials. However, this difference in the size of the median awards was not statistically significant.

The average award for the subset of awards was $236,292. The average award in the N.Y. Federal Court Trials was much higher but due to skewing as a result of exceptionally large awards, this comparison is not terribly helpful. Average awards are very sensitive to extremely high and low awards.

The median time from filing to decision in the subset of comparable cases was 16 months, significantly less than the 25 months it took to complete the N.Y. Federal Court Trials.

Conclusions

In light of the small number of cases that went to trial in the Southern District of New York, our findings show that there is a statistically greater probability of a plaintiff winning a discrimination case before an arbitrator than in federal court. These results are sufficiently robust that adding statistical covariates are not likely to turn the estimates around in the other direction for this sample of cases.

In order to further show the impact of these estimates, we simulated the expected dollar outcome of going to arbitration versus the federal courts. We found that the expected dollar outcome measured by the likelihood of winningtimes the expected payoff, was $127,704 for the federal courts, versus $110,500 for arbitration. After taking into account legal fees, the plaintiffs receive more on average with arbitration. Clearly, these estimates show that plaintiffs with employment claims are well served by arbitration relative to the federal courts, both in terms of speedy justice and the likelihood of a positive outcome.

Our findings provide data that contradicts charges that that private arbitration systems are "structurally biased" against employees seeking to vindicate civil rights. We found that in cases completed during the same time period, employment claimants had a higher success rate in the securities arbitrations (46%) than they did in the cases tried to conclusion in N.Y. federal court (34%).

When a claimant does get to have a trial, we found that the median monetary recovery is fairly comparable to the amount received in arbitration. While the average attorneys' fees awarded to prevailing claimants was higher in litigations compared to



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arbitrations, the median fee awards were approximately the same.

The data comparison also showed that judicial resolutions of employment cases in federal court, on average, consume more time than arbitral resolutions-25-month median time in the N.Y. Federal Court Trials, versus 16 months in the arbitrations. This was the case whether there was an award to the plaintiffs or not. This difference in time to resolution is statistically significant. This seems to support out the often-stated claim that arbitration is a faster way of resolving workplace disputes.

It is worth reiterating what is perhaps our most significant finding-that based on the data only a very small percentage of filed employment discrimination cases ever progress to a jury trial. This finding suggests that it is not mandatory arbitration systems that keep employees from having their discrimination claims heard by a jury, as many argue. Since civil right litigants rarely have their cases decided by a jury, the importance of the court as a dispute resolution forum for discrimination claims appears to be vastly overstated.

The statistical information presented here is not intended to finally resolve the broader policy debate on the advantages or disadvantages of mandatory predispute arbitration programs, However, it does provide empirical evidence that helps illuminate the arguments that have been made.

The Equal Employment Opportunity Commission (EEOC), in a 1997 Policy Statement on Mandatory Binding Arbitration of Employment Discrimination Disputes as a Condition of Employment," took the position that private arbitral systems are "structurally biased" against employees. Since that time, the agency has signaled that it is considering a change in position on the matter of mandatory pre-dispute employment arbitration.

2 The third group of cases we studied were jury verdicts in wrongful termination cases tried in state and federal courts in California between 1981 through April 30, 2001, as reported in three publications-Jury Verdicts Weekly, the San Francisco Daily Journal and the California Law Reporter (the California Court Trials). We found 930 such cases. Slightly more than half of these wrongful termination cases (450) also involved claims of discrimination while the balance asserted other types of claims, such as breach of contract, violation of public policy, fraud or misrepresentation, defamation or slander, and retaliatory termination.

We found that over the course of the period covered by this study, the plaintiffs prevailed in 45% of the wrongful termination/discrimination cases, and that plaintiffs won 62% of the cases that did not allege discrimination cases.

We determined the mean and average verdicts for each type of claim. Significantly, in the wrongful termination cases that also alleged discrimination, the highest median verdict ($495,351) was in the race discrimination cases, and the lowest ($227,479) was in the sexual harassment cases, while the lowest average verdict ($385,354) was cases alleging sex discrimination. As in the N.Y. Federal Court Trials, the average verdicts in the discrimination cases were skewed by the presence of several verdicts in the sample that exceeded $10 million.

In the nondiscrimination cases, the highest median award ($451,876) was in the cases alleging fraud and misrepresentation, while the lowest ($123,000) was in cases alleging defamation and slander.

Endnotes

1 Lisa Bingham, "On Repeat Players, Adhesive Contracts and the Use of Statistics in Judicial Review of Employment Arbitration Awards," 29 McGeorge L.Rev. 223 (Winter, 1998) (stating that "empirical research has a role to play" in the policy debate over whether arbitration is an appropriate process to resolve statutory employment discrimination claims). Bingham cited a 1998 study by William Howard comparing settled, litigated, and arbitrated outcomes in employment discrimination



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cases. See William M. Howard, "Arbitrating Claims of Employment Discrimination: What Really Does Happen? What Really Should Happen?," 50 J. of Disp. Resol. 40 (1995). Howard's study concluded that the mean and median trial outcomes were at least three times higher than comparable mean and median arbitration awards.

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# STATEMENT OF THE NATIONAL ASSOCIATON OF HOME BUILDERS

Introduction

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement on S. 1782, the *Arbitration Fairness Act of 2007*. Founded in 1942, NAHB is a federation of more than 800 affiliated state and local building industry associations. It is the voice of the housing industry in the United States. NAHB represents over 235,000 builder and associate members throughout the country, including individuals and firms that construct and supply single-family homes, as well as apartment, condominium, multi-family, commercial and industrial builders, land developers and remodelers. NAHB's builder members will construct 80 percent of the more than 1.36 million new housing units projected for 2007.

The Importance of Alternative Dispute Resolution

NAHB strongly supports the use of alternative dispute resolution (ADR), including binding arbitration, in consumer contracts. NAHB has found that ADR is often the most rapid, fair and cost effective means to resolving disputes—for both the builder and the buyer—arising out of the construction and/or sale of the home. In contrast, litigation is expensive, time-consuming and unlikely to produce the desired result—getting the problem repaired.

The *Arbitration Fairness Act of 2007* (S. 1782), introduced by Senator Feingold, would prohibit two parties from including in a contract a pre-dispute arbitration agreement. S. 1782 would also invalidate pre-dispute arbitration agreements in existing contracts. NAHB opposes S. 1782.

Invalidating binding arbitration provisions in residential construction contracts would undermine decades of jurisprudence strongly favoring arbitration of disputes where the parties have agreed to use the arbitration process. In enacting the Federal Arbitration Act, "Congress declared a national policy favoring arbitration and withdrew the power of states to require a judicial forum for the resolution of claims that the contracting parties agreed to resolve by arbitration"[1]. NAHB members rely on this long standing public policy every day when they negotiate and enter into residential real estate contracts containing arbitration provisions.

Furthermore, NAHB members have priced their products based upon an agreed upon contract. Because arbitration allows businesses to contain their legal costs, those savings are often included in the price of the product. For existing contracts that include arbitration provisions, S. 1782 would invalidate pre-dispute arbitration clauses. This will introduce, retroactively, significant risk to many businesses, as they would now face the potential for higher legal costs associated with litigation but would be unable to adjust existing contract prices to reflect this new risk. As many home builders are already struggling financially in the current housing market, this unfair retroactive change has the very real potential to put builders—and their thousands of workers—out of business.

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1 Southland Corp. v. Keating 465 U.S. 1, 10 (1984).



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Arbitration Benefits Home Buyers

Research by the U.S. Chamber of Commerce shows that arbitration is simpler, cheaper, and faster than litigation and is viewed as fair by winners and losers alike[2]. For the home buyer, use of arbitration also provides them with certainty that any dispute will be resolved in a quick, fair and less costly manner than litigation. Due to the higher costs of litigation, homeowners are frequently left with insufficient funds to perform repairs once legal fees and costs are deducted from their recoveries. Ultimately, arbitration offers the home buyer a cost effective means of dispute resolution.

Arbitration also can provide cost savings that are passed along to the home buyer. The ability to operate effectively in the home building industry and to price a home competitively depends on the degree to which the builder's overall costs are certain and predictable. The more confidence the builder has in pre- and post-construction costs directly corresponds with the builder's ability to pass those savings through to homebuyers. Use of mandatory arbitration agreements provides the builder with a degree of certainty that if a dispute arises, litigation costs will be contained.

Precluding the use of mandatory arbitration will expose home builders to increased risk of uncertainty. That risk is often factored into the cost of housing and, unfortunately, increases costs for all home buyers. As a result, passing this legislation may have a negative impact on housing affordability. According to a recent study completed by NAHB, even a modest $1,000 increase in the cost of a new, median-priced home forces 217,000 prospective buyers out of the marketplace.

Can Buyers Purchase New Construction without Agreeing to Arbitration?

While critics of arbitration often argue that these are clauses of adhesion, a person seeking a home has numerous options from which to choose, including choosing a builder who does not use arbitration. Although there have been few empirical studies on the use of arbitration in residential construction, one state, Texas, has conducted a survey on the use arbitration by home builders. According to this study, only about 52 percent of builders required arbitration[3]. Texas is not an aberration, and NAHB believes that similar results would be found in every other state. Consequently, home buyers nationwide should have no difficulty locating a builder who does not require arbitration.

The purchase of a home also differs significantly from other typical consumer contracts. Ultimately, as noted in the concurring opinion in Buecher v. Centex Homes, nearly every aspect of a home purchase contract can be negotiated:

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2 *Arbitration: Simpler, Cheaper and Faster than Litigation, U.S. Chamber Institute for Legal Reform, April, 2005*

3 "A Study of Residential Construction Arbitration: Final Report of the Arbitration Task Force." Texas Legislative Council, December 2006.



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> Every day throughout the state, homebuyers negotiate with home sellers over the terms of the transaction. As it happens, some consumers are better negotiators than others. But they all share the position of greatest strength in the transaction – the ability to walk away from a deal they do not like.[4]

While critics of arbitration often argue that these are clauses of adhesion, this is not the case with the purchase of a new home.

Parties will not Agree to Post-Dispute Arbitration

Critics have also argued that both parties can agree to arbitration after the dispute arises; however, the evidence suggests that when given the option to select arbitration as a means to resolve disputes after a claim has arisen the parties will not do so. It is doubtful that the parties will be able to achieve the benefits of arbitration by subsequent agreement because it is likely that strategic factors will cause one of the parties to refuse to arbitrate, even if the other makes a request.[5]

Economic, political, and legal incentives of the parties and their lawyers make it extremely rare for both the plaintiff's and defense's attorneys in a case to select arbitration after the dispute has arisen. Moreover, the hostility and suspicion regarding the opposing party's motives once a dispute occurs will also work to prevent the parties from agreeing to post-dispute arbitration.

Conclusion

NAHB believes that fairness of arbitration clauses is essential to their viability. Indeed, consumers are already protected in this regard. The courts offer substantial protections to consumers from improper and unfair binding arbitration clauses. According to a recent study, the courts are closely scrutinizing arbitration agreements and will strike down those arbitration clauses that are deemed to be overreaching.[6]

Moreover, private national ADR providers are also working to ensure that the arbitration provisions are fair to all parties. The American Arbitration Association (AAA) issued the Consumer Due Process Protocol in 1998, which identifies the type of provisions that encourage a fundamentally fair process when consumers sign arbitration agreements. Recommendations include: (1) access to information about the process; (2) independent and impartial neutrals including independent administration of the ADR process and consumer participation in neutral selection; (3) reasonable costs, location

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4 18 S.W.2d 807 (Tex. App. – San Antonio March 31, 2000) Id. at 812 (Green, J. concurring).

5 *See* Theodore Eisenberg and Geoffrey 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 (Winter 2007).

6 See John Townsend, *State Court Enforcement of Arbitration Agreements*, October 2006.



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and time frames; (4) clear notice of all arbitration provisions; (5) confidentiality and unfettered access to small claims court in lieu of arbitration if the small claims court has jurisdiction; and, lastly, (6) the arbitration must afford the same remedies available in court.

NAHB recognizes that binding arbitration remains a viable ADR tool only if the process is fair to all parties, and to the extent that there are legitimate problems with the use of arbitration in residential construction contracts, we would welcome the opportunity to work with the Subcommittee on those. However, S. 1782's complete prohibition on pre-dispute arbitration clauses is unwarranted.

# STATEMENT OF THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION (NELA)

## SUBMITTED TO THE SUBCOMMITTEE ON THE CONSTITUTION JUDICIARY COMMITTEE UNITED STATES SENATE 110th CONGRESS, 1ST SESSION

## FOR THE RECORD OF ITS HEARING ON DECEMBER 12, 2007,

## ON THE ARBITRATION FAIRNESS ACT, S. 1782

**STATEMENT OF**
**THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION (NELA)**

**SUBMITTED TO THE**
**SUBCOMMITTEE ON THE CONSTITUTION**
**JUDICIARY COMMITTEE**
**UNITED STATES SENATE**
**110th CONGRESS, 1ST SESSION**

**FOR THE RECORD OF ITS HEARING ON DECEMBER 12, 2007,**
**ON THE ARBITRATION FAIRNESS ACT, S. 1782**

The National Employment Lawyers Association (NELA) strongly supports S. 1782, the Arbitration Fairness Act of 2007 (AFA), and applauds Senator Feingold for introducing the bill and for holding a hearing on it. In this Statement, we set forth our reasons for this position and respond to some of the claims made by witnesses at the Subcommittee's December 12, 2007, hearing ("the hearing").

## I. Arbitrations That Are Not Covered By the Arbitration Fairness Act

As a preliminary matter, it is important to distinguish between, on the one hand, post-dispute voluntary arbitration and arbitration provided for by a collective bargaining agreement – neither of which is prohibited by the AFA – and, on the other hand, pre-dispute mandatory arbitration, which *is* prohibited by the AFA. NELA strongly supports arbitration when it is voluntarily agreed to by the employee post-dispute or when it is mandated by a collective bargaining agreement. We also support other forms of alternative dispute resolution that are non-binding, such as mediation.

A. *Post-Dispute Arbitration.* For consent to arbitration, or to any waiver of rights, to be voluntary, it must be *informed.* Before a dispute arises, an employee has no real understanding of the kind of dispute that she or he may have with her or his employer. Only *after* a dispute arises does an employee have sufficient information to be able to make an informed choice. At that point, binding arbitration may well be a useful tool for the employee to resolve the dispute. That is why we support arbitration clauses contained in contracts that are individually negotiated between employer and employee post-dispute.

B. *Arbitration Pursuant To A Collective Bargaining Agreement.* When binding arbitration of workplace disputes is required in a collective bargaining agreement, there are three safeguards to employees' rights not present when employers impose mandatory arbitration pre-dispute. First and most important, under current law, employees' statutory rights – *e.g.,* to be free of invidious discrimination, to be paid the minimum wage and overtime, to blow the whistle on employer wrong-doing without retaliation – are not waived by a collective bargaining agreement. An employee dissatisfied with the results of an arbitration of such a statutory claim is free to bring that claim before a judge and jury.[1] Second, when there is a collective bargaining agreement in place, the

[1] *See, e.g., Pryner v. Tractor Supply Co.*, 109 F.3d 354, 363 (7th Cir. 1997); *Pyett v. Pennsylvania Building Co.*, 498 F.3d 88, 92-93 (2d Cir. 2007), certiorari granted under the name of *Penn Plaza LLC v. Pyett*, No. 07-581 (U.S. Feb. 19, 2008); *Rogers v. New York University*, 220 F.3d 73, 75-76 (2d Cir. 2000) (per



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employee has a union to represent him or her, and is not facing an employer in arbitration alone. Third, in arbitration under a collective bargaining agreement, the arbitrators do not have the same structural incentives to reward the employer side that they do in private, mandatory arbitration. This is because the union, like the employer, is a "repeat player," and can, like the employer, direct future business to arbitrators.

C. *Other Alternative Dispute Resolution.* Non-binding forms of alternative dispute resolution, such as mediation, can be very useful to avoid unnecessary litigation and keep costs low for employers and employees alike. In fact, NELA lawyers frequently participate in mediation to resolve their clients' claims, with good results. If an employer's dispute resolution program involves progressive, and increasingly formal, steps culminating in binding arbitration, it is only that last step that is governed by the AFA. Thus, the testimony of two witnesses at the December 12, 2007, hearing – Mark De Bernardo, a Washington, D.C., lawyer who regularly represents companies, and Peter Rutledge, a professor at Catholic University Law School who formerly represented companies – that the AFA would destroy "alternative dispute resolution" is disingenuous at best.

## II. Why The Arbitration Fairness Act Is Necessary

Pre-dispute, binding, mandatory arbitration programs ("MA programs") to resolve employment disputes severely limit employees' ability to enforce their employment and civil rights and greatly reduce employers' accountability for discrimination and other unfair employment practices. Such programs set up a modern-day version of SEPARATE AND UNEQUAL JUSTICE for employees.

A. *Arbitration Strips Employees of Their Rights.*

1. Under arbitration, employees lose their rights to their day in a free, public court. Filing fees for state and federal courts are modest. But for arbitration, employees often have to pay exorbitant fees just to schedule a hearing. Arbitrators typically charge $250 to $450 an hour – and an arbitration can drag on for 100 hours or more.

2. Employees lose their Seventh Amendment right to a trial by jury as well as the right to appeal judgments against them. By definition, mandatory arbitration is conducted by arbitrators, not juries, and is binding, and thus unappealable.

3. Employees lose the substantive protections of our civil rights and employment laws. Arbitrators do not need to follow or even know the law.

4. Employees lose important remedies. Mandatory arbitration programs and arbitrators can limit the damages an employee could otherwise get in court.

5. Employees may lose their ability to challenge unlawful practices altogether because MA programs can shorten the time for filing a claim and eliminate disclosure of documents by the employer – or because they can't afford to pay the up-front fees required for arbitration (see point 1 above).

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curiam); *Plumley v. Southern Container, Inc.*, 303 F.3d 364, No. 07-3053 9373-74 (1st Cir. 2002); *Air Line Pilots Association, Int'l v. Northwest Airlines, Inc.*, 199 F.3d 477, 481-85 (D.C. Cir. 1999); contra, *Eastern Associated Coal Corp. v. Massey*, 373 F.3d 530, 533-34 (4th Cir. 2004).



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6. Employees lose the right to an impartial judge. By definition, an arbitrator is paid not by the public, but by the parties to the arbitration. In employment cases, the employer frequently pays most of if not the entire cost. As arbitrator and retired Alameda County, CA, trial judge Richard Hodge concedes, arbitrators "would have to be unconscious not to be aware that if [they] rule a certain way, [they] can compromise [their] future business."[2] Thus, companies can, and do, pick their 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 its employees.

*B. Arbitration Insulates Companies From Accountability For Employment Discrimination Or Other Unfair Employment Practices.*

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 while on family or medical leave; military and reserve personnel returning from Iraq or Afghanistan not getting their jobs back; blue- and white-collar employees who are required to work "off the clock" so their employers don't have to pay them overtime; and whistleblowers risking their careers to report dishonest or risky corporate or government behavior who are being retaliated against. It does not matter which laws are involved, and whether they are federal or state laws – the courts have held that *all* of them are subject to mandatory arbitration.

By instituting MA programs, companies effectively opt out of all the laws that require fair treatment on the job. As California Western Law School Professor Ellen Dannin has written, "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."[3]

*C. The Deck Is Stacked Against Employees in Most Employment Arbitrations: The Repeat Player Effect and Arbitration Outcomes.*

Hearing witnesses Rutledge and Richard Naimark of the American Arbitration Association (AAA)[4] testified that the repeat player phenomenon does not affect the outcome of arbitrations, basing their assertions on studies that purportedly show that employees win more arbitrations than employers do or that employees win more cases in arbitration than they do in court. Mr. Rutledge testified that "by most measures, the party with the inferior bargaining position achieves better, or at least comparable, outcomes in arbitration compared to litigation."[5] In so concluding, however, he

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[2] E. Berkowitz, "*Is Justice Served?*" *West* (the Los Angeles Times' Sunday Magazine), October 22, 2006, http://www.hobb.org/index.php?option=com_content&task=view&id= 1371&Itemid= 197& mosmsg=Item+successfully+saved (downloaded on November 25, 2007).

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

[4] Hereafter, the three witnesses Rutledge, Naimark, and De Bernardo collectively will be referred to as "the hearing witnesses."

[5] Rutledge Written Testimony at footnote 22.



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downplayed findings in the most recent studies (even in several studies that he relied on). For example, Eisenberg and Hill's study comparing litigation and arbitration[6] found an employee win rate in employment discrimination arbitration that has been calculated to be only 26% – one-third the employer win rate. By comparison, Eisenberg and Hill found an employee win rate of 44% in state court and over 36% in federal court litigation alleging employment discrimination – both significantly higher than the 26% arbitration win rate. Similarly, Mr. Rutledge gives short shrift to the important findings suggesting that employee win rates are lower in arbitrations that were imposed by employers through personnel handbooks or other mandatory avenues than for arbitrations pursuant to individually negotiated contracts.[7]

Mr. Rutledge completely ignores perhaps the most recent study, by Professor Alexander Colvin, of 836 employment arbitration awards reported by the AAA on its database (as required by California law). Professor Colvin found an employee win rate of only 19.7%, even using a broad definition of employee "win."[8]

NELA's analysis of the AAA's latest public reports, too, has found extremely high win rates for employers in AAA employment arbitrations. 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 a rate of 97% for the employer. Halliburton's win rate was only 32 out of 39 cases that went to decision – still a telling 82%.

Moreover, Rutledge *et al.*'s assertion that employees are more likely to prevail in arbitration is contrary to practitioners' experiences. According to Public Justice Staff Attorney Paul Bland, who handles precedent-setting complex civil litigation and specializes in cases involving mandatory arbitration, "the nearly universal perception among both plaintiff-side and defense-side lawyers is that arbitrators are more likely to have a pro-defense attitude than judges and juries [have]."[9]

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[6] *See, e.g.*, notes 3 and 41 of Mr. Rutledge's written testimony, all citing Theodore Eisenberg & Elizabeth Hill, Arbitration and Litigation of Employment Claims: An Empirical Comparison, 58 DISP. RES. J. 44, 44 (Nov 2003-Jan 2004).

[7] L. Bingham and S. 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) (employee win rate of 28% in employer-promulgated arbitrations, compared to 38% in all employment arbitrations); E. Hill, "AAA Employment Arbitration: A Fair Forum at Low Cost," 58 *Dispute Resolution Journal* 8-16 (May-June 2003) (employee win rate of 40% in employer-promulgated arbitrations, compared to 43% in all employment arbitrations).

[8] Colvin 2007.

[9] P. Bland, Testimony to the Subcommittee on the Constitution, United States Senate Judiciary Committee, on "S. 1782, The Arbitration Fairness Act of 2007" (December 12, 2007), http://judiciary.senate.gov/testimony.cfm?id=3055&wit_id=6829.



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**III. Contrary To The Hearing Witnesses' Claims, There Is No Clear Evidence That Employees Are More Likely To Get Their Claims Heard If They Are Shut Out Of Court And Instead Are Required To Arbitrate Their Cases.**

At the December 12, 2007, hearing, witnesses Rutledge, De Bernardo, and Naimark all claimed that arbitration is good for employees because it gives them access to a forum for resolving their employment disputes that they would not otherwise have. The factual premise for this claim is that plaintiffs' employment lawyers won't take most employees' cases to court because the cases aren't "worth" enough to warrant the costs and uncertainties of litigation, leaving employees without recourse if arbitration isn't available. As De Bernardo put it, rather over-dramatically –

> If S. 1782 is enacted, that civil justice system will be catapulted into chaos: ...any redress by the vast majority of individuals currently using the arbitration process will be rendered impossible as their claims will be abandoned and left homeless in the new judicial order....

No matter how many times or how colorfully this assertion is repeated, it remains just what it sounds like – rank hyperbole.

As an initial matter, it strains credulity for management lawyers like De Bernardo to claim that their true motive for preserving mandatory arbitration is to be sure that employees can pursue claims against their clients. Indeed, much available evidence suggests precisely the opposite: that companies adopt and defend mandatory arbitration because it *deters* employees from pursuing meritorious cases. Significantly, the high fees, the lower possibility of winning, the smaller damages, the repeat player disadvantage, and the possibility of having to pay the opposing party's fees deter people from filing claims – facts that management lawyers and their clients are certainly aware of. For example, in the late 1990s, as imposition of mandatory arbitration systems was growing exponentially throughout the economy, corporate defense lawyer Alan Kaplinsky wrote that "[a]rbitration is a powerful *deterrent to class action lawsuits*..."[10] Earlier, management attorney Paul Cane revealed the same motivation: "[a mandatory] arbitration agreement can discourage employees from bringing cases forward in the first place...."[11] Indeed, NELA members' experience confirms the deterrent effect of the prospect of binding arbitration on their and their clients' willingness to pursue cases. Attached to this testimony is just one example of a NELA member's case in which the client (Ms. Debbie Dantz) chose not to pursue her claims of a severely sexual and hostile environment when she was forced into arbitration, because she felt so strongly that the deck would be stacked against her in that forum.

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[10] Kaplinsky, "Excuse me, but who's the predator: Banks can use arbitration clauses as a defense," *Bus. Law.* 24 (May/June 1998) [emphasis supplied].

[11] 6 *Employment Discrimination Report* 875 (June 19, 1996) (BNA).



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For their assertion that plaintiffs' employment lawyers don't take cases that aren't "worth" enough to warrant litigation, the hearing witnesses actually rely on only one source: a study of NELA members done by one William Howard in 1995.[12]

In 1995, as part of the research for his dissertation on mandatory arbitration of employment cases, William Howard obtained a mailing list of NELA members and culled it to 321 individuals to whom he sent a survey about their practices and experiences with arbitration. One-hundred and one – less than a third of the group to whom it was sent – responded to the survey.[13]

Respondents were asked the percentage of cases "involving employment discrimination" on which they were "approached concerning representation" that they accepted. Both the mean and median acceptance rates elicited in response to this question were 5%.[14] Respondents were asked why they didn't accept more cases. Of the 90 respondents to this question, by far the largest proportion, 84% said they took so few cases because of "no provable case." Twenty-four percent said that it was because clients were "unable to pay retainer;" 17%, because they were "too busy already;" and only 18% because of "inadequate damages."[15] Respondents were also asked their minimum requirements in "provable damages" for accepting employment cases. Among the 82 respondents to this question, the mean minimum was $61,000 and the median $50,000.[16]

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[12] W.M. Howard, "Mandatory Arbitration of Employment Discrimination Disputes" (1995) (unpublished dissertation on file in NELA's Washington, D.C., office) and W.M. Howard, "Arbitrating Claims of Employment Discrimination," *Dispute Resolution Journal* (Oct.-Dec. 1995), at 40 (summarizing research) (hereafter, collectively, "Howard Dissertation"). The other sources that the hearing witnesses cite for this assertion are, on careful review, *also* factually based on the Howard Dissertation.

Rutledge also cites a law review article (Lewis Maltby, "Employment Arbitration and Workplace Justice," *38 U.S.F. L. Rev.* 105, 107 (2003)), which in turn cites 1994 testimony of NELA Founder Paul Tobias before the Commission on the Future of Worker-Management Relations that plantiffs' employment attorneys turned away at least 95% of employees who sought representation. However, while Mr. Tobias did testify that employment attorneys cannot represent many employees because of small damages and low likelihood of success, he did not venture to quantify this phenomenon, much less to estimate it at 95%. Proceedings of the Commission on the Future of Worker-Management Relations, http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1433&context=key_workplace (Tobias testimony at p. 6). Nor is any 95% estimate of the frequency of this problem reflected in the minutes of the day's proceedings, Transcript of Proceedings, http://digitalcommons. ilr.cornell.edu/cgi/viewcontent.cgi?article=1425&context=key_workplace.

[13] Characterizing this study as one "of 321 NELA lawyers," as several of the sources relying on it do, *see, e.g.*, Sherwyn *et al.*, "Assessing the Case for Employment Arbitration: A New Path for Empirical Research," 57 *Stan. L. Rev.* 1557, 1574-1575 (2005), is inaccurate. It is a study of *101* plaintiffs' lawyers. Even worse, in his Senate testimony, De Bernardo inflated this small study to a "survey of the plaintiffs' bar," without qualification (at n. 14) – essentially suggesting that this small sample represents the experiences of the *entire* plaintiffs' bar!

[14] Howard Dissertation at pp. 151, 206 (Appendix A: "Survey Package – Lawyers Representing Employees").

[15] Howard Dissertation at p. 152, Table 24.

[16] Howard Dissertation at pp. 149-150, Table 23.



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This study is a thin reed indeed on which to base the claim that mandatory arbitration makes employees better off because it gives them greater access to a system for resolving their employment disputes. In the first place, this study is far from representative of the plaintiffs' employment bar today.[17] In fact, the study did not even *attempt* to use a sample that was representative of NELA members, much less of all plaintiffs' employment lawyers or potential plaintiffs' employment lawyers.[18]

Even if it were representative and current, however, the Howard Dissertation does not stand for the proposition for which witnesses Rutledge *et al.* cite it – that 95% of cases are rejected *because they won't generate sufficient damages.*[19] To the contrary, the study found that the respondents didn't take 95% of the cases and that *one* of the reasons for this was that the cases wouldn't generate sufficient damages. Moreover, it found that the primary reason why clients were turned away is that they did not present "provable cases" – *not* that they don't have sufficient recoverable damages. Thus, even assuming the study's currency and accuracy, its own findings directly undercut the argument made by the hearing witnesses that employees who are not wealthy and who have only rather modest claims of colorable discrimination are better off with arbitration because they won't be able to retain a lawyer to represent them in litigation.

This confirms many NELA members' perception that the primary reason they turn away clients is that the employee does not have a case, and the primary reason she or he doesn't have a case is the employment-at-will doctrine: employers can fire (or mistreat) employees for any reason at all (unless it violates a federal or state law). Indeed, the methodological problems with the Howard Dissertation notwithstanding, we don't disagree with its overall conclusion that employees have difficulty finding find lawyers to represent them in employment disputes. When plaintiffs' employment lawyers turn away a case, it is likely to be because there is no federal or state law on which the employee can hang her hat. Employees have much less difficulty finding lawyers for meritorious statutory claims because of the provision of attorneys' fees under those statutes.

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[17] A study that is more than a dozen years old cannot be reflective of current experiences in such a rapidly changing field as employment law. In particular, in 1995, NELA lawyers would not yet have experienced the full impact on their cost-benefit analyses of the major changes to employment discrimination law that occurred in 1990, when the Americans with Disabilities Act was passed, and in 1991, when the Civil Rights Act of that year overturned several restrictive Supreme Court interpretations and for the first time made compensatory and punitive damages available under Title VII and the ADA.

[18] The entirety of Howard's analysis of the representativeness of his sample was contained in his cavalier statement that "it clearly can be concluded that the opinions and perceptions of these survey respondents represent lawyers regularly and extensively engaged in the practice of employment law" – which is based solely on the fact that a high percentage of the lawyers devoted 75% or more of their practice to employment law. Howard Dissertation at pp. 137-138. This analysis fails utterly to meet any scientifically accepted standard for showing that a survey's results are representative of a larger group.

[19] Lew Maltby, the author of the law review article cited by Rutledge as a source of the 95% figure (see note 13 *supra*), agrees that the statement that 95% of cases are rejected because they won't generate sufficient damages is not supported by the data. While, he believes, there is *some* number of legitimate cases that can't afford to be litigated but can afford to be arbitrated, that number is not 95%. Conversation between Maltby and Donna Lenhoff, NELA's Legislative & Public Policy Director.



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Importantly, if the reason these employees can't retain counsel is that they don't have colorable claims, then that reason will apply to arbitration as well as to litigation. In other words, the many employees who do not have colorable claims will have no more access to a lawyer to represent them if those claims go to arbitration than to trial in court – which means that the hearing witnesses' reliance on the difficulty of finding counsel for litigation is misplaced.[20]

The hearing witnesses appear to assume that arbitration is so simple a mechanism that employees will pursue arbitration without a lawyer to represent them. But legal representation is as necessary in arbitration as in litigation. Arbitration today involves navigation of complex procedural rules; selection of arbitrators; dispositive motions like motions to dismiss and for summary judgment; discovery, including depositions; witness examination and cross-examination; and frequent trips to court for decisions on these issues as well as on such issues as arbitrability, severability of terms, and grounds for appeal. Indeed, in recent years, there has been a proliferation of pretrial motions in employment arbitrations. **Companies are generally represented in arbitration – and by counsel who have extensive experience with employment arbitrators and with employment arbitration. If it was ever true that arbitration was so simple that laypeople could represent themselves without counsel, it is certainly not true today.

Another argument given for mandatory arbitration's effect of increasing employees' access to a dispute resolution system is that arbitration is generally less costly than litigation. Increasingly, however, this is simply not true. Initial filing fees can be between $150 and $6,000, depending on the provider and the amount in dispute. Administration fees run between $300 and $500. Often the parties also have to pay to rent the room where the arbitration is held – a reasonable estimate would be up to $600 per day. Most costly are the fees for the arbitrator or arbitrators themselves. It is not uncommon for arbitrators to charge $2,500 to $6000 per day; some charge in one-hour or even half-day increments. A single arbitration can involve a number of days of an arbitrator's time. The preliminary conference with the arbitrator to set ground rules, time schedule, etc., could easily take one-half of a day, as could a discovery dispute requiring the arbitrator's decision. Hearings not atypically last for three days, nor would it be unusual for the arbitrator to take a day to write the decision. The totals for these elements range from $14,750 to $38,300. The costs are multiplied if the agreement calls for three arbitrators; if there is more than one discovery dispute; if the employer files any dispositive motions; if the hearing lasts more than three days; or if the arbitrator takes longer than one day to write the decision. These costs are all *in addition to* the parties' fees for their own attorneys.

Richard Naimark testified that the AAA's rules for employment disputes set a maximum of $175 on the costs of an arbitration that the employee has to pay; the remainder is paid by the employer. However, there is no effective enforcement mechanism for these rules. If an arbitration clause provides for the costs to be split equally between the parties, AAA arbitrators can and, in NELA members' experience, do enforce it as written, despite its violation of the AAA rules. Moreover, of course, arbitrations conducted by other arbitration services providers are not subject to those rules at all.

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[20] Again assuming the Howard Dissertation to be reliable, in this context it is worth pointing out that plaintiffs' employment lawyer survey respondents reported no meaningful difference between the minimum provable damages needed to litigate a case than to arbitrate one. *See* Howard Dissertation at p. 150 (Table 23).



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There is another problem with the conclusion that the hearing witnesses draw from the relative ease of getting a lawyer and apparent lower costs of arbitration. Contrary to their claims, these factors do *not* translate into greater access for employees to a dispute resolution mechanism. That is because of the deterrent effect that the prospect of binding arbitration has on employees' willingness to pursue cases, discussed above.[21]

Finally, even if it were true that employees have greater access to a dispute resolution mechanism when mandatory arbitration is in place and choose to pursue arbitration, this mechanism's essentially involuntary denial of the right to trial in a public forum, by a jury of one's peers, presided over by an unbiased public servant, is not justified. Trial by fire is a simple dispute resolution mechanism that does not require lawyers and is much cheaper than litigation, yet no one would seriously argue that we should insist that employees forego litigation in its favor.

**IV. The Use of Mandatory Arbitration Programs Has Grown Exponentially Over the Last 15 Years.**

As NELA members can attest from the cases they see in their practices, the use of mandatory arbitration 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. In 1991, the percentage of employers in the private sector using employment arbitration was 3.6%. Today, 15% to 20% of United States employers, from Circuit City to Hooters to Halliburton, use mandatory arbitration programs (not counting under their union contracts) – covering over 30 million employees. This is a greater proportion of the non-union workforce than union contracts cover. Companies put mandatory arbitration clauses into employment applications, employment handbooks, and pension plans. Employees must sign these MA documents if they want to get a job or to keep the job they have.

Attached to my written testimony are several stories about real employees from around the country who have lost their employment rights because of MA programs – employees like Fonza Luke, of Princeton, AL, who 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.

S. 1782, the Arbitration Fairness Act (AFA), would 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 this separate and unequal system of "private justice" to continue.*

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[21] Witness De Bernardo put great emphasis on his contention that banning mandatory arbitration would be the death of alternative dispute resolution. That claim is patently not true. There are many ways to provide people with access to justice that don't require them giving up their rights, including: mediation; *voluntary,* post-dispute arbitration; a stronger EEOC that can really handle more claims; and union representation.



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**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



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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.***



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**Fonza Luke**
**Birmingham, Alabama**

*Fonza Luke tells the following story:*

Fonza Luke started working as a licensed nurse for Baptist Health Systems Medical Center Princeton (usually called "BMC") in 1971. For almost 30 years, she was a dedicated employee and received the highest performance ratings from the doctors she worked with every day. When the hospital needed her to work extra days and hours because of staffing shortages, she came in. Once, she worked 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 that she could do her job better.

In November 1997, Ms. Luke was required to attend a meeting of hospital employees where she was given a copy of a new "Dispute Resolution Program." She and the other employees were told that they would have to give up their right to go to court if they had legal claims against BMC, and instead bring all claims to binding arbitration. If they didn't sign the so-called "agreement" describing this program, they were told, they would lose their jobs.

She refused to sign this "agreement," because she did not want to give up her rights. She thought that it was just not right to make employees give up their rights to keep their jobs. She talked to her husband and her priest about it, and they both agreed that she shouldn't sign.

About a year later, the hospital again asked her to sign this "agreement." Again, she refused. In spite of what the hospital said, she was not fired for refusing.

About three years later, in early 2001, when Ms. Luke returned from a continuing education class in Atlanta, the hospital's human resources director told her that she was being fired for "insubordination" – to her complete shock. She was devastated because she never thought that she would lose her job after almost 30 years of working for BMC, always with good evaluations. She did not think that she was "insubordinate" at all. The only things she did that they considered "insubordinate" were things that younger, white employees did all the time without getting fired.

At that time, Ms. Luke went to see a lawyer. She believed that BMC had fired her because of her race and age – she was at that time 59 years old. She believed that the explanation of "insubordination" was just an excuse. With the help of her lawyer, she filed race and age discrimination claims with the U.S. Equal Employment Opportunity Commission, which, after a long investigation, ruled in her favor. The next step was to file a discrimination case in federal court, which she did.

But BMC asked the federal court to dismiss her case because, they said, she had agreed to bring all such claims to arbitration. She 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 BMC could force her to arbitrate, just because she had kept working in her job.



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Ms. Luke thought this was so unfair that she appealed the federal court's decision. But the appeals court agreed with the lower court, and ordered her into arbitration. The fact that she had specifically refused to agree to arbitration – twice – meant nothing.

The arbitrator was chosen by process of elimination from a list that was composed heavily of defense lawyers. According to her lawyer, with that list of arbitrators, it was impossible for her to get someone who was even in the middle of the road, much less someone who might be sympathetic to employees. She found it hard to believe that this arbitrator, whose time was paid for by BMC, could make a fair decision in her case.

In the end, Ms. Luke's claims of discrimination and retaliation were denied, and she got nothing – no relief whatsoever. She didn't think the arbitrator even *looked* at her side of the story.

Today, Ms. Luke has to work two jobs to make as much as she did at BHS.

When Ms. Luke testified about this case before a Senate Subcommittee in December, 2007, she 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. I wasn't allowed to bring the evidence of discrimination before a fair and impartial judge or a jury of my peers. Before a judge and jury instead of an arbitrator, I believe I would have gotten at least a more fair hearing."

***Ms. Luke's case is reported at Luke v. Baptist Medical Center Princeton, 99 Fed. Appx. 887, 2004 U.S. App. LEXIS 13161(11th Cir. 2004) (no published opinion). She testified before the U.S. Senate Judiciary Committee's Subcommittee on the Constitution on December 12, 2007. Her testimony can be found at http://judiciary.senate.gov/testimony.cfm?id=3055&wit_id=6827.***

***Ms. Luke can be reached through NELA's Legislative and Public Policy Director Donna Lenhoff, at 202.898.2880 or dlenhoff@nelahq.org.***



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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,



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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.***

**December 11, 2007**

**The Honorable Russell D. Feingold, Chairman**
**The Honorable Sam Brownback, Ranking Member**
**Subcommittee on the Constitution, Civil Rights and Property Rights**
**U.S. Senate Committee on the Judiciary**
**224 Dirksen Senate Office Building**
**Washington, DC 20510**

**Re: Letter in Support of the Arbitration Fairness Act, H.R. 3010 and S. 1782**

**Dear Mr. Chairman and Ranking Member Brownback:**

We, the undersigned organizations, strongly support the **Arbitration Fairness Act of 2007, H.R. 3010 and S. 1782,** introduced in the House by Representative Hank Johnson (D-GA) and in the Senate by Senator Russ Feingold (D-WI). This important legislation would end the predatory practice of forcing employees and consumers to sign away their rights to legal protections and access to the courts by making pre-dispute binding mandatory arbitration unenforceable in civil rights, employment, consumer, and franchise disputes.

In the private system of binding mandatory arbitration, none of the safeguards in our legal system are guaranteed for persons attempting to enforce their civil, employment and consumer rights. There is no impartial judge or jury, but rather arbitrators who rely on the companies for repeat business. With nearly no oversight or accountability, the employers, lenders or companies – or the arbitration service selected by them – set the rules for the secret proceedings, often limiting the procedural protections and legal remedies otherwise available to individuals in a court of law. For example, in arbitration, the time for filing a lawsuit is often shortened, and disclosure of documents by the employer, lender or company can be restricted or eliminated. In addition, the "loser pays" rules and exorbitant fees in arbitration are prohibitive to many individuals. The right to an appeal is severely curtailed by the arbitration process.

A cornerstone of hard-won civil rights protections is the right for victims of workplace discrimination or harassment to have their claims heard by an impartial judge and jury in the civil justice system. Increasingly, because of the unequal bargaining positions inherent in the employment relationship, employers strip this right away from workers with impunity and require them to agree to binding mandatory arbitration as a condition of hiring or continued employment. Once forced into binding mandatory arbitration, workers lose many of the essential protections established by the civil rights laws.

In a similarly disturbing trend, binding mandatory arbitration is proliferating in everyday consumer contracts for products and services such as credit cards, cell phones, mortgages, health insurance policies and nursing homes. The inequality inherent in mandatory arbitration particularly disadvantages the most vulnerable consumers, such as victims of predatory lending. Unscrupulous lenders use binding mandatory arbitration in subprime mortgages, payday loans and credit card contracts. The use of mandatory arbitration in consumer contracts is especially injurious where it disproportionately puts the elderly, low-income, and minority families at risk. In addition, the anti-predatory lending laws passed in some states are ineffective to deal with the



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prevalent abuse of binding mandatory arbitration because the Federal Arbitration Act currently preempts the state laws.

The Arbitration Fairness Act does not seek to eliminate arbitration and other forms of alternative dispute resolution agreed to voluntarily *after* a dispute arises, nor would it affect collective bargaining agreements that might include arbitration provisions. Its sole aim is to end *pre-dispute* binding mandatory arbitration, which eviscerates the enforceability of our civil and consumer rights. The protections established in our consumer protection and civil rights laws – including the Civil Rights Acts of 1964 and 1991, Title IX, the Age Discrimination in Employment Act, the Americans with Disabilities Act, the Family and Medical Leave Act, the Fair Labor Standards Act, the Equal Pay Act, and the Uniformed Services Employment and Reemployment Rights Act – are rendered meaningless if not enforceable in a court of law.

We strongly support the Arbitration Fairness Act of 2007, which would restore access to our civil justice system and preserve important civil, employment and consumer rights protections. We urge you and the other members of Congress to pass **H.R. 3010 and S. 1782**.

Sincerely,

**Alliance for Justice**
**American Association for Justice**
**American Association of People with Disabilities**
**Americans for Democratic Action**
**Asian American Justice Center**
**Association of Community Organizations for Reform Now (ACORN)**
**Campaign for Contract Agriculture Reform**
**Center for Responsible Lending**
**Consumer Action**
**Consumer Federation of America**
**Consumers for Auto Reliability and Safety**
**Consumers Union**
**DC Vote**
**Demos**
**Homeowners Against Deficient Dwellings**
**Japanese American Citizens League**
**Lawyers Committee for Civil Rights Under Law**
**Leadership Conference on Civil Rights**
**Legal Momentum**
**National Association for the Advancement of Colored People (NAACP)**
**National Association of Consumer Advocates**
**National Citizen's Coalition for Nursing Home Reform**
**National Consumer Law Center (On behalf of its low income clients)**
**National Contract Poultry Growers Association**
**National Council of La Raza**
**National Employment Lawyers Association**
**National Fair Housing Alliance**
**National Partnership for Women & Families**
**National Urban League**
**National Women's Law Center**



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**National Workrights Institute**
**Organization of Competitive Markets**
**Public Citizen**
**Rural Advancement Foundation International – USA**
**U.S. Public Interest Research Group**
**Women Employed**

cc: Members of the Senate Committee on the Judiciary
Senate Majority Leader Harry Reid
Senate Minority Leader Mitch McConnell
Representative Hank Johnson
Representative John Conyers, Jr.
Representative Lamar Smith
House Speaker Nancy Pelosi
House Minority Leader John A. Boehner



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# United States Senate

## Committee on the Judiciary
Subcommittee on the Constitution

**Hearing on S. 1782**

**THE ARBITRATION FAIRNESS ACT OF 2007**

**STATEMENT OF THE**
**PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION**
**IN CONNECTION WITH THE SUBCOMMITTEE'S**
**REVIEW OF THE ARBITRATION SYSTEM**

My name is Laurence Schultz. I have been representing public investors in claims against brokerage firms for more than 20 years. I am President of the Public Investors Arbitration Bar Association. PIABA is honored to present its position in support of the proposed Arbitration Fairness Act of 2007, S. 1782.

## INTRODUCTION

PIABA was organized in 1990. We are a national bar association with approximately 470 members who represent investors throughout the nation in arbitration disputes against members of the securities industry. Our members have represented tens of thousands of investors in arbitration and have arbitrated many thousands of cases against the brokerage industry. The vast majority of our clients seek to recover lost savings and retirement funds. Many are retirees with no independent ability to replace their losses.



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PIABA is dedicated to arbitration as an alternative method of dispute resolution for investors, provided the system is voluntary, provides neutral arbitrators and is fairly administered with neutral rules and procedures. To this end our members have worked with major arbitration forums in developing their arbitration rules and initiated many proposed rule and procedural changes designed to bring neutrality and fairness to the arbitration system. Some of these efforts have resulted in improvements in the arbitration system. None of these improvements alters the undeniable fact that the current investor arbitration system is neither voluntary nor unbiased. Nor is it fair to investors. Yet the industry has succeeded in forcing investors into mandatory arbitration as a condition of doing business with the brokerage industry.

PIABA supports investor choice. Arbitration of securities disputes, if held before a fair and impartial panel, can be attractive to investors. However, the choice to submit to arbitration must be made *after* the dispute has arisen in order to be considered truly voluntary. What we have now is a situation where mandatory arbitration clauses are foisted on consumers before any dispute even arises. These pre-dispute arbitration clauses are routinely enforced by the courts without regard to fairness or neutrality. This was not always the case.

## THE HISTORICAL EROSION OF INVESTOR CHOICE

Just twenty years ago, many investors had the right to choose between court and arbitration after a dispute arose. The blanket imposition of mandatory arbitration on investors dates back to the Supreme Court's decision in *Shearson/American Express, Inc. v McMahon*[1] in 1987. Prior to the *McMahon* decision, various brokerage firms included mandatory arbitration clauses in their documentation, mostly in margin or

[1] 482 U.S. 220, 107 S.Ct. 2332 (1987).



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option account agreements. But courts had often held these mandatory arbitration provisions unenforceable, and the SEC had adopted a rule prohibiting their use in claims arising under the federal securities laws.[2] In *McMahon* the Supreme Court reversed 34 years of established legal precedent and held that brokerage firms could enforce mandatory arbitration clauses against their clients even in cases involving federal statutes.

When *McMahon* was decided, the SEC found in a survey of brokerage firms that "96% of the margin accounts, 95% of the options accounts and 39% of the cash accounts" were subject to predispute arbitration clauses.[3] The survey also indicated that there was a movement toward putting these agreements in cash accounts. SEC Chairman Ruder testified to Congress,

> "I expressed vocally and vociferously my opposition to that trend. I believed then, and I believe now, that customer choice is an exceedingly important aspect of this industry and the movement apparently to push these clauses on the public so that they couldn't trade at all without them was in my mind simply terrible."[4]

In response, the investment firms gave assurances to the SEC that they did not intend to impose arbitration clauses in cash accounts and thus deprive American

[2] Exchange Act Rule 15c2-2, "Disclosure Regarding Recourse to the Courts Notwithstanding Arbitration Clauses in Broker-Dealer Customer Agreements."

[3] Letter from SEC Chairman David Ruder to New York Stock Exchange, July 8, 1988, in ARBITRATION REFORM: HEARINGS BEFORE THE SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE OF THE COMMITTEE ON ENERGY AND COMMERCE, HOUSE OF REPRESENTATIVES, 100TH CONGRESS, 2ND SESSION, ON MARCH 31, JUNE 9, AND JULY 12, 1988 (U.S. G.P.O., 1989), at p. 510. Similarly, James Buck, Sr. V.P. of the New York Stock Exchange, testified in that same hearing, "Most firms do not require arbitration agreements for cash accounts. Only in the case of margin accounts where the customer is borrowing money do you find overwhelming use of these clauses." *Id.* at p. 533.

[4] *Id.*, p. 512, Testimony of July 12, 1988. Chairman Ruder also testified to Congress on June 1, 1988, "I fail to see why one should deny access to the securities market to those people who are unwilling to waive their disputes in advance. I think it's unfair." See *id.*, p. 524.



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consumers of any choice.[5] Based on those assurances, the SEC backed away from legislation prohibiting pre-dispute mandatory arbitration clauses.

Today the situation is much different. Virtually every brokerage firm in America includes a mandatory arbitration provision in its account documentation for every type of account, including cash accounts. Even consumers who open a self-directed cash account at major discount brokerage firms like Charles Schwab, Fidelity, and Vanguard Brokerage Services must accept the mandatory arbitration provision. The provisions are almost always non-negotiable. The result is that if Americans want to buy a stock or a bond or seek to participate in the capital markets in America, they must give up their constitutional right to a jury trial before an independent and impartial judiciary and, instead, submit to mandatory arbitration.[6]

The number and types of American consumers who invest have also changed since the days before *McMahon*. The number of households who own stocks "has increased more than three-fold since the early 1980s."[7] Half of all U.S. households own shares of stock or stock mutual funds. Capital markets are not just for the wealthy, but hold the retirement hopes and financial security for consumers from all walks of life. And those ordinary Americans are increasingly older; indeed, seniors are the fastest growing segment of investing consumers.[8] They are also the most vulnerable to abuse by financial advisors and to unjust and unfair outcomes in mandatory arbitration.

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[5] *Id.*, pp. 474 ("many industry members will not require pre-dispute arbitration clauses in cash account agreements"), 514-516.

[6] Most investors, when they open their accounts, are not aware that mandatory arbitration is being imposed on them as a condition of investing. Customers are told by brokers that these new account documents are routine and must be signed in order to have an account with the firm.

[7] Investment Company Institute & Securities Industry Association, Equity Ownership in America, 2005 (Nov. 2005), Chapter 1, http://www.ici.org/pdf/rpt_05_equity_owners.pdf.

[8] *See id.*, Chapter 2.



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Mandatory securities arbitration today must be conducted in a system run by the dispute resolution arm of the Financial Industry Regulatory Authority (FINRA), the self-regulatory organization formed by the recent merger of the regulatory divisions of the New York Stock Exchange and the National Association of Securities Dealers.

Requiring arbitration before a single industry forum is a dramatic change from the arbitration alternatives in place when *McMahon* was decided. At the time of *McMahon* there were at least ten different arbitration forums. Most stock exchanges provided arbitration alternatives. Many arbitration clauses, and the rules of the American Stock Exchange, gave investors the option of avoiding arbitrating in an arbitration forum associated with the securities industry by allowing arbitration before the American Arbitration Association. So while investors may have had to arbitrate in response to *McMahon*, they could still choose among various arbitration forums. Different forums had different rules, different policies, different administrators and most important, different pools of arbitrators. These options were important in attempting to obtain fair process and just outcomes for investors.

Now all these options are effectively gone for ordinary investors. Over the last decade, we have seen a consolidation of the American securities markets, which recently culminated in the merger of the New York Stock Exchange and the National Association of Securities Dealers. Investors with pre-dispute arbitration clauses (virtually all investors) are forced into the only game left in town. The only available arbitration system is run by an association whose membership is made up of brokerage firms. FINRA now has a virtual monopoly on investor dispute resolution. There is no meaningful competition among arbitration forums. There is no alternative other than arbitration. The Arbitration Fairness Act of 2007 will remedy this situation by giving



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investing consumers a meaningful choice and restoring their right of access to the third branch of government – the courts.

Investor choice is the best option.

**THE PLAYING FIELD IS TILTED AGAINST THE INVESTOR**

As stated above, PIABA supports voluntary, arbitration, before a fair and unbiased panel of arbitrators pursuant to an agreement entered into after a dispute has arisen. A hallmark of the American judicial system is that both parties have a right to have their claims heard before a tribunal that is neutral, independent and unbiased. Unfortunately, investors can have no confidence that this is the case under the current, mandated system.

Investors who are required to arbitrate their disputes before FINRA appointed panels are often shocked to learn that FINRA rules require that one member of each three-member panel be from the securities industry. These individuals are often employed by brokerage firms as branch office managers or compliance officials, or even as attorneys who represent brokerage firms against investors in arbitrations. The mandatory participation of an industry representative on the arbitration panel creates an *appearance* of impropriety and bias. A consumer bringing a complaint is faced with a panel that appears to be a stacked deck. Bias or impropriety is perceived by the investor before the first word is spoken. By contrast, an investor plaintiff in a jury trial is entitled to exercise a challenge to a potential juror with a background in the securities industry. The very participation of an industry arbitrator undermines the credibility of the forum.



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The brokerage industry insists that an industry arbitrator is needed on every three-person panel so that someone on the panel will have knowledge of the securities industry, effectively providing an "expert" on the panel. If this rationale ever had any basis in fact, it has disappeared over the years. As arbitration has become mandatory, and is now the "only game in town," it has become more sophisticated. Cases are typically presented by lawyers and last several days. Lawyers for both sides commonly use retained expert witnesses to present evidence of industry practices, rules and procedures. Requiring another "expert" on the panel provides no value to the process, and cannot be justified particularly in view of the resulting appearance of bias.

Unfortunately for investors, the so-called "expertise," which the industry arbitrators bring to the table is often no more than bias. The industry panelist is pre-disposed to condone industry practices that have become institutionalized, and apply those standards rather than the practices mandated by FINRA, the SEC, or even securities laws passed by Congress or the states. The temptation is always very strong for industry arbitrators to condone inappropriate practices which have become the norm.

Examples of industry-wide abuses which have become routine practice throughout the brokerage industry, include:

1. Retirement seminar fraud;
2. Recommendations to retail customers based on research tainted by investment banking conflicts of interest;
3. Unsuitable sales of high-commission variable annuities, particularly to elderly investors;
4. Ignoring mutual fund break points; and
5. Improper sales of mutual fund B shares.

How can a branch manager or compliance officer serving as an arbitrator be expected to award an investor damages for these kinds of cases, when the arbitrator



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has the same conduct going on within his own firm, and perhaps his own office? To make matters worse, in sharp contrast to jury *voir dire* in court, FINRA arbitrators cannot be compelled to answer questions concerning their potential biases. Thus, an investor is simply in the dark as to what kinds of industry-wide wrongdoing the industry panelist or his/her firm may have engaged in previously, and how this could affect the outcome of the case.

Even today, as brokerage-sponsored hedge funds collapse and losses are sustained in bond funds filled with sub-prime paper, will industry arbitrators -- whose own firms may be involved in similarly deceptive practices – regard such conduct as deserving of damages? Or will they instead perceive these practices as the way business is done in the real world? And if the industry arbitrator finds the conduct unworthy of condemnation, it stands to reason that he or she will share his view with the other arbitrators, who often consider the industry arbitrator to be the FINRA – approved source of industry expertise. Thus, the non-industry arbitrators may be persuaded that what ought to be treated as an industry-wide scandal is simply business as usual.

A further source for conflict on the part of the industry arbitrator arises out of the increasing wave of mergers and consolidations in the securities industry. Today's Piper Jaffray broker may be a UBS Financial broker the next week. Yesterday's A.G. Edwards branch manager is today's Wachovia branch manager. That same manager may need to compete with another Wachovia branch manager for appointment to the manager's position. How severely can he be expected to sanction a firm that may be considering him for employment in the not-too-distant future? Perhaps this revolving door at the major firms helps to explain why, according to one survey of FINRA



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arbitration, investors have a much tougher time recovering their losses from the large brokerage firms than the smaller ones.[9]

There are other disparities between the impartiality of the court system and the systemic bias that results from mandatory arbitration. For example, investor advocates have long complained that FINRA permits arbitrators with financial ties to the securities industry (*i.e.,* attorneys whose firms perform work for a securities firm) to serve as public arbitrators. While FINRA has acknowledged this issue and is making progress on it, the rules still permit arbitrators with certain ties to the industry to serve as non-industry arbitrators. For example, attorneys who represent brokerage firms and therefore may be biased in their favor are allowed to serve as public arbitrators. In any courtroom, an investor would be entitled to remove this person from a jury for cause. In FINRA arbitration there is no such right.

In short, the current arbitration forum to which every investor must resort is systemically biased. Many of the individuals involved may have only the best of intentions; yet it is impossible to deny that there is an appearance of bias. No investor pursuing an arbitration claim against a brokerage firm can help but question the impartiality of an arbitrator who works for the brokerage industry, or an attorney who has brokerage firm clients.

PIABA believes that many of these systemic problems would be resolved quite rapidly if investors could choose between court and arbitration. In such an event the administrators of industry arbitration would have every incentive to make their forum attractive to investors.

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[9] *See* Edward . O'Neal, Ph.D. and Daniel R. Solin, *Mandatory Arbitration of Securities Disputes – A Statistical Analysis of How Investors Fare* 17 (2007), http://www.slcg.com/pdf/news/Mandatory %20Arbitration%20Study.pdf, pp. 10, 15-16. While PIABA did not participate in this study, its findings are consistent with the experiences of our members.



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**FINRA'S ARBITRATION RESULTS DEMONSTRATE UNFAIRNESS**

For the year 2006, FINRA reported that 58% of the arbitrations decided were dismissals of investor claims. It is noteworthy that investors were assessed fees and costs by arbitrators in the vast majority of those decisions. FINRA characterizes the remaining 42% of the decisions as customer "wins" irrespective of the amounts awarded. Thus, FINRA regards an award of as little as $1 as a customer "win". In some "win" cases the amount awarded to the investor was actually exceeded by administrative fees and costs assessed to the investor by the arbitrators. The 42% "win" rate is the lowest on record for FINRA arbitrations and is a decline from win rates of 61% as recently as 1999. The consistent decline of the "win" rate has been an alarming trend in FINRA arbitrations, and is further indication of a bias in the system.[10]

The study performed by Daniel Solin and Edward O'Neal, Ph.D. drew similar conclusions, and further concluded that investors pursuing claims against large FINRA-member firms tended to fare far worse than those pursuing claims against smaller firms.[11]

Nor is the declining success rate for public customers limited in its impact to those cases which go to hearing. Faced with these kinds of results in an arbitration system to which they must submit, investors are forced to accept unfavorable settlements which actually compound the impact of the unfairness to investors. In fact, a standard tactic of mediators retained through FINRA trying to reach a settlement before cases go to hearing is to urge investors to settle for far less than their actual

[10] The Securities Industry Conference on Arbitration, formed with the cooperation of the Securities and Exchange Commission, is conducting a neutral survey concerning fairness of the arbitration process. Parties and counsel on both sides have received SICA questionnaires. PIABA welcomes and looks forward to the results of the SICA survey.

[11] *See* footnote 10.



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losses by showing them statistics demonstrating that even when customers win at FINRA they only recover a fraction of their damages.

**INVESTORS ARE DENIED THEIR LEGAL RIGHTS**

As a general proposition, arbitration awards are final and binding on the parties, and are not subject to correction for errors of law or fact. Motions for vacatur of arbitration awards can be based on just few narrow grounds, such as corruption, fraud and arbitrator misconduct.[12] Such motions are granted only in the rarest of circumstances.

Even more disturbing is the concern that arbitrators are subject to little or no oversight. Courts have repeatedly held that the fact that arbitrators may have made legal errors is no basis for vacating their awards. Although the securities arbitration claims often require consideration of complicated legal issues there is no requirement that arbitrators be lawyers. In fact, the limited training that FINRA provides to arbitrators does not cover basic issues of substantive law such as state investor protection statutes. SRO arbitrators show a general aversion to applying any statutory remedies the way the state legislatures intended. State securities laws and consumer fraud statutes are routinely ignored. Arbitrators speaking at conferences have stated that they and their colleagues think that statutory remedies are "draconian." A recent study of NASD arbitration awards in Florida revealed that where arbitrators found liability to a standard equal to or greater than the requirements for liability under

[12] *See* the Federal Arbitration Act, 9 U.S.C. § 10.



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Florida's state securities act, they failed to award the statutory remedy in nearly 48% of the applicable cases![13]

In court, a judge is a trained and experienced attorney who is duty-bound to apply the law. And the judge's legal rulings are subject to review by appellate judges, who are equally duty-bound to follow the law. By contrast, legal rulings are made in arbitrations by panelists who may not even be attorneys, and those rulings are not subject to any meaningful review. As a result, consumers who have lost their life's savings get one shot at an arbitration panel, with no confidence that the law will be followed, and will have no recourse even if the legal rulings are clearly wrong.

The framers of the Constitution preserved the right to a jury trial for a reason. To an investor who has lost everything, no proceeding will ever be as important as his/her case to get the money back. There is no room for error in such a case. The expediency of resolving disputes by arbitration, while laudable, should not be forced upon such an investor. An investor should be able to choose to arbitrate a dispute after the dispute has arisen. Otherwise, the investor must be permitted to go to court, where constitutional rights will be protected.

**THE INDUSTRY'S ABUSE OF ARBITRATION DISCOVERY RULES**

Perhaps the best example of brokerage industry abuses that have been a continuing part of the FINRA mandatory arbitration process has been in the area of arbitration discovery. Prominent brokerage firms defending against investor claims have repeatedly ignored the arbitration discovery rules to the detriment of investors

[13] Mark A. Tepper, *SRO Arbitration: Is It Fair To Investors?*, 13(4) PIABA B.J. 51 (Winter 2006). The disregard of legislative remedies was substantially higher in three-person panels containing an industry arbitrator than in cases decided by a sole public arbitrator.



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trying to recover their losses. Unfortunately there has been little significant consequence to the offending firms.

Arbitration discovery is limited in that it does not provide for depositions or interrogatories. This is consistent with the purpose of arbitration, which is to provide a streamlined dispute resolution process. However, discovery of documents is an essential part of the rules. Obviously if brokerage firms are allowed to conceal unfavorable documents, investors will often be unable to successfully prove their claims.

Investor advocates have long complained that arbitrators were allowing the brokerage industry to abuse and even ignore document production obligations under the FINRA arbitration rules. These complaints were not without substance. Caught red-handed in several cases, in 2004 Merrill Lynch, Morgan Stanley and Citigroup were fined $250,000 each by FINRA for not producing documents in violation of discovery rules.

Unfortunately, these fines were nominal. The 20 cases cited by FINRA in its disciplinary proceeding represented only a fraction of those investors whose cases were prejudiced. Investors who were damaged by the discovery abuse recovered nothing from the sanctions and, because the fines were smaller than the gains from the brokerage firms' misconduct. There was no meaningful deterrence. The self regulatory system had failed.

The absence of deterrence was resoundingly clear in the case of Morgan Stanley. During this very period, and at least until March of 2005, Morgan Stanley refused to produce e-mails in thousands of arbitrations claiming the e-mails had been destroyed in the terrorist attacks of September 11, 2001. Finally, in September 2007



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FINRA announced that Morgan Stanley's statements to the arbitration panels about the destruction of these e-mails were false. Morgan Stanley cynically used 9/11 as a ruse to withhold documents from thousands of investors.

Morgan Stanley's 9/11 arbitration fraud continued for at least three and a half years and involved thousands of investors, many of whom lost their cases, were awarded reduced amounts or accepted reduced settlements. Morgan Stanley totally undermined the integrity of the arbitration process. For this, Morgan Stanley was fined just $12.5 million, of which just $9.5 million was set aside for the thousands of investors who were damaged by the fraud. The sum of $12.5 million is meaningless to Morgan Stanley. It represents just .025% of Morgan Stanley's 2006 revenues of over $50 billion. And the sum of $9.5 million spread among thousands of investors cannot begin to compensate them for the resulting damages.

More important, the fine does nothing to repair the damage done to the arbitration process, which no one with any modicum of integrity can claim was fair to Morgan Stanley investors. Had Morgan Stanley been required to resolve some of its clients' claims in court, rather than arbitration, there can be little doubt that this ongoing fraud would have been exposed earlier. Indeed, given the *in terrorem* effect of court sanctions and the contempt power, one would expect that Morgan Stanley would never have tried to get away with such an audacious scheme. If investor choice were still the law, this systematic fraud on the investing public (Morgan Stanley's own customers) would likely have been averted.



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**INDUSTRY'S AND REGULATORS' CONTENTION THAT ARBITRATION IS FAIR**

Representatives of the securities industry, and a few regulatory authorities, contend that arbitration is fair and therefore should remain mandatory. This specious reasoning is perhaps one of the best arguments to bar mandatory arbitration.

If the securities industry and these regulators truly believe the current system is fair as it is presently constituted, they should have no concern over making it voluntary. To the contrary, if it is indeed as fair as their claims would suggest, the arbitration system should not only survive, but it should continue to attract the majority of investor claims on a voluntary basis.

Unfortunately, the securities industry has engaged in a concerted campaign to conceal the true state of affairs in the existing system of mandatory arbitration of investor disputes. For example, in October 2007, the Securities Industry and Financial Markets Association ("SIFMA") issued a purported "white paper" on securities arbitration that referred to arbitration as the "success story of an investor protection focused institution."[14]

Notwithstanding the fact that this entire paper was prepared by employees of the securities industry and/or outside counsel who serve the securities industry (without any apparent involvement of either public investors or any other neutral participants in the arbitration forum), SIFMA still had to smudge their own statistical analyses in order to support their thesis. For example, in order to support the primary contention in the paper, that the "Total Percentage of Claimants Who Recover Damages or Other Relief in Arbitration or By Settlement is Favorable," SIFMA had to include thousands of cases where brokerage firms themselves were the "Claimant."

[14] http://www.sifma.org/regulatory/pdf/arbitration-white-paper.pdf.



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**THE SHROUD OF SECRECY**

Another problem which plagues the arbitration process is excessive secrecy .The public, the press, and other investors with claims similar to those being heard, have no right to attend arbitration hearings. They would not be barred from the courtroom. It is difficult to see who, other than

brokerage firms, benefits from this secrecy. Arbitration hearings are even off limits to securities regulators. This is anomalous and unfortunate because in addition to the SEC's role in overseeing the arbitration process, one of the original rationales for allowing private suits under provisions

of the federal securities laws was to act as a "necessary supplement to Commission action."[15] Arbitration secrecy denies both the SEC and state regulators direct evidence of securities violations that has a direct and often devastating impact on the investing public and American capital markets.

Arbitration secrecy promotes a divide and conquer mentality, and the brokerage firms take advantage of that tactic. They try to prevent shared discovery in multiple victim cases. They also (a) conceal documents in one case after those same documents have already been produced in other arbitrations; (b) tell different stories to different arbitration panels; and (c) repeat arguments to a second panel when the same argument has been rejected by a different panel (in court, "judicial estoppel" would stop that tactic). By hiding documents, preventing access to witnesses, tailoring stories, and fomenting inconsistent results, they successfully avoid full responsibility for their misconduct. And the hapless consumer often goes home with nothing, or with a paltry incomprehensible "award."

[15] *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964).



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**CONCLUSION**

In fairness to America's 90 million savers and investors, mandatory securities arbitration must be ended. Forcing investors into mandatory arbitration as a condition of buying and selling securities is fundamentally unfair. Only Congress can provide the necessary remedy, and that remedy is consumer choice. The Arbitration Fairness Act of 2007 provides that remedy. PIABA is pleased to support the bill.

We thank you for the opportunity to be heard on this important issue.

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**Testimony of Professor Peter B. Rutledge**
**Associate Professor of Law**
**Columbus School of Law, Catholic University of America**
**December 12, 2007**

**Hearing: "S. 1782: the Arbitration Fairness Act of 2007"**

**Senate Judiciary Committee**
**Subcommittee on the Constitution**



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Chairman Feingold, Ranking Member Brownback and Members of the Subcommittee. Thank you for the invitation to testify today. My name is Peter B. 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 and author of several articles in the field of arbitration. I am pleased to offer my thoughts on S. 1782, the Arbitration Fairness Act.

In October of this year, I had the privilege of testifying before a subcommittee of the House Judiciary Committee on H.R. 3010, the House companion bill to S. 1782. I trust that your staffs have reviewed that testimony, so I do not intend simply to rehash its contents here. Instead, I hope to highlight some of the most critical points that I sought to make in the House, to address some of the issues that arose during that hearing, and to discuss some intervening developments since that hearing.

**SUMMARY**

At bottom, I wish to convey four critical points to the subcommittee today:

- First, a thorough understanding of the available data and gaps in the data should drive the policy debate over the future of arbitration. Otherwise, there is a risk that the policy debate will be driven by a mixture of unrepresentative cases and untested hypotheses. The available empirical data on arbitration is growing. In important respects, that data demonstrate that individuals, in the aggregate, often are better off in a world with enforceable predispute arbitration agreements than in a world without one. In



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this regard, the data either are inconsistent with or flatly contradict some of the premises that appear to underpin efforts to abolish predispute arbitration.

- Second, to the extent there are particular instances of problematic arbitrations, the solution should not be to jettison the system altogether. In several respects, existing mechanisms serve to filter out truly unfair arbitrations. To the extent those mechanisms do not suffice, Congress would be better off analyzing structural deficiencies in the civil justice system than in abolishing predispute arbitration agreements for vast segments of the population.

- Third, if Congress were to eliminate predispute arbitration agreements, it ironically may make worse off the very parties whom it would be trying to protect. Individuals would find it more difficult to obtain a lawyer, would realize worse outcomes, and would receive justice at a far slower rate. For society as a whole, the costs of resolving these disputes without arbitration likely would rise, and individuals ultimately would bear those higher costs – whether in the form of higher prices, lower wages or lower share prices. The only people who, with certainty, benefit from this bill are the lawyers.

- Fourth, postdispute arbitration does not present a viable alternative to a system of enforceable predispute agreements.

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



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**I. The State of the Empirical Research**

As I explained to the House back in October, empirical research on arbitration has advanced greatly in the last fifteen years.[1] At the most general level, we have solid studies on questions such as whether arbitration benefits the repeat players[2] or whether arbitration leaves individuals better off or worse off than litigation.[3] More recently, Chris Drahozal at the University of Kansas recently edited an excellent volume synthesizing the available empirical research in the field of international arbitration.[4] Researchers at Cornell University and New York University, among others, are undertaking pathbreaking research in the area of employment arbitration.[5] Next month, participants at

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[1] In addition, a number of governmental studies have looked at various aspects of arbitration. *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* 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); 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).



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the annual meeting of the Association of American Law Schools will convene a panel addressing the state of the empirical literature on arbitration.

At the same time, important gaps remain in the empirical record. At the industry level, we probably have the best data about employment arbitration; the empirical record on consumer arbitration and, especially, franchise arbitration is far less developed.[6] Moreover, the amount of available data varies with the arbitration provider. Based on my review of the literature and my own data-gathering efforts, the American Arbitration Association and the organization JAMS have been quite willing to provide access to data about their caseloads; the amount of publicly available data for other organizations is more limited. Lastly, and perhaps most importantly, we are only beginning to get a good handle on the economics of arbitration and, particularly, the economic impact of a prohibition against predispute arbitration.[7] (I return to this last point later in my testimony.)

With the empirical record in this state, I would urge Congress to proceed cautiously. The risk is that the untested hypotheses or unrepresentative horror stories about arbitration will drive the discussion at the expense of the empirical reality. In my view, some of the "Findings" contained in Section 2 of S. 1782 reflect some of these biases about arbitration. Permit me to address several of them briefly:

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[6] 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 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).

[7] Peter B. Rutledge, *Whither Arbitration?*, 6 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.



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**Finding**: "A large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their right to have their dispute resolved by a judge or jury, and instead submit their claims to binding arbitration."[8]

**The Empirical Record:** As to the frequency of arbitration, the record is far more mixed than this finding suggests. One recent study of consumer arbitration in over thirty industries found that the frequency of clauses varied greatly across industries. Approximately 33% of surveyed companies employed arbitration clauses; nowhere were they universally used; industries such as the financial services sector used them 69.2% of the time while other industries such as food and entertainment never used them.[9] Another very recent study of corporate 8-K filings found that companies used arbitration clauses only about 11% of the time; the precise data again varied with the type of contract (with clauses more frequent in licensing and employment contracts), but with respect to no category of contracts did companies use arbitration clause a majority of the time.[10]

As to the waiver of the right to a jury trial, 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.[11]

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[8] S. 1782 §2(2).

[9] Demaine & Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 L & Contemp Probs 55 (Winter/Spring 2004).

[10] In a similar vein, a somewhat dated study of arbitration clauses in the securities industry found that clauses were used more frequently for higher-risk accounts. GAO: *How Investors Fare* at 28 (May 1992). Likewise, a survey of the telecommunications industry published in 2001 found that 16% of firms surveyed used external arbitration procedures in their employment disputes. *See* Colvin, *Relationship Between Employment Arbitration and Workplace Dispute Resolution Procedures*, 16 Ohio St J Disp Res 643 (2001).

[11] 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



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**Finding:** "Most consumers and employees have little or no meaningful option whether to submit their claims to arbitration."[12]

**The Empirical Record:** Again, as I've noted above, the record on the frequency of arbitration clauses is more mixed than this finding suggests. Even where arbitration clauses are used, it is important to emphasize that only a fraction of the disputes subject to arbitration clauses actually reach arbitration. At least in the employment context, we know that the arbitration clause is part of a broader "multi-stage" dispute resolution system whereunder many of the disputes resolve at an earlier stage.[13] This does not mean, of course, that arbitration is irrelevant. Rather, it serves as an essential piece of a broader tapestry of alternative dispute resolution processes.

Finally, as to the notion that individuals have "no meaningful option," it is important to place that comment into context. Individuals are presented with a variety of terms on a take it or leave it basis.[14] 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 month. Yet no one would deny there are valid economic reasons, some of which directly benefit me as an employee or a

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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).

[12] S. 1782 §2(3).

[13] *See* Lewin, *Dispute Resolution in NonUnion organizations*, in *Alternative Dispute Resolution in the Employment Arena* (53rd Annual conference on Labor at NYU) at 379 (discussing case study at Northrop-Grumman); Lipsky, *An Uncertrain Destination*, in *U.S. Corporations and ADR in Employment* (Estericher & Sherwyn, eds.) (2004); GAO, *Alternative Dispute Resolution:- Employers' Experiences* (1997).

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



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consumer, why my counterparty does not dicker over those terms. The same economic rationale that justifies these sorts of "take it or leave it" policies applies to arbitration.

**Finding:** "Private arbitration companies are sometimes under great pressure to devise systems that favor the corporate repeat players who decide whether these companies will receive their lucrative businesses."[15]

**The Empirical Record:** Some studies have found evidence of a repeat player phenomenon while others have found no demonstrable effect.[16] Furthermore, 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.[17] 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).

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[15] S. 1782 §2(4).

[16] *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).

[17] 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).



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**Finding:** "Mandatory arbitration undermines the development of public law for civil rights and consumer rights, because there is no meaningful judicial review of arbitrators' decisions."[18]

**The Empirical Record:** Public law can still develop in arbitration whether through publication of the awards or judicial decisions in actions to confirm the awards. Moreover, 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.

**Finding**: "Mandatory arbitration is a poor system for protecting civil rights and consumer rights because it is not transparent."[19]

**The Empirical Record:** This criticism is mistaken for three reasons. First, it misapprehends arbitration: there are at least two junctures where the merits of arbitration can be 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

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[18] S. 1782 §2(5).
[19] S. 1782 §2(6).



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precisely because, relative to 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.

**Finding:** "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."[20]

**The Empirical Record:** Here, it is important to unpack several propositions. As to the claim that arbitration clauses "deliberately tilt the systems against individuals," nearly all of the available academic studies, most of which concern employment arbitration, demonstrate precisely the opposite outcome.[21] That is, by most measures, the

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[20] S. 1782 §2(7).

[21] 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*



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party with the inferior bargaining position achieves better, or at least comparable, outcomes in arbitration compared to litigation.[22] Eliminating predispute arbitration might well make these individuals *worse* off – I return to this topic later in my testimony.

As to the claim that arbitration bans class actions and forces people to arbitrate far from their homes, the empirical evidence again suggests that these practices are not as widespread as the finding suggests. For example, a 2004 study of consumer arbitration clauses by Demaine and Hensler found that only 30.8% prohibited class actions.[23] As to the situs, 50% of the clauses they surveyed specified the situs of the arbitration, and in all but three cases was the specified situs near the individual's residence or place of service.[24] 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

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*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).

[22] 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.

[23] Demaine & Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 L & Contemp Probs 55 (Winter/Spring 2004).

[24] *Id.*



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appear in many respects to put consumers on equal terms with the businesses that drafted them … ."[25]

**The September 2007 Public Citizen Report**: The House hearing in October highlighted a recent report by Public Citizen on arbitrations in the credit card industry.[26] I commend Public Citizen for its attempt to contribute to a more systematic, rather than anecdotal, assessment of arbitration. But even here I would urge Congress to evaluate the findings with care.

The report contains sensational allegations about how a small cadre of arbitrators overwhelmingly favor the credit card industry over their customers and churn out a high number of awards, seemingly with little consideration or oversight. When I initially skimmed the report, I confess that some of these allegations gave me pause. But when I dug into the guts of the report, two things struck me. First, while the allegations at times are quite general, the underlying data focus largely on the work of a single arbitration association (the National Arbitration Forum) for a single company (MBNA) in a single industry (credit card collection actions). As you know, arbitration involves a far greater number of associations, companies and industries than the ones addressed in the Public Citizen report. Thus, the report does not provide a particularly helpful set of data upon which to base a decision about the future of arbitration.

The second striking feature of the Public Citizen report is that most of the arbitrations addressed in it appear to be default collection actions – that is, relatively straightforward arbitrations commenced by a bank when someone does not pay their

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[25] *Id.* at 72.

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



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credit card bill. Seen in this light, it is perhaps unsurprising that the company's win rates are so high (apart from cases of outright fraud or identity theft, the matters presumably are straightforward). Thus, the lopsided win-rates described in the Public Citizen report also are a poor metric upon which to make any decision about whether arbitration generally favors corporate interests.[27] Moreover, due to this focus on default collection actions, many of the more generalized complaints about arbitration are misplaced. For example, the report complains about how arbitration may deprive consumers of the opportunity to maintain a class action or to seek punitive damages. Yet procedural rights and remedies of this sort would be unavailable to an individual debtor, regardless of whether the case is heard in arbitration or in a court. And to the extent the judicial proceeding may be slower, more cumbersome and more expensive, it may well leave the individual debtor worse off.

**II. 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.[28] 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.

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[27] As I explain above, by various measures, other data on more typical disputes, such as employment arbitrations, shows that the system produces favorable outcomes for individuals.

[28] *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).



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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;
- 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.[29]

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[29] 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



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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.[30] 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 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.[31] 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.

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

[31] *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).



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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.[32]

**III. The Effect of Eliminating Pre-Dispute Arbitration**

What would happen if Congress prohibited predispute arbitration agreements? In my view, several things would occur:

- Many individuals will find it harder to obtain a lawyer willing to take their case;
- For those who actually find a lawyer willing to take their case, justice will not come quickly;
- When it does come, the outcome of litigation may be inferior to that in arbitration;
- The net social costs of resolving these disputes will rise, and these costs 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).

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



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Ironically, then, banning arbitration agreements may end up hurting some of the very groups that Congress is trying to protect. The only individuals who benefit from the ban are the lawyers, who reap higher fees engaging in more expense, more protracted litigation. Permit me to elaborate on each of these points.

**A. Difficulty In Obtaining a Lawyer**

Several scholars have documented how difficult it is for a plaintiff such as an employee to find an attorney willing to take her case in the civil justice system unless the amount in controversy is sufficiently high and the merits sufficiently strong.[33] According to one study, an employee needed to have a meritorious claim of at least $60,000 in order for an employment lawyer to be willing to litigate her case,[34] and a founder of the National Employment Lawyers' Association testified a few years ago that employment attorneys turned away at least 95% of employees who sought representation.[35] The upshot is that by eliminating predispute arbitration, Congress may well worsen an access-to-justice problem for the average claimant.

These ideas arose in the House hearing back in October, and Chairwoman Sanchez picked up on their centrality. She made the appropriate point that part of the debate here stems from the difficulties that individuals have had obtaining access to legal services. I responded that I could not agree more – it is something that we regularly

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[33] *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).

[34] *See* 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).

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



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consider in legal education in the context of clinical and *pro bono* work. But the solution, I would submit, is to improve access to legal services, not to jettison a system of dispute resolution that, based on the available empirical evidence, seems to yield a net benefit to the individuals whom Congress is trying to protect.

### B. The Speed of the Civil Justice System

For those who actually find a lawyer willing to take their case, justice will come far more slowly in a world without arbitration. 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. In fact, of all the empirical premises about arbitration that has been subject to empirical study, this is the one where the data results are most consistent.[36] For example, Delikat and Kleiner concluded in their study of securities arbitrations that mean and median times between filing and judgment were approximately 50% longer in litigation compared to arbitration.[37] Thus, for those claimants who desire speedy resolution of their claims (whether for financial reasons, psychological ones or others), arbitration is far superior.

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[36] 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).

[37] 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, 9 (2003).



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### C. Comparative Outcomes

As I've briefly alluded to above, most of the available empirical evidence suggests that arbitration actually leaves individuals better off than in litigation. If that is true, then conversely eliminating predispute arbitration may well leave those individuals worse off in terms of their recoveries. Allow me to elaborate on that claim here.

Scholars studying this issue ("Are individuals better off in arbitration?") employ a variety of methodologies for evaluating that question. Some look at raw win rates – that is, how often does the individual prevail in arbitration compared to the company? Others look at comparative win rates – how often does the individual recover in arbitration compared to litigation? Yet others look at comparative recovery rates – asking how much does the individual recover in arbitration compared to litigated?

While none of these methodologies is flawless, each undercuts the idea that arbitration is somehow stacked against the individual. For example, employing a raw win-rate methodology, a review of consumer arbitrations in California by the California Dispute Resolution Institute found that the consumer prevailed 71.2% of the time.[38] Under the comparative win-rate methodology, most studies find no significant difference between arbitration and litigation in terms of the frequency with which the individual prevails.[39] As to the comparative recovery methodology, the available studies reach conflicting conclusions,[40] but the best research appears to conclude that higher-

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[38] *See* 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* (August 2004). *See also* Mark Fellows, *The Same Result As In Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes,* METRO. CORPORATE COUNSEL 32 (July 6, 2006) (discussing results of California report in light of other studies of win rates in arbitration).

[39] Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1569 (2005).

[40] *Compare* Michael Delikat & Morris Kleiner, *Comparing Litigation And Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?, American Bar*



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compensated employees recover at least as much in arbitration as litigation whereas lower-compensated employees (those with a gross income of less than $60,000) might not.[41]

This last bit of data is an important. It might well suggest that arbitration leaves employees in a certain income category worse off. But the consensus on this data suggests a much more complex picture. Both the authors themselves and subsequent commentators noted that the sample size was small and the standard deviations significant. Moreover, the authors noted that the recovery differential might not be due to some flaw in the system of arbitration. Rather, the more likely cause might be the difficulty that lower-compensated employees encounter in obtaining legal counsel to litigate their case. Because their claims are likely to be lower on average, only employees with high-value, high-merit claims are going to be able to find attorneys willing to try their case, thus skewing the average recoveries from litigation. By contrast, the lower cost of arbitration may make it easier for them to resolve their claims without an attorney or to afford an attorney, thus lowering the average recoveries from arbitration in part due to the fact that more employees in this income echelon are able to have their case heard.

The bottom line is that eliminating arbitration will not meaningfully enhance the outcomes for individuals and may well produce inferior ones. To the extent there is a problem, the data suggest that the problem is not a systemic one with arbitration but

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*Association Litigation Section Conflict Management*, Vol. 6, Issue 3, 10 & Table 3 (2003) (arbitration yields higher recoveries), *with* 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) (reaching opposite conclusion).

[41] Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RES. J. 44, 44 (Nov 2003-Jan 2004).



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rather stems from difficulties that an individual encounters obtaining access to counsel in our civil justice system, as suggested during the dialogue with Chairwoman Sanchez back in October.

**D. Increase Costs of Resolving Disputes**

As I noted earlier, I believe that eliminating predispute arbitration agreements would increase the costs of resolving disputes. Here it is important to recall precisely why arbitration grew in popularity. A 1997 report by GAO evaluated the experiences of five employers with their alternative dispute resolution programs and helped to document how their interest with arbitration came about.[42] All five companies had adopted ADR programs, which included an arbitration component, after spending exorbitant fees defending against employment lawsuits. Brown & Root adopted its ADR program after spending $400,000 in legal fees to defend against an employment discrimination suit which it won.[43] Similarly, Rockwell adopted an ADR program after it spent over $1 million in legal fees defending against a wrongful discharge/disability discrimination suit which it too won.[44] The GAO went on to report that, after implementing the ADR programs, the companies' legal costs dropped sharply. Brown & Root, for example, reported a 90% reduction in its legal fees during the first three years of its ADR program.[45] Even factoring in the additional costs of the ADR system, Brown & Root's overall costs of dealing with employment conflicts, including ADR costs, were now less

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[42] GAO, *Alternate Dispute Resolution: Employers' Experiences With ADR in the Workplace* (1997).
[43] *Id.* at 39.
[44] *Id.* at 50.
[45] *Id.* at 40.



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than half of what the company used to spend on legal fees for employment-related lawsuits.[46]

If arbitration, as part of a larger fabric of ADR programs, can reduce corporate legal costs, do those savings actually benefit the individual? By the early 1990's, some government studies suggested that the answer was "yes." One early indication of the relationship between dispute resolution and individual wealth came in report of the Dunlop Commission, created by President Clinton.[47] 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.*[48]

This "dollar for dollar" statistic derives from a report of factual findings issued by the Secretaries of Labor and Commerce.[49] Those findings in turn trace to a 1988 study of wrongful termination litigation in California conducted by the Rand Corporation's Institute for Civil Justice.[50] In that study, researchers reviewed a sample of jury trials

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[46] *Id.* at 4, 19, 40.

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

[48] *Id.* at 50.

[49] 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).

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



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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 received by the claimant.[51]

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.[52]

Finally, one case suggests that the distributive benefits of cost savings might extend to the credit industry as well.[53] In one case, a finance company varied the interest rate on its credit facility with a consumer's willingness to agree to arbitration.[54] 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.

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[51] *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.

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

[53] 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).

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



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All of these anecdotes provided some indications that litigation was not only expensive for American companies but had identifiable negative wealth effects for their employees and price effects for their consumers. Recognizing that such anecdotes only have so much explanatory value, 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 cost of resolving those disputes in arbitration, the costs of various forms of dispute resolution outside arbitration 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 rests on several assumptions and the figures require further testing. But based on the data that I have been able to generate, it is my present belief 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 the amount actually recovered by the claimant. Rather, it reflects simply an estimate of how much more it will cost society to resolve these same disputes that, under current law, are arbitrable. This is why I say that the only people who come out ahead from the abolition of arbitration are the lawyers. 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. If $88 million is the net increased cost from eliminating the employment docket of a single arbitration institution, then imagine the cost of eliminating predispute arbitration in all consumer, employment and franchise contracts altogether.



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I said at the October House hearing, and I reiterate here: this is a tentative conclusion. The important topic that it addresses – the economic impact of arbitration – is largely unexplored terrain, and one that would benefit from serious, open debate among academics, policymakers and interested parties. That debate is now beginning to occur. I would urge Congress to let that debate run its course so that it has a more complete and accurate picture of the economic impact of this proposal.

**IV. Postdispute Arbitration Is Not a Viable Alternative.**

Let me close by addressing the idea that postdispute arbitration can simply reap all the benefits of predispute arbitration while preserving some greater modicum of "choice" for the individual. Opponents of predispute arbitration often argue that they do not reject 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 must also 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 fundamentally differ from their incentives in the predispute context.[55] Specifically, parties have more information in the postdispute context about the likely contours of the dispute. This superior information enables them to make more strategic calculations about which form of

[55] 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);



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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 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.[56]

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.[57] 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.

Experience under the recently enacted ban on predispute arbitration clauses in automobile dealer agreements lends some support to this hypothesis. As you know, in 2002, Congress amended the FAA and, for the first time since the FAA's enactment, explicitly banned predispute arbitration in a category of cases. The stated purpose of the law was to level the playing field between automobile manufacturers and their dealers (while leaving open the possibility of postdispute arbitration).[58] Yet, in a recent case from the Seventh Circuit, an automobile dealer actually sought to compel arbitration, and the manufacturer successfully resisted it with respect to part of their dispute – effectively

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

[57] 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.

[58] 15 U.S.C. §1226(a)(2).



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forcing the dealer to resolve the dispute in multiple forums.[59] Had the parties been able simply to enter into a predispute arbitration agreement, such strategic behavior likely never would have arisen.

To be sure, parties to predispute arbitration agreements 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.[60] 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 system for the few and a rickshaw system for the many."[61] 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,

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[59] *Volkswagen Of America, Inc. v. Sud's Of Peoria, Inc.*, 474 F.3d 966 (7th Cir. 2007).

[60] *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).

[61] 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.")



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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.[62]

**CONCLUSION**

In sum, Mr. Chairman, thank you for the opportunity to offer these views on S. 1782. 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 make worse off the very people whom Congress, through this legislation, is seeking to protect.

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



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**TESTIMONY OF**
**SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION**

**BEFORE THE**

**SENATE COMMITTEE ON THE JUDICIARY**
**SUBCOMMITTEE ON THE CONSTITUTION**

**UNITED STATES SENATE**

**HEARING ON**
**"S. 1782, THE ARBITRATION FAIRNESS ACT OF 2007"**

**DECEMBER 12, 2007**

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to submit testimony on the Arbitration Fairness Act, S. 1782. 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. In October, 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-

[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.)



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dispute agreements to arbitrate. A copy of our paper is attached to this testimony.[2]

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"

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[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").

[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).



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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 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;

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[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.

[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).



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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 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

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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).



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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.

***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.



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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.



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Testimony of Tanya Solov

Director, Illinois Securities Department
Illinois Secretary of State
On behalf of the North American Securities Administrators Association

Before the
United States Senate Committee on the Judiciary
Constitution Subcommittee

"S. 1782, the Arbitration Fairness Act of 2007"

December 12, 2007



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Chairman Feingold, Ranking Member Brownback, and Members of the Subcommittee,

I am Tanya Solov, Director of the Illinois Securities Department and I am honored to convey the North American Securities Administrators Association's (NASAA)[1] support for S. 1782, the Arbitration Fairness Act of 2007. State securities administrators view this issue with such importance that the second item listed on NASAA's 2007 Pro-Investor Legislative Agenda was "Restore Fairness and Balance in the Securities Arbitration System." We're delighted with your leadership on this subject and thank you for the opportunity to testify about arbitration from the perspective of investors on Main Street.

*The Role of State Securities Regulators*

The securities administrators in your states are responsible for enforcing state securities laws, the licensing of firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, and providing investor education programs and materials. Like me, ten of my colleagues are appointed by their Secretaries of State, others by their Governors, some are independent commissions, and five fall under the jurisdiction of their states' Attorneys General. We have been called the "local cops on the securities beat," and I believe that is an accurate characterization.

As the securities director for the state of Illinois, I interact with investors who approach me at various programs across the state or call my office with inquiries and complaints. My office works with criminal authorities to prosecute companies and individuals who

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, the U.S. Virgin Islands, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.



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commit crimes against our citizens, and brings civil actions for injunctions, penalties and restitution for investors. We also educate our constituents through publications, videos and seminars so that they may be better able to protect themselves.

*Mandatory Securities Arbitration*

The Constitutional right of investors to have their day in court was rendered meaningless after the U.S. Supreme Court held in *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987), that predispute arbitration clauses were enforceable in the securities context. The impact of that decision is more profound today because the profile of those investing in our capital markets has changed significantly since the *McMahon* case was decided in 1987. We've gone from a nation of savers to one of investors. Twenty years ago, those investing in the securities markets were higher income individuals with other secure sources of income such as a defined benefit pension plan. Today, roughly half of all U.S. households rely on the securities markets to plan and prepare for their financial futures. They include school teachers, fire fighters and policemen who work in your communities, invest in their 401(k) retirement plans, and depend on their financial advisors' representations regarding their financial future.

Twenty years ago, investors had a choice of investing with a firm that required arbitration or one that recognized a judicial forum for disputes. Today, almost every broker-dealer includes in their customer agreements, a predispute arbitration provision that forces public investors to submit all disputes that they may have with the firm and/or its associated persons to mandatory arbitration. The only chance of recovery for most investors who fall victim to wrongdoing on Wall Street is through a single securities arbitration forum maintained by the securities industry. Many investors remain unaware of this industry arbitration provision, fail to appreciate its significance, or feel powerless to negotiate a different approach to dispute resolution with their brokers.

It is not surprising that many investors view industry arbitration as biased and unfair. Even in 1987, Justice Blackmun, in the *McMahon* dissent, noted: "The uniform



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opposition of investors to compelled arbitration and the overwhelming support of the securities industry for the process suggest that there must be *some* truth to the investors' belief that the securities industry has an advantage in a forum under its own control." (482 U.S. 220, 260, citing Sheldon H. Elson of the ABA Arbitration Task Force). Investors' perception that the industry has an advantage is bolstered by arbitration statistics. An investor's chance of winning an arbitration award has declined from approximately 60% in 1989-90 to about 43% by 2006. (See Securities Arbitration-How Investors Fare, GA/GGD-92-74, (May 11, 1992); NASD Dispute Resolution Statistics). It is also noteworthy that a "win" in arbitration often amounts to recovery of only a fraction of the losses incurred by the investor and, in certain instances, the sum awarded amounted to less than the costs and fees the investor paid out of pocket to pursue the case.

When arbitration is inadequate to protect the substantive rights of investors, an independent judicial forum must be an option. Arbitration may be desirable and adequate if both parties knowingly and voluntarily agree to waive the Constitutional rights provided in court. The decision to make this waiver should be made at the time the dispute arises. At this point, both parties may make the determination whether their particular dispute is best decided in a court of law with court-supervised discovery, a written opinion, and appellate review of complex legal issues.

The Financial Industry Regulatory Authority (FINRA) should require its member firms to offer their customers a meaningful choice between binding arbitration and civil litigation. If arbitration really is fair, inexpensive, and quick, as its adherents claim, then these benefits will prompt investors to choose arbitration. If, on the other hand, arbitration does not offer these advantages, then this mode of dispute resolution should not be forced upon the investing public.

NASAA believes the "take-it-or-leave-it" clause in brokerage contracts is inherently unfair to investors, and we support the Arbitration Fairness Act of 2007 as a positive step in the right direction. In the securities context, the investor and the brokerage firms are



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not on equal footing. Brokerage firms have significantly more resources to fight investor claims and they currently have the benefit of arbitrating in their own industry forum with an industry member hearing the case. Adding to this advantage is the level of familiarity and comfort that firms have in the arbitration forum. Brokerage firms are literally "repeat customers" having resolved thousands of complaints by arbitration and by this fact enjoy an advantage over the individual investor who may well be facing an arbitration panel for the first time. The hazards of litigation for the firm are thereby reduced further diminishing a firm's motivation to settle a complaint. The option to litigate in an independent judicial forum would go a long way towards bringing balance to the process and helping wronged investors in their attempts to recover their losses.

Until mandatory securities arbitration is a thing of the past, NASAA will continue to work to eliminate the inherent industry bias in the existing system. NASAA has been at the forefront of trying to make certain the securities arbitration system is fair and transparent to all. We recognize that over the years NASD, now FINRA, adopted a number of changes in an effort to improve the arbitration system, but more is needed. The consolidation of NASD and NYSE into FINRA has effectively resulted in a single industry run forum for the resolution of disputes between public customers and the securities industry. As a consequence, NASAA's concerns, and those of others actively engaged in arbitration issues, have been further heightened. Indeed, the public members of the Securities Industry Conference on Arbitration (SICA) wrote to Securities and Exchange Commission Chairman Christopher Cox[2] to address certain questions raised by the consolidation with respect to the future of securities arbitration. NASAA believes that absent the option of pursuing a claim in court, investors should at least be given a choice of arbitration forums; however, where there is no choice but arbitration through a program administered by FINRA, then this one forum must at least be independent and fair to investors.

[2] Letter from Public Members of SICA to SEC Chairman Christopher Cox, (Jan. 12, 2007) (on file with author).



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*Reforms to the Current System*

Securities arbitration cases are heard by a three-member panel that includes one "non-public" or securities industry member, and two "public" members, who may have worked in the industry. Neither of the public arbitrators is required to be an investor advocate, even though the non-public arbitrator *is* required to be an industry representative, and only FINRA, the industry SRO, selects who is qualified to be in the arbitrator pool. As long as arbitration panels include a mandatory industry representative of the securities industry and include public arbitrators who could have ties to the industry, the arbitration process will be both perceptively and fundamentally unfair to investors.

Many have justified mandatory industry participation based on the industry representative's role as an educator for the other panelists. It may be acceptable only if all parties in the case voluntarily agree that an industry expert is needed. However, if there is not agreement then there is no justification for the industry presence. First and foremost, expert witnesses ably serve the purpose of educating the arbitrators. In addition, where arbitration was once selected on a voluntary basis by investors seeking to handle simple disputes, the advent of mandatory arbitration moved all customer grievances to a more sophisticated arbitration process. Cases are typically presented by lawyers, they generally last for several days and the use of retained expert witnesses to present industry practices, procedures and rules to the panels is typical.

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. However, industry arbitrators bring their particular experiences, based on their firm's training, policies and procedures, to the decision-making process. As evidenced by industry scandals and regulatory enforcement actions, the industry's way of doing things is not always in conformance with the law. Even if the industry arbitrator has no preconceived notions, the industry arbitrator creates a presumption of bias that is contrary to the principles of fair play and substantial justice. Do courts in



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complex medical malpractice cases insist that one physician be empanelled in the jury box to "educate" the other jurors? 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. It is also disconcerting that the industry believes that the public arbitrators are not capable of understanding a case and rendering a decision. If that is indeed true, investors should not be forced to bring their case in such a forum. NASAA submits that intellectual honesty should not be discarded at the door of the arbitration forum.

When *McMahon* was decided, that Court noted several arbitration forums where industry members sat on the panels. In most of those instances, the parties in arbitration were also both industry members who were on equal footing. Consequently, industry arbitrators and their expertise would have been appropriate. That is not the case in securities cases where the investor is not on equal footing with the brokerage firm. (*McMahon*, 482 U.S. at 224, citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.* 473 U.S. 614 (1985)).

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.

NASAA urges the removal of mandatory industry arbitrators from the arbitration process, and for public arbitrators to have no ties to the industry. This change will bring greater fairness to securities arbitration and instill greater confidence in retail investors that their complaints will be heard in a fair and unbiased forum.

*Change The Definition Of A "Win" In Arbitration*

FINRA should improve the statistics that it collects and disseminates on arbitration, particularly with respect to outcomes. Proponents of arbitration often point out that



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investors receive "some amount of compensation" in over half of the arbitrations that result in a decision. *See, e.g.,* Linda D. Feinberg, Testimony Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, House Committee on Financial Services, at 1 (Mar. 17, 2005).[3] To the extent this statistic is intended to suggest that investors "win" more often than not, it is misleading. An investor who recovers only a small fraction of their losses in the arbitration process can hardly be described as a "winner," especially when attorneys' fees and costs are added to the mix. Much more accurate, for example, would be data reflecting the ratio of amounts awarded in relation to damages claimed. Fairly assessing the pros and cons of arbitration as a means of dispute resolution requires access to meaningful and accurate statistics.

State securities regulators often hear directly from investors who relay their experiences and concerns about the arbitration process. NASAA is in a position to communicate such problems to the SEC and FINRA. Recently, NASAA was admitted as a voting member to SICA which is one group that works on arbitration procedures and issues. It would also be beneficial to allow NASAA to be an official observer at the National Arbitration and Mediation Committee (NAMC) meetings where FINRA will address arbitration rules and procedures.

*Conclusion*

NASAA believes that securities arbitration system should be truly voluntary, that more meaningful and accurate statistics concerning arbitration outcomes should be compiled and disseminated, and the balance in the composition of arbitration panels should be restored.

As long as securities arbitration remains mandatory, investors will continue to face a system that is not fair and transparent to all. For this reason, NASAA supports the

[3] *Available at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013652&ssSourceNodeId=1263.*



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passage of S.1782, the Arbitration Fairness Act of 2007, and respectfully suggests that it be amended to clarify that its provisions extend to securities arbitration.

I thank the Chairman and each member of this Subcommittee for allowing me the opportunity to appear today. I look forward to answering any questions you have and providing additional assistance to you in the future.



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# Party at Ralph's

**November 7, 2007; Page A22**

We're old enough to remember when Naderite groups like Public Citizen were embarrassed by their ties to trial lawyers. No more. This week in Washington, the famous "consumer" group, which has long resisted efforts to identify the sources of its funding, is rolling out the red carpet for America's plaintiff attorneys. Attendees of the Consumer Rights Litigation Conference are cordially invited to Saturday night's cocktail reception at Public Citizen headquarters, which a conference brochure describes as "an elegant old Dupont Circle Victorian mansion . . . generously loaned to us for this special event."

No word yet on what the famously ascetic Ralph Nader thinks about standing up for the little guy by sipping cabernet at a Dupont Circle manse, but what's clear is that the trial lawyers will have plenty to celebrate. That's because they'll be visiting Congressional offices tomorrow and Friday to check on the progress of pro-lawsuit legislation, and they will not be disappointed. Bills gathering momentum in both houses are anything but subtle in their support for more class-action lawsuits. Tillinghast Towers Perrin estimates that litigation costs the U.S. more than $260 billion a year, and that figure is heading due north.

The Democratic strategy is to attach an anti-arbitration provision to nearly every new law in order to limit non-lawsuit dispute settlement. Thus a House lending bill this week bans pre-dispute arbitration agreements related to mortgages, another House bill bans them in cases involving whistleblowers, and the Senate farm bill bans them even in meatpacking contracts.

The mother of them all is a bill that lunges to fulfill the trial bar's long-cherished dream: prohibiting all Americans from voluntarily agreeing at the start of any business relationship to settle disputes without litigation. Arbitration, which avoids the cost and time of going to court, has proven to be a popular form of alternative dispute resolution. Even lawyers concede its virtues. In 2003, an American Bar Association survey found that 78% of lawyers "believe that arbitration is generally timelier than litigation, and 56% feel it is more cost effective."

The lawyers may concede the principle, but they still want the money. And speaking of money, the trial bar has plenty to share with friendly lawmakers. Representative Hank Johnson (D., Ga.), who coincidentally collected more money from lawyers than from any other industry group in the 2006 election cycle, has introduced the Arbitration Fairness Act. The bill would outlaw pre-dispute arbitration agreements in the future for all private contracts involving consumers, employment and franchising. And it would *retroactively*



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rewrite hundreds of millions of existing private contracts, all voluntarily accepted by consenting adults.

You could then count the minutes until class-actions are detonated against Wall Street brokerages, with their 100 million customer agreements featuring pre-dispute arbitration clauses, or against America's cell phone carriers, with more than 60 million customers who have agreed to forgo litigation. Party at Ralph's, indeed.

The idea that Americans could do business and even settle arguments without litigation is evidently beyond the pale to Mr. Johnson. The Congressman also displays a peculiar understanding of American markets when he notes in the findings section of his bill that when companies offer contracts to potential customers, "people increasingly have no choice but to accept them."

What you will not see in the findings of this bill, where politicians typically describe the problem they intend to solve, is any evidence that arbitration harms consumers or anyone else. His remarkably fact-free narrative does claim that arbitration is often heavily stacked in favor of companies, but a 2004 study in Law and Contemporary Problems, a publication of Duke Law School, found exactly the opposite. Under existing law, judges can throw out arbitration agreements tilted too far in favor of one party, so most arbitration clauses tend to give the consumer a reasonably fair shake.

University of Kansas law professor Stephen J. Ware says that even in cases where arbitration contract terms are more favorable to sellers, the result is generally lower prices for consumers, because the cost of lawyering has been stripped out. "Recognition of this has been standard in the law-and-economics literature for at least a quarter of a century," he notes.

Balanced against this academic research comes a "study" from -- you guessed it -- Public Citizen, claiming that its sleuths have found an arbitration firm operating in California that has been unfair to consumers in a particular type of debt dispute. The lawyers will be drinking to that discovery all week in Washington. We trust the White House is paying attention, and will put a damper on the revels by promising to veto this litigation bonanza if it should ever hit the President's desk.



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*Expanding the Wireless Frontier*

The Honorable Russ Feingold
Chairman
Senate Judiciary Subcommittee on the Constitution,
Civil Rights, and Property Rights
506 Hart Senate Office Building
Washington, D.C. 20510

Re: S. 1782, the Arbitration Fairness Act of 2007

Dear Chairman Feingold:

CTIA-The Wireless Association® and the undersigned wireless carriers write to advise you of our concerns about the proposed Arbitration Fairness Act of 2007 (S. 1782). Wireless carriers make use of arbitration agreements with their customers in order to provide a streamlined and more effective forum for resolving disputes that may arise between consumers and their carrier of choice. Because individual arbitration is simple and relatively informal, it allows both companies and customers to resolve disputes in a manner that is faster, cheaper, and more easily tailored than litigation to resolving these disputes. Keeping customers satisfied is particularly important in the highly competitive wireless industry, because the largest cost most carriers face is the cost of obtaining new subscribers.

S. 1782 would eliminate the arbitration agreements between the carriers and their customers, harming both the carriers themselves and their several hundred million customers. That would be a shame, because wireless carriers that employ arbitration as a dispute resolution mechanism have designed their arbitration agreements to make arbitration an effective means of dispute resolution for their customers. Specifically:

- ***Arbitration is cheap for customers***: the carriers generally either pay all of the costs of arbitration, or cap the customer's costs at the equivalent filing fee in court.

- ***Arbitration is convenient for customers***: the carriers generally guarantee that arbitration will take place near where the customer lives or works.

- ***Arbitration is fair for customers***: under the wireless carriers' arbitration provisions, customers can generally recover similar remedies as in court, and are not required to keep an arbitration confidential.

Individual arbitration is the most effective avenue for consumers to obtain redress of their disputes. The overwhelming majority of disputes between customers and their wireless carriers are small (usually amounting to several hundred dollars or less), and individualized (about equipment problems or billing matters). These claims are not susceptible to class certification, nor are these claims large enough to pique the interest of most attorneys if they had to be litigated. While many wireless carrier arbitration agreements permit consumers to pursue claims in small claims court, consumers who wish to pursue a claim without the expense of hiring a lawyer can use the arbitration process to seek resolution of their claims.

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By eliminating this option and forcing disputes into litigation, S. 1782 will harm, not help, consumers. Wireless service providers, like other businesses, realize cost-savings from the use of arbitration agreements, and pass those savings on to their customers through lower prices for service and equipment. Any customers who then bring a claim in arbitration realize additional savings by avoiding the high cost of litigation. The bill would eliminate customers' ability to agree to invoke this inexpensive dispute-resolution mechanism, and likely lead to higher costs and greater delays in resolving these claims.

Before taking action that is likely to produce a more costly, less customer-friendly dispute resolution process, Congress should carefully review the existing data, which show that arbitration benefits customers and that customers obtain better results in arbitration than in litigation. For these reasons, we respectfully oppose this legislation as drafted.

Sincerely,

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| CTIA - The Wireless Association | Sprint Nextel Corporation |
| Alltel | AT&T |
| T-Mobile USA | U.S. Cellular |

Cc: Senator Sam Brownback
Senator Benjamin Cardin
Senator John Cornyn
Senator Richard Durbin
Senator Dianne Feinstein
Senator Lindsey Graham
Senator Edward Kennedy
Senator Arlen Specter

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