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MANDATORY BINDING ARBITRATION: IS IT FAIR AND VOLUNTARY?

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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Enclosures to Cliff Palefsky's Response to the Post-Hearing Questions have been retained in the official Committee hearing record available at the Subcommittee.

Report by the Searle Civil Justice Institute Consumer Arbitration Task Force, Consumer Arbitration Before the American Arbitration Association, March 2009. This report is available at the Subcommittee and can also be accessed at:

http://www.searlearbitration.org/p/full__report.pdf

Enclosures to the Prepared Statement of Public Citizen have been retained in the official Committee hearing record available at the Subcommittee.

Enclosure to the Prepared Statement of Bruce Yardwood on behalf of the American Health Care Association (AHCA) and the National Center for Assisted Living (NCAL) has been retained in the official Committee hearing record available at the Subcommittee.

MANDATORY BINDING ARBITRATION: IS IT FAIR AND VOLUNTARY?

TUESDAY, SEPTEMBER 15, 2009

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

The Subcommittee met, pursuant to notice, at 1:17 p.m., in room 2141, Rayburn House Office Building, the Honorable Steve Cohen (Chairman of the Subcommittee) presiding.

Present: Representatives Cohen, Conyers, Watt, Maffei, Johnson, Scott, Franks, and Coble.

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

Mr. COHEN. My apologies for being late. This hearing of the Committee on the Judiciary Subcommittee on Commercial and Administrative Law will now come to order. Without objection the Chair will be authorized to declare a recess of the hearing.

I will now recognize myself for a short statement. This past May, this Subcommittee held a hearing focused on the credit card industry's use of arbitration. Today's hearing is not focused on a specific industry. Instead this Subcommittee will examine the use of arbitration in employment contracts, long-term care facility admission contracts and other consumer contracts.

Also, the witnesses will update us on the recent developments in the last 4 months which necessitate us having a further discussion on the use of mandatory arbitration. We are looking at many changes to the realm of arbitration. The National Arbitration Forum has abandoned its consumer arbitration practice, and the American Arbitration Association has halted its practice of arbitrating debt collection cases.

Bank of America has chosen not to seek enforcement of arbitration agreements with specific customers and American Express is re-evaluating its arbitration policy.

The Federal Trade Commission is examining this process as well, and President Obama's administration is urging a new Federal agency be able to regulate the use of arbitration in consumer transactions.

While all of these changes are a positive step, it is unclear what impact they may have on the arbitration process. As a Nation that has championed civil rights and consumer protection laws, we must

balance the needs for quicker and inexpensive resolution for disputes with upholding a consumer's right to choose.

According to my colleagues on the other side, the Supreme Court has interpreted the FAA to permit challenges to an arbitration agreement if that challenge is based on generally applicable state contract law. As a result, they contend that courts around the country routinely strike down arbitration agreements that do not provide consumers with fair notice or fair procedures.

While some courts have struck down arbitration agreements, and decisions, it certainly hasn't happened routinely. Courts have done so only for the most egregious examples, such as where there is evidence that the arbitrators were corrupt or where the arbitration agreements were unconscionable.

And as we all know, it is difficult to prove corruption without expending enormous resources, which most employees and customers don't have the resources to carry that type of suit to conclusion. Further, most states have a very narrow view of what constitutes unconscionability. Thus the system does not protect consumers.

While arbitration may offer benefits, and certainly it does, and I understand that, and I have talked to many people about it, and they can facilitate the correction of certain problems and in an inexpensive and timely manner, I still have concerns about the use of mandatory binding arbitration agreements in any context in light of the lawsuit against the National Arbitration Forum.

Certainly sensitive to the importance of the arbitration process and how it can be helpful in resolving issues, but adhesion contracts cause me a problem and have since I learned about them in law school. Nevertheless, there are instances in which the process may not always be the best in the interest of the consumers or employees because sometimes they are adhesion contracts, and sometimes it doesn't allow them to get the proper redress of injuries they may suffer.

We must be sure the arbitration process is fair and voluntary so that all parties to a dispute can reap the benefits of arbitration. Accordingly, I look forward to receiving today's testimony, and I now recognize my colleague Mr. Franks, the distinguished Ranking Member for his opening remarks.

Mr. FRANKS. Well, thank you, Mr. Chairman, and Mr. Chairman, I would like to welcome the two Members here, Mr. Johnson and Ms. Sánchez. I had the privilege of seeing Ms. Sánchez's addition to her family, and I have this sneaking suspicion it may be a little Democrat. But I tell you, it was a precious, precious little boy, and it kind of gives the rest of us hope here.

Mr. Chairman, in all due deference to probably the opposing viewpoints at the table here, I guess I would start out by saying, you know, arbitration, I believe is a critical tool in our society because it makes justice prompt and accessible for millions of Americans, and without it too many citizens would be left out in the cold by overburdened courts and overpriced lawyers.

I feel strongly enough about this that I circulated a letter yesterday to all my colleagues seeking to set the record straight on arbitration, and because I believe that record is so full of myths that it can be hard for us to see the issue clearly.

Many times, for example, I hear claims that the voluntary use of pre-dispute arbitration agreements somehow undercuts consumers' indelible rights to jury trials, but I think that can be hardly further from the truth.

Jury trials are remote prospects in the vast majority of consumer lawsuits in the first place. The norm for these cases in court is not jury trial, but dismissal on pre-trial motions or disposition on summary judgment.

Many cases, of course, are settled, perhaps most significantly in consumer class actions. But class actions routinely leave consumers with pennies on the dollar for their claims. It is the wealthy trial lawyers who bring these cases, not the consumer plaintiffs, who reap the profits from litigation.

Still worse, the right to trial jury is simply hollow for those whose claims are too small for a lawyer to make. Millions upon millions of Americans who have claims that are clearly meritorious don't generate enough legal fees to attract a lawyer. These citizens face tall odds when they go it alone in court. It is the simple, flexible, inexpensive procedures of arbitration that allow them to seek and obtain meaningful relief.

Now, the second myth is that the courts have interpreted the Federal Arbitration Act to trump state laws, leaving consumers little recourse in the few cases in which arbitration might be unfair. But the Supreme Court has interpreted the act to permit anyone to challenge an arbitration agreement if the challenge is based on generally applicable state contract law.

In applying this standard, courts around the country regularly apply legal principles, such as state unconscionability law to strike down arbitration agreements that do not provide consumers with fair notice or fair procedures.

And the third myth is that arbitration involves high administrative fees and unduly limits discovery. The truth again is to the contrary. The American Arbitration Association, for example, limits consumers' fees to only $125 for arbitration claims seeking less than $10,000. The AAA's consumer due process protocol, meanwhile, calls for consumers to have access to discovery that is legally obtainable and relevant to their case.

Recently there has been one incident that has led to renewed calls for restrictions on mandatory binding arbitration, and that was the National Arbitration Forum's withdrawal from consumer arbitration. NAF's action followed a lawsuit over the Forum's debt collection relationships. But Mr. Chairman, this incident shows that problems are already being solved in the one sector that has been the poster child for enemies of arbitration.

NAF's debt collection experience provides no basis for reaching out to prohibit mandatory binding arbitration across the board. Too often Congress specializes in legislating unnecessary, quote, "solutions" to nonexistent problems. Such legislation typically serves only to strengthen special interests such as the plaintiff's trial bar.

I hope that Congress does not pursue an unnecessary solution to the mythical problems with arbitration. That legislation would come at a huge price, the sacrifice of one of the practical means that millions of Americans have to obtain justice. And with that, Mr. Chairman, I respectfully yield back.

Mr. COHEN. Thank you, and I thank you for your statement.

And I now recognize Mr. Conyers, distinguished Member of the Subcommittee and the congressperson from the state that has a football team, once again, for an opening statement.

Mr. CONYERS. Thank you, Mr. Chairman. We welcome the witnesses, but particularly our two Members of the Committee who have been making very important and unique contributions on the subject. This debate started in 1925 when we passed the first Federal Arbitration Act, but here is what brings us here today.

Arbitration has not always been beneficial to all parties. Arbitration has not been fair to all parties, and arbitration has sometimes eviscerated protection of some Federal consumer and civil rights statutes. I commend Ms. Sánchez, a former Subcommittee Chair herself, for her targeting and focus on one particular area of nursing homes, and that is critical, and that to Hank Johnson. His approach is a wider one.

Now, there are some more problems that have cropped up. The claim, well, there is secrecy in arbitration awards so we don't know who needs—we sometimes need to change the law and we don't get a chance to do it because the awards are required not to be published. So there is some wrongdoing that sometimes escapes our attention and ultimately harms everybody.

And then originally, arbitration was conceived of as one organization or organizations in the same industry. For example, if General Motors and Chrysler ended up in arbitration there would be some balance. The question, though, is what happens when it is an employee going up against an employer? That is a different situation.

And I am sorry to report that arbitrators have not always been found to be neutral, and that as a matter of fact there has been established relationships with parties on one side of the dispute or other that have made it unlikely to get a fair result.

And then mandatory provisions have escalated. They are in every kind of contract and it is a "take it or leave it" deal. It is in there. What is the matter with you? You don't like arbitration? What is your problem?

Credit card companies are infamous in the way they do this. Cell phone providers, again, that dictate their consumer product sales and service contracts have mandatory arbitration clauses, and so millions of consumers and employees are left with little or no way to change or modify or negotiate an arbitration clause, so——

I am looking at some studies by Public Citizen, Christian Science Monitor, Center for Responsible Lending, the Minnesota attorney general's decision, and I want to start this hearing. We have got some fine University of Michigan law school people here, and I want to get them up, as well as our distinguished Members of the Committee. Thank you, very much.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

During the Congressional debates on arbitration more than 70 years ago, witnesses testified about the potential benefits of this form of resolving disputes without judicial intervention.

They noted, for example, that when arbitration is properly used, it can help parties avoid the delay and costs of protracted litigation. And arbitration can serve to relieve the burden on courts to decide disputes.

Their testimony led Congress to pass the Federal Arbitration Act, which empowered courts to enforce arbitration agreements.

As we have since learned during the last 20 years, however, arbitration is not always beneficial to all parties, and it may eviscerate the protection of some federal consumer and civil rights statutes.

Others claim that the secrecy of arbitration awards hinders the development of the law, and awareness of wrongdoing by businesses, which ultimately harms all consumers and employees.

Still others assert that arbitration providers and arbitrators are not always neutral and, in fact, may have cozy relationships with parties on one side of these disputes.

Nevertheless, the use of mandatory provisions in various contractual agreements has rapidly escalated in recent years and, as a result, has become virtually ubiquitous.

Many businesses—from credit card companies to cell phone providers—dictate that their consumer product sale and service contracts include mandatory arbitration clauses. Similarly, many employers demand that their workers agree to arbitrate employment disputes as a condition of their employment.

As a result, millions of consumers and employees across our Nation are legally bound to mandatory arbitration clauses in contracts with little or no ability to negotiate them.

To those who wonder why these mandatory arbitration clauses are fundamentally unfair to consumers and employees, here are just a few reasons.

First, those who are charged with determining arbitration disputes may not really be neutral and independent.

For many years, former arbitrators, consumers, and employees have contended that arbitration providers tend to favor their business customers. Specifically, they assert that arbitrators often decide in favor of businesses and, in the rare instances when they rule in favor of consumers or employees, they often award damages lower than what was requested.

Indeed, this Subcommittee has heard from several witnesses supporting these assertions, as well as considered studies and analyses by Public Citizen, the Christian Science Monitor, and the Center for Responsible Lending that reached similar conclusions.

But it was not until this summer, when a lawsuit filed by the Minnesota Attorney General helped to focus a national spotlight on these serious allegations, that we learned how true they were.

The lawsuit alleged that the National Arbitration Forum, a major arbitration provider claiming that it is independent, neutral, and unaffiliated with any party to a dispute, was actually encouraging companies to insert arbitration agreements in their consumer contracts, and to appoint the Forum to arbitrate their disputes.

Worse, the complaint alleges, the Forum blackballed arbitrators who ruled against its favored businesses, and had financial ties to some businesses that were parties to disputes it arbitrated.

Obviously, arbitration under these circumstances could not be considered fair. The Forum quickly agreed to a settlement, which included its complete withdrawal from arbitrating consumer cases.

After this settlement, the American Arbitration Association, another major arbitration provider, promptly announced that it would cease arbitrating certain consumer disputes.

Despite these developments, nothing currently prevents other arbitration providers from providing services that are not independent.

Minnesota's lawsuit certainly calls into question whether arbitration proceedings are consistently conducted by neutral arbitrators.

But consumers and employees should not have to rely on governmental lawsuits to ensure that arbitration proceedings are fair.

Accordingly, I urge Congress to consider legislation that would restore integrity to the arbitration process, or limit the enforceability of mandatory arbitration clauses, or both.

Clearly, in the absence of governmental oversight, arbitration providers and businesses have established relationships that benefit them financially at the expense of consumers and employees.

Second, mandatory arbitration clauses are particularly unfair to consumers and employees, because they often lack any bargaining power over whether these clauses are included in contracts with their business counterparties.

It should come to no surprise that many of these clauses, when included in consumer and employment contracts, favor businesses.

By virtue of these clauses, consumers and employees legally lose their constitutional right to a jury trial. In addition, some of the procedural requirements these clauses impose can make it difficult, even cost-prohibitive, for consumers to protect their rights under the law.

Congress should not restrict the rights and options of consumers and employees to resolve disputes. Rather, arbitration should be one option among many to resolve disputes. It should not be the only option.

Third, the courts have greatly expanded the scope of the Federal Arbitration Act to apply to consumers and employees in respects not originally intended by the Act's drafters.

As we have learned, the Federal Arbitration Act was conceived to give courts the authority to enforce arbitration awards, and Congress intended for the Act to apply only to disputes between merchants of an equal bargaining position. The Act was not intended to apply to workers or consumers.

Nevertheless, the Supreme Court has substantially broadened the reach of the Act, which has, in turn, encouraged the inclusion of mandatory arbitration clauses in nearly every type of consumer and employment contract.

The Court's decisions have very much weakened the impact of Federal and State consumer protection laws and employee rights laws. As a result, many Americans have been denied their day in court.

Congress should therefore consider legislation clarifying the Act's original intent and spirit.

Legislation that protects consumers and employees is a common-sense solution for all Americans.

My colleagues, Representatives Linda Sánchez and Hank Johnson, each have introduced legislation that make positive steps toward a solution.

Their proposals will allow consumers, employees, franchisees, residents of long-term care facilities, and others to opt for arbitration, rather than have arbitration imposed on them as a pre-condition for service or employment. Their legislation would help ensure a fairer arbitration process because the terms of arbitration will not be dictated by one party to the dispute.

If Congress fails to be more assertive in protecting consumers and employees and guaranteeing the right to a jury trial, I fear that more Americans will be on the losing end when they have to arbitrate a dispute.

I thank the witnesses for being here today, and look forward to hearing their testimony.

Mr. COHEN. Cheer, cheer for Michigan, da, da—thank you for the gentleman's statement. Without objection other Members' opening statements will be included in the record and first I would like to—we have a panel of congresspeople.

And I do welcome Ms. Sánchez, the former Chairperson of this particular Committee, and Mr. Johnson, the Chairperson of another distinguished and important Subcommittee of the Judiciary Committee. And I welcome each of them to the Committee, and I would recognize the former Chairlady, Ms. Sánchez, for her statement.

TESTIMONY OF THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. SÁNCHEZ. Thank you, Chairman Cohen and Chairman Conyers and Ranking Member Franks and Members of the Committee for allowing me the opportunity to testify today about a very important piece of legislation, which also has a very deeply personal meaning for me.

Last Congress, when I chaired this Subcommittee, we held several hearings to investigate the fairness and usefulness of arbitration agreements. We learned among other things that arbitration

is a very useful alternative to the court system, but especially when the parties agreeing to arbitrate have about the same level of knowledge and the same amount of sophistication regarding it.

On the other hand, we also found that in certain circumstances arbitration agreements can be forced on vulnerable parties who have little knowledge about what they are signing, and quite frankly, little choice, if any choice, in the matter at all.

I want to be very clear that I strongly support the principles of arbitration and the arbitration process. Arbitration can clear court dockets, provide swift resolution and reduce legal fees. But because it can also limit evidence and damages and deny the possibility of a jury trial, it must be willingly entered into by both parties, not just the party with the superior economic power.

Checking a parent or other relative into a nursing home or other long-term care facility is a perfect example of a time when one party has no real power or choice in the matter. And for these reasons I introduced H.R. 1237, the Fairness in Nursing Home Arbitration Act, to make pre-dispute, mandatory arbitration clauses in long-term care contracts unenforceable and to restore to residents and their families their full legal rights.

This legislation would allow families and residents to maintain their peace of mind as they look for that perfect long-term care facility.

By 2040, the demand for long-term care services will more than double in this country and the long-term care industry is increasingly requiring patients or their guardians to sign binding, pre-dispute arbitration clauses as a prerequisite to admission.

Unfortunately, the inclusion of such mandatory clauses adds a confusing and legally binding complication to an event that is already difficult enough and sometimes even very heartbreaking. For desperate families who are unable to provide adequate care at home, the need for an immediate placement for their loved one makes the "take it or leave it" choice no choice at all.

Families who are in the midst of a very painful decision to place a parent in a nursing home rarely have the time or wherewithal to fully and thoughtfully consider mandatory arbitration clauses. They are in no position to adequately determine what agreeing to such a clause will mean for their loved one should the unthinkable happen.

Instead of some future dispute, what is real and immediate is the prospect of needing care for a loved one now. The emotional toll and the sense of vulnerability when moving a loved one into the care of strangers at a nursing home is something that I am familiar with. My father, who has been struggling with Alzheimer's for a number of years, took a turn for the worse in the past year, to the point where we could no longer provide safe and adequate care at home for him.

One of the last things that I wanted to worry about when searching for a perfect placement was whether or not he was forgoing his legal rights. Instead, I wanted to focus solely on the quality and the range of services that each facility had to offer. As it turned out, my family chose a facility that met other requirements but also had a mandatory pre-dispute arbitration clause in its contract.

This bill that I have introduced is for the families across the Nation who face similar decisions at a time when they are least prepared to make them. As we learned last year, average consumers are totally unfamiliar with the concept of arbitration. They may not even be aware of the rights that they are signing away when they agree to it. In short, I believe that Congress should act to protect these vulnerable families.

I want to also clarify that not all nursing home operators use mandatory, binding arbitration agreements upon admission. Some do try to protect vulnerable families, for instance, by offering arbitration on a voluntary basis. Others do admit patients immediately but give them time to consider whether arbitration is right for them.

This bill is fundamentally about fairness. It promotes fairness for families experiencing the trauma of a parent in declining health by making unenforceable mandatory, binding arbitration agreements that families were essentially forced to sign whether they wanted to or not.

Fairness demands that parties to a contract should have a legitimate choice, not a forced one, about whether or not to arbitrate their disputes. I am proud to note that several significant groups who advocate on behalf of seniors and consumers, including AARP, the National Senior Citizens Law Center, the Alzheimer's Foundation of America and the National Association of Consumer Advocates, all support H.R. 1237.

In closing, I just want to mention one thing because I have been accused of being anti-arbitration. What this bill seeks to do is just take away the unequal bargaining power in a pre-dispute situation. There is nothing that would take it away in a post-dispute, which means that parties after a dispute arises could agree to have their dispute settled in binding arbitration if they so choose.

But it would not force people into that scenario when they haven't had adequate time to recognize what they are signing when they sign a mandatory, pre-dispute, binding arbitration clause. I think you very much for the opportunity to testify today and I hope that you will join me in supporting this legislation.

[The prepared statement of Ms. Sánchez follows:]

PREPARED STATEMENT OF THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND MEMBER, COMMITTEE ON THE JUDICIARY

Hearing on Hearing on Mandatory Binding Arbitration: Is it Fair and Voluntary?
CAL Subcommittee
Rep. Linda T. Sánchez
September 15, 2009

Chairman Cohen, Chairman Conyers, and Ranking Member Franks, thank you so much for allowing me the opportunity to testify today about this very important legislation, which also has deeply a personal meaning to me.

Last Congress, when I chaired this Subcommittee, we held several hearings to investigate the fairness and usefulness of arbitration agreements. We learned, among other things, that arbitration is a very useful alternative to the court system, especially when the parties agreeing to arbitrate have about the same level of knowledge and sophistication regarding it.

On the other hand, we also found that, in certain circumstances, arbitration agreements can be forced on vulnerable parties who have little knowledge about what they are signing, and frankly little choice in the matter.

I want to be clear that I strongly support the principles of arbitration and the arbitration process. Arbitration can clear court dockets, provide swift resolution, and reduce legal fees. But, because it can also limit evidence and damages, and deny the possibility of a jury trial, it must be willingly entered into by both parties, not just the party with greater economic power.

Checking a parent or other relative into a nursing home or other long-term care facility is a perfect example of a time when one party really has no real power or choice in the matter.

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By 2040 the demand for long-term care services will more than double. And the long-term care industry is increasingly requiring patients or their guardians to sign binding, pre-dispute arbitration clauses as a prerequisite to admission.

Unfortunately, the inclusion of such mandatory clauses adds a confusing—and legally binding—complication to an event that is already difficult and even heartbreaking.

For desperate families who are unable to provide adequate care at home, the need for an immediate placement for their loved one makes the "take-it-or-leave-it" choice no choice at all.

Families who are in the midst of the painful decision to place a parent in a nursing home rarely have the time or wherewithal to fully and thoughtfully consider mandatory arbitration clauses.

They are not in a position to adequately determine what agreeing to such a clause will mean for their loved one should the unthinkable happen.

Instead of some future dispute, what's real and immediate is the proper care of a loved one **now**.

The emotional toll and the sense of vulnerability when moving a loved one into the care of strangers at a nursing home is something I am all too familiar with.

My father, who has been struggling with Alzheimer's for a number of years, took a turn for the worse in recent years, to the point where we could no longer provide safe and adequate care at home.

One of the last things I wanted to worry about when searching for that perfect placement was whether he was forgoing his legal rights. Instead, I wanted to focus solely on the quality and range of services the facility would provide him.

As it turned out, my family chose a facility that met our requirements but also had a mandatory, pre-dispute arbitration clause in its contract.

This bill is for the families across the nation who face similar decisions at a time when they are least prepared to make them.

As we learned last year, many average consumers are totally unfamiliar with the concept of arbitration. They may not even be aware of the rights they are signing away. In short, Congress should act to protect these vulnerable families.

Let me also clarify that not all nursing home operators use mandatory, binding arbitration agreements upon admission. Some do try to protect vulnerable families by, for instance, offering arbitration on a voluntary basis. Others admit patients immediately, but give them time to consider whether arbitration is right for them.

This bill is about fairness. It promotes fairness for families experiencing the trauma of a parent in declining health by making unenforceable mandatory, binding arbitration agreements that families were essentially forced to sign whether they wanted to or not.

Fairness demands that parties to a contract should have a legitimate choice, not a forced one, about whether or not to arbitrate their disputes.

I am proud to note that several significant groups who advocate on behalf of seniors and consumers, including the National Senior Citizens Law Center, the Alzheimer's Foundation of America, and the National Association for Consumer Advocates, support H.R. 1237.

I thank you for the opportunity to testify today and hope that you will all join me in supporting this legislation.

Mr. COHEN. Thank you, Congresswoman Sánchez. We welcome you back to your old home and thank you for your coming here.

Our next witness is Representative Hank Johnson, who represents Georgia's 4th Congressional District. He is a regional whip, and he also serves on the House Democratic leadership. He is on Armed Forces and Judiciary and Chairman of the Courts and Com-

petition Policy, a distinguished Member of this Subcommittee and my dear friend.

You are recognized.

TESTIMONY OF THE HONORABLE HENRY C. "HANK" JOHNSON, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. JOHNSON. Thank you, Chairman Cohen, and I have always tried to be as great a Member as you have set the example for me. But I want to get into this. Forced arbitration has been a concern of mine for many years, and I firmly believe that the Congress must act in this instance to protect consumers.

In the 100——

Mr. COHEN. Mr. Johnson, it has been suggested that you might need to pull the mike a little closer because some of us don't hear as well as we did 20 years ago.

Mr. JOHNSON. All right. Okay. In the 110th Congress I introduced the Arbitration Fairness Act, a bill that would prevent all forced pre-dispute arbitration clauses. That bill passed favorably out of this Subcommittee, and I reintroduced the legislation in this Congress, and I am proud to have the Chairman of the full Judiciary Committee and three other fine Members of this Subcommittee as original co-sponsors.

In fact, this bipartisan bill already has 90 co-sponsors. H.R. 1020, the Arbitration Fairness Act, does not eliminate all arbitration; it merely prevents forced pre-dispute arbitration clauses. Consumers may still opt to arbitrate a dispute with a company, but only when that consumer determines that it is the appropriate forum at the time the conflict arises and not before.

As Chairman of the Judiciary Committee, Judiciary Subcommittee on Courts and Competition Policy, I believe it is vital that consumers continue to have access to the courts and not be foreclosed from litigation by the constraints of pre-dispute forced arbitration clauses. Major arbitration companies, including the National Arbitration Forum and the American Arbitration Association, have recently stopped arbitrating consumer claims.

However, pre-dispute arbitration clauses remain in many of the consumer, franchisee and employment contracts. This means that the NAF and the AAA's grand gestures do not actually mitigate the harmful impact of forced arbitration clauses on consumers.

Another company will eventually fill the void and begin to arbitrate consumer claims again. There is no reason to think that the arbitration process will be any fairer to consumers when this occurs.

Just a few weeks ago, Bank of America voluntarily dropped its mandatory arbitration program for credit card disputes, deposit account disputes and disputes involving loans for automobiles, recreational vehicles and boats.

This is very noble of Bank of America, and it is the kind of reform we need, but we cannot count on companies to voluntarily remove arbitration clauses when so many of the companies benefit tremendously from them.

I recently wrote a letter to the attorney general of the state of Georgia addressing the need for close scrutiny of arbitration

clauses in home builder contracts. The personal harm alleged by several of my constituents shows how difficult it is for consumers to prevail in the arbitration process.

The abusive practices that harm these victims are indicative of a much larger problem where consumers are forced to agree to arbitration clauses that strongly favor the company to the detriment of the consumer.

You know, it is okay to, across the backyard fence, to lie to your neighbor about the length and weight of the fish that you caught or about your previous career as an actor or a model or something like that.

I mean, you can do that. But in court, at the courthouse, you must take an oath of office and swear to tell the truth, and that promise or that oath is enforceable through the criminal laws of this Nation and various states. But we have no kind of fundamental check and balance on arbitration proceedings with respect to having to tell the truth.

And secondly, well, I am not going to go into all the particulars. I know that our witnesses to come will go into various aspects of forced arbitration and why we need to take action as a legislature to correct this imbalance which has existed. Thank you.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF THE HONORABLE HENRY C. "HANK" JOHNSON, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Thank you, Chairman Cohen, for the opportunity to testify today before the Commercial and Administrative Law Subcommittee. Forced arbitration has been a concern of mine for many years and I firmly believe that Congress must act in this instance to protect consumers.

In the 110th Congress, I introduced the Arbitration Fairness Act, a bill that would prevent *all* forced pre-dispute arbitration clauses. That bill passed favorably out of this Subcommittee. I re-introduced my legislation in this Congress, and am proud to have the Chairman of the Full Judiciary and three other fine members of this Subcommittee as original cosponsors. In fact, this bipartisan bill already has over 90 cosponsors.

The Arbitration Fairness Act does not forbid arbitration clauses. It merely prevents *forced pre-dispute* arbitration clauses. Consumers may still opt to arbitrate a dispute with a company. But only when that consumer determines that it is the appropriate forum at the time the conflict arises and not before.

As Chairman of the Judiciary Committee Subcommittee on Courts and Competition Policy, I believe it is vital that consumers continue to have access to the courts and not be foreclosed from litigation by the constraints of a pre-dispute forced arbitration clause.

Major arbitration companies, including the National Arbitration Forum and American Arbitration Association have recognized that the arbitration process, in its mandatory form, is unfair to consumers. Recently, Bank of America voluntarily dropped its mandatory arbitration program for credit-card disputes, deposit account disputes and disputes involved loans for automobiles, recreational vehicles and boats.

These small steps towards eliminating forced arbitration clauses only underscores the need for Congress to enact my legislation along with Representative Sanchez's Fairness in Nursing Home Arbitration Act. Pre-dispute forced arbitration agreements are nearly always the product of unequal bargaining power between the consumer and the business. The scales of justice ought not to be so weighted.

I recently wrote a letter to the Attorney General of the State of Georgia addressing the need for close scrutiny of arbitration clauses in home builder contracts. The personal harm alleged by several of my constituents pertains to just one company's abuse of the arbitration process. However, the abusive practices that harmed these victims of arbitration is indicative of a much larger problems where consumers are forced to sign arbitration clauses that strongly favor the company to the detriment of the consumer.

Arbitration agreements remain in many other consumer, employment, and franchisee agreements. Congress must act to prohibit forced arbitration before consumers suffer any more harm.

Again, I thank Chairman Cohen for the opportunity to testify before the Commercial and Administrative Law Subcommittee today.

Mr. COHEN. Thank you, Mr. Johnson. I appreciate the witnesses. Is there any Member of the panel that would like to ask a question of our colleagues? If not, we thank you for your testimony and your work in authoring these bills, and we will have hearings and obviously you are welcome to attend or go to the recesses of your office and watch by the magic of television.

So we now dismiss the first panel and welcome the second panel.

I thank the witnesses for participating in today's hearing. Without objection, your written statement will be placed in the record, and we would ask that you limit your oral remarks to 5 minutes. You have got a lighting system, and the green means you are within the first 4 minutes.

When it is yellow it means you need to be starting to think about the fact that, in 1 minute or less, you will have a red light, which means you are supposed to stop. If you do stop at that point, you will be one of our best witnesses. Subcommittee Members will be permitted to ask questions subject to the same 5-minute limit, which is rarely kept.

Our first witness is Ms. Alison Hirschel. Professor Hirschel serves as the "elder" law attorney—oh, I guess that is for older people. Yes, I didn't think it fit you—at the Michigan Poverty Law Program, a statewide back-up center for legal services programs, where her practice includes litigation, legislative and administrative advocacy and professional and community education efforts.

Prior to coming to Michigan in 1997, she spent 12 years at Community Legal Services in Philadelphia as a staff attorney, co-director there of the Elderly Law Project, and finally as deputy director. Thank you for being here, Professor Hirschel, and you may begin your 5 minutes.

TESTIMONY OF ALISON E. HIRSCHEL, NATIONAL CONSUMER VOICE FOR QUALITY LONG-TERM CARE, WASHINGTON, DC

Ms. HIRSCHEL. Thank you very much, Chairman Conyers, Chairman Cohen, Ranking Member Franks——

Mr. COHEN. You need to pop your button on, I guess, to get audio.

Ms. HIRSCHEL. Okay. Chairman Conyers, Chairman Cohen, Ranking Member Franks and Members of the Subcommittee, thank you for inviting me here today to speak on behalf of NCCNHR: The National Consumer Voice for Quality Long-term Care.

For the past 24 years, I have been a public interest lawyer representing long-term care consumers, and I know from my practice that residents and families often sign admissions agreements when they are under enormous stress. Frequently, because of a medical crisis or the loss of the caregiver, the resident needs immediate placement and the facility to which they are being admitted might be the only option they have.

Most consumers who sign admissions contracts don't realize that they include an arbitration clause, and even if they notice them, they don't know that arbitrators are often industry lawyers with an incentive to favor the facility, or that arbitration can be costly for consumers, or that awards are generally significantly lower than jury awards, and that there is virtually no appeal.

The last thing on most consumers' minds at the time of admissions is how they will seek a remedy if something goes wrong. Consumers enter a long-term care facility looking for care and compassion, not arbitration or litigation. Even if the consumer understands the provisions, most won't challenge them.

No resident or family wants to get off on the wrong foot with a facility that will hold the resident's very life in their hand. No one wants to be marked a troublemaker before the resident has even entered the facility, especially about a legal provision in the admissions contract that they hope will never apply to them.

Unfortunately, sometimes things do go grievously wrong. In the case of Vunies B. High, a 92-year-old Detroit area woman who happened to be the sister of the legendary boxer Joe Louis, she had dementia, and her family admitted her to an assisted living facility where they thought she would be safe.

Unfortunately, on a frigid night in February of last year, when the staff failed to properly supervise her, she wandered out of that facility wearing only her pajamas and froze to death. Only then did her family discover that the admissions agreement contained a mandatory binding arbitration provision.

It stated, like many of these provisions, that in case of any dispute, the provider has the sole and unfettered option to resolve the dispute in binding arbitration. The provider would choose the location for the arbitration. The provider would choose the rules, and the provider retained its rights to any action against Ms. High in court though she was required to give up that right if she had an action against the facility.

Fortunately, the Federal court in that case determined that the contract was unenforceable for a number of reasons, including the unequal bargaining power of the parties, the lack of discussion of the provision with Ms. High or her family, Ms. High's obvious confusion, and the fact that the agreement was presented to Ms. High and her family after she had already moved into the facility, and was, in fact, never signed.

The High family was lucky the arbitration agreement was invalidated. Courts routinely enforce onerous arbitration clauses signed under the most coercive conditions. When arbitration agreements are enforced, harrowing abuse or neglect may never be brought to light, and that is an important incentive for facilities to provide quality care, and it is lost when those things don't come to light.

As Yale law professor, Judith Resnik, notes in a forthcoming book, secretiveness in outcomes is often a signature of arbitration. She notes that "arbitration is often a set of procedures without transcripts, public observers or reported outcomes."

At the same time we are seeing a dramatic rise in the number of mandatory arbitration clauses, government surveys and studies continue to provide disturbing evidence of serious neglect and avoidable injuries and deaths in nursing homes. This is particu-

larly shocking in an industry that receives $75 billion in taxpayer money each year through Medicare and Medicaid.

Proponents of forced pre-dispute arbitration agreements lament that funds that should be spent on resident care are allegedly diverted to pay for litigation and liability insurance.

But I want to be clear about two points: First, what really costs taxpayers unfathomable sums of money is poor care itself. Poor care leads to unnecessary and frequent hospitalization for conditions that never should have arisen and to surgery, specialists' visits, medications and durable medical equipment to address ills that never should have been suffered.

Second, even if providers are spared the expense of litigation and increased premiums should those occur, there is no guarantee that those savings will be used to improve resident care or do anything that benefits residents. Nothing prevents providers from simply using those funds to increase their investors' returns.

As testimony in several congressional hearings has disclosed, nursing home corporations are setting up complex operating and financing structures that hide ownership, bleed funding out of facilities, limit accountability and reduce nursing staff and quality of care.

We should be limiting corporate abuse of public funds, not residents seeking justice. And finally, let me just note that I am not anti-arbitration. I am only opposed to pre-dispute, binding, forced arbitration.

Arbitration wasn't intended as an end-run around justice or a way to keep wrongdoing out of the public eye. And in cases in which consumers already suffered grievous harm, Congress should not permit long-term care facilities to add the bitter burden of denial of the fundamental right of access to the court.

Thank you.

[The prepared statement of Ms. Hirschel follows:]

PREPARED STATEMENT OF ALISON E. HIRSCHEL

Chairman Conyers, Chairman Cohen, Ranking Member Franks and members of the Subcommittee:

Thank you for inviting me to speak on behalf of NCCNHR: The National Consumer Voice for Quality Long Term Care.[1] For more than 30 years, NCCNHR has provided a national voice for long-term care residents, their families, ombudsmen, and consumer advocates, such as the Michigan Campaign for Quality Care which I represent. Thirty years ago, I started my career as an intern at the House Select Committee on Aging. And for the past 24 years, I have been a public interest lawyer representing long term care consumers on issues ranging from their initial admissions to facilities to their sometimes tragic experiences of abuse or neglect in those facilities.

Residents and families often sign admission agreements at times of enormous stress in their lives and when they feel they have very limited options. Seeking admission to a facility is rarely a slow and deliberative process in which consumers carefully evaluate the quality and services at numerous facilities and ponder every page of the often voluminous admissions package to compare it to admission agreements of other nearby facilities. Frequently, the admission occurs after a medical crisis or the loss of a caregiver when the resident needs an immediate placement.

[1] NCCNHR (formerly the National Citizens' Coalition for Nursing Home Reform) is a nonprofit membership organization founded in 1975 by Elma L. Holder to protect the rights, safety and dignity of America's long-term care residents

Indeed, sixty percent of nursing home admissions are directly from a hospital. The facility to which the applicant is being admitted will often be the only facility that has a bed, will accept the resident, or is close to the resident's family and friends.

Most consumers who sign these contracts are unaware that they include an arbitration clause, and they may not understand the provisions even if they notice them. They don't know that the arbitrators are often health care industry lawyers who have an incentive to find for the facility and limit awards so that they will be hired by the provider for future disputes. They don't understand that arbitration can be very costly for the consumer, that arbitration awards are generally significantly lower than jury awards, and that there is no real ability to appeal. Moreover, the last thing on most consumers' minds at the time of admission is how they will seek a remedy if something goes wrong. They enter a long term care facility looking for care and compassion, not litigation or arbitration.

Even if the long term care facility explains the binding arbitration clause, most consumers will not challenge it. First, nothing about the long term care admissions process is like a negotiation between two equal parties. Consumers may not have any other options and they generally sign whatever paperwork is presented to them. Second, no resident or family wants to get off on the wrong foot with a facility that will hold the fragile resident's life in its hands. No one wants to be marked a troublemaker before the resident has even entered the facility, especially about a legal provision applicants do not expect to ever affect them.

Unfortunately, sometimes things do go grievously wrong as they did for Vunies B. High, a 92 year old Detroit area resident with dementia. She was the sister of the legendary boxer Joe Louis, a graduate of Howard University, an accomplished woman who served as a long time English teacher and counselor in Detroit public schools. Ms. High's family placed her in an assisted living facility because they thought she would be safe there. On a frigid night in February of last year, staff of the facility failed to notice when Ms. High wandered out of that facility wearing only her pajamas. She froze to death. Her family then discovered that the admissions agreement contained a mandatory, binding arbitration provision. It, like many mandatory arbitration clauses, stated that in the case of any dispute:

- The *provider* had the sole and unfettered option to choose to resolve the dispute in binding arbitration;
- The *provider* would choose the location for the arbitration;
- The *provider* would choose the rules (the rules of the American Arbitration Association or of the American Health Lawyers Association Alternative Dispute Resolution Service Rules of Procedure for Arbitration);
- And the *provider* retained its right to institute any action against Ms. High in any court of competent jurisdiction, though Ms. High was required to forego that option as well as her right to a jury trial in any matter that was litigated in court.

In addition, the agreement contained a limitation of only $100,000 in damages, in addition to medical costs incurred, a provision Ms. High's family also did not recall. When Ms. High's family sought redress for her tragic and preventable death, the facility, relying on the arbitration agreement, moved to dismiss the case. Fortunately, the federal court determined that the contract was unenforceable for a number of reasons including:

- The unequal bargaining power of the parties;
- The lack of discussion of the provision with Ms. High or her family;
- Ms. High's obvious limitations and confusion;
- The unilateral nature of the arbitration provision;
- The fact that the agreement was presented to Ms. High and her family after she had already moved into the facility; and
- The context of presenting the agreement in an elder care facility.

The High family was lucky the arbitration agreement was invalidated. Courts routinely enforce onerous arbitration provisions signed under the most coercive conditions. When arbitration agreements are enforced, harrowing abuse or neglect may

never be brought to light and an important incentive for facilities to provide quality care is therefore lost.

As Yale Law Professor Judith Resnik notes in a forthcoming book, "[S]ecrecy about both processes and outcomes is often a signature of [arbitration]. . . ."[2] She cites a federal court decision that observes that confidentiality is part of the character of arbitration itself to prevent it from having precedent and gaining the trappings of adjudication.[3] And that secrecy often includes banning disclosures by participants, barring attendance by third party observers, and excluding or limiting the media.[4] As Professor Resnik concludes, "The [Alternative Dispute Resolution] packet . . . is often a set of procedures without transcripts, public observers, or reported outcomes."[5]

At the same time we are seeing a dramatic rise in the number of mandatory arbitration clauses, government studies continue to provide disturbing evidence of serious neglect and avoidable injuries and deaths in nursing homes. According to a Government Accountability Office (GAO) report in 2007, twenty percent of nursing homes have been cited for putting their residents at risk of serious injury or death—a shockingly high figure in an industry that receives more than $75 billion taxpayer dollars through Medicare and Medicaid each year. And the GAO says that state surveys understate the actual jeopardy and harm residents are experiencing.

It is true that we have an elaborate nursing home enforcement system. But that enforcement system is, like many nursing homes themselves, seriously understaffed and enormously challenged by its vital responsibilities. In my home state, a shortage of surveyors has meant that complaints take weeks, months, and sometimes as long as a year to investigate. In that period, records are lost or altered, witnesses and evidence disappear, and surveyors are no longer able to substantiate even extremely serious and legitimate complaints. And when the neglect or abuse cannot be substantiated, no penalty can be imposed.

Moreover, while surveyors miss a lot at nursing homes, licensed assisted living facilities—which do not have the benefit of federal regulation—are inspected even less often and less rigorously, and regulators in my state have few remedies if problems are discovered. And there is no enforcement in unlicensed facilities like the one in which Ms. High resided. Thus, an overburdened enforcement system in nursing homes, a limited system in licensed assisted living, and a nonexistent enforcement system in unlicensed homes cannot be an adequate substitute for litigation in egregious cases.

Proponents of forced pre-dispute arbitration agreements lament that funds that should be spent on resident care are allegedly diverted to pay for litigation and liability insurance. But I want to be clear about two points: First, what really costs taxpayers unfathomable sums of money is poor care itself. Poor care leads to unnecessary and frequent hospitalization for conditions that never should have arisen, and to surgery, specialists' visits, medications, and durable medical equipment to address ills that never should have been suffered. When a Wisconsin nursing home ignored for more than five days Glen Macaux's doctor's orders to inspect and assess his surgical site, the resulting infection caused septic shock, excruciating pain, severe depression, and total disability—as well as hospital bills of almost $200,000.

Second, even if providers were spared the expense of litigation and increased insurance premiums—by tipping the playing field very much in their own favor—there is no guarantee that savings will be invested in adequate staffing, training, supplies, or in creating safe and appealing environments. Nothing prevents providers from using those funds to increase investors' returns instead of improving residents' care and lives. The Government Accountability Office showed that when Congress increased Medicare funding for skilled nursing facilities specifically to improve nurse staffing levels, the amount of nursing care residents received was virtually unchanged. And the Centers for Medicare and Medicaid Services recently re-

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[2] *See* Chapter 14 in Judith Resnik and Dennis Curtis, REPRESENTING JUSTICE: THE RISE AND FALL OF ADJUDICATION AS SEEN FROM RENAISSANCE ICONOGRAPHY TO TWENTY-FIRST CENTURY COURTHOUSES (Yale University Press, forthcoming 2010).

[3] *Id.* citing Iberia Credit Bureau, Inc. v. Cingular Wireless, 379 F. 3d 159, 175 (2005).

[4] *Id.*

[5] *Id*

duced Medicare funding to nursing homes because it concluded that some of the therapy Medicare paid for was given by aides, not licensed physical therapists, and that it was often given to residents concurrently in groups while the government was billed for individual treatments. Moreover, as testimony in several Congressional hearings has disclosed, nursing home corporations are setting up complex operating and financing structures that hide ownership, bleed funding out of the facilities for corporate profits, limit accountability, and reduce nursing staff and quality of care. We should be concerned about corporate abuse of public funds, not with residents seeking justice in the courts when they become victims of neglect and abuse that is often caused by corporate greed.

Finally, let me note that we are not anti-arbitration. We are only opposed to predispute, binding, forced arbitration. Arbitration was not intended as an end run around justice or a way to keep wrongdoing out of the public eye. In cases in which consumers have already suffered grievous harm, Congress should not permit long term care facilities to add the bitter burden of denial of the fundamental right of access to the courts.

Thank you.

Mr. COHEN. Thank you, Professor Hirschel, and you did good on your red light.

Our second witness is Mr. Stuart Rossman. He is another University of Michigan attendee, I believe, while in undergraduate school. He is a National Consumer Law Center staff attorney directing litigation efforts there. He has 13 years in private practice and we welcome him here.

He has founded and chaired the attorney general's Abandoned House Task Force, a project ready to assist municipalities and community groups in seeking solutions to abandoned properties. Thank you, sir, we welcome your testimony.

TESTIMONY OF STUART T. ROSSMAN, NATIONAL CONSUMER LAW CENTER, BOSTON, MA

Mr. ROSSMAN. Mr. Chairman, Members of the Committee, thank you very much for inviting me here. As was noted, I am Director of Litigation for the National Consumer Law Center, which is a 40-year-old national organization representing the interests of low income and elderly consumers in the areas of access to credit, affordable home ownership and utility rights.

We are dedicated to enforcing the substantive rights of consumers and we are proud supporters of the Arbitration Fairness Act that has been filed.

In my practice, arbitration clauses are ubiquitous. They show up in credit cards. They show up in bank accounts. They show up in telephone and cell phone contracts. They appear in personal, home and car loans, utility agreements and in student financing.

They are particularly prevalent in predatory products where we are dealing with the most vulnerable consumers, items such as payday loans, rent-to-own contracts and subprime mortgages and credit cards all contain the forced arbitration clauses.

Forced arbitration clauses prevent access to the constitutionally protected judicial system. It prevents people from having access to the rules of evidence, the rules of civil procedure, appellate review and their right to jury.

You are well aware of the problems which have been discussed and will be discussed this afternoon, but ostensibly we are dealing

with issues where the arbitration provisions show up as contract of adhesion with no choice between alternative products.

They are required prior to the dispute no one can even imagine what the problems could be down the road. There is a lack of transparency and secrecy. There is a lack of accountability with a right of review.

There is a bias toward the merchant as the repeat user, the repeat player bias that we have heard about. There is susceptibility for conflict of interest and then there is the expense to the consumer.

As has been noted, there have been two major developments this past month in this area. First is as a result of a suit brought by the Minnesota Attorney General's Office, the National Arbitration Forum has dropped doing all consumer arbitration cases. They are no longer accepting new arbitration cases or processing them.

The claims that were brought by the Minnesota Attorney General's office dealt with conflicts of interest, but there were also issues involving the level and the quality of the service that was being provided and whether it was biased.

Then, in response to a letter from the Minnesota Attorney General's Office or otherwise, the American Arbitration Association announced that it was suspending its debt collection arbitrations pending further consideration of appropriate safeguards.

And then the Bank of America and JPMorgan Chase both announced that they would be dropping arbitration clauses in all of their credit card agreements. Bank of America went further to indicate that it was dropping it in its deposit agreements and its automobile loans.

That is a welcome development as a first step, but is not enough, and Federal legislation still is needed. With the debt collection, the problem is not the actor, the bad apple so to speak, but the system itself.

The opportunity for abuse and for profiteering are inherent in the relationship. It is an intrinsic flaw where the arbitration company draws its income from satisfying the debt collector or risk losing that account. Private justice where the funds are being paid for by private parties is inherently going to end up being biased.

The fact that NAF is no longer in the business does not mean that there are not plenty of pretenders to the throne waiting in the wings to take over this very lucrative business. The American Arbitration Association did in fact drop debt collection arbitration, but it did not drop the enforcement of forced arbitration clauses against plaintiffs, when they brought their own cases.

Furthermore, we have no idea what safeguard would be put in place, when they would be put in place and, most important, who will enforce them. Without enforcement, they are just pieces of paper.

And finally, Bank of America and JPMorgan Chase should be congratulated for dropping the credit card requirements, but that still means that eight out of the ten largest credit cards companies in the United States still have mandatory arbitration clauses and the banks can always reverse their policies. As has been seen recently on a number of occasions, banks announce policies and can easily reverse them a year or two later down the road.

Congress created consumer rights and enforcement under the Fair Debt Collection Practices Act and Fair Credit Reporting Act, Truth in Lending and other statutes, but I am particularly interested, as a civil rights lawyer, in the access to fair credit. And I would be very concerned if under the Equal Credit Opportunity Act or the Equal Credit Opportunity Act my clients were no longer able to assert their rights under those statutes.

For 10 years I filed suit against the automobile finance industry for claims of discrimination. We were able to get systemic change in those industries as a result of those lawsuits. I would not have wanted to tell my clients, Betty Cason or Edwin Borlay that they did not have their day in court to assert their ECOA claims because of an arbitration clause, when they couldn't possibly have known about the discrimination at the time that they entered into their loan agreements.

At NCLC we say that economic justice is a civil right and I would ask this Committee and Congress to sustain those civil rights by passing the Arbitration Fairness Act and all other consumer litigation intended to protect consumers from forced arbitration clauses. Thank you very much.

[The prepared statement of Mr. Rossman follows:]

PREPARED STATEMENT OF STUART T. ROSSMAN

RECENT DEVELOPMENTS IN THE FORCED ARBITRATION MARKET AND THE CONTINUED NEED FOR PROTECTIVE LEGISLATION

Subcommittee on Commercial and Administrative Law

House Committee on the Judiciary

September 15, 2009

Testimony provided by:

Stuart T. Rossman

Director of Litigation

National Consumer Law Center

7 Winthrop Square, 4th Floor

Boston, MA 02110

Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee, thank you for inviting me to testify today regarding the Arbitration Fairness Act and recent developments in the arbitration industry.

I am the Director of Litigation at the National Consumer Law Center.[1] For the past 10 years I have been responsible for coordinating and litigating cases at NCLC on behalf of income and/or age qualified individuals, primarily in the areas of consumer financing and affordable housing, in state and federal courts throughout the United States . Prior to my work at the National Consumer Law Center, I served as the Chief of the Trial Division and the Business and Labor Protection Bureau of the Massachusetts Attorney General's Office and worked in private practice. I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing across the country in order to promote economic justice for all consumers.

Over the last ten to fifteen years, there has been a quiet revolution in the way many corporations do business. Practically every credit card agreement, cell phone contract, mortgage and even many non-union employment contracts now contain a pre-dispute mandatory arbitration clause. Buried in the fine print of these agreements, phrased in legalese, is a clause which says that by agreeing to the contract, the consumer or employee has agreed that any

[1] The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Consumer Arbitration Agreements* (5th Ed. 2007), *Fair Debt Collection* (6th Ed. 2008) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal with predatory lending, unfair debt collection practices and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics.
This testimony was written by Stuart T. Rossman, Director of Litigation and Arielle Cohen, Staff Attorney, NCLC.

dispute which arises will *not* be adjudicated in the court system, with its accountability to the public, but by an arbitration company. Hundreds of millions of contracts now contain these clauses. Hundreds of thousands of consumers forced into arbitration every year discover that they have inadvertently signed away their legal rights.

Arbitration companies are selected by the corporation, are often located far from the consumer's home and – as I will discuss – have strong financial incentives to rule in favor of the corporation regardless of the merits of the dispute. **These incentives are inherent to pre-dispute "forced" arbitration.** Recent voluntary agreements by arbitrators and credit providers to refrain from using arbitration are helpful to consumers, but do not and cannot remedy the inequities that are intrinsic to pre-dispute mandatory arbitration. Prompt legislative action is needed to make pre-dispute binding mandatory arbitration clauses unenforceable in civil rights, employment, consumer, and franchise disputes.

The essential problem with forced arbitration is that it creates a system strongly biased in favor of the corporation and against the individual. This is true for a number of reasons:

- There are a number of private arbitration companies who compete to be selected by corporations in their standard form contracts with consumers and employees. Arbitration companies perceived as less favorable to corporations will not receive any business. This sets up conditions for a 'race to the bottom' among arbitration companies to be the most corporation-friendly. The marketing materials of arbitration companies – touting the advantages to businesses of using arbitration – bear this out.
- At the level of individual arbitrators, corporations can "blackball" arbitrators who rule against them. This is possible because the corporations are repeat players, with access to the previous decisions of particular arbitrators. The public, and the individual consumers

involved in arbitration, do not have access to that history. Therefore, the roster of arbitrators becomes heavily tilted in favor of corporate interests.

- The procedures of arbitration tend to favor the corporations as well. Consumers who are unaware that they agreed to arbitration may fail to respond to notices, resulting in default judgments. The high fees and 'loser pays' rules typical of arbitrations also discourage consumers from participating. Even if they do respond, they are at a disadvantage to the repeat players, who understand the process, know what information to submit and how to do so, and have often selected an arbitration company geographically distant from the consumer.

You have heard and will hear from others more regarding the fundamental problems with forced arbitration. Instead of repeating their testimony, I'd like to spend some time going over current events. In recent months, there have been a number of developments in the arbitration industry, with several arbitration companies getting out of the consumer debt arbitration business and at least one corporation voluntarily agreeing to refrain from enforcing forced arbitration clauses. These developments, which I will summarize, certainly are helpful to consumers, but they do not completely or permanently solve the problems I outlined above, and therefore do not obviate the need for legislation.

I. National Arbitration Forum

On July 14, 2009, Minnesota Attorney General Lori Swanson filed a lawsuit against the National Arbitration Forum. NAF is – or was – the largest arbitrator of consumer credit disputes in the country. According to NAF, it has been appointed as arbitrator in "hundreds of millions" of contracts. In 2006, it processed more than 200,000 consumer collection arbitration claims.

The Attorney General's investigation of NAF revealed a series of agreements and transactions conducted in 2006 and 2007 whereby NAF, a New York based hedge fund group and one of the country's largest debt collection agencies became financially and managerially intertwined. The lofty goal of this alliance was nothing less that the expansion of arbitration (specifically provided by NAF) into "a comprehensive, alternative legal system."

The debt collection agency (a large law firm) was to play "an active role in landing new customers/partners" for NAF – essentially steering customers to NAF over other legal or arbitration-based collection options. It appears that they were quite successful in that regard; in 2006, 60% of the consumer collection claims filed with NAF originated with that particular debt collection law firm.

The Attorney General's lawsuit was based on allegations of consumer fraud, deceptive trade practices and false statements in advertising. The AG alleged that the National Arbitration Forum represented to consumers and the public that it was independent and neutral, operated like an impartial court system, and was not affiliated with and did not take sides between the parties, when in fact, it was closely associated with owners of debt and advertised itself to corporations as a particularly favorable forum for collection actions.

On July 17, 2009, NAF agreed to a consent decree.[2] Without admitting any wrongdoing or liability, NAF agreed to "the complete divestiture by the NAF Entities of any business related to the arbitration of consumer disputes." Consumer arbitration was defined to include "any arbitration involving a dispute between a business entity and an individual which relates to goods, services, or property of any kind… or payment for such goods, services, or property" and "includes any claim by a third party debt buyer against a private individual."

[2] A copy of the Minnesota Office of the Attorney General's July 19, 2009, press release announcing the agreement with the National Arbitration Forum, with the Consent Decree and the amendatory letter to the American Arbitration Association referenced in the release attached, are provided herewith as Exhibit 1.

Some have argued that the litigation shows that NAF was a 'bad apple' and that its departure from the consumer arbitration business will eliminate any unfairness or abuses. This view is mistaken. First, the specific actions which formed the basis for the complaint against NAF are only tangentially related to the basic inequities of the forced arbitration system. As I explained above, all arbitration companies make their money by convincing corporations to select them as a forum for debt collection and other disputes. NAF took this a step further, by actually becoming financially and organizationally entangled with a debt collection agency, but the incentive to look after the interests of corporations exists for all arbitration companies. Second, because the provision of arbitration services is a lucrative business, other companies will step into the void created by NAF's departure. This may not happen immediately, given the current political and public attention focused on consumer arbitration, but without legislation preventing the use of forced arbitration clauses, it will happen as soon as that attention moves elsewhere. Finally, while the terms of the settlement agreement apply broadly to consumer disputes, employment disputes are not included. Forced arbitration of employment disputes is particularly problematic, because it amounts to a waiver by the employee of civil rights and anti-discrimination laws.[3]

II. American Arbitration Association

On July 23, 2009, the American Arbitration Association issued a press release announcing its decision not to accept new arbitration filings under pre-dispute arbitration agreements in cases involving credit card bills, telecom bills or consumer finance matters and

[3] For additional discussion of the limitations of the NAF consent decree, see the July 22, 2009 Testimony of F. Paul Bland, Jr. before the Subcommittee on Domestic Policy of the U.S. House of Representatives' Committee on Oversight and Government Reform, attached as hereto as Exhibit 2.

calling for "Reform of Debt Collection Arbitration."[4] AAA identified these categories of arbitration as needing additional protections due to a high rate of non-participation by consumers. Although it came on the heels of the NAF settlement agreement, AAA denied that the decision to stop accepting new arbitration filings was made at the behest of any outside entity.[5]

As in the case of the NAF settlement, the AAA decision is a positive development for consumers, but not a solution to the problem. The decision does not cover the full spectrum of consumer arbitrations. It provides no insights into what reforms AAA might agree to make and what additional protections conceivably could be provided to consumers. Like the NAF settlement, forced arbitration in employment disputes is not addressed. Finally, since AAA's decision was made voluntarily for business reasons, they may alter it at any time and begin arbitrating cases again.

III. Bank of America

On August 13th, 2009, Bank of America issued a fact sheet announcing that it would not enforce pre-dispute arbitration clauses in certain categories of consumer contracts – specifically, credit card, auto, marine and recreational vehicle loans and deposit accounts.[6] According to company spokespeople, the decision came as a result of customer perceptions that arbitration was unfair. Bank of America's intention is "to resolve more disputes directly with our customers."

[4] See July 23, 2009 American Arbitration Association News Release attached hereto as Exhibit 3.
[5] See July 20, 2009 Letter from American Arbitration Association to Minnesota Attorney General attached hereto as Exhibit 4.
[6] See August 13, 2009 Fact Sheet about Bank of America's Arbitration Position attached hereto as Exhibit 5.

Once again, while this is a positive development, it is not a permanent or widespread solution. Other financial companies have not leapt to follow Bank of America's lead, and Bank of America may reverse its decision at any time.

IV. Conclusion

I want to return to the quotation from the negotiations between NAF and the debt collection agency regarding their goal of turning arbitration into "a comprehensive, alternative legal system." Companies have an obvious interest in circumventing the judicial system in favor of a system they control. Companies must not be allowed to force consumers and employees to give up their substantive and procedural rights in advance and submit to decision-making by profit-motivated third parties selected by the companies. Such a system will always be biased against individual consumers and workers, and is contrary to basic principles of due process and fairness. NCLC strongly supports the passage of enforceable arbitration related consumer protection legislation designed to effectively, fairly and consistently level the playing field between consumers and corporations in the future.

STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

LORI SWANSON
ATTORNEY GENERAL

102 STATE CAPITOL
ST. PAUL, MN 55155
TELEPHONE: (651) 296-6196

For Immediate Release
July 19, 2009

Contact: Ben Wogsland at: (651) 296-2069
(612) 818-0965 (pager)

NATIONAL ARBITRATION FORUM BARRED FROM CREDIT CARD AND CONSUMER ARBITRATIONS UNDER AGREEMENT WITH ATTORNEY GENERAL SWANSON

Swanson Also Wants Congress to Ban "Fine Print" Forced Arbitration Clauses

Minnesota Attorney General Lori Swanson and the National Arbitration Forum—the country's largest administrator of credit card and consumer collections arbitrations—have reached an agreement that the company would get out of the business of arbitrating credit card and other consumer collection disputes.

"I am very pleased with the settlement. To consumers, the company said it was impartial, but behind the scenes, it worked alongside credit card companies to get them to put unfair arbitration clauses in the fine print of their contracts and to appoint the Forum as the arbitrator. Now the company is out of this business," said Swanson.

Swanson sued the National Arbitration Forum on Tuesday, alleging that the company--which is named as the arbitrator of consumer disputes in tens of millions of credit card agreements--hid from the public its extensive ties to the collection industry. The lawsuit alleged that the Forum told consumers and the public that it is independent and neutral, operates like an impartial court system, and is not affiliated with and does not take sides between the parties. The lawsuit alleged that the Forum worked behind the scenes, however, to convince credit card companies and other creditors to insert arbitration provisions in their customer agreements and then appoint the Forum to decide the disputes. The suit also alleged that the Forum has financial ties to the collection industry. The suit alleged that the company arbitrated 214,000 consumer arbitration claims in 2006, nearly 60 percent of which were filed by laws firms with which the Forum is linked through ties to a New York hedge fund.

Under the settlement, the National Arbitration Forum will, by the end of the week, stop accepting any new consumer arbitrations or in any manner participate in the processing or administering of new consumer arbitrations. The company will permanently stop administering arbitrations involving consumer debt, including credit cards, consumer loans, telecommunications, utilities, health care, and consumer leases.

Credit card companies, banks, retail lenders, and cell phone companies increasingly place—in the fine print of their consumer agreements—what are known as "mandatory predispute arbitration clauses." Through these clauses, the consumers waive, in advance, their

right to have their day in court if a dispute arises. Instead, the consumer agrees—usually without knowing it—that any dispute will be resolved by an arbitrator selected by the credit card company or other creditor. Credit card companies are among the most prolific users of mandatory arbitration clauses. Just by keeping a credit card, the consumer agrees to the terms and conditions of the card, even if the arbitration provision was sent to the consumer after the card was issued. As a result of mandatory arbitration clauses, which appear in tens of millions of consumer agreements, hundreds of thousands of consumer disputes are resolved each year not by a judge or jury, but by a private arbitration system.

Swanson said that late this week she accepted an invitation from Congressman Dennis Kucinich, Chairman of the Congressional Committee on Oversight and Government Reform, to testify before the Committee this coming Wednesday in Washington, D.C. She said she will ask Congress to prohibit the use of mandatory pre-dispute arbitration clauses in consumer contracts.

"The playing field is tilted against the ordinary consumer when credit card companies bury unfair terms like forced arbitration clauses in fine print contacts. Congress should change that," said Swanson.

Swanson also announced that she sent a letter to the American Arbitration Association asking it to play a leadership role by ceasing to accept arbitration filings on consumer credit and collection matters arising out of mandatory pre-dispute arbitration clauses.

Swanson noted that the City of San Francisco is in litigation with the Forum and that other state Attorneys General have contacted her about these issues since the announcement of the lawsuit. "I am very pleased with the results of our lawsuit. It is good for consumers that this company will no longer be able to administer credit card and consumer debt collection arbitrations. I hope other jurisdictions will use whatever authority they have to look at other possible remedial relief in this area," said Swanson.

The settlement allows the Company to continue to arbitrate internet domain name disputes (which the company handles under an appointment from the Internet Corporation for Assigned Names and Numbers (ICANN)), personal injury protection claims (which the company performs under appointment and supervision under the New Jersey state government), and cargo disputes (which the company performs under rules established by the U.S. Department of Transportation). These areas were not part of the lawsuit, and the company performs the work under the supervision of government or non-government organizations (NGOs). Accordingly, the settlement does not affect this very limited activity.

The Consent Decree and amendatory letter are attached.

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STATE OF MINNESOTA

COUNTY OF HENNEPIN

DISTRICT COURT

FOURTH JUDICIAL DISTRICT

Case Type: Other Civil
(Consumer Protection)

State of Minnesota by its Attorney General,
Lori Swanson,

Plaintiff,

vs.

National Arbitration Forum, Inc.,
National Arbitration Forum, LLC, and
Dispute Management Services, LLC, d/b/a
Forthright,

Defendants.

Court File No. 27-CV-09-18550
Judge John L. Holahan

CONSENT JUDGMENT

WHEREAS, Plaintiff State of Minnesota, by and through its Attorney General, Lori Swanson ("State"), filed a Complaint in this matter on July 14, 2009 ("Complaint") against National Arbitration Forum, Inc., National Arbitration Forum, LLC, and Dispute Management Services, LLC, d/b/a Forthright (hereinafter, collectively, the "NAF Entities") (the State, and the NAF entities are hereinafter collectively referred to as the "Parties");

WHEREAS, this Consent Judgment shall not be construed as an admission of wrongdoing or liability by the NAF Entities;

NOW, THEREFORE, in the interest of resolving this action, the State and the NAF Entities hereby stipulate and consent to entry of this Consent Judgment, as set forth below:

1. The purpose of this Consent Judgment is to require the complete divestiture by the NAF Entities of any business related to the arbitration of consumer disputes.

2. The term "Consumer Arbitration" means any arbitration involving a dispute between a business entity and a private individual which relates to goods, services, or property of any kind allegedly provided by any business entity to the individual, or payment for such goods, services, or property. The term includes any claim by a third party debt buyer against a private individual. It does not include, however, the arbitration of internet domain name disputes on behalf of the Internet Corporation for Assigned Names and Numbers (ICANN), the processing of personal injury protection (PIP) disputes, the processing of shipping or storage disputes under 49 CFR § 375.211, or arbitrations where a NAF Entity is appointed and supervised by a government entity.

3. On or after July 24, 2009, no NAF Entity shall:

a. Accept any fee for processing any new Consumer Arbitration.

b. Administer or process any new Consumer Arbitration.

c. In any manner participate in any new Consumer Arbitration.

d. Attempt to influence the outcome of any arbitration proceeding currently pending before it.

4. The NAF Entities shall not engage in any deceptive practices, or make any false or misleading statements, in violation of Minn. Stat. §§ 325F.69, subd. 1; 325D.44, subd. 1; and 325F.67.

5. The NAF Entities shall pay investigative costs to the State of Minnesota within ten days of the date this Consent Judgment is signed. Notwithstanding this payment, the NAF Entities shall also pay the State of Minnesota an amount equal to any amount paid to the City of San Francisco over the next six months, in excess of the City's actual investigative expenses and attorneys' fees.

6. The Parties have read this Consent Judgment and voluntarily agree to its entry.

7. In consideration of the stipulated relief, the sufficiency of which is acknowledged, the Office of the Attorney General, by execution of this Consent Judgment, hereby fully and completely releases the NAF Entities, including all of their past and present agents, employees, officers, directors, subsidiaries, shareholders, and affiliates, of any and all claims of the Attorney General connected with or arising out of the allegations in the State's Complaint in the above-captioned action, up to and including the date of this Consent Judgment.

8. Promptly after receiving notice that the Court executes this Consent Judgment, the State shall voluntarily dismiss the above-captioned action pursuant to Minnesota Rule of Civil Procedure 41.01(a).

9. The Parties shall cooperate to implement and facilitate this Consent Judgment, including the exchange of information reasonably necessary for that purpose or to confirm the NAF Entities' compliance with this Consent Judgment.

10. Any failure by any Party to this Consent Judgment to insist on performance by any other Party of any provision of this Consent Judgment shall not be deemed a waiver of any of the provisions included herein.

11. The Parties agree to bear their own costs and fees in this matter.

12. Each Party participated in the drafting of this Consent Judgment, and each agrees that the Consent Judgment's terms may not be construed against or in favor of any Party by virtue of draftsmanship. Each signatory further agrees they have authority to enter into this Consent Judgment.

13. This Consent Judgment, including any issues relating to interpretation or enforcement, shall be governed by the laws of Minnesota. The Court shall retain jurisdiction over this matter to enforce the terms of this Consent Judgment.

Dated: 7/17/09

National Arbitration Forum, Inc.

By: _____
Its _____

Dated: 7/17/09

National Arbitration Forum, LLC

By: _____
Its _____

Dated: 7/17/09

Dispute Management Services, LLC, d/b/a Forthright

By: _____
Its CEO

Dated: 7/17/09

LORI SWANSON
ATTORNEY GENERAL
STATE OF MINNESOTA

_____
Lori Swanson

IT IS SO ORDERED.

Dated: _____

BY THE COURT:

_____
John L. Holahan
Hennepin County District Court Judge

LET JUDGMENT BE ENTERED ACCORDINGLY.

OFFICE OF THE ATTORNEY GENERAL
State of Minnesota
ST. PAUL, MN 55155

LORI SWANSON
ATTORNEY GENERAL

July 19, 2009

President
American Arbitration Association
Corporate Headquarters
1633 Broadway
10th Floor
New York, New York 10019

Dear President:

This office recently concluded a year long investigation of National Arbitration Forum ("NAF"). The investigation concluded with an agreement by NAF that it would no longer arbitrate consumer debt disputes. I enclose a copy of the Consent Order and the amendatory letter. While the lawsuit focused on conflict of interest issues, our investigators and attorneys also interviewed over one hundred consumers who complained about the arbitration process. Based on our investigation, it is my conclusion that pre-dispute mandatory arbitration provisions are fundamentally unfair to the consumer. This is particularly the case with credit card contracts and other consumer contracts—such as cell phone, utility, loan, and hospital agreements—where the mandatory arbitration provisions are hidden in the fine print. Our findings include the following:

First, pre-dispute mandatory arbitration agreements are nearly always the product of unequal bargaining power between the consumer and the business. In almost every interview we found that the consumer was not aware of the arbitration provision. In many cases the consumer never saw the provision, because it was simply mailed with a monthly statement. The consumer is given virtually no opportunity to reject the provision. Yet, through these provisions, the consumer gives up their important right to have his or her day in court.

Second, because the consumer is unaware of the mandatory arbitration provision, in many cases the consumer ignored the notice of arbitration served on them. Since they did not know that they agreed to arbitration, and were unfamiliar with the arbitration process, they didn't believe they were obligated to respond to an arbitration notice from an office in Minnesota. It is part of our democracy that we have a right to redress in a court of law, and that includes the notion that the court should be easily accessible to the consumer. Through pre-dispute mandatory arbitration clauses, consumers forfeit this important right without even knowing it.

Third, it is apparent, based on many interviews with consumers, arbitrators and employees of NAF, that arbitrators have a powerful incentive to favor the dominant party in an arbitration; namely, the corporation. Indeed, there is a term commonly used in the arbitration industry called "repeat player bias," describing a phenomena describing where an arbitrator is more likely to favor the party that is likely to send future cases. This bias does not exist in a court, where the judge is not reliant on a dominant player for his or her future income. In the case of NAF, arbitrators and employees claimed that arbitrators who issued an award against the corporation, or who failed to award attorney's fees against the consumer, were simply "deselected" and not appointed to future proceedings.

Fourth, consumers are not aware they can submit exhibits, and many are not aware that there will only be a "document hearing" with no opportunity to be heard. For instance, victims of identity theft were not told to submit a copy of a police report, even though arbitrators were advised that, absent such documentation, the claim of identity theft should be ignored.

Fifth, the arbitration process is fundamentally unfair for holding corporations responsible for any wrongdoing. In some cases, consumers forfeited important rights in the fine print of contracts they had never seen. Consumers who we interviewed in the NAF investigation were told that, when they initiated a claim against the corporation, the claim could be delayed for up to one year before there was any review of the matter.

There are many other defects in the process. The fundamental problem with consumer arbitrations under "fine print" contracts is that the arbitration company draws its income from the dominant participant--namely the credit card company, telecommunications company, the hospital, etc.--and personnel have a financial incentive to make sure that the corporation is pleased with the outcome. Otherwise, the corporation will undoubtedly look to other arbitration administrators. As noted above, this "repeat player" bias does not occur in court, since judges rely on taxpayers—not litigants—for their income.

In short, for the above reasons and many others, I ask that your organization take the initiative to announce that it will not accept the arbitration of credit card and other consumer debt claims based on pre-dispute mandatory arbitration clauses. Because the AAA and NAF are the largest arbitration companies, I believe such a proclamation by AAA would be a powerful signal to Congress that reform is desperately needed in this area.

Sincerely,

LORI SWANSON
Attorney General

Enclosure

TESTIMONY TO THE SUBCOMMITTEE ON DOMESTIC POLICY OF THE U.S. HOUSE OF REPRESENTATIVES' COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

ARBITRATION OR "ARBITRARY": THE MISUSE OF ARBITRATION TO COLLECT CONSUMER DEBTS

July 22, 2009

By F. Paul Bland, Jr.*
Staff Attorney
Public Justice

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* 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 U.S. Courts of Appeal for the Third, Fourth, Fifth, Eighth and Ninth Circuits, and in the high courts of California, Florida (two cases), Maryland (five cases), New Mexico (two cases), Washington (two cases), and West Virginia. 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 Maryland Trial Lawyer of the Year in 2009, and in 2006 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 both 2001 and 2009. 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.

INTRODUCTION AND SUMMARY

For more than ten years, I and other attorneys at Public Justice have spoken to hundreds if not thousands of consumers and consumer attorneys about their experiences arbitrating consumer debts before the National Arbitration Forum (NAF). Consumers and attorneys approaching us for help, or reporting to us on their experiences, have repeatedly reported widespread abuses throughout the NAF system that raise serious doubts about the trustworthiness of the private dispute resolution system that has been increasingly replacing the constitutional civil justice system.

Pursuant to consent decree with the Attorney General of Minnesota, NAF has just announced that it is withdrawing from the business of consumer debt collection. While NAF has publicly stated that it was innocent of any wrongdoing and is just a victim of overzealous pursuit by the Minnesota Attorney General and consumer lawyers, the hard facts establish that NAF pursued the business of debt collection arbitrations by cultivating relationships with and the favor of creditors, fundamentally to the detriment of consumers.

The troubling practices in which the NAF engaged may well reappear before too long (perhaps with some of the same persons operating under some different institutional name). So long as there is money to be made in debt collection arbitrations, arbitration providers will try to make it, even if their efforts mean that consumers are deprived of fair hearings.

This testimony will address the following issues:

1. The collection industry's use of mandatory binding arbitration before the National Arbitration Forum to collect consumer debts; and
2. Concerns about systemic irregularities and abuses that are prevalent in the National Arbitration Forum's debt collection arbitrations.

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 http://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.

I. COMPANIES COLLECTING CONSUMER DEBTS HAVE A SYMBIOTIC RELATIONSHIP WITH THE NATIONAL ARBITRATION FORUM

When debt buyers and credit card companies have been unable to collect on a debt, they commonly turn to binding mandatory arbitration before NAF to effect collection of the debt. The relationship between NAF and creditors begins with the credit card contract: credit card companies draft the contract, which includes a clause requiring consumers to arbitrate their disputes—usually before a specific arbitration provider—rather than sue in court. Most credit-card issuers include these mandatory arbitration clauses in their contracts.[1]

NAF, far more so than the two other major players in the arbitration industry, the American Arbitration Association (AAA) and JAMS, has financial interests strongly aligned with credit card companies and debt collectors. Indeed, a recent lawsuit brought by the Minnesota Attorney General against NAF charges that these financial ties run deep: it alleges that NAF "is financially affiliated with a New York hedge fund group that owns one of the country's major debt collection enterprises" and that NAF conceals this relationship from consumers.[2] Even before this lawsuit brought the shared ownership between NAF and debt collectors into the light, however, the impropriety of NAF's financial relationship with debt collectors was perfectly clear. In 2008, CNN's personal finance editor called NAF "the folks who are the worst actors in this industry,"[3]

and the Wall Street Journal observed that, more than other arbitration providers, NAF works with a handful of large companies, and a "significant percentage of its work includes disputes involving consumers, rather than disputes between businesses."[4] In contrast, AAA and JAMS arbitrate more employment disputes and contractual disputes between companies.[5]

As a result of NAF's focus on consumer debt, NAF receives substantial fees from its creditor and debt collector clients. For example, First USA Bank disclosed in court filings that it had paid NAF at least $5 million in fees between 1998 and 2000. During that same period, First USA won 99.6% of its 50,000 collection cases before NAF.[6] While advocates for banks invoke the possibility that the bank could have been equally successful in court, "[m]aybe, however, the millions of dollars it paid the NAF in fees tend to produce overwhelmingly favorable results."[7] In sharp contrast, it would be shocking for a public court to be so financially dependent on a litigant appearing before it.

Among America's major arbitration providers, NAF also has the dubious distinction of most aggressively marketing itself to credit card companies and debt collectors.[8] While NAF trumpets itself to the public as fair and neutral, "[b]ehind closed doors, NAF sells itself to lenders as an effective tool for collecting debts."[9] In its solicitations and advertising, NAF "has overtly suggested to lenders that NAF arbitration will provide them with a favorable result."[10] BusinessWeek revealed one of the most shocking examples of NAF marketing to debt collectors when it described a September, 2007, PowerPoint presentation aimed at creditors—and labeled "confidential"—that

promises "marked increase in recovery rates over existing collection methods."[11] The presentation also "boasts that creditors may request procedural maneuvers that can tilt arbitration in their favor. 'Stays and dismissals of action requests available without fee when requested by Claimant—allows claimant to control process and timeline.'" Speaking on condition of anonymity, an NAF arbitrator told BusinessWeek that these tactics allow creditors to file actions even if they are not prepared, in that "[i]f there is no response [from the debtor], you're golden. If you get a problematic [debtor], then you can request a stay or dismissal."[12] BusinessWeek also highlighted another disturbing NAF marketing tactic: NAF "tries to drum up business with the aid of law firms that represent creditors." Neither AAA nor JAMS cooperate with debt-collection law firms in such a manner.[13]

NAF has an arsenal of other ways of letting potential clients know that NAF can immunize them against liability. In one oft-cited example, an NAF advertisement depicts NAF as "the alternative to the million-dollar lawsuit."[14] Additionally, NAF sends marketing letters to potential clients in which it "tout[s] arbitration as a way of eliminating class action lawsuits, where thousands of small claims may be combined . . . . [Class actions] offer a means of punishing companies that profit by bilking large numbers of consumers out of comparatively small sums of money."[15] NAF's marketing letters also urge potential clients to contact NAF to see "how arbitration will make a positive impact on the bottom line" and tell corporate lawyers that "[t]here is no reason for your clients to be exposed to the costs and risks of the jury system."[16] Finally, in an interview with a magazine for in-house corporate lawyers, NAF's managing director Anderson

once boasted that NAF had a "loser pays" rule requiring non-prevailing consumers to pay the corporation's attorney's fees.[17]

NAF's practices in another dispute resolution arena—that of internet domain name disputes—further demonstrate NAF's willingness to suggest to potential clients that it will decide in their favor. In this area of its business, NAF issues press releases that laud its arbitrators' rulings in favor of claimants. These press releases, which feature headlines such as "Arbitrator Delivers Internet Order for Fingerhut" and "May the Registrant of magiceightball.com Keep the Domain . . . Not Likely," "do little to engender confidence in the neutrality of the NAF." The other two domain name dispute arbitration providers do not issue such press releases.[18]

II. NAF'S ARBITRATIONS ARE RIFE WITH SYSTEMIC IRREGULARITIES AND OVERSIGHTS THAT DENY THE VAST MAJORITY OF CONSUMERS A FAIR HEARING

In September 2007, Public Citizen issued a report analyzing data from NAF consumer arbitrations in California. This report found that, out of the more than 19,000 cases between January 1, 2003, and March 31, 2007, creditors won 94% of the time.[19] In response, some proponents of NAF arbitration have argued that the win rate for creditors is wholly reasonable because so many cases are defaults, where the consumer fails to respond to the notice of arbitration. One arbitrator, for example, said that "[b]ecause they're defaults, the power of the arbitrator is such that *you have no choice* as long as the parties have been informed."[20] In our experience and that of many other consumer lawyers and consumers with whom we've spoken, this NAF arbitrator's approach is

normal and typical of that of nearly all NAF arbitrators. The arbitrator's words are revealing: they suggest that an arbitrator is *compelled* to enter an award for the creditor in the full amount of whatever the creditor claims in the event of a default. In court, however, creditors do not automatically win in the event of a default. Instead, in a properly functioning legal system, a creditor winning a default still should be required to produce evidence that the consumer actually owed the debt, and the creditor still should be required to produce some evidence to verify the amount owed. Any other approach invites abuse – since the vast majority of consumers predictably default, if no proof is required, creditors will be rewarded for adding on imaginary or inflated claims. NAF arbitrators, in contrast to many courts, have demonstrably and notoriously unquestionably accepted creditors' assertions at face value in many tens of thousands of cases, without requiring any proof, breakdown or verification whatsoever, and awarding 100% of the sum demanded.

Another key distinction between collection cases before NAF and in court is the manner in which the decisionmaker is selected. This section will detail these differences between collection cases before NAF and in court, then it will describe the experiences of consumer attorneys representing clients in NAF arbitrations.

A. NAF's Procedures for the Selection and Retention of Arbitrators Are Kept Secret and Favor Creditors

Under NAF Rule 21(c), either party to the arbitration gets one chance to strike a potential arbitrator without cause: "the Forum shall submit one Arbitrator candidate to all

Parties making an Appearance. A Party making an Appearance may remove one Arbitrator candidate by filing a notice of removal within ten (10) days from the date of the notice of Arbitrator selection." Any subsequently appointed arbitrators can be disqualified for bias under NAF Rule 23.

This rule, however, omits a key aspect of NAF's arbitrator selection process: *how arbitrators are assigned to a case in the first place*. NAF keeps that crucial bit of information secret, and there is reason to believe that the selection is not random. On its website, NAF boasts that it has a total of more than 1,500 arbitrators in all 50 states, but that statistic has little significance if the vast majority of cases are steered to a small number of persons. (NAF has also been known to falsely state in court filings that certain lawyers, law professors, and former judges are NAF arbitrators when in fact they are not.[21]) Indeed, a large body of information establishes that NAF intentionally funnels the vast majority of cases to a very small group of selected arbitrators. The evidence further establishes that the major repeat players are more likely to decide cases in favor of creditors. In contrast, those arbitrators who rule for consumers are blackballed, meaning that they are no longer assigned to cases. In effect, this system gives credit card companies and debt buyers an additional strike, since arbitrators to whom they object would never be assigned to their cases in the first instance.

Data provided by the NAF pursuant to California Code of Civil Procedure § 1281.96, which requires arbitration providers to disclose certain information about their arbitrations, reveal that a tiny number of NAF arbitrators decide a disproportionate number of cases. The Center for Responsible Lending recently analyzed this data and

reached two startling conclusions: (a) companies that arbitrate more cases before certain arbitrators consistently get better results from those arbitrators, and (b) individual arbitrators who favor creditors over consumers get more cases in the future.[22] Similarly, the Christian Science Monitor analyzed one year of data and found that NAF's ten most frequently used arbitrators—who were assigned by NAF to decide nearly three out of every five cases—ruled for the consumer only 1.6% of the time. In contrast, arbitrators who decided three or fewer cases during that year found in favor of the consumer 38% of the time.[23] Likewise, Public Citizen's analysis found that one particular arbitrator, Joseph Nardulli, handled 1,332 arbitrations and ruled for the corporate claimant 97% of the time. On a single day—January 12, 2007—Nardulli signed 68 arbitration decisions, giving debt holders and debt buyers every cent of the nearly $1 million that they demanded.[24] If Nardulli worked a ten-hour day on January 12, 2007, he would have averaged one decision every 8.8 minutes. Busy arbitrators like Nardulli are well-compensated for workdays like this one—as one former NAF arbitrator noted, "I could sit on my back porch and do six or seven of these cases a week and make $150 a pop without raising a sweat, and that would be a very substantial supplement to my income . . . . I'd give the [credit-card companies] everything they wanted and more just to keep the business coming."[25]

Further evidence of NAF's propensity for steering arbitrations to those arbitrators who will rule in favor of its clients comes from outside of the consumer realm. In addition to handling consumer debt collection cases, NAF has also handled a large number of internet domain name disputes. A study of its handling of those cases

demonstrates the same patterns NAF has displayed in consumer cases: it curries favor with the party which selects the arbitrator, it determines which of the arbitrators on its panel will favor the party which selects them, and it funnels nearly all of its cases to those arbitrators. Law professor Michael Geist observed that, in domain name arbitrations, NAF's "case allocation appears to be heavily biased toward ensuring that a majority of cases are steered toward complainant-friendly panelists. Most troubling is data which suggests that, despite claims of impartial random case allocation as well as a large roster of 131 panelists, the majority of NAF single panel cases are actually assigned to little more than a handful of panelists."[26] Professor Geist went on to note that "an astonishing 53% of all NAF single panel cases . . . were decided by only six people," and the "complainant winning percentage in those cases was an astounding 94%." Importantly, neither of the other two domain name arbitration services had such a skewed caseload. Like aggressive advertising to potential clients, this method of attracting business is unique to NAF.

The second component of NAF's business-friendly system of arbitrator selection is its documented blackballing of arbitrators who dared to rule in favor of consumers. Harvard law professor Elizabeth Bartholet went public with her concerns that, after she awarded a consumer $48,000 in damages, NAF removed her from 11 other cases, all of which involved the same credit card company, on the credit card company's objection. As Bartholet described her experience to BusinessWeek, "NAF ran a process that systematically serviced the interests of credit card companies."[27] Bartholet told the Minneapolis Star-Tribune that "[t]here's something fundamentally wrong when one side

has all the information to knock off the person who has ever ruled against it, and the little guy on the other side doesn't have that information. . . .That's systemic bias."[28] Another deeply troubling element of Bartholet's experience comes from how NAF explained Bartholet's removal from her cases to the parties in those cases. NAF sent letters to the parties stating that "due to a scheduling conflict, the Arbitrator previously appointed is not available to arbitrate the above case." When Bartholet asked the NAF case administrator about the letters, the administrator "agreed that [Bartholet] was likely being removed simply because of [her] one ruling against the credit card company." NAF's legal counsel did not deny this explanation.[29]

Similarly, former West Virginia Supreme Court Justice Richard Neely stopped receiving NAF assignments after he published an article accusing the firm of favoring creditors. In that article, Justice Neely lamented that NAF "looks like a collection agency" that depends on "banks and other professional litigants" for its revenue; he described NAF as a "system set up to squeeze small sums of money out of desperately poor people."[30]

B. NAF Arbitrations Deny Consumers Some of the Protections They Would Be Granted in Court Proceedings

Other aspects of NAF's arbitration practices raise further doubts about the trustworthiness of the process and the ability of consumers to get a fair hearing in arbitration, as compared to the experiences they would have in court. Proponents of arbitration frequently cite to a law review article from 1990 in support of their argument

that consumers in credit-card collection cases fare equally poorly in court as in arbitration.[31] This article, however, predates the explosion of third-party debt buyers and their inability to provide proper evidence to substantiate their claims. Because of the way debt is now sold and resold, for pennies on the dollar, debt buyers frequently lack any meaningful substantiation of their claims and instead put forward "proof" that, because it fails to comport with the rules of evidence, is admissible in NAF arbitrations but would be insufficient in many courts. Before turning to the protections available in court that are absent in NAF proceedings, it is necessary to briefly discuss the rise of the third-party debt buyer industry.

Third-party debt collection, in which debt buyers pay pennies on the dollar for defaulted consumer debt, is a hugely profitable business. Despite the faltering economy, companies that collect and buy consumer debt are flourishing, and the industry's current revenues of around $17 billion are expected to increase by six percent each year over the next three years.[32] The industry has already undergone massive growth: in 2005, debt buyers purchased $66.4 billion worth in credit card debt, up from $4.4 billion just ten years earlier.[33]

Bad debts are typically sold and resold, at increasingly bargain prices, as new buyers attempt to collect debts that others have given up on. As of 2007, the average price of one dollar in bad credit card debt was 5.3 cents.[34] One debt buyer, Encore Capital Group, recently scored $5 billion worth of credit card loans from Citibank, Bank of America, and Capital One, for 3 cents on the dollar.[35] One court case offers a telling example of the way consumer debts are tossed from debt buyer to debt buyer: the

successor company to Providian assigned an account to Vision Management Services, which three days later reassigned the account to Great Seneca Financial Corporation. Less than a month later, Great Seneca Financial Corporation assigned the account to Account Management Services, which after four months sold the account to Madison Street Investments. After five months, Madison Street Investments sold the debt to Jackson Capital, and on the same day it received the account, Jackson Capital sold the debt to Centurion.[36] A huge number of debt buyers operate out of an endlessly shifting set of corporate shell entities that come into and go out of business regularly, having the same group of employees making calls on behalf of numerous supposedly separate corporations from the same phones and offices.

Moreover, because these consumer debts are bought and resold so many times, as part of enormous portfolios of debt that are divided up and resold to other buyers who do the same, debt buyers frequently lack adequate documentation of the loan, including the original contract between the consumer and the lender. In the case of credit card debt and arbitrations brought to collect this debt, this lack of documentation means that (a) there is no evidence of the consumer's agreement to arbitrate any disputes that arise between himself and the lender, and (b) there is no evidence of the amount the consumer actually owes. Instead, creditors simply offer a generic form contract and an affidavit stating the amount owed. As will be explained below, these and other practices work enormous harm on consumers who find themselves forced into arbitration over credit card debt.

In NAF arbitrations, creditors frequently attempt to demonstrate the amount allegedly owed by simply producing an affidavit from one of their employees. In many

courts, however, such an affidavit, standing alone, is not sufficient to collect a debt. A number of states require that a creditor seeking to collect on a debt must file a copy of the instrument itself. In Connecticut, for example, Practice Book § 17-25 states that in defaults for a failure to appear, "the affidavit shall state that the instrument is now owned by the plaintiff, and a copy of the executed instrument shall be attached to the affidavit." Similarly, pursuant to Ohio Civil Rule 10(D), account or written instrument must be attached to the pleading. If the account or written instrument is not attached, the reason for the omission must be stated in the pleading." Under Florida Rule of Civil Procedure 1.130, "[a]ll bonds, notes, bills of exchange, contracts, accounts, or documents upon which action may be brought or defense made, or a copy thereof or a copy of the portions thereof material to the pleadings, shall be incorporated in or attached to the pleading." In yet more states, including Georgia, "[w]here records relied upon and referred to in an affidavit are neither attached to the affidavit nor included in the record and clearly identified in the affidavit, the affidavit is insufficient."[37]

In contrast, in NAF arbitrations concerning debts in Connecticut, Ohio, Florida, and Georgia, the debt collector has no obligation to produce a copy of the original instrument—which is convenient for the debt buyer, since the repeated sale and resale of the debt as part of an enormous package of debts has likely left the debt buyer without any actual evidence or documentation of an individual account. If called upon to produce a contract, the debt buyer will probably present a generic form contract with no evidence that the consumer was ever bound by that particular contract. This issue is particularly relevant in the arbitration context because creditors must demonstrate that the contract

contained an arbitration clause. But because consumer contracts undergo frequent revisions and are often allegedly amended by "bill stuffers," the version of the contract that the consumer actually received may not have contained the clause. [38]

Even in courts where the debt can be proved using only an affidavit, other basic procedural protections apply in court but can be easily evaded by filing an NAF arbitration instead. For example, some states, including Indiana, Minnesota, and New York, require that sworn pleadings from out-of-state be accompanied by a certificate authenticating the affiant's authority, and courts may reject affidavits submitted without that certificate.[39] NAF arbitrations offer no such protection. Moreover, pursuant to regular rules of evidence, affidavits must be made based on personal knowledge and affirmatively demonstrate that the affiant is competent to testify on the matters contained in the affidavit—a requirement that frequently cannot be met by the debt buyer's affiant.[40]

C. NAF Arbitrations Suffer from a Number of Other Systemic Procedural Irregularities that Raise Doubts About the Trustworthiness of the Process

Over the years, we have spoken to hundreds of consumers and consumer attorneys about NAF. They have told us, again and again, about how NAF takes creditors' assertions at face value, without requiring substantiation, resulting in a system that is rigged against consumers. In preparation for this testimony, we have also conducted an informal poll of a large number of consumer attorneys to survey their experiences of procedural irregularities in NAF debt collection arbitrations. Their stories are too

numerous and too lengthy to report in full, but below we offer some examples of common practices in NAF debt collection arbitrations and the names and contact information of attorneys who can have witnessed these practices. These stories, all of which derive from NAF's willingness to enter awards despite lack of substantiation, give rise to serious concerns about the reliability of the private justice system that is quickly replacing American courts.

1. NAF enters awards against individuals who are the victim of identity theft

The numerous stories of individuals who had NAF awards entered against them even though they were victims of identity theft are among the most troubling of all the NAF horror stories: even the briefest impartial review of the creditor's case would reveal that these individuals did not owe the debt that the creditor claimed.[41] The following individuals represent just a few instances of NAF's entering awards against identity theft victims.

Buddy Newsom never had an MBNA credit card account. When he received a document from MBNA about an account in his name, he immediately contacted MBNA to explain that it was not his. Subsequently, Newsom discovered that an employee in his construction business—who was later prosecuted for embezzlement—had opened credit card accounts in his name. Nevertheless, when MBNA initiated an arbitration proceeding, NAF entered an award against Newsom for $17,759.65, the full amount demanded by MBNA, even though Newsom had objected to arbitration on the ground that there was no account and thus no arbitration agreement. After learning of the award,

Newsom's attorney contacted the arbitrator, who explained that he receives a stack of 40-50 "uncontested" cases from NAF every month, and that Newsom's case was included in that set. The arbitrator simply rubber-stamped Newsom's case with an award for the creditor in the full sum, as he did for all the others. When Newsom's attorney contacted an NAF case manager, he learned that NAF had actually received the information about the identity theft but decided not to forward that information to the arbitrator—because it had been received one day too late.[42]

Six months after Beth Plowman used her MBNA card to pay a hotel bill while on a business trip to Nigeria in 2000, MBNA called her to collect more than $26,000 spent at sporting goods stores in Europe. Plowman had received no credit card statements during those six months; MBNA told her that "her sister"—Plowman has no sisters—had changed the address on the account to an address in London. Plowman filed an identity theft report with the police and heard nothing more from MBNA. But two years later, a debt collection agency that had purchased the debt from MBNA got an arbitration award against her from NAF.[43]

Troy Cornock received a letter from NAF claiming that he owed money on an MBNA credit card, but he had never signed a credit card agreement or made any charges on the account, which had been opened by his ex-wife. NAF ruled against him anyway.[44] But when MBNA attempted to enforce the NAF award in court, the court granted Cornock's motion for summary judgment, stating that "in the absence of a signed credit card application or signed purchase receipts demonstrating that the defendant used and retained the benefits of the card, the defendant's name on the account, without more, is

insufficient evidence that the defendant manifested assent. . . . To hold otherwise *would allow any credit card company to force victims of identity theft into arbitration*, simply because that person's name is on the account."[45]

Irene Lieber, who lives on $759 a month in Social Security disability payments, was hounded by a debt collection agency after her MBNA credit card was stolen. Lieber later received a notice of arbitration from NAF. With the help of a legal services attorney, she asked to see the case against her or for the claim to be dismissed. But Lieber heard nothing until another notice arrived, stating that NAF had issued a $46,000 award against her.[46]

In addition to all of these stories, several attorneys told us that NAF had entered awards against their clients even though they were the victims of identity theft:

- Joanne Faulkner, Connecticut, 203-772-0395, j.faulkner@snet.net
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com
- Jane Santoni, Maryland, 410-938-8666, jane@williams-santonilaw.com

2. NAF enters awards even though consumer never received notice of arbitration

NAF's habitual practice of failing to ensure that consumers receive adequate notice of arbitration has been observed by courts asked to confirm arbitration awards as well as by consumer attorneys.

A Connecticut court, for example, denied a debt buyer's motion to confirm an NAF award noting that NAF rules provide "no procedure by which the arbitrator makes any determination of whether the defendant has received actual notice of the demand for arbitration . . . . and if the defendant does not respond in writing to the demand for

arbitration, NAF simply decides the case 'on the papers.' This certainly results in a high likelihood that the outcome of the arbitration will be in the defendant's favor."[47]

Attorneys frequently reported that NAF entered awards against their client even though the client could affirmatively demonstrate that he or she never received notice of arbitration. New York attorney Kevin Mallon (phone: 212-822-1474; email: kmallon@lawsuites.net), for example, reported that NAF erroneously insisted that his client had been served with notice of arbitration. The client was able to verify that he had not been served, however, by demonstrating that he had, in fact, been getting married on the day that he allegedly received notice of arbitration. Mallon wrote NAF a letter explaining the lack of proper service, but NAF responded by taking his letter as a substantive response to the creditors' allegations and entered an award against his client.

California attorney Aurora Harris (phone: 714-288-0202; email: roraharris@aol.com) noted that an individual in Minnesota is responsible for certifying that notices of arbitration have been sent, even though that certification offers no evidence that the notice of arbitration was actually mailed or that it was sent to the proper address.

Other attorneys who reported that NAF entered awards against their clients despite lack of proper notice of arbitration include:

- Rebecca Covey, Florida, 954-763-4300, rebeccacovey@lemonadvice.com
- Angela Martin, North Carolina, 919-708-7477, martingodawgs@aol.com
- Bob Martin, New York, 212-815-1810, rmartin@dc37.net
- John Mastriani, Texas, 713-665-1777, mrmastriani@gmail.com
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com
- Dale Pittman, Virginia, 804-861-6000, dale@pittmanlawoffice.com

- Rich Tomlinson, Texas, 713-627-2100, rtomlinson@houstonconsumerlaw.com

3. NAF enters awards despite the creditor's failure to prove the existence of an arbitration agreement

One of consumer attorneys' most frequent comments about NAF was that NAF routinely entered arbitration awards against their clients in the absence of any reason to believe that the clients had actually agreed to arbitration. One particularly telling example comes from California attorney Aurora Harris (phone: 714-288-0202; email: roraharris@aol.com). NAF had entered an arbitration award when the purported contract between Chase and her client was three illegible pages. Upon closer inspection, Harris realized that the contract supposedly containing the arbitration agreement was actually three unrelated pages from three different contracts, with inconsistent page numbers and overlapping content—and nowhere in those three pages was there actually an arbitration agreement.

Another example comes from Iowa attorney Ray Johnson (phone: 515-224-7090; email: johnsonlaw29@aol.com) who has had clients who could not possibly have agreed to arbitration, because (a) the account was so old that it predated the use of arbitration clause, and (b) the consumer had closed the account before the credit card company amended the contract to add an arbitration provision.

Other attorneys reporting NAF's failure to verify the existence of an arbitration agreement include:

- Craig Jordan, Texas, 214-855-9355, craig@warybuyer.com
- John Mastriani, Texas, 713-665-1777, mrmastriani@gmail.com
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com

- Dale Pittman, Virginia, 804-861-6000, dale@pittmanlawoffice.com
- Joe Ribakoff, California, 562-366-4715, killerrib@gmail.com

4. NAF enters awards even though debts are past the statute of limitations

We have spoken to a large number of consumers, and to a number of attorneys, who have reported that NAF arbitrators entered awards against consumers clients even though the alleged debts were past the statute of limitations. I have seen NAF enter awards in cases that are more than half a dozen years past the statute of limitations. Some other attorneys who have had this experience include:

- Terry Adler, Michigan, 810-695-0100, lemonade1@sbcglobal.net
- Ray Johnson, Iowa, 515-224-7090, johnsonlaw29@aol.com
- Bob Martin, New York, 212-815-1810, rmartin@dc37.net
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com

5. NAF enters awards with impermissible fees added on

Several attorneys noted that NAF enters awards that have impermissible junk and attorneys fees added, even when those fees may be prohibited by law.

- Joanne Faulkner, Connecticut, 203-772-0395, j.faulkner@snet.net
- Aurora Harris, California, 714-288-0202; roraharris@aol.com
- Ray Johnson, Iowa, 515-224-7090, johnsonlaw29@aol.com
- Bob Martin, New York, 212-815-1810, rmartin@dc37.net
- Joe Ribakoff, California, 562-366-4715, killerrib@gmail.com

CONCLUSION

In all too many cases, American consumers are denied the fair and impartial arbitration that they are promised. Rather than presenting an expedient and just way to

resolve disputes, arbitrations before the NAF have been operating simply as an arm of the debt-collection industry. Even though NAF has now withdrawn from the business of consumer arbitration, the circumstances that allowed NAF to profit from credit card arbitration remain unchanged, and it would be all too easy for another company to start up where NAF left off.

[1] *See* Consumers Union, *Best and Worst Credit Cards*, Consumer Reports, Oct. 2007. *See also* Day to Day, *Marketplace Report: Credit Disputes Favor Companies* (NPR radio broadcast Sept. 28, 2007) (available at 2007 WLNR 19048094) ("[I]t's often hard to find a credit card that doesn't make arbitration mandatory."); Simone Baribeau, *Consumer Advocates Slam Credit-Card Arbitration*, Christian Sci. Monitor, July 16, 2007 ("[I]f you own a credit card, chances are you have a mandatory arbitration clause.").
[2] Compl. ¶ 2, *State v. Nat'l Arbitration Forum, Inc.*, (Minn. Dist. Ct. filed July 14, 2009).
[3] Am. Morning (CNN television broadcast June 6, 2008) (transcript available at http://transcripts.cnn.com/TRANSCRIPTS/0806/06/ltm.03.html).
[4] Nathan Koppel, *Arbitration Firm Faces Questions Over Neutrality*, Wall St. J., Apr. 21, 2008.
[5] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[6] Consumers Union, *Consumer Rights: Give Up Your Right to Sue?* Consumer Reports, May 2000.
[7] Joseph Garrison, *Is ADR Becoming "A License to Steal"?* Conn. L. Trib., Aug. 26, 2002, at 4.
[8] *See* Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One-Sided*, Wash. Post, Mar. 1, 2000, at E1 ("[A]rbitration industry experts say [that] the forum's business involves more corporate-consumer disputes, in large part because of the company's aggressive marketing."). *Cf.* Michael Geist, *Fair.com? An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, 27 Brook. J. Int'l L. 903, 907 (2002) (in analysis of domain name arbitration providers, noting that "[m]arketing techniques clearly illustrate one area of differentiation between providers, with the NAF adopting a far more aggressive approach than the other providers in the marketing of its services").
[9] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008. *See also* Sean Reilly, *Supreme Court Looks at Arbitration in Alabama Case This Week*, Mobile Reg., Oct. 1, 2000, at A1 ("In marketing letters to potential business clients, [NAF's] executives have touted arbitration as a way of eliminating class action lawsuits, where thousands of small claims may be combined."); Sarah Ovaska, *3 Cases Cite Payday Lending: Consumer Groups Say Arbitration Clauses Deny People Recourse to Courts*, News & Observer, Jan. 7, 2007 ("[NAF], which in 2006 resolved $3 billion worth of claims involving debts and other disputes, has been singled out by consumer advocates, who criticize it for advertising its services to businesses.").
[10] Ken Ward, Jr., *State Court Urged to Toss One-Sided Loan Arbitration*, Charleston Gazette & Daily Mail, Apr. 4, 2002, at 5A.
[11] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[12] *Id.*
[13] *Id.*
[14] Nadia Oehlsen, *Mandatory Arbitration on Trial*, Credit Card Mgmt., Jan. 1, 2006, at 38
[15] Sean Reilly, *Supreme Court Looks at Arbitration in Alabama Case This Week*, Mobile Reg., Oct. 1, 2000, at A1.
[16] *See* Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One-Sided*, Wash. Post, Mar. 1, 2000, at E1.
[17] *See Do An LRA: Implement Your Own Civil Justice Reform Program NOW*, Metropolitan Corp. Counsel, Aug. 2001.
[18] Michael Geist, *Fair.com? An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, 27 Brook. J. Int'l L. 903, 907 (2002).
[19] Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 15 (2007), http://www.citizen.org/documents/ArbitrationTrap.pdf.
[20] Justin Scheck, *Neutral Takes Path from Construction to Credit Cards*, The Recorder, Oct. 2, 2007 (emphasis added).
[21] This information comes from the declaration of a West Virginia attorney in the case of *McQuillan v. Check 'N Go of North Carolina*, which Public Justice is happy to provide upon request.
[22] Joshua M. Frank, Center for Responsible Lending, *Stacked Deck: A Statistical Analysis of Forced Arbitration* (2009), http://www.responsiblelending.org/credit-cards/research-analysis/stacked_deck.pdf.
[23] Simone Baribeau, *Consumer Advocates Slam Credit-Card Arbitration*, Christian Sci. Monitor, July 16, 2007.
[24] Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 17 (2007), http://www.citizen.org/documents/ArbitrationTrap.pdf.
[25] Chris Serres, Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions? Star Trib. (Minneapolis), May 11, 2008, at 1D.

[26] Michael Geist, *Fair.com? An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, 27 Brook. J. Int'l L. 903, 912 (2002).
[27] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[28] Chris Serres, *Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions?* Star Trib. (Minneapolis), May 11, 2008, at 1D.
[29] *Courting Big Business: The Supreme Court's Recent Decisions on Corporate Misconduct and Laws Regulating Corporations*, 110th Cong. (2008) (statement of Elizabeth Bartholet), *available at* http://judiciary.senate.gov/hearings/testimony.cfm?id=3485&wit_id=7313.
[30] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[31] Hillard M. Sterling & Philip G. Schrag, *Default Judgments Against Consumers: Has the System Failed?* 67 Denver U. L. Rev. 357 (1990).
[32] Jessica Silver-Greenberg, *Snagging Debt Collectors*, BusinessWeek, Dec. 1, 2008.
[33] Walter V. Robinson & Beth Healy, *Debt Collectors Hunt the Innocent*, Boston Globe, Sept. 13, 2006.
[34] Robert M. Hunt, *Overview of the Collections Industry*, available at http://www.ftc.gov/bcp/workshops/debtcollection/presentations/hunt.pdf.
[35] Jessica Silver-Greenberg, *Snagging Debt Collectors*, BusinessWeek, Dec. 1, 2008.
[36] *Miller v. Wolpoff & Abramson, LLP*, No. 1:06-CV-207-TS, 2007 WL 2694607, at *8 (N.D. Ind. Sept. 7, 2007).
[37] *Powers v. Hudson & Keyse, LLC*, 656 S.E.2d 578 (Ga. App. 2008).
[38] *See, e.g.*, *Creech v. MBNA Am. Bank, N.A.*, 250 S.W.3d 715 (Mo. Ct. App. 2008) ("In its argument in this Court, Appellant claims that the original agreement with Respondent probably had an agreement to arbitrate and was later amended to include an arbitration agreement. Appellant claims that the amendment was sent by mail to Respondent. Neither party filed with the trial court the original account agreement; instead, Respondent relies upon a copy of the 'amendment' which Appellant claims was mailed to Respondent a short time after the account was opened and which has never been acknowledged as received by Respondent.").
[39] Ind. Code § 34-37-1-7; Minn. Stat. § 600.09; N.Y. C.P.L.R. 2309(c) (McKinney).
[40] For examples of courts rejecting affidavits on this basis, see, e.g., *Palisades Collection L.L.C. v. Gonzalez*, 809 N.Y.S.2d 482 (Civ. Ct. 2005), *Luke v. Unifund CCR Partners*, 2007 WL 2460327 (Tex. App. Aug. 31, 2007).
[41] *See* Sheryl Harris, *Consumers Should Be Suspicious of Arbitration Clause*, Plain Dealer (Cleveland), Feb. 17, 2005, at C5. ("Even victims of identity theft have been wrestled into arbitration [with NAF] and held responsible for charges racked up by thieves.").
[42] Interview with Buddy Newsom and his attorney, Mark Pearson.
[43] Eileen Ambrose, *Read the Fine Print: Arbitration Clause Can Sting You*, Fort Wayne J. Gazette, Mar. 15, 2005, at 8.
[44] Gary Weiss, *Credit Card Arbitration* (Oct. 11, 2007), Forbes.com, http://www.forbes.com/2007/ 10/10/gary-weiss-credit- oped-cx_gw_1011weiss.html.
[45] *MBNA Am. Bank, N.A. v. Cornock*, No. 03-C-0018, slip. op. at 25 (N.H. Super Ct. Mar. 20, 2007) (emphasis added).
[46] Laura Rowley, *Stacking the Deck Against Consumers* (Oct. 17, 2007), Yahoo! Finance, http://finance.yahoo.com/expert/article/moneyhappy/48748.
[47] *CACV of Colo., LLC v. Corda*, No. NNHCV054016053, 2005 WL 3664087 (Conn. Super. Ct. Dec. 16, 2005). *See also Asset Acceptance, LLC v. Wheeler*, --- S.E.2d ----, 2009 WL 71504, at *1 (Ga. Ct. App. Jan. 13, 2009) (affirming vacatur of NAF arbitration award where consumer had not received proper notice);

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The American Arbitration Association® Calls For Reform of Debt Collection Arbitration
Largest Arbitration Services Provider Will Decline to Administer Consumer Debt Arbitrations until Fairness Standards are Established

New York, NY– (July 23, 2009) – The American Arbitration Association (AAA), the world's largest conflict management and dispute resolution services organization, today recommended in a House subcommittee hearing that the process surrounding consumer debt collection arbitration needs major reform and recommended a national policy committee to identify and research solutions. AAA said it will not administer any consumer debt collection programs until those solutions are determined.

AAA senior vice president Richard Naimark told the Domestic Policy Subcommittee of the House Oversight and Government Reform Committee that the AAA "has not administered significant numbers of debt collection arbitrations relative to some other organizations," and has not handled any since June after it concluded a single high-volume program. However, he said that AAA had independently reviewed areas of the process and concluded that it had some weaknesses. As a result of that review, it is evident to the AAA that "a series of important fairness and due process concerns must be addressed and resolved before we will proceed with the administration of any consumer debt collection programs." According to Mr. Naimark, areas needing attention from the national policy committee include consumer notification, arbitrator neutrality, pleading and evidentiary standards, respondents' defenses and counterclaims, and arbitrator training and recruitment.

"AAA has been working with the Domestic Policy Subcommittee to review potential improvements in consumer debt collection arbitration procedures for some time. We believe that arbitration can play a major role in consumer debt collection disputes. A national policy committee dedicated to meaningful reform can enhance an array of due process elements so that there is deeper fairness and transparency. Consumers deserve an alternative to litigation, but they also need to be able to trust that option. Our goal will be to achieve that trust," Mr. Naimark said after the hearing.

"We have been studying this issue for some time. We made our decision to impose a moratorium on administering consumer debt arbitration independently and not at the behest of any outside entity as has been claimed. We commend the Domestic Policy Subcommittee for its initiatives to protect consumers in debt collection cases, and we will continue to work with it willingly and enthusiastically," Mr. Naimark said.

About the American Arbitration Association
The global leader in conflict management since 1926, the American Arbitration Association is a not-for-profit, public service organization committed to the resolution of disputes through the use of arbitration, mediation, conciliation, negotiation, democratic elections and other voluntary procedures. In 2008, 138,447 cases were filed with the Association in a full range of matters including commercial, construction, labor, employment, insurance, international and claims program disputes. Through 30 offices in the United States, Ireland, Mexico, and Singapore, the AAA provides a forum for the hearing of disputes, rules and procedures and a roster of impartial experts to resolve cases. Find more information online at www.adr.org.

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Dispute Resolution Services Worldwide

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July 20, 2009

Ms. Lori Swanson
Attorney General
State of Minnesota
1400 Bremer Tower
445 Minnesota Street
St. Paul, MN 55101

Dear Attorney General Swanson:

I have received your letter dated July 19, 2009 and would like to respond to the very important issues raised and concerns you have expressed about consumer debt arbitration programs. Like you, the American Arbitration Association ("AAA") is deeply committed to providing access to justice for consumers, and we have worked with great dedication over the years to develop widely respected protocols, codes of ethics and other procedures to ensure that arbitrations administered under the auspices of the AAA are handled fairly and efficiently.

The AAA is unique with respect to our governance structure in that other ADR providers are almost exclusively organizations that operate for a profit, whereas the AAA is an 83 year old not-for-profit organization with a mission dedicated to developing the widespread, effective and ethical use of alternative dispute resolution. As part of our governance structure, we have a Board of Directors that provides divergent representative viewpoints of former judges, government and union officials, and the plaintiff and corporate bars. Fortunately, the AAA is able to draw on those varied experiences, in addition to our own, in developing dispute resolution processes that accommodate the needs of parties not only for a cost effective and efficient method of resolving disputes, but more importantly dispute resolution processes that are fair and which accommodate the particular characteristics of the parties.

Regarding some of the specific points you have raised, I would like to first make you aware that the AAA is not currently administering any large debt collection programs of the type described in your letter, and in fact, the AAA has only administered one such program which ended in June of this year. After the

conclusion of the AAA's administration of that caseload, the AAA engaged in a significant effort to identify and consider many of the aspects of debt collection arbitration programs that give rise to legitimate concerns.

Those concerns include issues related to matters such as the notice that is provided to consumers, arbitrator neutrality, the amount and type of evidence that a business is required to submit when they file a demand for arbitration against a consumer, and other matters such as a consumer's ability to defend an arbitration in light of claims such as of identity theft. You have also expressed some thoughts about consumers' knowledge of the arbitration process and their perceived ability to obtain access to the arbitral forum, which are concerns shared by the AAA.

It is the AAA's view that each of these issues must be studied individually to determine whether the arbitration process can be accommodated to address the concerns raised. An AAA representative will be presenting various ideas about how it might be possible to do so at the July 22nd hearing of the Domestic Policy Subcommittee of the House Committee on oversight and Government Reform. I understand that you will be a witness at that hearing as well and we look forward to sharing our views in detail with you at that time. In the meantime, and until such that there is some consensus on how concerns about the administration of debt collection arbitrations might be successfully addressed, the AAA has implemented a moratorium on the administration of any consumer debt collection arbitration programs.

However, I would also like to note that an important distinction should be made between consumer debt collection caseloads that are filed in large numbers almost exclusively by a single business claimant on the one hand, and individual consumer arbitrations on the other. In connection with individual consumer arbitration filings, it is the view of the AAA that considerable success has been achieved in creating an arbitral forum that is accessible and fair to consumers. More specifically, the Searle Civil Justice Institute at Northwestern University recently completed an in depth examination of consumer arbitrations administered by the AAA that found that consumer arbitration is an inexpensive and quick way to resolve consumer disputes, that the "repeat-player" effect was not statistically significant, and that attorneys' fees are granted to consumers in the majority of cases where the consumer sought such an award.

In addition, the Searle Institute found that the AAA's fidelity to the Consumer Due Process Protocol was effective in identifying and responding to consumer arbitration agreements that did not meet the AAA's minimum standards of fairness and due process. Finally, for consumer arbitrations other than debt collection arbitrations administered by the AAA, the vast majority of cases (72% of consumer cases filed with the AAA in 2008) are filed by the *consumer* party. This evidence would suggest that AAA arbitration provides a meaningful avenue for the resolution of consumer disputes. While the Searle study did not investigate consumer debt arbitration caseloads which can fairly be viewed as a subset of consumer arbitration, the Searle institute has now commenced a study of consumer debt collection arbitrations which will also be informative with respect to improvements that might be implemented into the arbitration process.

I hope that this letter adequately explains the AAA's current position and practices with the administration of consumer and debt collection arbitrations. To the extent that you have any additional questions or concerns, we would welcome the opportunity to discuss it with you further.

Sincerely yours,

William K. Slate II

William K. Slate II

Bank of America

Fact Sheet about Bank of America's Arbitration Position

- Bank of America's Consumer businesses will no longer enforce mandatory arbitration in new banking disputes with individual customers. This applies to the bank's consumer credit cards; auto, recreational vehicle and marine loans; and deposit accounts.
    - Bank of America eliminated mandatory arbitration in its mortgage and home equity agreements several years ago.
    - Bank of America dramatically reduced its use of arbitration in credit card collection actions in mid-2008.
- With this additional change, a customer with a new dispute with Bank of America regarding a credit card loan; auto, recreational vehicle or marine loan; or deposit account will no longer be subject to mandatory arbitration.
- Existing individual customers who currently have the right to arbitrate a dispute will retain that right, but the bank will not require it.
- This change will be reflected in future Bank of America customer agreements, as we update those agreements beginning later this year
- This complements other efforts to respond to our customers. In addition to taking actions to avoid serious disputes, Bank of America works closely with customers in distress.
    - In 2008, Bank of America modified nearly one million U.S. consumer credit card and unsecured loans. During the first six months of the year, the company has already modified 600,000 more, representing approximately $6 billion in credit.
    - Bank of America also modified 230,000 mortgage loans in 2008 and 150,000 mortgage loans during the first six months of this year.
    - For more information on Bank of America's lending and investment efforts, our Quarterly Impact Report is available via newsroom.bankofamerica.com.

Mr. COHEN. Thank you, sir, we appreciate your testimony.

Our third witness has a positive and a negative to me, his great first name Stephen, Mr. Stephen Ware. He is a professor at the University of Kansas School of Law, which brings back pangs from 1½ years ago.

He teaches at the school there, doesn't take SATs for his basketball players, taught six different law schools including Samford's

Cumberland School of Law, which started in Tennessee and was a faculty member there for 2 years.

He is the author of two books, several other publications and a frequent speaker at academic conferences, continuing legal education programs and a "Rock Shock Jayhawk." You are welcome.

TESTIMONY OF STEPHEN J. WARE, UNIVERSITY OF KANSAS, SCHOOL OF LAW, LAWRENCE, KS

Mr. WARE. Thank you very much, Chairman Cohen, Ranking Member Franks, Members of the Subcommittee.

Although I am a professor of law at the University of Kansas, I speak to you today not on behalf of my university or anyone else, but on my own as an individual scholar who specializes in arbitration law.

Thank you for inviting me to testify. As someone who has spent the last 16 years focused on arbitration, it is a real honor for me to get the chance to talk to the elected officials who ultimately control the future of arbitration in this country.

And my suggestion and request to you is to please proceed with caution because arbitration does a lot of good, including a lot of good for ordinary citizens. For example, I am a consumer, and I like to see arbitration clauses in the contracts of the companies I do business with.

That tells me that the company is saving money on legal fees because arbitration tends to be a quicker and cheaper process and competition over time will force the company to pass on some of those savings to me. And if I ever have a claim against one of those companies, I would like to save my own time and money by having access to the quicker and cheaper process.

So if arbitration and litigation tend to reach similar outcomes, and by outcomes I mean who wins and how much money they win, but arbitration reaches those outcomes quicker and cheaper than litigation, then arbitration is good for everybody.

It is good for the business and it is good for the consumer or employee or whoever has a dispute with the business. And that is basically the conclusion I have reached in my career of studying arbitration.

Sure the trial lawyers who feel threatened by arbitration can tell stories of particular consumers and employees who did not fare well in a particular arbitration, but people can also tell stories of particular consumers and employees that did not fare well in litigation.

So we shouldn't be comparing arbitration to some ideal imaginary dispute resolution process. We should be comparing the reality of arbitration with the reality of litigation, as those are the two options available to parties today. And when the comparison moves beyond stories, beyond anecdotes, to serious empirical studies arbitration looks very good for consumers and employees overall.

So what is at issue here in the bills before Congress? Basically you are being asked what should be the law on arbitration clauses in consumer contracts, employment contracts and similar contracts, and there are at least three possible answers to that question.

One answer is none of these arbitration clauses should be enforced and that is the answer of the Arbitration Fairness Act. If you enact that bill or something similar, you will say none of these arbitrations clauses shall be enforced. At the other extreme would be laws saying all of these arbitration clauses should be enforced. Nobody is advocating that and that is not what current law does.

What current law does under the Federal Arbitration Act is enforce some of these arbitration clauses. The Federal Arbitration Act instructs courts to enforce the fair ones, don't enforce the unfair ones, and courts frequently decline to enforce arbitration clauses.

Courts have spent generations developing legal doctrine that are sensitive to the case-by-case variations in the facts of a case. Arbitration agreements can be written in a wide variety of ways, and the consent parties give to arbitration agreements can incur under a wide variety of circumstances.

I suggest that courts, being sensitive to those factual differences, courts resolving cases individually, is a better approach than legislation which necessarily paints with a broad brush. I thank you for your attention and look forward to any questions.

[The prepared statement of Mr. Ware follows:]

PREPARED STATEMENT OF STEPHEN J. WARE

Testimony of Stephen J. Ware
Professor of Law
University of Kansas
September 15, 2009

Hearing on "Mandatory Binding Arbitration – Is it Fair and Voluntary?"

House Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

Chairman Cohen, Ranking Member Franks and Members of the Subcommittee. Thank you for inviting me to testify. My name is Stephen Ware, and I am a Professor of Law at the University of Kansas. I speak to you today, not on behalf of my university, but as an individual scholar who specializes in arbitration law.

I am writing my third book on arbitration and have published twenty arbitration articles in scholarly journals, as well as several arbitration-related articles in non-academic publications. Within the field of arbitration law, I have devoted special attention to arbitration involving consumers, employees and other ordinary individuals. In fact, I have devoted much of the last 16 years of my professional life to researching the law, economics and practice of such arbitration. Based on this experience, I conclude that current law is generally very good at ensuring that binding arbitration is fair and voluntary.[1] Therefore, I am very concerned about bills in Congress that would, in my view, worsen arbitration law and harm the very people they are designed to help.[2]

I begin by addressing the voluntariness of arbitration then turn to its fairness.

Arbitration Is More Voluntary Than the Alternative (Litigation)

Litigation in the court system is the default process of dispute resolution. Parties can contract into alternative processes of dispute resolution, but if they do not do so then each party retains the right to have the dispute resolved in litigation. By contrast, a dispute does not go to arbitration unless the parties have contracted to have an arbitrator resolve that dispute.[3] In other words, arbitration binds only those who contracted for it. In this important sense, arbitration is not "mandatory" but litigation is. Parties who

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[1] I have proposed some changes to the Federal Arbitration Act but these proposals generally deal with topics that have not become the subject of Congressional hearings. *See* Stephen J. Ware, *Interstate Arbitration*, in EDWARD BRUNET ET AL., ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 88-126 (2006).

[2] Such bills include the Arbitration Fairness Act (H.R. 1020) and the Fairness in Nursing Home Arbitration Act (H.R. 1237). The Arbitration Fairness Act would prevent courts from enforcing pre-dispute arbitration agreements between (1) consumers and their sellers, (2) employees and their employers, and (3) franchisees and their franchisors. Similarly, the Fairness in Nursing Home Arbitration Act would prevent courts from enforcing pre-dispute arbitration agreements between a long-term care facility (such as a nursing home) and a resident of a long-term care facility or anyone acting on behalf of such a resident. I expect that enactment of these bills would largely end arbitration of disputes between such parties.

During a hearing on last year's version of The Fairness in Nursing Home Arbitration Act (H. R. 6126) Representative Hank Johnson stated that the bill "would not gut arbitration as an alternative dispute resolution; it would simply bar pre-dispute mandatory arbitration agreements in nursing home agreements." *Hearing on H.R. 6126, the "Fairness in Nursing Home Arbitration Act of 2008" Before the Subcomm. on Comm. and Admin. Law of the H. Comm. on the Judiciary,* 110th Cong. (2008) (statement of Rep. Hank Johnson), *transcript available at* 2008 WL 2381657. Respectfully, this sets up a false choice. In fact, the most likely result of barring pre-dispute arbitration agreements is to "gut" arbitration. That is because arbitration almost never occurs except as a result of pre-dispute agreements. *See infra.*

[3] Here, I am speaking of the contractual, binding arbitration that is the subject of this hearing and of the Arbitration Fairness Act and the Fairness in Nursing Home Arbitration Act. By contrast, non-contractual arbitration and non-binding, court-annexed arbitration are very different from contractual, binding arbitration. *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION §§ 2.55, 4.32 (2d ed. 2007).

never contracted to be bound by the results of litigation may be lawfully subjected to binding litigation. By contrast, parties who never contracted to be bound by the results of arbitration may not be lawfully subjected to binding arbitration.

Arbitration Arising Out of a Contract is Voluntary, Rather than Mandatory

What some call "mandatory arbitration" is better called "contractual arbitration" because it, unlike some other arbitration,[4] does not occur unless the parties have previously formed a contract stating their agreement to arbitrate the dispute. Arbitration is not mandatory when it arises out of a contract, because contracts are formed voluntarily. The rare cases in which consent to a contract is involuntary--as when "A grasps B's hand and compels B by physical force to write his name" to the signature line of a contract,[5] or when A puts a gun to B's head and says "sign or I'll shoot"--result in contracts that are voidable on the ground of duress so courts do not enforce them. By contrast, in the absence of duress it is inaccurate to say that a contract containing an arbitration clause results in arbitration that is "involuntary" or "mandatory."

What critics of contractual arbitration object to is not duress. They object to arbitration clauses in form contracts presented take-it-or-leave-it to consumers, employees, and other ordinary individuals. For instance, Section 2(3) of the Arbitration Fairness Act says that many parties to form contracts are unlikely to read or understand the arbitration clause and may not even know that there is an arbitration clause on the form.[6]

That is a valid point and it is a point that applies to a wide range of contracts, not just to contracts with arbitration clauses. Form contracts have long outnumbered custom-drafted contracts.[7] For many generations, courts and commentators have debated a variety of legal doctrines focused on form contracts.[8] All that has been said in that ongoing debate applies to form contracts with arbitration clauses just as much as it applies to form contracts without arbitration clauses.

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[4] *Id.*

[5] RESTATEMENT (SECOND) OF CONTRACTS § 174 cmt. a, illus. 1 (1979).

[6] Section 2(3) of H.R. 1020 says: "Most consumers and employees have little or no meaningful option whether to submit their claims to arbitration. Few people realize, or understand the importance of the deliberately fine print that strips them of rights; and because entire industries are adopting these clauses, people increasingly have no choice but to accept them. They must often give up their rights as a condition of having a job, getting necessary medical care, buying a car, opening a bank account, getting a credit card, and the like. Often times, they are not even aware that they have given up their rights."

[7] *See, e.g.*, W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971) (estimating that 99% of all contracts were standard form agreements).

[8] *See, e.g.*, Nathan Isaacs, *The Standardizing of Contracts*, 27 YALE L.J. 34 (1917); Edwin W. Patterson, *The Delivery of a Life Insurance Policy*, 33 HARV. L. REV. 198 (1919); Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943); KARL N. LLEWELLYN, THE COMMON LAW TRADITION DECIDING APPEALS 362 (1960); Randy E. Barnett, *Consenting to Form Contracts*, 71 FORDHAM L. REV. 627 (2002); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203 (2003) .

Importantly, those who argue against enforcement of some clauses on form contracts do so because they believe the clauses are too one-sided (substantively unconscionable) or because the clauses generally do not receive the *knowing* consent of the non-drafting party, but not because the contracts containing the clauses are mandatory or involuntary. The non-drafting party is always free, in the absence of duress, to simply walk away from the proposed contract.

This is true even if the form contracts of an entire industry all have many of the same clauses. An example is the mortgage (or security interest), a common clause of loan agreements and what enables the lender to take collateral from the borrower if the borrower defaults on the loan. A few years ago, I borrowed $220,000. The lender insisted that I grant it a mortgage on my home. This clause was non-negotiable, take-it-or-leave-it. I am confident that other lenders, when faced with my request for a loan of that amount, would also have insisted on this same non-negotiable clause. I am also confident that the vast majority of other people borrowing that amount of money would have no choice but to accept this clause as well. Does that make my mortgage involuntary or mandatory? Of course not. I could have rented a home or perhaps bought a smaller home without borrowed funds. There are always alternatives, albeit more and less attractive ones. I consented, in the absence of duress, to a contract containing the lending industry's take-it-or-leave-it clause, just as I and many other people consent, in the absence of duress, to contracts containing take-it-or-leave-it arbitration clauses. Calling the results of these routine transactions "mandatory arbitration" is no more appropriate than referring to "mandatory mortgages." Both the arbitration and the mortgage are entirely voluntary.

In short, to call arbitration arising out of form contracts "mandatory" is inaccurate rhetoric. As the leading scholarly treatise on federal arbitration law explains, this use of the term "mandatory" "is extremely confusing language because it ignores altogether the consensual element in contracts."[9]

A related reason for referring to arbitration arising out of form contracts as "contractual," rather than "mandatory," is that doing so reserves the word mandatory for arbitration that really is mandatory--arbitration that occurs even though the parties have not contracted for it. For example, the Federal Insecticide, Fungicide, and Rodenticide Act requires chemical manufacturers to arbitrate certain disputes with each other even though neither of them contracted for arbitration.[10] That is truly mandatory arbitration. Arbitration arising out of a form contract is not.

In sum, contractual arbitration is voluntary, not mandatory. A form contract's arbitration clause is no more mandatory than that form contract's other clauses. No one seriously suggests modern society can do without form contracts by making them unenforceable unless parties invest the time to become knowledgeable about all their terms. Commerce would slow to a snail's pace. So courts will continue to enforce form

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[9] IAN R. MACNEIL, RICHARD E. SPEIDEL, THOMAS J. STIPANOWICH, G. RICHARD SHELL, FEDERAL ARBITRATION LAW § 2:36 n.5 (1995).

[10] *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION § 2.55(b)(1) (2d ed. 2007).

contracts voluntarily entered into even though the party who did not draft the form (such as a consumer or employee) is not knowledgeable about all the terms. Lack of knowledge about terms on form contracts raises important issues but they are not issues of voluntariness or duress. They are issues of fairness or unconscionability, the issues to which I now turn.

Current Law is Generally Well-Suited to Ensuring That Binding Arbitration is as Fair as the Alternative (Litigation)

In assessing the fairness of binding arbitration as it is currently practiced in this country, one must avoid the temptation to compare arbitration to some hypothetical ideal process of dispute resolution. Instead, the current reality of arbitration should be compared to the current reality of litigation. Those are the two options parties now have for binding dispute resolution.

A comparison of arbitration and litigation should consider at least two factors: outcomes and process costs. The outcomes include who wins a case (e.g., consumer or business) and how much money is awarded to the winner. Process costs are the costs of getting to the outcome, such as the time and legal fees spent on pleadings, discovery, motions, trial or hearing, and appeal.

In comparing the outcomes and process costs of arbitration and litigation, we should examine careful empirical studies of large numbers of cases, rather than be led astray by anecdotes about a handful of (potentially unrepresentative) cases. Unfortunately, however, even careful empirical studies cannot provide definitive answers.

> Empirical studies can tell us the relative levels of awards and process costs in arbitration and litigation, but that does not mean they can tell us the relative levels of awards and process costs in arbitration and litigation *in comparable cases*. The probative value we give to empirical studies should turn on our level of confidence that the studied cases going to arbitration are comparable to the studied cases going to litigation. And, in reality, nobody knows whether the cases going to arbitration are comparable to the cases going to litigation. . . .
>
> In other areas of study, a scholar can (to a great extent) overcome this methodological problem. Suppose, for example, that a court requires mediation of all cases with odd docket numbers, but not of cases with even docket numbers. A scholar could then compare the results of the odd cases to the results of the even cases and attribute any differences to the rule requiring mediation. With a sufficiently large sample size, we would be quite confident that the odd cases are comparable to the even cases. That is because the odd and even docket numbers are completely unrelated to anything that might plausibly affect the results of the cases.
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> In contrast, the selection of cases between arbitration and litigation is very different. [C]ases go to arbitration when, and only when, there is an

> arbitration agreement. The [parties that] use arbitration agreements may be systematically different from the [parties that] do not use arbitration agreements.[11]

In sum, "[e]mpirical studies are vulnerable to the possibility that the studied cases going to arbitration are systematically different from the studied cases going to litigation."[12] Therefore, in comparing arbitration and litigation, we must be cautious about how much weight we give empirical studies, although we should surely give them far more weight than anecdotes about a handful of (potentially unrepresentative) cases.

With this caution noted, what do empirical studies of arbitration tell us? The empirical evidence indicates that arbitration tends to have lower process costs than litigation.[13] With respect to outcomes, the empirical evidence indicates that arbitration tends to result in lower awards for some types of cases but higher awards in other types of cases and that, overall, consumers and employees fare as well as in arbitration as in litigation.[14]

In short, empirical studies do not support the notion that consumer and employment arbitration is unfair.

The Importance of Enforcing Pre-Dispute Arbitration Agreements

As noted above, litigation in the court system is the default process of dispute resolution. Parties can contract into arbitration, but if they do not do so then each party retains the right to have the dispute resolved in litigation.

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[11] Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 755-56 (2001).

[12] *Id* at 556. *See also* David Sherwyn, Samuel Estreicher & Michael Heise, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1564-66 (2005).

[13] *See* Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 753-55 (2001) (citing and summarizing studies of employment arbitration); Peter B. Rutledge, *Whither Arbitration?* 6 GEO. J. L. PUB. POL'Y 549, 576-79 (2008); Peter B. Rutledge, *Arbitration – A Good Deal for Consumers: A Response to Public Citizen* 22-24 (2008) (refuting Public Citizen's charge that "Arbitration often costs consumers more than court.") That arbitration reduces process costs is confirmed by survey evidence. *See* ABA SECTION OF LITIGATION TASK FORCE ON ADR EFFECTIVENESS, SURVEY ON ARBITRATION (August 2003) at 19, *available at* http://www.abanet.org/litigation/taskforces/adr/surveyreport.pdf.

[14] Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 755-56 (2001) (citing and summarizing studies of employment arbitration); Searle Civil Justice Institute Consumer Arbitration Task Force, *Consumer Arbitration Before the American Arbitration Association*, March 2009, at 109, http://www.searlearbitration.org/p/full_report.pdf (recent study of consumer arbitration finding that consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, DISP. RESOL. J., Nov. 2003/Jan. 2004, at 44; Peter B. Rutledge, *Whither Arbitration?* 6 GEO. J. L. PUB. POL'Y 549, 560 (2008)(concluding that "most measures—raw win rates, comparative win rates, comparative recoveries, and comparative recoveries relative to amounts claimed—do not support the claim that consumers and employees achieve inferior results in arbitration compared to litigation.").

A contract for binding arbitration can be made before or after a dispute arises. In rare instances, parties agree to arbitrate a dispute that has already arisen between them. Far more often, the agreement to arbitrate is formed prior to any dispute. Contracts of all kinds include clauses obligating the parties to arbitrate, rather than litigate, disputes arising out of or relating to the contract. These are pre-dispute arbitration agreements.

Critics of pre-dispute arbitration agreements involving ordinary individuals (such as consumers and employees) argue that arbitration must be bad for such individuals if businesses obtain individuals' consent to arbitration through pre-dispute form contracts in which the arbitration clause is unlikely to be the focus of attention.[15] The argument continues by suggesting that if arbitration really was good for them, individuals would choose it post-dispute, when they have had time to consider (perhaps in consultation with a lawyer) the pros and cons of arbitration versus litigation. According to this view, only post-dispute arbitration agreements should be enforced. As explained below, this view is simplistic and erroneous.

Arbitration's Lower Process Costs Benefit All Concerned (Except Perhaps Lawyers)

As noted above, available empirical data indicates that arbitration tends to have lower process costs than litigation. (By "process costs," I refer to the time and legal fees spent on pleadings, discovery, motions, trial or hearing, and appeal.) Lower process costs obviously benefit consumers to the extent they (or their lawyers) bear those costs. Lower costs to consumer plaintiffs increase access to justice, especially in smaller cases for which it can be difficult to attract a lawyer.[16]

In addition, consumers also benefit from the lower process costs paid by businesses. That is because whatever lowers costs to businesses tends over time to lower prices to consumers. While the entire cost-savings is passed on to consumers only under conditions of perfect competition,[17] some of the cost-savings is passed on to consumers under non-competitive conditions, even monopoly.[18] The extent to which cost-savings

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[15] *See* Stephen J. Ware *The Case for Enforcing Adhesive Arbitration Agreements - with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 262 n.21 (2006) (citing those who make this argument).

[16] As plaintiffs' attorney Kenneth L. Connor acknowledged during a hearing last year, "lawyers are businesspeople too, and they simply, from an economic feasibility standpoint, can't handle a case that is not likely to yield back a return to the client and to the lawyer who represents him." *Hearing on H.R. 6126, the "Fairness in Nursing Home Arbitration Act of 2008" Before the Subcomm. on Comm. and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. (2008) (response of Ken Connor to question from Ranking Member Chris Cannon), *transcript available at* 2008 WL 2381657. Available research bears this out. *See, e.g.*, William M. Howard, *Arbitrating Claims of Employment Discrimination: What Really Does Happen? What Really Should Happen?*, DISP. RESOL. J., Oct.-Dec. 1995, at 40, 44 (reporting, based on survey of employment lawyers, that before accepting a case lawyers required, on average, minimum provable damages of $60,000 to $65,000 and a retainer of $3,000 to $3,600).

[17] *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 7 (6th ed. 2003) ("The forces of competition tend to make opportunity cost the maximum as well as minimum price."); Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 91-93.

[18] *See, e.g.*, POSNER, *supra* note 17, at 276 & Figure 9.4 ("If costs fall (unless these are fixed costs), the optimum monopoly price will fall and output will rise."), and "virtually all costs are variable in the long

are passed on to consumers is determined by the elasticity of supply and demand in the relevant markets.[19] Therefore, the size of the price reduction caused by enforcement of consumer arbitration agreements will vary, as will the time it takes to occur. But it is inconsistent with basic economics to question the existence of the price reduction.

The analogous point can be made about the effect on wages of the enforcement of employment arbitration agreements. While one can question the size or timing of the wage increase caused by this enforcement, it is inconsistent with basic economics to question the existence of it.[20] This point applies similarly with respect to arbitration agreements in other contexts as well. It is merely an example of the general insight that contract terms favorable to sellers go hand-in-hand with lower prices. "Recognition of this has been standard in the law-and-economics literature for at least a quarter of a century."[21]

In sum, the process-cost savings of arbitration are a social good, increasing the size of the pie by resolving disputes more efficiently. The only harm from process-cost savings comes to those (like lawyers) who sell process.[22]

Limiting arbitration so that only post-dispute agreements are enforced would fail to produce all the social gains produced by enforcing pre-dispute arbitration agreements. That is because arbitration will not occur nearly as often if an enforceable arbitration agreement can only be made after a dispute arises. Neither party is likely to agree, post-dispute, to arbitrate claims for which arbitration is expected to be less favorable to that party than litigation would be.[23] Thus post-dispute arbitration agreements are unlikely to occur even if both parties and their lawyers expect that the process costs (for both sides) are lower in arbitration than litigation. By contrast, pre-dispute agreements are formed at a time when both parties are uncertain about whether there will be a dispute and, if so, what sort of dispute it will be.[24] That is the time when both sides have an incentive to

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run." *Id.* at 123. A good explanation of this point is Jerry A. Hausman & Gregory K. Leonard, *Efficiencies from the Consumer Viewpoint*, 7 GEO. MASON L. REV. 707, 708-09 (1999).

[19] *See, e.g.*, Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361, 367 (1991).

[20] Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 747-51 (2001).

[21] Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 92.

[22] Even this is part of the overall social benefit from reducing the costs of processing cases. "To the extent that the costs of adjudication are reduced, disputes can be resolved more efficiently, *i.e.*, fewer resources need to be devoted to adjudication. Some bright young people who would have become trial lawyers enter other fields instead. Whatever those people produce is a gain to society from the cost savings of arbitration." Stephen J. Ware, *Arbitration under Assault: Trial Lawyers Lead the Charge*, CATO Institute Policy Analysis no. 433, April 18, 2002, at 9, http://www.cato.org/pubs/pas/pa-433es.html.

[23] Several commentators have made this point with respect to employment arbitration. *See* Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 567-68 (2001); David Sherwyn, *Because it Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 BERKELEY J. EMP. & LAB. L. 1, 57 (2003); Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 314 (2003).

[24] Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 746 (2001).

choose the forum that reduces process costs.

This point about arbitration generally also applies to arbitration involving consumers and employees in particular. After a consumer or employment dispute with a business arises, the business can consult its lawyers to assess whether arbitration or litigation will be more favorable to its side of the case. If litigation is more favorable than arbitration for the business then the business will not agree to arbitration if proposed by the consumer or employee post-dispute. Conversely, after a dispute arises, the consumer or employee can similarly try to consult one or more lawyers to assess whether arbitration or litigation will be more favorable to their side of the case. If they conclude that litigation is more favorable than arbitration to them then they will not agree to arbitration if proposed by the business post-dispute.

Enforcement of Pre-Dispute Arbitration Agreements is Good Policy

To reiterate, post-dispute agreements to arbitrate are unlikely to be more than rare events. This rarity is not due to any fault of arbitration. This rarity is due to litigation's status as the default process of dispute resolution. Once a dispute arises, parties are unlikely to contract out of the default process because of one party's self interest in whatever tactical advantages it can gain from litigation, whether from an easily-impassioned jury or expensive and time-consuming pre-trial discovery and post-trial appeals. Only a naively simplistic view would deny that disputing parties and their lawyers assess the case before them and try to maneuver into a process that is expected to advantage their side. That sort of self-interested maneuvering is inherent in the adversary system and lawyers might not be fully serving their clients if they did not engage in it.

In sum, the enforcement of pre-dispute agreements to arbitrate is needed to produce most of the social benefits resulting from arbitration's lower process costs. Enforcement of these agreements allows consumers and employees to compel arbitration of disputes when, post-dispute, the business would prefer litigation. Similarly, it allows businesses to compel arbitration of disputes when, post-dispute, the consumer or employee would prefer litigation. Allowing each side to compel the other to perform the contract is good policy for the same reason that enforcing contracts generally is good policy. Enforcing contracts constrains opportunistic behavior and allows people to rely on each other's promises. These policies are especially important with respect to contracts in which parties promise to use a relatively quick and efficient dispute-resolution process like arbitration.

Current Law Protects Against Unfair Arbitration Agreements

Finally, I emphasize that current law does not require courts to enforce all arbitration agreements. The Federal Arbitration Act allows courts to invalidate unconscionable arbitration agreements.[25] And this is not just a theoretical protection. Each year, there are many cases in which courts hold particular arbitration agreements

[25] 9 U.S.C. § 2 (arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.")

unconscionable.[26] For example, courts often refuse to enforce arbitration agreements that prohibit class actions or require the consumer or employee to pay a significant portion of the fees charged by the arbitrator or arbitration organization.[27] So we currently have a very sensible system in which courts determine, case-by-case, which arbitration agreements should not be enforced and which provide for a fair process and so should be enforced. As every case is different and arbitration agreements can be written in a wide variety of ways, I believe these issues are better handled on a case-by-case basis in the courts, rather than with the overly broad brush of legislation. In short, I recommend that you allow arbitration law to continue to develop in the courts, rather than enact a bill such as H.R. 1020 or H.R. 1237.

Thank you very much for your time and attention. I would be happy to answer any questions that you may have.

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[26] *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION 61-65 (2d ed. 2007) (collecting representative cases); Stephen A. Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts are Circumventing the Federal Arbitration Act*, 3 HASTINGS BUS. L.J. 39, 48 (2006) (finding that unconscionability challenges to arbitration agreements in California succeeded in whole or in part in approximately 58% of cases, compared to only 11% in the non-arbitration context); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 BUFF. L. REV. 185, 194 (2004) (finding that arbitration agreements were found unconscionable in 50.3% of cases in 2002-2003, as opposed to 25.6% for other types of contracts).
[27] *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION 64 (2d ed. 2007).

Mr. COHEN. Thank you, sir. Appreciate your testimony, Professor Ware.

Mr. WARE. I stayed within the 5 minutes, too.

Mr. COHEN. Right, you did, you beat the 5-minute clock. Beulah didn't have to hit the buzzer.

Our final witness is Mr. Cliff Palefsky. He is a civil rights and employment lawyer and a partner in the San Francisco law firm of McGuinn, Hillsman and Palefsky, co-founder of the National Employment Lawyer's Association and co-chair of their Mandatory Arbitration Task Force.

He has been involved in many arbitration decisions. He has been involved in state and Federal legislative efforts dealing with mandatory arbitration of civil rights claims. Mr. Palefsky, welcome.

TESTIMONY OF CLIFF PALEFSKY, NATIONAL EMPLOYMENT LAWYERS ASSOCIATION, SAN FRANCISCO, CA

Mr. PALEFSKY. Thank you very much, Mr. Chairman. I think I should start with presenting my bias here.

I am an employment lawyer. We are the folks that Congress has asked to help enforce your civil rights laws and your whistleblower laws and your wage and hour laws. I believe that I have an ethical obligation to my clients to get their cases resolved as quickly as possible without even filing a complaint if I can, because that is what people in the employment context need.

That is my bias. You will have a hard time finding anyone in this country who is a bigger proponent of ADR than me, a bigger user of ADR than me. We have led the Nation in encouraging the use of mediation for employment disputes.

Let me tell you what I have learned over the past 20 years. Civilizations are evaluated by the quality of their civil justice systems. We are still lecturing, today, other countries about the rule of law, while in contemporary America, American workers and consumers are being sent to secret tribunals with no right of appeal.

It is extraordinary that we sit here and debate the right of terrorists to access a Federal court, when the victims of sexual harassment and whistleblowers are denied that opportunity and are told that they must not only go to secret tribunals with no right of appeal, but they must pay for that privilege.

The notion that arbitration and our public constitutional court system are equivalent is the modern day version of separate but equal. It would be malpractice for any practicing attorney to equate the two systems and to not understand the differences.

In every single material defining respect, they are the exact opposites. Public versus private, free versus pay, full discovery versus no discovery or limited discovery, a judge who is required to follow the law versus not follow the law, the right to appeal versus the right not to appeal and a judge whose economic future is dependent on satisfying the repeat user.

Arbitration is a dispute resolution system. It is not a justice system. It cannot be confused as a justice system. In the employment context, it is important to realize that none of these notions that Professor Ware talks about in terms of voluntariness apply.

Our laws, the Norris-LaGuardia Act, the National Labor Relations Act, say it is the public policy of this country to recognize that

individual workers do not have the ability to freely negotiate terms of labor.

Ever since the 13th amendment, we have recognized that the free market has failed to protect employees. The notion that if you don't like this arbitration clause, quit, give up your job, give up your health insurance is a proper way to regulate the workplace, has been discredited.

What is at stake here is the integrity of the laws that you have passed. You have passed the civil rights laws and we cannot enforce them. They are being undermined. You have passed whistleblower laws and we cannot enforce them. If you blow the whistle and no one hears, you are not a whistleblower, you are a sitting duck. You are a sucker.

If you want to know what America would look like if all sex harassment claims were sent to arbitration, look at the securities industry in the 1970's and 1980's, when movies like "Bonfire of the Vanities" and "Working Girl" were held up as models of how accurate they are.

If you want to know what America would look like if all whistleblower claims went to arbitration, look at the securities industry where they have compelled arbitration of whistleblower claims up to the present date.

If you want to know what America would look like if subprime lending claims go to arbitration, look at what happened here until last year or 2 years ago, when Freddie Mac and Fannie Mae said they would not longer buy loans with mandatory arbitration clauses.

What is going on, in fact, is do-it-yourself tort reform. Congressman Franks, I would love to address what you believe are myths. In fact all state regulation of the arbitration relationship essentially has been preempted. Your own state of Arizona has specifically excluded employment contracts from your arbitration statute. That has been preempted.

The notion that courts all over the country are enforcing unconscionability arguments is simply not true. We have had that success in California, but all over the country courts are not striking down clauses. They are finding the most egregious clauses to be just fine because it clears their dockets.

What is going on is a scandal in the house of justice and the Judiciary Committee must recognize—don't worry about statistics. You would never suggest to any other country that justice is provided in secret conference rooms by judges who have to please the repeat user. For-profit justice has never worked. It will never work. Thank you very much.

[The prepared statement of Mr. Palefsky follows:]

PREPARED STATEMENT OF CLIFF PALEFSKY

House of Representatives Judiciary Committee

Sub-Committee on Commercial and Administrative Law

Prepared Testimony of

Cliff Palefsky

Co-Chair of the National Employment Lawyers Association's

Mandatory Arbitration Task Force

MANDATORY BINDING ARBITRATION:

IS IT FAIR AND VOLUNTARY?

September 15, 2009

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Prepared Testimony of

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Mandatory Arbitration Task Force

The National Employment Lawyers Association ("NELA") is an organization of over 3,000 of this country's leading civil rights and employment lawyers. NELA's members include not only attorneys in private practice but also lawyers on the staffs of the Equal Employment Opportunity Commission and various State anti-discrimination agencies. We are the attorneys to whom Congress looks for help in enforcing our nation's civil rights and labor laws.

I am a civil rights and employment lawyer. I am also a founding board member of the National Employment Lawyers Association. For the past twenty years I have coordinated NELA's activities with regard to mandatory arbitration. I have participated in the litigation of many of the leading cases involving mandatory arbitration of employment claims in the State and Federal courts.

NELA strongly supports all voluntary forms of alternative dispute resolution, including arbitration and mediation. In fact, NELA has been at the forefront nationally in encouraging mediation as a preferred method for resolving employment disputes. We helped draft the Due Process Protocol for the Resolution of Statutory Disputes and worked closely with the American

Arbitration Association in the development of their specialized employment arbitration rules and procedures.

Because there appears to be such a great disparity between the public perception of arbitration and its day to day reality, both legal and factual, it is important to begin these comments by setting forth some basic facts about the process which are often misunderstood.

Unlike our constitutionally defined civil justice system, arbitration is not designed with the primary goal of achieving the legally correct result. Its primary objective is finality and economy in achieving that finality. Although most of the general public is unaware of the fact, arbitrators are not required to know or follow the law. Moreover, a legally incorrect ruling cannot be appealed or rectified. The law is clear that a decision reached through binding arbitration must be confirmed even if there is an error of fact or law on the face of the award that causes substantial injustice to the parties.

Litigants for whom a quick and final decision is of primary importance, who do not require much discovery to establish their cases, and who are willing to risk a decision that could impose a result contrary to law, are certainly entitled to opt for binding arbitration of their claims. But the requirement that all claims by employees, including civil rights, whistleblower and wage and hour claims, be submitted to arbitration as a condition of employment is another matter entirely. The problem is even more acute when the forum selection is controlled by the employers, the procedures are drafted by the employers' lawyers, and those procedures do not conform to consensus minimum standards of due process.

Simply put, you cannot allow the entity being regulated by your legislation to unilaterally opt out of the requirements of that legislation. But that is exactly what is occurring every day in the contemporary American workplace. The main push by employers for mandatory arbitration occurred immediately after Congress passed the Americans with Disabilities Act and the 1991 amendments to the Civil Rights Act of 1964, which added the right to trial by jury and general damage to the civil rights laws for the first time. In numerous public presentations to bar associations and employer groups, management attorneys publicly touted mandatory arbitration agreements as a way to avoid the new civil rights legislation. They literally cited to the success employers in the securities industry had in defeating sex harassment and discrimination claims as a reason to compel arbitration. Indeed, even the American Arbitration Association, a theoretically neutral organization, created marketing materials that pointed to the "proliferation" of new civil rights statutes such as Title VII, the Americans with Disabilities Act, and the Older Worker Benefit Protection Act as reasons why companies should compel arbitration of all employment claims. They went further and told employers that they could limit discovery, eliminate punitive damages, and keep all proceedings off limits to the public and press.

CONGRESS DID NOT INTEND THE FEDERAL ARBITRATION ACT TO APPLY TO EMPLOYMENT CONTRACTS

The historical and legislative record is very clear that Congress never intended the Federal Arbitration Act to apply to employment contracts at all. The original impetus for the Act came from the ABA's Committee on Commerce, Trade and Commercial Law. Its purpose was always to be a commercial arbitration act that would permit the Federal courts to enforce pre-dispute arbitration clauses between merchants. Shortly after the bill's introduction it came to the attention of Andrew Furuseth, the President of the International Seamen's Union of America.

Mr. Furuseth was very concerned about the bill's possible application to employees who would have no ability to negotiate or refuse to sign these clauses. Mr. Furuseth explained:

> "The bill provides for the re-introduction of *forced or compulsory labor* if the freeman through his necessities shall be induced to sign. Will such contracts be signed? Esau agreed, because he was hungry. It was the desire to live that caused slavery to begin and continue. With the growing hunger in modern society, there will be but few that will be able to resist. The personal hunger of the seaman and the hunger of the wife and children of the railroadman will surely tempt them to sign and so with sundry other workers in interstate and foreign commerce." Proceedings of the 26th Annual Convention of the International Seamen's Union of America 203-5 (1923).

In response to those objections, the Chair of the ABA Committee told Congress that it was "never the intention of this bill to make an industrial arbitration in any sense." To address any ambiguity or doubt he suggested adding language stating that "*nothing herein contained shall apply to seamen or any class of workers in interstate and foreign commerce,*" which at the time represented the fullest extent of Federal jurisdiction over the employment relationship.

Similarly, Secretary of Commerce Herbert Hoover made the identical point. In fact, Secretary of Commerce Hoover wrote:

> "If objection appears to the inclusion of workers' contracts in the law's scheme, it might well be amended by stating 'but nothing herein shall apply to contracts of employment of seamen, railroad employees or any other class of workers engaged in interstate or foreign commerce.'"

Secretary Hoover's proposed language, intended to make it clear that the FAA would have no application whatsoever to workers contracts, was added to the FAA *verbatim* as an amendment to Section 1.

Nevertheless, in 2001, the United States Supreme Court decided the case of *Circuit City Stores v. St. Clair Adams, 532 U.S. 105 (2001),* and determined for the first time that the FAA would in fact extend to all employment contracts except those of workers who literally carried goods across state lines. There is no real question that neither the drafters of the FAA nor Congress ever intended the FAA to apply to employment contracts at all because of the lack of voluntariness and the potential for the very abuses that are presently occurring. It is essential that you restore the FAA to its original intention of excluding employment contracts from its application.

FALSE JUSTIFICATIONS

Employers have tried to justify stripping their employees of their statutory and constitutional rights by the use of several demonstrably false justifications.

The most common is that they are motivated by trying to create access to justice for employees who otherwise couldn't hire a lawyer or afford access to court. It should be obvious that employers have no interest in creating more claims or making it easier for employees to bring claims. And indeed, the imposition of mandatory arbitration agreements has actually reduced the number of claims. Leading management lawyers openly state that the arbitration requirement actually deters claims because of the high costs of arbitration, the limited discovery, the repeat player advantages and the smaller damage awards in arbitration. And significantly, because of the reality that arbitration is a far inferior forum with a lower chance of success, an arbitration requirement makes it far less likely that an employee can get a lawyer to take his or her case on a contingency basis, which is the only way most employees can afford to hire a

private attorney. In reality, a mandatory arbitration agreement is intended to, and in fact does, reduce access to real justice for most employees.

All empirical evidence demonstrates that it is virtually always the employer that seeks to compel arbitration, and not the employee, which is the very best evidence as to employers' true motives. If arbitration truly provided better access to equal justice for employees, there would be no need to compel arbitration as a condition of employment. These rationalizations are simply dishonest.

STATISTICS

In 2002 the California legislature passed a statute requiring arbitration providers to post on the Internet statistics regarding the results of employment and consumer arbitrations. As a result we now have access to the statistical information that confirms just how unfair mandatory arbitration is to employees.

Professor Alexander Colvin of Cornell University has conducted the most comprehensive statistical analysis of the outcome of employment cases. A copy of his study is attached as Exhibit A. The results of his study confirm what practitioners have known to be true for years. Employees have a dramatically lower winning percentage in arbitration, the damages they receive when they win are significantly lower, and employers who are repeat players have a profound advantage in arbitration. According to Professor Colvin's study, employees win only 21.4% of the time in arbitration compared with 56.6% of the time in State courts. The mean damages award in arbitration was only 20% of the mean damage award in State court cases in which damages were awarded. And repeat player employers win 3 times as often as non-repeat

players. When Professor Colvin compared the mean award in all cases, the mean award for employees in arbitration was a shocking 9% of the mean award in State court trials. Professor Colvin also confirmed the same profound repeat player advantage that earlier studies had found. His study determined that the employee win rate where there was a repeat employer-arbitrator pairing was only 12%. There was a similar reduction in the amount of damages awarded against repeat players.

DO-IT-YOURSELF DEREGULATION

Employers are not content with just imposing arbitration on their employees. Many use their arbitration agreements and the courts' willingness to enforce them as a device to strip employees of substantive rights and remedies. What they are doing is, in every sense, "do-it-yourself deregulation." They are literally rewriting if not opting out of the laws passed by Congress and State legislatures. It is very common for arbitration clauses to shorten the statute of limitations periods set by Congress. They often limit the damages that are otherwise legally available. They prohibit or so severely restrict discovery that it becomes nearly impossible to sustain the burden of proof necessary to prevail on an employment claim because in the employment context almost all of the documents and witnesses are under the control of the employer. Many arbitration clauses prohibit the consolidation of claims in order to increase the employees' costs and avoid the presentation of compelling evidence of pattern and practices of illegal conduct. Many clauses prohibit class actions even though such "representative" actions are specifically authorized by the nation's wage and hour laws and are the only practical and effective way to enforce those laws.

PUBLIC JUSTICE

For years we mocked the Soviet Union and other nations for their secret civil justice systems. Justice is not dispensed in secret tribunals, off limits to the public and press. To this day we lecture other nations on the importance of the "rule of law." Indeed, our commitment to the rule of law is so great that we debate the right of accused terrorists to access a Federal court. Yet, we have relegated American employees to secret tribunals with no right of appeal—and force them to pay for the privilege. The public courthouse doors are shut to working Americans. Employees are forced to present their claims in private conference rooms, under rules drafted to give the employers every advantage, to arbitrators selected and paid by their employers, who have full knowledge that if they find against the employer they will not be selected again. What is at stake is the very integrity of our justice system, our constitutional values, and democracy itself.

VOLUNTARY v. MANDATORY ARBITRATION

NELA fully supports and encourages the use of all voluntary forms of alternative dispute resolution. We think mediation is an ideal way to resolve many if not most employment disputes. And indeed, in California, well over 90% of all employment cases get submitted to mediation or a similar process, and most are successfully resolved. Voluntary arbitration can also be a valuable alternative form of dispute resolution in many categories of cases. But mandatory arbitration and voluntary arbitration are very different processes. The only check and balance that was ever contemplated for arbitration was the knowing and voluntary consent of the users. When the process is voluntary, the parties themselves can ensure that they have the

procedures and discovery they need to prepare their case. They can jointly participate in the selection of the arbitrator and every arbitrator knows that they will need the consent of both parties to be selected for future cases. If arbitration was truly voluntary, the marketplace would be able to ensure fairness.

There is a lot more to a civil justice system than simply moving money around. There is a significant emotional component to the process. No system of justice can succeed without the confidence of its users. There is no question that mandatory arbitration does not have the confidence of employees or consumers. Indeed, the mere act of forcing the process on a party undermines the confidence that is required for it to be successful. If a party does not have confidence in the process going in, he or she will never have confidence in the result. In justice systems, the perception of fairness is just as important as the fact of fairness and there can be no real debate that mandatory arbitration does not have the perception of fairness. Additionally, the abuses and scandals that are occurring everyday in the mandatory arbitration context are generating so much bad publicity that the negative impression is spilling over and undermining the credibility of the very useful and effective other voluntary forms of ADR.

COSTS AS A DETERRENT

Contrary to the cynical pronouncements of defenders of mandatory arbitration, the process imposes huge costs on employees. American citizens already pay taxes to support a public justice system. An employee can access a Federal or State court for a filing fee of about $300. And in most jurisdictions, fee waivers are available for those who cannot afford to pay. At the American Arbitration Association, the filing fees alone can be as high as $13,000 just to get in the door. And after the filing fee is paid, the arbitrators often charge in excess of $400 per

hour per arbitrator. It is not uncommon for the fees in employment cases to exceed $40,000, $50,000 and sometimes even $80,000. Moreover, most providers require the fees to be paid up front. When they are not fully paid up front, the providers refuse to release the award until the fees are paid. Few employees can afford the cost of arbitration and the high cost serves as a significant deterrent to the bringing of valid claims. Even though several courts have said there is no precedent in American jurisprudence for the requirement that an employee pay for the cost of a tribunal to vindicate statutory rights, in most states it is still perfectly legal for the employer to bar the court house door and require employees to pay thousands of dollars they can't afford to vindicate their statutory claims.

PREEMPTION OF STATE ADMINISTRATIVE AGENCIES AND LABOR LAWS

States have traditionally exercised primary jurisdiction over the employment relationship. Most, if not all, States have created administrative agencies to assist workers in collecting owed wages or in dealing with unlawful discrimination and to help workers who cannot afford to hire attorneys. These State agencies are indispensible to low wage earners who need an expeditious resolution of their claims in order to put food on their tables. However, the U.S. Supreme Court recently ruled in *Preston v. Ferrer* that an arbitration agreement ousts these State agencies of jurisdiction and renders them useless. That means that an employer can essentially require employees to waive their access to these agencies as a condition of employment. The public policy implication of this practice is profound. It is a serious violation of States' rights and in effect a complete deregulation of the employment relationship.

At least 16 States have statutes on the books that prohibit or render unenforceable pre-dispute agreements to arbitrate employment claims similar to the original intention of the FAA.

A table of these State statutes is attached as Exhibit B. But these efforts at employee protection have all been rendered moot by the Supreme Court's decisions holding that these laws are preempted by the Federal Arbitration Act. The Court's jurisprudence in this area is directly contrary to its holdings in other areas limiting the scope of Federal preemption and respecting traditional areas of State regulation.

EEOC POLICY STATEMENT

The Equal Employment Opportunity Commission, the agency charged by Congress with responsibility for enforcing this nation's civil rights laws, has issued an extensive policy statement dealing with mandatory arbitration. While strongly supporting the utilization of voluntary ADR procedures, the EEOC stated that, "agreements that mandate binding arbitration of discrimination claims as a condition of employment are contrary to the fundamental principles evinced in the Federal anti-discrimination statutes," and are thus illegal and unenforceable. EEOC, Policy Statement on Mandatory Binding Arbitration of Employment Discrimination Disputes as a Condition of Employment, 133 Daily Lab.Rep (BNA) E-4 (July 11, 1997), attached as Exhibit C. This EEOC policy was approved unanimously by the Republican and Democratic appointees to the Commission.

Among the EEOC's objections are that arbitration is not governed by the statutory requirements and standards of Title VII; it is conducted by arbitrators given no training and possessing no expertise in employment law; and it forces employees to pay exorbitant "forum fees" in the tens of thousands of dollars, greatly discouraging aggrieved employees from seeking relief.

NATIONAL ACADEMY OF ARBITRATORS RESOLUTION

The National Academy of Arbitrators, the leading and most respected national organization of professional labor-management arbitrators and the body which gave labor arbitration its credibility, has taken the historic step of passing a resolution condemning mandatory arbitration of statutory employment disputes. In 1997, the Academy stated that it, "opposes mandatory employment arbitration as a condition of employment when it requires waiver of direct access to either a judicial or administrative forum for the pursuit of statutory rights" (National Academy of Arbitrators Statement and Guidelines, 103 Daily Lab.Rep. (BNA) E-1 (May 29, 1997)). The Academy has expressed strong concern that mandatory arbitration often results in arbitral fora which do not provide elements of fundamental fairness to employees, and in which arbitrators are often not able or willing to enforce the claimed statutory rights. In fact, the Academy took the unprecedented step of filing a brief in the matter of *Duffield v. Robertson Stephens* (1998 USApp.Lexis 9284 (9th Cir. 1998)), stating:

> "The strength and justification for the enforcement of agreements to arbitrate, and for the limited judicial review of arbitration awards, rests on the foundation that agreements to arbitrate be voluntary . . . unless a party has agreed to arbitrate, it will not be compelled to do so. Likewise, the immunity from judicial review of an arbitrator's alleged error of law or fact is premised on the voluntary choice of the parties to submit to an arbitrator's judgment. Without the voluntariness of the arbitration agreement, the public policy favorable to arbitration lacks a foundation." (Academy *Amicus* Brief in *Duffield*, cited above.)

CONCLUSION OF THE COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS

The requirement of voluntariness was also supported by the recommendations of the "Commission on the Future of Worker-Management Relations" (The "Dunlop Commission"), a

Blue Ribbon Presidential Commission consisting of business and labor leaders, government officials and professional neutrals. In its December 1994 "Report and Recommendations," the Commission stated that, "binding arbitration agreements should not be enforceable as a condition of employment." Commission on the Future of Worker-Management Relations: Report and Recommendations (December 1994). The Commission also expressed concern that:

> "...the potential for abuse of ADR created by the imbalance of power between employer and employee, and the resulting unfairness to employees who, voluntarily or otherwise, submit their disputes to ADR. These concerns are obvious if the process is controlled unilaterally by employers, such as when employees are required to sign mandatory arbitration clauses as a condition of employment."

IMPACT ON THE COURTS

Mandatory arbitration is more than unfair. It is a scandal occurring in broad daylight. And the corrupting influence of for-profit justice is impacting the courts as well. The best and the brightest sitting judges are being recruited off the bench to join ADR firms at an alarming rate. There have been instances of bidding wars for certain sitting judges between various providers at the same time those judges are ruling on arbitration issues and declaring that public policy "favors arbitration." There are numerous reports of sitting judges hiring consultants to help make themselves more attractive to arbitration providers so that they too can enjoy the lucrative multiple six-figure salaries being earned in private judging. Judges are being told to keep synopses of their decisions and how to obtain the approval of the large firms with which they need to curry favor in order to obtain their business when they leave the bench. And all over the country, there are reports of judges declining assignments to criminal departments

because they know that the civil assignments give them more exposure to the people who will be hiring them when they leave the bench.

THE NEIMAN MARCUS PROGRAM

An excellent example of the abuse of mandatory arbitration agreements can be found in the Neiman Marcus Company's program. Two years ago, in response to wage and hour violations being redressed by class actions, Neiman Marcus sent an email to all of its employees notifying them that by merely continuing employment they would be bound by a new dispute resolution program. The company didn't even attempt to get the workers to sign an arbitration agreement. They simply announced that by not quitting and surrendering their job and health benefits they would be bound by the new program.

And quite a program it was. It required that all arbitrators be residents of Texas (where Neiman is headquartered) even if the cases were arbitrated in California under California law. It required that all arbitrators be members of the Texas bar. It shortened the statute of limitations on claims below the period provided by law. It prohibited the joinder of claims of more than one employee and, more significantly, the bringing of claims as class actions. This class action prohibition was so important to the company, and so obviously the primary purpose of the program, that Neiman Marcus actually provided that if the ban on class actions was struck down by a court, the entire arbitration agreement would be voided rather than having the illegal clause severed and the case proceed as a class action in arbitration. And perhaps the most audacious provision allowed the "respondent" to add two additional arbitrators to the panel at any time prior to the actual arbitration hearing if it didn't like the way the chosen arbitrator was conducting the pre-hearing proceedings.

I received several calls from low wage Neiman workers all over the country who did not want to sign the agreement but did not want to be fired. The first three employees contacted me for assistance but were too afraid to be identified out of a fear of retaliation. I was contacted by a fourth employee, Tayler Bayer, who wanted to challenge the agreement. Mr. Bayer had a pending EEOC charge for disability discrimination when the new illegal policy was rolled out. In July 2007 we filed a charge with the EEOC challenging the shortened statute of limitations because it so clearly violated the express terms of the ADA. We filed another complaint with the NLRB challenging the prohibition on consolidation of claims and class actions because it plainly violated the Section 7 right of employees to engage in concerted action for mutual protection.

Last month, the EEOC issued a "cause finding" determining that the shortened limitations period was illegal. The General Counsel of the NLRB has determined that the prohibition on consolidation of claims did indeed violate the NLRA. He is still considering whether to challenge the prohibition on class actions.

Despite these preliminary agency findings, Neiman Marcus is not only fighting the agencies, but has kept the oppressive plan in place during its recent round of layoffs. It will be several years before Neiman Marcus employees will even know if they may take their wage and hour and discrimination claims to court.

Unfortunately, the Neiman Marcus plan is not the exception. Companies all over the country are rewriting and opting out of the laws regulating the employment relationship and State courts are powerless to protect them. And it is not an adequate response to point to alleged "minimum standards of fairness" adopted by either the American Arbitration Association or JAMS. Both providers have what they call "minimum standards" which state that they will not

administer arbitrations where the employees do not have the same rights and remedies they would have in court and where they don't have a meaningful role in the selection of the arbitrator. But both of those national providers, clearly concerned about offending their corporate clients, have refused to apply and enforce their own minimum standards against the Neiman Marcus plan or other companies' plans that similarly reduce the statute of limitations and/or restrict the ability of employees to obtain the full scope of class-wide relief they could get in court. Even though two Federal agencies have now determined the Neiman Marcus plan to be violative of the laws passed by this Congress, these providers are still afraid to enforce their own policies. If they won't enforce their own policies, how can anyone have confidence that they will enforce the discrimination laws against a significant repeat customer?

NOT SEPARATE BUT EQUAL

The Supreme Court's jurisprudence on arbitration is the modern day version of "separate but equal." Courts often mistakenly assert that arbitration is just a change of forum with no impact on substantive rights. We know that isn't true because employees lose the right to have the law enforced – which is the ultimate substantive right. The Supreme Court has imposed on the nation not merely a legal fiction, but a factual fiction. Arbitration is not a separate but equal forum. Indeed, in every material defining respect, arbitration is the exact opposite of our constitutionally defined system: public versus private, free versus costly, discovery versus no discovery, follow the law versus not required to follow the law, and appeal versus no appeal. What we have is a judicially created "public policy in favor of docket clearing" that seems to foreclose any examination of the lack of true voluntariness or the standards actually required for the waiver of the constitutional rights.

Voluntary arbitration agreements can offer the parties all of the flexibility they need to design an arbitration process appropriate for that particular case. Or they could choose some other form of alternative dispute resolution like mediation which works extraordinarily well for employment cases. Mandatory arbitration on the other hand, drafted and then imposed on the weaker party by the repeat player, has now been shown to be what everyone always knew it was: a far inferior forum for the resolution of statutory claims that is undermining the enforcement of the nation's laws. It is negating both State and Federal legislative actions regulating the workplace. It is in every way an assault on the nation's civil rights, whistleblower and wage and hour laws.

Because of a series of Supreme Court decisions that have limited the ability of State courts and State legislatures to remedy this abuse, nothing short of Federal legislation can restore Congress' original intent in the passage of the Federal Arbitration Act and of the numerous civil rights, whistleblower and wage and hour laws.

There is a scandal in the house of justice. For-profit justice does not work, has never worked, and never will work. The implications of this subversion of our civil justice system are profound but not yet fully understood by most lay people. The laws of Congress have no meaning if they can't be enforced. Our constitutional democracy is undermined when our basic constitutional rights cannot be enforced. *Brown v. Board of Education* would never and could never have been decided by an arbitrator. If the laws that Congress passes are to have any meaning at all, it is essential that all Federal agencies and commissions recognize this scandal for what it is. Congress must pass the Arbitration Fairness Act, and the EEOC, the NLRB, the Department of Labor, and the SEC must step up and ensure full enforcement of the civil rights

and labor laws to the fullest extent of their authority. We are not seeking any new rights or remedies. We are merely talking about full enforcement of the laws that this Congress has already passed and the full protection of the First Amendment Right of Petition, the Fifth Amendment Right of Due Process, and the Seventh Amendment Right to Trial by Jury guaranteed to all Americans by the Bill of Rights.

We urge Congress to do everything in its power, as soon as possible, to ensure the full enforcement of the laws you passed. There is a scandal in the house of justice and people of good conscience can no longer pretend it isn't happening. You simply cannot support full enforcement of civil rights law and support mandatory arbitration.

Thank you very much for holding this hearing and for the opportunity to appear before you today.

ATTACHMENT A

Conflict at Work in the Individual Rights Era: An Examination of Employment Arbitration[1]

LERA 61st Annual Meetings
San Francisco, CA
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[1] An earlier version of this paper was presented at: Research Conference on Access to Civil Justice: Empirical Perspectives, NYU Law School, November 14-15, 2008.

EXHIBIT A

Introduction

Employment arbitration has grown dramatically in the wake of the 1991 *Gilmer* decision[2]. The proportion of workers covered by nonunion employment arbitration procedures now likely exceeds those covered by union representation.[3] Indeed, recent estimates suggest that for perhaps a third or more of nonunion employees, arbitration not litigation is the primary mechanism of access to justice in the employment law realm.[4] Yet our empirical knowledge of the nature of this system remains minimal at best. Basic questions such as the typical characteristics and outcomes of cases in employment arbitration remain to be definitively answered.

Part of the reason for the limitations in the empirical research on employment arbitration is the private nature of this dispute resolution mechanism. Whereas decisions by the courts are a matter of public record, availability arbitration decisions are generally subject to the consent of the parties, limiting access to the public, including to researchers. As a result, much of the existing empirical research has of necessity been based on convenience samples of decisions that the parties have consented to be made public, typically through the collections of organizations such as the American Arbitration Association (AAA). This introduces natural concerns about selection bias in these samples. In an analogy to the well-known "bottom-drawer" effect where researchers tend to only publish successful research studies, it may be that publically

[2] *Gilmer v. Interstate/Johnson Lane*, 500 U.S. 20 (1991).
[3] Alexander J.S. Colvin, "Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?" *Employee Rights and Employment Policy Journal*, Vol. 11, No. 2, pp. 405-447 (2008).
[4] David Lewin, "Employee Voice and Mutual Gains", Labor and Employment Relations Association (LERA) Proceedings (2008).

available collections of decisions suffer from a "top-drawer" effect where they over-represent the relatively well-reasoned, presentable decisions.

The present paper moves beyond past research by analyzing employment arbitration outcomes using a representative dataset of cases administered by the American Arbitration Association (AAA) that derive from employer-promulgated arbitration procedures. I present outcome statistics on key measures such as employee win rates, award amounts, arbitrator fees and length of time to process cases. I then turn to the issue of whether there are repeat player effects in arbitration and, if so, whether we can identify possible explanations for them. Lastly, I examine the issue of self-representation by employees in employment arbitration.

The Data

The data for this study are based on arbitrator service provider filings required under California state law. Under the California Civil Procedure Code, organizations that provide arbitration services within the state are required to make available to the public certain prescribed information on arbitration cases administered by the service provider that involve consumers.[5] This provision applies to employment arbitration cases that are initiated under employer promulgated agreements, i.e. as opposed to individually negotiated agreements. The effect of this law is to override contracts that protect the presumptively private nature of arbitration and allow public access to information on arbitration outcomes. The provision proscribes what types of information need to be filed, including the name of the employer, the arbitrator, filing and disposition dates, amounts

[5] Cal.Civ.Proc.Code SS 1281.96 (West 2007)

of claims, amounts awarded, and fees charged. At the same time, many other pieces of information, notably the name of the employee and the basis for the claim, are not included. More generally, the arbitration service providers are not reqnired to provide the complete arbitration decision accompanying the award. Despite these significant limitations, the California Code filings provide a major new source of data on employment arbitration outcomes, which allows us to analyze a number of questions regarding this dispute resolution system.

In the present study I analyze cases administered by the American Arbitration Association (AAA). The reason for focusing on the AAA is that it is the largest of the arbitration service providers in the employment arbitration field and has provided the most complete filings in this area. An additional advantage is that to comply with the California Code requirements, the AAA has decided to include in its filings all employment arbitration cases under employer-promulgated procedures that it administers nationally. As a result, the AAA filings provide a much larger dataset that is not restricted to cases heard in California. Based on a comparison of arbitration service provider filings, those compiled by the AAA appear relatively comprehensive. A general problem with all filings in this area is that they contain some degree of missing data on particular variables. For example, although the California Code provision requires the service provider to include information on the employee's salary level, in many cases the parties decline to provide this information. Although some degree of missing data exists in all the service provider filings, the AAA filings include substantially fewer instances of missing data than those of other service providers.

The dataset analyzed in this paper includes all employment cases from the AAA California Code filings (what I will refer to henceforth as the AAA-CC filings) for the period January 1, 2003 through December 21, 2007. This produced a total of 5,592 cases. Of these, 1,647 were employment mediation cases administered by the AAA. For purposes of this analysis, I focused on the remaining 3,945 employment arbitration cases in the dataset. Data on the individual cases was compiled from the filings by a team of four graduate students working under my supervision. I also separately re-checked the data for typographical and other errors. For many of the analyses conducted in this study, I focus on the 1,213 of the cases which resulted in awards, with the remainder of the cases being settled or withdrawn prior to the award stage.

Arbitration Outcomes

Given the relative limited extent of existing information on employment arbitration, some of the most interesting questions still relate to the basic descriptive outcomes from arbitration. Knowing what the average and typical outcomes of arbitration are will allow us to develop a general portrait of how this dispute resolution system operates. They also provide an initial basis for moving towards comparisons of litigation and arbitration outcomes. Whereas there have been increasingly sophisticated analyses of litigation and its outcomes in recent years[6], our understanding of arbitration has lagged

[6] See e.g. David Benjamin Oppenheimer. Verdicts Matter: An Empirical Study of California Employment Discrimination and Wrongful Discharge Jury Verdicts Reveals Low Success Rates for Women and Minorities. 37 U.C. DAVIS LAW REVIEW 511 (2003); Kevin M. Clermont and Stewart J. Schwab, "How Employment Discrimination Plaintiffs Fare in Federal Court," 1(2) Journal of Empirical Legal Studies, 429-458 (2004); Eisenberg, T., and M. Schlanger. 2003. "The Reliability of the Administrative

behind. Although the present data does not allow a comparison of systematically matched cases in litigation and arbitration, to begin to compare across systems it is initially necessary to establish what the arbitration outcomes are.

Win Rates

One of the most basic questions in arbitration is who wins? Past research in this area has mostly used convenience samples of arbitration awards maintained by organizations like the AAA or the securities industry service providers. These studies tended to show relatively high employee win rates in arbitration. For example, early studies by Bingham, Maltby and Howard found employee win rates in the 65-75 percent range.[7] More recent studies, including those by Bingham and Sharaff, and by Hill found lower, though still substantial, employee win rates in the 40-45 percent range.[8] Examining securities industry employment arbitration cases, Delikat and Kleiner found a similarly high 46 percent employee win rate.[9] These employee win rates compare favorably to employee win rates found in litigation, ranging from the 33 and 36 percent

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Office of the U.S. Courts Database: An Initial Empirical Analysis." Notre Dame Law Review, Vol. 78 (August), 1455–96.

[7] Lisa B. Bingham. 1998. "An Overview of Employment Arbitration in the United States: Law, Public Policy and Data." *New Zealand Journal of Industrial Relations*, 23(2): 5-19 at 11; Lewis L. Maltby. 1998. "Private Justice: Employment Arbitration and Civil Rights." *Columbia Human Rights Law Review*, 30(29): 29-64; William M. Howard. 1995. "Arbitrating Claims of Employment Discrimination." *Dispute Resolution Journal*, 50 (Oct-Dec): 40-50.

[8] Lisa B. Bingham and Shimon Sarraf. 2000. "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."; Elizabeth Hill. 2003. "AAA Employment Arbitration: A Fair Forum at Low Cost." *Dispute Resolution Journal*, Vol. 58, no. 2 (May-Jul 2003), pp. 8-16.

[9] Michael Delikat and Morris M. Kleiner. 2003. "Comparing Litigation and Arbitration of Employment Disputes: Do Plaintiffs Better Vindicate Their Rights in Litigation?" *Conflict Management*, Vol. V1, Issue 3, pp. 1-11.

employee win rates in federal court employment discrimination trials reported in studies by Delikat and Kleiner and by Eisenberg and Hill, to the employee win rates in the 50-60 percent range found in studies of state court trials.[10] A note of caution in interpreting these findings, however, is that studies by both Eisenberg and Hill and by Bingham and Sharaff found that employee win rates were lower in cases based on employer-promulgated procedures than in cases based on individually negotiated contracts.[11]

What are the employee win rates in the AAA-CC filings data? To answer this question, it is necessary to make decisions about how to classify an employee "win". Most generally, any case in which the employee receives some award represents a case in which the arbitrator has ruled in the employee's favor on at least some aspect of his or her claim. On the other hand, if the employee receives an award, but the amount is relatively small and/or the award is much lower than the amount claimed, the employee might view the outcome of the case as unsuccessful. Taking a narrow view of an employee win as cases in which the employee receives all or at least some substantial portion of the amount claimed would produce a lower estimate of the employee win rate in arbitration. By contrast, using a broader definition of an employee win will increase the estimated win rate. To take a conservative approach in this study, I use a broad definition of an employee win as including any case in which some award of damages, however small, is made in favor of the employee. Using this broad definition, the

[10] See: Delikat and Kleiner (2003); Eisenberg and Hill (2003); Oppenheimer (2003).
[11] Lisa B. Bingham and Shimon Sarraf. 2000. "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."; Theodore Eisenberg and Elizabeth Hill. 2003. "Arbitration and Litigation of Employment Claims: An Empirical Comparison." *Dispute Resolution Journal*, (Nov. 2003-Jan. 2004), Vol. 58(4): pp. 44-54 at 50.

employees won 260 of the 1,213 cases in the AAA-CC filings which terminated in an award, corresponding to an employee win rate of 21.4 percent.

This employee win rate is substantially lower than that found in previous employment arbitration studies, which tended to use selective samples. It is also lower than employee win rates in litigation. However, it should be noted that we are not necessarily comparing apples and oranges here. The characteristics of cases in arbitration may differ systematically from those in litigation. For example, it could be that arbitration contains more low value cases than litigation. Different patterns of pre-hearing settlement may also affect the distribution of cases heard in each system. Some of these differences may serve to depress or to increase the arbitration win rate relative to litigation.[12] What this estimate tells us is the unadjusted employee win rate in arbitration. The difference between this win rate and the employee win rate in litigation indicates that there exists an arbitration-litigation gap. The task for future research is then to analyze what factors may explain this gap and whether or not it is problematic from a public policy perspective. A useful analogy can be drawn to the male-female wage gap. An initial task in labor economics is to identify the existence and size of a gap between average male and female wages. Once such a gap is identified, the task becomes to understand the factors leading to the gap and the degree to which they represent more general labor market forces (e.g. differences in education and skill levels) or discrimination based on gender. Similarly in employment dispute resolution research, the next task in analyzing the arbitration-litigation gap will be to determine the degree to

[12] For a good discussion of these issues and how they may tend to inflate or deflate arbitration-litigation differences, see: David Schwartz, "Mandatory Arbitration and Fairness" *Notre Dame Law Review* (forthcoming, 2009).

which it is due to factors such as greater access to low value claims or due to tendencies of arbitrators to favor employers in their decision-making.

Award Amounts

When we turn to award amounts, similar patterns emerge in employment arbitration outcomes. Earlier studies tended to find relatively high average awards, broadly similar to those found in litigation. For example, in Delikat and Kleiner's study of securities industry employment arbitration outcomes, they found a median damage award of $100,000 ($117,227 in 2005 dollars[13]) and a mean damage award of $236,292 ($276,998 in 2005 dollars) for the 186 awards in their sample where the employee received some type of monetary damage award.[14] These amounts were roughly comparable to the outcomes in a sample of federal court employment discrimination trials they examined, where the median damage award was $95,554 ($112,015 in 2005 dollars) and the mean award was $377,030 ($441,981 in 2005 dollars). Eisenberg and Hill find similar roughly results for employment arbitration outcomes overall using a selective sample of AAA awards, however again also find relatively less favorable outcomes for employees where arbitration is based on an employer-promulgated procedure.[15]

In the AAA-CC filings data, there were 260 awards in which the employee received some amount of monetary damages. Amongst these cases, the median amount of damages awarded was $36,500 and the mean award was $109,858, with a standard

[13] Dollar amounts from earlier studies are converted to constant 2005 dollars so as to allow easier comparability to the results from the AAA-CC filings data. The year 2005 is chosen as the midpoint of the date range in the AAA-CC filings data.
[14] Delikat and Kleiner, supra.
[15] Eisenberg and Hill, supra.

deviation of $238,227. The high mean compared to the median and relatively large standard deviation reflects the skewed nature of the distribution of arbitration awards, with a small number of large awards producing a high average outcome. Although average outcomes are commonly calculated based on cases in which an award is made, it is also informative to calculate the average outcome over all cases, including those in which zero damages are awarded. This provides an estimate of the expected outcome of the average case, including the chance of a zero recovery outcome. Calculated on this basis, the mean award amount for the 1,213 arbitration cases in the AAA-CC filings data where an award was made was $23,548, with a standard deviation of $119,003.

Although, as noted above, the data do not allow a standardized comparison of arbitration and litigation case outcomes, it is nonetheless informative to look at studies of employment litigation outcomes to get a sense of the relative level of outcomes in the two systems and whether or not a gap exists to be explained. Studies by Eisenberg and his co-authors find relatively higher damage awards in employment litigation than those found here for employment arbitration. For example, in a sample of 408 federal court employment discrimination trials, they found a median award of $150,500 ($176,426 in 2005 dollars) and a mean award of $336,291 ($394,223 in 2005 dollars). Similarly, in a study of California state court trial outcomes, Oppenheimer found a median award of $296,991 ($355,843 in 2005 dollars) for 69 common law discharge cases in 1998-99 and a median award of $200,000 ($239,632 in 2005 dollars) for 136 employment discrimination cases in 1998-99. While we cannot say what the difference would be if the same case were presented to an arbitral and a litigation forum, what we can say is that overall the median damage award in employment litigation is about 5-10 times as large as

the median award in employment arbitration. Being able to identify the rough order of magnitude of this gap does indicate the importance of taking future steps to identify the causes for it, both as a matter of academic research interest and from a public policy perspective. Explaining this arbitration-litigation gap is of particular importance given that a key element of the majority's reasoning in *Gilmer v. Interstate/Johnson Lane* relied on the presumption that arbitration was acceptable "[s]o long as the prospective litigant may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."[16]

Time to Resolution

One area in which arbitration is widely considered to hold an advantage compared to litigation is in producing more timely resolution of claims. This is clearly a generally desirable feature of a dispute resolution procedure in that it reduces costs, provides sooner certainty in outcomes and reduces the detrimental effect of the passage of time on the ability to fairly try cases. For employment cases, concerns about the negative effects of time delays in dispute resolution are heightened. For employees, employment cases often involve disruption of their existing employment situation and difficulty in finding equivalent alternative job opportunities. For the employer, delay may also be detrimental in producing ongoing disruption to its operations and attendant uncertainty about the status of personnel policies and practices that are implicated in the claim. Although not unusual for the courts in general, times to disposition in employment litigation continue

[16] *Gilmer v. Interstate/Johnson Lane*, 500 U.S. 20 at 28 (1991), quoting *Mitsubishi Motors v. Soler Chrysler-Plymouth* 473 U.S. 614 (1985).

to be substantial. Estimates indicate cases typically take around two to two-and-a-half years to reach trial in federal and state courts.[17]

Analysis of the AAA-CC filings data indicates that time to hearing in employment arbitration is substantially faster than in litigation. The mean time to disposition for an employment arbitration case that resulted in an award was 361.5 days. Put alternatively, the time it takes to obtain a resolution after a hearing is about half as long in arbitration as in litigation. This is a substantial advantage for arbitration. In a comparison, however, it is also important to recognize that most cases in both litigation and arbitration are settled before a final hearing. Although this reduces the typical time to resolution in litigation, this is also true in arbitration. Amongst employment arbitration cases that were settled prior to an award, the mean time to disposition was 284.4 days. Lastly, it is not obvious that even with its reduced time to disposition that arbitration is sufficiently expeditious as would be desirable for an employment dispute resolution procedure. A year to resolve cases is still a relatively long period for a dispute to be ongoing both for employees who rely on their jobs for their primary source of income and for employers needing to move forward with their operations. Labor arbitration procedures in unionized workplaces have come under increasing criticism for similar delays that also commonly result in periods of close to a year before a hearing and award. In the case of labor arbitration, these delays have been driven by the relatively small cadre of experienced arbitrators acceptable to both unions and management. The results found here indicate that similar delays before hearing are emerging in employment arbitration.

[17] Eisenberg and Hill, supra; Delikat and Kleiner, supra.

Arbitration Fees

A frequent criticism of employment arbitration is that arbitrators and service providers charge fees, which may be substantial, whereas filing fees for access to the courts are small by comparison. The concern is that arbitration fees imposed on employees through employer-promulgated arbitration agreements will create a barrier preventing employee access to a forum for enforcing their statutory rights. The AAA-CC filings include data on arbitrator fees charged in the cases. Amongst all employment arbitration cases, the median fee charged was $2,475 and the mean fee charged was $6340. However, this includes cases that were settled prior to a final hearing, where fees charged may only have related to the initial filings or any preliminary motions or requests. Amongst the cases that resulted in a final award following a hearing, the median fee charged was $7,138 and the mean fee charged was $11,070.

While the overall amount of arbitration fees is an important consideration, the specific concerns were directed primarily at the possibility of individual employees having to bear substantial arbitration fees in order to protect their statutory rights. In the instance of employment arbitration administered under the auspices of the AAA, these concerns are mitigated by that service provider's adoption of an organizational policy of requiring employers that utilize its services to bear the costs of arbitration fees. Although organizational policies are not always universally reflected in actual practices, the AAA-CC filings data include information on the allocation of fees that allow a check on this question. Amongst these cases, the employer paid all arbitration fees 97 percent of the time.

Plaintiff Salary Levels

Accessibility to low income plaintiffs is a problem that has plagued the civil justice system. One of the potential advantages offered by arbitration is that its relative simplicity and speediness could reduce costs to use the system and thereby enhance accessibility. The argument has been made that whereas employment litigation requires relatively high potential claim amounts to justify financing of cases, arbitration will allow lower value claims to reach a hearing.[18] Based on this reasoning, advocates for employment arbitration have argued that it will allow more low income plaintiffs to enforce statutory employment rights. Responding to this line of argument, critics of employment arbitration have noted that claim amounts in employment disputes do not always correspond to differences in income levels and more generally questioning the presumption of greater accessibility of arbitration.[19]

The AAA-CC filings data includes information on plaintiff salary levels. In accord with the California Code filing requirements, the AAA data classifies plaintiff salaries into three categories: $0-$100,000; $100,001-$250,000; and $250,001 or greater. Although there is a relatively high frequency of missing data on this variable due mostly to the failure of the parties to provide this information, plaintiff salary levels are included for 1,538 cases. For plaintiffs in these cases, 1,267 or 82.4 percent had salaries under

[18] *See e.g.*, Samuel Estreicher. *Predispute Agreements to Arbitrate Statutory Employment Claims*, 72 N.Y.U. L. REV. 1344 (1997); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Pre-Dispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559 (2001).

[19] See Schwartz (forthcoming, 2009), supra. Professor Schwartz also advances a very interesting analysis of the relative incentives on the parties to choose between litigation and arbitration forums suggesting that many of the assumptions about the value of mandatory arbitration in obtaining a trade-off favoring accessibility for low value claims are incorrect.

$100,000, 214 or 13.9 percent had salaries between $100,001 and $250,000, and 57 or 3.7 percent had salaries over $250,001. This data indicates that the large majority of the plaintiffs in AAA employment arbitration cases had relatively modest salary levels.

Unfortunately, comparable data on salary levels in employment litigation is not yet readily available. There are frequent citations of anecdotal reports from plaintiff attorneys that potential claim amounts of as much as $60,000 may be necessary to justify bringing a case forward in litigation. However, there is a dearth of good systematic research on this issue in employment litigation.

One interesting comparison is to look at the claim amounts in employment arbitration. This provides one indication of the degree to which large potential claim amounts may also be necessary to finance cases in employment arbitration. Although there is also a relatively high frequency of missing data on this variable, the AAA-CC filings data includes reports of the amount claimed by the plaintiff. Overall, amongst 1,736 cases in which this was reported, the median amount claimed was $106,151 and the mean amount claimed was $844,814. The average in this instance is heavily skewed by some very large claim amounts. To get a better sense of the feasibility of low claim amounts in arbitration, it is useful to examine the left end of the distribution of claim amounts. The cut-off for the bottom quartile of the claim amount distribution (the 25th percentile) was $36,000, meaning that three-quarters of all cases involved claims greater than that amount. Ten percent of the cases did involve claims of $10,000 or less. However, overall most cases in employment arbitration appear to involve sizable claim amounts.

How does plaintiff salary level relate to prospects for success in employment arbitration? Both employee win rates and award amounts are positively related to salary levels in employment arbitration. Whereas the employee win rate was 22.7 percent amongst plaintiffs with salary levels below $100,000, this win rate rises to 31.4 percent for plaintiffs with salary levels between $100,001 and $250,000, and to a win rate of 42.9 percent for plaintiffs with salary levels over $250,001.[20] Similarly, whereas for plaintiffs with salary levels below $100,000 the mean award amount was $19,069 (including zero damage award cases), for plaintiffs with salary levels between $100,001 and $250,000 the mean award amount was $64,895, and for plaintiffs with salary levels over $250,001 the mean award amount was $165,671.

Repeat Player Issues

Issues related to repeat players have proven particularly controversial in studies of employment arbitration. In dispute resolution more generally, repeat players have long been identified as having advantages relative to one-shot participants in dispute resolution processes.[21] These concerns are heightened in regard to employment arbitration because employers are systematically much more likely to be repeat players in arbitration. By contrast, it will be very rare for an individual employee to participate in employment arbitration more than once. This can be contrasted with forums such as labor arbitration where both participants, union and management, are typically repeat players. A particular concern is that arbitrators might tend to favor employers in employment

[20] Albeit, we should exercise caution in over-interpreting the significance of the finding for the highest salary level group since it is based on a relatively small cell size of 14 observations.
[21] E.g. Galanter…

arbitration in hopes of securing future business from these repeat players. If employers do derive some unfair advantage from being repeat players in employment arbitration, this could undermine the legitimacy of this forum for resolving statutory employment rights.

A series of studies by Lisa Bingham in the 1990s first raised to prominence concerns that employers had an undue advantage as repeat players in employment arbitration. [22] Although Bingham used relatively small, samples of cases from AAA files, she found some evidence that employers who participated in multiple arbitration cases enjoyed greater success than those who only participated in a single case. Subsequently, Bingham's findings have come under criticism from some other researchers who note that her results showed only that regular participants in arbitration performed better, not that there was a bias by arbitrators seeking future business.[23]

There are a series of different possible reasons for an employer repeat player advantage in employment arbitration. In analyzing the empirical evidence in this area, it is useful to begin by identifying these different explanations:

1) Larger employers, who are more likely to be repeat players, may enjoy advantages from greater resources available to devote to cases. This could include the ability to hire

[22] Bingham, Lisa B. 1995. "Is There a Bias in Arbitration of Non-Union Employment Disputes?" *International Journal of Conflict Management*, Vol. 6, no. 4 (October), pp. 369–97. Bingham. 1996. "Emerging Due Process Concerns in Employment Arbitration: A Look at Actual Cases." *Labor Law Journal*, Vol. 47, no. 2, (February) pp. 108–26. Bingham. 1997. "Employment Arbitration: The Repeat Player Effect." *Employee Rights and Employment Policy Journal*, Vol. 1, pp. 189–22. Bingham. 1998. "On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards." *McGeorge Law Review*, Vol. 29, no. 2 (Winter), pp. 223–59.

[23] Elizabeth Hill. "AAA Employment Arbitration: A Fair Forum at Low Cost." *Dispute Resolution Journal*, Vol. 58, no. 2 (May-Jul 2003), pp. 8-16; David Sherwyn, Samuel Estreicher, and Michael Heise. "Assessing the Case for Employment Arbitration: A New Path for Empirical Research." *Stanford Law Review*, Vol. 57, pp. 1557-1591 (2004).

better defense counsel and more specialized in-house personnel devoted to dealing with legal claims.

2) Employers who are repeat players may develop greater expertise with the arbitral forum, which then works to their advantage in future arbitration cases.

3) Larger employers, who are more likely to be repeat players, they be more likely to adopt human resource policies that ensure greater fairness in employment decisions.

4) Larger employers, who are more likely to be repeat players, may be more likely to adopt internal grievance procedures that lead to the resolution of meritorious cases before they reach arbitration.

These first four explanations, all relate to the employers participation in multiple arbitration cases and/or general advantages accruing to size. They lead to a prediction of greater success for repeat employers in arbitration, but not a specific concern about repeat use of the same arbitrators to decide cases involving the same employer. By contrast, two other explanations relate specifically to repeat employer-arbitrator relationships:

5) Arbitrators may be biased in favor of employers out of hope of being selected in future cases. This bias may be heightened by the employer typically paying the entire arbitrator fee and by the limited experience of employees with arbitration.

6) Repeat employers may develop expertise in identifying, and then selecting, employment arbitrators who tend to favor employers in their decision-making. Lacking equivalent repeat player experience, employees will be less likely to be able to identify and then reject the pro-employer arbitrators.

These latter two explanations should lead to a greater employer degree of success in cases where there is a repeat employer-arbitrator pairing, even compared to repeat employer cases in general.

The large number of cases in the AAA-CC filings dataset and the availability now of four years worth of data allow an improved analysis of the potential for either repeat employer or repeat employer-arbitrator pairing effects. I begin by looking at repeat employer effects.

Overall in the AAA-CC filings dataset, 2,613 out of 3,941 or 66.3 percent of cases involved repeat employers, defined as any employer with more than one case in the dataset. This indicates that a repeat employer is in fact the typical situation in employment arbitrations administered by the AAA. As predicted by the above arguments, repeat employers faired better in arbitration than one-shot employers. Whereas employees won 31.6 percent of cases involving one-shot employers, they won only 16.9 percent of cases involving repeat employers, which was a statistically significant difference ($p<.01$). Similarly, whereas the mean damage award was $40,546 in cases involving one-shot employers, the mean damage award was only $16,134 in cases involving repeat employers, which was also a statistically significant difference ($p<.01$). These results confirm earlier research indicating a repeat employer effect in employment arbitration. However, they are also consistent with explanations 1-4 for the repeat employer effect, described above, which do not implicate employer-arbitrator repeat effect bias.

To test for a repeat employer-arbitrator pairing bias, I classified all cases where the same arbitrator heard more than one case involving the same arbitrator. Two different

approaches have been advocated in the literature for such classifications. In her research, Bingham used a classification scheme that coded each appearance of a multiple pairing as a repeat employer-arbitrator case.[24] Sherwyn, Estreicher and Heise, by contrast, argue that the first instance in which the pairing occurs should not be classified as a repeat employer-arbitrator case, only subsequent incidents of the same pairing.[25] Their reasoning is that arbitrator bias will only emerge as reciprocation in second and subsequent cases where the arbitrator is selected by the same employer. Although I think there is some plausibility to this argument, my view is that in selecting an arbitrator a second and subsequent times, the employer will take into consideration the arbitrator's decision in the initial case involving the employer. From the arbitrator's side, if there is a temptation to be biased towards an employer in hopes of obtaining future arbitration business, the arbitrator can signal this to the employer by more employer-favorable decision-making in the initial case on which the arbitrator is selected. Thus, if there is a repeat employer-arbitrator bias, it should be manifested in more favorable decisions towards employers on the first as well as subsequent cases involving a repeat employer-arbitrator pairing. Following an approach that I have also taken in earlier research in this area[26], I initially proceed by classifying all cases involving a repeat pairing as repeat employer-arbitrator cases. However, to explore the alternative approach advocated by Sherwyn, Eisenberg and Heise, I also test the repeat employer-arbitrator classification

[24] Bingham, supra.
[25] David Sherwyn, Samuel Estreicher, and Michael Heise. "Assessing the Case for Employment Arbitration: A New Path for Empirical Research." *Stanford Law Review*, Vol. 57, pp. 1557-1591 (2005).
[26] Alexander J.S. Colvin, "Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?" *Employee Rights and Employment Policy Journal*, Vol. 11, No. 2, pp. 405-447 (2008).

suggested by those authors, which is restricted to second and subsequent instances of the pairing.

Overall in the AAA-CC filings dataset, 624 out of 3,934, or 15.9 percent of cases involved repeat employer-arbitrator pairings. This is a much larger group of repeat employer-arbitrator pairings than examined in previous studies, reflecting the size of the data available through the California Code filing requirements. Overall, employers were more successful in cases involving repeat employer-arbitrator pairings. Whereas the employee win rate was 23.4 percent in cases that did not involve a repeat employer-arbitrator pairing, the employee win rate was only 12.0 percent in cases involving a repeat pairing, which was a statistically significant difference. Similarly, whereas the average damage award was $27,039 in cases not involving a repeat pairing, it was only $7,451 in cases that involved a repeat employer-arbitrator pairing, also a statistically significant difference ($p<.05$). To more precisely identify possible explanations for the repeat player effect, it is useful to separately aualyze the subset of cases involving repeat employers. To the degree that effects are due to a repeat employer-arbitrator pairing effect rather than the more general advantages of repeat employers, they should be identifiable in this subpopulation. When the analysis is restricted to this subsample, the employee win rate is 12.0 percent for cases involving a repeat employer-arbitrator pairing, compared to 18.6 percent for cases that do not involve a repeat pairing, which is a statistically significant difference ($p<.05$). In this subsample, the mean award amount is $7,451 for cases involving a repeat employer-arbitrator pairing, whereas the mean award

is $19,146 for cases that do not involve a repeat pairing, though this difference is only of marginal statistical significance.[27]

Do these results change when we take the alternative approach to classifying repeat employer-arbitrator pairings advocated by Sherwyn, Estreicher and Heise? Using their alternative classification approach, the employee win rate is 12.2 percent with versus 22.5 percent without a repeat employer-arbitrator pairing, which is a statistically significant difference ($p<.01$). Similarly, the mean award amount is $3,203 with versus $25,843 without a repeat employer-arbitrator pairing, which is also a statistically significant difference ($p<.05$). When we restrict the analysis to the subsample of repeat employers, the employee win rate is 12.2 percent with versus 16.8 percent without a repeat employer-arbitrator pairing and the mean award amount is $3,203 with versus $20,939 without a repeat pairing, though only the latter difference is of marginal significance. Overall, the use of the alternative classification approach produces slightly smaller differences in employee win rates and slightly larger differences in mean award amounts. However, the general pattern of results is very similar across the two methodologies. How exactly the repeat employer-arbitrator might operate in the area of signaling between the two sides is an interesting research question, but the alternative positions do not appear to have major effects on the outcomes.

Taken as a whole, the results indicate that there is a strong repeat employer effect in employment arbitration and a smaller, but substantial repeat employer-arbitrator pairing effect. Although the former effect appears to be larger, the latter is of greater concern from a policy standpoint. If the effect is due to either arbitrator bias or an

[27] The difference in award amounts is statistically significant at the 90 percent confidence level in a one-tailed test, but falls just short of the 90 percent level in a two-tailed test.

employer ability to systematically select more employer favorable arbitrators, one should be concerned that the employment arbitration system is being slanted against employees in these cases. Although alternative explanations may be offered, it is also plausible that the results actually understate the extent of the repeat employer-arbitrator pairing effect. In cases where employees are able to retain plaintiff counsel who are relatively experienced in this area and knowledgeable about employment arbitration, it is possible that these attorneys will enter into agreements with employer counsel to repeatedly use the same employment arbitrators in multiple cases where the arbitrators in question are acceptable to both sides. Put alternatively, where plaintiff counsel are able to act as a repeat player in arbitration, we would expect to see instances of repeat employer-arbitrator pairings that reflect the existence of repeat players on both sides, akin to the situation commonly seen in labor arbitration. These relatively employee favorable repeat employer-arbitrator pairings are likely to bias upward the level of employee success seen in repeat pairing cases overall. If it were possible to remove them from the sample, the remaining repeat pairing cases are likely to provide evidence of a stronger repeat employer-arbitrator effect.

Self-Representation

One of the possible benefits of employment arbitration is that the relatively simplicity of the forum might make self-representation by employees more plausible than in litigation. Alternatively, given that arbitration is a private forum, one might also be concerned that self-represented employees will be more disadvantaged in arbitration than in the public forum of litigation where judges may view themselves as having a greater

public obligation to protect the interests of the self-represented. The AAA-CC filings include data on whether or not employees in the cases were self-represented, allowing empirical analysis of questions related to this phenomenon. To what extent is self-representation used in employment arbitration? What is the effect of using counsel versus self-representation on outcomes in employment arbitration?

Overall, employees were self-represented in 980 out of 3,940 cases or 24.9 percent of the time. In cases where the employee was self-represented the employee win rate was 18.3 percent versus an employee win rate of 22.9 percent in cases where the employee was represented by counsel, which was a statistically significant difference ($p<.10$). Though it should be noted that this is no necessarily all that large a difference in win rates given that there is likely to a selection effect in which counsel can identify in advance cases where the employee is less likely to be successful. Turning to award amounts, the mean award received by self-represented employees was $12,228 compared to a mean award of $28,993 for employees represented by counsel, which was a statistically significant difference ($p<.05$). Again, there may be some selection effect here as plaintiff attorneys may be unable financially to take on cases below a certain value threshold.

These results suggest that while a substantial minority of employees do use self-representation, in the large majority of instances employees are retaining counsel to represent them in employment arbitration. The cases in which employees do have representation by counsel are on average those in which they have a greater chance of success and recover larger damage awards. Thus employment arbitration appears to be a dispute resolution system predominantly based on employee representation by counsel, as

is the case with litigation. To the degree that representation by counsel continues to be difficult for many employees to obtain, due to factors such as low value of claims, lack of legal sophistication of employees, and limited resources of plaintiff attorneys, employment arbitration is providing at most a limited response to this problem.

Conclusion

In the often vociferous debates over employment arbitration, empirical research has at times been criticized as unable to answer the key policy questions implicated in the rise of this new system of dispute resolution.[28] Assuming any individual study will definitely resolve what are complex issues involving a multitude of factors and influences is to create an unrealistic expectation. In practice, empirical research is more typically accumulative in nature as studies gradually enhance our base of knowledge through which to make judgments about policy issues. The present study has taken this approach in trying to extend our understanding of employment arbitration. The availability of a broader, more representative set of data about arbitration under employer-promulgated procedures by virtue of the California Code service provider reporting requirements allows a more accurate and complete picture to begin to emerge of the outcomes of employment arbitration.

What are the key findings of this study and what do they suggest are major future research needs? Estimates of employee win rates and damage award amounts based on the AAA-CC filings data indicate that arbitration outcomes are generally less favorable to

[28] See e.g., Steven Ware, "The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration" *Ohio State Journal on Dispute Resolution* Vol. 16, p. 735 (2001).

employees than those from employment litigation. Although the AAA-CC filings do not provide sufficient information on case characteristics to identify further the factors explaining these differences, the identification of a sizable arbitration-litigation gap indicates the importance of future research that gathers additional data on cases that will help identify the factors leading to these differences. Arbitration does appear to produce relatively quicker resolution of employment claims, albeit not necessarily as quickly as would be ideal for either employee or employer needs. On the closely debated issue of repeat player effects in arbitration, this study finds strong evidence of a repeat employer advantage and, more problematically, evidence of an advantage to employers in repeat employer-arbitrator pairings. The existence of an employer advantage in repeat employer-arbitrator pairings may reflect arbitral bias in some of these cases. More generally it indicates limitations in the ability of the plaintiff attorney bar to play a substitute role as a repeat player on behalf of employees in employer arbitration akin to the role played by unions in labor arbitration. This is not to say that plaintiff attorneys never or cannot play this role, but rather that there may not be sufficient numbers of plaintiff attorneys experienced in employment arbitration accessible to employees to be able to counter-act employer advantages in this area. Lastly, the results of this study indicate that while employees are self-represented in a substantial number of arbitration cases, they tend to receive less favorable outcomes than employees represented by attorneys and representation by counsel is the more common situation in employment arbitration. The question of providing effective and accessible representation for employees continues to be an important issue for investigation in future research in this area.

ATTACHMENT B

STATE	CITATION	TEXT
Alabama	Ala. Code § 8-1-41 (2000).	The following obligations cannot be specifically enforced: (1) An obligation to render personal service; (2) An obligation to employ another in personal service; (3) An agreement to submit a controversy to arbitration; (4) An agreement to perform an act which the party has not power lawfully to perform when required to do so; (5) An agreement to procure the act or consent of the wife of the contracting party or of any other third persons; or (6) An agreement, the terms of which are not sufficiently certain to make the precise act which is to be done clearly ascertainable.
Arizona	Ariz. Rev. Stat. § 12-1517 (2000).	A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract. This article shall have no application to arbitration agreements between employers and employees or their respective representatives.
Arkansas	Ark. Stat. Ann. § 16-108-201 (1999).	A written provision to submit to arbitration any controversy thereafter arising between the parties bound by the terms of the writing is valid, enforceable, and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract; provided, that this subsection shall have no application to personal injury or tort matters, employer-employee disputes, nor to any insured or beneficiary under any insurance policy or annuity contract.
Georgia	Off. Code Ga. Ann. § 9-9-2 (2000).	This part shall apply to all disputes in which the parties thereto have agreed in writing to arbitrate and shall provide the exclusive means by which agreements to arbitrate disputes can be enforced, except the following, to which this part shall not apply: (9) Any contract relating to terms and conditions of employment unless the clause agreeing to arbitrate is initialed by all signatories at the time of the execution of the agreement.
Idaho	Idaho Code § 7-901 (1999).	A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract. This act does not apply to arbitration agreements between employers and employees or between their respective representatives (unless otherwise provided in the agreement).

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STATE	CITATION	TEXT
Iowa	Iowa Code § 679A.1 (1999).	A written agreement to submit to arbitration an existing controversy is valid, enforceable, and irrevocable unless grounds exist at law or in equity for the revocation of the written agreement. A provision in a written contract to submit to arbitration a future controversy arising between the parties is valid, enforceable, and irrevocable unless grounds exist at law or in equity for the revocation of the contract. This subsection shall not apply to any of the following: (a) A contract of adhesion; (b) A contract between employers and employees; (c) Unless otherwise provided in a separate writing executed by all parties to the contract, any claim sounding in tort whether or not involving a breach of contract.
Kansas	Kan. Stat. Ann. § 5-401 (1999).	(a) A written agreement to submit any existing controversy to arbitration is valid, enforceable and irrevocable except upon such grounds as exist at law or in equity for the revocation of any contract. (b) Except as provided in subsection (c), a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable except upon such grounds as exist at law or in equity for the revocation of any contract. (c) The provisions in subsection (b) shall not apply to: (2) contracts between an employer and employees, or their respective representatives.
Kentucky	(1) Ky. Rev. Stat. § 417.050 (1998). (2) Ky. Rev. Stat. § 336.700 (1998).	(1) A written agreement to submit any existing controversy to arbitration or a provision in [a] written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law for the revocation of any contract. This chapter does not apply to: (1) Arbitration agreements between employers and employees or between their respective representatives. (2) Notwithstanding any provision of the Kentucky Revised Statutes to the contrary, no employer shall require as a condition or precondition of employment that any employee or person seeking employment waive, arbitrate, or otherwise diminish any existing or future claim, right, or benefit to which the employee or person seeking employment would otherwise be entitled under any provision of the Kentucky Revised Statutes or any federal law.

STATE	CITATION	TEXT
Louisiana	La. Rev. Stat. §§ 9:4216 (2000).	Nothing contained in this Chapter shall apply to contracts of employment of labor or to contracts for arbitration which are controlled by valid legislation of the United States or to contracts made prior to July 28, 1948.
Maryland	Md. Cts. And Jud. Proc. Code Ann. § 3-206 (1999).	A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy arising between the parties in the future is valid and enforceable, and is irrevocable, except upon grounds that exist at law or in equity for the revocation of a contract. This subtitle does not apply to an arbitration agreement between employers and employees or between their respective representatives unless it is expressly provided in the agreement that this subtitle shall apply.
New Hampshire	New Hampshire Rev. Stat. Ann. § 542:1 (1999).	A provision in any written contract to settle by arbitration a controversy thereafter arising out of such contract, or an agreement in writing to submit to arbitration any controversy existing at the time of the agreement to submit, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. The provisions of this chapter shall not apply to any arbitration agreement between employers and employees, or between employers and associations of employees unless such agreement specifically provides that it shall be subject to the provisions of this chapter.
North Carolina	N.C. Gen. Stat. § 1-567.2 (1999).	(a) Two or more parties may agree in writing to submit to arbitration any controversy existing between them at the time of the agreement, or they may include in a written contract a provision for the settlement by arbitration of any controversy thereafter arising between them relating to such contract or the failure or refusal to perform the whole or any part thereof. Such agreement or provision shall be valid, enforceable, and irrevocable except with the consent of all the parties, without regard to the justiciable character of the controversy. (b) This Article shall not apply to: (2) Arbitration agreements between employers and employees or between their respective representatives, unless the agreement provides that this Article shall apply.
Oklahoma	15 Okl. St., § 818 (1999).	This act shall apply only to agreements made subsequent to the effective date of this act. This act does not apply to employer and employee relations. This act shall not apply to contracts between insuror and insured, except where both the insured and insuror are insurance companies.

STATE	CITATION	TEXT
South Carolina	S.C. Code Ann. § 15-48-10 (1999).	This chapter shall not apply to: (2) Arbitration agreements between employers and employees or between their respective representatives unless the agreement provides that this chapter shall apply; provided, however, that notwithstanding any other provision of law, employers and employees or their respective representatives may not agree that workmen's compensation claims, unemployment compensation claims and collective bargaining disputes shall be subject to the provisions of this chapter and any such provision so agreed upon shall be null and void. An agreement to apply this chapter shall not be made a condition of employment.
Washington	Rev. Code Wash. § 7.04.010 (2002).	Two or more parties may agree in writing to submit to arbitration, in conformity with the provisions of this chapter, any controversy which may be the subject of an action existing between them at the time of the agreement to submit, or they may include in a written agreement a provision to settle by arbitration any controversy thereafter arising between them out of or in relation to such agreement. Such agreement shall be valid, enforceable and irrevocable save upon such grounds as exist in law or equity for the revocation of any agreement. The provisions of this chapter shall not apply to any arbitration agreement between employers and employees or between employers and associations of employees, and as to any such agreement the parties thereto may provide for any method and procedure for the settlement of existing or future disputes and controversies, and such procedure shall be valid, enforceable and irrevocable save upon such grounds as exist in law or equity for the revocation of any agreement.
Wisconsin	Wis. Stats. § 788.01 (1999).	A provision in any written contract to settle by arbitration a controversy thereafter arising out of the contract, or out of the refusal to perform the whole or any part of the contract, or an agreement in writing between 2 or more persons to submit to arbitration any controversy existing between them at the time of the agreement to submit, shall be valid, irrevocable and enforceable except upon such grounds as exist at law or in equity for the revocation of any contract. This chapter shall not apply to contracts between employers and employees, or between employers and associations of employees, except as provided in § 111.10, nor to agreements to arbitrate disputes under §§ 101.143(6s) or 230.44(bm).

ATTACHMENT C

TEXT

EEOC Policy Statement on Mandatory Arbitration

EEOC NOTICE Number 915.002, 7/10/97

1. *SUBJECT*: Policy Statement on Mandatory Binding Arbitration of Employment Discrimination Disputes as a Condition of Employment.

2. *PURPOSE*: This policy statement sets out the Commission's policy on the mandatory binding arbitration of employment discrimination disputes imposed as a condition of employment.

3. *EFFECTIVE DATE*: Upon issuance.

4. *EXPIRATION DATE*: As an exception to EEOC Order 205.001, Appendix B, Attachment 4, § a(5), this Notice will remain in effect until rescinded or superseded.

5. *ORIGINATOR*: Coordination and Guidance Programs, Office of Legal Counsel.

6. *INSTRUCTIONS*: File in Volume II of the EEOC Compliance Manual.

7. *SUBJECT MATTER*:

The United States Equal Employment Opportunity Commission (EEOC or Commission), the federal agency charged with the interpretation and enforcement of this nation's employment discrimination laws, has taken the position that agreements that mandate binding arbitration of discrimination claims as a condition of employment are contrary to the fundamental principles evinced in these laws. EEOC Motions on Alternative Dispute Resolution, Motion 4 (adopted Apr. 25, 1995), 80 Daily Lab. Rep. (BNA) E-1 (Apr. 26, 1995).[1] This policy statement sets out in further detail the basis for the Commission's position.

I. Background

An increasing number of employers are requiring as a condition of employment that applicants and employees give up their right to pursue employment discrimination claims in court and agree to resolve disputes through binding arbitration. These agreements may be presented in the form of an employment contract or be included in an employee handbook or elsewhere. Some employers have even included such agreements in employment applications. The use of these agreements is not limited to particular industries, but can be found in various sectors of the workforce, including, for example, the securities industry, retail, restaurant and hotel chains, health care, broadcasting, and security services. Some individuals subject to mandatory arbitration agreements have challenged the enforceability of these agreements by bringing employment discrimination actions in the courts. The Commission is not unmindful of the case law enforcing specific mandatory arbitration agreements, in particular, the Supreme Court's decision in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 33 (1991).[2] Nonetheless, for the reasons stated herein, the Commission believes that such agreements are inconsistent with the civil rights laws.

II. The Federal Civil Rights Laws Are Squarely Based In This Nation's History And Constitutional Framework And Are Of A Singular National Importance

Federal civil rights laws, including the laws prohibiting discrimination in employment, play a unique role in American jurisprudence. They flow directly from core Constitutional principles, and this nation's history testifies to their necessity and profound importance. Any analysis of the mandatory arbitration of rights guaranteed by the employment discrimination laws must, at the outset, be squarely based in an understanding of the history and purpose of these laws.

Title VII of the historic Civil Rights Act of 1964, 42 U.S.C. § 2000e *et seq.*, was enacted to ensure equal opportunity in employment, and to secure the fundamental right to equal protection guaranteed by the Fourteenth Amendment to the Constitution.[3] Congress considered this national policy against discrimination to be of the "highest priority" (*Newman v. Piggie Park Enters.*, 390 U.S. 400, 402 (1968)), and of "paramount importance" (H.R. Rep. No. 88-914, pt. 2 (1963) (separate views of Rep. McCulloch *et al.*)),[4] *reprinted in* 1964 Leg.

[1] Although binding arbitration does not, in and of itself, undermine the purposes of the laws enforced by the EEOC, the Commission believes that this is the result when it is imposed as a term or condition of employment.

[2] The *Gilmer* decision is not dispositive of whether employment agreements that mandate binding arbitration of discrimination claims are enforceable. As explicitly noted by the Court, the arbitration agreement at issue in *Gilmer* was not contained in an employment contract. 500 U.S. at 25 n.2. Even if *Gilmer* had involved an agreement with an employer, the issue would remain open given the active role of the legislative branch in shaping the development of employment discrimination law. *See* discussion *infra* at section IV. B.

[3] *See, e.g.*, H.R. Rep. No. 88-914, pt. 1 (1963), *reprinted in* United States Equal Employment Opportunity Commission, Legislative History of Title VII and XI of the Civil Rights Act of 1964 ("1964 Leg. Hist.") at 2016 (the Civil Rights Act of 1964 was "designed primarily to protect and provide more effective means to enforce. . . civil rights"); H.R. Rep. No.88-914, pt.2 (1963) (separate views of Rep. McCulloch *et al.*), *reprinted in* 1964 Leg. Hist. at 2122 ("[a] key purpose of the bill . . . is to secure to all Americans the equal protection of the laws of the United States and of the several States"); Charles & Barbara Whalen, The Longest Debate: A legislative history of the 1964 Civil Rights Act 104 (1985) (opening statement of Rep. Celler on House debate of H.R. 7152: "The legislation before you seeks only to honor the constitutional guarantees of equality under the law for all. . . . [W]hat it does is to place into balance the scales of justice so that the living force of our Constitution shall apply to all people . . . ."); H.R. Rep. No. 92-238 (1971), *reprinted in* Senate Committee on Labor and Public Welfare, Subcommittee on Labor, Legislative History of the Equal Employment Opportunity Act of 1972 ("1972 Leg. Hist.") at 63 (1972 amendments to Title VII are a "reaffirmation of our national policy of equal opportunity in employment").

[4] William McCulloch (R-Ohio) was the ranking Republican of Subcommittee No. 5 of the House Judiciary Committee, to which the civil rights bill (H.R. 7152) was referred for initial consideration by Congress. McCulloch was among the individuals responsible for

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Hist. at 2123.[5] The Civil Rights Act of 1964, 42 U.S.C. § 2000a *et seq.*, was intended to conform "[t]he practice of American democracy ... to the spirit which motivated the Founding Fathers of this Nation — the ideals of freedom, equality, justice, and opportunity." H.R. Rep. No. 88- 914, pt. 2 (1963) (separate views of Rep. McCulloch *et al.*), *reprinted in* 1964 Leg. Hist. at 2123. President John F. Kennedy, in addressing the nation regarding his intention to introduce a comprehensive civil rights bill, stated the issue as follows:

> We are confronted primarily with a moral issue. It is as old as the Scriptures and it is as clear as the American Constitution.
>
> The heart of the question is whether all Americans are to be afforded equal rights and equal opportunities, whether we are going to treat our fellow Americans as we want to be treated.

President John F. Kennedy's Radio and Television Report to the American People on Civil Rights (June 11, 1963), Pub. Papers 468, 469 (1963).[6]

Title VII is but one of several federal employment discrimination laws enforced by the Commission which are "part of a wider statutory scheme to protect employees in the workplace nationwide," *McKennon v. Nashville Banner Publ'g Co.*, 513 U.S. 352, 357 (1995). *See* the Equal Pay Act of 1963 ("EPA"), 29 U.S.C. § 206(d); the Age Discrimination in Employment Act of 1967 ("ADEA"), 29 U.S.C. § § 621 *et seq.*; and the Americans with Disabilities Act of 1990 ("ADA"), 42 U.S.C. § § 12101 *et seq.* The ADEA was enacted "as part of an ongoing congressional effort to eradicate discrimination in the workplace" and "reflects a societal condemnation of invidious bias in employment decisions." *McKennon*, 513 U.S. at 357. The ADA explicitly provides that its purpose is, in part, to invoke congressional power to enforce the Fourteenth Amendment. 29 U.S.C. § 12101(b)(4). Upon signing the ADA, President George Bush remarked that "the American people have once again given clear expression to our most basic ideals of freedom and equality." President George Bush's Statement on Signing the Americans with Disabilities Act of 1990 (July 26, 1990), Pub. Papers 1070 (1990 Book II).

III. The Federal Government Has The Primary Responsibility For The Enforcement Of The Federal Employment Discrimination Laws

The federal employment discrimination laws implement national values of the utmost importance through the institution of public and uniform standards of equal opportunity in the workplace. *See* text and notes *supra* in Section II. Congress explicitly entrusted the primary responsibility for the interpretation, administration, and enforcement of these standards, and the public values they embody, to the federal government. It did so in three principal ways. First, it created the Commission, initially giving it authority to investigate and conciliate claims of discrimination and to interpret the law, *see* § § 706(b) and 713 of Title VII, 42 U.S.C. § § 2000e-5(b) and 2000e-12, and subsequently giving it litigation authority in order to bring cases in court that it could not administratively resolve, *see* § 706(f)(1) of Title VII, 42 U.S.C. § 2000e-5(f)(1). Second, Congress granted certain enforcement authority to the Department of Justice, principally with regard to the litigation of cases involving state and local governments. *See* § § 706(f)(1) and 707 of Title VII, 42 U.S.C. § § 2000e-5(f)(1) and 2000e-6. Third, it established a private right of action to enable aggrieved individuals to bring their claims directly in the federal courts, after first administratively bringing their claims to the Commission. *See* § 706(f)(1) of Title VII, 42 U.S.C. § 2000e-5(f)(1).[7]

While providing the states with an enforcement role, *see* 42 U.S.C. § § 2000e-5(c) and (d), as well as recognizing the importance of voluntary compliance by employers, *see* 42 U.S.C. § 2000e-5(b), Congress emphasized that it is the federal government that has ultimate enforcement responsibility. As Senator Humphrey stated, "[t]he basic rights protected by [Title VII] are rights which accrue to citizens of the United States; the Federal Government has the clear obligation to see that these rights are fully protected." 110 Cong. Rec. 12725 (1964). *Cf. General Tel. Co. v. EEOC*, 446 U.S. 318, 326 (1980) (in bringing enforcement actions under Title VII, the EEOC "is guided by 'the overriding public interest in equal employment opportunity ... asserted through direct Federal enforcement' ") (*quoting* 118 Cong. Rec. 4941 (1972)).

The importance of the federal government's role in the enforcement of the civil rights laws was reaffirmed by Congress in the ADA, which explicitly provides that its purposes include "ensur[ing] that the Federal Government plays a central role in enforcing the standards established in [the ADA] on behalf of individuals with disabilities." 42 U.S.C. § 12101(b)(3).

IV. Within This Framework, The Federal Courts Are Charged With The Ultimate Responsibility For Enforcing The Discrimination Laws

While the Commission is the primary federal agency responsible for enforcing the employment discrimination laws, the courts have been vested with the final responsibility for statutory enforcement through the construction and interpretation of the statutes, the adjudication of claims, and the issuance of relief.[8] *See, e.g., Kremer v. Chemical Constr. Corp.*, 454 U.S. 461, 479 n.20 (1982) ("federal courts were entrusted with ultimate enforcement responsibility" of Title VII); *New York Gaslight Club, Inc. v. Carey*, 447 U.S. 54, 64 (1980)

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working out a compromise bill that was ultimately substituted by the full Judiciary Committee for the bill reported out by Subcommittee No. 5. His views, which were joined by six members of Congress, are thus particularly noteworthy.

[5] *See also Albemarle Paper Co. v. Moody*, 422 U.S. 405, 416 (1975) (The Civil Rights Act of 1964 is a "complex legislative design directed at an historic evil of national proportions").

[6] Commitment to our national policy to eradicate discrimination continues today to be of the utmost importance. As President Clinton stated in his second inaugural address:

> Our greatest responsibility is to embrace a new spirit of community for a new century .... The challenge of our past remains the challenge of our future: Will we be one Nation, one people, with one common destiny, or not? Will we all come together, or come apart?
>
> The divide of race has been America's constant curse. And each new wave of immigrants gives new targets to old prejudices .... These forces have nearly destroyed our Nation in the past. They plague us still.

President William J. Clinton's Inaugural Address (Jan. 20, 1997), 33 Weekly Comp. Pres. Doc. 61 (Jan. 27, 1997).

[7] Section 107 of the ADA specifically incorporates the powers, remedies, and procedures set forth in Title VII with respect to the Commission, the Attorney General, and aggrieved individuals. *See* 42 U.S.C.§ 12117. Similar enforcement provisions are contained in the ADEA. *See* 29 U.S.C. § § 626 and 628.

[8] In addition, unlike arbitrators, courts have coercive authority, such as the contempt power, which they can use to secure compliance.

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("Of course the 'ultimate authority' to secure compliance with Title VII resides in the federal courts").[9]

A. The Courts Are Responsible For The Development And Interpretation Of The Law

As the Supreme Court emphasized in *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 57 (1974), "the resolution of statutory or constitutional issues is a primary responsibility of courts, and judicial construction has proved especially necessary with respect to Title VII, whose broad language frequently can be given meaning only by reference to public law concepts." This principle applies equally to the other employment discrimination statutes.

While the statutes set out the basic parameters of the law, many of the fundamental legal principles in discrimination jurisprudence have been developed through judicial interpretations and case law precedent. Absent the role of the courts, there might be no discrimination claims today based on, for example, the adverse impact of neutral practices not justified by business necessity, *see Griggs v. Duke Power Co.*, 401 U.S. 424 (1974), or sexual harassment, *see Harris v. Forklift Sys., Inc.*, 510 U.S. 17 (1993); *Meritor Savings Bank, FSB v. Vinson*, 477 U.S. 57 (1986). Yet these two doctrines have proved essential to the effort to free the workplace from unlawful discrimination, and are broadly accepted today as key elements of civil rights law.

B. The Public Nature Of The Judicial Process Enables The Public, Higher Courts, And Congress To Ensure That The Discrimination Laws Are Properly Interpreted And Applied

Through its public nature — manifested through published decisions — the exercise of judicial authority is subject to public scrutiny and to system-wide checks and balances designed to ensure uniform expression of and adherence to statutory principles. When courts fail to interpret or apply the antidiscrimination laws in accord with the public values underlying them, they are subject to correction by higher level courts and by Congress.

These safeguards are not merely theoretical, but have enabled both the Supreme Court and Congress to play an active and continuing role in the development of employment discrimination law. Just a few of the more recent Supreme Court decisions overruling lower court errors include: *Robinson v. Shell Oil Co.*, 117 S. Ct. 843 (1997) (former employee may bring a claim for retaliation); *O'Connor v. Consolidated Coin Caterers, Corp.*, 116 S. Ct. 1307 (1996) (comparator in age discrimination case need not be under forty); *McKennon*, 513 U.S. 352 (employer may not use after-acquired evidence to justify discrimination); and *Harris*, 510 U.S. 17 (no requirement that sexual harassment plaintiffs prove psychological injury to state a claim).

Congressional action to correct Supreme Court departures from congressional intent has included, for example, legislative amendments in response to Court rulings that: pregnancy discrimination is not necessarily discrimination based on sex (*General Elec. Co. v. Gilbert*, 429 U.S. 125 (1978), and *Nashville Gas Co. v. Satty*, 434 U.S. 136 (1977), overruled by Pregnancy Discrimination Act of 1978); that an employer does not have the burden of persuasion on the business necessity of an employment practice that has a disparate impact (*Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989), overruled by § § 104 and 105 of the Civil Rights Act of 1991); that an employer avoids liability by showing that it would have taken the same action absent any discriminatory motive (*Price Waterhouse v. Hopkins*, 490 U.S. 228 (1989), overruled, in part, by § 107 of the Civil Rights Act of 1991); that mandatory retirement pursuant to a benefit plan in effect prior to enactment of the ADEA is not prohibited age discrimination (*United Air Lines, Inc. v. McMann*, 434 U.S. 192 (1977), overruled by 1978 ADEA amendments); and, that age discrimination in fringe benefits is not unlawful (*Public Employees Retirement Sys. of Ohio v. Betts*, 492 U.S. 158 (1989), overruled by Older Workers Benefit Protection Act of 1990).

C. The Courts Play A Crucial Role In Preventing And Deterring Discrimination And In Making Discrimination Victims Whole

The courts also play a critical role in preventing and deterring violations of the law, as well as providing remedies for discrimination victims. By establishing precedent, the courts give valuable guidance to persons and entities covered by the laws regarding their rights and responsibilities, enhancing voluntary compliance with the laws. By awarding damages, backpay, and injunctive relief as a matter of public record, the courts not only compensate victims of discrimination, but provide notice to the community, in a very tangible way, of the costs of discrimination. Finally, by issuing public decisions and orders, the courts also provide notice of the identity of violators of the law and their conduct. As has been illustrated time and again, the risks of negative publicity and blemished business reputation can be powerful influences on behavior.

D. The Private Right Of Action With Its Guarantee Of Individual Access To The Courts Is Essential To The Statutory Enforcement Scheme

The private right of access to the judicial forum to adjudicate claims is an essential part of the statutory enforcement scheme. *See, e.g., McKennon*, 513 U.S. at 358 (granting a right of action to an injured employee is "a vital element" of Title VII, the ADEA, and the EPA). The courts cannot fulfill their enforcement role if individuals do not have access to the judicial forum. The Supreme Court has cautioned that, "courts should ever be mindful that Congress ... thought it necessary to provide a judicial forum for the ultimate resolution of discriminatory employment claims. It is the duty of courts to assure the full availability of this forum." *Gardner-Denver*, 415 U.S. at 60 n.21.[10]

Under the enforcement scheme for the federal employment discrimination laws, individual litigants act as "private attorneys general." In bringing a claim in

[9] *See also* H.R. Rep. No. 88-914, pt.2 (1963) (separate views of Rep. McCulloch et al.), *reprinted in* 1964 Leg. Hist. at 2150 (explaining that EEOC was not given cease-and-desist powers in the final House version of the Civil Rights Act of 1964, H.R. 7152, because it was "preferred that the ultimate determination of discrimination rest with the Federal judiciary").

[10] *See also* 118 Cong. Rec. S7168 (March 6, 1972) (section-by-section analysis of H.R. 1746, the Equal Opportunity Act of 1972, as agreed to by the conference committees of each House; analysis of § 706(f)(1) provides that, while it is hoped that most cases will be handled through the EEOC with recourse to a private lawsuit as the exception, "as the individual's rights to redress are paramount under the provisions of Title VII it is necessary that all avenues be left open for quick and effective relief").

court, the civil rights plaintiff serves not only her or his private interests, but also serves as "the chosen instrument of Congress to vindicate 'a policy that Congress considered of the highest priority.' " *Christiansburg Garment Co. v. EEOC*, 434 U.S. 412, 418 (1978) (quoting *Newman v. Piggie Park Enters., Inc.*, 390 U.S. 400, 402 (1968)). *See also McKennon*, 513 U.S. at 358 ("[t]he private litigant who seeks redress for his or her injuries vindicates both the deterrence and compensation objectives of the ADEA").

V. Mandatory Arbitration Of Employment Discrimination Disputes "Privatizes" Enforcement Of The Federal Employment Discrimination Laws, Thus Undermining Public Enforcement Of The Laws

The imposition of mandatory arbitration agreements as a condition of employment substitutes a private dispute resolution system for the public justice system intended by Congress to govern the enforcement of the employment discrimination laws. The private arbitral system differs in critical ways from the public judicial forum and, when imposed as a condition of employment, it is structurally biased against applicants and employees.

A. Mandatory Arbitration Has Limitations That Are Inherent And Therefore Cannot Be Cured By The Improvement Of Arbitration Systems

That arbitration is substantially different from litigation in the judicial forum is precisely the reason for its use as a form of ADR. Even the fairest of arbitral mechanisms will differ strikingly from the judicial forum.

1. The Arbitral Process Is Private In Nature And Thus Allows For Little Public Accountability

The nature of the arbitral process allows — by design — for minimal, if any, public accountability of arbitrators or arbitral decision-making. Unlike her or his counterparts in the judiciary, the arbitrator answers only to the private parties to the dispute, and not to the public at large. As the Supreme Court has explained:

> A proper conception of the arbitrator's function is basic. He is not a public tribunal imposed upon the parties by superior authority which the parties are obliged to accept. He has no general charter to administer justice for a community which transcends the parties. He is rather part of a system of self-government created by and confined to the parties. . . .
>
> *United Steelworkers of Am. v. Warrior and Gulf Navigation Co.*, 363 U.S. 574, 581 (1960) (quoting from Shulman, *Reason, Contract, and Law in Labor Relations*, 68 Harv. L. Rev. 999, 1016 (1955)).

The public plays no role in an arbitrator's selection; s/he is hired by the private parties to a dispute. Similarly, the arbitrator's authority is defined and conferred, not by public law, but by private agreement.[11] While the courts are charged with giving force to the public values reflected in the antidiscrimination laws, the arbitrator proceeds from a far narrower perspective: resolution of the immediate dispute. As noted by one commentator, "[a]djudication is more likely to do justice than . . . arbitration . . . precisely because it vests the power of the state in officials who act as trustees for the public, who are highly visible, and who are committed to reason." Owen Fiss, *Out of Eden*, 94 Yale L.J. 1669, 1673 (1985).

Moreover, because decisions are private, there is little, if any, public accountability even for employers who have been determined to have violated the law. The lack of public disclosure not only weakens deterrence (*see* discussion *supra* at 8), but also prevents assessment of whether practices of individual employers or particular industries are in need of reform. "The disclosure through litigation of incidents or practices which violate national policies respecting nondiscrimination in the work force is itself important, for the occurrence of violations may disclose patterns of noncompliance resulting from a misappreciation of [Title VII's] operation or entrenched resistance to its commands, either of which can be of industry-wide significance." *McKennon*, 513 U.S. at 358-59.

2. Arbitration, By Its Nature, Does Not Allow For The Development Of The Law

Arbitral decisions may not be required to be written or reasoned, and are not made public without the consent of the parties. Judicial review of arbitral decisions is limited to the narrowest of grounds.[12] As a result, arbitration affords no opportunity to build a jurisprudence through precedent.[13] Moreover, there is virtually no opportunity for meaningful scrutiny of arbitral

[11] Article III of the Constitution provides federal judges with life tenure and salary protection to safeguard the independence of the judiciary. No such safeguards apply to the arbitrator. The importance of these safeguards was stressed in the debates on the 1972 amendments to Title VII. Senator Dominick, in offering an amendment giving the EEOC the right to file a civil action in lieu of cease-and-desist powers, explained that the purpose of the amendment was to "vest adjudicatory power where it belongs — in impartial judges shielded from political winds by life tenure." 1972 Leg. Hist. at 549. The amendment was later revised in minor respects and adopted by the Senate.

[12] Under the Federal Arbitration Act, arbitral awards may be vacated only for procedural impropriety such as corruption, fraud, or misconduct. 9 U.S.C. § 10. Judicially created standards of review allow an arbitral award to be vacated where it clearly violates a public policy that is explicit, well-defined, "dominant" and ascertainable from the law, *see United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 43 (1987), or where it is in "manifest disregard" of the law, *see Wilko v. Swan*, 346 U.S. 427, 436-37 (1953). The latter standard of review has been described by one commentator as "a virtually insurmountable" hurdle. *See* Bret F. Randall, *The History, Application, and Policy of the Judicially Created Standards of Review for Arbitration Awards*, 1992 BYU L. Rev. 759, 767. *But cf. Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1486-87 (1997) (in the context of mandatory employment arbitration of statutory disputes, the court interprets judicial review under the "manifest disregard" standard to be sufficiently broad to ensure that the law has been properly interpreted and applied).

[13] Congress has recognized the inappropriateness of ADR where "a definitive or authoritative resolution of the matter is required for precedential value, and such a proceeding is not likely to be accepted generally as an authoritative precedent," *see* Alternative Dispute Resolution Act, 5 U.S.C. § 572(b)(1) (providing for use of ADR by federal administrative agencies where the parties agree); or where "the case involves complex or novel legal issues," *see* Judicial Improvements and Access to Justice Act, 28 U.S.C. § 652(c)(2) (providing for court-annexed arbitration; § § 652(b)(1) and (2) also require the parties' consent to arbitrate constitutional or statutory civil rights claims). Similar findings were made by the U.S. Secretary of Labor's Task Force on Excellence in State and Local Government Through Labor-Management Cooperation ("Brock Commission"), which was charged with examining labor-management cooperation in state and local government. The Task Force's report, "Working Together for Public Service" (1996) ("Brock Report"), recommended "Quality Standards and Key Principles for Effective Alternative Dispute Resolution Systems for Rights Guaranteed by Public Law and for Other Workplace Disputes" which include that "ADR should normally not be used in

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decision-making. This leaves higher courts and Congress unable to act to correct errors in statutory interpretation. The risks for the vigorous enforcement of the civil rights laws are profound. *See* discussion *supra* at section IV. B.

3. Additional Aspects Of Arbitration Systems Limit Claimants' Rights In Important Respects

Arbitration systems, regardless of how fair they may be, limit the rights of injured individuals in other important ways. To begin with, the civil rights litigant often has available the choice to have her or his case heard by a jury of peers, while in the arbitral forum juries are, by definition, unavailable. Discovery is significantly limited compared with that available in court and permitted under the Federal Rules of Civil Procedure. In addition, arbitration systems are not suitable for resolving class or pattern or practice claims of discrimination. They may, in fact, protect systemic discriminators by forcing claims to be adjudicated one at a time, in isolation, without reference to a broader — and more accurate — view of an employer's conduct.

B. Mandatory Arbitration Systems Include Structural Biases Against Discrimination Plaintiffs

In addition to the substantial and inevitable differences between the arbitral and judicial forums that have already been discussed, when arbitration of employment disputes is imposed as a condition of employment, bias inheres against the employee.[14]

First, the employer accrues a valuable structural advantage because it is a "repeat player." The employer is a party to arbitration in all disputes with its employees. In contrast, the employee is a "one-shot player"; s/he is a party to arbitration only in her or his own dispute with the employer. As a result, the employee is generally less able to make an informed selection of arbitrators than the employer, who can better keep track of an arbitrator's record. In addition, results cannot but be influenced by the fact that the employer, and not the employee, is a potential source of future business for the arbitrator.[15] A recent study of nonunion employment law cases[16] found that the more frequent a user of arbitration an employer is, the better the employer fares in arbitration.[17]

In addition, unlike voluntary post-dispute arbitration — which must be fair enough to be attractive to the employee — the employer imposing mandatory arbitration is free to manipulate the arbitral mechanism to its benefit. The terms of the private agreement defining the arbitrator's authority and the arbitral process are characteristically set by the more powerful party, the very party that the public law seeks to regulate. We are aware of no examples of employees who insist on the mandatory arbitration of future statutory employment disputes as a condition of accepting a job offer — the very suggestion seems far-fetched. Rather, these agreements are imposed by employers because they believe them to be in their interest, and they are made possible by the employer's superior bargaining power. It is thus not surprising that many employer-mandated arbitration systems fall far short of basic concepts of fairness. Indeed, the Commission has challenged — by litigation, *amicus curiae* participation, or Commissioner charge — particular mandatory arbitration agreements that include provisions flagrantly eviscerating core rights and remedies that are available under the civil rights laws.[18]

The Commission's conclusions in this regard are consistent with those of other analyses of mandatory arbitration. The Commission on the Future of Worker-Management Relations (the "Dunlop Commission") was appointed by the Secretary of Labor and the Secretary of Commerce to, in part, address alternative means to resolve workplace disputes. In its Report and Recommendations (Dec. 1994) ("Dunlop Report"), the Dunlop Commission found that recent employer experimentation with arbitration has produced a range of programs that include "mechanisms that appear to be of dubious merit for enforcing the public values embedded in our laws." Dunlop Report at 27. In addition, a report by the U.S. General Accounting Office, surveying private employers' use of ADR mechanisms, found that existing employer arbitration systems vary greatly and that "most" do not conform to standards recommended by the Dunlop Commission to ensure fairness. *See* "Employment Discrimination: Most Private-Sector Employers Use Alternative Dispute Resolution" at 15, HEHS-95-150 (July 1995).

The Dunlop Commission strongly recommended that binding arbitration agreements not be enforceable as a condition of employment:

> The public rights embodied in state and federal employment law — such as freedom from discrimination in the workplace . . . — are an important part of the social and economic protections of the nation. Em-

cases that represent tests of significant legal principles or class action." Brock Report at 82.

[14] A survey of employment discrimination arbitration awards in the securities industry, which requires as a condition of employment that all brokers resolve employment disputes through arbitration, found that "employers stand a greater chance of success in arbitration than in court before a jury" and are subjected to "smaller" damage awards. *See* Stuart H. Bompey & Andrea H. Stempel, *Four Years Later: A Look at Compulsory Arbitration of Employment Discrimination Claims After Gilmer v. Interstate/Johnson Lane Corp.*, 21 Empl. Rel. L.J. 21, 43 (autumn 1995).

[15] *See, e.g.*, Julius G. Getman, *Labor Arbitration and Dispute Resolution*, 88 Yale L.J. 916, 936 (1979) ("an arbitrator could improve his chances of future selection by deciding favorably to institutional defendants: as a group, they are more likely to have knowledge about past decisions and more likely to be regularly involved in the selection process"); Reginald Alleyne, *Statutory Discrimination Claims: Rights 'Waived' and Lost in the Arbitration Forum*, 13 Hofstra Lab. L.J. 381, 428 (Spring 1996) ("statutory discrimination grievances relegated to . . . arbitration forums are virtually assured employer-favored outcomes," given "the manner of selecting, controlling, and compensating arbitrators, the privacy of the process and how it catalytically arouses an arbitrator's desire to be acceptable to one side").

[16] Arbitration of labor disputes pursuant to a collective bargaining agreement is less likely to favor the employer as a repeat-player because the union, as collective bargaining representative, is also a repeat-player.

[17] *See* Lisa Bingham, "Employment Arbitration: The effect of repeat-player status, employee category and gender on arbitration outcomes," (unpublished study on file with the author, an assistant professor at Indiana U. School of Public & Environmental Affairs).

[18] Challenged agreements have included provisions that: (1) impose filing deadlines far shorter than those provided by statute; (2) limit remedies to "out-of-pocket" damages; (3) deny any award of attorney's fees to the civil rights claimant, should s/he prevail; (4) wholly deny or limit punitive and liquidated damages; (5) limit back pay to a time period much shorter than that provided by statute; (6) wholly deny or limit front pay to a time period far shorter than that ordered by courts; (7) deny any and all discovery; and (8) allow for payment by each party of one-half of the costs of arbitration and, should the employer prevail, require the claimant, in the arbitrator's discretion, to pay the employer's share of arbitration costs as well.

Mr. COHEN. Thank you, sir. We will now have 5-minutes of questions. Same rules on the clock, and I will begin. Mr. Ware, you stated that you like to go to stores that have arbitration agreements. Do you read those arbitration agreements before you go into a store?

Mr. WARE. Well, when I receive a credit card or a cell phone contract, I often look to see the arbitration clause, and I am pleased to see when there is one in there.

Mr. COHEN. That is kind of like the "Good Housekeeping Seal of Approval" to you?

Mr. WARE. Well, no, it is a plus for the reason I gave earlier. I——

Mr. COHEN. And the reason was because they will save money, and they pass the savings on to you?

Mr. WARE. Yes, it is the more efficient way of resolving disputes, and I am confident that over time anything that saves businesses money will be helpful to consumers.

Mr. COHEN. So do you also suggest consumers, and you should go to stores that maybe don't recycle because they save money, and they can pass the savings on to you or maybe employ people at very low wages or get their products from Asia where they have children and women working in sweatshops?

Mr. WARE. Well, obviously, Chairman Cohen, we all want retailers and other businesses to follow all the laws you referred to there and those laws should be enforced. If the conduct——

Mr. COHEN. But you don't—no. You don't have to recycle, and you can buy goods from Asia where they pay people $1 an hour, and they don't have kind of rights, but you would get a cheaper product.

Mr. WARE. And each individual consumer ought to be able to decide if he or she doesn't want to support a business that engages in those sorts of activities, and I think arbitration is importantly distinct from those examples in that arbitration has not shown to be harmful to consumers and employees.

Mr. Palefsky says don't look at statistics. Don't worry about statistics because when you move past anecdotes and get to statistics, arbitration looks pretty darn good for consumers and employees.

Mr. COHEN. Well, if you like it, which obviously you do and you like that, you could always do it voluntarily. Why should it be compulsory?

Mr. WARE. Oh, well, that is a hugely important point, Chairman Cohen, the distinction between pre-dispute arbitration agreements and post-dispute arbitration agreements.

And the fact of the matter is after a dispute arises the business can consult its lawyer and ask itself which forum would be more favorable to it for that particular dispute, arbitration and litigation, and the business can't be expected to act against its self-interest at that point and agree post-dispute to arbitration, when that would be the more favorable process for the consumer. Similarly a consumer can consult a lawyer and will choose the process that is more favorable to it post-dispute.

So we don't see many post-dispute arbitration agreements. It is very rare. And this is through no fault of arbitration, but just the fact that litigation is the default. That is what happens when the parties don't both agree to arbitrate, and it is very rare that they are going to both see arbitration after the fact as more favorable to them.

Whichever party sees advantages to litigation, whether it be a jury or greater discovery, the more expensive motion practice, et cetera, that party can be expected to choose litigation.

Mr. COHEN. Thank you, sir. Mr. Rossman and Palefsky seemed equally passionate, and I will recognize Mr. Palefsky first, since

your name was mentioned. Do you have any thoughts on that testimony?

Mr. PALEFSKY. Well, absolutely. First of all, I did not mean to suggest that statistics don't bear us out. Statistics do bear us out. In California, we were able to pass a statute that required arbitration providers to post the results of consumer employment arbitration, and those results were profound.

Employees win a fraction of the time compared to what they win in court. The mean damage award of all cases is only 9 or 10 percent. The statistics actually support dramatically what we have been saying, that the laws that you have passed are being undermined, and that arbitration is not an equal forum.

The statistic that you must focus on is the huge cost of arbitration. It can cost $40,000, $50,000, $80,000 to bring a sex harassment case to arbitration. Really, this is a form of double taxation. Americans are already paying for a public justice system. There is no precedent in American jurisprudence to force someone to pay a judge to have a law enforced.

So the notion that arbitration is cheaper for most plaintiffs is simply not true. The filing fees alone at the American Arbitration Association can be $13,000, just to file before the arbitrators start charging $400 or $500 per hour.

Mr. COHEN. Let me ask you this, sir, you and if Ms.—if anybody else wants to jump in, you are allowed to, the class actions are prohibited. What kind of an injustice happens when people can't bring class actions for small claims?

Mr. PALEFSKY. If people can't bring class actions for small claims you are basically allowing people to cheat, to steal people's rights and steal people's money, if there is no way to vindicate the smaller claims.

It simply is not economical to bring a claim for $100 either in arbitration or in court, so the only way your consumer protection laws and the only way justice will ever be reached in certain small claims is through the class action procedure. That is why Federal law has specifically designated class action procedures in various consumer statutes.

And in the wage and hour context, in the Fair Labor Standards Act, you specifically created a collective action process recognizing that individual workers can't afford to bring claims for their small wages that are owed for their overtime; that they fear retaliation.

So without the ability to bring class actions for smaller claims you are basically giving a "Get Out of Jail Free Card," and it is an invitation to cheat and to steal.

Mr. COHEN. Mr. Ware, is there a way to take your love for arbitration cases but also have group love and have class actions?

Mr. WARE. Yes, Mr. Chairman, absolutely. You can have class actions in arbitration. And so the question of whether consumers should be allowed to sign away their right to class action is really a separate question from whether that class action is going to proceed in litigation or arbitration.

And it is important, it seems to me, to recognize that from the consumers' standpoint class actions are something of a mixed bag. In other words, if I win a class action, what do I win, maybe a $5

coupon to buy more services from a company that I am already having a dispute with and don't want to deal with them anymore.

Whereas, if I give up that right to class action in favor of arbitration, then when I have a real dispute, a dispute I care about as opposed to one a plaintiff's lawyer brought on my behalf, I may have the better access to justice in the quicker, cheaper process.

So to me it is a very mixed question whether consumers should want to give up that right to class action. If, however, you conclude that they should not be able to, then you have got a separate issue from arbitration as a whole. Arbitration Fairness Act reaches far more broadly than class action.

Mr. COHEN. But don't you think there are times when the class action tends to change the policies and the practices of the merchant and that is a benefit to everybody, even in you just got the $5 coupon you don't want to use, that they don't continue to use those same unscrupulous practices that got them a judgment rendered against them?

Mr. WARE. Yes, Mr. Cohen, I agree with you that that would go into the cost benefit analysis of whether it is a worthwhile right. And again, if you disagree with my assessment of those pros and cons, you can tackle class action separately in a much more narrow bill than the ones that have been considered in Congress.

Mr. ROSSMAN. I just—if you don't mind Mr. Chairman——

Mr. COHEN. Sure, Mr. Rossman.

Mr. ROSSMAN. Listening to the concerns, particularly the fact is that Congress has already taken care of the issue of $5 coupons and the Class Action Fairness Act was passed 4 years ago and that class actions are, in fact, the sole way that many consumer laws can be enforced.

In the Equal Credit Opportunity Act cases that I was just mentioning to you, the remedy that we sought was to get systemic change in the way that automobile loans were being handled across the country, which were leading to discrimination against African Americans and Hispanics.

We were seeking future injunctive relief to change those policies. You cannot get that relief in arbitration. It was only by being able to try cases, in Tennessee as a matter of fact, that we were able to get those changes made across the industry. That authority was required from the United States Federal District Court judge.

I am also somewhat confused by the professor talking about making informed judgments. It would seem to me being able to make a choice, whether you are the merchant or the consumer, after dispute arises, and you can make the cost benefit analysis knowing what is at stake, certainly makes more sense than making that cost benefit analysis in a vacuum where you don't even know what the dispute is. You can't even conceive of it.

As I said to you beforehand, I doubt very much that Mrs. Cason, when she went in to buy her Nissan car was thinking about preserving her civil rights, preventing discrimination at that point in time and how she was going to be enforcing it 5 years down the road.

I think that it proves the case. You should have the opportunity to consult with counsel, knowing what your full rights are and

knowing what the dispute is when you make that decision, not buying a pig in poke.

Mr. COHEN. Thank you. And Ms. Hirschel, you gave the example of the nursing home situation. My father had to go into a nursing home, and it was a very difficult time. He had Alzheimer's, and we were lucky to get a nursing home to take him, and most people are fortunate. Sixty percent of admits come from hospitals, and that is kind of the rules. It is tough.

Is there a way to have a process whereby the people have a little bit more opportunity, you know, to render independent judgment rather than, you know, "Oh, my God, my loved one needs this care, I am lucky to have a bed, and let us move on?"

Ms. HIRSCHEL. If you are asking if there is some sort of compromise that is available, my answer to that would unfortunately be no, because the longer a resident is in a nursing home the more vulnerable those people feel. The more they understand that every aspect of their life, from the meals that they need to going to the bathroom, is dependent on the staff in that facility.

So if you say, well, after 30 days they should be more comfortable, at that point we can talk about arbitration. It is still a situation in which the person is very vulnerable and unwilling to create a problem by resisting an arbitration agreement.

In addition, you know many nursing home residents don't even now have access to a telephone. Many nursing homes don't have any involved family. Nursing home residents don't have any involved family. They are hardly in a position to consult a lawyer 30 days or 60 days after they enter a nursing home for advice about what the implications of the arbitration agreement with a mandatory arbitration would be.

And they are simply not in a position—the majority of nursing home residents have some form of cognitive impairment. They are simply not in a position to understand what the implications of that clause would be.

Mr. COHEN. Thank you.

And with that I recognize the Ranking Member, Mr. Franks, for questioning.

Mr. FRANKS. Thank you Mr. Chairman. Mr. Ware, I guess sometimes it is good to restate the obvious, and that is binding arbitration in the context that we have discussed is something that people sign up for ahead of time.

This is not something that is imposed upon them later and sometimes, you know, it occurs to me it gives them at least an initial option to say whether I would rather subject myself to binding arbitration or a court system that I may have some of the same questions as to the ultimate justice that may come out of that.

And you have made some, I think, very compelling statements related to the similar outcome, but I was struck by Mr. Palefsky's comments that seem to diverge significantly from yours. I thought the one about the terrorist was kind of interesting.

I am not sure we could get terrorists to sign a binding arbitration agreement. It might go against some of their own philosophical persuasions, and I am not sure if they did that they would hold themselves accountable to it in the long run.

But can you give me some idea as to why it seems that Mr. Palefsky's remarks are so divergent from your own?

Mr. WARE. Thank you, Mr. Franks. Mr. Palefsky, when he backed away from his statement about "don't worry about statistics," he then picked the one empirical study that supports his side of the case in contrast to several that cut the other way.

The one empirical study he is referring to was the Colvin article he attached to his testimony, and the Colvin article even cites all the other studies and says, oh, these are surprising results and they contradict what we have seen in the other studies.

More importantly, the Colvin study, at least what Palefsky attached to his testimony is a—it is not even a published article, and the way of course scholarship works, empirical studies are published, and then other scholars have a chance to look at them and critique them and debate develops. So it is clearly a reach by Mr. Palefsky to pull the one study that contradicts the norm and then act as if it is the only study.

Mr. FRANKS. The one area I found myself somewhat fascinated was that sometimes I am afraid in the last couple of years this Committee has in some cases granted more constitutional and legal deference to terrorists than they have American citizens, but that is another subject entirely.

What conclusion do you draw from the recent legal action against the National Arbitration Forum for its debt collection processes and practices?

Mr. WARE. Well, as the Minnesota attorney general's investigation revealed, which scholars in the field had known already, is that debt collection, whether it be through arbitration or litigation, debt collection raises a set of issues unique to debt collection.

It has a lot to do with the defendant, the debtor being hard to serve with process and to give notice of the dispute, and then a lot of debtors in that situation don't show up to court and for arbitration to defend the case so a default judgment arises.

Those issues peculiar to debt collection, in fact, have caused the FTC to have a series of events around the country studying both arbitration and litigation of debt collection issues because they recognize how unique those issues are.

And in the arbitration context, obviously the recent developments with the National Arbitration Forum and the American Arbitration Association have largely put those issues aside so that that has been taken care of, the concerns about that have been taken care of and those issues are simply inapplicable when we are talking about other consumer and employment arbitration.

Mr. FRANKS. On one of the written statements that you have, this is pointed out here, in your statement you make the argument that "contractually agreed to mandatory binding arbitration is actually more voluntary than litigation." Could you explain that detail? Do you think that, as you have said, that arbitration remains generally as fair as litigation?

Mr. WARE. Well that is just a simple point that arbitration doesn't happen unless there is a contract theme that is going to happen, and sometimes the contract—even pre-dispute consumer, even the sort of things that would be covered by the Arbitration Fairness Act—everyone would agree is voluntary.

For example, I have formed a contract with a home builder where the home builder, the builder and I, both agree to put an arbitration clause in the contract. I don't think anybody would dispute the voluntariness of that pre-dispute consumer transaction, yet the AFA made that unenforceable.

So those aren't the kind of transactions I think Members are concerned about. I think the form contract, which is often not read or understood by consumers, and those problems are problems or issues that go far beyond arbitration.

Lots of form contracts have lots of clauses that courts sometimes find unconscionable. So my point, again, is let us handle this as we do now on a case-by-case basis in the courts, where courts are sensitive to the particular clauses and the particular facts of the case.

Mr. FRANKS. Mr. Chairman, I have one more question, but I am out of time, so I yield back.

Mr. COHEN. If you would like to take it, I will go ahead and yield to you.

Mr. FRANKS. Okay, thank you. Just briefly, opponents of arbitration claim that if we eliminate pre-dispute arbitration agreements consumers will still be able to agree to arbitrate their disputes after the disputes arise. Now, I understand you have already addressed that to a degree, but help—just restate it in a way that the Committee can understand as to why that is fairly unlikely?

Mr. WARE. It is highly unlikely. It doesn't happen now and there is no reason why it is going to happen a lot in the future, simply because at that point, once there is a dispute both sides can look at the dispute and say what is in my self-interest for this dispute?

So even if arbitration has lower process costs, it is quicker and cheaper than litigation, there will often be usually one party who says I don't want those quicker and cheaper lower process costs. I would rather have the forum that is better for me for whatever tactical reasons in that case, and you can't expect lawyers and their clients to think any other way. We have an adversary system where each side is supposed to look after their own interests.

Mr. FRANKS. Thank you.

And thank you, Mr. Chairman.

Mr. COHEN. You are welcome.

Mr. Johnson, do you seek recognition?

Mr. JOHNSON. Yes, I do, Mr. Chairman. Thank you very much. Is it—well, you have been studying the arbitration process for 14 years you said?

Mr. WARE. Sixteen now, Mr. Johnson.

Mr. JOHNSON. Sixteen, and have you gotten some idea out of that study as to the success rate for the merchants or the commercial interest that has the consumer locked into it? Do you know what the rates are in terms of how many times the consumers win and how many times they lose, the percentage?

Mr. WARE. Yes, Mr. Johnson. Those are the empirical studies we were discussing earlier, and Mr. Palefsky and I were referring to the employment arbitration studies. In the consumer arbitration side there has been a little less study but——

Mr. JOHNSON. And that is what I want to know is of the small amount of study that has been done are you aware of the results of those studies?

Mr. WARE. Yes sir, I think the most reliable one is the recent study by my faculty colleague at the University of Kansas, Chris Drahozal. His study which he testified about here recently, shows very comparable results in consumer actions in arbitration and litigation, again, supporting the general conclusion that arbitration and litigation do about as well for consumers in terms of outcomes as each other.

Mr. JOHNSON. All right. Thank you.

And Mr. Palefsky, do you have any response to the kind professor from Kansas?

Mr. PALEFSKY. I think that he is wrong. I know that many studies in the past try to find out how can you find out what happened in arbitration because no one was making those results available. They were secret, but now that we have the California statistics—once those statistics were posted online by the providers, that is where we learned that the National Arbitration Forum credit card cases were going 99 percent where the banks win.

That is where we learned that employees were winning between 12 and 20 percent. So I think that some of the older studies didn't have the kind of accurate information and out of fairness to Professor Colvin, he did publish a paper.

It is cited in his paper—what we have attached here is an updated version, and Mr. Colvin, Professor Colvin's statistics are directly from the providers. So we know that the system is not working. And if it was in fact a better system for consumers you know the companies would not be tripping over themselves to force it on them.

Mr. JOHNSON. All right. Thank you sir.

And Mr. Ware, is it true that you don't have to take an oath of office, excuse me, an oath before testifying, an oath to testify truthfully in an arbitration proceeding?

Mr. WARE. Well, different arbitration——

Mr. JOHNSON. Yes or no, if I could, because I am going to run out of time shortly. Is that true or is that false?

Mr. WARE. It varies.

Mr. JOHNSON. I mean well, what public officer with the authority to administer an oath on behalf of the government would be available for an arbitration proceeding?

Mr. WARE. None, but perjury is a ground for courts vacating an arbitration award.

Mr. JOHNSON. Well, but perjury does require an oath that you take to tell the truth, the whole truth and nothing but the truth, under penalty of perjury, and that is the legal route to address issues of lying.

Mr. WARE. Yes, Mr. Johnson, but Federal Arbitration Act Section 10 allows courts to vacate arbitration awards when there is corruption in the arbitration process such as someone lying.

Mr. JOHNSON. And then, you know, is it true the arbitration costs are almost unbearable for the consumer?

Mr. WARE. No. In the vast majority of cases the arbitration costs are very low. The fees to file a claim in arbitration, for example the AAA Consumer Due Process Protocol, very low fees comparable to the fees paid in court.

Mr. JOHNSON. But oftentimes the proceeding is held in a city different from the one that the consumer lives in and where the dispute arose. Is that correct?

Mr. WARE. No, I think that is quite rare that an arbitration clause requires the consumer to travel far.

Mr. JOHNSON. Well, that was carefully worded now. I mean it really puts—average arbitration clause doesn't put any restrictions on where the arbitration proceeding would take place. It is so broad that it leaves that up to the commercial interest to decide what is in their best interest.

But oftentimes I understand that, you know, these arbitration proceedings actually take place—like if I live in Atlanta, and I signed up for a cell phone agreement in Atlanta, and something happened in where—and if you are like my momma you don't like anybody taking a nickel or a penny away from you, and they don't deserve it.

She will pursue matters like that to the end of the earth, but you would have to sometimes go to the end of the earth to deal with the location of the arbitration hearing.

Mr. WARE. And courts have held unconscionable the few arbitration clauses that have required the consumer to travel a long way, while now many consumer arbitration agreements are written to say that the arbitration will be in the county or judicial district where the consumer resides.

Mr. JOHNSON. Thank you. I will yield back.

Mr. COHEN. Thank you.

And now I recognize the gentleman in his Carolina blue, Mr. Coble.

Mr. COBLE. Thank you sir. Professor Ware, the Chairman and Mr. Franks and Mr. Johnson commenced their examination with you. I don't want you to feel slighted so I will make you my leadoff hitter as well.

I was going to ask about the Minnesota case, but I think you pretty well addressed that. Let me ask you this, Professor, to your knowledge, has the American Arbitration Association ever stated that pre-dispute contractual agreements to arbitrate are generally unfair to consumers?

Mr. WARE. No, definitely not. That is an important distinction that the AAA has only, and maybe even temporarily, refrained from taking new debt collection arbitration cases. But they have not said that the problems that the concerns about debt collection reached beyond that to other consumer and employment arbitration.

Mr. COBLE. Thank you, sir.

Mr. Palefsky, are there any aspects of binding arbitration that you feel are effective and should be permitted or retained?

Mr. PALEFSKY. Oh, I think binding arbitration can be a great way to resolve many disputes, sir. Contract disputes between parties of equal bargaining power. In my practice, executives fighting over severance, I think voluntary arbitration can be a very effective method.

I do believe that mediation is a much better way. And if I might correct Mr. Ware, the American Arbitration Association refuses to accept pre-dispute clauses in the health care field and the Amer-

ican Arbitration Association issued a press release in 1997 saying that employment arbitration should be voluntary.

Mr. COBLE. Well, let me—I am on a race with a red light so let me interrupt you. Let me put another question to you, Mr. Palefsky. Do you believe, Mr. Palefsky, there are instances—or, strike that. Are there any instances where consumers can voluntarily consent to binding arbitration?

Mr. PALEFSKY. Of course. I think knowing and voluntary consent is all that is required to make it a valid arbitration agreement. I don't have any problem with the current—all right, here is the problem. The only check and balance that was ever contemplated to keep arbitration fair was voluntariness, that the parties themselves ensured fairness.

This notion that a consumer has to run to court and litigate unconscionability, which would cost you $20,000, and if you win, it goes on appeal for 2 years, it is going to cost a consumer $50,000 in 2 years to challenge an unfair arbitration clause in court.

Mr. COBLE. Well——

Mr. PALEFSKY. That serves nobody's interest. Make it voluntary, and the marketplace will ensure fairness.

Mr. COBLE. Ms. Hirschel, if nursing homes cannot utilize binding arbitration, how would this affect that industry?

Ms. HIRSCHEL. Well, I know that there is often an expressed concern about the cost that nursing homes would suffer, but there are two things that I would like to say about that. One is that if you are looking at liability insurance premiums, the Center on Medicare Advocacy did a study in 2003 that showed that liability insurance premiums were not tied to insurance pay-out.

The second thing is if you are looking at litigation costs, there was a study in Florida that showed that only a very small number of nursing homes were repeatedly sued, and that those were the facilities that were entirely predictable because they were the facilities that were cited over and over for egregious violations.

So I think that both the liability insurance costs and the litigation costs are costs that are not necessarily going to go up or are clearly tied to ending mandatory pre-dispute binding arbitration.

Mr. COBLE. Mr. Rossman, I don't want you to feel——

Mr. ROSSMAN. Thank you.

Mr. COBLE [continuing]. Ignored. Is it your view that binding arbitration is an ineffective venue for consumers?

Mr. ROSSMAN. Well, once again, that is a sweeping response. I think that pre-dispute is ineffective because there is no way that a consumer can make a considered and informed judgment when they are just entering into a transaction as to any conceivable dispute that would arise under that contract.

If after they have entered into the contract a dispute arises and they are given an opportunity to choose between going through arbitration or through litigation, I think that it is a perfectly acceptable choice at that point in time, but at that point they know what they are buying.

Mr. COBLE. Let me go to my lead-off man and let him sum up.

Mr. WARE. Well, my response to that last point is again, when I and my home builder put an arbitration clause in our contract pre-dispute, we were making a deal that we both thought was

going to save us money, and this bill we are discussing would take money out of our pockets and put it in the hands of trial lawyers.

Mr. ROSSMAN. Congressman, if I could just a second, you are using the home builder there. Are there other home builders you could conceivably go to? What do you do when all but one mobile telephone company in the United States requires mandatory pre-dispute arbitration? What do you do if now eight out of ten credit card companies require that you have mandatory pre-dispute arbitration clause and prior to August it was 10 out of 10.

Mr. WARE. If the consumer really prioritizes avoiding arbitration, the consumer can pick the cell phone or credit card company that doesn't require it, and for the bulk of the consumers who don't pay attention to that and get an arbitration clause, they are getting what courts are saying in a case-by-case basis is a fair process, or if it is not fair, a court will hold it unconscionable in that case.

Mr. COBLE. Mr. Rossman, I was going to brag to my Chairman from Tennessee at beating the red light, but you cost me that favor, so I yield back.

Mr. ROSSMAN. I apologize, and I beg your forgiveness.

Mr. COHEN. Thank you, Mr. Coble.

Mr. Scott from Virginia is recognized.

Mr. SCOTT. Thank you. Mr. Rossman, could you explain the legal concept of adhesion contracts and explain why all of these just aren't thrown out based on that legal principle?

Mr. ROSSMAN. Well, the adhesion contract is a contract where there is a clause that is a mandatory or a required portion and it is a "take it or leave it." Either you take the contract with the arbitration clause or you don't take the contract.

If in fact we are dealing in a marketplace where the alternative is really not between taking the contract with the arbitration clause or not taking the contract, but rather the situation of having access to the service or not having access to the service, that is no choice at all.

The reality of it is that, you know, until recently, unless you were a member of the AFL-CIO or a member of AARP, you could not get a credit card in the United States without a mandatory arbitration clause.

If you want to get a cell phone right now in the United States, you have to accept it with a mandatory arbitration clause, unless you are with the one carrier with limited coverage in the United States that doesn't require it.

I would argue that in our modern society that access to credit cards, access to mobile phones, have become virtual necessities, and that it is no choice whatsoever. It is a "take it or leave it" under those circumstances.

And although there are, in fact, laws that find that clauses can be unconscionable, the reality is that there are different levels of unconscionability depending on what state you are in. If you are in California or in Massachusetts, you may find that there is a much higher level of unconscionability or less of a tolerance for unconscionability.

But it is not the same across the United States, and there are many places where that will, in fact, be allowed, and, in fact, there have been cases that have allowed it throughout the United States.

That kind of checkered enforcement is inexcusable. Where I live shouldn't determine whether or not I have a choice between credit cards or phone service.

Mr. SCOTT. Are there other anti-trust implications, Mr. Rossman?

Mr. PALEFSKY. Absolutely. Pre-dispute clauses that designate a single provider are, in every definition, contracts in restraint of trade. They eliminate competition in the providing of ADR services. They lock you into perhaps the most expensive—I can get an arbitrator to arbitrate without any filing fee at all. Or I can go the American Arbitration Association and pay a $13,000 filing fee and arbitrators who charge $500 an hour.

It is absolutely inappropriate to allow one party to contract in advance, not only with the consumer to mandate the use of a single provider, but they work out deals with the providers themselves to get special arrangements in the administration of their case loads.

It is not uncommon for these major arbitration providers to have case managers assigned to a particular company no matter where the arbitration arises. One person in that organization is charged with keeping the customer satisfied.

It is an invitation to abuse. And if consumers had the ability to choose the arbitration provider, it would do wonders to improving the fairness of the system and reducing the cost. There is no reason in the world—ADR used to be a noble endeavor undertaken by people who really were concerned with solving problems.

In the labor arbitration field, they would charge $100 an hour to resolve a dispute. Those very same arbitrators, when they are doing my sex harassment cases, are charging $500 an hour because they can. And that is exactly the result of these pre-dispute restraints of trade.

Mr. SCOTT. Could you explain what the EEOC thinks of mandatory arbitration?

Mr. PALEFSKY. The EEOC unanimously, the Republican and Democrat commissioners, passed a policy statement which is probably the best thing ever written on mandatory arbitration. They say that it has structural biases against the claimants.

They say it interferes with their ability to enforce the law, to do the job that you have asked them to do. They point to the high costs. They point to the limited discovery. They point to the private hearings, and the EEOC has stated unequivocally—again, it is a shame that this has turned into a partisan issue.

Justice need not be a Democrat or Republican issue. The EEOC unanimously has a policy statement which is attached to my testimony which I urge you all to read because you cannot say you support civil rights and support mandatory arbitration of civil rights claims.

The reason we passed the civil rights laws was to provide access to a Federal court and a judge who was obligated to apply the law. Arbitrators do not need to know or follow the law. That is not acceptable for laws of Congress. That is not acceptable for civil rights laws.

We are talking about the Lilly Ledbetter Fair Pay Act where we had to fix Supreme Court decisions. We can't enforce that. Arbitrators don't need to know the law or enforce it or respect the acts of

Congress. That is not acceptable. We cannot be a Nation of laws if there is no place to go to enforce the laws.

What does it mean to live in a constitutional democracy if Congress can pass a law and the people you are trying to protect don't have the right to have the law enforced? The Supreme Court has built a fiction that arbitration is just another forum with no impact on substantive rights. That is simply false as a matter of fact, because you lose the right to have the law enforced.

Here is the law, on appeal, that "an arbitration award has to be confirmed even if there are errors of law or fact on the face of the award that result in a substantial injustice." Think about that for a second, that our courts are obligated to put their imprimatur on a judgment that is false on its face in the enforcement of this Nation's civil rights laws. Is that what you had in mind?

Mr. SCOTT. Thank you.

Mr. COHEN. Thank you, Mr. Scott. Would you like to go on any further?

Mr. SCOTT. Well, yes, can you say a word about the structural biases in the arbitration that the EEOC pointed out?

Mr. PALEFSKY. Right. The structural biases deal with one, the privacy makes it difficult for witnesses to gather access of similar treatment, pattern and practice. Who else was discriminated against? Who else was harassed?

The cost: most people can't afford their day-to-day life. You can't afford $20,000 or $30,000 to bring the case. You cannot—discrimination cases are different than a lot of other cases. There are a lot of small consumer cases where you don't need a lot of discovery, but in discrimination cases, I am trying to prove someone's state of mind. I cannot do that without depositions.

In the employment case, all of the witnesses, all of the documents are under the control of the employer. Ethical rules preclude me from getting that information informally. I simply cannot sustain my burden of proof without adequate discovery.

In many arbitration forums, they don't even permit depositions. In the securities industry, in FINRA arbitrations, I represent whistleblowers, and I am not allowed to take a single deposition.

That is like saying, tie your hands behind your back and come out fighting and argue your case to arbitrators selected by the securities industry who know that if they find against this firm, they will never sit again.

There is a reason that we appoint judges for life. There is a reason that we have financial disclosures for our judges. You cannot design a system where the decision maker has a financial interest in pleasing the repeat user. As a concept it does not work and it cannot work.

And it is incredible that anyone in this room on this Committee would suggest that for-profit justice where the decision maker has an economic interest in the outcome of the case is equivalent to our constitutional system of justice.

I wanted to point out to you that in the Declaration of Independence, Thomas Jefferson listed the grievances against the king that justified this revolution, and we know that he said "for depriving us of the benefit of trial by jury." But he was also concerned about the repeat user.

In the Declaration of Independence he said, "He has made judges dependent on his will alone for the tenure of their offices and the amount in payment of their salaries." Those words are truer today. At the turn of the last century, arbitration was so disfavored because of the very abuses that we see occurring today, that courts were not even permitted to enforce pre-dispute clauses.

Everything that we are seeing happening today happened 100 years ago. The FAA was passed in 1925 to permit Federal courts to once again be able to enforce arbitration clauses between merchants. It was never intended to apply in the adhesion context. It was specifically never intended to apply to employment claims.

And that is how it was interpreted in the courts for 70 years, and it was certainly never intended to apply to statutory claims for the laws that you pass to encourage people to blow the whistle. If you don't want people to blow the whistle, take the laws off the books.

If you don't like the civil rights laws, take them off the books. But do not pretend you want to enforce those laws and say that we can't bring those to a free court to a judge who is obligated to follow the law.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. COHEN. Thank you, I appreciate it. We have finished our first round. We are not going to have a second round. I think we have a pretty good idea about where Mr. Ware and Mr. Palefsky stand. I am going just allow the other two witnesses to have, like, 2 minutes if you would like to have anything further to say.

Ms. Hirschel?

Ms. HIRSCHEL. Thank you very much. All I want to say is that this really is a gross injustice, especially in the nursing home context, and it is an injustice that only Congress can solve, and I ask you to do that. Thank you.

Mr. COHEN. Thank you.

And Mr. Rossman?

Mr. ROSSMAN. Just once again, thanking the Committee for allowing us to testify today. The issue here is whether or not consumers are going to be able to enforce the rights that this Congress has given each and every one of them, to allow them a right to seek a full and fair hearing where they have the right to be able to have an impartial arbitrator determine their claims is one that I think that is one that is both constitutional as well as a hallmark of our system of justice.

By going forward and having a system, as Mr. Palefsky says, where one party is literally paying for the cost of the arbitrator, One thing I do want to clarify, and I will end on this note, I think it has been passed around what the cost of arbitration is, and I think somewhere in the testimony I saw someone said that the filing fee was $125. I believe—Professor, you may correct me on that—I believe that is for a documents-only filing.

And the reality of it is that, whether it be a labor case or a consumer case, you are not going to be able to file these on the papers. We have to do discovery and we have to go through hearings on this and when the arbitrator has to decide a case is being paid by the hour, I suspect that he has very, or she, has very little incentive for doing it as expeditiously as would be the case with a Fed-

eral district court judge who is on the mandate from the chief judge of the district to clear the docket as quickly as possible.

So you have a system that is inherently not only more expensive when you actually assert your rights, but it is in the interest of the arbitrators to drag it out and move it along as much as possible to get as much fees as they possibly can under the circumstances.

Mr. COHEN. Thank you, sir.

And Mr. Palefsky, I want to ask one last question. You distinguish employment law and statutory violations as areas where you don't think the laws of arbitration should apply in a unique way. Any there any other type of cases that would fit into the category that you think should be maybe carved out?

Mr. PALEFSKY. I think that every American citizen has the constitutional right to access to the right of petition, to the right of due process and to the right to trial by jury, and that right should not be waived unless it is waived knowingly and voluntarily.

The answer to your question is yes. I don't think adhesion contracts are an appropriate way to waive constitutional rights. I think an adhesion contract is a privilege that we extend to business to allow them to conduct routine commercial transactions where the rights that are being exchanged come from the parties.

It is not an appropriate way to waive constitutional rights, and it is certainly not an appropriate way to waive the protections of statutes that Congress passes after the free market has failed to protect those consumers, nursing home victims, workers, investors on Wall Street.

Mr. FRANKS. Mr. Chairman, could we ask Mr. Ware—the other three got final thoughts. Would you be willing to let him have a final thought?

Mr. COHEN. Sure.

Mr. WARE. Just——

Mr. COHEN. Gentlemen, you are not in Kansas anymore.

Mr. WARE. Thank you, Mr. Chairman, just to say very quickly that we should not be comparing arbitration to this mythical vision of litigation where everything is wonderful. We need to compare it to the reality of litigation and the practical effect on consumers and employees's access to justice.

Mr. COHEN. Thank you, Mr. Ware.

I thank all the witnesses for their testimony today and the Members who attended. Without objection, Members will have 5 legislative days to submit any additional written questions which are forwarded to the witnesses. I ask you to respond, unlike certain people that have come to us from the state of New Jersey, in a timely manner, they will be made part of the record.

Without objection, the record will remain open for 5 legislative days from the submission of any other additional material. Again, I thank everyone for their time and patience. The hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 2:53 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

RESPONSE TO POST-HEARING QUESTIONS FROM ALISON E. HIRSCHEL, NATIONAL CONSUMER VOICE FOR QUALITY LONG-TERM CARE, WASHINGTON, DC

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on Mandatory Binding Arbitration: Is it Fair and Voluntary?
September 15, 2009

Alison Hirschel, Esq., Michigan Poverty Law Program

Questions from the Honorable Steve Cohen, Chairman

1. **In your written testimony you indicate that residents and families often sign admission agreements to nursing homes at times of enormous stress in their lives, when they might not be prepared to sort through voluminous admissions packages and assess the complex legal implications of various provisions (including arbitration clauses). What do you think would help remedy the problem and better protect consumers in such situations from siguing contract provisions they may not fully comprehend?**

   Unfortunately, I do not think there are any measures that would adequately protect consumers from feeling compelled to sign contract provisions they do not fully understand or to which they are reluctant to agree. As I noted in my testimony, residents often do not have access to a telephone, may not have any involved family, and may not be able to leave the facility. An estimated two-thirds of residents have some cognitive impairment as well as physical frailties. As a result of these circumstances, it is unlikely that residents would be able to consult a lawyer after admission. Moreover, the vast majority of residents will not understand the implications of the contract provisions even if they are given a period of time after admission to consider the documents and even if the documents use large print or relatively simple language.

   The residents' families – when they are involved -- are also unlikely to be able to sift through the documents and make a careful and well-reasoned decision. Many family members remain very stressed after the resident is admitted because they must visit and follow up on care for their loved one, tie up myriad financial and personal affairs for the resident, and juggle their usual work and family obligations. They will have little time or inclination to pour through dozens of pages of documents in the period after the initial admission. Moreover, even if they read and understand the documents and are disinclined to sign a mandatory arbitration agreement, they will often be too intimidated to refuse. Because they understand that their vulnerable loved one's entire life is in the hands of the facility staff, they will be reluctant to risk being considered a troublemaker or someone who is already contemplating litigation. Instead, they will likely sign the documents and hope that litigation is never required.

2. **You noted in your written testimony that sixty percent of nursing home admissious come directly from a hospital. Do you have any information you can share about these admissions, and the extent to which individuals in this sixty percent category face conditions that might preclude them from appreciating the details of an arbitration clause?**

While I do not have data specifically on the sixty percent who are admitted from the hospital, I can provide information about the extremely vulnerable condition of nursing home residents in general at the time of admission. According to the most recent National Nursing Home Survey which was completed by the National Center for Health Statistics in 2004, almost 85 percent of newly admitted residents are 75 or older and 41 percent mmwere 85 or older. Moreover, the population of newly admitted residents tend to be sicker than their counterparts just a few years ago. A report by the Kaiser Commission on Medicaid and the Uninsured entitled, "Changes in Characteristics, Needs, and Payment for Care of Elderly Nursing Home Residents: 1999-2004" noted that health quality indicators have declined considerably for new nursing home residents since 1999. In 2004, 69 percent of newly admitted residents had one or more of five serious physical impairments, including strokes, heart disease, and hip fractures, and 34 percent of those admitted were diagnosed with one or more mental or cognitive conditions, including dementia and schizophrenia. And between 1999 and 2004, the percentage of residents who had both physical and mental or cognitive impairments increased by 50 percent. Obviously, many residents facing these very significant physical and cognitive challenges will be unable to parse through dozens of pages of an admissions agreement, identify and analyze the arbitration provisions which may be buried in the contract, and appreciate the terms to which they are agreeing. Moreover, vulnerable individuals in this situation are also extremely unlikely to feel empowered to negotiate the terms of the contract.

3. **In your written testimony you refer to Yale Law Professor Judith Resnik's upcoming book, Representing Justice: The Rise and Fall of Adjudication As Seen From Renaissance Iconography to Twenty-First Century Courthouses, and reference a federal court decision observing that "confidentiality is part of the character of arbitration itself." You also referred to the secretiveness in outcomes during your oral statement In your opinion, is that confidentiality problematic? If so, why? Do you think it is possible to expose (and prevent) the disturbing cases of neglect and abuse in facilities without public litigation?**

I am extremely concerned about confidentiality requirements and lack of a public record in arbitration cases concerning abuse and neglect in long term care facilities. When those who have been grievously harmed by abuse and neglect in nursing homes have had the opportunity to litigate their claims, the lawsuits have often generated considerable media coverage. Publicity about these shameful events – which providers prefer to remain confidential -- have alerted regulators to conditions and possible trends they might not have identified, warned

consumers about providers they should avoid, and put enormous pressure on poor quality providers to improve care. In addition, some of the litigation has created precedential rulings on standards of care and other important legal issues that help to shape future litigation and facility behaviour. If the litigation in these cases had been conducted in secrecy, none of these valuable outcomes would have emerged.

Because arbitration is conducted in secrecy, we have no data on how many claims are filed against long term care facilities, whether particular providers are more often involved, what kinds of abuse and neglect are alleged, the characteristics of facilities against whom claims are made, how often consumers prevail, and what kind of awards they receive. We simply cannot determine the neutrality of the arbitrators or the fairness of the proceedings. Moreover, we cannot compile any meaningful statistical analysis of the process of mandatory arbitration or the facts and issues at stake in these disputes.

Confidentiality and the lack of a public record or precedent may work well in arbitration between corporate entities who seek to avoid publicity about their business disputes. But secrecy in resolving disputes involving harrowing injuries to vulnerable individuals by providers in an industry that receives billions of dollars of public funding each year does not serve the public interest.

4. **In your written testimony you cite a 2007 GAO report which revealed that twenty percent of nursing homes have been cited for putting residents at risk of serious injury or eveu death. You also noted, according to the same report, that state surveys understate the actual jeopardy and harm residents experience. Do you have any sense of what the overall actual numbers would be if states reported accurately?**

Since my testimony, the GAO has released another report addressing the continuing issue of understatement of serious care problems in nursing facilities. *See* "Nursing Homes: Addressing the Factors Underlying Understatement of Serious Care Problems Requires Sustained CMS and State Commitment," GAO-10-70 (November, 2009). It attributes this significant problem to a multitude of factors including pervasive shortages of surveyors, increased reliance on surveyors with less than 2 years experience, inadequate training, and occasional pressure by external stakeholders (such as providers) to limit citations. A 2008 GAO study, "Nursing Homes: Federal Monitoring Surveys Demonstrate Continued Understatement of Serious Care Problems and CMS Oversight Weaknesses," GAO-08-517, noted that between FY 2002 and FY 2007, 15 percent of federal surveys in facilities identified actual harm or immediate jeopardy citations that had been overlooked by state surveyors. Moreover, 70 percent of federal surveys identified at least one citation at the lowest level of harm that state surveyors had failed to cite.

While the federal "look behind" surveys reveal significant under-reporting by states of both the most serious and lesser violations, no survey is likely to identify

all the harm residents experience in facilities. First, facilities are often able to anticipate when surveyors will appear for the annual survey or follow up surveys. They can therefore bring in additional staff, ensure records are in order, and present a picture to surveyors that is not representative of every day life in the facility. Families, residents, and advocates frequently report that facilities seem entirely different—from offering linen tablecloths and pleasant music to scheduling significant additional staffing—when the survey team is expected to appear. Second, surveyors review charts for and interview only a sample of residents and may be unaware of harm suffered by residents who are not included in the sample. Finally, when surveyors investigate complaints—often months after the complaint was filed—they are frequently unable to substantiate violations and issue citations for very serious incidents because the resident may have died or left the facility, staff may no longer be employed at the facility, records may be missing or altered, and conditions present at the time of the incident may no longer exist. .

5. **In your written statement you suggested that in Michigan, because of the shortage of surveyors, complaints of abuse and neglect can take up to a year to investigate. How pervasive is the shortage of surveyors in the United States? What is the remedy to eliminate the shortage? Is it strictly a funding issue for more surveyors, or something more systemic?**

The GAO has documented pervasive staff shortages among state surveyors since 2003. The November, 2009 GAO report cited in my answer to question 4, above, demonstrates that these shortages continue to exist and that Michigan's experience is not unusual. The report notes that 72 percent of state survey directors asserted that they are always or frequently understaffed while 16 percent are sometimes understaffed. The average surveyor vacancy rate was 14 percent while a quarter of the states had vacancy rates above 19 percent.

While funding for surveyor positions is certainly an issue (and Michigan surveyors are paid much less than many could earn in the private sector), states face other challenges in filling vacant surveyor positions. First, surveyors have to travel frequently and may spend considerable time away from home. Second, they may experience a hostile reception in some nursing facilities or face pressure from various stakeholders to ignore, change, or eliminate citations. Third, some surveyors are frustrated when they observe neglect or abuse but are unable to take action to address the situation immediately. Finally, because of on-going shortages and the requirements of the federal enforcement system, many surveyors face heavy workloads and considerable pressure to complete their work on tight deadlines. These factors contribute both to the difficulty in attracting qualified applicants and the frequent turn-over among surveyor staff.

To address this problem, the GAO recommended that CMS establish a national pool of surveyors who could augment state survey teams that are experiencing workforce shortages. This model has been used for inspections of other types of

facilities such as organ transplant centers. CMS declined to implement that recommendation, noting that states are responsible for meeting performance expectations and should not be compensated with additional federal resources if, because of poor management decisions, they fail to do so. CMS also expressed concern that it would be improper for CMS to dictate to states how to make personnel decisions. CMS has agreed to work with a federal/state workgroup to determine if a national pool might ever be appropriate and to identify other strategies to address workforce issues. In response to the report, the Association of Health Facilities Survey Agencies also made a useful suggestion that federal funding be made available to support state efforts to recruit and retain surveyors.

6. **Do you believe that licensed assisted living facilities should be subject to federal regulation as nursing homes currently are? Is there another way to provide oversight and ensure careful inspection and adherence to proper conditions for the residents of these facilities?**

I do believe all assisted living facilities should be regulated although I appreciate the costs involved in creating and maintaining a survey and enforcement system. In Michigan, we have both licensed and unlicensed assisted living facilities. A survey of unlicensed facilities in two urban regions of the state in 2002 noted that because of the lack of government oversight of these facilities, it has not been possible to obtain the most basic information about these facilities, including an accurate count of facilities or the number of residents served in unlicensed homes. *See* Mickus, M., *Complexities and Challenges in the Long Term Care Policy Frontier: Michigan's Assisted Living Facilities,* Michigan Applied Public Policy Research Program (2002), available at: http://www.ippsr.msu.edu/Publications/ARAssistedLiving.pdf. Moreover, the study found that residents of the unlicensed facilities appeared to have very similar characteristics to residents of licensed assisted living facilities and nursing homes. Because their facilities were not licensed, however, they did not have access to the regulatory safeguards and advocacy services available to residents of licensed facilities.

As Professor Mickus noted in the above study, because there is no central registry or way of identifying unlicensed facilities, we are unable to track the number of facilities or residents, the quality of care and life in these facilities, demographic information about residents, and other critical data that would permit better long term care planning in the state. Regulation is the only mechanism that can assure residents receive quality of care and quality of life and that states obtain the data they require to address the needs of the vulnerable population who reside in these facilities.

Regulation of these facilities is particularly important now. As a result of state and federal policies to reduce nursing home utilization and an increasing reliance on home and community based care, the acuity level of residents in these facilities

has increased significantly. The Association of Health Facility Survey Agencies has raised this concern in several of its recent annual meetings and it was discussed among participants in the Assisted Living Workgroup who submitted their final report and recommendations to the U.S. Senate Special Committee on Aging in 2003. *See* The Assisted Living Workgroup, *Assuring Quality in Assisted Living: Guidelines for Federal and State Policy, State Regulation, and Operations* (April, 2003). Numerous problems in assisted living such as failure to diagnose and treat dementia and other chronic conditions, poor medication management, and other issues have been repeatedly documented in both peer-reviewed journals and the media. A recent report submitted to the national Institute of Justice also documented problems with current regulatory systems in the states and the failure to protect residents from abuse and neglect. *See* Hawes, C. and Kimball, A.M., *Detecting, Addressing and Preventing Elder Abuse in Residential Care Facilities,* Report to the National Institute of Justice from the Texas A&M Health Science Center, College Station, TX..

While state regulation of all assisted living facilities would be a first step, I support federal regulation. In states like Michigan that faces enormous budget pressures and huge deficits, it is inconceivable that the state would voluntarily take on a significant oversight and enforcement role for facilities unless it is mandated to do so. Moreover, state efforts to regulate assisted living facilities would face powerful resistance from providers who prefer to remain unlicensed and who have considerable influence with legislators. Finally, federal regulation would provide a uniform set of standards for assisted living facilities across the country instead of the current patchwork and confusing mix of regulations we now face.

7. **In your written statement you noted that "arbitration was not intended as au end run around justice or a way to keep wrongdoing out of the public eye," and that you only oppose pre-dispute, binding, forced arbitration. What do you believe is the goal of arbitration, and in what – if any –circumstances do you believe non-binding arbitration can be a useful and productive tool? What can Congress do to increase its productivity and prevent abuse?**

Arbitration is an appropriate and useful tool when both parties decide, after a dispute arises, that it is the most efficient way to resolve the matter. In those cases, arbitration might resolve the case more quickly than litigation and do so to all parties' satisfaction. The key to ensuring that arbitration is appropriate is that it is truly voluntary after the dispute has arisen and after both parties—operating on a level playing field -- have had a reasonable opportunity to consider the options to resolve the dispute.

While I cannot speak from personal experience about non-binding arbitration, I have consulted with trial attorneys who report they have <u>not</u> found non-binding arbitration to be useful in nursing home abuse and neglect cases. In their experience, defendants are rarely willing to negotiate seriously until they are in

litigation. Non-binding arbitration only delays the litigation and increases the likelihood that the resident who has been harmed will die before the conclusion of the proceedings. And in these cases, justice delayed can be justice denied

8. **During his opening statement, Ranking Member Franks stated: "Jury trials are remote prospects in the vast majority of consumer lawsuits in the first place. The uorm for these cases iu court is uot jury trial, but dismissal ou pre-trial motions or disposition on summary judgment." Please respond to the accuracy of that statement in the context of disputes arising between residents and long-term care facilities.**

I do not litigate long term care abuse and neglect cases myself, but I have consulted trial attorneys who assure me that these cases are rarely disposed of by dismissal on pre-trial motions or summary judgment. David Couch, a trial lawyer in Arkansas, told me that in 25 years of litigating these cases, both as a defense lawyer and now as a plaintiff's attorney, he could not recall a single malpractice case involving a long term care facility that was resolved by a motion for summary judgment. I also posed this question to Professor Lisa Tripp of John Marshall Law School, an expert on arbitration in long term care settings. She noted that most abuse and neglect cases involving residents of long term care facilities result in settlements and that residents who have the ability to have their cases heard in public by a jury of their peers have a better chance of obtaining a fair settlement.

9. **Supporters of the use of pre-dispute binding arbitration agreements contend that arbitration "is a critical tool in our society because it makes justice prompt and accessible for millions of Americans, and without it too many citizens wonld be left out in the cold by overburdened courts and overpriced lawyers." Please respond to that contention.**

It is essential to note that the legislative proposals under consideration do not bar arbitration or limit citizens' access to arbitration. As I have stated, I do not oppose arbitration in general and appreciate its value in appropriate circumstances. I object only to pre-dispute, mandatory arbitration clauses. If, after a dispute arises, consumers believe they are being "left out in the cold by overburdened courts and overpriced lawyers," they can choose at that point to enter into arbitration.

Moreover, I think it is mandatory pre-dispute arbitration clauses that do indeed leave some Americans out in the cold. Anecdotal evidence suggests that pre-dispute mandatory arbitration cases result in lower awards for plaintiffs and make it more difficult to find lawyers who are willing to accept these cases. An April, 11, 2008 front page article in the Wall Street Journal illustrates that point. *See* "Nursing Homes, in Bid to Cut Costs, Prod Patients to Forego Lawsuits – Big Payouts Fade As Arbitration Rises" *Wall Street Journal* (Nov. 11, 2008). The

article describes the case of Mary Hight, a Mississippi nursing home resident who appeared to have died from dehydration and neglect four hours after facility staff refused to call an ambulance for her. Her daughter was forced to push her wheelchair uphill to the hospital, but it was too late to save her. Although the arbitrator found the nursing home was negligent both in allowing Mrs. Hight to become dehydrated and in failing to obtain emergency care for her, he awarded only $90,000 for pain and suffering to Mrs. Hight's family and did not award punitive damages. The family's attorney asserted that the firm's expenses in arbitrating the case were greater than the award and he is now wary of accepting similar cases. He noted, "You know, at the end of the day, you won't get the relief you want."

Moreover, plaintiffs are left out in the cold in many arbitration cases because the contract provisions sometimes limit discovery and damages, shorten the statute of limitations, prohibit punitive damages, limit the choice of arbitrators, require that the arbitration take place in distant locations, require up-front payment for arbitrators, and contain other restrictions that disadvantage consumers. These provisions do *not* make justice accessible to Americans who would fare much better in court.

10. In yonr oral statement yon indicated that the long-term care indnstry "receives $75 billion in taxpayer money each year throngh Medicaid and Medicare." What is the Federal Government's position regarding the nse of pre-dispnte binding arbitration in long-term care facility admission agreements? Does the Federal Government snpport or oppose the use of snch agreements? Please explain.

On January, 9 2003, the Director of Survey and Certification at CMS issued a rather weak and limited opinion on mandatory arbitration agreements in nursing homes (Ref: S&C-03-10). It did not discuss the appropriateness of these agreements but asserted that its primary focus should be "the quality of care actually received by nursing home residents that may be compromised by such agreements." It stated:

> Under Medicare, whether to have a binding arbitration agreement is an issue between the resident and the nursing home. Under Medicaid, we will defer to State law as to whether or not such binding arbitration agreements are permitted subject to the concerns we have where Federal regulations may be implicated. Under both programs, however, there may be consequences for the facility where facilities attempt to enforce these agreements in a way that violates Federal requirements.

The policy explains that an enforcement action may be initiated against a facility that discharges or retaliates against a resident who refuses to sign a binding arbitration agreement. While it is undoubtedly true that discharging or retaliating

against a resident for refusing to sign such an agreement violates federal law, CMS should bar the nursing facilities it regulates from requiring mandatory arbitration clauses under any circumstances. Since CMS correctly asserts it is illegal for facilities to take action against residents who refuse to sign such agreements, it should also protect residents who are unaware that they have signed such agreements or too intimidated to refuse to sign them.

11. In your oral testimony you stated that "what really costs taxpayers unfathomable sums of money is poor care itself." What is the interplay between the use of pre-dispute binding arbitration agreements and poor care?

Poor care does indeed cost enormous sums of money. For example, facilities are often cited for inadequate infection control practices. In CMS's July, 20, 2009 revisions to its infection control guidelines for Medicare and Medicaid certified facilities, it noted:

> Infections are a significant source of morbidity and mortality for nursing home residents and account for up to half of all nursing home resident transfers to hospitals. Infections result in an estimated 150,000 to 200,00 hospital admissions per year at an estimated cost of $673 million to $2 billion annually. When a nursing home resident is hospitalized with a primary diagnosis of infection, the death rate can reach as high as 40 percent.

High costs are also associated with treatment of pressure ulcers ("bedsores"). The Agency for Health Care Research and Quality (AHCRQ) reported that patients hospitalized with pressure ulcers stay nearly three times longer than those without pressure ulcers – 14.1 days, compared to 5.0 days. The mean cost per hospitalization for patients whose principal diagnosis was pressure ulcers was $16,800. Based on the AHCRQ data, the Center for Medicare Advocacy estimates that the total annual cost for residents admitted to the hospital from long term care facilities with a primary diagnosis of pressure ulcers was $43,747,200. The mean cost per hospitalization for patients whose secondary diagnosis was pressure ulcers was $20,400. The Center for Medicare Advocacy estimates that the total annual cost for long term care residents who enter the hospital with this diagnosis is $817,142,400. *See* Agency for Healthcare Research and Quality, *Hospitalizations Related to Pressure Ulcers Among Adults 18 Years and Older,* Healthcare Cost and Utilization Project, Statistical Brief, #64, December, 2008. And nursing homes experience considerably higher daily costs for caring for resident with pressure ulcers in the facility. *See* David M. Smith, M.D, *Pressure Ulcers in the Nursing Home,* 123 Annals of Internal Medicine 433 (1995).

As noted above, litigation of cases of preventable pressure ulcers and infections as well as other abuse and neglect has a significant impact on nursing facility providers. Litigation often results in adverse publicity, the possibility of

significant jury awards, increased scrutiny by state and federal investigators, market pressures, and demands from insurance companies to reduce risk by improving care and adopting quality improvement systems. All of these results create incentives to provide better care. When consumers who suffer from abuse and neglect are denied the opportunity to litigate these cases, those powerful incentives to improve the quality of care and reduce needless human suffering and unnecessary expense are lost.

As I have observed, it appears that awards in arbitration tend to be lower than Settlements or awards in litigation of abuse and neglect cases. Professor Lisa Tripp notes that the key factor in providing quality care in nursing homes is sufficient staff. She cites empirical evidence supporting the cause and effect relationship between limiting financial liability and profit-maximizing behaviour that results in reductions in staffing and poor resident outcomes. *See* L. Tripp, *A Senior Moment: The Executive Branch Solution to the Problem of Binding Arbitration Agreements in Nursing Home Admission Contracts,* 31 Campbell L. Rev. 157, 189-90. Professor Tripp analyzed the much publicized trend of private equity firms purchasing nursing home chains and then cutting staff as well as supplies, activities, and services to increase profits. She notes that "When private equity groups limit their liability through Byzantine corporate structuring, "[t]he first thing owners do is lay off nurses and other staff that are essential to keeping patients safe.'" She concludes, "While the act of limiting liability through arbitration is obviously not identical to making a company judgment-proof through corporate manipulation, the same principle underlies both actions: it is rational for profit-maximizing actors in human capital-intensive firms like nursing homes to boost the bottom line by cutting staff when their liability for negligence is limited."

12. You referred during the hearing to a 2003 Center on Medicare Advocacy study that showed that liability iusurauce premiums were not tied to insurance pay-outs. You also referred to a study in Florida that "showed that only a very small number of nursing homes were repeatedly sued, and that those were the facilities that were entirely predictable because they were the facilities that were cited over and over for egregious violations." Please explain in greater detail the two studies.

A. The 2003 study by the Center for Medicare Advocacy

This study demonstrated that insurance companies raise premiums based on national, rather than state-specific, nursing home pay-out experience. According to the report:

> The director of rates and forms at the South Carolina Department of Insurance explained this apparent anomaly with the observation that since insurance carriers write policies nationally, increased claims in one state can affect other states.[1] A similar view was expressed by the managing director of the insurance company CNA HealthPro, who acknowledged that rate increases in Connecticut reflected both Connecticut and national claims experience. As [an article in *The Hartford Courant*] recounted, "the company has too little data for Connecticut alone to be statistically credible."[2] Large rate increases in Wisconsin also represent claims filed elsewhere, since Wisconsin has one of the lowest rates of liability claims nationwide.[3]

Thus, the report concludes that arguments about litigation causing increases in the cost of liability insurance are overstated. Although insurance premiums have risen in many states, there are multiple explanations that go beyond tort litigation.

B. The Florida study

The Florida study was a 4 month investigation conducted in 2001 by the *Sun-Sentinel* and the *Orlando Sentinel*. The newspapers reviewed 924 lawsuits filed during the previous five years against nursing homes in eight counties of South and Central Florida, which accounted for one-third of the state's 679 nursing homes. According to the published report:

> The cases studied contained allegations that included rape, physically abusive staff, poor medical decisions and outright neglect. Hundreds of the lawsuits accused nursing homes of allowing festering bedsores that led to infections and amputations, allowing multiple falls that snapped brittle bones, and allowing untreated cases of malnutrition and dehydration -- many leading to death. Almost half the suits claimed residents died at the hands of the nursing homes.

"Skyrocketing Suits Spur Crisis in Care Residences Plagued with Financial Dilemmas: Special Report: Nursing Homes on Trial." *Sun-Sentinel* (Mar. 4, 2001). The newspapers compared the tort litigation information to the state survey data. According to the investigative report, "[h]omes slapped with a high number of quality violations in state inspections were sued three times as often as homes with the fewest violations…." "Quality Violations Often Lead to Suits: Even the Best Homes Can End Up in Court: Special Report: Nursing Homes on Trial," *Sun-Sentinel*, (Mar. 6, 2001). Moreover, nonprofit homes -- with one-third fewer violations than for- profit homes -- were sued less than half as often. *Id.* Between 1996 and 2000, the 10 facilities (out of 143 in South Florida) that had 15 or more lawsuits filed against them had an average of 48.7 deficiencies during the period (ranging from 24 to 72). During the same five-year period, the 25 facilities with zero lawsuits had an average of 20 deficiencies (ranging from 1 to 44).

"Some Well-Kept Nursing Homes Have Never Been Sued," *Sun-Sentinel* (Mar. 5, 2001).

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1 South Carolina: "Higher insurance rates raise nursing home costs," Charleston, SC, AP Wire (Sep. 16, 2001).

2 Diane Levick, "Liability Headaches For Caregivers," *The Hartford Courant* (Aug. 31, 2001).

3 Phill Trewyn, "Nursing home liability insurance on the rise," *The Business Journal of Milwaukee* (Jul. 13, 2001).

RESPONSE TO POST-HEARING QUESTIONS FROM STUART T. ROSSMAN,
NATIONAL CONSUMER LAW CENTER, BOSTON, MA

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on Mandatory Binding Arbitration: Is it Fair and Voluntary?
September 15, 2009

Responses of Stuart Rossman, Esq., National Consumer Law Center

Questions from the Honorable Steve Cohen, Chairman

1. **A witness who testified at one of this Subcommittee's hearings last term had written an article suggesting that mandatory binding arbitration agreements are a defense against consumer litigation. How neutral is mandatory arbitration agreements if they are considered a defense to consumer lawsuits?**

ANSWER:

Mandatory, pre-dispute arbitration agreements imposed by businesses and financial institutions upon consumers as a prior condition to gaining access to fundamental financial products are anything but neutral. To the contrary, such provisions exclusively are controlled by the purveyor and structured specifically to deny consumers the opportunity to protect their interests through legal actions by denying them full and fair due process rights to discovery, equitable relief, class certification, jury trials and appellate review. The consumer is required to waive his or her rights at a point in the transaction where they do not have access to counsel or an awareness of the potential ramifications of their actions. Nor do they have any alternatives, as a practical matter, since such clauses are ubiquitous in many types of standard consumer contracts like credit card agreements, cell phone contracts, home construction agreements and nursing home admission contracts. There is a built in bias to the mandatory arbitration process because the business is a repeat customer, which provides a substantial source of income for the chosen arbitrators, while the consumer is a one time participant. The costs and expenses of the arbitration bear more heavily on the consumer and serve as a realistic deterrent upon their participation in the process. By relegating consumer issues to a private, non-public forum, mandatory binding arbitration agreements restrict consumer access to information regarding alleged consumer abuses and serve as a shield against potential enforcement actions by public officials or scrutiny by the press. Finally, the secret system of mandatory arbitration hampers the important functions of our open judicial system in regards to educating the public about potential consumer abuses and providing an available record of how the law is being interpreted and applied when consumer harm occurs. Without the establishment of legal precedent, Congress has little way of assessing the effectiveness of federal consumer laws and determining whether improvements need to be made. The public also loses the benefit of learning facts that might encourage or spur political or legal reforms.

2. **Are there alternatives to mandatory binding arbitration that you would find fair for consumers and businesses?**

ANSWER

Alternative dispute resolution mechanisms are a critical component to any properly functioning judicial system. There clearly are times when, based on the facts and circumstances, mediation and/or arbitration are the preferable, more efficient, option for settling a contested issue. However, in order to be fair, both sides must have a say in the decision *after* the dispute arises. The choice of such an option should be made upon a fully informed judgment, with benefit of counsel and an awareness of the ramifications of the decision. It never should be coerced, procured under duress or made without knowledge of the nature of the dispute, the remedies available and the due process rights that are at stake. If there is a supervised, level playing field for consumers and businesses, the parties can *voluntarily* choose whether alternative dispute resolution mechanisms are appropriate options for their particular case.

3. **Consumer advocates argue that arbitration clauses can be drafted to undermine certain legal protections, such as consumer lending laws protecting credit cardholders. In your opinion, and based on any evidence yon have, are companies drafting clauses to do that?**

ANSWER

Virtually every federal and state consumer protection law enacted in the past 50 years has been structured to provide that the consumer is expected to be the primary enforcer of the rights and remedies contained in said statutes. Such a system is natural given that most consumer related claims involve small dollar values spread over a broad marketplace. Although violations of the substantive provisions of these acts may result in substantial benefits to the business in gross, the harm caused to the individual consumer, although material, may not justify the expense or effort for enforcement by the consumer, let alone by a public agency. The costs and expenses only are increased if the pursuit of the relevant cause of action requires proof of pattern or practice, information that in the consumer context often exclusively is in the control of the business. Therefore the consumer protection laws provide incentives for private actions, including, but not limited to express rights to choice of forum, injunctive and other equitable relief, class actions and fee shifting. To undermine these important protections, businesses have drafted arbitration clauses that unilaterally designate inconvenient forums for the proceedings, deny access to injunctive and other equitable relief which are not available in a non-judicial setting, prohibit class actions which enable the pooling of smaller claims to enable joint enforcement efforts that reflect the true magnitude of the damages at stake and require upfront expenditures of expenses that are beyond the means of most consumers. As such, they are defeating the very legislative policies incorporated in consumer statutes intended to protect consumer interests.

4. **Consumer advocates argue that some businesses forbid class action lawsuits with the use of arbitration clauses. What effect does this have on consumers arbitrating their claims?**

ANSWER

In actuality, many consumer advocates argue that mandatory pre-dispute arbitration clauses specifically are intended to defeat access to consumer class action lawsuits which are an important enforcement mechanism enacted by Congress and state legislatures to protect the interests of consumers. As a practical matter, without the right to join claims as part of a class action, many consumer violations will go unasserted and will not be vindicated. Many consumer claims involve the presentation of sophisticated elements of proof in order to achieve comparatively small individual damages recoveries. Although such recoveries are material for the claimants, and significant when taken in the aggregate for the entire marketplace, they usually do not justify the expenditure of time, effort and expense required to procure competent legal counsel and to prove their case, especially in the circumstances usually found in the consumer context where the business has access to, and controls, all of the evidence and records in the case. By expressly forbidding class action lawsuits in mandatory pre-dispute arbitration clauses, businesses are attempting to deprive consumers of the procedures that make it possible for them to fulfill the legislative mandate intentionally set forth in most consumer protection statutes. Without the ability to certify a class, and the opportunity to pool resources, aggregate claims and share a common prosecution of available causes of action, many consumers forced to arbitrate their dispute will not be able to assert their rights in any reasonable, cost effective fashion.

5. **Regarding the lawsuit and resulting settlement between the Minnesota Attorney General and the National Arbitration Forum, what has happened to the bnsinesses who used the Forum to arbitrate their disputes with consumers? Is the Minnesota Attorney General focusing its atteution on those businesses who had such close relationships with the Forum that the arbitrations were not neutral?**

ANSWER

Businesses which included the National Arbitration Forum ("NAF") as one available arbitrator option under the terms of their consumer contracts prior to NAF's cessation of consumer related arbitration business this past summer merely selected another one of the alternative private arbitration companies available for hire. When the contract called for arbitration only before NAF, however, some Courts have ruled that the mandatory arbitration clause fails and arbitration is not compelled under the agreement. *See*, *Carr v. Gateway, Inc.*, 2009 WL 4263796 (Ill. Ct. App. Nov. 24, 2009); *Carideo v. Dell, Inc.*, 2009 WL 3485933 (W.D. Wash. Oct. 26, 2009); *but see, Adler v. Dell Inc.*, 2009 WL 4580739 (E.D. Mich. Dec. 3, 2009). I am not in a position to respond as to where the Minnesota Attorney General's Office currently is focusing its attentions with regards to the NAF matter.

6. **You indicate in your testimony that practically every credit card agreement, cell phone contract, mortgage and even many non-union employment contracts – including "hundreds of millions" of contracts – now contain a pre-dispute mandatory arbitration clause. Do you have a sense of who exactly is being impacted most by these contracts? How many low-income individuals are affected by these binding clauses?**

ANSWER

Prior to the recent announcements by certain banks modifying their mandatory pre-dispute arbitration policies for consumer contracts, virtually every credit card agreement and cell phone contract in the country included binding arbitration provisions. As a result almost every consumer with a credit card or cell phone, whether they qualify as a low income individual or not, was impacted by such clauses and suffered equally the same loss of rights. It is impossible to determine exactly how many low income individuals were affected, but the number is significant, particularly for those who had access to banking accounts (i.e. the proportion of low income consumers who are "unbanked" is much higher than in other segments of the American population). It should be noted, however, that mandatory pre-dispute arbitration clauses also have become the overwhelming norm in many sub-prime lending products (i.e. payday loans, auto finance pawn, etc.) often relied upon by low income individuals in lieu of traditional prime banking products (including credit cards) that otherwise are not available to them.

7. **You testified that arbitratiou companies have strong financial incentives to rule in favor of the corporation, and that these incentives are inherent to pre-dispute "forced" arbitration. Do you believe it could be possible to eliminate or reduce these inceutives without legislative action to make pre-dispute binding mandatory arbitration clauses nnenforceable in certain disputes?**

ANSWER

The fundamental flaw in any privately based alternative dispute mechanism is the built in potential bias by mediator or arbitrator towards the source of their income. In the case of voluntary decisions to engage in arbitration *after* a dispute has arisen, the parties are in a position to negotiate terms that will ameliorate if not eliminate this problem (i.e. through the joint selection of the arbitrator and an equal sharing of costs). With mandatory pre-dispute arbitration agreements for consumers, however, there never is a level playing field from the beginning. Since the business or financial institution gets to choose the arbitration company prior to the "agreement" and because of the adhesive nature of the contract which gives the consumer few or no options, the arbitrator automatically is beholden to business or financial institution for repeat assignments. Inherent in the system is the problem that the arbitrator naturally will favor the party that controls their access to future, very lucrative, business over the consumer who has no leverage and, as an individual, little impact on the arbitrators overall profit margin. In light of the disparity between the positions of businesses and consumers in the mandatory pre-dispute arbitration context, it would not be possible to reduce, let alone eliminate, these

incentives. Therefore, preserving and protecting consumer access to the public judicial justice system, and the level playing field it guarantees, is vital.

8. **You wrote in your statement that the essential problem with forced arbitration is that it creates a system strongly biased in favor of the corporation and against the individual. You suggested that one of the reasons for this problem is that arbitration procedures tend to favor corporations, and the high fees and 'loser pays' rules discourage consumers from participating. Would changing the arbitration rules and procedures create greater equity iu the process, or is it uecessary to legislate against pre-dispute, forced arbitration altogether?**

ANSWER

Merely changing the arbitration rules and procedures will not, in and of themselves, level the playing field for consumers participating in mandatory pre-dispute arbitration proceedings because of the inherent biases built into the system as discussed above in the answer to Question 7. Of course, limiting higher fees would be helpful to consumers and eliminating a "loser pays" rule would remove a major disincentive for consumers participating in arbitration. However, given the nature and size of most consumer claims, which in the non-mortgage related area tend to involve material amounts at stake for the average consumer but do not justify the payment of the up front costs, legal fees and expenses involved in private arbitration, any non-public dispute resolution mechanism will present significant barriers for the consumer. Alternatively, if the business or financial institution is required to pick up most if not all of the arbitration company's payments (which presumably it can afford more easily than an individual consumer and absorb as a cost of doing business) it feeds the same financial conflicts of interest for arbitrators previously mentioned.

9. **You indicate that all arbitration companies make their money by convincing corporations to select them as a forum for debt collectiou and other disputes. Could Congress play a role in creating alternative incentives for arbitration companies, which would facilitate greater justice iu the process?**

ANSWER

Unfortunately, at least in the case of mandatory pre-dispute arbitration agreements in consumer contracts, justice has a price. As discussed above, business and financial institution control of the source of income earned by arbitration companies through mandatory pre-dispute arbitrations taints the entire alternative dispute resolution mechanism. If an arbitration company does not consistently find in favor of the entity that is determining its profit margin it runs the real risk that the business or financial services institution will take its repeat business elsewhere. Congress could take away that power by substituting public funds for the private arbitration payments, capping arbitration fees and/or requiring governmental supervision of the arbitrator assignment process. However, we believe that such an intrusion by government would be a serious misuse of federal tax dollars and resources that also would unnecessarily undercut the

authority and primacy of the federal judicial system already in place to protect consumer interests in an unbiased, publically available forum.

10. **Why do you believe a system of pre-dispute, binding arbitration will always be biased against individual consumers and workers? Is there any way to improve the system and level the playing field between consumers and corporations?**

ANSWER

Congress already has taken important steps to level the playing field between consumers and corporations by including provisions in virtually every federal consumer statute that enable consumers to enforce their own rights and guaranty their access to justice through the judicial system. The availability of jury trials, appellate review, class action certifications, injunctive relief, statutory damages, multiple damages for intentional and wilful violations, fee shifting provisions as well as the application of the Federal Rules of Evidence and the Federal Rules of Civil Procedure all are intended to empower and protect consumers' interests. Conversely, mandatory pre-dispute arbitration provisions have been inserted in consumer contracts as adhesive clauses by businesses and financial institutions specifically and intentionally to circumvent these sources of consumer empowerment and protection and to defeat the Congressional public policy that infuses consumer statutes. Instead, private dispute resolution mechanisms are involuntarily imposed upon consumers seeking financial services, cell phone access and other basic components of modern life in the Unites States. Through their built in biases and conflicts of interest, as discussed above, they substitute a flawed system that stacks the deck against consumers. Finally, by removing these disputes from the public forum they are preventing access to information about alleged violations of the consumer laws from government enforcement authorities, the press and consumers and protecting businesses and financial institutions from public scrutiny of their practices and procedures. Arbitration may be a valid and useful system of dispute resolution, providing fairness, efficiencies and economies for adversarial parties who might otherwise engage in litigation—but it should be based upon mutual, informed consent, voluntary engagement, a truly neutral forum, transparency and accountability, none of which are present in the mandatory pre-dispute consumer context.

11. **You refer in your written testimony to recent decisions by the American Arbitration Association and Bank of America, which you suggest are positive developments, but uot permanent or widespread solutions. You indicate that because they made their decisions voluntarily, they may alter the decision at any time and begin arbitrating cases once again. Can you envision a way to encourage more companies to follow Bank of America's lead, or to provide incentives to make such decisions permauent? Also, have any other corporations dropped the use of pre-dispute binding arbitratiou since Bank of America stopped maudatiug arbitration to resolve disputes?**

ANSWER

Since the hearing on September 15, 2009, a number of additional financial institutions have joined Bank of America in agreeing to eliminate mandatory pre-dispute arbitration provisions in their new credit card agreements. They include JP Morgan Chase, Capital One, PNC Bank, TD Bank, Regions Bank. JP Morgan Chase and Capital One also have agreed that their new credit card agreements will allow their customers the right to a jury trial and the right to participate in a class action. On January 5, 2010, it was announced that HSBC Holdings tentatively has agreed to settle claims it illegally colluded with other banks to require credit card holders to arbitrate disputes, including debt collections. Under the agreement, HSBC apparently will drop an arbitration clause and a ban against class actions from its consumer credit card agreements until at least 2013. The announcement follows settlements between cardholders and JP Morgan Chase, Capital One and Bank of America in a lawsuit that had accused Bank of America, Capital One, Chase, Citibank, Discover, HSBC and others of having secretly met or consulted some 30 times for the purpose of requiring cardholders to arbitrate all disputes with credit card companies in violation of the antitrust laws. All of the settlements must be approved by a federal court in New York before they can take effect. These developments are laudable. They also demonstrate that financial services companies can transact business with consumers at a profit without requiring mandatory pre-dispute arbitration provisions in their credit card agreements. Finally, they lead to the inescapable conclusion that external scrutiny and effective consumer protection efforts are a necessary impetus for permanent, widespread change. It is not a coincidence that these newly adopted policies follow on the heels of proposed arbitration fairness legislation, Congressional hearings over the past 12 months, the Minnesota Attorney General's lawsuit against the National Arbitration Forum and the settlement of private antitrust enforcement actions. Remove the pressure and eliminate the oversight and one would have to be concerned that new policies would be rescinded and the old policies resurrected. Adding consumer protections to federal law governing arbitrations is the only way to insure that abusive practices are permanently and effectively prohibited.

12. **During his opening statement, Ranking Member Franks stated: "Jury trials are remote prospects in the vast majority of consumer lawsuits in the first place. The norm for these cases in court is not jury trial, but dismissal on pre-trial motions or dispositiou on summary judgment." Please respond to the accuracy of that statement in the context of consumer disputes.**

ANSWER

It is true that jury trials are remote prospects in the vast majority of all civil lawsuits, not merely consumer lawsuits. In fact, the vast majority of all civil lawsuits, including consumer cases, result in settlements achieved by parties, represented by counsel, litigating in a neutral forum subject to established rules of procedure and evidence that provides for open public access and scrutiny and supervision by an independent jurist. Specifically in the case of class actions, any such settlement is subject to the review and approval of the Court pursuant to the provisions of Rule 23 of the Federal Rules of Civil

Procedure and the recently enacted Class Action Fairness Act. None of these important restrictions and protections applies in the mandatory pre-dispute arbitration context for consumers.

13. **Supporters of the use of pre-dispute binding arbitration agreements contend that arbitration "is a critical tool in our society because it makes justice prompt and accessible for millions of Americans, and without it too many citizens would be left out in the cold by overburdened courts and overpriced lawyers." Please respond to that contention.**

ANSWER

Limiting the contention to mandatory pre-dispute arbitration provisions included in consumer agreements, the hypothetical benefits of the process are far outweighed by the significant rights and protections consumers are required to abandon without full advice or consent as part of a contract of adhesion in order to gain access under duress to credit cards, cell phones, nursing home admissions or other critical resources in modern society. Furthermore, it appears that when placed under scrutiny, financial institutions are willing and able to forego the "critical tool". For example, a spokesman for JP Morgan Chase & Co. recently said that the bank's decision to remove the mandatory pre-dispute arbitration clauses from its future credit card agreements was a new policy that "reflects [the banks] commitment to clearer and simpler communication with our customer." In fact, as discussed above, mandatory pre-dispute binding arbitration clauses are intended to be, and operate as, an expedient method for businesses and financial institutions to deprive consumers of access to justice until and unless they are prohibited by federal law.

14. **You stated during the hearing that "somewhere iu the testimony I saw someone said that the filing fee was $125. I think . . . that is for a documeuts-only filing." Please explain the typical types of filings a party can present and the typical fees associated with each such filing.**

ANSWER

Each arbitration provider has different types of filing requirements and separate fee schedules. It would be difficult, therefore, to define a "typical" set of standards. As an example, however, I have attached a copy of the American Arbitration Association's Consumer Arbitration Costs posting from its website, dated January 6, 2010, setting forth the fees charged in its consumer arbitrations effective January 1, 2010. The posting sets forth the different types of filings that are possible in consumer arbitration proceedings and the fees and costs associated with the different services to be provided. Unlike court forums that only require a single filing fee payable upon initiating an action, arbitration is a pay-as-you-go system that often charges for such things as the issuance of a subpoena, filing a motion or receiving a written decision that provide the arbitrator's rationale. I believe that in my testimony I was responding to the contention by another witness that arbitration filing fee only cost consumers $125. My rejoinder was that I believed that such a fee usually applied in "documents-only" filings which create a proceeding where

there is no hearing and the arbitrator decides the dispute solely upon the written submissions of the parties. Such proceedings obviously are the least expensive to procure because they require the least amount of time, effort and attention by the arbitrator. However, most consumer disputes cannot be resolved though such expedited proceedings because of the contested factual issues and the need for discovery by the consumer since the business or financial institution often has exclusive possession, control or custody of critical records, documents and agreements, usually maintained in an electronic format. Therefore, many consumer claims require further discovery proceedings and/or at least one or more hearings that may result in higher fees, costs and expenses for the consumer.

January 8, 2010

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Consumer Arbitration COSTS

Rules Effective September 15, 2005
Fees Effective January 1, 2010

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

Administrative Fees

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

Arbitrator Fees

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

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

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

Fees and Deposits to be Paid by the Consumer:

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

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

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

Fees and Deposits to be Paid by the Business:

Administrative Fees:

If neither party's claim or counterclaim exceeds $10,000, the business must pay $775 and a Case Service Fee of $200 if a hearing is held. A portion of this fee is refundable pursuant to the Commercial Fee Schedule.

If either party's claim or counterclaim exceeds $10,000, but does not exceed $75,000, the business must pay $975 and a Case Service Fee of $300 if a hearing is held. A portion of this fee is refundable pursuant to the Commercial Fee Schedule.

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

Arbitrator Fees:

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

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

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

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

Questions

Further information on fees is available in the Supplementary Procedures for Consumer-Related Disputes, effective September 15, 2005. These rules are available in the Consumer section of Focus Areas on the AAA Web site.

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

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RESPONSE TO POST-HEARING QUESTIONS FROM STEPHEN J. WARE, UNIVERSITY OF KANSAS, SCHOOL OF LAW, LAWRENCE, KS

Replies by Professor Stephen J. Ware
to
Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on Mandatory Binding Arbitration: Is it Fair and Voluntary?
September 15, 2009

Professor Stephen J. Ware, School of Law, University of Kansas

Questions from the Honorable Steve Cohen, Chairman

1. In light of the settlement by the National Arbitration Forum, how can Americans be confident that if they enter into an arbitration with their employer, that the arbitration provider will be neutral and independent? Why should Congress rely on arbitration providers to police themselves, and employers to choose neutral arbitrators, when not doing so can benefit their bottom lines?

To begin, I would not draw conclusions about arbitration as a whole based on allegations against NAF.

Nonetheless, I do not believe Congress should rely on arbitration providers (or individual arbitrators) to police themselves. I believe Congress should continue to rely on the courts, as guided by the Federal Arbitration Act, to police the neutrality of arbitration in the United States. Courts currently do this in at least two important ways.

First, the Federal Arbitration Act allows courts to invalidate unconscionable arbitration agreements.[1] And this is not just a theoretical protection. Each year, there are many cases in which courts hold particular arbitration agreements unconscionable.[2] For example, courts often refuse to enforce arbitration agreements that prohibit class actions,[3] limit remedies,[4] or require

[1] 9 U.S.C. § 2 (arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.")

[2] *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION 61-65 (2d ed. 2007) (collecting representative cases); Stephen A. Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts are Circumventing the Federal Arbitration Act*, 3 HASTINGS BUS. L.J. 39, 48 (2006) (finding that unconscionability challenges to arbitration agreements in California succeeded in whole or in part in approximately 58% of cases, compared to only 11% in the non-arbitration context); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 BUFF. L. REV. 185, 194 (2004) (finding that arbitration agreements were found unconscionable in 50.3% of cases in 2002-2003, as opposed to 25.6% for other types of contracts).

[3] *See, e.g.*, Ting v. AT&T, 319 F.3d 1126, 1150 (9th Cir. 2003); Powertel v. Bexley, 743 So.2d 570 (Fla.App. 1999); Whitney v. Alltel Communications, Inc., 173 S.W.3d 300 (Mo. App. 2005); Kinkel v. Cingular Wireless, LLC, 857 N.E.2d 250 (Ill. 2006); Leonard v. Terminix International Company, LP, 854 So.2d 529, 538-39 (Ala. 2003); Williams v. Aetna Fin. Co., 700 N.E.2d 859, 866-67 (Ohio 1998); State of West Virginia ex rel. Dunlap v. Berger, 567 S.E.2d 265 (W.Va. 2002).

the consumer or employee to pay a significant portion of the fees charged by the arbitrator or arbitration organization.[5] So I believe that we currently have a very sensible system in which courts determine, case-by-case, which arbitration agreements should not be enforced and which provide for a fair process and so should be enforced.

Second, courts do not enforce all arbitration awards. Federal Arbitration Act § 10(a) permits courts to vacate an arbitration award:

> (1)Where the award was procured by corruption, fraud, or undue means.
> (2) Where there was evident partiality or corruption in the arbitrators, or either of them.
> (3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
> (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[6]

Here, as well, current law sensibly allows courts to determine, case-by-case, which arbitration awards were the result of an unfair process and thus should not be enforced and which awards were the result of a fair process and so should be enforced.

2. In your written testimony, you suggest that arbitration is fair and voluntary for employees. How can arbitration be fair in situations when the forum selection is controlled by the employers, the procedures are drafted by the employers' lawyers, and those procedures do not conform to consensus minimum standards of due process?

Your question calls attention to factors such as the bargaining (or lack thereof) in the formation of the arbitration agreement and the arbitration process prescribed by that agreement. These are the factors courts routinely consider in deciding whether an arbitration agreement is unconscionable.[7] As these factors vary from case to case, I believe they are better handled on a case-by-case basis in the courts, rather than with the overly broad brush of legislation.

3. Cliff Palefsky, who testified at the hearing, contends in his written statement that "Leading management lawyers openly state that the arbitration requirement actually deters claims because of the high costs of arbitration, the limited discovery, the repeat

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[4] *See, e.g.,* Booker v. Robert Half Int'l, 413 F.3d 77 (D.C.Cir.2005); Ingle v. Circuit City Stores, Inc. 328 F.3d 1165 (9th Cir.2003); Armendariz v. Foundation Health Psychcare Services, Inc., 99 Cal.Rptr.2d 745 (Cal.2000); State ex rel. Dunlap v. Berger, 567 S.E.2d 265 (W.Va.2002).
[5] *See, e.g.,* Ingle v. Circuit City Stores, Inc. 328 F.3d 1165 (9th Cir. 2003); Armendariz v. Foundation Health Psychcare Services, Inc., 99 Cal.Rptr.2d 745 (Cal. 2000); Brower v. Gateway 2000 Inc., 676 N.Y.S.2d 569, 574 (App. Div. 1998); D.R. Horton, Inc. v. Green, 96 P.3d 1159 (Nev. 2004).
[6] 9 U.S.C. § 10(a).
[7] *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION § 2.25 (2d ed. 2007).

player advantages and the smaller damage awards in arbitration." Please respond to the accuracy of that statement. Have some leading management lawyers made such statements?

I am not aware of any management lawyers making such statements. The statement's assertion of "high costs" and "smaller damage awards in arbitration" conflicts with the empirical studies cited at footnotes 13 and 14 of my written testimony. That testimony summarizes those studies as follows: "The empirical evidence indicates that arbitration tends to have lower process costs than litigation. With respect to outcomes, the empirical evidence indicates that arbitration tends to result in lower awards for some types of cases but higher awards in other types of cases and that, overall, consumers and employees fare as well as in arbitration as in litigation."

4. In your written statement, you claim that "empirical studies do not support the notion that consumer and employment arbitration is unfair." Have you reviewed Professor Colvin's January 2009 analysis, which Mr. Palefsky attached to his testimony, of arbitrations in California which concluded that mandatory arbitration is indeed unfair to employees? Mr. Colvin confirmed the same repeat player advantage that other studies have found, and concluded that the mean award for employees in arbitration was 9% of the mean award in State court trials.

I have reviewed Professor Colvin's January 2009 paper, which Mr. Palefsky attached to his testimony, and would not characterize it as concluding that arbitration is unfair to employees.

As page 24 of that paper says, it is "unrealistic" to expect "any individual study [to] definitely resolve what are complex issues involving a multitude of factors and influences. . . . [E]mpirical research is more typically accumulative in nature as studies gradually enhance our base of knowledge through which to make judgments about policy issues." In other words, it would be rash to make policy based on the findings of a single study. More prudent is to allow empirical evidence to accumulate over time.

I share this view that Professor Colvin's study ought to be combined with other empirical studies in forming a thorough, balanced view of what empirical research can tell us about employment arbitration. As Professor Colvin acknowledges, the employee win rate in his study "is substantially lower than that found in previous employment arbitration studies."[8] That discrepancy may be caused by any number of factors. Different studies examine different data covering different time periods. The results of arbitration may vary over time depending on the strength of the claims that happen to go to arbitration during particular time periods. Similarly, the results of litigation may vary over time depending on the strength of the claims that happen to go to litigation during particular time periods.

Perhaps the bulk of future studies by other scholars will reach conclusions similar to Professor Colvin's, (although the most recent studies suggest otherwise, at least in the area of consumer

[8] Page 7.

arbitration.[9]) If that occurs, then it would no longer be accurate to summarize the relevant empirical studies as indicating that consumers and employees fare as well as in arbitration as in litigation. But even if that occurs, complexities and uncertainties will remain.

For example, Professor Colvin alludes to the "apples and oranges" problem in comparing arbitration and litigation and he recognizes that "the characteristics of cases in arbitration may differ systematically from those in litigation."[10] I made this point in my written testimony (quoting an article of mine):

> Empirical studies can tell us the relative levels of awards and process costs in arbitration and litigation, but that does not mean they can tell us the relative levels of awards and process costs in arbitration and litigation *in comparable cases*. The probative value we give to empirical studies should turn on our level of confidence that the studied cases going to arbitration are comparable to the studied cases going to litigation. And, in reality, nobody knows whether the cases going to arbitration are comparable to the cases going to litigation.[11]

For this reason, as I stated in my written testimony, "even careful empirical studies cannot provide definitive answers."

5. Employment cases require substantial discovery. They are very document intensive. Almost all of the documents and witnesses in employment cases are under the control of employers. If arbitration limits the amount of discovery, how can arbitration be fair for employees who need discovery to prove their claims? Arbitration would seem to favor employers.

Courts currently police arbitration to ensure adequate discovery, and courts tend to be especially vigilant about this in the context of employment arbitration.[12] The fact that arbitrators, arbitration agreements and individual cases in arbitration vary with respect to appropriate discovery is yet another reason for arbitration law to rely on fact-sensitive, case-by-case, resolution in the courts, rather than on legislation.

6. Mr. Palefsky stated during the hearing that: "Arbitration is a dispute resolution system. It is not a justice system. It cannot be confused as a justice system." Is Mr. Palefsky correct?

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[9] *See* http://www.searlearbitration.org/p/full_report.pdf
[10] Page 7.
[11] Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 755-56 (2001).
[12] *See, e.g.*, Cole v. Burns Int'l Security Services, 105 F.3d 1465 (D.C. Cir. 1997); Armendariz v. Foundation Health Psychcare Services, Inc., 99 Cal.Rptr.2d 745 (Cal. 2000).

No. Mr. Palefsky made this assertion more fully in his written testimony in which he asserted that "There is a lot more to a civil justice system than moving money around. There is a significant emotional component to the process. No system of justice can succeed without the confidence of its users. There is no question that mandatory [sic] arbitration does not have the confidence of employees or consumers. Indeed, the mere act of forcing the process on a party undermines the confidence that is required for it to be successful."[13]

Here, Mr. Palefsky makes several assumptions with which I disagree. First, he refers to contractual arbitration as "mandatory arbitration." As I explained in my written testimony, what some call "mandatory arbitration" is better called "contractual arbitration" because it, unlike some other arbitration, does not occur unless the parties have previously formed a contract stating their agreement to arbitrate the dispute. Arbitration is not mandatory when it arises out of a contract, because contracts are formed voluntarily.[14] We should reserve the word mandatory for arbitration that really is mandatory--arbitration that occurs even though the parties have not contracted for it.[15]

Second, Mr. Palefsky argues that "forcing the process on a party undermines the confidence that is required for it to be successful." But this is a stronger argument against litigation than against arbitration because litigation is more appropriately described as "forced on" parties than arbitration. As my written testimony explained, litigation in the court system is the default process of dispute resolution. Parties can contract into alternative processes of dispute resolution, but if they do not do so then each party retains the right to have the dispute resolved in litigation. By contrast, a dispute does not go to arbitration unless the parties have contracted to have an arbitrator resolve that dispute. In other words, arbitration binds only those who contracted for it. In this important sense, arbitration is not "mandatory" but litigation is. Parties who never contracted to be bound by the results of litigation may be lawfully subjected to binding litigation. By contrast, parties who never contracted to be bound by the results of arbitration may not be lawfully subjected to binding arbitration.

Third, Mr. Palefsky implies that arbitration is just about "moving money around" while claiming that litigation is more sensitive to the "emotional" needs of disputing parties. This romanticized view of litigation cannot go unchallenged. Many parties to lawsuits find that litigation leaves them feeling powerless as lawyers take over the dispute and charge high fees to navigate an elaborate and byzantine process that rarely allows the disputants themselves to be heard by a judge or jury. By contrast, arbitration tends to have a less intimidating process and is more likely to include a timely hearing at which the parties themselves can tell their stories. With respect to the "emotional component" of dispute-resolution, litigation could learn a lot from arbitration.

The interests of trial lawyers like Mr. Palefsky may be served by more litigation and less arbitration. But if Mr. Palefsky believes that all Americans have great confidence in the

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[13] Page 9.

[14] My written testimony explained that the fact that an arbitration clause appears in a form contract does not make arbitration arising out such a contract "mandatory."

[15] For example, the Federal Insecticide, Fungicide, and Rodenticide Act requires chemical manufacturers to arbitrate certain disputes with each other even though neither of them contracted for arbitration. *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION § 2.55(b)(1) (2d ed. 2007). That is truly mandatory arbitration. Arbitration arising out of a form contract, as my written testimony explains, is not.

litigation system for all disputes, then I must disagree with him. Litigation, like arbitration, is imperfect and the realities of arbitration should be compared to the realities of litigation, not to some imaginary litigation system that has earned everyone's utmost confidence.

7. During the hearing Stuart Rossman, who testified at the hearing, stated that: "You cannot get [future injunctive relief] in arbitration." Is that accurate? Can the arbitrator offer the same or greater types and amounts of relief as a judge or jury?

No, Mr. Rossman's description is not accurate. Arbitration offers the same types and amounts of relief as litigation. Many arbitration agreements provide that the arbitrator may order any remedy that a court could order.[16] And this is the default interpretation of arbitration agreements that are silent on remedies. For example, arbitrators order parties to pay punitive damages[17] and issue injunctions[18] even though the arbitration agreement may not expressly authorize those remedies. The Supreme Court has recognized that "arbitrators do have the power to fashion equitable relief,"[19] which includes injunctions. The American Arbitration Association Consumer Due Process Protocol provides that "The arbitrator should be empowered to grant whatever relief would be available in court under law or in equity."[20] Similarly, the AAA's Employment Due Process Protocol states that "The arbitrator should be empowered to award whatever relief would be available in court under the law."[21]

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[16] *See, e.g.,* Am.Arbitration Ass'n, Commercial Arbitration Rules, R-43(a)(2005)("The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract.")

[17] *See, e.g.,* Todd Shipyards Corp. v. Cunard Line, 943 F.2d 1056 (9th Cir.1991); Raytheon Co. v. Automated Business Sys., Inc., 882 F.2d 6 (1st Cir.1989); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378 (11th Cir.1988).

[18] *See, e.g.,* Saturday Evening Post Co., v. Rumbleseat Press, Inc., 816 F.2d 1191 (7th Cir.1987); Matter of Sprinzen (Nomberg), 415 N.Y.S.2d 974, 977 (N.Y.1979).

[19] Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 32 (1991).

[20] http://www.adr.org/sp.asp?id=22019#PRINCIPLE_14._ARBITRAL_REMEDIES

[21] http://www.adr.org/sp.asp?id=28535

RESPONSE TO POST-HEARING QUESTIONS FROM CLIFF PALEFSKY,
NATIONAL EMPLOYMENT LAWYERS ASSOCIATION, SAN FRANCISCO, CA

Answers to Questions for the Record from Cliff Palefsky, Esq.
Congressional Subcommittee on Commercial and Administrative Law
Hearing on Mandatory Binding Arbitration: Is it Fair and Voluntary?
September 15, 2009

Question 1: **You contend in your written statement that arbitration saves employers money by limiting discovery. Is discovery important in employment cases? How would limiting discovery impact the employee's case? The employer's case?**

Employment cases are different than many other types of cases. The most important distinction is that all of the documents and witnesses are under the control of the employer, and ethical rules prohibit attorneys from contacting most current employees to obtain information informally.

Because employees have the burden of proof, it is their responsibility to obtain and present the evidence necessary to sustain that burden. Due to the nature of employment claims, depositions are especially important. Most employers don't acknowledge discrimination. They usually assert a different reason for their action, and the employee must prove that that reason is a 'pretext.' It is extraordinarily difficult to prove pretext when you don't even hear the false reason until you are at the hearing. Cross-examination is obviously problematic, as is finding and getting the testimony of witnesses to contradict the false reason. And because, in employment cases, we have to prove someone's 'state of mind,' depositions and the ability to cross examine witnesses in advance of the hearing, are absolutely essential.

Similarly, because the employers have all of the documents, there needs to be a full exchange of relevant information before the hearing. Allowing the employer to present documents for the first time at the hearing is obviously unfair. Although some document production is available in arbitrations, the scope is often considerably limited. But more importantly, you often need depositions of certain witnesses to know which documents exist and where they reside.

Because the employer has full access to all documents and emails, they do not have a similar need for full discovery. And of course, the witnesses are usually current employees who are completely available to the employer and their lawyers, under their control, and often very concerned for their own jobs.

The advantage to the employers in prohibiting or limiting discovery cannot be overstated.

Question 2: **Please explain in greater detail why you believe Congress, when it passed the Federal Arbitration Act, did not intend for it to apply to employees.**

The historical and legislative record is very clear that Congress never intended the Federal Arbitration Act to apply to employment contracts at all. The original impetus for the Act came from the ABA's Committee on Commerce, Trade and Commercial Law. Its purpose was

always to be a commercial arbitration act that would permit the Federal courts to enforce pre-dispute arbitration clauses between merchants. Shortly after the bill's introduction it came to the attention of Andrew Furuseth, the President of the International Seamen's Union of America. Mr. Furuseth was very concerned about the bill's possible application to employees who would have no ability to negotiate or refuse to sign these clauses. Mr. Furuseth explained:

> "The bill provides for the re-introduction of *forced or compulsory labor* if the freeman through his necessities shall be induced to sign. Will such contracts be signed? Esau agreed, because he was hungry. It was the desire to live that caused slavery to begin and continue. With the growing hunger in modern society, there will be but few that will be able to resist. The personal hunger of the seaman and the hunger of the wife and children of the railroadman will surely tempt them to sign and so with sundry other workers in interstate and foreign commerce." Proceedings of the 26th Annual Convention of the International Seamen's Union of America 203-5 (1923).

In response to those objections, the Chair of the ABA Committee told Congress that it was "never the intention of this bill to make an industrial arbitration in any sense." To address any ambiguity or doubt he suggested adding language stating that "*nothing herein contained shall apply to seamen or any class of workers in interstate and foreign commerce,*" which at the time represented the fullest extent of Federal jurisdiction over the employment relationship.

Similarly, Secretary of Commerce Herbert Hoover made the identical point. In fact, Secretary of Commerce Hoover wrote:

> "If objection appears to the inclusion of workers' contracts in the law's scheme, it might well be amended by stating 'but nothing herein shall apply to contracts of employment of seamen, railroad employees or any other class of workers engaged in interstate or foreign commerce.'"

Secretary Hoover's proposed language, intended to make it clear that the FAA would have no application whatsoever to workers' contracts, was added to the FAA *verbatim* as an amendment to Section 1.

Nevertheless, in 2001, the United States Supreme Court decided the case of *Circuit City Stores v. St. Clair Adams, 532 U.S. 105 (2001),* and determined for the first time that the FAA would in fact extend to all employment contracts except those of workers who literally carried goods across state lines. There is no real question that neither the drafters of the FAA nor Congress ever intended the FAA to apply to employment contracts at all because of the lack of voluntariness and the potential for the very abuses that are presently occurring. It is essential that you restore the FAA to its original intention of excluding employment contracts from its application.

I am attaching a copy of our brief in *Circuit City v. Adams*, which contains a comprehensive analysis of the legislative and legal history of the FAA.

Question 3: **Some are concerned that arbitration of employment disputes is particularly problematic because it amounts to a waiver by the employee of civil rights and anti-discrimination laws. Laws which Congress passed in response to protect minorities and women, and persons with disabilities. Do you have any specific examples you can provide of clients who were forced to waive civil rights and anti-discrimination rights? Which laws were waived? Can you envision a way to build in protections for these rights without legislating against forced arbitration, or is legislation the only solution?**

The waiver of civil rights and protections against discrimination occurs in many different ways.

First, access to an essentially free Federal court and a federal judge sworn to uphold the law was a major purpose of the Civil Rights laws. That right is obviously lost. Having to pay, or even risk paying, tens of thousands of dollars in order to litigate a claim constitutes a de facto waiver of all statutory rights.

Second, the Civil Rights laws were amended in 1991 to provide the right to a trial by jury at the request of either party. One of the reasons for the addition of jury trial rights was Congress' frustration with how the sex harassment and other civil rights laws were being interpreted and applied by judges. The right to a trial by jury is one of our most cherished and important civil rights. That right is lost.

Third, arbitrators are not required to know or follow the law. As shocking as that sounds, that is the law. That means that even a facially incorrect legal ruling cannot be corrected or appealed. Therefore, employees are literally waiving all of the protections under the Civil Rights laws if they are waiving the right to have the law properly interpreted and enforced.

The most obvious examples can be found in cases where an employee has prevailed on a claim, but the arbitrator has refused to follow the law and award attorneys' fees. *See, Di Russa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818(2d Cir. 1997). The fee shifting provisions of the Civil Rights laws are absolutely essential to ensuring access to counsel.

Fourth, the Civil Rights laws were intended to work in conjunction with state anti-discrimination agencies which were set up to provide a low cost administrative forum for victims of discrimination who couldn't afford counsel or who wanted to avoid full blown litigation. In many cases these state administrative fora are the only place low wage earners can go for justice. Under the present state of the law, an arbitration agreement can prevent access to these agencies.

Fifth, many arbitration agreements actually change the substantive law. Some shorten statutes of limitations, some limit statutory remedies, some prohibit class actions, some shift the burden of proof, some prohibit reinstatement and some prohibit the awarding of costs and fees to the prevailing employee. These all constitute significant waivers of statutory rights. I am attaching a copy of the Neiman Marcus plan which I referred to in my written testimony as an example of such an abusive plan.

Legislation prohibiting mandatory arbitration agreements is the only way to ensure the full enforcement of the civil rights laws.

Question 4: **In your written statement, you discuss the National Employment Lawyers Association's involvement with drafting the American Arbitration Association's specialized employment arbitration rules and procedures. Are arbitration providers required to follow these when they arbitrate employment disputes? Do these protocols ensure a fair arbitration process for employers and employees who have agreed to a pre-dispute arbitration clause?**

The American Arbitration Association did develop specialized employment rules and have stated an intention to comply with the Due Process Protocol, which was developed by a diverse group of interested parties. The employment rules are reasonable and appropriate for most employment cases submitted on a post-dispute basis, but they still do not eliminate the unfairness and structural problems with pre-dispute, mandatory clauses. For instance, there is a profound and statistically documented repeat player advantage. Repeat employers win more and pay less than non repeat players. Arbitrators are obviously concerned about repeat business, and they know that finding against an employer or large employer-side firm will normally mean they won't be selected again. This economic interest in pleasing the repeat player is profound and is not eliminated by fair arbitration procedures.

The fact that arbitrators do not have to follow the law and that incorrect decisions can't be appealed is also unaffected by theoretically fair procedures.

But most significantly, the AAA rules are not mandatory. Employers can and do modify them in their arbitration clauses. And in those cases where employers want to overreach, they simply designate another provider. Only JAMS and AAA have minimum standards of due process. The hundreds of other providers don't, and indeed, many don't have any employment rules at all.

And even AAA and JAMS do not enforce their own minimum standards. Even though both say they will not administer cases where the employee does not have the same rights and remedies as they would in a court of law, both refuse to enforce their standards against clauses that shorten the statutes of limitation and prohibit class actions and the joinder of claims. Both have caved to corporate threats and pressure and modified their own policies in the face of employer opposition. The only real way to ensure fairness is to make the agreement completely and truly voluntary. That way the parties themselves can ensure that they have the rules they need, the arbitrator they want, the discovery they need, and an appropriate cost structure to have a fair proceeding. The mere act of forcing a particular forum and process on someone is inherently inconsistent with the perception of fairness that is necessary for any system of justice to succeed.

Question 5: **Professor Stephen Ware, who testified at the hearing, contends that state law can adequately protect consumers and employees from the abuses of mandatory binding arbitration. Others claim that the parties to a dispute can appeal the arbitrator's decision. Please respond in detail.**

Professor Ware is simply wrong. Virtually all state laws that are arbitration specific have been held to be preempted by the FAA. *See, Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995); *Doctor's Assocs. v. Casarotto*, 517 U.S. 681 (1996); *Perry v. Thomas*, 482 U.S. 483 (1987); *Preston v. Ferrer*, 552 U.S. 346 (2008). The only remaining state law doctrine that remains a viable way to challenge unfair agreements is unconscionability. But even that doctrine is not available in many states. And indeed, the standard varies considerably. In some states the agreement must "shock the conscience." In most states the standards are simply too high to be of any use. And to be sure, even in states where the doctrine is available, if the trial court refuses to compel arbitration, the employer is entitled under federal law to a stay of all proceedings and an immediate appeal. That means that an employee faced with an unfair clause has to find and pay a lawyer to file a complaint in state court, litigate the issue of unconscionability, and then defend an appeal. That process can take well over a year or two and cost tens of thousands of dollars. It is not a practical way to ensure fairness. There is no incentive to employers to draft clauses properly because employees will either not be aware of the illegal terms, agree to use them anyway, or not be able to afford the time or cost of challenging them.

Similarly, the assertion that an employee can appeal an incorrect decision is also wrong. The grounds for the appeal of arbitration awards are strictly defined in the Federal Arbitration Act. They are limited to proving fraud, bias or some other form of misconduct by the arbitrator, or that the arbitrator exceeded his or her jurisdiction. It is black letter law that errors of law are not appealable. The Supreme Court has also recently decided that parties may not even agree to expand the possible grounds for review (*Hall St. Associates*, 552 U.S. 576 (2008)). The actual law is that an arbitrator's award must be confirmed, even if there are errors of law or fact on the face of the award, that result in a substantial injustice to the parties.

Question 6: **During his opening statement, Ranking Member Franks stated: "Jury Trials are remote prospects in the vast majority of consumer lawsuits in the first place. The norm for these cases in court is not jury trial, but dismissal on pre-trial motions or disposition on summary judgment." Please respond to the accuracy of that statement in the context of employment disputes.**

Representative Franks' assertions are very misleading. The right to a jury trial is a constitutionally guaranteed right. And it is virtually free. It is also a mistake to focus only on the right to a 'jury' or a 'trial.' The most important right is the right to access a free and public court where the judge is obligated to follow the law. Most employment cases in court settle...and they should. Both parties benefit from an appropriate settlement. In fact, over 90

percent of employment cases filed in court settle compared to approximately 65% that are in arbitration.

Another fallacy in his assertion is that the dichotomy is between an arbitration or a full jury trial. In fact most courts now incorporate all forms of alternative dispute resolution ("ADR") into their case management procedures. For example, virtually every case filed in a California state or federal court is required to utilize some voluntary ADR process, such as mediation or voluntary arbitration before proceeding to trial. In fact, these ADR processes, overseen by the courts and often subsidized by the courts, are the very best ADR processes available to employees and some of the best ways to ensure fairness in ADR.

More significantly, implicit in Representative Franks' assertion is the suggestion that cases sent to arbitration are not subject to the very same motions to dismiss and summary judgment motions. Even though in the past these dispositive motions were rare in arbitration, that is not the case today. In fact, the proliferation of abusive motions to dismiss and summary judgment motions in arbitrations has become so profound that FINRA and the AAA have recently implemented rules to place some limits on them. Even so, not only AAA and JAMS, but virtually every arbitration provider, now expressly permits these motions in arbitration. These motions are becoming routine in arbitration, and the additional costs involved in lawyer and arbitrator compensation can be profound.

And it should be pointed out that these types of motions are especially burdensome and are granted more often against unrepresented parties. So the suggestion that arbitration provide a meaningful forum for unrepresented workers is often very wrong.

Question 7: **Supporters of the use of pre-dispute binding arbitration agreements contend that arbitration "is a critical tool in our society because it makes justice prompt and accessible for millions of Americans, and without it too many citizens would be left out in the cold by overburdened courts and overpriced lawyers." Please respond to that contention.**

The proponents of mandatory arbitration are wrong in each of those assertions. Mandatory arbitration is not "accessible." Small claims courts are basically free, and handle small claims very efficiently without attorneys. Public courts have filing fees of only a few hundred dollars and are accessible to most plaintiffs because of fee waivers. Administrative wage-and-hour and anti-discrimination agencies are largely free and provide great access and assistance to unrepresented workers. On the other hand, arbitration is very expensive. Filing fees alone can be $13,000 at the AAA, and arbitrators routinely charge between $300 to $500 per hour per arbitrator. It is absolutely false to suggest that arbitration is a lower cost or more accessible option for employees.

It is certainly true that in many jurisdictions, courts are overburdened and that it can take several years to get to trial. But courts that are incorporating ADR into their case management processes are seeing dramatic caseload reductions. In California, in both state and federal court

trial dates are now assigned within one year of filing. By contrast, in FINRA arbitration the average time to hearing is in excess of 14 months according to their statistics.

Another fallacy in the assertion is that mandatory arbitration is the only alternative to years of delay in courts. In fact, most employment cases are well suited to mediation which is a fabulous alternative process which does indeed save everyone time and money. Parties are always free to agree to voluntary arbitration, mediation, conciliation, or any other voluntary process to expedite the process.

And as discussed above, even cases that are filed in court are subjected to ADR processes, which are usually much cheaper and fairer than mandatory arbitration.

If arbitration actually provided less expensive and quicker access to equal justice it would not be necessary to make it mandatory.

And finally, for all of the reasons stated in response to previous questions, it is wrong to call mandatory arbitration "justice." High costs, limited discovery, financially interested arbitrators, and the inability to have incorrect legal decisions corrected does not fit any commonly understood definition of justice.

Question 8: **During the hearing, you stated: "Arbitration is a dispute resolution system. It is not a justice system. It cannot be confused as a justice system." Please expound on your statements.**

Arbitration is a dispute resolution system. It is not a justice system. The ultimate goal of arbitration is finality, not reaching the legally correct result. Legally incorrect results cannot be corrected. That is not justice. Justice is a search for the truth and the correct result.

In every single material defining characteristic, arbitration is the exact opposite of our constitutionally defined justice system. Public v. private. Free v. costly. Full discovery v. limited discovery. Follow the law v. not have to follow the law. Appeal v. no appeal. A justice system is governed by principles of due process. A justice system does what is required to reach the correct result. Arbitration is an agreement to be bound by an arbitrary and oftentimes incorrect result.

It is not accurate to suggest that arbitration is a justice system. Justice systems are not designed and controlled by the more powerful parties to a dispute. Justice systems do not have decision makers with clear economic interests in pleasing repeat users. It demeans our constitution, our constitutional democracy, and the very reason for our public courts to suggest that mandatory arbitration is an equivalent justice system.

MATERIAL SUBMITTED BY THE HONORABLE TRENT FRANKS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARIZONA, AND RANKING MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

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September 14, 2009

Preserve Fair, Low-Cost Dispute Resolution for Consumers

Oppose the Arbitration Fairness Act

Dear Colleague,

On July 29, 2009, Rep. Henry C. "Hank" Johnson circulated a "Dear Colleague" letter about arbitration and his bill, H.R. 1020 (the Arbitration Fairness Act of 2009). I would like to take this opportunity to correct several assertions made about arbitration.

Rep. Johnson's letter implies that consumers' "indelible rights" to a jury trial are somehow harmed by voluntary agreements containing pre-dispute arbitration clauses. In reality, a jury trial is an unlikely prospect in the vast majority of consumer claims brought in litigation, which are typically dismissed by pre-trial motions to dismiss or summary judgment. Those consumer class actions that are settled (without any jury trial) usually leave consumers with pennies on the dollar for their claims. But most significantly, the right to a trial by jury rings hollow if a consumer's claim is so small that no lawyer will take the case. While the lack of an attorney effectively bars most consumers from proceeding in court, the simple, flexible procedures of arbitration allow consumers to proceed even if they have no representation. As a result, arbitration is often the only practical forum for resolving small-to-medium-sized consumer claims.

Rep. Johnson is also mistaken that "the courts have interpreted the [Federal Arbitration] Act to trump state laws leaving consumers very little recourse." The Supreme Court has interpreted the FAA to permit anyone to challenge an arbitration agreement if that challenge is based on generally applicable state contract law. Applying this standard, courts around the country routinely apply legal principles such as state unconscionability law to strike down arbitration agreements that do not provide consumers with fair notice or fair procedures.

Accordingly, despite Rep. Johnson's claims that burdensome arbitration clauses are often "buried" in "fine print," "written in dense legalese," and enforced "without a signature," the record is replete with instances in which courts have refused to enforce provisions with those characteristics under state law. Rep. Johnson's concerns for "high administrative fees" and a "lack of discovery" are particularly misdirected. The American Arbitration Association (AAA) limits consumer fees to only $125 for arbitration claims seeking less than $10,000. The AAA's Consumer Due Process Protocol calls for consumers to have access to discovery that is legally obtainable and relevant to their case.

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I would like also to address Rep. Johnson's statement regarding the AAA. Rep. Johnson's letter states, "[r]ecently, two major arbitration associations, the American Arbitration Association and the National Arbitration Forum agreed to refrain from arbitrating all future consumer arbitrations." This is not accurate: the AAA continues to provide consumers with the same fair, speedy, and low-cost dispute resolution services that it has provided for many years. The AAA announced that it is not currently administering any ***debt collection*** arbitrations and has placed a moratorium on administering consumer ***debt collection*** arbitrations until a series of important fairness and due process concerns are addressed and resolved.

The AAA made no similar announcement with respect to consumer arbitrations as a whole. In fact, the AAA is on record in this Congress as stating that, "[b]ased on our over 83 years of experience, and our recent experience with consumer debt arbitration, we believe that if properly executed and designed, arbitration can provide a prompt, effective and fair forum for the resolution of these disputes.

Moreover, far from evidence that H.R. 1020 should be enacted, the recent events in the debt collection arena confirm that H.R. 1020 is unnecessary. The specific concerns that were raised against one debt-collection arbitration provider, the National Arbitration Forum (NAF), have already been resolved under existing legal frameworks. In addition, the allegations against NAF were limited to a very specific subset of cases. Debt collection cases present unique concerns regardless of the forum in which the dispute is heard, and recent studies show that consumers in debt collection cases fare no better in court than they do in arbitration.

It would be a serious mistake to make generalizations about arbitration as a whole or impugn the integrity of the AAA. The AAA has long protected consumer rights in arbitration through its landmark Consumer Due Process Protocol, which was created over a decade ago with input from consumer, government, legal, business and academic experts, drawn from such organizations as the AARP, Consumers Union, Consumer Action, American Council on Consumer Interests, the Federal Trade Commission, the National Association of Attorneys General, and the National Association of Consumer Agency Administrators. A recent study by the Searle Center on Law, Regulation, and Economic Growth confirmed that the AAA vigorously enforces the Protocol in each case, and that consumers win a majority of claims that they bring in arbitration before the AAA.

H.R. 1020 is an unnecessary "solution" to a problem that does not exist. Courts around the country already police arbitration agreements for fairness, and concerns that arose with regard to one provider of a subset of consumer arbitrations have already been resolved by existing legal frameworks. In addition, like most "fixes" to systems that are not broken, H.R. 1020 comes with a huge cost. It promises to eliminate arbitration as a simple, low-cost alternative for the countless consumers whose claims are not large enough to attract an attorney.

Most sincerely,

Trent Franks
United States Congress

U.S. House of Representatives
Domestic Policy Subcommittee
Committee on Oversight and Government Reform
Jim Jordan (OH-4), Ranking Member, Domestic Policy Subcommittee
Darrell Issa (CA-49), Ranking Member, Full Committee

Justice or Avarice: The Misuse of Litigation to Harm Consumers

Staff Report
U.S. House of Representatives
111th Congress
July 22, 2009

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I. Executive Summary

Arbitration is a form of alternative dispute resolution (ADR) that has been used as an effective method to resolve disputes outside of the courts. The Supreme Court, in *Southland Corp. v. Keating*,[1] interpreted the Federal Arbitration Act,[2] as enacted in 1925, as a "national policy favoring arbitration."

Our investigation has found that debt collection is a pervasive, multi-faceted problem affecting arbitration and litigation. The same issues affect the National Arbitration Forum (NAF), the American Arbitration Association (AAA), and the courts. In its Majority report, the Domestic Policy Subcommittee claims that NAF denied consumers service of process, due process, and failed to properly apply the law.[3] However, the Majority omitted relevant facts indicating that consumers face identical issues in trial courts.

It is a logical fallacy to abstract from 239 case files from an organization that focused sixty percent of its business on debt collections and claim from this limited data that all mandatory consumer arbitration is harmful to consumers. Notwithstanding, the Majority report released by the staff of the Domestic Policy Subcommittee is a bridge to their political ends. AAA's debt collection cases composed less than ten percent of its business and it faced the same difficulties with due process as the Majority reported concerning NAF.

The problem is not arbitration. The problems consumers face in debt collection arbitration have nothing to do with arbitration. Arbitration provides a service; if businesses use that service and consumers are injured as a result, the remedy is to target those businesses, not dispute resolution providers.

A Congressional investigation on mandatory arbitration for consumers is not yet ripe. **First**, the Executive branch is taking a hard look at consumer debt collection. **Second**, the Searle Center at Northwestern University is conducting a full-blown comparison between consumer-focused arbitration and litigation and plans to release its findings by the end of the year. **Third**, any legislative action that seeks to abolish mandatory arbitration has failed to exhaust less restrictive and more effective alternatives, including model due process protocol legislation and amendments to the Fair Debt Collection Practices Act (FDCPA). **Fourth**, there is not sufficient evidence to show that litigation is better for consumers, and the best evidence available indicates the outcomes in court are abysmal for consumers.

This report should signal the need for hearings on legislative options that do not terminate mandatory arbitration. The relevant question is not mandatory arbitration – such an inquiry should not be about how to protect the income of trial lawyers – instead,

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[1] 465 U.S. 1 (1984).
[2] 9 U.S.C. §1, *et seq.*
[3] *See generally*, Staff Report of the Domestic Policy Subcommittee Majority Staff, Oversight and Government Reform Committee, Chairman Dennis J. Kucinich, *Arbitration Abuse: an examination of Claims Files of the National Arbitration Forum*, July 21, 2009.

investigations should focus on the salience of mandatory due process consumer arbitrations.

II. Litigation, More Than Arbitration, Harms Consumers

The number of consumer debt cases filed in New York City is comparable to the total number of civil and criminal cases filed in the federal trial courts.[4] According to the Urban Justice Center, New York City Civil Court is the "credit card court," where the majority of the cases filed throughout the five boroughs are consumer debt cases.[5] The Urban Justice Center stated:

> **Once a judgment is obtained by a creditor against a debtor, the situation goes from bad to tragic. A creditor with a judgment can garnish wages and freeze bank accounts.** Often, due to additional penalties, interest, fees and costs, **the ultimate judgment obtained far exceeds any original debt** that might have accrued. **Sometimes, the defendant never owed the alleged debt, which may have been the result of identify theft, mistaken identity, clerical errors, or illegal fees and charges**.[6]

A report by the Urban Justice Center (Urban Justice Report) claimed debt collectors game the court system by failing to serve consumers with either a summons or a complaint, giving consumers no notice of the lawsuits against them.[7] In New York, all creditors are represented by counsel while consumers are "virtually never represented by counsel."[8] In the court system, "80.0% of cases result in default judgments, which are routinely granted without the requisite proof to establish the damages sought."[9] The materials submitted in support of default judgments "almost always constitute inadmissible hearsay" yet "were approved 100% of the time."[10] The Urban Justice Center reported, "[t]he court system is being used to endorse hundreds of thousands of default judgments, which then wreak havoc on the lives of hundreds of thousands of New Yorkers."[11] Moreover, "debt collection litigation in New York City Civil Court has a massive monetary impact [of] almost $800 million [on New Yorkers]."[12]

The Urban Justice Report stated debt collectors obtained default judgments because consumers failed to answer the complaint or appear at a court-ordered hearing or conference.[13] This evidence parallels a 2006 investigation of consumer debt cases in small claims court in Massachusetts, where 80% of the people sued on consumer debts in

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[4] Urban Justice Center, *Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor*, (Oct. 2007), *available at* www.urbanjustice.org/cdp (last visited June 22, 2009) at 1.
[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.* at 1-2.
[11] *Id.* at 2.
[12] *Id.* at 9.
[13] *Id.* at 17.

Massachusetts courts failed to appear.[14] According to the *Boston Globe*, 60% of the more than 120,000 small claims cases filed in Massachusetts in 2005 were filed by debt collectors.[15] In Chicago, more than 119,000 civil lawsuits against alleged debtors were pending as of June 2008.[16] Twelve-thousand of these Chicago suits were assigned to a single judge—twice the number of debt collection lawsuits on that judge's docket one year previously.[17]

According to the Federal Trade Commission (FTC), debt collection law firms have experienced significant growth and debt collection attorneys collect on all types of consumer debt, including "credit card accounts, healthcare debts, mortgages, and auto loans."[18] The FTC reported, "collection law firms in the United States had revenues of $1.17 billion in 2006, and . . . this figure will grow at a rate of 16% a year to $2.3 billion by 2011."[19]

A. Consumers Lack Notice In Litigation

The Urban Justice Center described the lack of notice in consumer debt litigation, where "the problem is 'sewer service,' the failure of the plaintiff or its process server to serve the defendant. As a result, many defendants are simply not aware that they have been sued."[20]

As the Urban Justice Report explains, the overwhelming majority of judgments in consumer credit litigation are obtained on default, and consumers have no knowledge that a judgment has been entered against them.[21] Moreover, the courts become forums for abuse, as "[l]earning that a bank account has been frozen is particularly shocking and debilitating when a person has no knowledge that a judgment has been entered against him or her. When the funds are exempt from collection, freezing an account subjects a person to needless litigation and expense."[22] Courts harm consumers, who "incur significant expenses in the form of attorney fees and lost wages for time spent appearing in court."[23]

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[14] *Id.*

[15] Beth Healy, *A Debtor's Hell: Part 2, A Court System Compromised*, BOSTON GLOBE, July 31, 2006, *available at* http://www.boston.com/news/special/spotlight_debt/part2/page1.html (last visited July 18, 2009); *See also* FTC Report, *infra*, "Often these addresses [of debtors] are out of date, yet the courts assume the defendant was notified unless the letter is returned. This is a flawed system, the *Globe* found in a test: Of 100 letters sent to the same person at incorrect addresses across the state, just 52 came back . . . the other 48 simply went missing." *Id.*

[16] Ameet Sachdev, *Debt Collectors Pushing To Get Their Day In Court*, CHICAGO TRIBUNE, June 8, 2008, *available at* http://www.chicagotribune.com/news/nationworld/chi-sun-debtchasers-jun08,0,2426495,print.story (last visited July 18, 2009).

[17] *Id.*

[18] FTC Report, *Collecting Consumer Debts: The Challenges of Change – A Workshop Report*, (2009), available at: http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf, at 14 (hereinafter "FTC Report").

[19] *Id.*

[20] *Supra* note 1 at 22-23.

[21] *Id.*

[22] *Id.* at 23.

[23] *Id.* at 24.

The Federal Trade Commission (FTC) undertook a "comprehensive assessment of the debt collection industry and its practices" on the Fair Debt Collection Practices Act (FDCPA) (hereinafter "FTC Report").[24] The FTC Report stated, "consumers frequently do not appear to contest debt collection lawsuits because they have not been properly served, and, if they do not appear, the court enters a default judgment."[25] In short, "[c]ollectors are almost never asked to prove the debts they claim; defendants are rarely informed of their rights. And debtors, usually too strapped to afford a lawyer, have to contend with this legal mismatch alone."[26]

B. Litigation Clogs the Court, Further Harming Consumers

The FTC stated, "[t]he vast number of debt collection suits filed in recent years has posed considerable challenges to the smooth and efficient operation of courts."[27] The FTC reported, "[t]he majority of cases on many state court dockets on a given day often are debt collection matters."[28] Consumer advocates report "courts across the country are flooded by debt collection lawsuits."[29] As noted by the FTC, "[j]udges have expressed concern that the burden of handling the number of debt collection lawsuits on their dockets is making it difficult for them to handle other cases in an expeditious manner."[30]

The FTC stated, "debt collectors frequently use the court system in ways that harm consumers."[31] One consumer group described the litigation tragedy for consumers as follows:

> We estimate that in the past year, upwards of 80% of lawsuits against our clients based on credit cards were filed by a debt buyer. . . . When our lawyers challenge the bare and conclusory assertions made in lawsuits, the plaintiffs are unable to come forward with basic proof of the debt. . . . The frustration for our clients is endless, and they sometimes suffer monetary loss. The time and expense for our staff in unraveling these situations is significant.[32]

The problem is not arbitration but the unenforceability of the Fair Debt Collection Practices Act (FDCPA) because "[debt] collection law firms routinely take actions that appear to violate the FDCPA as well as raise troubling ethical questions."[33]

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[24] FTC Report, at 2.
[25] *Id.* at 57.
[26] *Id.* at 56-57.
[27] *Id.* at 55-56.
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] FTC Report, at 56.
[32] *See generally id.* (citing NCLC-NACA Comment at 16-19; DC 37 Comment at 3).
[33] *Id.* (citing NEDAP Comment at 4).

III. Mandatory Arbitration Is Better for Consumers

In 2007, Public Citizen published a report to demonstrate how "binding mandatory arbitration is a rigged game in which justice is dealt from a deck stacked against consumers."[34] Public Citizen's report centered on the use of mandatory arbitration clauses by the credit card industry.[35] While Public Citizen's report relied solely on data from two sources, National Arbitration Forum (NAF) arbitrations involving First USA Bank and NAF arbitrations in California involving MBNA Bank, the report broadly asserted arbitration, as a whole, was unfair and unjust.[36]

Empirical evidence suggests that mandatory arbitration clauses are not harmful to consumers. Arbitration, unlike litigation, can be efficiently improved. The Federal Trade Commission recently forced a debt collection company "that used false threats and other unlawful tactics to collect consumers' debt to settle FTC charges that they violated federal law."[37]

A. There Is No Arbitration Bias: If Anything, Consumers Do Better in Arbitration Than in Court

Current empirical legal research reflects the degree to which Public Citizen's attempt to discredit mandatory arbitration clauses is statistically flawed.[38] The FTC stated:

> Debt collection *court* cases in major United States cities were likely to be decided in favor of creditors or debt collectors 96 to 99 percent of the time. According to arbitration proponents, because the 'outcomes in arbitration mirror outcomes in court,' this suggests that there is no greater 'creditor bias' in arbitration awards than in adjudicated cases.[39]

The FTC claims arbitration is better for consumers because it allows consumers to "engage in 'document hearings' or 'telephone hearings' (thus avoiding the need and expense of traveling or taking time away from work) . . . pay an inexpensive fee . . . have their cases resolved more quickly; and . . . use simpler rules and procedures."[40] While

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[34] Public Citizen Report, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, (2007), at 1, *available at*: http://www.citizen.org/documents/ArbitrationTrap.pdf.
[35] *Id.*
[36] *Id.* at 1-2.
[37] Press Release, FTTC, *Debt Collectors Settle with FTC; Abusive Practices Affected Consumers Nationwide*, FTC v. Oxford (2009), *available at*: http://www.ftc.gov/opa/2009/07/oxford.shtm (last visited July 8, 2009).
[38] *See* Amy J. Schmitz, *Legislating in the Light: Considering Empirical Data in Crafting Arbitration Reforms*, _ HARV. NEG. L. REV. __ (forthcoming); *see also* Peter B. Rutledge, *Arbitration – A Good Deal for Consumers: A Response to Public Citizen* 10-11 (2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091.
[39] FTC Report at 58-59.
[40] *Id.* at 59-60.

debt collection cases in courts are typically resolved by a judge entering a default judgment, "arbitrators are required to review the merits of each matter before reaching a decision even if the consumer does not appear."[41]

The Searle Civil Justice Institute (SCJI), part of the Searle Center on Law and Regulation at Northwestern University Law School, reviewed 301 American Arbitration Association (AAA) case files involving consumer arbitrations.[42] Research by the Searle Center ("Searle Study") reported, "[i]n cases with claims seeking less than $10,000, consumer claimants paid an average of $96 ($1 administrative fees + $95 arbitrator fees)."[43] The Searle Study found consumers won relief in 53.3% of the cases they filed and recovered an average of $19,255.[44] Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of the cases where consumers sought such an award.[45] Moreover, the Searle Study concluded there are reputation-based incentives for arbitrators to be impartial.[46]

In several debt collection cases where businesses prevailed in arbitration, the arbitrator protected the consumer from overreaching claims by awarding less than the full amount requested by the creditor.[47] The American Enterprise Institute confirmed that arbitration provides more protection than the consumers would typically receive in a default judgment proceeding in court.[48]

Protecting consumers in arbitration is not merely a question of protecting the consumer defendant when sued by a debt collector, but also protecting the consumer plaintiff who seeks arbitration to remedy his or her disagreements. While the Minority staff does not agree that the Arbitration Fairness Act (AFA) is the best remedy for protecting consumers, we do believe arbitration can provide more fairness to consumers. In the American Arbitration Association's (AAA) analysis of consumer cases awarded between January and August 2007, consumers prevailed in 48% of cases in which they were the claimant and businesses prevailed in 74% of the cases in which they were the claimant.[49] Moreover, arbitrators are less overburdened than judges when dealing with consumer claims. In 2006, AAA appointed 535 different arbitrators to 930 consumer

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[41] *Id.* at 59-60.
[42] Searle Civil Justice Institute, *Consumer Arbitration Before the American Arbitration Association*, (hereinafter "Searle Study") at xii, *available at*: http://www.searlearbitration.org/report/.
[43] *Id.* at xiii.
[44] *Id.*
[45] *Id.* at xiv.
[46] Searle Study at 13, citing GORDON TULLOCK, TRIALS ON TRIAL: THE PURE THEORY OF LEGAL PROCEDURE 127-128 (1980).
[47] Sarah Rudolph Cole and Ted Frank, *The Current State of Consumer Arbitration*, Fall 2008, *available at* http://www.aei.org/docLib/20081117_DRFall2008.pdf, reviewing the following studies: *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure*; Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases (Ernst & Young, 2004); The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes (Mark Fellows, 2006); Arbitration – A "Good Deal" for Consumers (Professor Peter Rutledge, 2008).
[48] *Id.*
[49] AAA Document Productions, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload* (AAA 0017633).

cases, with the median number of appointments as one.[50] Sixty-four percent of the arbitrators were appointed to only one case and 81% of the arbitrators were appointed on two or fewer cases.[51]

The Majority staff report alleged problems with debt collection arbitration by focusing on NAF. However, in a series of consumer debt collection cases handled by the AAA, neutral and former law school dean Francis Spalding withdrew from his assigned debt collection cases. Spalding found inconsistencies with AAA's protocol, false statements by debt collectors, improper notice and acceptance by consumers, and a lack of proof for the allegations.[52]

Spalding argued:

> [I]t would be entirely improper for an arbitrator to enter an award in favor of [a debt collector] in the instance of any of the cases to which I was assigned on September 2, 2008. Nor, in my opinion, is it proper to classify as a fair system one in which, typically, only [the debt collector] appears . . . in which it is far easier for the arbitrator to enter an award in favor of [the debt collector] than for [the consumer]—and in which, one supposes, the expectation both of [the debt collector] and AAA staff is likely that a high proportion of default awards will fully favor [the debt collector]; and in which [the debt collector]'s standard presentation format appears in every file in a batch of nineteen presumably random selected cases is utterly deficient in multiple dimensions, as discussed above.[53]

The Majority's narrow analysis and its failure to incorporate other facts that arose from the investigation cloaks the fact that debt collection, not arbitration, is the catalyst harming consumers most.

Ernst & Young noted consumers prevailed more often than businesses in cases that went to arbitration, consumers obtained favorable results in close to 80% of the cases reviewed, and a substantial majority of consumers surveyed were satisfied with the arbitration process as shown by the 69% who indicated that they were satisfied or very satisfied with the arbitration process.[54]

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[50] Email from Ryan Boyle to Jennifer Coffman, Dec. 18, 2007 4:49 PM E.S.T. (AAA 0025526); *See also* Email from Ryan Boyle to Richard Naimark, July 25, 2007 5:35 P.M. E.S.T. (AAA 017407); Email from Ryan Boyle to Pierre Paret, Richard Naimark, Dec. 7, 2007 4:18 P.M. E.S.T. (AAA 0025697).
[51] *Id.*
[52] AAA Produced Documents, at AAA 0017392 – 0017394.
[53] *Id.* at AAA 0017394.
[54] Mary Batcher, et al., The Ernst & Young Study, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases, 16 WORLD ARBITRATION AND MEDIATION REPORT, 3 (2005); *Cf.* Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 16-17, App. A (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf.

Seventy-eight percent of trial attorneys find arbitration faster than lawsuits.[55] Ninety-three percent of consumers using arbitration find it to be fair.[56] Consumers prevail 20% more often in arbitration than in court.[57]

Professor Peter B. Rutledge, in discussing litigation, stated, "studies of debt collection actions in major cities reveals that the lender typically wins between 96% and 99% of the time, right in line with lender win-rate date cited in the Public Citizen Report."[58] Rutledge argued the higher win-rate for business claimants is due to the fact that businesses tend to bring debt collection actions in which the likelihood of success for the business is high.[59]

In recent state action to protect consumers, California recognized the ability for arbitration to "safeguard . . . impartiality by retaining unbiased arbitrators, by complying with the California Arbitration Act in letter and in spirit, and by treating opposing parties to a dispute with fairness and equality."[60]

B. Consumers Prefer Arbitration

A 2005 study by the U.S. Chamber of Commerce Institute for Legal Reform surveyed 609 adult arbitration participants and a sub-sample national cross-section of 31,045 adult arbitration participants in binding arbitrations that reached a decision, finding 66% said they would use arbitration again, 75% found arbitration to be a fair process, 72% percent found arbitration to result in a fair outcome, and 84% were satisfied with the length of their arbitration.[61] Eight-hundred registered voters who indicated they were likely to vote in the 2008 Presidential election were surveyed by the U.S. Chamber of Commerce between December 17-20, 2007 regarding consumer disputes.[62] Eighty-two percent of those surveyed strongly preferred arbitration over litigation to "resolve any serious dispute between a business and a consumer," 71% believed arbitration agreements "should not be removed" from contracts consumers sign with companies providing goods and services, 40% believed it would be "very difficult" to resolve "a

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[55] AAA Document Productions, (AAA 0017829).
[56] *Id.*
[57] *Id.*
[58] Peter B. Rutledge, *Arbitration – A Good Deal for Consumers: A Response to Public Citizen* 10-11 (2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091.
[59] *Id.*
[60] COMPLAINT FOR INJUNCTIVE RELIEF AND CIVIL PENALTIES FOR VIOLATIONS OF BUSINESS AND PROFESSIONS CODE SECTION 17200, *California v. National Arbitration Forum.; FIA Card Services, N.A.; Columbia Credit Services, Inc.*; (Filed Mar. 21, 2008) Case No. C80-98-473569.
[61] John Allen Chalk, Sr., Chair-Elect of the State Bar of Texas ADR Section, *Arbitration Empirical Studies*, ALTERNATIVE RESOLUTIONS, Winter 2009, v. 18, No. 1, at 2, citing *Arbitration: Simpler, Cheaper, and Faster Than Litigation*, Harris Interactive Survey (April 2005).
[62] *Id.* at 3, citing Survey by Public Opinion Strategies and Benenson Strategy Group, *Key Findings From a National Survey of Likely Voters* (U.S. Chamber Institute for Legal Reform) (2008).

serious consumer dispute with a company," and more than 50% believed that a court dispute, if resolved, would not be "resolved fairly to the consumer."[63]

A Navigant Consulting study observed consumers were successful in 32.1% of approximately 34,000 California consumer arbitration cases between 2003 and 2007.[64] The Navigant study reported that in an additional 16.4% of these arbitrations, the initial claims against consumers were reduced in the arbitration awards; in the cases that went to final hearing, the claims against consumers were reduced in 37.4% of the final hearing cases; in 33,935 of these cases where an arbitration fee was paid, the consumer paid no arbitration fee in 99.3% of the cases; and in the other 0.7% of the cases, the consumer paid a median fee of $75.00; and in cases where the consumer did not appear, the actual damages awarded to the debt collector-claimant were 22.6% less than damages sought by the claimant.[65]

The Searle Study presented empirical evidence showing consumer arbitration to be a speedy process, with the AAA reporting that, on average, its consumer cases took four months to resolve on the basis of documents and six months to resolve on the basis of in-person hearings.[66] The California Dispute Resolution Institute (CDRI), examining data disclosed by six arbitration providers from January 2003 to February 2004, found a mean disposition time of 116 days and a median disposition time of 104 days.[67] Mark Fellows reported that the National Arbitration Forum's (NAF) average disposition time in 2003-2004 was 4.35 months for consumer claimants and 5.60 months for business claimants.[68] These consumer claimants paid arbitration fees averaging $46.63 while business claimants paid arbitration fees averaging $149.50.[69]

IV. There are less restrictive and more effective alternative means, other than banning mandatory arbitration, to help consumers.

To claim that mandatory arbitration for consumer debt disputes is abusive or predatory is not only anecdotally false but empirically unproven. The FTC has stated, "[d]espite useful discussion . . . the workshop record does not contain adequate information to enable the agency at this time to make recommendations relating to debt

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[63] *Id.*, citing Jeff Nielsen, Garrett Rush, Jonathan Hartley, MEMORANDUM, *National Arbitration Forum: California Consumer Arbitration Data*, July 11, 2008, *available at* http://www.instituteforlegalreform.com/index.php?option=com_ilr_docs&issue_code=ADR&doc_type=STU.
[64] *Id.*
[65] *Id.*
[66] Searle Study at 8.
[67] 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*, 21 (Aug. 2004), *available at* http://www.mediate.com/cdri/cdri_print_aug_6.pdf. The six providers were the AAA, ADR Services, Arbitration Works, ARC Consumer Arbitrations, JAMS, and Judicate West. Searle Study at 14.
[68] Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, METRO. CORP. COUNSEL, at 32 (2006).
[69] *Id.*

collection litigation and arbitration."[70] In August 2009, the FTC will convene a roundtable at Northwestern law school to "discuss problems in debt collection litigation and arbitration and possible solutions," and will involve "state court judges, debt collectors, collection attorneys, consumer advocates, arbitration firms, and other interested stakeholders."[71]

Moreover, in a letter from Professor Peter Rutledge to the House Judiciary Committee, he stated:

> Congress may well conclude that additional study is needed to fill in gaps in the available data. In light of Public Citizen's concession that "data on arbitration are scarce," it is particularly hard to understand why Congress should rush headlong into abolishing a system of dispute resolution that has prevailed for nearly twenty years before the empirical picture is even complete.[72]

The arbitration debate is too often split between those who are staunch advocates of banning the enforcement of pre-dispute agreements versus those who are unwaveringly committed to the individual freedom to contract. A middle approach would be one advocated by Professor Schmitz: regulating consumer arbitrations through due process protocols.

Professor Amy J. Schmitz of the University of Colorado law school views the Arbitration Fairness Act (AFA) as overbroad, claiming it limits the options for consumers by leaving them in either small-claims court or slow and costly litigation.[73] Schmitz argued, "FTC notice is a starting place for disclosures, but is not sufficient and does not address other issues."[74] Schmitz finds that "FTC notice is cheap and easy for companies to incorporate."[75] Schmitz identified cost, notice, venue, small claims court carve-outs, and provisions for class proceedings in arbitration as the five key consumer issues affecting the arbitration versus litigation debate.[76] The AAA Consumer Due Process Protocol allows consumers to opt for small claims court and the Minority staff supports legislation that allows for venue to be in the consumer's home-state. A policy that combines consumer due process protocols together with notice provisions from the Fair Debt Collection Practices Act is an effective, well-tailored approach to protecting consumers in arbitration. Schmitz defends this position as a starting place and advocates

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[70] Federal Trade Commission, *Collecting Consumer Debts: The Challenges of Change*, Feb. 2009 at 55.
[71] *Id.* at viii.
[72] Letter from Peter B. Rutledge, Professor of Law, University of Georgia, to Honorable John Conyers and Honorable Lamar Smith, House Judiciary Committee (July 30, 2008) (on file with author).
[73] Interview with Amy J. Schmitz, Professor of Law, University of Colorado, in Washington, D.C. (July 20, 2009).
[74] *Id.*
[75] *Id.*
[76] *Id.*

that fair notice and venue to consumers does not negatively impact the benefits of arbitration to businesses.[77]

A. Enhancing the Fair Debt Collection Practices Act (FDCPA)

Abolishing mandatory arbitration fails to address two inherent problems with arbitration: first, debt collectors lack information about consumers,[78] and second, debt collectors "do not provide adequate information to consumers, thereby making it more difficult for consumers to assess whether they actually owe the debt in question and exercise their rights under the FDCPA. Improving the flow of information within the debt collection system is critical to reforming the industry."[79]

To remedy these informational problems, the FTC recommends that Section 809(a) of the FDCPA be amended to require debt collectors to obtain and provide in the "validation notices" sent to consumers, the name of the original creditor and an itemization of the principal, total of all interest, and total of all fees and other charges constituting the debt.[80]

The FTC has found that consumers would benefit from knowing about their rights under the FDCPA, and "including information about them in the validation notices collectors already are required to provide would seem to impose small marginal costs on debt collectors."[81]

Additionally, the FDCPA already provides a private action for consumers who suffer abusive debt collection practices:

> In enacting the FDCPA, Congress made clear that the FDCPA was intended to be a "primarily self-enforcing" statute, with private individual and class actions providing collectors with a powerful incentive to comply with the statute. To deter illegal collection practices, Congress authorized courts to award individual consumers who sued successfully under the FDCPA any actual damages they suffered, plus additional, "statutory," damages up to $1,000. Congress capped statutory damages for a class action of consumers at the lesser of $500,000 or 1 percent of the debt collector's net worth.[82]

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[77] *Id.*
[78] FTC Report, at iv-v.
[79] *Id.* at 20-21.
[80] *Id.* at v.
[81] *Id.* at 27.
[82] *Id.* at 66.

FTC enforcement works, for "[d]efendants in FTC actions challenging debt collection practices as unlawful have paid tens of millions of dollars in disgorgement of ill-gotten gains, consumer redress, and civil penalties."[83]

B. Model Protocol Legislation

Based upon concerns that arbitration allows "business to systematically prevent consumers from enforcing their full procedural and substantive rights," the American Arbitration Association (AAA) established the National Consumer Disputes Advisory Committee made up of representatives from the courts, the alternative dispute resolution (ADR) profession, consumer groups, government, academia, and industry in 1997.[84] The mission of the Committee was "to reach a consensus among diverse interest groups about the development and implementation of fair consumer conflict resolution standards."[85] In April 1998, the Committee created the Consumer Protocol, a statement of 15 principles designed "to impact not only the AAA, but also to influence courts, state and federal legislatures, and other providers of ADR services to consumers."[86]

The Searle Study reported, "[e]ach of the major arbitration providers has its own due process protocol or protocols."[87] The AAA's Consumer Due Process Protocol, together with the notice recommendations made in the previous section concerning the FDCPA, ensures that consumers have fair arbitrations while having knowledge of their rights.[88]

As noted in the Searle Study, the AAA reviews the arbitration clauses submitted with a demand for arbitration to determine compliance with the Due Process Protocol before it administers any consumer cases.[89] The Searle Study stated, "AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations."[90] If, after undertaking a review, the AAA determines that "a dispute resolution clause on its face, substantially and materially deviates from the

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[83] *Id.* at 9.
[84] Lucille M. Ponte, *Boosting Consumer Confidence In E-Business: Recommendations For Establishing Fair And Effective Dispute Resolution Programs For B2c Online Transactions*, 12 ALB. L.J. SCI. & TECH. 441, 450-451 (2002).
[85] *Id.*
[86] *Id.* at 451-452.
[87] Searle Study at 16; National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (Apr. 17, 1998), *available at* http://www.adr.org/sp.asp?id=22019; JAMS, JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness (revised Jan. 1, 2007), *available at* http://www.jamsadr.com/rules/consumer_min_std.asp; National Arbitration Forum, Arbitration Bill of Rights (2007), *available at* www.adrforum.com/users/naf/resources/ArbitrationBillOfRights3.pdf.
[88] *See* AAA Document Productions at (AAA 0003779) and (AAA 0004517).
[89] Searle Study, at 30.
[90] Searle Study, at xiv.

minimum due process standards of this Protocol, the Association may decline to administer cases arising under this clause."[91]

The Due Process Protocol sets out an overarching principle of "fundamental fairness."[92] The Searle study found, "the bulk of protocol provisions address procedural aspects of arbitration . . . [t]he protocols typically require: (1) independent and impartial arbitrators; (2) reasonable arbitration costs; (3) a reasonably convenient hearing location; (4) reasonable time limits for the proceeding; (5) the right to representation; (6) adequate discovery; and (7) a fair hearing."[93]

As an additional protection, the AAA Consumer Rules allows a party to seek relief in small claims court even when the party had agreed to arbitrate.[94] In addition, the Due Process Protocol requires the arbitrator to follow the law in making a decision and to issue a written award (with reasons upon request).[95] The American Bar Association (ABA), observed that 86.2% of attorneys in the General Practice Solo and Small Firm Division believed their clients' interest were best served by alternative dispute resolution (ADR) solutions and 68.6% would use arbitration more if arbitrators were required to follow the law, with 55.4% claiming they would use arbitration more often if the arbitrators were lawyers or judges.[96] The AAA Due Process Protocol clearly meets these demands.

The AAA's Consumer Due Process Protocol is effective and in a "sample of AAA consumer arbitrations, the majority of consumer arbitration clauses (2229 of 299, or 76.6%) fully complied with the Consumer Due Process Protocol as applied by the AAA."[97] According to the Searle Study, the AAA's review of arbitration clauses for protocol compliance is effective at "identifying and responding to those clauses with protocol violations."[98] The Searle Study claimed:

> [T]he AAA effectively reviews arbitration clauses for protocol compliance and appropriately responds to clauses that do not comply. A number of businesses have responded to AAA compliance efforts by changing their arbitration clauses to comply with the Protocol. Any consideration of the need for legislative

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[91] *Id.* at 27, citing American Arbitration Association, Rules Updates, *Consumer Arbitrations: Notice to Consumers and Businesses*, *available at* http://www.adr.org/sp.asp?id=24714&printable=true (last visited July 18, 2009).
[92] National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (Apr. 17, 1998), *available at* http://www.adr.org/sp.asp?id=22019, princ. 1.
[93] Searle Study, at 21, Consumer Due Process Protocol, princs. 3, 6-9, 12 & 13.
[94] AAA Consumer Rules, American Arbitration Association, *Supplementary Procedures for the Resolution of Consumer-Related Disputes* (effective Sep. 15, 2005), *available at* http://www.adr.org/sp.asp?id=22014.
[95] Searle Study, at 21, Consumer Due Process Protocol, princ 15.
[96] John Allen Chalk, Sr., Chair-Elect of the State Bar of Texas ADR Section, *Arbitration Empirical Studies*, 18 ALTERNATIVE RESOLUTIONS, Winter 2009, No. 1, at 2, citing an independent survey administered by Surveys and Ballots, Inc., and published by the National Arbitration Forum.
[97] Searle Study at 110.
[98] *Id.*

> action should take into account such private regulation of consumer arbitration.[99]

In 98.2% of cases subject to AAA's protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was identified and responded to by the AAA.[100] According to Kansas law professor Chris Drahozal, in 2007 "[t]he AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases because the business failed to comply with the Consumer Due Process Protocol. More than 150 businesses have either waived problematic provisions or revised arbitration clauses in response to the Consumer Due Process Protocol."[101]

Congress should protect consumers by requiring that all arbitration providers abide by a model Due Process Protocol, shaped after the AAA's Consumer Due Process Protocol and that all arbitration agreements inform the consumer of his or her rights under the Fair Debt Collection Practices Act (FDCPA). Banning mandatory arbitration is not the solution. Professor Amy Schmitz stated, "legislative solutions should focus on regulating procedures in arbitration and curbing arbitration clause terms, rather than barring enforcement of all pre-dispute arbitration agreements in consumer contracts."[102]

V. Conclusion

The Majority cherry-picked case files from an investigation to buttress their political objectives. This report takes a more balanced view, by considering facts left out from the Majority report. Debt collection was a problem for the two major arbitration providers and will continue to be a problem for the courts. This report has shown how debt collection harms consumers more in litigation than in arbitration and the FDCPA and a model Due Process Protocol can be fruitfully combined to preserve arbitration while protecting consumers. Moreover, Congress must be cautious in its legislative actions because empirical data on debt collection and arbitration is still needed. The FTC will hold a roundtable on "Protecting Consumers in Debt Collection Litigation and Arbitration" on August 5-6, 2009 at the Searle Center on Law, Regulation, and Economic Growth at Northwestern University School of Law. Kansas law professor Chris Drahozal is currently working on an empirical study concerning debt collection arbitration and the consumer. The results of these efforts will more clearly frame an investigation on arbitration and debt collection and guide Congress's next steps. It is important that Congress not attempt solutions without the necessary data to support them.

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[99] *Id.* at 111-112.

[100] Statement of Christopher R. Drahozal, *Hearing on Arbitration or 'Arbitrary': The Misuse of Arbitration to Collect Consumer Debts*, July 22, 2009, Subcomm. on Domestic Policy, H. Comm. on Oversight and Government Reform, at 11.

[101] *Id.*

[102] Amy J. Schmitz, *Curing Consumer Warranty Woes Through Regulated Arbitration*, 23 OHIO ST. J. ON DISP. RESOL. 627, 640-641.

About the Committee

The Committee on Oversight and Government Reform is the main investigative committee in the U.S. House of Representatives. It has authority to investigate the subjects within the Committee's legislative jurisdiction as well as "any matter" within the jurisdiction of the other standing House Committees. The Committee's mandate is to investigate and expose waste, fraud and abuse.

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Opening Statement
Of
Michael F. Kelly
CEO
Forthright

Domestic Policy Subcommittee
Oversight and Government Reform Committee

Wednesday, July 22, 2009
2154 Rayburn HOB
2:00 p.m.

Chairman Kucinich, Ranking Member Jordan, and members of the Committee, thank you for the opportunity to discuss the vital role that consumer arbitration can and should play in the U.S. justice system.

Arbitration is a simple, fair, and cost-effective way for consumers and businesses to resolve disputes outside of the traditional litigation system. American consumers benefit from arbitration in myriad ways that I will briefly outline for you in my remarks.

First, however, I want to relate to the Committee the National Arbitration Forum's recent announcement that it is no longer accepting consumer arbitration cases. In spite of this announcement, my belief remains strong that arbitration provides the superior access to justice to consumers and that arbitration is an excellent method of resolving consumer disputes.

Unfortunately, the FORUM lacks the necessary resources to defend against increasing challenges to arbitration leveled from all fronts, including from state Attorneys General and the class action trial bar.

Mounting legal costs, a challenging economic climate, and increased legislative uncertainty surrounding the future of arbitration have prompted the FORUM to announce that it will no longer accept consumer arbitration cases.

I want to emphasize that FORUM's exit from the consumer arbitration arena represents a significant loss for consumers. Without access to arbitration, consumers with smaller value claims will not be able to secure legal representation, and will be left to navigate the litigation system by themselves.

Arbitration provides consumers with several significant advantages compared with court litigation. These advantages include:

Consumer arbitration is simple. Consumers can submit and respond to arbitration claims in their own words, in plain English, and are not bound by the formalities of legal proceedings that could prevent them from telling their stories and proving their cases.

Consumer arbitration is accessible. Arbitration provides every consumer with access to justice, especially low- and middle-income consumers who often cannot afford lawyers or prolonged trials. Many lawyers will not even accept representation for smaller-value claims, such as those often settled in arbitration. Arbitration gives these consumers a full and fair opportunity to resolve disputes, and allows consumers to hold businesses accountable for mistakes.

Consumer arbitration is flexible. Consumers can elect to appear for a hearing in person, via telephone, or simply by submitting documents, which saves consumers the expense of missing work or travelling to a hearing. Alternatively, all parties have the right to retain an attorney to represent them in arbitration, though every consumer receives the same protections regardless of whether there is an attorney present.

Consumer arbitration is affordable. Filing fees at the National Arbitration Forum started at just $19 for claims up to $1,500, and fees did not climb above $40 until the size of the consumer claim exceeded $13,000. Low income consumers could have filing fees waived in arbitration and bring a claim against a business without paying anything. When fees prevented consumers from asserting a claim with the National Arbitration Forum, fees were shifted to the business party.

Consumer arbitration is fair. Consumers receive the same or better protections in arbitration as in court. National Arbitration Forum neutrals are independent legal experts who were bound by comprehensive rules, including the FORUM Arbitration Bill of Rights, Code of Conduct for Arbitrators, Statement of Principles, and Code of Procedure.

FORUM arbitrators were required to consider the merits of each case, apply the same laws that would apply in court, and empowered to issue all of the same remedies that can be awarded in court. In addition, courts enter default judgments against consumer parties that do not participate in litigation, whereas arbitrators independently consider the evidence for every claim and rule on the merits, regardless of the participation of the consumer.

Consumer arbitration decisions are confirmed by courts. To be legally enforceable, an arbitration decision must be confirmed by a court. Although courts do demonstrate respect for arbitral decisions, courts have shown that they are more than willing to overturn arbitration awards where the arbitrators exceeded his/her powers, demonstrated bias, or failed to provide due process to a party.

The National Arbitration Forum consumer protections, simple procedures, low fees, quick resolutions, and efficient administration meant that consumers could resolve disputes and obtain the same outcome they would have received in court.

Perhaps just as important as the FORUM's consumer protections was our continued commitment to *increasing* consumer protections in arbitration. Over the last twenty years, for example, consumer and judicial feedback have directly led to improvements in our arbitration process, such as: lower consumer filing fees, improved service rules, tightened restrictions on hearing

jurisdictions and arbitrator qualifications, a consumer liaison, a new educational website designed to help consumers navigate the arbitration process, and on and on.

Opponents of consumer arbitration often make scurrilous and baseless claims about the arbitration process, using anecdotes and misleading statistics to give the appearance of impropriety where there is none.

Arbitration opponents, including the trial bar and the advocacy group Public Citizen, cite apples-to-oranges comparisons of arbitration and litigation, and use ominous jargon like "repeat player effect" to try to demonstrate that consumers face a stacked deck in arbitration.

Data and outcomes research for similar cases confirm that win rates for consumers and businesses are the same in arbitration as in court.

- For example, consumers bringing arbitration claims against businesses prevailed 65.5 percent of the time in arbitration, and 61.5 percent of the time in court, according to the Bureau of Justice Statistics, U.S. Department of Justice. In other words, consumers prevailed an additional 4 percent of the time in arbitration versus the courts.

- Businesses bringing claims against consumers prevailed 77.7 percent of the time in arbitration, and 76.8 percent of the time in court, according to the same study – virtually identical results.

- In a study of consumer debt collection matters in particular, lenders prevailed against consumers in 93.8 percent of cases, compared to 96 percent of cases in court. That means that consumers in arbitration actually prevailed in 2.2 percent more cases than consumers in court, and at a lesser expense to the consumers.

Repeat users in arbitration obtain no better results than repeat users in court.

Claims made by arbitration opponents about the inherent bias of the arbitration system are simply not true. National Arbitration Forum consumer arbitration cases were decided by experienced, independent legal professionals. FORUM neutrals were former judges or experienced attorneys who are impartial, bound to a code of professional ethics, and decide cases outside of any influence from the FORUM or the other parties. Experienced FORUM neutrals would simply never jeopardize their considerable professional reputations or standing in the community by deciding an arbitration case on any basis other than the merits of that particular case.

Congress enacted the Federal Arbitration Act in 1925 to establish arbitration as an antidote to the "costliness and delays of litigation." For more than 80 years, arbitration has provided access to justice for millions of American consumers, and Congress and the U.S. Supreme Court have repeatedly endorsed consumer arbitration as an effective and fair alternative dispute resolution process.

Now, legislation currently before Congress, the Arbitration Fairness Act of 2009 (H.R. 1020), threatens to eliminate arbitration as an effective means of alternative dispute resolution, deny many consumers access to justice altogether, and clog state courts with thousands of additional cases at a time when state court systems face historic backlogs and budget crises.

The Arbitration Fairness Act will cause considerable harm to American consumers, the very group it is intended to protect. Middle- and low-income Americans will lose access to justice because they cannot afford lawyers, prolonged trials, or because attorneys often will not accept representation for smaller-value claims.

Consumers will no longer be able to force businesses to arbitrate claims, but will instead have to engage in complex, expensive and unpredictable litigation. For additional context, consider what the reality of dispute resolution through litigation – a reality that Newsweek recently referred to as "Litigation Hell" – means for consumers:

For even the most minor case, a consumer will have to hire an attorney, who bills at upwards of $100 per hour. The attorney will accumulate billable client hours for discovery, procedural motions, and jury selection – all of which are being further delayed by overcrowded court dockets and understaffed courts. In the end, a contingent fee attorney would need to receive a verdict for thousands of dollars to recover his/her billable fees. Claims of that size are not the reality for most consumers who use arbitration to resolve disputes. Litigation is great for lawyers, but not for consumers, as the costs of litigation would be prohibitive for all but the richest litigants.

Businesses can afford long and costly litigation, so consumers will again be disadvantaged, and the costs of litigation will simply pass to consumers in the form of increased prices for products and services, or decreased wages for employees.

Eliminating arbitration will also flood federal and state courts with consumer credit cases – which have roughly tripled in some jurisdictions since 2000 – at a time when budget cuts are forcing personnel reductions. States will be forced to hire additional judges and staff; build and furnish new courthouses; and implement more administration to manage the process – the cost of which will fall to American consumers in their role as taxpayer.

In fact, the only party that will benefit from the Arbitration Fairness Act is trial lawyers, because the legislation will increase legal fees, and force disputes that would otherwise be efficiently resolved in arbitration into lucrative and expensive class action lawsuits.

The answer to isolated abuses of the arbitration process by industry bad actors is not to eliminate arbitration.

The answer is to ensure that consumer due process protections are preserved in arbitration.

The answer is to codify industry best practices, including those that were employed by the National Arbitration Forum.

The answer is to continue to allow affordable access to arbitration, not only for corporations and the rich, but for all Americans.

The answer is to protect arbitration as the best option for consumers and businesses to resolve disputes outside of the court system.

Thank you.

Statement of Christopher R. Drahozal

John M. Rounds Professor of Law
University of Kansas School of Law

Chair, Consumer Arbitration Task Force
Searle Civil Justice Institute

July 22, 2009

House Committee on Oversight and Government Reform
Subcommittee on Domestic Policy

Hearing on
Arbitration or 'Arbitrary':
The Misuse of Arbitration to Collect Consumer Debts

Chairman Kucinich, Ranking Member Jordan, and Members of the Subcommittee: I appreciate the opportunity to testify on what is known colloquially as "debt collection arbitration" – arbitration claims brought by creditors seeking to recover amounts alleged to be owed by consumers. I am the John M. Rounds Professor of Law at the University of Kansas School of Law, and the Chair of the Consumer Arbitration Task Force of the Searle Civil Justice Institute. I also am an Associate Reporter for the Restatement, Third, of the U.S. Law of International Commercial Arbitration, and have written extensively on the law and economics of arbitration.

I. Overview

My testimony today addresses empirical evidence on two central issues arising out of debt collection arbitration: (1) how consumers fare, in particular relative to how consumers fare in similar cases in court; and (2) whether arbitration is biased in favor of repeat players – i.e., parties that appear more frequently in arbitration. Both critics and supporters of arbitration in consumer settings have come to recognize the importance of empirical evidence in making sound public policy decisions in the area.[1] Indeed, Professor Peter B. Rutledge has recently written that "there now appears to be a consensus that the future of arbitration should be decided by data, not anecdote."[2]

The empirical evidence I discuss is from an ongoing study by the Searle Civil Justice Institute of consumer arbitrations administered by the American Arbitration Association. The study is discussed in more detail below. Key findings from the study (including preliminary results from an examination of debt collection cases in court) are the following:

- In a sample of AAA consumer arbitrations, business claimants won some relief in 83.6% of awarded cases and in those cases recovered an average of 93.0% of the amount claimed. By comparison, in a sample of cases from Oklahoma state courts, business claimants bringing debt collection cases won some relief in 99.7% of the cases going to judgment, and in those cases were awarded 99.5% of the amount sought. Similarly, in a sample of cases in which the federal government sought to recover unpaid student loan debts in federal court, the government won some relief in 99.7% of the cases, and in those cases was awarded 99.3% of the amount sought.

- In addition, the study found mixed evidence as to whether a repeat-player effect exists in arbitration (i.e., whether repeat businesses fare better than non-repeat businesses in arbitration). Using a traditional definition of repeat-player business, the study found no

[1] Peter B. Rutledge, Whither Arbitration?, 6 GEO. J.L. PUB. POL'Y 549, 589 (2008) (concluding that "[i]ncreased congressional attention" to consumer and employment arbitration "can be valuable, for it promotes discussion and study about this valuable dispute resolution tool" but also "can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study"); Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration 2 (2008), available at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf ("Rutledge concludes Whither with the warning that congressional scrutiny of arbitration 'can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study.' We agree.").

[2] Peter B. Rutledge, Common Ground in the Arbitration Debate, 1 Y.B. ARB. & MED. 1 (2009).

statistically significant repeat-player effect in arbitration. When an alternative definition was used, the study did find some evidence of a repeat-player effect, but the data suggest that any such effect is due to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims), rather than any bias in arbitration.

II. Creditors in AAA Consumer Arbitrations: Summary of Results from the Searle Study

In March 2009, the Consumer Arbitration Task Force of the Searle Civil Justice Institute – of which I serve as chair – released a Preliminary Report on Consumer Arbitration Before the American Arbitration Association.[3] The American Arbitration Association ("AAA") is a leading provider of arbitration services, including arbitrations between consumers and businesses. The study is the most comprehensive empirical research to date on consumer arbitration procedures and outcomes. Funding for the study comes exclusively from the initial grant establishing the Searle Center at Northwestern Law School from the late Daniel C. Searle, longtime philanthropist and Northwestern University trustee. A copy of the Executive Summary is appended at the end of this statement, and a full copy of the Preliminary Report is available at www.searlearbitration.org.

A. Empirical Methodology

The primary dataset studied by the Task Force consists of 301 AAA consumer arbitrations that were closed by an award between April and December 2007.[4] (The focus on cases closed by an award during this time period is based on the availability of the original case files.) Just over twenty percent (61 of 301, or 20.3%) of the cases in the sample involved claims brought by businesses against consumers, typically as creditors seeking to recover amounts allegedly owed by consumers for services rendered or goods supplied. The most common types of business claimants in the sample were law and accounting firms (20 of 61, or 32.8%), home builders (13 of 61, or 21.3%), and real estate brokers (12 of 61, or 19.7%). Credit card companies and other lenders made up another roughly fifteen percent of the business claimants in the sample.

The sample of cases was coded for approximately 200 variables describing various aspects of the arbitration process. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA. Prior to release, the report was reviewed by independent academic experts on arbitration and empirical studies, including both critics and supporters of consumer arbitration. It also was subject to

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[3] Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association (Mar. 2009), available at www.searlearbitration.org.

[4] Beginning in fall 2007, the AAA administered a number of arbitrations brought by a single buyer of consumer debt. Those cases were not covered by the Preliminary Report because no awards were issued until 2008 and insufficient data was available on those cases. We are currently in the process of studying the procedures and outcomes in those cases, and will report our findings when they become available.

review by the SCJI Board of Overseers, which consists of general counsels, plaintiffs' lawyers, defense lawyers, academics, and state and federal judges.

B. Outcomes

A central controversy in discussions of debt collection arbitration is how consumers fare. A number of empirical studies have examined the success rate of consumers in such arbitrations, focusing on claims against credit cardholders and using data on arbitrations administered by the National Arbitration Forum. The studies find a win-rate for business claimants (almost exclusively credit card issuers or their assigns) ranging from 67.9% to 99.6%.[5] Much of the variation in these results is due to differences in how the studies treat cases that are settled or dismissed before an award.

The Searle study, which instead looked at AAA arbitrations involving different types of business claimants, found that business claimants won some relief in 83.6% of the awarded cases and recovered an average of $20,648 in those cases – or 93.0% of the amount claimed. By comparison, consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255 in those cases, or 52.1% of the amount claimed.

These numbers do not in themselves show that arbitration is a biased means of resolving consumer disputes. Despite suggestions to the contrary, a high win-rate for business claimants by itself does not show bias. The win-rate is only meaningful in comparison to some baseline. A fifty percent win-rate for claimants may be extremely high if claimants bringing similar claims tend to win at a lower rate in court, or extremely low if claimants bringing similar claims tend to win at a higher rate in court. The same is true of a ninety-percent win-rate or even a ninety-nine percent win-rate.

Nor does comparing the win-rates of business claimants to the win-rates of consumer claimants provide evidence of bias in arbitration. As we explained in our Preliminary Report, the differing success rates for business claimants and consumer claimants appear to result from two factors, neither of which are evidence of bias.[6] First, the types of claims businesses in our sample bring differ from the types of claims consumers bring. Businesses tend to bring claims for amounts they are owed for services already rendered (the subject of this hearing). In such cases, the business faces fewer hurdles to establishing liability, and, when it does so, the amount

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[5] Mark Fellows, The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes, METRO. CORP. COUNSEL, July 2006, at 32 (business claimants "prevail in 77.7% of the cases that reach a decision"); Jeff Nielsen et al., Navigant Consulting, National Arbitration Forum: California Consumer Arbitration Data 1 (July 11, 2008), available at http://www.instituteforlegalreform.com/index.php?option=com_ilr_docs&issue_code=ADR&doc_type=STU (businesses prevailed in 67.9% of NAF arbitrations either heard by an arbitrator or dismissed); Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers 15 (Sept. 2007), available at http://www.citizen.org/documents/ArbitrationTrap.pdf ("In 19,294 cases in which an arbitrator was appointed, the business won in 18,091 (or 93.8%)"); Answers and Objections of First USA Bank, N.A. to Plaintiff's Second Set of Interrogatories, Ex. 1, Bownes v. First U.S.A. Bank, N.A. et al., Civ. Action No. 99-2479-PR (Ala. Circuit Ct. 2000), available at http://www.tlpj.org/briefs/McQuillan%20exhibits%2016-19%20(300dpi).pdf (last visited Dec. 10, 2008) (bank prevailed in 19,618 NAF arbitrations, while credit cardholder prevailed in 87).

[6] Searle Civil Justice Institute, supra note 3, at 70.

it should be awarded is relatively easy to calculate and prove. Consumers tend to bring claims alleging delivery of defective goods or improper performance of services. Such cases tend to present more difficult questions of proving both liability and damages. Accordingly, consumers tend to win less often in cases that make it to an award, and, when they do win, tend to recover a lower percentage of the damages they seek. Second, a number of business claims are resolved on an ex parte basis, because the consumer fails to respond to the demand for arbitration.[7] Conversely, the business respondent appeared in every case brought by a consumer. The greater number of defaults is another important factor in explaining the higher success rate of business claimants.

Instead, the proper comparison is between outcomes in cases in arbitration and outcomes in similar cases in court. In the next phase of the Searle study we are seeking to undertake such a comparison. Some preliminary results of that inquiry are reported in Part III of this statement.

C. Repeat-Arbitrator Bias

A related concern is so-called "repeat-arbitrator bias." Unlike judges, who get paid regardless of how many cases they decide, arbitrators get paid only when they are selected to decide a case. These differing compensation structures have given rise to fears that arbitrators will be biased in favor of "repeat players," parties that are more likely to be in a position to appoint the arbitrator in a future case.[8] In debt collection arbitrations, the creditor is a repeat player; consumers are unlikely to be repeat players, although their attorneys may be.

Prior academic studies have found some evidence of a "repeat-player effect" – that repeat players have higher win-rates in arbitration than non-repeat players. But the studies have generally attributed the repeat-player effect to better screening of cases by repeat players rather than bias by arbitrators.[9] The findings of the Searle study are similar.

First, the study found no statistically significant repeat-player effect using a traditional definition of repeat-player business. Consumer claimants won some relief in 51.8% of cases against businesses that appear more than once in the AAA dataset (repeat businesses) and 55.3% of cases against businesses that appear only once (non-repeat businesses) – a difference that is not statistically significant.

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[7] Of the sixty-one cases brought by business claimants, twenty-two (or 36.1%) were resolved on an ex parte basis – i.e., without the consumer appearing in the case. Id. at 70 n.59.

[8] E.g., Richard M. Alderman, Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform, 38 HOUS. L. REV. 1237, 1256 (2001); David S. Schwartz, Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration, 1997 WIS. L. REV. 33, 60-61; see also Public Citizen, Arbitration Debate Trap, supra note 1, at 24-26.

[9] E.g., Lisa B. Bingham, Unequal Bargaining Power: An Alternative Account for the Repeat Player Effect in Employment Arbitration, IRRA 50TH ANN. PROC. 33, 39-40 (1998); Lisa B. 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 ALTERNATE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NEW YORK UNIVERSITY 53RD ANNUAL CONFERENCE ON LABOR 303, 323 tbl. 2 (Samuel Estreicher & David Sherwyn eds. 2004); Elizabeth Hill, AAA Employment Arbitration: A Fair Forum at Low Cost, DISP. RESOL. J., May/July 2003, at 15.

Second, using an alternative definition of repeat player, the study found some evidence of a repeat-player effect. Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses (as defined based on the AAA's categorization of businesses in enforcing its Consumer Due Process Protocol) – a difference that is statistically significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that any repeat-player effect is attributable to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims) rather than arbitrator bias.

III. Creditors in Court: Preliminary Results

As noted above, the next phase of the Searle study is seeking to compare outcomes in the AAA consumer arbitration cases we studied to outcomes in similar court cases. That phase is underway, and we are able to report some preliminary results. These results are preliminary; that is, they are subject to further analysis and review. Although we do not expect them to change significantly, that remains a possibility. We also will be considering data from other courts than those described below, which may or may not give similar results. Nonetheless, the data below provide some insights into the outcomes of debt collection cases in court.

A. Federal Court Student Loan Cases

Data on federal court cases compiled by the Administrative Office of the U.S. Courts are widely used by researchers studying court outcomes. Included in the dataset are cases brought by the federal government that seek to recover amounts owed on unpaid student loans. In those cases, a creditor (i.e., the federal government) is seeking to recovery an amount (averaging just over $17,000) allegedly owed by a consumer. The cases are debt collection cases in federal court seeking an amount similar to the amount sought in the AAA consumer cases we studied.

We examined all federal court cases terminated between late 2006 and late 2007, the most recent period for which data is available, coded as involving unpaid student loans. Our sample consists of those cases in which a prevailing party and some amount demanded were recorded in the dataset, so that we could calculate win-rates and the percentage of the amount demanded that was recovered by a prevailing plaintiff.[10] To correct obvious coding errors in the data, we examined federal court docket sheets available on Westlaw, and, when necessary, the original court files using PACER.

[10] Because the cases all involved claims for unpaid loans, the amount sought likely is specified in the complaint filed in the case. We have no reason to believe that our focus on those cases in which the amount demanded was coded as a non-zero amount biases our results in any way.

Of the 382 cases in our sample, 286 (or 73.5%) were resolved by default judgment, and another 84 (22.0%) by consent judgment. Another 11 cases were adjudicated by pretrial motion (usually on summary judgment); the government won all 11 of those cases. No case made it to trial, by jury or by judge. In only one case (1 of 382, or 0.3%) did the defendant prevail.[11] Overall, then, excluding consent judgments, the government as creditor won in 297 out of 298 cases (99.7%), with 286 (or 96.0%) of those cases consisting of default judgments.

Moreover, the government recovered the entire amount sought (or more) in 96.6% (285 of 295[12]) cases in which it prevailed. Overall, the government recovered an average of 99.3% of the amount it sought.

B. Oklahoma State Court Cases

The vast majority of debt collection cases are brought in state court, rather than federal court.[13] Unfortunately, the availability of systematic data from state courts is much more limited. As part of the next phase of the Searle study, we collected data from a random sample of court files from cases in Oklahoma district courts for which complete case filings are available online.[14] The sample consists of 421 cases seeking less than $10,000 filed in Oklahoma district courts and closed between March 31, 2007, and December 31, 2007 (the dates covered by our AAA consumer cases).

Of those 421 cases, 419 were brought by creditors seeking to recover unpaid debts. (The other two were brought by consumers; both of the cases with consumer claimants settled). The majority of the creditor claims (245 of 419, or 58.5%) were brought by a party other than the original creditor, either a debt collection agency or debt buyer. This is not surprising, because Oklahoma law precludes such parties from suing in small claims court.[15]

Over two-thirds of the claims brought by creditors (282 of 421, or 67.0%) resulted in default judgments in favor of the creditor. Just over a quarter (108 of 421, or 25.7%) were dismissed (usually either because of a settlement or for inability to serve process, although it is difficult to be certain). An additional twenty-two cases (5.2% of the sample) resulted in agreed awards in favor of the creditor. Nine cases were decided on summary judgment; in eight of those

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[11] In that case, the court originally entered a default judgment against the consumer. Later, the default judgment was vacated and the case was dismissed, based on the parties' agreement that the consumer was not liable for the debt. Arguably, the case should not have been included in the sample at all, because the case was terminated in 2008, rather than in the sample period.

[12] Data on the amount recovered were missing in two of the cases. In a number of the cases, the damages awarded were more than the amount claimed, almost always because interest continued to accrue while the case was pending. In all of those cases, the creditor recovered the full amount of principal sought, and so accordingly we capped the recovery at 100% of the amount claimed.

[13] Federal Trade Commission, Collecting Consumer Debts: The Challenges of Change 55 (Feb. 2009).

[14] A number of states permit online access to court filings. Oklahoma courts are unusual, if not unique, in that they permit a user to search for cases closed in particular months or years. The sole reason we chose Oklahoma courts to study was the ability to search court files online in such a manner.

[15] 12 Okla. Stat. § 1751(B) ("No action may be brought under the small claims procedure by any collection agency, collection agent, or assignee of a claim ...."). We are also studying other divisions of the Oklahoma district courts (including the small claims division), but do not have yet have results to report.

cases the creditor prevailed. No case made it to trial, by jury or by judge. Overall, of the cases that made it to judgment (i.e., were not dismissed or settled), the creditor prevailed 99.7% (290 of 291) of the time, with 96.9% (282 of 291) of those judgments entered by default.

Of the cases in which the creditor had judgment entered in its favor (excluding agreed judgments), the creditor recovered at least 100% of the amount of damages claimed 98.6% (284 of 288 cases) of the time.[16] In the four cases (1.4% of the total judgments) in which the creditor recovered less than 100% of the amount sought, the percent recovered ranged from 30% to 97%.[17] Overall, creditors recovered on average 99.5% of the amount they sought in cases in which judgment was entered in their favor.

IV. Limitations and Conclusions

While the empirical results presented in the Searle study are the most comprehensive available, the study nonetheless has limitations. First, its findings on arbitration are limited to AAA consumer arbitration. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. That said, in setting national policy concerning arbitration, information on consumer arbitrations administered by the AAA, a leading provider of arbitration services, certainly is necessary for making an informed decision. Second, our preliminary findings on debt collection actions in court are, as stated, preliminary, and are limited to particular types of claims and specific courts. The study is ongoing: we are continuing to examine other courts and other types of claims, and any additional findings may vary. Third, cases are not selected into arbitration randomly; thus, finding truly comparable cases between court and arbitration is extremely difficult.

Despite these limitations, the preliminary findings nonetheless appear to be inconsistent with the argument that high win-rates for businesses in debt collection arbitrations show that arbitration is biased in favor of those businesses. Instead, the win-rates, while high in absolute terms and higher than win-rates for claims brought by consumers in arbitration, appear similar to win-rates for comparable claims brought in court. Thus, while the findings are only preliminary, they nonetheless suggest that business win-rates in debt collection cases may be due to the types of claims being brought and not to the forum in which they are adjudicated.

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[16] In two of the cases, the judgment document itself was not available in the online database. In a number of the cases, the damages awarded were more than the amount claimed, almost always because interest continued to accrue while the case was pending. In all of those cases, the creditor recovered the full amount of principal sought, and so accordingly we capped the recovery at 100% of the amount claimed.

[17] In the case in which the creditor recovered thirty percent of the amount sought, the creditor sought to recover the collateral for the loan as well. The difference between the amount sought and the amount recovered may reflect the value of the collateral.

Searle Center on Law, Regulation, and Economic Growth

Searle Civil Justice Institute

CONSUMER ARBITRATION BEFORE THE AMERICAN ARBITRATION ASSOCIATION

Executive Summary
March 2009

Issues and Background

Empirical evidence has become a central focus of the policy debate over consumer and employment arbitration. Both supporters and opponents of the proposed Arbitration Fairness Act, which would make pre-dispute arbitration clauses unenforceable in consumer and employment (and franchise) agreements, have recognized that empirical evidence on the fairness and integrity of consumer and employment arbitration proceedings is essential to making an informed decision on the bill. Yet the empirical record, particularly on consumer arbitration, has critical gaps.

One set of issues on which further empirical research would be helpful is the costs, speed, and outcomes of consumer arbitrations. How much do consumers pay to bring claims in arbitration? How long do consumer arbitrations take to resolve? How do consumers fare in arbitration, particularly against businesses that are repeat users of arbitrators and arbitration providers? While a number of important studies on employment arbitration have been provided, the empirical record on these issues in consumer arbitrations is sparse.

A second set of issues of interest involves the enforcement of arbitration due process protocols -- privately created standards setting out minimum requirements of procedural fairness for consumer and employment arbitrations. Due process protocols commonly require independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court. Leading arbitration providers have pledged not to administer arbitrations arising out of arbitration clauses that violate the protocols. But empirical evidence on the effectiveness of these private enforcement efforts is lacking.

Searle Civil Justice Institute Task Force on Consumer Arbitration

To shed light on these issues, the Searle Civil Justice Institute (SCJI) undertook a large-scale study of consumer arbitrations administered by the American Arbitration Association (AAA). The AAA is a leading provider of arbitration services, including arbitrations between consumers and businesses. SCJI commissioned a Task Force to advise and lead this study of consumer arbitrations. Although the study will ultimately examine many aspects of AAA consumer arbitrations, the initial research inquiries were directed at two topics:

1. Costs, Speed, and Outcomes of AAA Consumer Arbitrations. This aspect of the Preliminary Report assesses key characteristics of the AAA consumer arbitration process. In particular, it examines the following research questions:

    - General characteristics of AAA consumer arbitration cases including claimant type (i.e., consumer or business), types of businesses involved, and amounts claimed.
    - Costs of consumer arbitration (arbitrator fees plus AAA administrative fees), including the impact of the arbitrator's power to reallocate such fees in the award.
    - Speed of the arbitration process from filing to award, in the aggregate and by claimant type (i.e., consumer or business).
    - Various measures of outcomes such as win-rates, damages awarded, and evidence of as well as possible explanations for any repeat-player effects.

In addition to these broad research questions, SCJI also examined the extent to which consumer arbitrations are resolved ex parte; the frequency with which arbitrators award attorneys' fees, punitive damages, and interest; and results for consumers proceeding pro se.

2. AAA Enforcement of the Consumer Due Process Protocol. This aspect of the Preliminary Report provides an empirical analysis of how effectively the AAA enforces compliance with the Consumer Due Process Protocol. It considers a number of key research questions including:

    - To what extent do the consumer arbitration clauses comply, in their own right, with the Due Process Protocol?
    - How effective is AAA review of arbitration clauses for compliance with the Due Process Protocol?
    - To what extent does the AAA refuse to administer consumer cases because of the failure of businesses to comply with the Due Process Protocol?
    - How do businesses respond to AAA enforcement of the Protocol?

In addition to these research questions, SCJI examined several other issues that arise in connection with the Due Process Protocols.

Data and Methodology

SCJI reviewed a sample of AAA case files involving consumer arbitrations. The primary dataset consists of 301 AAA consumer arbitrations that were closed by an award between April and December of 2007. (The focus on cases closed by an award during this particular timeframe is based on the availability of the original case files.) This sample of cases was then coded for approximately 200 variables describing various aspects of the arbitration process, including a review of the arbitration clause in the file. In addition, when possible a broader AAA dataset comprising all consumer cases closed between 2005 and 2007 was utilized. The AAA maintains this dataset in the ordinary course of its business, collecting data for internal purposes but not

recording all variables of interest to SCJI. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA.

Key Findings – Costs, Speed, and Outcomes of AAA Consumer Arbitrations

The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.

In cases with claims seeking less than $10,000, consumer claimants paid an average of $96 ($1 administrative fees + $95 arbitrator fees). This amount increases to $219 ($15 administrative fees + $204 arbitrator fees) for claims between $10,000 and $75,000. These amounts fall below levels specified in the AAA fee schedule for low-cost arbitrations, and are a result of arbitrators reallocating consumer costs to businesses.

AAA consumer arbitration seems to be an expeditious way to resolve disputes.

The average time from filing to final award for the consumer arbitrations studied was 6.9 months. Cases with business claimants were resolved on average in 6.6 months and cases with consumer claimants were resolved on average in 7.0 months.

Consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255; business claimants won some relief in 83.6% of their cases and recovered an average of $20,648.

The average award to a successful consumer claimant in the sample was 52.1% of the amount claimed and to a successful business claimant was 93.0% of the amount claimed. This result appears to be driven by differences in types of claims initiated by consumers and business. Business claims are almost exclusively for payment of goods and services while consumer claims are seeking recovery for non-delivery, breach of warranty, and consumer protection violations.

No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.

Consumer claimants won some relief in 51.8% of cases against repeat businesses under a traditional definition (i.e., businesses who appear more than once in the AAA dataset) and 55.3% against non-repeat businesses – a difference that is not statistically significant.

Utilizing an alternative definition of repeat player, some evidence of a repeat-player effect was identified; the data suggests this result may be due to better case screening by repeat players.

Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses under an alternative definition (based on the AAA's categorization of businesses in enforcing the Consumer Due Process Protocol) – a difference that is statistically

significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that such effect is attributable to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims).

Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.

Consumer claimants sought to recover attorneys' fees in over 50% of the cases in which they were awarded damages and were awarded attorneys' fees in 63.1% of those cases. In those cases in which the award of attorneys' fees specified a dollar amount, the average attorneys' fee award was $14,574.

Key Findings – AAA Enforcement of the Due Process Protocol

A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.

Most arbitration clauses in consumer contracts that come before the AAA are consistent with the Consumer Due Process Protocol as applied by the AAA. The same is true for cases in which protocol compliance was a matter for the arbitrator to enforce.

AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations.

In 98.2% of cases in the sample subject to AAA protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.

In 2007, the AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases (9.4% of its consumer case load), because the business failed to comply with the Consumer Due Process Protocol. The most common reason for refusing to administer a case (55 of 129 cases, or 42.6%) was the business's failure to pay its share of the costs of arbitration rather than any problematic provision in the arbitration clause.

As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.

In response to AAA review, more than 150 businesses have either waived problematic provisions on an ongoing basis or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. This is in addition to the more than 1550 businesses identified

by the AAA as having arbitration clauses that comply with the Protocol. By comparison, AAA has identified 647 businesses for which it will not administer arbitrations because of Protocol violations.

Policy Implications and Next Steps

The empirical findings in the SCJI Preliminary Report on AAA consumer arbitrations have important implications for those interested in discussing and formulating public policy regarding arbitration.

1. Not all consumer arbitrations, arbitration providers, or arbitration clauses are alike. Differing results from empirical studies of arbitration may reflect variations associated with case mix, type of claimant, or provider review processes. This suggests the need for a nuanced approach to public policy concerning arbitration.

2. Private regulation complements existing public regulation of the fairness of consumer arbitration clauses. Policy makers should not ignore the role that arbitration providers can play in promoting fairness on behalf of consumers.

3. Courts could usefully reinforce the AAA's enforcement of the Consumer Due Process Protocol by declining to enforce an arbitration clause when the AAA has refused to administer an arbitration arising out of the clause or by otherwise reinforcing the role of the Due Process Protocol.

4. Arbitration may be less expensive for consumers than sometimes believed. For many consumers, the AAA arbitration process costs less than the amount specified in the AAA rules because arbitrators often shift some portion of the costs to businesses. Moreover, arbitrators award attorneys' fees to a substantial proportion of prevailing consumers in AAA consumer arbitrations.

5. Empirical studies have tended to find that repeat players fare better in arbitration than non-repeat players. To the extent such a repeat-player effect exists in arbitration, the critical policy question is what causes it. Our findings are consistent with prior studies in suggesting that any repeat-player effect is likely caused by better case screening by repeat players rather than arbitrator (or other) bias in favor of repeat players. A further as yet unresolved question is whether a repeat-player effect exists in litigation, and, if so, how litigation compares to arbitration in this regard.

While the empirical results presented in the SCJI Preliminary Report on Consumer Arbitration may usefully inform the policy debate on consumer arbitration, the Report nonetheless has limitations. First, its findings are limited to AAA consumer arbitrations. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. Second, its findings on the costs, speed, and outcomes of AAA consumer arbitrations are difficult to interpret without a baseline for comparison, such as the procedures and practices in traditional court proceedings. A future phase of this research project by the Searle Civil Justice

Institute's Task Force on Consumer Arbitration will undertake that comparison. It will seek to compare the procedures in AAA consumer arbitration with procedures available for consumers in court as well as comparing empirically key process characteristics of courts and arbitration.

Testimony
Of
Richard W. Naimark
On behalf of the American Arbitration Association

Domestic Policy Subcommittee
Oversight and Government Reform Committee
Wednesday, July 22, 2009
2154 Rayburn HOB
2:00 p.m.

"Arbitration or Arbitrary: The Misuse of Mandatory Arbitration to Collect Consumer Debts"

Thank you, Chairman Kucinich, Congressman Jordan and members of the Domestic Policy Subcommittee for the opportunity to present the views and experiences of the American Arbitration Association (AAA) on the important issues being considered by the Domestic Policy Subcommittee of the House Committee on Oversight and Government Reform.

I. Introduction

As the world's largest provider of alternative dispute resolution (ADR) services, the AAA has during its 83-year history taken a leadership role in the development of standards of fairness, ethics, and best practices. The AAA has pioneered the development of time and court tested arbitration rules, protocols and a Code of Ethics jointly authored with the American Bar Association. During the past eight decades, the AAA has administered over 2 million cases involving a wide range of subjects. Various governmental entities have also turned to the AAA to assist in the resolution of disputes through over 300 state and federal statutes and regulations. The AAA is a not-for-profit public service organization dedicated to the proper and ethical use of arbitration, mediation and other forms of alternative dispute resolution. However, the AAA is not an industry or trade organization and the AAA speaks here only from its own experience and viewpoint, and not for any other organizations.

While the AAA has not administered significant numbers of debt collection arbitrations relative to some other organizations, the AAA did process consumer debt collection arbitrations in a single high volume program. However, the AAA's administration of that program ended in June of this year and consequently at this time the AAA is not administering any debt collection programs.

As a result of the AAA's review and our experiences administering debt collection arbitrations, in addition to our consideration of a number of policy concerns that have been raised, it is the AAA's position that a series of important fairness and due process concerns must be addressed and resolved before we will proceed with the administration of any future debt collection arbitrations. Until such time, the AAA has placed a moratorium on the administration of any consumer debt collection arbitration programs. Further, we suggest that to the extent that the program improvements offered here are implemented, that they are done so not just within the AAA but as part of a broader debt collection arbitration reform.

Our testimony will begin with an exploration of the AAA's administration of consumer arbitrations generally, and will then move on to recommend changes for the administration debt collection arbitrations to accommodate some of the unique aspects of that caseload.

II. Consumer Arbitration

In recent years, the use of ADR and arbitration has grown to include consumer agreements. Often implemented through standardized contracts, the use of arbitration in consumer agreements for the purchase of goods and services has raised legitimate concerns regarding fairness, rights, and the ability of the parties to participate. The AAA's administration of consumer arbitrations is currently governed by the Consumer Due Process Protocol ("Consumer Protocol"), attached as Appendix A.

To evaluate and address concerns unique to consumer arbitration, the AAA convened the National Consumer Disputes Advisory Committee in 1997, which was composed of consumer, government, legal, business and academic experts, drawn from such organizations as the AARP, Consumers Union, Consumer Action, American Council on Consumer Interests, the Federal Trade Commission, the National Association of Attorneys General, the National Association of Consumer Agency Administrators, Fannie Mae, and Freddie Mac. One of the Advisory Committee's specific objectives was to have the Consumer Protocol influence state and federal laws governing consumer arbitration.

The stated mission of the Advisory Committee was:

> *To bring together a broad, diverse, representative national advisory committee to advise the American Arbitration Association in the development of standards and procedures for the equitable resolution of consumer disputes.*

The result of the Advisory Committee's deliberations was the Consumer Protocol, which articulates a number of fundamental principles to enhance the fairness and efficiency of consumer ADR. The Consumer Protocol constituted a voluntary set of standards and minimum requirements which the AAA has adopted, but which are not necessarily applied to arbitrations outside of AAA administration. The Consumer Protocol provides for common sense "fair play"

requirements, such as reasonable fees for the consumer, reasonably accessible locale, no limitation of any remedy that would be accessible in court, and access to small claims court. The AAA will not administer an arbitration that does not materially comply with the provisions of the Consumer Protocol.
The AAA applies the Consumer Protocol primarily through our *Supplementary Procedures for Consumer-Related Disputes* ("Supplementary Procedures"), attached as Appendix B, to consumer cases. The Supplementary Procedures also establish guidelines for consumers to request a deferral or waiver of fees, including requesting an arbitrator who will serve without charge. One unique aspect of the Supplementary Procedures is the "small claims opt out" which permits a consumer, whether they are a claimant or respondent in a case, to opt out of an arbitration and into a small claims court proceeding.

We bring the Consumer Protocol to the attention of the Subcommittee because it has had a meaningful and important impact on the AAA's administration of consumer arbitrations. We also believe that this collaborative approach represents the best avenue to establishing standards of fairness and balance to the specifics of the process of consumer debt collection arbitration. Evidence of the AAA's fidelity to the principles contained in the Consumer Protocol and the beneficial use of arbitration to resolve consumer disputes are reflected in a recent independent study conducted by the Searle Civil Justice Institute at Northwestern University Law School. The Executive Summary of the Searle Study is attached as Appendix C.[1] The Searle Study reviewed a representative sample of approximately 300 AAA consumer arbitration case files that were awarded between April and December of 2007. Among the most compelling findings in the Searle study are that:

- **The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.** In cases with claims seeking less than $10,000, consumer claimants paid an average of $96.
- **AAA consumer arbitration seems to be an expeditious way to resolve disputes.** The average time from filing to final award for the consumer arbitrations studied was 6.9 months.
- **No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.** Consumer claimants won some relief in 51.8% of cases against repeat businesses and 55.3% against non-repeat businesses.
- **Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.**

[1] The entire Searle Study, in addition to other information about the Searle Institute, can be found at http://www.searlearbitration.org.

- **A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.**
- **AAA's review of arbitration clauses for Protocol compliance was effective at identifying and responding to clauses with Protocol violations.** In 98.2% of cases in the sample subject to AAA Protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.
- **The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.**
- **As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.**

The Searle findings are clearly a reaffirmation of the effectiveness of the Consumer Protocol, the Supplementary Rules, the AAA's administration of consumer arbitrations, and the value that arbitration can bring in the resolution of small but nonetheless important disputes between consumers and businesses. The Consumer Protocol should be considered by the Subcommittee and others interested in arbitration policy as providing necessary and minimum fairness requirements that should be made a part of any consumer arbitration process. However, it should also be explicitly noted that the Searle study did *not* focus on consumer debt arbitration, which can fairly be viewed as a subset type of consumer arbitration and which requires some additional consideration. As a result, we turn to specific matters related to debt collection arbitrations that require additional attention beyond the issues addressed in the Consumer Protocol.

III. Consumer Debt Arbitrations

The AAA has implemented detailed procedures to ensure that consumer debt arbitrations are administered in a manner consistent with the Consumer Protocol, however, there are certain aspects of consumer debt arbitrations, each of which requires additional consideration. These same aspects of consumer debt collections are also factors in the context of litigation when similar cases proceed through the courts, as evidenced by the study *Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor,*[2] which was conducted by the Urban Justice Center. That study reviewed 600 of the 320,000 consumer debt litigations that were filed in New York City Civil Court in 2006 and found that: in 93.3% of those cases the defendant did not appear; defendants are virtually never represented by counsel; and that 80% of the cases result in default judgments against the consumer without requisite proof to establish the damages sought. Recognizing both the similarities and the differences of the litigation and the arbitration processes in matters of consumer debt arbitration, the AAA offers the following potential improvements and enhancements. With the implementation of these additional

[2] Available at http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf

changes, it is the AAA's expectation that the arbitral forum can provide an effective and meaningful alternative to litigating consumer debt arbitrations. This point is particularly important in light of the fact that if arbitration is no longer available for these disputes, a very large number of small dollar claims will be filed in our already overburdened courts. The AAA's position is that each one of the following issues is critical to the administration of debt collection, and that each must be further considered and improvements implemented before additional debt collection arbitrations should proceed.

A. Notice

One of the most difficult issues surrounding the consumer debt arbitration caseload is that consumers rarely appear or participate in the arbitration process. As a result, the arbitration proceeds in their absence in the same manner that a properly commenced litigation proceeds where a defendant does not appear. While it may be that some consumers do not participate as a result of a conscious decision not to do so, the fact is that large numbers of consumers do not appear in debt collection arbitrations. This raises a fair question whether the communications regarding the commencement of the arbitration are being received and understood by the respondents.

The AAA's various rules provide for more informal methods of service than those used in the context of a litigation. The rationale for this is that the parties through their contractual agreement have consented to a more informal method of service, which saves time and money. Consequently, the AAA's rules provide that notice of the commencement of an arbitration can be accomplished by serving notice by mail addressed to the party, or its representative at the last known address, or by personal service provided that reasonable opportunity to be heard with regard to the dispute has been granted to the party.

Notably, the AAA implemented a notice process for our debt collection arbitrations that greatly exceeded the requirements typically contained in our rules. Specifically, we required the claimant business party to serve the demand for arbitration in a manner that could be tracked, with the expectation that a signature would be obtained indicating the each demand had been received. In addition, the AAA's first communication to the consumer respondent was sent initially by certified mail, return receipt requested. After some time, also in an attempt to ensure a greater number of respondents received notice of an AAA arbitration proceeding, the AAA switched to a mailing method in which the United States Postal Service confirms the date and time that the communication was delivered to the addressee. Even after this change, the rate of non-appearance by the consumer remained high. The challenge, therefore, is to take appropriate steps to deliver demands for arbitration, and other arbitration related correspondence in a manner that is more likely to convey the importance of the documents that are being sent to encourage participation by the consumer.

Possible alternative steps that might be taken to address these concerns, include the following:

1. Consider a tiered method of communication for delivering initiation letters. If an initial communication is sent by regular mail and responded to by the consumer, no additional efforts would need to be made. However, if a letter is returned or not signed for when sent by certified mail, we could request that the claimant must confirm the correct address, or re-serve the individual in a manner specified for the service of process under relevant state or federal law.

2. Require service in a manner similar to a summons and complaint in litigation. It should be noted that this manner of services substantially increases the cost of the arbitration and delays the process and potentially impedes the use of arbitration as an informal method of resolving disputes.

3. Multiple methods of AAA communication should be contemplated. For example, if the AAA's initiating letter is sent by U.S. Postal Service with an acknowledgment of delivery, consideration should also be given to sending duplicate initiating letters by other means such as overnight mail or first-class mail. The claimants in these cases might also maintain respondents' e-mail addresses or faxes and if so, communicating via those methods should also be attempted.

4. Careful reemphasizing of the content of the AAA communications should take place so that consumers understand that the consequences of arbitration are serious and significant. Communications should also be tailored so that the arbitration process will appear less forbidding and more accessible.

B. Arbitrator Neutrality

AAA Arbitrators are carefully screened, trained and must go through a rigorous conflict of interest and disclosure process in each AAA arbitration. Nonetheless, it is argued that an appearance of bias might result from arbitrators hearing many cases involving the same business party. To address those concerns, the following steps should be implemented:

1. Limits on the number of cases that an arbitrator may hear involving one particular party should be implemented.
2. Communicate that limitation to the parties to address perceptions regarding arbitrator neutrality.
3. To the extent permissible under applicable law, eliminate the ability of businesses to disqualify arbitrators solely because of prior adverse rulings.
4. Automate arbitrator appointment for debt collection arbitrations so that arbitrators on the roster of debt collection arbitrations are appointed on a random or rotating basis.

C. Pleading and Evidentiary Standards

There are currently no specific rules regarding the documentation that is required to prove that a particular debt is owed. As a result, some claimants provide only limited information about the debt they claim is owed, such as a bill reflecting an outstanding balance. However, affidavits from persons knowledgeable of the debt owed, or other evidence that the debt claimed is owed in the amounts stated in the demands for arbitration is usually not provided. A related problem arises out of allegations that claimants in these types of matters seek attorneys' fees and interest in amounts that may exceed the amounts that can be permissibly recovered under applicable law. The following procedures are therefore suggested to address these concerns:

1. Implement supplemental requirements for consumer debt arbitrations which would specify the documentation and supporting evidence required for demands for arbitration.
2. Provide additional specialized arbitrator training so that arbitrators can identify and address issues regarding the appropriate amount of interest and attorneys' fees that may be awarded.
3. Reinforce the need for arbitrators to be satisfied with their understanding of the applicable law relevant to the particular case, as well as any other evidence submitted.

D. Respondents' Defenses or Counterclaims

In cases where the consumer does participate or make an appearance where they raise the issue that they were the victim of identity theft, or that they never contracted for the goods or service in question, such issues can be fact-intensive and may require a sizable amount of the arbitrator's time to fully consider. However, the relatively limited compensation available to arbitrators may not adequately cover the time required to fully consider those more complicated arbitrations. The following are possible actions that can be taken to address these concerns:

1. Change the administrative fee and arbitrator compensation structure to provide additional compensation to arbitrators in cases where defenses are raised that might require substantially more time to consider. Require that much or all of that additional expense be charged to the business claimant, a policy which is consistent with the AAA's administration of other consumer arbitrations.
   In cases that are contested for reasons such as identity theft, provide a hearing process that accommodates these more factually complex disputes.

E. Arbitrator Training and Recruitment

The AAA maintains a highly qualified and experienced roster of arbitrators who participate in ongoing professional training and education. Arbitrators serving on consumer debt collection cases also receive additional orientation specific to this type of case. Given AAA's brief experience with this particular caseload, we would substantially boost the orientation and training of consumer debt collection arbitrators to ensure focus on the important peculiarities of these cases. The following are the types of issues that would be included in arbitrator training.

1. Substantive law regarding consumer protection statutes and other applicable laws that are common to consumer debt arbitrations.
2. The AAA's procedures for consumer debt arbitration, including evidentiary standards.
3. Notice issues.
4. Identity theft issues.
5. Interest and attorneys' fees, and the extent that they can be awarded in consumer debt arbitrations.

F. Creation of a Consumer Debt Protocol Committee

Similar to the group that was convened to create the Consumer Due Process Protocol, the AAA recommends that a committee of individuals with expertise in the area of consumer debt and arbitration be convened to discuss the matters raised in this testimony and to determine whether these suggestions are viable. We believe that a platform of fair-play standards and safeguards can be arrived at by consensus and collaboration, as evidenced by our previous experience with such standards. Having such procedural safeguards in place will enhance consumer and legal community confidence in the fairness of the process.

G. Continued Publication of Results

The AAA currently maintains a database accessible to the public on our website of all consumer arbitrations of all types conducted nationwide by the AAA. This should continue as an expression of transparency and a source of information for parties subject to disputes. Also, the previously referenced Searle Institute study is an example of valuable insight to be gained through research by reputable, non-partisan organizations and individuals. The Searle Center plans additional studies in the area of consumer debt arbitration, which should provide additional valuable insight.

IV. Conclusion

The AAA appreciates the opportunity to present our thoughts and suggestions on consumer debt arbitration today. Based on our over 83 years of experience, and our recent experience with consumer debt arbitration, we believe that if properly executed and designed, arbitration can provide a prompt, effective and fair forum for the resolution of these disputes.

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

R. BRUCE JOSTEN
EXECUTIVE VICE PRESIDENT
GOVERNMENT AFFAIRS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062-2000
202/463-5310

September 1, 2009

Federal Trade Commission
Office of the Secretary, Room H-135 (Annex A)
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: Debt Collection Roundtable – Comment, Project No. P094806

Dear Secretary:

The U.S. Chamber of Commerce, the world's largest business federation representing more than three million businesses and organizations of every size, sector, and region, is writing to you to comment on the recent Roundtables on Debt Collection held by the FTC. The Chamber strongly believes that pre-dispute arbitration agreements offer a valuable means of dispute resolution that is mutually advantageous to consumers, employees, and businesses. We support the FTC's decision to hold regional roundtables to examine the important issues facing consumers in debt-collection litigation and arbitration proceedings. In addition, we appreciate the FTC's recognition that these issues are not unique to or caused by arbitration, but are equally if not more prevalent in the court system.

Consumers face a myriad of problems in courtroom debt-collection proceedings. For instance, at the time that debt collectors file complaints, consumers may lack sufficient information regarding the amount of money allegedly owed. Moreover, consumers frequently do not receive proper notice that a debt-collection action has been initiated against them. As a result, consumers often do not appear in court, and creditors usually win by default. The consumers who do participate must navigate the complex court system without an attorney and often without knowing what evidence they should present or how to present it.

Some of the problems may not be unique to the court system, but are also alleged to be present to some degree in arbitration proceedings. At the same time, however, the simplicity and convenience of the arbitration process provide important advantages to consumers that the court system cannot match. We commend the FTC for recognizing these advantages, and for approaching these roundtables with the view that arbitration can and should be part of the solution for consumers.

The Court Debt-Collection System

A number of media sources have picked up on problems plaguing courtroom debt-collection proceedings. For example, the *Boston Globe* has reported that "the small-claims courts have mutated into a system that often ignores individual rights and shows favoritism

toward collectors and their lawyers."[1] According to the *Globe*, the court debt-collection system today is "tilted against" consumers, often with "no oversight by judicial officials."[2] Moreover, the stories of abuses that have become commonplace in court were described by the chief justice of the Massachusetts district court system as nothing short of "horrific."[3]

Combined with the fact that many consumers do owe money to the creditors who bring these actions, the result is that consumers virtually never win debt collection actions in court.[4] According to preliminary results from an ongoing study by the Searle Civil Justice Institute, "business claimants bringing debt collection cases [in court] won some relief in 99.7% of the cases going to judgment, and in those cases were awarded 99.5% of the amount sought."[5]

As extensively discussed during the roundtables, a number of issues have contributed to the present state of affairs in courtroom debt-collection proceedings. Unfortunately, the problems in court are unlikely to go away. As the *Boston Globe* reported, small claims cases in Massachusetts are rising while "court budgets have been slashed and court staff reduced by 14 percent."[6] Court officials admit that "there's barely time to get through the docket" as things currently stand, "much less attend to the considerations behind each claim."[7] And Massachusetts is not alone: the *New York Times* recently reported that at least 25 state court systems are suffering from budget shortfalls in a crisis that will require "court cutbacks and fee increases."[8]

Arbitration and Consumers

Some allege that the problems plaguing debt collection proceedings are not unique to the court system, but may also occur to some degree in arbitration as well. But to the extent that issues exist, they largely stem from the nature of debt collection itself.

There have been recent, troublesome allegations brought against one provider of debt collection arbitrations, the National Arbitration Forum (NAF). According to a suit filed by the Minnesota Attorney General, NAF had undisclosed ties to the debt collection industry, leading some to question whether proceedings before that forum reflect an appearance of impropriety. But this particular issue has now been resolved: as part of a settlement with the Minnesota Attorney General, the NAF has agreed to stop administering consumer debt-collection arbitrations altogether.

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1 *Dignity Faces a Steamroller: Small-Claims Proceedings Ignore Rights, Tilt To Collectors*, BOSTON GLOBE, July 31, 2006.

2 *Id.*

3 *Id.*

4 *Id.*

5 *"Arbitration or Arbitrary: The Misuse of Mandatory Arbitration to Collect Consumer Debts: Hearing Before the Domestic Policy Subcomm. of the Oversight & Government Reform Comm.*, 111th Cong. 1 (2009) (statement of Christopher R. Drahozal, Professor of Law, University of Kansas School of Law).

6 *Dignity Faces a Steamroller, supra* note 1.

7 *Id.*

8 John Schwartz, *Pinched Courts Push To Collect Fees and Fines*, N.Y. TIMES, Apr. 6, 2009.

Of course, no system is perfect. But arbitration provides benefits to consumers that our civil court system does not. For example, unlike court proceedings, a consumer usually has the choice to conduct his or her arbitration over the phone or "on the papers," which saves the consumer from having to take any days off from work to resolve the dispute.

Further, arbitration's streamlined procedures with regard to discovery and evidence are navigable by ordinary consumers. While it is exceedingly difficult for consumers with modest claims to secure an attorney for litigation—effectively barring them from the complex and expensive procedures of our court system—consumer arbitration procedures are designed to enable consumers to effectively participate even without an attorney.

Arbitration also takes a great deal of pressure off of the clogged court system. While budget shortfalls are leading many states to cut court services and raise fees, businesses usually foot the bill for most if not all of the cost of a consumer arbitration. Not only are the pressures on the court system eased by the availability of arbitration, non-profit forums like the leading American Arbitration Association (AAA) do not have the same financial and time pressures that have led courts to give less attention to consumers in each of the massive number of debt collection claims filling the court system.

These same benefits work to the advantage of consumers in arbitration claims that they initiate themselves, not just in debt-collection claims in which they are defendants. Primary among these benefits is the simplicity of the arbitration process. For example, to initiate a claim under the AAA's rules, a consumer claimant is asked to (1) briefly explain the dispute; (2) provide the names and addresses of the consumer and the business; (3) specify the amount of money at issue; and (4) describe the relief the consumer wants. These requirements are less stringent than required in courts of general jurisdiction, and individuals can navigate them without an attorney.

The AAA has also instituted its landmark Consumer Due Process Protocol, which prescribes a number of procedural protections that ensure that consumers involved in an arbitration before the AAA get a fair shake. Moreover, the AAA caps the amount of fees that consumers may have to pay at only $125 in claims alleging up to $10,000 in damages.[9] The Supreme Court, too, has ensured that an arbitration agreement may not be enforced if it will force a consumer to pay excessive costs to arbitrate.[10]

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[9] American Arbitration Association, *Supplementary Procedures for Consumer Related Disputes* § C-8, *available at* http://www.adr.org/sp.asp?id=22014. If the consumer is pursuing a claim of between $10,000 and $75,000, the consumer's arbitration costs are capped at only $375. *Id.*

[10] *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000). The availability of court review for fairness does not solely extend to the costs setting: the Supreme Court has interpreted the Federal Arbitration Act (FAA) to permit anyone to challenge an arbitration agreement if that challenge is based on generally applicable state contract law. Applying this standard, courts around the country routinely apply state legal principles to strike down arbitration agreements that do not provide consumers with fair notice or fair procedures.

Finally, arbitration is much faster than litigation. Even if consumers are able to overcome the many obstacles presented by the court process, such as motions to dismiss and summary judgment, they may wait many years to receive a decision. By contrast, most arbitrations last only a matter of months before a consumer is able to get a determination on the merits.[11]

Given the many benefits for consumers that are available in arbitration, it is thus unsurprising that the Searle Center recently found that consumers win a majority of cases that they bring against businesses in arbitration.[12] Because of the difficulty of obtaining an attorney without the promise of a large damages award, many of those consumers would likely have been unable even to pursue their claims in court if arbitration were unavailable.

The Path Forward

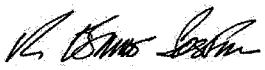
Debt collection proceedings present a number of challenges regardless of the forum, and the FTC's regional roundtables could not come at a better time. The present economic crisis has left many consumers in heavy debt and our nation's courts at the breaking point. At the same time, it is clear that the vast majority of consumers do indeed owe the debts claimed. There must be a mechanism for the collection of those debts.

We believe that while no system is perfect, arbitration provides benefits for both consumers and our overburdened courts. Any productive approach to the issues raised in the regional roundtables must incorporate arbitration as part of the solution.

In its testimony at the Chicago Roundtable, the AAA proposed convening a "Consumer Debt Protocol Committee" that would recommend specific procedural safeguards to protect the due process rights of consumers in arbitration debt collection proceedings. The AAA's previous success in bringing together a broad and inclusive coalition to develop its well-regarded Consumer Due Process Protocol would serve as the model for this new Committee. Under the AAA's proposal, this new working group will address due process issues that are unique to debt collection claims, including notice, arbitrator neutrality, pleading and evidentiary standards, respondent defenses and counterclaims, and arbitrator training and recruitment.

The U.S. Chamber of Commerce strongly supports the AAA's proposal. We believe that it provides an effective path forward that will preserve the benefits of arbitration while addressing the unique problems inherent to debt collection proceedings.

Sincerely,



R. Bruce Josten

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11 Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association: Preliminary Report xiii (March 2009) ("The average time from filing to final award for the consumer arbitrations studied was 6.9 months.")

12 *Id.* (reporting that in the AAA arbitrations studied, "[c]onsumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255")

Statement for the Record of
Christopher R. Drahozal

John M. Rounds Professor of Law
University of Kansas School of Law

Chair, Consumer Arbitration Task Force
Searle Civil Justice Institute

September 15, 2009

House Judiciary Committee
Subcommittee on Commercial and Administrative Law

Hearing on
Mandatory Binding Arbitration:
Is It Fair and Voluntary?

Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee:
I am pleased to submit this statement for the record on the use of arbitration to resolve consumer and employment disputes. I am the John M. Rounds Professor of Law at the University of Kansas School of Law, and the Chair of the Consumer Arbitration Task Force of the Searle Civil Justice Institute. I also am an Associate Reporter for the Restatement, Third, of the U.S. Law of International Commercial Arbitration, and have written extensively on the law and economics of arbitration.

I. Overview

This statement provides an update on the Searle Civil Justice Institute's ongoing study of consumer arbitrations administered by the American Arbitration Association (AAA). The next phase of the study will seek to compare outcomes of debt collection arbitrations administered by the AAA to outcomes of debt collection cases in court.[1] Focusing on debt collection cases enables us to analyze roughly comparable cases in arbitration and in court.[2] We hope to issue a report on this phase of the study within the next month or two. Some preliminary findings are as follows:

- In a sample of AAA arbitrations brought to recover amounts allegedly owed by consumers, creditors won some relief in 86.2% of awarded cases, and in those cases were awarded an average of 92.9% of the amount sought.

- By comparison, in a sample of student loan collection actions brought on behalf of the federal government in federal court, the government (i.e., the creditor) won some relief in 99.7% of the cases going to judgment, and in those cases was awarded 99.3% of the amount sought.

- Similarly, in a sample of debt collection actions in Oklahoma state courts, creditors won some relief in 99.3% of cases seeking less than $10,000 and going to judgment and 100% of small claims going to judgment. In the cases seeking less than $10,000, prevailing creditors were awarded 99.5% of the amount sought; in small claims cases, prevailing creditors were awarded 96.2% of the amount sought.

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[1] In July 2009, the AAA announced a moratorium on its administration of most types of debt collection arbitrations. American Arbitration Association, Notice on Consumer Debt Collection Arbitrations, *available at* http://www.adr.org/sp.asp?id=36427 (last visited Sept. 13, 2009). The AAA's announcement came after the National Arbitration Forum announced that it was permanently ceasing to administer new consumer arbitrations, in settlement of a lawsuit brought by the Minnesota Attorney General alleging fraud and deceptive practices. Consent Judgment, ¶ 3, Minnesota v. National Arbitration Forum, Inc., No. 27-CV-09-18559 (Minn. Dist. Ct. July 17, 2009), *available at* http://pubcit.typepad.com/files/nafconsentdecree.pdf. The debt collection cases we studied were resolved prior to the AAA's moratorium.

[2] Moreover, the most commonly cited evidence of asserted bias in consumer arbitrations comes from a study of debt collection arbitrations. *See* Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers (Sept. 27, 2007), *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf (studying arbitrations administered by the National Arbitration Forum). We have not studied arbitrations administered by the NAF, and offer no opinions on those arbitrations.

II. Creditors in AAA Consumer Arbitrations: Summary of Results from the Searle Study

In March 2009, the Consumer Arbitration Task Force of the Searle Civil Justice Institute – of which I serve as chair – released a Preliminary Report on *Consumer Arbitration Before the American Arbitration Association.*[3] I discussed the results of the first phase of the Searle study at a hearing of this Subcommittee on May 5, 2009.[4]

The primary dataset studied by the Task Force consists of 301 AAA consumer arbitrations that were closed by an award between April and December 2007.[5] (The focus on cases closed by an award during this time period is based on the availability of the original case files.) Just under twenty percent (58 of 301, or 19.3%) of the cases in the sample involved debt collection cases brought by businesses against consumers.[6] Creditor claimants in the AAA arbitrations studied won some relief in 86.2% of the awarded cases, and the prevailing creditor recovered an average of 92.9% of the amount claimed. By comparison, consumers won some relief in 53.3% of the cases they filed, and prevailing consumer claimants recovered an average of 52.1% of the amount claimed.

These numbers do not in themselves show that arbitration is a biased means of resolving consumer disputes. Despite suggestions to the contrary, a high win-rate for business claimants by itself does not show bias. The win-rate is only meaningful in comparison to some baseline. A fifty percent win-rate for claimants may be extremely high if claimants bringing similar claims tend to win at a lower rate in court, or extremely low if claimants bringing similar claims tend to win at a higher rate in court. The same is true of a ninety-percent win-rate or even a ninety-nine percent win-rate.

Nor does comparing the win-rates of business claimants to the win-rates of consumer claimants provide evidence of bias in arbitration. As we explained in our Preliminary Report, the differing success rates for business claimants and consumer claimants appear to result from two factors, neither of which is evidence of bias.[7] First, the types of claims businesses in our

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[3] Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association (Mar. 2009), *available at* www.searlearbitration.org.

[4] Statement of Christopher R. Drahozal, *Hearing on the Federal Arbitration Act: Is the Credit Card Industry Using it to Quash Legal Claims?*, Subcommittee on Commercial and Administrative Law, House Committee on the Judiciary, 111th Cong., 1st Sess. (May 5, 2009), *available at* http://judiciary.house.gov/hearings/pdf/Drahozal090505.pdf.

[5] Beginning in fall 2007, the AAA administered a number of arbitrations brought by a single buyer of consumer debt. Those cases were not covered by the Preliminary Report because no awards were issued until 2008 and insufficient data was available on those cases. We are currently in the process of studying the procedures and outcomes in those cases, and will report our findings when they become available.

[6] The Preliminary Report distinguished between claims brought by consumers and claims brought by businesses, and presented its results on that basis. To enhance the comparability of the AAA arbitration cases to the debt collection cases in court, we restricted our sample by excluding three AAA consumer arbitrations that likely should not be classified as involving debt collection. Accordingly, the number of AAA consumer arbitrations in the sample is fifty-eight instead of sixty-one.

[7] Searle Civil Justice Institute, *supra* note 3, at 70.

sample brought differed from the types of claims consumers brought. Businesses tended to bring claims for amounts they were owed for services already rendered. In such cases, the business faces fewer hurdles to establishing liability, and, when it does so, the amount it should be awarded is relatively easy to calculate and prove. Consumers tended to bring claims alleging delivery of defective goods or improper performance of services. Such cases tend to present more difficult questions of proving both liability and damages. Accordingly, consumers tend to win less often in cases that make it to an award, and, when they do win, tend to recover a lower percentage of the damages they seek. Second, a number of business claims were resolved on an ex parte basis, because the consumer failed to respond to the demand for arbitration.[8] Conversely, the business respondent appeared in every case brought by a consumer. The greater number of defaults is another important factor in explaining the higher success rate of business claimants.

Instead, the proper comparison is between outcomes in cases in arbitration and outcomes in similar cases in court. In the next phase of the Searle study we are seeking to undertake such a comparison. Some preliminary results of that inquiry are reported in Part III of this statement.

III. Creditors in Court: Preliminary Results

As noted above, the next phase of the Searle study is seeking to compare outcomes in the AAA debt collection arbitrations we studied to outcomes in similar court cases. That phase is underway, and we are able to report some preliminary results. These results are preliminary; that is, they are subject to further analysis and review. Although we do not expect them to change significantly, that remains a possibility. We also will be considering data from other courts than those described below, which may or may not give similar results. Nonetheless, the data below provide some insights into the outcomes of debt collection cases in court.

A. Federal Court Student Loan Collection Cases

Data on federal court cases compiled by the Administrative Office of the U.S. Courts are widely used by researchers studying court outcomes. Included in the dataset are cases brought by the federal government to recover amounts owed on unpaid student loans. In those cases, a creditor (i.e., the federal government) is seeking to recover an amount (averaging just over $17,000) allegedly owed by a consumer. The cases are debt collection cases in federal court seeking an amount similar to the amount sought in the AAA consumer cases we studied.

We examined all federal court cases terminated between late 2006 and late 2007, the most recent period for which data is available, coded as involving unpaid student loans. Our sample consists of those cases in which a prevailing party and some amount demanded were recorded in the dataset, so that we could calculate win-rates and the percentage of the amount

[8] Of the fifty-eight debt collection arbitrations brought by creditors, twenty-two (or 37.9%) were resolved on an ex parte basis – i.e., without the consumer appearing in the case.

demanded that was recovered by a prevailing plaintiff.[9] To correct obvious coding errors in the data, we examined federal court docket sheets available on Westlaw, and, when necessary, the original court files using PACER.

Of the 382 cases in the sample, 286 (or 74.9%) were resolved by default judgment, and 84 (or 22.0%) by consent judgment. Another 11 cases were adjudicated by pretrial motion (usually on summary judgment); the government won all 11 of those cases. No case made it to trial, by jury or by judge. In only one case did the defendant prevail.[10] Overall, then, excluding consent judgments, the government as creditor won in 297 out of 298 cases (99.7%), with 286 (or 96.0%) of those cases consisting of default judgments.

Moreover, the government was awarded the entire amount sought (or more) in 96.6% (285 of 295[11]) of the cases in which it prevailed. Overall, the government was awarded an average of 99.3% of the amount it sought.

B. Oklahoma State Court Cases

The vast majority of debt collection cases are brought in state court, rather than federal court.[12] Unfortunately, systematic data from state courts are much less available. As part of the next phase of the Searle study, we collected data from a random sample of court files from cases in Oklahoma district courts for which complete case filings are available online.[13] The sample consists of 419 cases seeking less than $10,000 and 330 small claims cases filed in Oklahoma district courts and closed between March 31, 2007, and December 31, 2007 (the dates covered by our AAA consumer arbitration sample).

Of the 419 cases brought by creditors seeking less than $10,000,[14] over two-thirds (282 of 419, or 67.3%) resulted in a default judgment in favor of the creditor. In one case, a default judgment in favor of the creditor was vacated and the case resolved in favor of the consumer.

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[9] Because the cases all involved claims for unpaid loans, the amount sought likely is specified in the complaint filed in the case. We have no reason to believe that our focus on those cases in which the amount demanded was coded as a non-zero amount biases our results in any way.

[10] In that case, the court originally entered a default judgment against the consumer. Later, the default judgment was vacated and the case was dismissed, based on the parties' agreement that the consumer was not liable for the debt. Arguably, the case should not have been included in the sample at all, because the case was terminated in 2008, rather than in the sample period.

[11] Data on the amount recovered were missing in two of the cases. In a number of the cases, the damages awarded exceeded the amount claimed, almost always because interest continued to accrue while the case was pending. In all of those cases, the creditor recovered the full amount of principal sought, and so accordingly we capped the recovery at 100% of the amount claimed.

[12] Federal Trade Commission, Collecting Consumer Debts: The Challenges of Change 55 (Feb. 2009).

[13] A number of states permit online access to court filings. Oklahoma courts are unusual, if not unique, in that they permit a user to search for cases closed in particular months or years. The sole reason we chose Oklahoma courts to study was the ability to search court files online in such a manner.

[14] The majority of the creditor claims (245 of 419, or 58.5%) were brought by a party other than the original creditor, either a debt collection agency or debt buyer. This is not surprising, because Oklahoma law precludes such parties from suing in small claims court. 12 Okla. Stat. § 1751(B) ("No action may be brought under the small claims procedure by any collection agency, collection agent, or assignee of a claim ....").

Just over a quarter (105 of 419, or 25.1%) were dismissed (usually either because of a settlement or for inability to serve process, although it is difficult to be certain). An additional twenty-two cases (5.3% of the sample) resulted in agreed awards in favor of the creditor. Nine cases were decided on summary judgment; in eight of those cases the creditor prevailed. No case made it to trial, by jury or by judge. Of the cases that made it to judgment (including the case in which a default judgment was vacated), the creditor prevailed 99.3% (290 of 292) of the time,[15] with 96.6% (282 of 292) of those judgments entered by default. The prevailing creditor was awarded at least 100% of the amount of damages claimed 98.6% (284 of 288 cases) of the time.[16] Overall, prevailing creditors were awarded on average 99.5% of the amount they sought.

Of the 330 small claims cases brought by creditors, more than half (173 of 330, or 52.4%) resulted in a default judgment in favor of the creditor. Roughly a quarter (84 of 330, or 25.5%) were dismissed (usually either because of a settlement or for inability to serve process, although again it is difficult to be certain). An additional fifty-four cases (16.4% of the sample) resulted in agreed awards in favor of the creditor. Eighteen cases were decided at a hearing; the creditor prevailed in all of those cases. Of the cases that made it to judgment, the creditor prevailed in every one (191 of 191, or 100.0%), with 90.6% (173 of 191) of those judgments entered by default. The prevailing creditor was awarded at least 100% of the amount of damages claimed 87.4% (167 of 191 cases) of the time. Overall, prevailing creditors were awarded on average 96.2% of the amount they sought.

IV. Limitations and Conclusions

While the empirical results presented in the Searle study are the most comprehensive available, the study nonetheless has limitations. First, its findings on arbitration are limited to AAA consumer arbitration. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. That said, in setting national policy concerning arbitration, information on consumer arbitrations administered by the AAA, a leading provider of arbitration services, certainly is necessary for making an informed decision. Second, our preliminary findings on debt collection actions in court are, as stated, preliminary, and are limited to particular types of claims and specific courts. The study is ongoing: we are continuing to examine other courts and other types of claims, and any additional findings may vary. Third, cases are not selected into arbitration randomly; thus, finding truly comparable cases between court and arbitration is extremely difficult.

Despite these limitations, the preliminary findings nonetheless appear to be inconsistent with the argument that high win-rates for businesses in debt collection arbitrations show that arbitration is biased in favor of those businesses. Instead, the win-rates, while high in absolute

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[15] Because of corrections to the data coding, some of these numbers differ slightly from those reported in my July testimony before the Subcommittee on Domestic Policy of the House Oversight Committee. None of the changes is material.

[16] In two of the cases, the judgment document was not available in the online database. In a number of the cases, the damages awarded were more than the amount claimed, almost always because interest continued to accrue while the case was pending. In all of those cases, the creditor recovered the full amount of principal sought, and so accordingly we capped the recovery at 100% of the amount claimed.

terms and higher than win-rates for claims brought by consumers in arbitration, appear similar to win-rates for comparable claims brought in court. Thus, while the findings are only preliminary, they nonetheless suggest that business win-rates in debt collection cases may be due to the types of claims being brought and not to the venue in which they are adjudicated.

STATEMENT

in support of

ALTERNATIVE DISPUTE RESOLUTION PROGRAMS IN EMPLOYMENT

and in opposition to

H.R. 1020, "THE ARBITRATION FAIRNESS ACT"

before the

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

of the

JUDICIARY COMMITTEE

of the

UNITED STATES HOUSE OF REPRESENTATIVES

on behalf of

THE COUNCIL FOR EMPLOYMENT LAW EQUITY

by

Mark A. de Bernardo
Executive Director and President

September 15, 2009

I. Statement of Interest

Thank you for this opportunity to submit comments *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* H.R. 1020, "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, testified before the U.S. Congress several times in support of ADR, and/or advised employers on ADR issues for more than 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 for their employees* – and because it is the right thing to do.

Jackson Lewis is a national law firm of more than 565 lawyers in 43 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.

Clearly, the CELE in particular, and the employer community in general, has a *very* strong interest in any initiative, such as H.R. 1020, which would so drastically undermine the use of Alternative Dispute Resolution programs in employment. I am here today to provide real-world context.

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 H.R. 1020 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 H.R. 1020'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]

H.R. 1020 would effectively *end* arbitration in America.

ADR – a common, useful, positive, pro-active, timely, effective *and* cost-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 H.R. 1020 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 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;

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[1] Section 4(4)(b)(1) of H.R. 1020 – "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).

(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 am absolutely convinced 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]

(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

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

employee is happier and more productive. Litigation is a destroyer of the employment relationship; ADR is a preserver of the employment relationship;

(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 than 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 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 arbitrations which do go to trial and are dismissed.[8] Thus, if you are an employee with a grievance, you

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[4] The median award for employees who prevail in arbitration and in court is 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. II. & 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.*

[7] *See id.*

[8] *See id.*

have a better chance of winning,[9] virtually no chance of being dismissed, and a higher median award[10] 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[11] to take on cases for which only modest 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;

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[9] In fact, beyond the low success rate of plaintiffs in court decisions, *most* plaintiffs' claims are dismissed on motions. One study of more than 3,400 employment discrimination cases in federal courts in which a definitive judgment was reached found that 60 percent were dispensed of by pre-trial motions, with employers the victors in 98 percent of those decisions. Lewis Maltby, *Employment Arbitration: Is It Really Second-Class Justice?*, Dispute Resolution Magazine, 23-24 (Fall 1999).

[10] 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 - $100,000 for 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.

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

- **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,[12] 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.[13] 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") are highly qualified professionals experienced in the legal process, with an established record of objectivity, and subject-matter expertise. They are reliable, 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

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[12] 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 of Website Posted Data Pursuant to Section 1281.96 of the Code of Civil Procedure* (August 2004), available at http://www.mediate.com/cdril/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).

[13] 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.

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

If H.R. 1020 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;[14] *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;[15] 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 that 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 ADR-in-employment programs. With ADR – like most employment policies – "one size" does *not* fit all. Employers typically and appropriately tailor their ADR programs to their own company's needs, priorities, and employee relations culture.

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

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

(2) **<u>Designation of a company executive</u>** 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

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[14] 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 H.R. 1020 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).

[15] 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 fee up front, and typically require a payment of a contingency fee of between 33 and 40 percent of any award. 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.

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, and/or the Judicial Arbitration & Mediation Services;

(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 H.R. 1020, that would impose a death penalty on ADR as an employment practice.

VI. Who Loses If H.R. 1020 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,[16] a greater potential for legal extortion of employers who terminate even the most deserving employees, and credit deadbeats who intentionally leave $1,000 balances on multiple credit cards because they believe they are unlikely to be pursued for $1,000 because it would be irrational and cost-prohibitive. As a consequence, the costs of products and services would 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, as discussed earlier, *most* plaintiffs' attorneys are unlikely to accept litigation with only a modest expectation of damages;[17]

(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,[18] H.R. 1020 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);

(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

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[16] 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.

[17] *See* Lewis L. Maltby, *supra, note 4*.

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

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 less 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. Who would bear the cost? We would; 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 H.R. 1020 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 H.R. 1020 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 experienced than any jury), but whose cases – thrust upon the court system – may be worth a "nuisance settlement."

All the rest of us? We lose. H.R. 1020 – 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 historically have created 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.[19] 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.[20]

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[21] was passed and signed into law in October 1999 to promote the use of ADR in the federal court system. This law mandates that U.S. District Courts 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*[22] 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

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[19] 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.

[20] *See id.*

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

[22] See *New Law Authorizes ADR in All District Courts*, THE THIRD BRANCH, published and available at http://www.uscourts.gov/tb/feb99tb/newlaw.html.

litigation."[23] Clearly, the intent of promoting ADR methods within the court system is to lighten the federal court docket.

H.R. 1020 stands in opposition to this worthwhile goal. H.R. 1020 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."[24] Nearly two-thirds (66.2 percent) also predicted that "ADR use will increase in the future."[25]

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[26]… and *not* employees – a public opinion poll found that 83 percent of employees *favor* arbitration.[27]

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).[28]

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

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[23] *See id.*

[24] *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).

[25] *See id.*

[26] 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 trended up since then.

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

[28] *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).

IX. Our Well-Established National Labor Policy Strongly Supports the Use of Arbitratiou Agreemeuts iu Employee Relations

It is clear that Congress's intent in enacting the Federal Arbitration Act was to encourage the use of arbitration.[29] Since its enactment in 1925,[30] and codification in 1947,[31] 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"),[32] in which Congress specifically endorsed the arbitration of Title VII[33] 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]."[34] 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 amendments to the ADRA[35] require each U.S. District Court to adopt local rules regarding the use of ADR. The ADRA's Findings and Declaration of Policy notes that:

> 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.[36]

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.[37] The Federal Election Commission resolved all 26 employee complaints brought to the agency's Equal

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[29] *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."

[30] 43 Stat. 883.

[31] 9 U.S.A. §1 (1994).

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

[33] 42 U.S.C. §§2000e *et seq.*

[34] 105 Stat. at 1081, *reprinted in* notes to 42 U.S.C. § 1981.

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

[36] Pub. L. No. 105-315, §2(1).

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

Employment Opportunity director in a recent three-year period.[38] 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 H.R. 1020 would do, would have far-reaching and disastrous impacts on American jurisprudence and American society.

H.R. 1020 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.

I thank you for the opportunity to express the Council for Employment Law Equity's views.

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[38] *See id.*

PREPARED STATEMENT OF BRUCE YARDWOOD ON BEHALF OF THE AMERICAN HEALTH CARE ASSOCIATION (AHCA) AND THE NATIONAL CENTER FOR ASSISTED LIVING (NCAL)

STATEMENT
Of
Bruce Yarwood

On Behalf Of The
AMERICAN HEALTH CARE ASSOCIATION
&
NATIONAL CENTER FOR ASSISTED LIVING

Before The
House Judiciary Subcommittee on Commercial and Administrative Law

Hearing On
Mandatory Binding Arbitration: Is it Fair and Voluntary?

September 15, 2009

Thank you Chairman Cohen, Ranking Member Franks, and members of the Committee. It is my pleasure to offer the long term and post-acute care profession's perspective on arbitration on behalf of the American Health Care Association and the National Center for Assisted Living (AHCA/NCAL).

In the increasingly litigious environment, a growing number of health care and long term care providers – including nursing facilities and assisted living residences – have incorporated arbitration clauses into their admissions materials given to residents when being admitted to the facility or residence. AHCA/NCAL supports the use of arbitration agreements as a viable option for long term care providers and their residents to resolve legal disputes. Arbitration is less adversarial than traditional litigation, produces quicker results and has been determined to be both fair and appropriate by our courts.

AHCA/NCAL and our members are committed to ensuring that long term care facilities place paramount importance on the delivery of high quality care and provide a safe and secure environment for the millions of Americans residing in our nation's nursing facilities and assisted living residences. When legal concerns arise, we believe that arbitration provides a fair and timely resolution for both the consumer and long term care provider.

On behalf of the profession responsible for caring for our nation's most vulnerable citizens, I am proud of the advances we have made in delivering high quality long term care services and we remain committed to sustaining these gains in the years and decades ahead – when, as we all know, demand for long term care will by all accounts dramatically increase.

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Americans are living longer and our nation's aging population is growing – many of whom have significant medical or cognitive conditions which require care in a nursing facility. Currently more than three million Americans rely on the care and services delivered in one of the nation's nearly 16,000 nursing facilities each year, one million are cared for in more than 38,000 assisted living residences, and the demand for such services is going to increase dramatically every year. A March 2008 report from the National Investment Center for the Seniors Housing & Care Industry (NIC) indicates that the demand for long term care services will more than double by 2040.

The efforts and initiatives advanced by the association that I represent today seek to enhance and improve quality of care and services provided in our nation's nursing facilities and assisted living residences each day.

Quality – AHCA's First Priority

Before I address the benefits of arbitration as an alternative to litigation in resolving disputes, allow me to take a moment to assure the Committee that the troubling anecdotes presented today represent the exception instead of the rule within the long term care community. Long before the words quality and transparency were the catch words of the federal government and their oversight of healthcare, they were truly the compass for AHCA/NCAL and its member facilities.

AHCA/NCAL has been working diligently to change the debate regarding long term care to focus on quality – quality of life for patients, residents and staff; and quality of care for the millions of frail, elderly and disabled individuals who require our services. We have been actively engaged in a broad range of activities which seek to enhance the overall performance and excellence of the entire long term care sector. While keeping patients and their care needs at the center of our collective efforts, we continue to challenge ourselves to improve, and enhance quality.

Quality – A Transparent Process

This week, AHCA and the Alliance for Quality Nursing Home Care are releasing a report that analyzes and assesses the status and trends of quality in nursing facilities since the 2002 inception of *Quality First*. This Quality Report is the first of its kind, featuring research and critical analysis by leading experts in the fields of Quality and long term and post acute care services. The entire report is available at www.ahcancal.org – some highlights of the report include:

- "Nursing and rehabilitation facilities have evolved to serve two distinct patient populations: short-stay rehabilitation and medically complex patients, and long-stay chronic care residents."
  -Nursing and Rehabilitation Facilities of the 21st Century (Avalere Health, LLC)
- "Almost 40 percent of short-stay Medicare patients were discharged to the community in 2006 after a stay of about 25 days, highlighting the interdependence of facility and home-based care."
  -Nursing and Rehabilitation Facilities of the 21st Century (Avalere Health, LLC)
- "The acuity of the nursing home resident population has increased dramatically and the length of stay of most patients is now less than 90 days."
  -Changes in the Quality of Nursing Home Care in the U.S. (Mor, et al)
- "It is clear that nursing home quality is multi-dimensional; what is also becoming clear is that it is no more appropriate to compare all nursing homes with one another than it would be appropriate to compare an Obstetrics hospital with an Oncology hospital."
  -Changes in the Quality of Nursing Home Care in the U.S. (Mor, et al)

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- "Working in concert with all stakeholders at both the national and state level we can, together, assist nursing homes to become high performance organizations that, in partnership with their staff and residents, will be able to demonstrate the long term care community's ability to deliver the best."
  -Mary Jane Koren, M.D., M.P.H., Chair, National Steering Committee for Advancing Excellence in America's Nursing Homes

We remain committed to sustaining – and building upon – these quality improvements for the future.

Arbitration – A Fair & Efficient Alternative

In the late 1990's, the long term care profession was subject to excessive liability costs, which were exacerbated by an increasingly litigious environment. As a result, operators of nursing facilities and assisted living residences were forced into making difficult decisions including poteutial closure or divestiture of facilities, and corporate restructuring. In addition to pursuing state and national tort reform legislative initiatives to enable facilities to continue to operate and provide essential loug term care services in a difficult environment, the profession sought alternatives to traditional litigation including arbitration. This trend was especially true in states such as Florida, Arkansas, and Texas, where state laws fostered an exponential growth in the number of claims filed against long term care providers – even those with a history of providing the highest quality care.

Arbitration is a legal process where the parties enter into an agreement to resolve disputes by an unbiased, unrelated third party. AHCA/NCAL represents the vast majority of our nation's nursing facilities and assisted living residences and supports the use of arbitration clauses as a viable option for long term care providers to resolve legal disputes. When legal concerns arise, we believe that fair and timely resolution – the kind that is often the product of arbitration – is in the best interest of both the consumers and their care providers.

Over the course of the past ten years arbitration has became a more widely used alternative in long term care. This growth has been across the board for long term care providers – from single owner facilities to national chain facilities; and for non-proprietary and for-profit organizations. As a service to our member facilities and the residents they serve, in 2002 AHCA/NCAL developed a model arbitration agreement form for possible use in the admission process.

This model agreement in no way alters the rights or remedies available to a resident under state tort law. It states in plain English that entering into the arbitration agreement is not a condition of admission into the facility. Further, the model form provides a 30-day window for the resident or their representative to reconsider and, in writing, rescind the arbitration agreement. This 30-day "cooling off period" far exceeds the period of time found on most arbitration clauses.

A recent survey conducted by Aon Global Risk Consulting contained findings regarding the content of arbitration clauses and the methods by which these arbitration agreements are presented to residents and/or their agents. The June 2009 report entitled "The American Health Care Association: Special Study on Arbitration in the Long Term Care Industry," found that of the fourteen respondents to AON's qualitative study (representing 7% of the skilled nursing occupied beds), none required a signed arbitration agreement as a condition of admission; none attempted to limit awards beyond state statutory caps; and all incorporated explicit warnings that the arbitration agreement precluded a jury trial. Most of the survey respondents utilized a stand-alone arbitration agreement, as opposed to a clause in the admission agreement. According to the AON survey, all respondents inform the resident (or agent) that

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the agreement is not a condition of admission. 79 percent of the respondents allowed for a period in which the arbitration agreement could be revoked. Those respondents offering a revocation period indicated that revocation is exceedingly rare, with responses ranging from less than 2 percent to less than 5 percent. Six of fourteen respondents offered the applicant a separate brochure, video, or other educational opportunity related to arbitration agreements.

AHCA/NCAL supports the use of arbitration because unlike traditional litigation, our members have experienced that arbitration is more efficient, less adversarial, and has a reduced time to settlement. As this Committee is no doubt aware, most cases are resolved through settlement. Arbitration facilitates that process. Another Aon report entitled "Long Term Care – 2008 General Liability and Professional Liability Actuarial Analysis" found, "Arbitration reduces the time to settlement by more than two months on average." It further found that "very few claims actually go all the way to arbitration [as] most claims are settled in advance."

Timely resolution of disputes is of unique importance to residents of long term care facilities and their families. Often the individuals are very frail elderly in their twilight years and it is a comfort for families to reach a settlement during their loved one's lifetime.

In addition, because it vastly reduces transaction costs, arbitration may also enable patients and their families to retain a greater proportion of any financial settlement than with traditional litigation. The same report found that "currently, 55.2% of the total amount of claims costs paid for GL/PL claims in the long term care industry is going directly to attorneys. This means that less than half of the dollars spent on liability is actually going to the patients and their families." The decreased transaction costs associated with arbitration means more of any award received goes to the party whom is most deserving – the patient or resident, not their legal representative.

"Fairness in Nursing Home Arbitration Act of 2009" – An Unfair & Inappropriate Bill

We believe that the *Fairness in Nursing Home Arbitration Act of 2009* (H.R. 1237 and S. 512) and the *Arbitration Fairness Act* (H.R. 1020 and S. 931) are misguided attempts to restrict and weaken the Federal Arbitration Act (FAA), which has been in place for more than 80 years. The FAA appropriately recognizes the strong national interest in disputes being resolved in a forum other than the courts when both parties agree to do so. We firmly believe that this legislation and other efforts to undermine the FAA is bad public policy and a step in the wrong direction.

Unfortunately, this debate is colored by anecdotes and misinformation perpetuated by high-profile trial attorneys who traditionally oppose any effort to bring balance to the personal injury playing field, and who give too little consideration to the harmful consequences on the long term care industry that follow from the high transaction costs of traditional litigation and the resulting financial drain on the system. Entering into a nursing facility or assisted living residence can often be a time of uncertainty and apprehension, but assertions that family members are threatened into signing the arbitration agreement are simply untrue. As I stated earlier, AHCA/NCAL developed a model arbitration agreement that was provided to members which clearly states that there is a 30-day "out clause" and that declining to sign the form will not have an affect on admission to the facility.

It is important for this Committee to recognize that the FAA does not inherently foster or sanction any disregard for traditional notions of fair play when it comes to entering an arbitration contract. The FAA simply requires that an arbitration agreement be enforced "save upon such grounds as exist at law or in equity for the revocation of any contract." Numerous courts across this nation have not hesitated to

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invalidate nursing home arbitration agreements when they have found that a representative lacked authority to act for the resident, a resident lacked the capacity to enter the agreement, or that an arbitration agreement was otherwise unconscionable, either in the substance of its terms or in the way it was presented to and signed by the resident or the resident's representative.

The *Fairness in Nursing Home Arbitration Act of 2009* needlessly discriminates against long term care providers and more importantly the patients and residents in our nation's nursing facilities and assisted living residences by eliminating their federal right to agree to arbitrate future disputes. Pre-dispute arbitration agreements are a viable legal option for long term care consumers and providers, and their use should not be eliminated by misguided policies – nor should the consumer's choice to agree to arbitrate pre-dispute be denied as is the legislation would do. It is clear that if the legislation were to become law, even residents who voluntarily chose to submit to pre-dispute arbitration would have that right to choose denied, a right that is not denied in any other consumer transaction.

A May 1, 2008, letter to Congress signed by twenty business organizations including the Business RoundTable and the U.S. Chamber of Commerce echoes our concerns with this bill – and other legislative efforts to limit the use of arbitration. The letter states, "Even though arbitration has been used to amicably resolve disputes for more than 80 years, those who wish to dismantle the arbitration system are attempting to effectively abolish all pre-dispute arbitration by using anecdotes and a handful of poorly designed or inaccurate studies to validate their unfounded claim that the system is broken."

Public sentiment is also opposed to eliminating the use of arbitration to resolve disputes. In fact, the U.S. Chamber of Commerce's Institute for Legal Reform recently conducted a national poll which found that "given the choice, voters strongly prefer [82%] arbitration over litigation to resolve any serious dispute with a company." The bipartisan survey, which was released in April 2008, also concluded that "voters strongly believe Congress should NOT remove arbitration agreements from the contracts consumers sign with companies providing goods and services (71%)."

Like the vast majority of Americans, AHCA/NCAL believes that legislative proposals to limit arbitration and undermine the FAA is bad public policy. We strongly support the use of arbitration as a reasonable, intelligent option for both patients and providers to help assist in the resolution of legal disputes, and aggressively oppose efforts to diminish the use of arbitration by American businesses, especially those unfairly targeting long term care consumers and providers.

Thank you for the opportunity to offer these comments on behalf of millions of professional, compassionate long term caregivers and the millions of frail, elderly, and disabled Americans they serve each day.

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PREPARED STATEMENT OF PUBLIC CITIZEN

Statement of Public Citizen

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

Hearing on "Mandatory Binding Arbitration: Is it Fair and Voluntary?"

September 15, 2009

Public Citizen would like to thank the Subcommittee for holding the hearing "Mandatory Binding Arbitration: Is it Fair and Voluntary?" Public Citizen is a national nonprofit membership organization that has advanced consumer rights in administrative agencies, the courts, and the Congress, for thirty-eight years.

Our work in the area of pre-dispute mandatory binding arbitration contracts, or "forced arbitration," has focused primarily on consumer arbitrations. Since 2007 Public Citizen has published four reports on consumer arbitration: "The Arbitration Trap: How the Credit Card Companies Ensnare Consumers,"[1] "The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration," [2] "Home Court Advantage: How the Building Industry Uses Forced Arbitration to Evade Accountability,"[3] and our report released on September 14, 2009, "Forced Arbitration: Unfair and Everywhere."[4] [Attached]

We would like to draw the Subcommittee's attention to three particular issues that are relevant to today's hearing:

1. Forced arbitration is fundamentally unfair to consumers, both in its nature and its prevalence in the consumer economy.

2. There have been significant developments in consumer arbitration recently, involving the nation's largest consumer arbitration provider and one of the nation's largest banks.

3. The only way to cure the unfairness of consumer arbitration is to pass federal legislation that stops companies from forcing it on consumers.

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[1] Available at http://www.citizen.org/documents/ArbitrationTrap.pdf.
[2] Available at http://www.citizen.org/documents/ArbitrationDebateTrap%28Final%29.pdf.
[3] Available at http://www.fairarbitrationnow.org/uploads/HomeCourtAdvantage.pdf.
[4] Available at http://www.citizen.org/documents/UnfairAndEverywhere.pdf.

I. The Fundamental Unfairness of Forced Arbitration

The Federal Arbitration Act, passed in 1925, was intended to provide an informal dispute resolution mechanism for businesses to resolve disagreements.[5] At the time, arbitration was voluntary, chosen by sophisticated parties that had bargaining power with respect to each other.[6] In the early 1980s, the United States Supreme Court opened the door for large corporations to force their customers and non-union employees into arbitration,[7] and many have seized the opportunity. Today, a consumer must forego the right to litigate any future disputes in court to obtain a wide range of goods and services, including credit cards.[8] A consumer with a dispute must bring a claim individually, not as a member of a class, in a private, secretive forum, chosen by the business.

Arbitration began to spread about ten years ago. In 2005, credit cardholders filed an antitrust action accusing the 13 largest card issuers of illegally colluding to require mandatory arbitration clauses in their cardholder agreements.[9] The plaintiff cardholders claim that the banks formed an "Arbitration Coalition" in late 1998 or early 1999 to "'force[] unwilling and unaware cardholders to accept arbitration clauses and class action prohibitions on a 'take-it-or-leave-it basis' through the joint exercise of immense market power.'"[10] Regardless of whether the collusion allegations in this suit are true, all of the named banks employ, or have employed, arbitration clauses. As our most recent report demonstrates, arbitration is now nearly ubiquitous in a variety of consumer service contracts.

A. The unfair nature of forced arbitration.

Arbitration is now forced on consumers in millions of "take-it-or-leave it" form contracts for services like credit cards.[11] These contracts are non-negotiable, and corporations draft all of the terms, which means that they determine which arbitration provider will be named in the contract. As a result, arbitration companies like the American Arbitration Association (AAA) and the National Arbitration Forum (NAF) have competed to be written into these form contracts.[12] An arbitrator's repeat business and the resulting income are determined by his or

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[5] *See* Jean Sternlight, *Creeping Mandatory Arbitration: Is It Just*, 57 STAN. L. REV. 1631, 1636 (2005).
[6] *Id.* at 1635-36.
[7] *See generally* David S. Schwartz, *If You Love Arbitration, Set It Free: How "Mandatory" Undermines "Arbitration"*, 8 NEV. L. J. 400 (2007).
[8] *See* Theodore Eisenberg & Geoffrey Miller, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Non-Consumer Contracts*, 41 U. MICH. J.L. REFORM 871, 871 (2008).
[9] *Ross v. Bank of America, N.A*, 524 F.3d 217, 220 (2d Cir. 2008).
[10] *Id.* at 220-21.
[11] *See* Robert Berner & Brian Grow, *Banks vs. Consumers (Guess Who Wins)*, BUS. WK., June 5, 2008 *available at* http://www.businessweek.com/magazine/content/08_24/b4088072611398.htm?campaign_id=rss_daily.
[12] *See* Sternlight, *supra*, at 1650.

her reputation ruling in past cases.[13] Arbitration firms market themselves as the business-friendly alternative to court, and they collaborate with law firms that specialize in debt collection to work with the law firms' client base.[14]

Once the arbitration providers are written into credit card contracts, they must ensure that their client companies are pleased with the results of their arbitrations, lest they lose future business.[15] Our 2007 *Arbitration Trap* report documented cases of arbitrators being blackballed by arbitration providers for ruling against their corporate clients.[16] AAA's annual reports have referred to the corporations that file arbitrations as its "clients and customers."[17] Our report also found that a select pool of 28 arbitrators handled 89.5 percent of cases in which an NAF arbitrator was appointed – and ruled for the company nearly 95 percent of the time.[18] Another 120 arbitrators handled slightly more than 10 percent of the cases in which an arbitrator was assigned, ruling for businesses 86 percent of the time and for consumers 10 percent of the time.[19] In a single day, NAF's busiest arbitrator issued 68 arbitration decisions,[20] or roughly one every 7 minutes (assuming an 8-hour work day).

Forcing arbitration on consumers has nothing to do with providing them a quicker, simpler, less expensive forum in which to pursue disputes, as its proponents claim. In reality, forced arbitration works as a shield and a sword against consumers: (1) it blocks consumers from bringing claims against businesses; and (2) it gives creditors a forum that helps them collect debts, even when they lack evidence or are violating the law, and in which they can run up additional fees to charge consumers.

To deter most consumer claims, 10 out of 12 credit card providers and banks studied by Public Citizen prohibit consumers from bringing actions on a class-wide

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[13] *See* Peter B. Rutledge, *Toward A Contractual Approach For Arbitral Immunity*, 39 GA. L. REV. 151, 165 (2004) (Arbitrators "may also develop reputations with particular types of parties. For example, an arbitrator may be perceived as 'industry friendly' in securities law disputes or being 'contractor friendly' in construction disputes. Through these activities designed to enhance their reputations, arbitrators generate business in the form of fees and, hopefully, future appointments.").

[14] *See* Berner & Grow, *supra* ("NAF sells itself to lenders as an effective tool for collecting debts. The point of these pitches is to persuade the companies to use the firm to resolve clashes over delinquent accounts . . . A September, 2007, NAF PowerPoint presentation aimed at creditors and labeled 'confidential' promises 'marked increase in recovery rates over existing collection methods.' At times, NAF does this kind of marketing with the aid of law firms representing the very creditors it's trying to sign up as clients.").

[15] *See* Sternlight, *supra*.

[16] *See, e.g.*, PUBLIC CITIZEN, THE ARBITRATION TRAP at 30-31 (Describing the case of Harvard law professor Elizabeth Bartholet, who resigned from NAF in February 2005, citing concern for NAF ethics and "its apparent systematic bias in favor of the financial services industry.").

[17] *See* Testimony of Laura MacCleery, Director, Public Citizen's Congress Watch division, before House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, October 25, 2007 at 4.

[18] PUBLIC CITIZEN, THE ARBITRATION TRAP at 15.

[19] *Id.*

[20] *Id.* at 16.

basis.[21] Common consumer harms like overcharging fees on credit cards and other consumer products are small-dollar-value claims,[22] and can only be challenged through consumer class actions.[23] By banning class actions, service providers deter consumers from bringing claims that are feasible only if brought on a class basis.[24] They have effectively immunized themselves because, as Judge Richard Posner has said, "[t]he *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30."[25]

More than 99 percent of "consumer arbitrations" are debt collection claims filed by businesses, usually credit card companies or collection companies, against consumers, pursuant to arbitration that was unilaterally imposed by the business.[26] Arbitration makes it easier for debt collectors and creditors to obtain judgments in cases that are disputed, particularly cases that involve mistaken identity or identity theft. Our "Arbitration Trap" report examined NAF's credit card collection arbitrations, finding that corporations beat consumers almost 94 percent of the time.[27]

B. Recent findings on the prevalence of forced arbitration.

Our new report, "Forced Arbitration: Unfair and Everywhere," examined 68 consumer contracts for credit cards, bank accounts, cellular telephones, computers, cable and internet providers, securities brokerages and home builders.[28] Of the companies from which we obtained contracts, 75 percent use forced arbitration, and

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[21] PUBLIC CITIZEN, FORCED ARBITRATION: UNFAIR AND EVERYWHERE 9, 11 (2009) available at http://www.citizen.org/documents/UnfairAndEverywhere.pdf.
[22] *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 77 (2008); *see also Ross v. Bank of America, N.A*, 524 F.3d at 224 (2008) ("[A]ctions that result in significant aggregate revenue to the banks (concerning, e.g., late fees, overlimit fees, foreign transaction fees, APR, etc.) generally harm individual consumers in only small amounts[.]")
[23] *See Scott v. Cingular Wireless*, 161 P.3d 1000, 1005 (Wash. 2007) ("As we have noted before, when consumer claims are small but numerous, a class-based remedy is the only effective method to vindicate the public's rights.").
[24] *See* Bar-Gill & Warren, *supra*, at 78 ("The widespread inclusion of arbitration clauses in standard credit card contracts inoculates lenders against the possibility of class action lawsuits, which would otherwise change the economics of pursuing debtor's rights."); *see also Scott*, 161 P.3d at 1007-08 ("We . . . conclude that since this clause bars any class action, in arbitration or without, it functions to exculpate the drafter from liability for a broad range of undefined wrongful conduct, including potentially intentional wrongful conduct[.]").
[25] *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).
[26] *See* Majority Staff Report, Domestic Policy Subcommittee, House Oversight and Government Reform Committee, *Arbitration Abuse: an Examination of Claims Files of the National Arbitration Forum* (2009) [hereinafter Domestic Policy Report] at 7 n.8 ("The NAF produced records that show only 7 of 4,894 NAF arbitrations in West Virginia (0.14%), and only 79 of 14,408 in Minnesota (0.5%) were filed by consumers. The General Counsel of First USA Bank testified in an August, 1999 deposition that fewer than 10 of their 40,713 arbitrations after January of 1998 were filed by consumers."). Public Citizen's own analysis of NAF's California data produced similar results: business brought all but 118 out of nearly 34,000 studied cases, or about 99.6 percent. *See* PUBLIC CITIZEN, THE ARBITRATION TRAP 1-2 (2007) *at* http://www.citizen.org/documents/ArbitrationTrap.pdf.
[27] *Id.* at 4.
[28] PUBLIC CITIZEN, UNFAIR AND EVERYWHERE at 1.

nearly two-thirds force consumers to accept these terms as a condition of doing business.[29]

For the rare consumer who understands forced arbitration, merely obtaining information about arbitration policies is extremely difficult. For example, only three of the 10 credit card providers we queried would share the contractual language of their arbitration clauses with us.[30] Several credit card companies told us that we had to apply for a credit card and be approved before we could see their terms.[31] But the mere act of applying for a credit card risks harm to one's credit rating.[32]

Other credit card representatives provided information over the telephone that was almost certainly false.[33] Auto dealers told us we could not see contractual agreements until signing final paperwork to buy a car.[34] All of the bank representatives we encountered were completely unaware of their arbitration policies.[35]

Prior to NAF's termination of its credit collection business, American Express representatives twice referred us to the company's "arbitration provision division."[36] In both instances, the phone number they provided was to the National Arbitration Forum.[37] Three weeks after NAF ended its consumer arbitration practice, we called American Express back to see whether the firm still referred arbitration questions to NAF.[38] After we were bounced from agent to agent for 30 minutes, a representative offered to transfer us to "another customer service department that knows about arbitration."[39] That "department" turned out to be NAF.[40]

Our report's findings significantly rebut one of the most popular arguments in favor of forced arbitration holding that, though consumer contracts are mostly non-negotiable adhesion contracts, consumers can still choose not to accept any

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[29] These findings omit auto dealerships, where we believe arbitration is nearly universal but few businesses would provide clear information.
[30] PUBLIC CITIZEN, UNFAIR AND EVERYWHERE at 5.
[31] *Id.* at 3.
[32] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REPORT TO CONGRESS ON CREDIT SCORING AND ITS EFFECTS ON THE AVAILABILITY AND AFFORDABILITY OF CREDIT, Submitted to the Congress pursuant to section 215 of the Fair and Accurate Credit Transactions Act of 2003, at 15-16, 22 (2007).
[33] *See* PUBLIC CITIZEN UNFAIR AND EVERYWHERE at 6 ("For example, JPMorgan Chase said that Visa or MasterCard served as the arbiter of its disputes. Bank of America said that arbitration is free to consumers except for the cost of their own attorneys. These statements are almost certainly untrue.").
[34] *Id.* at 17-18.
[35] *Id.* at 10.
[36] *Id.* at 6.
[37] *Id.*
[38] *Id.* at 7.
[39] *Id.*
[40] *Id.*

contract that contains an arbitration clause. "Forced Arbitration" exposes the faulty assumptions upon which this argument rests.

The free market argument assumes that consumers are well-informed about all of the terms contained in the contracts that they sign, which is not the case.[41] Consumers are rarely aware of arbitration clauses because they are often buried deep in long form contracts, sometimes by the drafter's careful design.[42] As our report outlines, it is an onerous task to obtain basic details about arbitration, such as what it is and whether it is required in a particular contract. Even the most astute consumers cannot make informed decisions about arbitration when it is so difficult to obtain most basic details about product features.

Even if consumers had perfect information, many consumer service providers offer the same provisions in their contracts as their competitors. As our report shows, the vast majority of service providers across the board require arbitration. Nine out of 10 studied cell phone providers require arbitration. Consumers living in areas not serviced by the provider that does not require arbitration, Virgin Mobile, must choose between accepting forced arbitration or foregoing a cell phone altogether. For many consumer services, there is no meaningful consumer choice whether or not to accept arbitration.

II. Recent Developments in Consumer Arbitration

On July 14, 2009, Minnesota Attorney General Lori Swanson sued NAF, alleging that NAF committed fraud and engaged in false advertising and deceptive trade practices by intentionally misrepresenting its independence and neutrality and hiding its extensive ties to the debt collection industry.[43]

The Minnesota complaint included the following allegations:

- Despite NAF's representations to the public that it is an independent and neutral arbitration company, it actively concealed the fact that the New

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[41] *See* Bar-Gill & Warren. *supra*, at 27-32 (summarizing the general state of research on consumer information related to financial products).

[42] *E.g. Ting v. AT&T*, 319 F.3d 1126, 1133-34 (9th Cir. 2003) ("Before presenting the C[onsumer] S[ervice] A[greement] to its customers, AT&T conducted extensive market research designed to predict how consumers would react to the CSA, which AT&T planned to mail with a cover letter and a set of frequently asked questions. AT&T's cover letter stated in bold text '[P]lease be assured that your AT&T service or billing will not change under the AT&T Consumer Services Agreement; there's nothing you need to do.' AT&T's market study concluded that most customers 'would stop reading and discard the letter' after reading this disclaimer. AT&T did not change the substance of the letter as a result of its market research-indeed, internal AT&T documents indicate that the letter was specifically intended to make customers less alert to the details of the CSA.")

[43] *See Minnesota AG Sues Credit Card Arbitration Firm*, Reuters, July 14, 2009 *available at* http://www.reuters.com/article/governmentFilingsNews/idUSN1427883420090714; Kathy Chu & Taylor McGraw, *Minnesota Lawsuit Claims Credit Card Arbitration Firm Has Ties To Industry*, USA TODAY, July 15, 2009 *available at* http://www.usatoday.com/money/perfi/credit/2009-07-14-credit-card-arbitration-firm-lawsuit_N.htm.

York hedge fund, Accretive, had substantial ownership and management stakes in both NAF and the largest debt collection law firm in the country.[44] This law firm handled at least 58 percent of the 214,000 consumer arbitrations conducted by NAF in 2006.[45]

- NAF worked closely with creditors behind the scenes to: (1) encourage them to file arbitration claims as an efficient and less costly way to collect debt from consumers;[46] (2) draft arbitration clauses,[47] (3) advise creditors on arbitration legal trends,[48] (4) help them or their lawyers draft claims to be filed against consumers – the equivalent of a judge in a court of law helping one party to a dispute draft a summons and complaint,[49] and (5) refer them to debt collection law firms (including firms owned by Accretive), which then file arbitration claims against consumers with NAF.[50]

- NAF actively solicited companies to steer it arbitration business by emphasizing its services as a less costly and more effective collection tool than the courts. For example, NAF told one financial services company that "the customer does not know what to expect from Arbitration and is more willing to pay," "[customers] ask you to explain what Arbitration is then basically hand you the money," and that the creditor has "all the leverage [in arbitration] and the customer really has no choice but to take care of the account."[51]

- In 2008, principals at the Accretive hedge fund helped NAF craft responses to media inquiries about its arbitration practices and the two worked together to "devise 'talking points' and a plan to lobby members of Congress on how to kill or weaken the Arbitration Fairness Act[.]"

On July 17, 2009, NAF settled the case by agreeing to stop accepting all future consumer arbitrations.[52] On July 18, AAA announced that it will stop participating in consumer debt-collection disputes until new guidelines are established.[53]

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[44] *See* Compliant, *Swanson v. Nat'l Arbitration Forum, Inc.*, 9-31 (Minn. 4th Jud. Dist. July 17, 2009) (No. 27-CV-09-18550), *available at* http://puhcit.typepad.com/files/2009-07-14-signed-complaint-with-exhibits.pdf.
[45] *Id.* at 29.
[46] *Id.* at 33-35.
[47] *Id.* at 35-37.
[48] *Id.* at 38.
[49] *Id.*
[50] *Id.*
[51] *Id.* at 35.
[52] Robin Sidel & Amol Sharma, *Credit-Card Disputes Tossed Into Disarray*, WALL STREET J., July 21, 2009, *available at* http://online.wsj.com/article/SB124822374503070587.html.
[53] *Id.*

Effective August 13, 2009, Bank of America, one of the three largest credit card providers in the United States, stopped requiring its customers to resolve their disputes in the unfair system of forced arbitration.[54] JP Morgan Chase has also ceased arbitrating consumer credit disputes.[55]

III. The Urgent Need for Legislative Action

Despite the recent developments, forced arbitration remains as unfair to consumers as ever. Forced arbitration creates financial conflicts of interest that produce companies like NAF, which cater to business parties. The best way to prevent another NAF from emerging is to prohibit arbitration from being foisted on consumers in the terms of a non-negotiable form contract. We continue to support the Arbitration Fairness Act, sponsored by Representative Hank Johnson and Senator Russ Feingold,[56] which would give consumers a meaningful choice between going to arbitration or court. Common sense says that forced arbitration is unfair. If a particular type of arbitration is good for consumers, then corporations shouldn't have to force it on them.

Forced arbitration proponents have argued that NAF was simply one bad apple that should not spoil the whole bunch. For example, Lisa Rickard of the United States Chamber of Commerce Institute for Legal Reform proclaimed that, "To take this one situation and use it to [disparage] the whole system I think is a serious mistake and a travesty for the consumer," and that the NAF case "should not be taken as indicative for any other problems in the industry."[57] Far from being a single "bad apple," NAF was by far the largest consumer arbitration provider, handling approximately 214,000 disputes in 2006 alone. By contrast, AAA reported handling roughly 61,000 consumer cases from 2004 until May of 2009.[58] NAF handled consumer arbitrations for lenders MBNA/Bank of America, JP Morgan Chase, Citigroup, Discover Card, Deutsche Financial, and American Express, among others.[59] Through its collaboration with lenders and integration with debt collectors, NAF sought to place itself "at the center of a broad arbitration ecosystem."[60] In the world of consumer arbitrations NAF was in many ways the "whole bunch."

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[54] Joshua Freed, *Bank of America Drops Arbitration Requirement*, Associated Press, Aug. 13, 2009 *available at* http://www.google.com/hostednews/ap/article/ALeqM5gyiq1HgTjY-B3wYINcgyu_ymNvbwD9A2AUGG1.

[55] Martin Merzer, *Credit Card Binding Arbitration System Crumbling*, CreditCards.com, July 23, 2009 at http://www.creditcards.com/credit-card-news/credit-card-binding-arbitration-system-crumbling-1282.php.

[56] H.R. 1020, 111th Cong. (2009); S. 931, 111th Cong. (2009).

[57] Bill Swindell, *Opponents Get Assist On Arbitration*, NAT'L J. CONGRESSDAILY, Aug. 21, 2009.

[58] Testimony of David Arkush, Director, Puhlic Citizen's Congress Watch division, before House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, May 5, 2009, at 8, *available at* bttp://judiciary.house.gov/hearings/pdf/Arkush090505.pdf.

[59] *See Swanson v. Nat'l Arbitration Forum, supra*, at 5.

[60] *Id.* at 10.

Moreover, the Chamber of Commerce made no suggestion that it viewed NAF as a "bad apple" until after NAF settled with the State of Minnesota's lawsuit,[61] which alleged that the Chamber and NAF collaborated to undermine Public Citizen's "Arbitration Trap" report that questioned the integrity of NAF's arbitration practices.[62] The complaint alleged that although NAF had a role in the Chamber's report it thought it would "be best if no administrators are associated with . . . [the report] and if the Chamber (and the Arbitration Coalition of industry supporters) are front and center on this."[63]

Another provider could easily step in and fill the void created by NAF's departure. And companies like Bank of America and JPMorgan Chase could resume forcing arbitration on their customers as soon as another provider is available. Only prompt legislative action can prevent this from happening again.

Bank of America's decision to halt forced arbitration, while a step in the right direction, demonstrates problems inherent in forced arbitration:

Consumers don't like forced arbitration. Bank of America says it made the change in response to complaints from its customers about forced arbitration. This confirms recent polling conducted by Lake Research, which found that 60 percent of Americans polled oppose forced arbitration.[64] However, consumers can only express disapproval if they are aware that the practice exists. The Lake Research poll also found that 79 percent expect that they can sue a company in the event of a major dispute, and 64 percent have no recollection of seeing arbitration in any terms of agreement for goods and services.[65]

Forced arbitration is still favored by most banks and other businesses. Bank of America has finally listened to its customers, but, as our "Unfair and Everywhere" report demonstrates, thousands of other banks and consumer service providers are still using forced arbitration every day to deny consumers and employees a fair shake. Capital One, Citigroup, and Discover Financial Services have not yet made their intentions clear. American Express insists that its arbitration program is voluntary,[66] and Sprint Nextel still "uses arbitration most often to resolve customer-

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[61] *See* Press Release, *U.S. Chamber: Minnesota AG should not Leverage Arbitration Lawsuit to Benefit Trial Bar*, July 21, 2009, at http://www.instituteforlegalreform.com/component/ilr_media/30/pressrelease/2009/464.html.
[62] *See Minnesota v. Nat'l Arbitration Forum, supra*, at 32.
[63] *Id.*
[64] Lake Research Partners, National Study of Public Attitudes on Forced Arbitration: Findings from a Survey of 800 Likely 2010 Voters Nationwide 4 (2009) *available at* http://www.fairarbitrationnow.org/uploads/Forced%20Arbitration%20Study%20Slides%200409.pdf.
[65] *Id.* at 14-15.
[66] Joshua Freed, *Bank of America Drops Arbitration Requirement*, supra.

service and collection disputes."[67] Forced arbitration is also rampant in many other areas, from private employers to nursing homes.

The company has all the control in forced arbitration. Forced arbitration proponents often (though not always) present arbitration as a voluntary decision between two parties to a contract, waiving their right to sue and substituting a binding decision of an arbitrator. Bank of America's unilateral termination of the arbitration agreement it required of customers shows where the real choice lies. Arbitration is imposed or withdrawn at the whim of the business.

There are no safeguards in place to prevent Bank of America from unilaterally reinstating forced arbitration when public attention wanes. Credit card providers have made similar moves in the past. For example, in 2007, Citigroup made much of its decision to discontinue the practice of "universal default" (the practice whereby credit card companies unilaterally raise customers' rates for negative credit activity, like being late on an unrelated credit card, mortgage, utility or car payment) when Congress was considering banning the practice.[68] About six months later, the company quietly resumed the practice.[69] It took congressional action through the Credit CARD Act to finally end "universal default" for good.[70] Congress must enact the Arbitration Fairness Act before Bank of America has a chance to change its mind and re-impose forced arbitration on all of its customers.

We object to forced arbitration because we reject the unfair practice of *forcing* people into arbitration as a condition for service, before any dispute has arisen. A solid majority of Americans—59 percent—also opposes forced arbitration clauses being hidden in the fine print of employment and consumer contracts, and supports the Arbitration Fairness Act.[71] This number includes majorities of men, women, Democrats, independents, and Republicans.[72]

Prohibiting corporations from forcing consumers into arbitration is a market-based solution: When arbitration is agreed upon voluntarily after a dispute arises, arbitration companies must offer a fair process that both parties would choose willingly.

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[67] Robin Sidel & Amol Sharma, *Credit-Card Disputes Tossed Into Disarray*, Wall Street Journal, July 21, 2009, *available at* http://online.wsj.com/article/SB124822374503070587.html.
[68] *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 20 (2008).
[69] *Id.*
[70] *See* Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No 111-24, § 108 (2008).
[71] Lake Research Partners, National Study of Public Attitudes on Forced Arbitration at 4, 7.
[72] *Id.* at 5-6, 8-9.

PREPARED STATEMENT OF AARP

STATEMENT FOR THE RECORD

SUBMITTED TO THE

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW OF THE HOUSE JUDICIARY COMMITTEE ON

MANDATORY BINDING ARBITRATION

IS IT FAIR AND VOLUNTARY?

SEPTEMBER 15, 2009

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On behalf of AARP's 40 million members, thank you for holding today's hearing on mandatory binding arbitration. AARP's statement will focus specifically on the Fairness in Nursing Home Arbitration Act (H.R. 1237/S. 512) and pre-dispute arbitration clauses in long-term care facility contracts.

Pre-dispute arbitration or mandatory binding arbitration clauses in long-term care facility contracts are harmful to residents and their families. These arbitration clauses force a Hobson's choice -- waive the right to seek redress in the courts or get care in another facility, assuming there is one in their area without an arbitration clause. AARP's testimony focuses on the situations that individuals and their families face as they enter long-term care facilities, the harmful impact of pre-dispute arbitration clauses, and AARP's support for the Fairness in Nursing Home Arbitration Act (H.R. 1237/S. 512).

Quality in Long-Term Care Facilities

Long-term care facilities include an array of providers such as nursing homes, assisted living facilities, and other residential care facilities that provide a home to residents and supportive services to assist them with daily activities, such as eating, dressing, and bathing. Such facilities may also provide services such as nursing care, rehabilitation, or therapy. Approximately 16,000 nursing homes in this country provide care to about 1.5 million of our most vulnerable residents. Including individuals who use nursing homes for short-term rehabilitation, about three million people use nursing homes each year. And about one million Americans live in assisted living facilities.

Quality of care and quality of life for residents in long-term care facilities can vary greatly. And, while the quality of care in our nation's nursing homes has improved over the last 22 years since the enactment of federal nursing home quality standards in the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), much more needs to be done. Many facilities do provide high quality care, but there are also too many facilities that show significant quality deficiencies that can cause harm to residents on their annual inspections.

The Government Accountability Office (GAO) has found that a small but significant share of nursing homes continue to experience quality of care problems. Three years ago, one in five nursing homes in this country were cited for serious deficiencies – deficiencies that cause actual harm or place residents in immediate jeopardy. GAO has also noted variations among states in citing such deficiencies, and that deficiencies are understated when found in federal comparative surveys but not in corresponding state surveys. In addition, some facilities consistently provide poor quality care or are "yo-yo" facilities that go in and out of compliance with quality standards. Almost half the nursing homes reviewed by GAO for a March 2007 report – homes with prior serious quality problems – cycled in and out of compliance over five years and harmed residents. Quality also varies greatly in other types of long-term care facilities, such as assisted living, which are regulated at the state level.

Long-Term Care Facilities and Arbitration Clauses

When older adults suffer a decline in health or are discharged from the hospital and are unable to care for themselves, these individuals, their families, or other caregivers are often faced with the daunting task of finding nursing home care. Often these decisions are made in a crisis situation and individuals may be pressured to accept the first available bed, without enough time to adequately compare nursing homes in order to find the one that offers the best quality of care or to consider other options. Thus, they may select a facility they would not have otherwise chosen if they had the luxury of shopping around and comparing facilities.

People seeking nursing home admission are among the frailest Americans. In 2006, nearly half (45 percent) of all residents had dementia and more than half depended on a chair for mobility or were unable to walk without extensive or constant support from others. In 2004, nearly 80 percent of residents needed help with four or five activities of daily living (bed mobility, transferring, dressing, eating and toileting). Most nursing home residents are elderly: 88 percent are 65 or older and 45 percent are 85 or older. About 75 percent of nursing home residents age 65 and older are women, and at the time of admission, over half of nursing home residents are widowed. Nursing home residents in recent years have had higher disease prevalence and multiple conditions are more common, indicating an increasingly sicker population, according to a Kaiser Family Foundation analysis. Nursing home residents are also often on multiple

medications that must be managed and coordinated to prevent adverse reactions.

Prospective assisted living residents can be similar to prospective nursing home residents. Assisted living facilities also may provide care to frail residents who could be cared for in a nursing home or whose care would have, until recently, been provided in a nursing home.

It is often in this context of crisis and vulnerability that prospective nursing home residents and their families face the nursing home admissions process. People seeking nursing home admission or someone acting on their behalf are typically given a lengthy, complicated contract. Many facilities, such as nursing homes and assisted living facilities, include provisions in their admissions contracts requiring that residents and their families agree to forego the use of the court system to resolve a wide range of future disputes. Instead, they must agree to submit their cases which may involve abuse, assault, malnutrition, neglect, and even death to arbitration. The admissions contract typically is presented on a "take it or leave it" basis, with no room for the resident to negotiate the terms.

Clearly, most people seeking nursing home admission are focusing on the quality and range of services available, and are not thinking about possible future disputes. When they are presented with admissions contracts, they often do not know that an arbitration requirement is buried in the fine print of the multi-page document. In the rare instance in which they are aware of the clause, they often

cannot understand its technical language or its significant implications for their rights.

In most instances, facilities present the contract after the person decides to apply for admission, rather than beforehand, when the individual or his or her representative would have more time to assess the contract provisions and how they affect their rights. And there may not be sufficient time for the resident or his or her representative to sit down with a nursing home representative or a trusted advisor who can answer questions and explain the terms of the contract and the arbitration provision. In addition, even if there is time for a conversation with the facility representative, that person is not always adequately informed about the details of the arbitration provisions or able to answer questions from the perspective of the resident or family, especially about the important legal rights involved.

Even if prospective residents and their families are aware that the admissions contract contains an arbitration provision, they often do not understand what it means. Nor do they realize the many rights and protections they would forego in arbitration. Arbitration usually is extremely expensive for consumers and places severe restrictions on many of their rights, including their ability to obtain documents and other evidence which makes it difficult for them to prove their case and gives the facility a considerable advantage.

In addition, unlike judges and juries, arbitrators do not have to follow prior court or arbitral decisions; their decisions and the facts about the dispute typically are confidential, so no one else can learn about them; and the bases for appealing an arbitrator's decision are extremely limited; misinterpretation or misapplication of the law is not a basis for appeal. Arbitrators usually do not need to issue written decisions, making appeals even more difficult. Consumers usually have limited, if any, knowledge on which to base their choice of an arbitrator – if they have a choice - and arbitrators may have a bias toward "repeat players" – to get a company's future business, an arbitrator may not want to rule against such a party too often or order them to pay large awards to other parties, even when such awards are justified. Finally, these disadvantages to consumers from the arbitration process itself are all in addition to the fact that the consumers have waived their basic right of access to the courts and a jury.

However, consumers strongly support maintaining the right of nursing home residents and their families to take nursing homes to court in cases of neglect and abuse. For example, an AARP poll of Arkansas residents age 40 and older released in January 2007 found that 85 percent of respondents strongly support maintaining the right of nursing home residents and their families to take nursing homes to court for neglecting and abusing nursing home residents. Another one in ten somewhat support this action.

Potential residents and their families also do not have equal bargaining power with the facility and are virtually powerless to negotiate the arbitration provision or

to gain admission to the facility without it, assuming they are aware of it. Potential residents and their families must often make quick decisions in stressful situations and deal with an immediate need for services – foregoing the care and services is not an option. If other nursing homes also have arbitration clauses in their admissions contracts, the individual effectively has no choice among facilities. Individuals and their families also deal with potential financial limitations and stress and anxiety from having to give up independence and leave one's home to enter a nursing home. Arbitration was designed to provide a mechanism for two parties with equal bargaining power to resolve a dispute. Potential residents of long-term care facilities, such as nursing homes and assisted living facilities, do not have equal bargaining power with the facilities.

A court case from New Mexico provides a good example of the unequal bargaining power between potential nursing home residents, their families and the facility, and the circumstances that frequently exist at the time of admission. New Mexico's court of appeals ruled that the arbitration clause in a nursing home contract was unenforceable so that the family of a woman, Ruth Painter, who died three days after entering the home can pursue their case in court alleging inadequate care. The court agreed with the family and an *amicus* brief filed by AARP and NCCNHR: The National Consumer Voice for Quality Long-Term Care that the heavily medicated, seriously ill woman could not be expected to understand the fine print in her contract that limited her legal rights.

Ruth Painter was 57 years old, suffered from several serious health conditions (including heart disease, chronic obstructive pulmonary disease, and atrial fibrillation), and was taking numerous prescription medications when she was taken by emergency transport to a medical center. When she was discharged more than a week later, she was physically unable to care for herself and she and her family decided she needed to move to a nursing home. She and her son visited a nursing home and she and her daughter returned the next day so she could be admitted.

While she was being admitted, Ms. Painter became short of breath and was literally propped up in bed receiving oxygen during the admissions process. Three days after admission, her health seriously deteriorated and she was taken by ambulance to a hospital where she died. Her family sued the facility, alleging negligent care and breach of contract. The facility moved to dismiss the suit based on a clause in the admissions contract that required that all disputes be resolved in arbitration.

A trial court declared the arbitration clause unconscionable and unenforceable based on its findings that: Ruth Painter had a 10th-grade education; for more than a year prior to her death her mental condition seemed to decline and her son had assumed responsibility for her finances; and the admissions agreement was 41 pages long and contained various other documents, including several contractual agreements, health directives, questionnaires and facility policies. According to the court, "Much of the [Arbitration] Agreement is in small print, and

[the admissions director] admitted it was often inconsistent and could be confusing." Ultimately, the trial court ruled that "[r]equiring a heavily medicated, seriously ill individual, such as Ruth Painter, who had limited education and comprehension to sign an Arbitration Agreement that was hidden away in the middle of a confusing and complicated Admission Agreement, would be unconscionable."

Fairness in Nursing Home Arbitration Act

AARP believes that it is essential for vulnerable residents to have access to the courts when they are injured, neglected, or abused. AARP thus supports the bipartisan Fairness in Nursing Home Arbitration Act (H.R. 1237/S. 512) introduced by Representative Linda Sanchez (D-CA) and Senators Mel Martinez (R-FL) and Herb Kohl (D-WI).

H.R. 1237 would make pre-dispute arbitration provisions between long-term care facilities and a resident of the facility or a person acting on behalf of the resident unenforceable, ensuring that future and some current residents of long-term care facilities and their families are not forced into arbitration or terms that may have a substantial adverse impact on their rights. This legislation is also important because it would provide uniform, nationwide protection against such pre-dispute arbitration provisions. While some states have taken action to address this important issue, consumers, regardless of the state in which they live, should not be forced to give up their rights to seek redress through the courts to resolve

cases of injury, neglect, and abuse. This bill would protect this essential right of older adults, individuals with disabilities, and their families, including some of the most vulnerable Americans.

As the Subcommittee considers this legislation, we would like to work with you and the bill's sponsors to help ensure this bill would apply to all current residents of long-term care facilities, not just those whose pre-dispute arbitration agreements are made, amended, altered, modified, renewed or extended on or after the date of enactment of the bill. The protections provided under this legislation should be available to all current long-term care facility residents. Some may argue that arbitration clauses in long-term care facility admission contracts are needed to limit costly lawsuits against facilities. But the answer to this concern is not to limit an individual's legal rights and protections, and require that they waive their right to resolve disputes in court. The answer is to improve the underlying care and services provided by facilities to decrease the likelihood of disputes that need to be resolved in court. This would help residents, their families, and the facilities themselves.

Conclusion

We appreciate the subcommittee's work on the important issue of pre-dispute arbitration clauses and their adverse impact on current and future long-term care facility residents and their families. AARP encourages the subcommittee to pass the Fairness in Nursing Home Arbitration Act (H.R. 1237) and expand its scope to include all current long-term care facility residents. We look forward to working with you and your colleagues on both sides of the aisle to protect the rights of current and future long-term care facility residents and their families.

STATEMENT OF THE NATIONAL ASSOCIATON OF HOME BUILDERS ON "Mandatory Binding Arbitration - Is it Fair and Voluntary?"

September 15, 2009

Introduction

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement on "Mandatory Binding Arbitration - Is it Fair and Voluntary?" 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 200,000 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.

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 2009* (H.R. 1020), introduced by Rep. Hank Johnson, would prohibit two parties from including in a contract a pre-dispute arbitration agreement. H.R. 1020 would also invalidate pre-dispute arbitration agreements in existing contracts. NAHB opposes H.R. 1020.

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

1 Southland Corp. v. Keating 465 U.S. 1, 10 (1984).

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, H.R. 1020 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 most home builders are struggling financially in the current housing market, this unfair retroactive change has the very real potential to put more builders out of business.

Arbitration is Fair

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.

Critics often suggest that arbitration firms will rule more often in the favor of businesses in order to win their repeat business. This argument, however, is rebutted by the statistical analysis conducted by the Searle Civil Justice Institute. In their March 2009 report, the Institute concluded that there was no statistically significant repeat-player effect:

> Under the usual definition of a repeat business, we find no statistically significant repeat-player effect… Under an alternative definition of a repeat business, based on the AAA's categorization of businesses in enforcing compliance with the Consumer Due Process Protocol, we find some evidence of a repeat-player effect as to win-rate …but not as to the percentage of claim amount recovered by consumer claimants (claimants actually recover a higher percentage of the amount claimed against repeat businesses than against non-repeat businesses). But the evidence suggests that any repeat-player effect is not due to arbitrator (or other) bias in favor of repeat businesses. Instead, it appears to result from case screening by repeat businesses, with those businesses resolving consumer claims prior to an award at a much higher rate than non-repeat businesses.[3]

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2 *Arbitration: Simpler, Cheaper and Faster than Litigation, U.S. Chamber Institute for Legal Reform, April, 2005*

3 Searle Civil Justice Institute, preliminary report, "*Consumer Arbitration before the American Arbitration Association.*" March 2009, pg 110.

The report also found with the American Arbitration Association, the average time from filing to final award was 6.9 months and that upfront costs for consumer claimants was quite low.[4]

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 on to homebuyers. Use of mandatory arbitration agreements provides the builder with a degree of certainty that if a dispute arises, legal 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, eliminating pre-dispute binding arbitration agreements may have a negative impact on housing affordability.

Arbitration is Voluntary

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 of arbitration by home builders. According to this study, only about 52 percent of builders required arbitration[5]. 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:

> 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. [6]

While critics of arbitration often argue that these are clauses of adhesion, this is not the case with the purchase of a new home.

Conclusion

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4 Ibid. Pg 109.
5 "A Study of Residential Construction Arbitration: Final Report of the Arbitration Task Force." Texas Legislative Council, December 2006.
6 18 S.W.2d 807 (Tex. App. San Antonio March 31, 2000) Id. at 812 (Green, J. concurring).

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.[7]

Moreover, private national ADR providers are 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 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. 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 issues. However, a complete prohibition on pre-dispute arbitration clauses is unwarranted.

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7 See John Townsend, *State Court Enforcement of Arbitration Agreements*, October 2006.

PREPARED STATEMENT OF RICHARD W. NAIMARK ON BEHALF OF THE AMERICAN ARBITRATION ASSOCIATION

Testimony
Of
Richard W. Naimark
On behalf of the American Arbitration Association

United States House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law
Tuesday, September 16, 2009

"Mandatory Binding Arbitration – Is It Fair and Voluntary?"

We appreciate the opportunity to share the experiences of the American Arbitration Association (AAA) on the important issues being considered by the Subcommittee on Commercial and Administrative Law as it examines the use of arbitration to resolve disputes in a variety of contexts.

The AAA is a not-for-profit public service organization with an 83-year history in the administration of justice. The AAA has pioneered the development of arbitration rules, protocols and codes of ethics jointly authored with organizations such as the American Bar Association.

Arbitrators who hear cases that are administered by the AAA are not employees of AAA, but are instead individuals who are independent, screened and trained. The AAA does not represent the alternative dispute resolution (ADR) industry or other arbitral institutions, but as a result of our unique position and longstanding leadership in the field of alternative dispute resolution, we believe the AAA has an important contribution to make to the subject matter of this hearing. The AAA has long advocated the broader application of high standards and due process protections in arbitration proceedings. We call on Congress to take action to make these voluntary standards mandatory requirements for all such arbitrations. Over a decade ago, the AAA and other leading organizations developed a series of due process protocols to address particular needs and issues related to the use of ADR in the fields of healthcare, employment, and consumer agreements. These protocols are intended to provide guidance not only to ADR providers, but also to legislative and regulatory policymakers at the federal and state levels. The AAA and a few other responsible organizations adopted these protocols, which Congress never codified, and consequently we must now address a number of issues in poorly crafted and overly broad legislative proposals.

We must make no mistake in our focus that the primary issue at hand is access to justice. The reality in this country is that our legal system is either inaccessible or difficult to navigate for most Americans. Individuals with claims with dollar values 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.

To further the public policy debate, the AAA has developed model draft federal legislation which would codify many of the due process protections contained in the consumer and employment due process protocols through the creation of a new chapter 4 within Title 9 of the U.S. code. This "Chapter 4" approach was recently incorporated into a major Senate bill after careful analysis. The Chapter 4 element, combined with a protocol-based approach to codifying appropriate standards and protections, would provide the best course of action to enhance the use of arbitration in the healthcare, employment, and consumer contexts. This draft bill, attached as Appendix I, can serve as a model or basis for a more effective and constructive approach to ensuring fairness in the use of ADR. This model legislation also incorporates a mechanism to greatly reduce the likelihood of unintentional legislative impact on international and commercial arbitration. Several current legislative proposals, though well-intentioned, would have far-reaching unintended impact on a broad spectrum of domestic and international commercial arbitration through amendment of the FAA.

Healthcare Arbitration

In 1997, the leading associations involved in medicine, law, and alternative dispute resolution formed the Commission on Health Care Dispute Resolution. Representatives of the American Medical Association, the American Bar Association, and the AAA developed standards on the appropriate use of ADR in resolving disputes in the health care environment between patients and health care providers. The resulting Healthcare Due Process Protocol (available at www.adr.org/sp.asp?id=28633) serves as a widely accepted standard for the use of ADR in this important field. As noted by the Commission, its Final Report is "…meant to provide guidance not only to private managed health care organizations considering the voluntary adoption of ADR programs as a form of review of plan determinations, but also to legislative and regulatory bodies considering the establishment of standards governing the use of ADR in the health plan environment."

The Healthcare Due Process Protocol includes a number of standards and protections beyond those proposed in the Fairness in Nursing Home Arbitration Act (H.R. 1237). The Commission, in formulating this Protocol, weighed the unique context in which healthcare agreements are signed, and found that agreements to arbitrate should be made after the dispute arises. The Senate Judiciary Committee, in reporting that chamber's previous version of this legislation (S. Report 110-518), noted:

> "This principal is supported by the Commission on Health Care Resolution, which consists of members of the American Medical Association, the American

> Bar Association, and the American Arbitration Association. These preeminent doctors, lawyers and arbitrators unanimously agreed that `in disputes involving patients, binding forms of dispute resolution should be used only where the parties agree to do so after a dispute arises."

However, because H.R. 1237 currently amends the Federal Arbitration Act (Chapter 1 of Title 9 of the U.S. Code) in a manner that could have unintended impact and would set a poor precedent, we have suggested technical changes to this legislation, primarily the creation of the Chapter 4 mechanism, which would improve it substantially, while retaining the basic goals of the legislation.

Employment Arbitration

In the employment arena, the AAA similarly convened the Task Force on Alternative Dispute Resolution in Employment, a coalition of consumer, employee, business and regulatory interests, to develop the Due Process Protocol on Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship.

The Task Force included individuals from the Federal Mediation and Conciliation Service, the ACLU, the ABA, the AAA, the National Employment Lawyers Association, and other interested organizations. The full Protocol is available at www.adr.org/sp.asp?id=28535.

The Task Force's work product represents the best consensus thinking about what constitutes due process, fair play and a level playing field in the area of employee-employer disputes. There was no limitation of subject matter for discussion.

The AAA's rules for the arbitration of disputes arising out of employer-promulgated plans conform to and implement this Due Process Protocol. Under these rules, for example, the filing fees payable by the employee are capped at $150. No other costs associated with the administration of the arbitration are charged to the employee, including arbitrator compensation (regardless of whether there are one or three arbitrators), hearing fees, and hearing room rental. All such costs are shifted to the employer.

Employment arbitrations conducted under this Protocol have been proceeding in an orderly and efficacious manner for ten years and have provided redress for thousands of employees and employers in that time. Studies support the balance and effectiveness of the process in this setting.

Consumer Arbitration

In recent years, the use of ADR and arbitration has grown to include consumer agreements. Often implemented through standardized contracts, the use of arbitration in consumer agreements for the purchase of goods and services has raised legitimate concerns regarding fairness, rights, and the ability of the parties to participate. The AAA's administration of consumer arbitrations is currently governed by the Consumer Due Process Protocol and a specialized set of implementing rules and procedures.

To evaluate and address concerns unique to consumer arbitration, the AAA convened the National Consumer Disputes Advisory Committee in 1997, which was composed of consumer, government, legal, business and academic experts, drawn from such organizations as the AARP, Consumers Union, Consumer Action, American Council on Consumer Interests, the Federal Trade Commission, the National Association of Attorneys General, the National Association of Consumer Agency Administrators, Fannie Mae, and Freddie Mac. One of the Advisory Committee's specific objectives was to have the Consumer Due Process Protocol influence state and federal laws governing consumer arbitration.

The result of the Advisory Committee's deliberations was the Consumer Due Process Protocol, which articulates a number of fundamental principles to enhance the fairness and efficiency of consumer ADR. The Consumer Due Process Protocol constituted a voluntary set of standards and minimum requirements which the AAA has adopted, but which are not necessarily applied to arbitrations outside of AAA administration. This Protocol provides for common sense "fair play" requirements, such as reasonable fees for the consumer, a reasonably accessible locale, no limitation of any remedy that would be available in court, and access to small claims court. The AAA will not administer an arbitration that does not materially comply with the provisions of the Consumer Due Process Protocol, and in fact, the AAA has declined to administer hundreds of companies' arbitrations because of Protocol violations. The full Consumer Due Process Protocol is available at www.adr.org/sp.asp?id=22019.

The AAA applies the Consumer Due Process Protocol through our Supplementary Procedures for Consumer-Related Disputes ("Supplementary Procedures"). The Supplementary Procedures also establish guidelines for consumers to request a deferral or waiver of fees, including requesting an arbitrator who will serve without charge. Under the Supplementary Procedures, the consumer's costs are capped at $125 or $375, for claims of up to $10,000 or between $10,000 and $75,000, respectively. Other costs, including administrative fees and additional arbitrator compensation costs, are borne by the business. One unique aspect of the Supplementary Procedures is the "small claims opt out" which permits a consumer, whether they are a claimant or respondent in a case, to opt out of an arbitration and into a small claims court proceeding.

Efficacy of the Protocol-Based Approach

While much of the debate on these issues has been driven by anecdotal evidence, statistical evidence is supportive of the fairness and effectiveness of protocol-driven ADR. The efficacy of the Consumer Due Process Protocol for consumer cases administered by the AAA was documented through a recent independent study conducted by the Searle Civil Justice Institute at Northwestern University Law School. The Searle Study reviewed a representative sample of approximately 300 AAA consumer arbitration case files that were awarded between April and December of 2007. Among the most compelling findings in the Searle study are that:

- The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low. In cases with claims seeking less than $10,000, consumer claimants paid an average of $96.
- AAA consumer arbitration seems to be an expeditious way to resolve disputes. The average time from filing to final award for the consumer arbitrations studied was 6.9 months.
- No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business. Consumer claimants won some relief in 51.8% of cases against repeat businesses and 55.3% against non-repeat businesses.
- Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.
- A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Consumer Due Process Protocol when the case was filed.
- AAA's review of arbitration clauses for Consumer Due Process Protocol compliance was effective at identifying and responding to clauses with Protocol violations. In 98.2% of cases in the sample subject to AAA Consumer Due Process Protocol compliance review, the arbitration clause either complied with the Protocol or the non-compliance was properly identified and responded to by the AAA.
- The AAA refused to administer hundreds of caseloads because of non-compliance by businesses with Protocol due process standards.
- As a result of AAA's compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.

The Searle findings are clearly a reaffirmation of the effectiveness of the Consumer Due Process Protocol, the Supplementary Rules, the AAA's administration of consumer arbitrations, and the value that arbitration can bring in the resolution of small but nonetheless important disputes between consumers and businesses. The full report and related documents can be found at www.searlearbitration.org.

Consumer Debt Arbitration

Recent developments in the field of consumer debt collection have resulted in significant changes in this field.

The Federal Trade Commission held a two-day conference on the litigation and arbitration of consumer debt collection cases, and has scheduled two more conferences in the fall and winter of this year. Notably, many of the issues and problems in the administration of these cases appear to be driven by the unique nature of the cases. A number of issues have special significance in consumer debt collection caseloads, including proper notice, quality of proofs, and independence of arbitrators.

While the AAA has not administered significant numbers of debt collection arbitrations relative to some other organizations, the AAA did process consumer debt collection arbitrations in a single high volume program. However, the AAA's administration of that program ended in June, 2009 and consequently at this time the AAA is not currently administering any debt collection programs.

As a result of the AAA's review of this caseload and our experiences administering debt collection arbitrations, in addition to our consideration of a number of policy concerns that have been raised, it is the AAA's position that a series of important fairness and due process concerns must be addressed and resolved before we will proceed with the administration of any future debt collection arbitrations. Until such time, the AAA has placed a moratorium on the administration of any consumer debt collection arbitration programs.

Further, the AAA offered a series of recommendations on debt collection arbitration to the Domestic Policy Subcommittee of the House Oversight and Government Reform Committee, and is exploring the development of specific additional procedures, standards, and fairness protections as part of a broader debt collection arbitration reform.

Conclusion

We appreciate the opportunity to present the AAA's recommendations and suggestions on the resolution of consumer, healthcare, and employment disputes. Based on our over 83 years of experience, we believe that if properly executed and designed, arbitration can provide a prompt, effective and fair forum for the resolution of these disputes. The protocols and the attached draft bill draw upon the collective wisdom of experts and key organizations in their respective fields, and should be given serious consideration by Congress as it responds to issues in the use of arbitration.

PREPARED STATEMENT OF THE AMERICAN ASSOCIATION OF HOMES AND SERVICES FOR THE AGING (AAHSA)

Statement for the Record
Mandatory Binding Arbitration – Is It Fair and Voluntary

The American Association of Homes and Services for the Aging (AAHSA) appreciates this opportunity to submit a statement for the record on pre-dispute arbitration agreements in consumer contracts. We would be concerned about any outright ban that would prevent nursing homes and assisted living facilities from asking residents to sign a pre-dispute arbitration agreement, even if the arbitration agreement is not required for admission. Properly structured, pre-dispute arbitration agreements can preserve recourse to time- and money-saving arbitration while preserving consumer rights and ensuring a level playing field.

AAHSA members help millions of individuals and their families every day through mission-driven, not-for-profit organizations dedicated to providing the services that people need, when they need them, in the place they call home. Our 5,800 member organizations, many of which have served their communities for generations, offer the continuum of aging services: adult day services, home health, community services, senior housing, assisted living residences, continuing care retirement communities and nursing homes. AAHSA's commitment is to create the future of aging services through quality people can trust.

Unfortunately, high quality services do not protect even the best long-term care providers from lawsuits that may have little merit. Litigation against long-term care providers has become a lucrative sub-specialty among some in the legal profession. Arbitration provides a timely and cost-effective alternative for both providers and consumers to resolve differences in a fair, reasonable and expeditious manner.

AAHSA would oppose an outright prohibition on pre-dispute arbitration agreements because a ban is unnecessary to protect consumers from unfair coercion. It is not unusual for not-for-profit nursing homes, assisted living, and continuing care retirement communities to use arbitration agreements, in accordance with the Federal Arbitration Act and the laws of the states in which facilities are located. Properly structured, these agreements can give both providers and consumers an expeditious alternative to long and costly lawsuits. Federal legislation invalidating pre-dispute arbitration agreements is unnecessary because the states have already developed extensive consumer protections specifically for long-term care agreements. These protections form the basis of recommendations AAHSA has made to its own members.

First, we recommend to our members that signing an arbitration agreement should not be a condition of admission to a nursing home or other long-term care facility. State courts have often found arbitration agreements to be unconscionable if admission to a facility was predicated on signing an agreement. It should be noted, however, that the Centers for Medicare and Medicaid Services (CMS) do not prohibit arbitration agreements as a condition of admission for Medicare patients. CMS also leaves it up to the states to determine if they will accept mandatory arbitration in Medicaid admissions. We believe most of our members do not require arbitration agreements as a condition of admission.

In addition, many agreements, following case law, have a rescission period, another practice AAHSA recommends to its members. This clause gives consumers a chance to reconsider and cancel their agreement to arbitrate.

We also recommend to our members, based on case law, that arbitration agreements should not limit a resident's rights and remedies under law, other than to specify the forum and procedures for dispute resolution. Most if not all states that have addressed this issue have found limitations on rights and remedies to be a trigger for determining an arbitration agreement was unconscionable. The more onerous the contract, the less likely it has been to be enforced under existing law and practice. Consequently, most long-term care providers do not draw up arbitration agreements that conflict with consumers' rights. Additionally, we recommend to our members that the arbitration agreements be mutual, that the provider also agrees to arbitration of all issues, rather than carving out some areas for litigation. Again, this has been heavily litigated and we recommend the most conservative approach to our members.

We do not see a need for legislation, since we believe that current federal and state law and the common-sense guidelines we have recommended to our members adequately protect the interests of both consumers and providers of goods and services. The high rate of litigation over arbitration agreements in our field means acceptable parameters defining substantive and procedural requirements for valid arbitration agreements are clearly defined in long-term care. Residents or their representatives have had significant success in state courts and this success is visible in the way providers draft their agreements. Among AAHSA's membership, most but not all residents sign arbitration agreements that are offered at the time of admission, and most disputes are settled regardless of whether there is an arbitration requirement or not.

Quality of services is not determined by the forum chosen for resolution of whatever disputes may arise between providers and consumers. We urge the Senate not to foreclose recourse to agreements that can expedite the resolution of disputes for all parties and prevent unnecessary expense that takes resources away from resident services.

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