MANDATORY BINDING ARBITRATION AGREEMENTS: ARE THEY FAIR FOR CONSUMERS?

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

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MANDATORY BINDING ARBITRATION AGREEMENTS: ARE THEY FAIR FOR CONSUMERS?

TUESDAY, JUNE 12, 2007

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

The Subcommittee met, pursuant to notice, at 10:37 a.m., in Room 2237, Rayburn House Office Building, the Honorable Linda Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Sánchez, Johnson, Delahunt, Cannon, and Jordan.

Staff present: Norberto Salinas, Majority Counsel; and Daniel Flores, Minority Counsel.

Ms. SÁNCHEZ. Good morning. I would bang my gavel, but I don't have a gavel presently, but we are going to call this Subcommittee on Commercial and Administrative Law to order.

I will recognize myself for a short statement.

In 1925, Congress passed the Federal Arbitration Act to free up the courts from an increasingly heavy docket and to place arbitration agreements on the same footing as contracts. At the time, Congress found several benefits to arbitration, including lower costs than litigating in courts, a choice of neutral arbitrators with expertise in the disputed area of law, and a quicker resolution to the dispute.

However, the use of arbitration has expanded from simply involving disputes between commercial parties, to issues between consumers and businesses, employees and employers, and shareholders and corporations. This once-rare alternative to litigation has become commonplace and arbitration clauses are now frequently included in legal contracts of every variety.

As arbitration has increased in popularity, what was once a choice has become a mandatory part of many consumer contracts. In fact, according to a 2004 survey, one-third of all our major consumer transactions are covered by mandatory arbitration clauses. Despite all the benefits of arbitration, mandatory arbitration agreements may not always be in the best interests of consumers.

Mandatory binding arbitration clauses in agreements may require consumers to pay fees to arbitrate a claim or travel several States away for complaint proceedings. Advocates also have shown that businesses often fare better than consumers in arbitration matters. In fact, in one instance, it was reported that a particular bank won an astonishing 99.6 percent of the almost 20,000 arbitra-

tion cases in which it participated. Besides the advantage of regular customers in the arbitration game, there are real questions about due process and the non-public nature of arbitration decisions.

Considering that the Federal Arbitration Act was created only to cover businesses in equal bargaining positions, we have to wonder how today's current use of arbitration agreements comport with the legislative history and the spirit of the act. Congress must now carefully consider whether arbitration is fair for all of the parties to a dispute.

Today's oversight hearing will provide an opportunity to learn more about the effect of arbitration on consumers and whether mandatory binding arbitration clauses are an equitable use of the arbitration process. First, we must review the history of arbitration and the reason that Congress codified it.

Second, we must understand how the use of arbitration has evolved since 1925 and how it came to be used in the consumer business context of today. Finally, we must decide how best to ensure that the benefits of arbitration are maintained, while addressing its negative aspects. It is also important to note that several bills regarding arbitration agreements have been introduced.

To help us learn more about mandatory and binding arbitration agreements, we have four witnesses here with us this afternoon. We are pleased to have F. Paul Bland, Jr., an attorney at Trial Lawyers for Public Justice; Mark Levin, a partner at Ballard Spahr Andrews and Ingersoll; Jordan Fogal, an author and consumer advocate; and David Schwartz, a professor at the University of Wisconsin Law School.

Accordingly, I look forward to today's testimony, and I welcome all of our witnesses.

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

Mr. CANNON. Thank you, Madam Chair.

Mandatory binding arbitration clauses in consumer contracts have become more common in recent years. Some consumer advocates argue that this is unfair. The claim is that the practice excessively benefits companies over consumers and urge that use of mandatory binding arbitration clauses in consumer contracts be restricted. Proposals to restrict the freedom of contract should be viewed cautiously and proposals to restrict the freedom of contracting mandatory arbitration should be viewed with special caution.

Arbitration is the classic means of alternative dispute resolution for those wishing not to bring their dispute before Federal or State courts. For many years, the law and the courts have strongly encouraged arbitration. It can efficiently afford justice and it eases the burden on our strained court system.

Free access to efficient arbitration is particularly useful in the area of consumer contracts. Consumers benefit from a quicker, less cumbersome and less expensive way of resolving their often small-scale disputes, and companies benefit from these same advantages because consumer claims can be repetitive and large in number.

The use of mandatory binding arbitration clauses has risen not because companies want to disadvantage consumers, but because companies increasingly believe they need to protect themselves from abusive class action suits. Actual or perceived abuses of class action tort cases and class action lending disclosure suits, along with the web of inconsistent substantive law and civil procedure in competing jurisdictions entertaining such lawsuits have prompted companies to resort more and more to mandatory binding arbitration.

In this way, companies have sought to introduce a more orderly, less expensive and more consistent set of rules for the resolution of customer disputes. They are not seeking to create a problem for consumers. They are trying to solve the serious problem they confront themselves.

Is this solution working for both sides? I expect that the evidence today will support the conclusion that it is, that consumers are being fairly treated. For example, aware of consumer protection concerns, companies have developed what are known as "fair" clauses in consumer contracts. These clauses protect against undue advantage to companies in arbitration.

They include provisions that comply with consumer due process procedures of the major arbitrating services; allow either the consumer or the company to invoke arbitration; provide for fee-shifting, including for indigent consumers; and open off-ramps to small claims court for certain claims.

In addition, consumer contracts increasingly include opt-out clauses. These clauses allow consumers during a specified time after entering into a contract to opt out of mandatory binding arbitration clauses. Consumers who opt out will still preserve the rest of the bargain embodied in their contract. The National Arbitration Forum recently published a synopsis of independent studies and surveys on the benefits of consumer arbitration.

The results of these studies included the following. Consumers prevail 20 percent more often in arbitration than in court. Monetary relief for individuals is higher in arbitration than in lawsuits. Arbitration is about 36 percent faster than litigation, and 64 percent of American consumers would choose arbitration over a lawsuit for monetary damages, and 93 percent of consumers using arbitration find it to be fair.

The evidence from empirical studies suggests that mandatory binding arbitration is fair to consumers. Institutional and market forces appear to be working to promote the use of fair arbitration clauses in procedures, and in turn, arbitration is delivering fair results to consumers. There does not appear to be an urgency for Congress to intervene in this area.

Restricting the freedom of contract over how to enter into arbitration would reduce the options available to consumers and it would reduce competition in the legal services and dispute resolution markets. When the consumer confronts fewer services and less competitive markets, the consumer inevitably suffers. Trial lawyers and public advocacy groups—the lawyers who bring class actions—might gain from restrictions, but consumers likely would not.

I look forward to the testimony today, and I yield back.

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

I would now like to recognize the gentleman from Georgia, Mr. Johnson, for his opening statement.

Mr. JOHNSON. I want to thank the Chairwoman for holding such an important oversight hearing today.

The right to a jury trial is guaranteed by the Federal Constitution, yet this right is lost as more and more businesses impose arbitration agreements on their customers. Although today's hearing focuses on consumers, this problem has also permeated the employment and healthcare industries.

The Federal Arbitration Act was enacted as an alternative to resolve disputes between businesses on equal footing. But today businesses impose these so-called "agreements" through envelope stuffers or in small-print notices which are often overlooked by the average consumer. This take-it-or-leave-it position leaves consumers, employees, and small businesses at a disadvantage. Coupled with high administrative fees, lack of discovery and limited opportunity to appeal, it has swayed away from its original purpose as a voluntary expedited process to resolving disputes, and it has become a tool for businesses to divert disputes into a private legal system.

A fundamental feature of a fair justice system is that both sides to a dispute have equal access to that system. Mandatory arbitration agreements give one side the upper hand. It is my hope, Madam Chair, that although we are looking only into the issue of consumer arbitration agreements today, we will have other hearings in other areas such as employment.

Thank you very much.

Ms. SÁNCHEZ. Thank you, Mr. Johnson.

Without objection, other Members' opening statements will be included in the record.

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

I am now pleased to introduce our panel of distinguished witnesses for today's hearing.

Our first witness is Paul Bland, a staff attorney for Public Justice. Mr. Bland serves as a member and former co-chair of the board of directors of the National Association of Consumer Advocates. Mr. Bland is also the co-author of Consumer Arbitration Agreements, published by the TLPJ Foundation and the National Consumer Law Center.

Our second witness is Mark Levin, a litigation partner at Ballard Spahr Andrews and Ingersoll. Mr. Levin concentrates his practice in complex commercial and class action litigation, with particular expertise in consumer financial services litigation and the structuring and enforcement of consumer arbitration clauses. Mr. Levin has co-published several consumer financial services and arbitration articles which have appeared in Arbitration of Consumer Financial Services Disputes, and The Business Lawyer.

Our third witness is Jordan Fogal. Ms. Fogal, a political activist, has waged a public advocacy campaign in the Houston area for homeowners affected by questionable practices of developers. Ms. Fogal has also been active in calling attention to the lack of lending laws to protect homeowners who get tricked into buying defective homes.

Our final witness is David Schwartz, associate professor at the University of Wisconsin Law School. Professor Schwartz's research interests include federalism, workers' rights and the law of the workplace. Prior to joining the University of Wisconsin Law School faculty, Professor Schwartz was senior staff attorney at the American Civil Liberties Union of Southern California in my home town of Los Angeles.

I want to thank all of the witnesses for their willingness to participate in today's hearing.

Without objection, your written statements will be placed in their entirety into the record of these proceedings. We would ask that you limit your oral remarks to 5 minutes.

You will note that we have a lighting system that starts with a green light. After 4 minutes, it will turn yellow to warn you have 1 minute remaining. Then it will turn red when the 5 minutes have expired. At that time, if you still have not finished your testimony, I would ask you to just conclude your final thought so that we have an opportunity to hear from all of our witnesses.

After each of you has presented your testimony, Subcommittee Members will be permitted to ask questions, subject to a 5-minute limit. Those are the ground rules.

So at this point, we are ready to proceed with the testimony. I would ask Mr. Bland if he would pleased proceed.

TESTIMONY OF F. PAUL BLAND, JR., PUBLIC JUSTICE, WASHINGTON, DC

Mr. BLAND. Thank you very much, Chairwoman.

Arbitration, the way it is practiced in consumer cases today in America, has essentially become a lawless system. It is a system without rules. The arbitrators have a huge incentive to tilt the playing field. There are a lot of companies who compete for work as private arbitration companies. They compete against each other. It is lucrative work. Private arbitrators frequently make $300, $400, even $500 an hour in this city and a lot of other cities, and they want this work.

Now, the companies, the corporations are the ones who right standard-form contracts. I am sure that every Member of this Committee and everyone in this room has a cell phone and a credit card. None of you wrote the terms of the agreement that govern your cell phone or your credit card. They were written by the bank, the cell phone company, whoever. Those are the companies who are picking the arbitration providers.

So if you are an arbitration provider and you want this lucrative work, what you have to do is you have to pitch your services toward the companies who are writing the contracts. That is how you get the work. That is how the market works. So as a result, it creates a dynamic which is a race to the bottom. It shows up in a bunch of different ways. I spelled out a huge number of illustrations of this in my testimony.

For example, one problem is again and again every time a private arbitrator rules in favor of a consumer in a significant way, they get blackballed and they don't hear any more cases. So if you want to work as an arbitrator, and you want to be able to charge $500 an hour, you better work for the company who is picking you.

If you bite the hand that feeds you and you rule for the consumer, you may never work as an arbitrator again. This has happened a lot. That is a problem.

A second problem is the arbitration companies, like the National Arbitration Forum referred to by the Ranking Member, send out advertisements to corporations, to banks, trying to get them to pick them. So they will send out an advertisement that says, we want a better system—the American Arbitration Association—because if you pick us, we can set up the following things that will make for rules favored on your side against the consumer.

Now, when companies start advertising for business like that, that is a problem. You don't get that in the court system. I never have gotten in my 20 years of practicing as a lawyer a letter from a judge saying, "Hey, file your case in this district of Texas and we are going to see you get a really big bang-up result." If I did get that letter, I can guarantee you the judge would be disbarred and it would be on the editorial page of The Wall Street Journal. But the arbitration companies act like this all the time. That is another problem.

Another example is they have loaded panels. Who is going to be the arbitrator? When the companies go to pick the arbitration panels, the people who they pick, who show up on the panels, are a problem. Let me give you an example. Someone recently approached us about a health insurance case in Michigan. It was a medical malpractice case. The woman has breast cancer. Her doctor proposes a certain course of treatment. The HMO won't do it. They won't cover it.

As a result, she ends up not getting the treatment and metastasizes. She is dying. She considers this a medical malpractice case. She wants to go to court. They want to force her into arbitration. She gets a list from the American Arbitration Association of seven names.

Okay, so instead of a jury of her peers, she has these seven names. This is the universe of people who can decide her case. Every single person on the list from the American Arbitration Association, notwithstanding the due process protocols and everything, is somebody who works for an insurance company or they work for a law firm where all the work they do is for an insurance company.

So if it was your spouse or if it was you who had a medical malpractice claim or any other claim against a corporation who you felt had really done something wrong to you, do you want to have a jury or do you want to have a defense lawyer who works for that industry deciding the case?

Now, why do I say it is lawless? I say it is lawless because courts do not meaningfully review arbitration decisions. In order to make it so quick and so streamlined, the court system has established a set of rules and they have interpreted the 1924 act to basically say that there is virtually no judicial review of arbitration decisions. There was a case last year from the Seventh Circuit Court of Appeals. Judge Posner wrote that even if an arbitrator's decision was wacky—"wacky," think about that word—as a matter of law, and that was not grounds for overturning it.

The year before, the Third Circuit Court of Appeals in Philadelphia found that even if an arbitrator's decision had gross errors of law, that was not grounds for overturning a decision. In a case involving Steve Garvey, the U.S. Supreme Court, with Justice O'Connor writing for the court, said that even if an arbitrator's fact-finding was silly—"silly" fact-finding—that was not grounds for overturning the case.

About once a week in my practice of law, because I wrote a book on this and I do a lot of cases in this area, about once a week some consumer or employee someplace in America contacts our firm and says, we had an arbitrator who issued a terrible decision, that ignored all the evidence; they just ruled for the company and they wouldn't even listen to me; they fell asleep while I was talking; it was completely unfair.

And I will say, gee, were the errors of law wacky? Yes. Was the fact-finding silly? Well, according to the courts, you have no remedy at all. We turn that case down every time because it is next to impossible to get these cases overturned. It is a problem when you have a private system of justice, where you have an incentive to suck up to one side, and then no one is looking over their shoulders. Even if they were the best people in the world, honest and intelligent people make mistakes. But when there is no appeal, that is a problem.

[The prepared statement of Mr. Bland follows:]

PREPARED STATEMENT OF F. PAUL BLAND, JR.

TESTIMONY TO THE SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW OF THE U.S. HOUSE OF REPRESENTATIVES' COMMITTEE ON THE JUDICIARY

HEARING ON MANDATORY BINDING ARBITRATION AGREEMENTS: ARE THEY FAIR TO CONSUMERS?

June 12, 2007

by F. Paul Bland, Jr.

Staff Attorney

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

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

INTRODUCTION AND SUMMARY

This testimony will make the following points:

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

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

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

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

BACKGROUND ON PUBLIC JUSTICE.

Public Justice (formerly Trial Lawyers for Public Justice) is a national public interest law firm dedicated to using trial lawyers' skills and resources to advance the public good. We

specialize in precedent-setting and socially significant litigation, carrying a wide-ranging docket of cases designed to advance the rights of consumers and injury victims, environmental protection and safety, civil rights and civil liberties, occupational health and employee rights, protection of the poor and the powerless, and overall preservation and improvement of the civil justice system.

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

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

In just the last generation, there has been a largely unnoticed but very important revolution in the way many corporations do business. Fifteen years ago, only a handful of corporations required consumers or non-unionized employees to submit their claims to binding

arbitration. Now, these mandatory arbitration clauses are in tens of millions of form contracts. Here are just a few examples:

- All of the largest credit card companies in the U.S. have binding arbitration clauses, and it is very hard to find any credit card issuer that does not have such a clause. Similarly, it is very hard to get a checking account or most loans or other financial services products without submitting to an arbitration clause.[3]
- The vast majority of cell phone and residential phone companies require their customers to accept binding arbitration clauses on a take-it-or-leave-it basis. Cingular, Sprint, T-Mobile, Verizon, Working Assets Long Distance, Qwest, and many other companies have such clauses. It would be hard for a customer to get a cell phone without giving up her or his right to a jury trial.
- Millions of persons are required by their employers to submit all claims – wage and hour claims, civil rights claims, everything – to binding arbitration. Employers such as Anheuser-Busch, Cheesecake Factor, Circuit City, Ford Motor Co., Hooters, Hughes Electronics, Kentucky Fried Chicken, Lenscrafters, Marriott International, Pfizer, Rockwell, Ralph's Grocery/Albertsons, Waffle House and General Electric (among thousands of others) all require their employees to agree to mandatory arbitration clauses

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

as a condition of getting or keeping a job.[4]

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

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

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

mortuaries, pest control companies, securities broker services, pet boarding companies, etc., all regularly require customers to sign them as a condition of service.

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

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

In light of these sorts of common practices, it should not be surprising that most people first learn that a company says that they have lost the right to sue – and have "waived" their constitutional right to trial by jury – only after a dispute rises. In most cases, an individual's first awareness of an arbitration clause comes as a bitter surprise. We have spoken to literally

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

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

Unfortunately, many courts do little to require that individuals actually receive meaningful notice that they are supposedly "agreeing" to give up their constitutional rights and submit to arbitration.

- In one case, where a consumer bought a computer over the phone, the arbitration clause was sent to consumers inside the box with a computer. For a consumer to reject the

clause, she would have to pack up and send back the computer in the box within 30 days. While anyone familiar with human nature and consumer behavior can predict that few consumers would take such a step, courts have upheld such clauses. *E.g., Hill v. Gateway 2000 Inc.*, 105 F.3d 1147 (7th Cir. 1997).

- Alabama's highest court upheld an arbitration agreement that was not even in the contract that the consumers signed. Public Justice represented a husband and wife who purchased title insurance when they bought a farm. When they later found out that there were serious defects in the title, the title insurance company attempted to force them to arbitrate their claim despite the fact that the original contract they signed had not contained the arbitration clause. Instead of including the arbitration agreement in the contract, the insurance company had sent it to the consumers in the mail weeks later. Yet the court held it was enforceable. *McDougle v. Silvernell*, 738 So. 2d 806 (1999).
- And in an unusual case where one of our clients did know her employer gave her an arbitration clause and refused to sign it, the U.S. Court of Appeals for the Eleventh Circuit held that she was still bound by it because she failed to quit her job as a nurse at Baptist Medical Center-Princeton in Alabama, after having worked there as a nurse for almost 30 years. *Luke v. Baptist Medical Center-Princeton*, No. 03-14342 (11th Cir. March 11, 2004).
- In another case, a court compelled arbitration against the estate of a woman who died in a nursing home. Although the woman was legally blind and could not understand the contents of the papers she signed, the court said that no one can defend against the enforcement of a contract just because they signed it without reading it. *Estate of Etting*

v. Regent's park at Aventura, Inc., 891 So.2d 558 (Fla. Dist. Ct. App. 2004).

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

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

There is some empirical evidence and a good deal of academic analysis showing that

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

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

One particularly troubling aspect of the repeat-player syndrome is the tendency of corporate repeat-players to blackball arbitrators who might rule against them. This tendency was revealed by a study of mandatory arbitration in managed care cases in California, which found a small number of cases in which an arbitrator awarded a plaintiff more than one million dollars against a health maintenance organization (HMO). Marcus Nieto & Margaret Hosel, *Arbitration in California Managed Health Care Systems* 22-23 (2000). In each instance, that was the only

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

HMO case that the arbitrator ever handled, *id.*, suggesting that every time an arbitrator entered a substantial verdict against an HMO, the arbitrator was unable to get any further work from an HMO in the state. That same study also found that arbitrators were far more likely than judges to enter summary judgment for defendant HMOs.

In the last few months, there have also been two publicly disclosed episodes of arbitrators who were handling cases for the National Arbitration Forum ("NAF") being blackballed after ruling for consumers against NAF's most prominent client, MBNA Bank. The first episode of an NAF arbitrator being blackballed is described in the deposition of Harvard Law Professor Elizabeth Bartholet, taken on September 26, 2006, by a lawyer challenging NAF as being biased in a consumer case against Gateway Computers.[8] Professor Bartholet had also served as an independent contractor arbitrator for NAF, until she resigned. Her deposition describes how she was also blackballed by a credit card company after she ruled against it in a single arbitration. At the time that the credit card company decided to block her from hearing any more cases involving itself, she was scheduled to hear a number of other consumer cases. NAF sent out letters to the consumers falsely stating that she would no longer be the arbitrator in their cases, because she had a scheduling conflict. The professor, however, did not have a scheduling conflict; instead, NAF had sent out this explanation to conceal the fact that in reality she had been blackballed by a lender who did not like how she ruled in a past case.

The second recent disclosure came in an article written by Richard Neely, a former justice

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

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

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

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

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

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

o We recently received an exemplar of a medical group's mandatory arbitration clause that

provides that all patients of this medical group must submit to arbitration before an organization entitled "The National Insurance Arbitration Promotion Association." This organization, which was selected by the doctors' insurance company, explicitly has the goal of "help[ing] the company stay in business," stresses to patients that most lawsuits against doctors are allegedly baseless, and pledges that patients' recoveries will be limited (without respect to the law in a state), and that limitations periods will be shortened, as well as providing other terms that favor doctors.

- In a number of cases, parties in insurance cases being handled by the American Arbitration Association ("AAA"), have received a short list of potential arbitrators, where every name on the list is someone who works directly or indirectly for the insurance industry. We have a "strike sheet" in one case, for example, where the plaintiff's lawyer went through and annotated how each prospective arbitrator was connected to the insurance industry.
- Public Justice was involved in a case in Alabama, involving a lawsuit against a title insurance company for fraud and breach of contract. Our client was offered a list of potential arbitrators from AAA, and every potential arbitrator on the list either worked directly for a title insurance company or was an attorney at a law firm that did substantial work defending insurance companies.
- One NAF advertisement labeled "Professionals and the National Arbitration Forum," consists of a list of favorable quotes, all of which come from attorneys or officials affiliated with corporations, and none of whom principally represents individual plaintiffs. Another NAF News Release includes a list of persons who endorse its work,

and every one of those 21 persons specializes in representing financial institutions and banks. It is clear that the NAF targets its advertising at lenders.

- In one case filed by a consumer against ITT Capital Finance Corp., NAF chose as an arbitrator a lawyer whose law firm represented a host of other ITT entities.
- From material taken from NAF's website disclosures pursuant to California's disclosure requirement, enclosed as Exhibit 8 hereto are the results from a single quarter's worth of decisions by just one NAF arbitrator. This person handled 80 cases brought by banks against individuals, and ruled for the bank in all 80 cases. In 78 of the 80 cases, she gave the bank 100% of the amount it claimed, in two cases, she gave slightly less. She also ruled on one claim brought by a consumer against a bank, and dismissed it.
- Several consumer attorneys have told Public Justice that they sought to become AAA arbitrators, only to be told that the AAA lists in their state are filled. They later learned that more corporate defense lawyers were subsequently been added to the list.

There is also evidence that even when arbitrators do find for plaintiffs, they tend to make smaller awards to individuals with employment and civil rights claims, *Armendariz v. Foundation Health Psychare Servs.*, 6 P.3d 669 (Cal. 2000), or to individual medical malpractice plaintiffs, Marcus Nieto and Margaret Hosel, *Arbitration in California Managed Health Care System*, 21 (2000), than do courts or juries.

Corporate supporters of mandatory arbitration routinely point to "studies" claiming that consumers and employees do well in mandatory arbitration. Some of these studies, like the American Bankers Association-funded Ernst & Young report praising the National Arbitration Forum, suffer from grave methodological files. (That study, for example, literally ignores 1,000

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

Sometimes, arbitration company representatives appear to be not only aware of, but cavalier about, consumers' perceptions of pro-corporate bias. I am familiar with a case where West Virginia consumer lawyer Dan Hedges learned that an arbitrator proposed by the AAA previously served as defense counsel in cases similar to the one he was then handling. Mr. Hedges expressed to the arbitration company, AAA, that this was not fair to his client. Instead of taking the complaint seriously, the AAA representative laughed and said, "Yeah, I thought you would like that."

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

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

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

[9] Mr. Kaplinsky is a prominent corporate defense lawyer who represents banks. According to his firm's website, its "Consumer Financial Services Group has developed one of the pre-eminent and largest consumer financial services litigation defense practices in the country, defending banks and other financial institutions throughout the United States in class actions and other complex litigation." http://www.ballardspahr.com/home.htm. In an article entitled "Excuse me, but who's the predator: Banks can use arbitration clauses as a defense," *Bus. Law.* 24 (May/June 1998), Kaplinsky wrote that "Consumers have been ganging up on banks. But now the institutions have found a way to defend themselves." *Id.* at 24. The article makes clear that mandatory arbitration is this "defense" for financial institutions against consumer claims, and notes that "Arbitration is a powerful deterrent to class action lawsuits. . . ." *Id.* 24-26.

("the class action bar").

- A January 14, 1999 letter from an NAF official to a prospective client states in the very first sentence that "A number of courts around the country have held that a properly-drafted arbitration clause in credit applications and agreements *eliminates class actions* . . . ." (Emphasis in original.) This letter also promises that NAF arbitration "*will make a positive impact on the bottom line.*" (Emphasis in original.)[10]
- Another advertisement distributed to corporate in-house counsel on NAF letterhead states that its rules provide for "[v]ery little, if any, discovery." See Exhibit 15 hereto.

NAF is not alone in its approach, AAA also actively solicits business from its corporate contacts. Paul Van Loon, a Regional Vice President of AAA, sent a memo to AAA's Northern California panelists asking for their help. "Part of our marketing effort for 2000 will be to develop business contacts with corporations headquartered in Northern California," wrote Loon, who wanted the panelist to "make the introduction for us" to any corporate contacts they might have.

These sort of solicitations and promises show what is inherently unfair and wrong with a system where companies can hand pick private judging services to replace publicly accountable

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

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

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

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

First, the most common problem – that the arbitrator is a lawyer who principally represents parties just like the defendant in a case – is generally not grounds for challenging an arbitration clause or an arbitrators' decision. This is a fairly well established and widely recognized day-to-day reality, and courts accept generally such arrangements without question.

Even for more egregious illustrations of bias, however, a number of courts have said that they will only consider issues relating to whether an arbitrator is biased after the arbitration is complete. Consider what this would mean to an individual – you might have to go through a process with a decision maker who can charge you tens of thousands of dollars in fees, could

order you to pay the other sides' attorneys' fees, might take years to decide the case, and only then could you go to court to argue that the arbitrator was unfairly biased towards the other side.

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

IV. Arbitrators Are Immune From Any Meaningful Judicial Review.

Judicial review of arbitration is less than minimal; it approaches non-existent. The general rule is that judicial review of arbitrators' decisions "is very narrow; one of the narrowest standards of judicial review in all of American jurisprudence." *Lattimer-Stevens Co. v. United Steelworkers of Am. Dis. 27*, 913 F.2d 1166, 1169 (6th Cir. 1990).[11] Consider a few illustrations:

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[11] *See also First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) ("the court will set aside [an arbitrator's] decision only in very unusual circumstances."); *Baravati v. Josephthal, Lyon & Ross*, 28 F.3d 704, 706 (7th Cir. 1994) ("[J]udicial review of arbitration awards is tightly limited."); *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998) ("judges follow the law . . ., while arbitrators, who often . . . are not lawyers and

- The U.S. Court of Appeals for the Seventh Circuit remarked in a decision issued last year that courts should not review arbitrators' interpretations of contracts even if they are "wacky," so long as the arbitrator attempted to "interpret the contract at all." *See Wise v. Wachovia Securities, Inc.*, 450 F.3d 265, 269 (7th Cir. 2006).
- The U.S. Court of Appeals for the Third Circuit considered an arbitrator's decision that "inexplicably" cited and relied upon language that was not included in a key document. The court held, though, that "such a mistake, while glaring, does not fatally taint the balance of the arbitrator's decision in this case. . . ." *Brentwood Medical Associates v. United Mine Workers of America*, 396 F.3d 237, 238 (3d Cir. 2005). This vividly demonstrates how narrow the review of arbitration decisions is – they are upheld even when they are based upon "glaring mistakes" of law.
- In a case involving baseball player Steve Garvey, the U.S. Supreme Court held that "courts are not authorized to review the arbitrator's decision on the merits" even if the arbitrator's fact finding was "silly." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2002).
- In another case, the California Supreme Court held that even when an arbitrator's

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cannot be compelled to follow the law and their errors cannot be corrected on appeal (there are no appeals in arbitration), although there are some limitations on the power of arbitrators to flout the law."); *Di Russa v. Dean Witter Reynolds Inc.*, 121 F.3d 818, 821 (2d Cir. 1997) (to modify or vacate an arbitration award, a court must find both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case), *cert. denied*, 118 S. Ct. 695 (1998); *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998) (arbitrator's decision may only be overturned for manifest disregard of the law in "severely limited" circumstances, where a court finds that "the arbitrators knew of a governing legal principle yet refused to apply it . . .").

decision would "cause substantial injustice" on its face, that it was not subject to judicial review. *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992).

- In a case decided a few months ago by the U.S. Court of Appeals for the Eleventh Circuit, the court angrily decried persons who try to "convert arbitration losses into court victories," and noted that the only basis for challenging an incorrect arbitration decision is where a party can prove with "clear evidence" that the arbitrator was conscious of the law and deliberately ignored it; "showing that the arbitrator merely misinterpreted, misstated or misapplied the law is insufficient." *B.L. Harbert International, LLC v. Hercules Steel Co.*, 441 F.3d 905, 910 (11th Cir. 2006). The court went on to state that parties who challenge arbitration awards should be sanctioned more often for asking for judicial review, and that this would be "an idea worth considering" in order to discourage future challenges to arbitration.

The law governing judicial review of arbitration also encourages arbitrators not to give any reasons for their decisions because then it is entirely impossible to attack their decisions. *See Fellus v. AB Whatley, Inc.*, 2005 WL 9756090 (N.Y. Sup. Ct. Apr. 15, 2005) (in the absence of a reasoned decision supporting an arbitration award, there was no basis for court to decide whether arbitrator manifestly disregarded the law.); *H&S Homes v. McDonald*, 2004 WL 291491 (Ala. Dec.17, 2004) (in the absence of an explanation of damages awarded by arbitrator, the court had no basis to determine whether arbitrator manifestly disregarded the law; arbitrator's failure to give reasons for the award did not itself constitute manifest disregard of the law). As a result, many arbitrators have told me that they are discouraged by the major arbitration firms from producing written decisions in most cases because doing so basically gives arbitrators a means of

putting themselves beyond any scrutiny. The upshot of all this is clear – arbitration is largely a system above and beyond the law.

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

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

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

Unfortunately, a number of other courts have not taken such a tack. Some courts have concluded that current federal law favors arbitration so much that even if a contract term would

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

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

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

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

In addition, some arbitration clauses and the rules of some arbitration providers require that all parties to a dispute keep all facts about both the dispute and the arbitrator's resolution of the dispute "confidential." Furthermore, "[a]rbitrators have no obligation to the court to give their reasons for an award," *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 976 n.8 (1960), and it is common for arbitrators to provide no written explanation for

their decisions. *See* Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 Sup. Ct. Rev. 331, 397-98 (1996). Even when arbitrators do produce written decisions, "arbitrators' decisions are not intended to have precedential effect even in arbitration (unless given that effect by contract), let alone in the courts." *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998). This phenomenon recently led the Chief Justice of the Texas Supreme Court to caution that the spread of arbitration could undermine the integrity of the law. "'A privately litigated matter may well affect public rights,'" [Chief Justice Wallace] Jefferson said. 'Its resolution may ultimately harm the public good or, because those decisions are secret, impede an innovation to a recurring problem, much to the detriment of Texas citizens.'" Mike Ward, *Texas' Chief Justice Calls for Overhaul of State Courts*, American-Statesman, Feb. 21, 2007. Professor Richard Reuben, a proponent of alternative dispute resolution, has similarly cautioned that arbitration can sacrifice important public values of transparency and accountability. Richard C. Reuben, *Democracy and Dispute Resolution: The Problem of Arbitration*, 67 Law & contemp. Probs. 279, 298-302 (Winter/Spring 2004).

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

lawsuits to build her own claims of negligent or intentional misconduct. Repeat-player companies can gain similar information through private channels. Thus, by requiring private arbitration the company may again deprive the consumer of certain relief she might have obtained through litigation." (citations omitted)).

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

B. Arbitration Is Often Extremely Expensive for Individuals.

In paying taxes, American citizens cover the costs of operating the court system, so they are only required to pay a nominal filing fee to initiate a lawsuit. People forced into arbitration frequently pay far greater fees to file their case, and to have the decision maker hear their case and to hear various motions that go with the case, than the fees consumers must pay to file a case in court. We have seen a number of arbitration clauses that require individual consumers to pay fees that exceed the amount of money they would stand to gain if they won their cases. A

number of consumers and consumer attorneys have told us that they (or their clients) would abandon their cases if forced into arbitration, because they could not afford the fees likely to be charged by the arbitrators. This problem is exacerbated by the widespread practice of hidden or uncertain fees, where an arbitration service provider loudly touts a small "filing fee," but then adds on a variety of subsequent fees for handling disputes over discovery, motions and the like. In one recent employment case, a person was required to pay arbitration fees of more than $60,000 to pursue civil rights claims.

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

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

Many corporations add to their arbitration clauses terms that ban individuals from bringing or participating in class action cases, either in court or in arbitration. While many courts have struck down these types of contract terms as being unconscionable and unenforceable, other

courts have upheld them, citing in several cases that there is a strong presumption in favor of enforcing arbitration clauses. (From a legal perspective, this argument is puzzling, because the U.S. Supreme Court has held that parties can bring class actions in arbitration, so a federal policy favoring arbitration should say nothing about bans on class actions. Nonetheless, these provisions are often enforced.)

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

Some courts have recognized the importance of preserving consumers' access to class action proceedings. In *Ting v. AT&T*, 182 F. Supp. 2d 902 (N.D. Cal. 2002), *aff'd in relevant part*, 319 F.3d 1126 (9th Cir. 2003), the federal district court held that AT&T's arbitration clause for long distance telephone customers was unconscionable in part because it deprived consumers of the right to bring or participate in class action proceedings. The *Ting* court held that the ban on class actions amounted to an exculpatory clause because it would have been economically

infeasible to prosecute each claim on an individual basis. *Id.* at 918. *See also*, *West Virginia ex rel. Dunlap v. Berger*, 567 S.E.2d 265 (W. Va. 2002) ("[P]ermitting the proponent of such a contract to include a provision that prevents an aggrieved party from pursuing class action relief would go a long way toward allowing those who commit illegal activity to go unpunished, undeterred, and unaccountable."); *Powertel, Inc. v. Bexley*, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999) ("Class litigation provides the most economically feasible remedy for the kind of claim asserted here. The potential claims are too small to litigate individually, but collectively they might amount to a large sum of money. . . By requiring arbitration of all claims Powertel has precluded the possibility that a group of its customers might join together to seek relief that would be impractical for any of them to obtain alone.") Many other courts have refused to address this issue, however. *See, e.g.*, *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Edelist v. MBNA Am. Bank*, 790 A.2d 1249 (Del. Super. Ct. 2001) ("The surrender of that class action right was clearly articulated in the arbitration amendment. The court finds nothing unconscionable about it and finds the bar on class actions enforceable.").

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

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

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

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

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

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

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

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

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

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

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

- NAF appears to funnel a very large number of cases to a few carefully picked arbitrators who nearly always rule for lenders. As one illustration, one NAF arbitrator in California has decided more than 500 cases where MBNA bank sued customers, ruling for the bank in all but a handful of cases.
- In 1998 First USA Bank gave sworn interrogatory answers in an Alabama case where consumers were challenging an arbitration clause. The court required the defendant to produce statistics about its experience in arbitration. The statistics showed that where the credit card issuer had sued its customers more than 50,000 times in arbitration, only four customers had brought cases against the company in arbitration! The statistics also showed that out of almost 20,000 arbitration cases that were completed, the bank had won all but 87, for a win/loss rate of 99.6%.
- Instead of filing normal complaints with supporting documents to start a case, certain debt collectors file claims with the NAF in the form of pure digital data streams, that the NAF then formats into documents that are sent to the NAF arbitrators with pre-printed orders. The arbitrators are not sent any original documents establishing that the consumers actually agreed to either the arbitration clauses or the credit contracts, but simply receive digital information with a blanket assertion from the lenders that all consumers agreed to arbitration and owed the asserted amounts listed for the accounts.
- Many NAF arbitrators decide very large numbers of cases, often 40 or more, in a single

day. In the overwhelming majority of cases, NAF arbitrators simply sign the pre-printed orders generated by the home office, that award the lender the full sums that the lender has requested for the loans, any fees related to the loans, attorneys' fees and arbitration fees.

- A large number of cases have been documented establishing that the NAF has entered awards in favor of MBNA and other lenders against persons who were identity theft victims who did not, in fact, owe any debts. Our office regularly receives calls and letters from consumers who report that this has happened to them.
- It appears that there are thousands, if not tens or hundreds of thousands, of cases where NAF arbitrators have awarded sums to lenders (and particularly MBNA) for debts that were past (and sometimes quite far past) the relevant statute of limitations.
- MBNA Bank and its attorneys boast publicly about a provision of MBNA's contract that purportedly permits consumers to "opt out" of MBNA's arbitration provision if they choose, and argue that this provision means that MBNA's arbitration provision is not mandatory. Nonetheless, there are several documented cases where the NAF entered awards against consumers in favor of MBNA even though particular consumers opted out of MBNA's arbitration system – who have registered mail receipts to prove this fact, and who notified NAF of this fact.
- NAF regularly awards large sums for attorneys' fees to lenders against consumers in cases, but it is not evident from the records in these cases that the creditors' attorneys did anything other than forward information from the lender's records to NAF in an e-mail with digital data.

- We have received a substantial number of allegations from consumers who report that NAF officials failed to send notices of debt collection arbitrations to consumers at their actual address, and it appears that NAF makes little effort to ascertain the correct addresses for consumers. Nonetheless, my office has had conversations with literally hundreds of consumers and consumer attorneys that suggests that NAF rarely (if ever) overturns default awards against consumers who report to it that they did not receive timely notices of claims.
- In a great many cases, NAF officials issue sworn certifications that notices were sent to consumers at specific addresses on specific dates, and make these certifications as much as eight months after the dates on which the acts took place. It is not credible to imagine that the persons making these certifications could remember this kind of specific information so long after the fact.
- Under the laws of many states, attorneys appearing in arbitrations that take place in those states must either be admitted to practice in those states, or must receive permission to appear in those arbitrations on a pro hac vice basis. (Most states only permit out-of-state attorneys to appear in a small number of cases in a state on a pro hac vice basis, and require that fees be paid for pro hac vice admissions to state bar authorities.) In hundreds of cases, if not far more, NAF arbitrators have permitted attorneys for creditors to appear in cases without requiring them to seek pro hac vice basis.
- A substantial body of anecdotal experience from consumers and consumer lawyers across the U.S. indicates that NAF rarely if ever grants any kinds of extensions to consumer debtors, and regularly enters default awards against consumers who were as little as one

day late in responding to arbitration notices.

- By contrast, numerous consumers and consumer attorneys report that NAF regularly grants extensions to its lender clients, particularly MBNA Bank, when the lenders request extensions or miss deadlines.
- Although documents from NAF cases in many states establish that NAF arbitrators regularly include significant sums in their awards for lenders for the lenders' attorneys' fees and both parties' arbitrators' fees, NAF consistently does not include sums for these items in the disclosures it makes on its website related to arbitrations that are conducted in California. It appears that in reporting on California arbitrations, NAF just rolls the attorneys' fees and arbitration fees into the lender's overall claim, so that consumers looking at NAF's website cannot determine the size of these fees in consumer cases.

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

CONCLUSION

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

Ms. SÁNCHEZ. The time of the gentleman has expired. I thank you for your testimony.

Mr. Levin, would you please proceed?

TESTIMONY OF MARK J. LEVIN, ESQUIRE, BALLARD SPAHR ANDREWS AND INGERSOLL, LLP, PHILADELPHIA, PA

Mr. LEVIN. Madam Chair, Ranking Member Cannon, I know and like and respect Mr. Bland, but I could not disagree more conceptually and intellectually with his positions.

It is my position, as one who has practiced law for 30 years and been a practitioner in the consumer arbitration area for more than a decade, that arbitration agreements are fair to consumers because there is a dynamic presently in place that ensures fairness to consumers and to all other parties involved.

That system has never worked better than it does today. It involves four components. First, the Federal Arbitration Act itself. The Supreme Court has noted that the FAA, was enacted with consumers, among others, in mind, and it has operated effectively for more than 80 years through ever-changing economic, social and political times, to ensure that arbitration agreements are as enforceable as other contracts and that arbitration agreements and arbitration proceedings are fair.

Contrary to what Mr. Bland said, courts do scrutinize arbitration agreements that are alleged by consumers to be unfair, and they do that because the FAA makes them do that. The courts determine the validity of these contracts. The Supreme Court has called them the "gatekeepers," and they do, from personal experience, a superb job of doing that. Courts also have some powers of review following an arbitration award to ensure that the proceeding was not biased and that the arbitrator did not manifestly disregard the law.

The second component of the system is the companies with whom consumers deal. In my experience, companies do act in good faith to draft arbitration agreements that are fair to the consumer, even giving the consumer a right to reject the arbitration agreement at the outset of the transaction with no strings attached. Today, the vast majority of arbitration agreements require the arbitrator to apply substantive law and authorize the arbitrator to award the same remedies that a consumer could obtain if he or she were in court.

This includes, very importantly, the ability of the consumer who prevails in arbitration to recover attorneys fees and costs if applicable law so provides. I note that in almost all Federal and State consumer protection statutes do require fee-shifting, so this right is preserved in arbitration. The U.S. Supreme Court has said time and time again that when you go to arbitration, you are not losing your substantive claims. You are merely changing the forum for resolving them.

The third component, the arbitration administrators. Again, I hear Mr. Bland's apocryphal stories, but I think the best testimony on behalf of organizations such as the AAA and the NAF is the consumer protocols, consumer procedural rules and the consumer fee schedules that are especially designed to ensure that consumers are treated fairly.

I note that the AAA's, the American Arbitration Association's, consumer due process protocol was drafted with the intense involvement of all consumer groups that had an interest in working with that group and devising due process protocols. That is in my statement. There is a list of the participants at the end.

The administrators will not deal with the agreements of companies that do not meet their fairness standards. The arbitration fees for small claims are actually far less than the fees for filing a lawsuit in court. Justice Ginsburg herself has called the fees charged by the AAA and the NAF, "models for fair costs in fee allocation." Both organizations will even waive that small fee if the consumer can't afford to pay it.

And finally, the courts. Again, based on my experience, courts very rigorously scrutinize arbitration agreements to make sure that they are fair, and they are quite vigilant in refusing to enforce those relatively few agreements that they conclude do not pass muster under applicable State and Federal laws. They take their job as gatekeepers very seriously.

To the extent there are comments made in the witness submissions that have been made or at today's hearing about cases in which arbitration agreements were not fair, the courts invalidated them. I think that shows that the system is working as it was intended to do. It should not be viewed as an indictment for all consumer arbitration agreements, the vast majority of which are drafted in order to be fair and scrupulously complied with applicable laws.

My final thought, in closing, is that I submitted a good bit of empirical evidence, which I believe rebuts the testimony about the unfairness of arbitration. That empirical evidence shows that arbitration is fair to consumers, and also arbitration does reduce the cost of providing goods and services to consumers, which is another element of fairness.

Thank you.

[The prepared statement of Mr. Levin follows:]

PREPARED STATEMENT OF MARK J. LEVIN

Testimony of

Mark J. Levin

Partner, Ballard Spahr Andrews & Ingersoll, LLP

before the

Subcommittee on Commercial and Administrative Law

of the

House Judiciary Committee

"Mandatory Binding Arbitration Agreements: Are They Fair for Consumers?"

June 12, 2007

I appreciate the opportunity to participate in this hearing concerning the fairness of mandatory consumer arbitration agreements. The topic is important to millions of businesses and employers nationwide and to their customers and employees.

By way of background, I am a partner in the law firm of Ballard Spahr Andrews & Ingersoll, LLP in the firm's Philadelphia office. I obtained a B.A. and M.A. at New York University; a Ph.D. in English Literature at the University of Pennsylvania; and my J.D. at Villanova University. Following law school I clerked for the Honorable John Biggs of the United States Court of Appeals for the Third Circuit. I have practiced law for 30 years and for the past 11 years I have been extensively involved along with other partners in my firm with the drafting and enforcement of arbitration clauses in consumer contracts such as credit card and other loan agreements.

I have been counsel in numerous significant consumer arbitration actions in the United States Supreme Court and other federal and state appellate and trial courts throughout the

country.[1] I am often retained by national and state trade associations to submit amicus briefs in important consumer arbitration cases.[2] In addition, I have co-authored more than a dozen scholarly articles dealing with various consumer arbitration issues.[3] I have also served as an instructor in several continuing education seminars involving consumer arbitration. I am here today to provide my own views on the subject of consumer arbitration, and my law firm and I are not being compensated in any fashion for my testimony. Accordingly, my opinions do not necessarily reflect the opinions of any of my firm's clients.

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1 See, e.g., Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444 (2003); Baron v. Best Buy Co., Inc., 260 F.3d 625 (11th Cir. 2001); Cappalli v. National Bank of the Great Lakes, 281 F.3d 219 (3d Cir. 2001); Providian Fin. Corp. v. Coleman, No. 02-60943 (5th Cir. May 21, 2003) (per curiam); Jenkins v. First American Cash Advance of Georgia, Inc., 400 F.3d 868 (11th Cir. 2005), cert. denied, 126 S. Ct. 1457 (2006); Kaneff v. Delaware Title Loans, Inc., No. 06-4703 (E.D. Pa. March 6, 2006); Shales v. Discover Card Services, Inc., Civil Action No. 02-80, 2002 WL 2022596 (E.D. La. Aug. 30, 2002); Perrone v. Household Bank (SB), N.A., No. L20010020 (D. Mass. June 26, 2001); Kennedy v. Conseco, No. 00-CV-04399 (N.D. Ill. Jan. 11, 2001); Zawikowski v. Beneficial National Bank, No. 98 C 2178, 1999 WL 35304 (N.D. Ill. Jan. 11, 1999); Pick v. Discover Fin. Servs., Inc., 2001 U.S. Dist. LEXIS 15777 (D. Del. Sept. 28, 2001); Gipson v. Cross Country Bank, Civil Action No. 2:03cv269-A, 2005 U.S. Dist. LEXIS 1400 (M.D. Ala. Jan. 28, 2005); Schuetz v. SLM Financial Corp., No. 1:03-CV-1842 (N.D. Ga. Sept. 26, 2003); Rosen v. Saks Inc., 2003 Ill. App. LEXIS 1252 (Ct. App., 1st Dist. Oct. 8, 2003), review denied, 2004 Ill. LEXIS 142 (Ill. Jan. 28, 2004); Providian National Bank v. Screws, 2003 Ala. LEXIS 298 (Ala. Sup. Ct. Oct. 3, 2003); Tsadilas v. Providian National Bank, No. 4948N, 2004 WL 2903518 (N.Y. App. Div. Dec. 16, 2004); Christine Williams v. Direct Cable TV, et al., No. CV-97-009, 1997 WL 579156 (Henry Co. Ala. 1997); Gloria Perry v. Beneficial National Bank USA, et al., No. CV-97-218, 1998 WL 279174 (Macon Co. Ala. May 18, 1998).

2 See, e.g., Salley v. Option One Mortgage Corp., No. 50 EAP 2005, 2007 Pa. LEXIS 1195 (Pa. Supreme Court) (amicus brief filed April 12, 2006); Discover Bank v. Szetela, No. 02-829 (U.S. Supreme Court) (amicus brief filed Dec. 30, 2002).

3 See, e.g., Arbitration of Consumer Financial Services Disputes 513 (PLI 1999); 53 Bus. Law. 1075 (May 1998); 54 Bus. Law. 1405 (May 1999); 55 Bus. Law. 1427 (May 2000); 56 Bus. Law. 1219 (May 2001); 57 Bus. Law. 1287 (May 2002); 58 Bus. Law. 1289 (May 2003); 59 Bus. Law. 1265 (May 2004); 60 Bus. Law. 775 (Feb. 2005); 61 Bus. Law. 923 (Feb. 2006); 62 Bus. Law. ___ (Feb. 2007).

INTRODUCTION

Based upon my experience, I firmly believe that the system that is presently in place in connection with consumer arbitrations under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§1 et seq., is working very well and, in particular, provides abundant protections to consumers who are parties to arbitration agreements with companies or employers. These protections emanate from (1) the FAA itself, (2) the companies whose contracts contain arbitration agreements, (3) the neutral third-party arbitration administrators who typically administer companies' arbitration programs and (4) the state and federal courts which rigorously enforce the FAA and applicable state laws.

My partners and I have always counseled our clients that the fundamental principle in implementing a consumer arbitration program is to be fair to consumers. Our clients uniformly follow that advice, and I believe that the vast majority of companies that have adopted consumer arbitration programs likewise follow the same standard of fairness. As a practical matter, companies have no choice but to be fair in their consumer arbitration agreements, because if they are not, the arbitration administrators will not administer their arbitrations and the courts will not enforce their arbitration agreements.

Companies and employers favor arbitration because, as the United States Supreme Court has repeatedly stated, arbitration is faster, less costly and more efficient than litigation, *not* because it provides some sort of trap for unwary consumers. In fact, the Supreme Court has emphasized that arbitration is favored in consumer disputes: "[T]he Act [FAA], by avoiding 'the delay and expense of litigation,' will appeal 'to big business and little business alike, corporate interests [and] individuals.' Indeed, arbitration's advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation." Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 280 (1995) (citations

omitted). Arbitration enables companies to reduce the costs of dispute resolution which, in turn, inures to the benefit of consumers.

The Supreme Court has also stated in numerous cases that an arbitration agreement is not an exculpatory clause for companies or employers. That is because by agreeing to arbitrate, "a party does not forgo ... substantive rights" but "only submits to their resolution in an arbitral, rather than a judicial, forum." Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26 (1991); accord, Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. at 90 ("even claims arising under a statute designed to further important social policies may be arbitrated because 'so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum,' the statute serves its functions") (citation omitted).

While you may read or hear about instances where a particular arbitration agreement did not strike the proper balance between protecting the consumer's rights and the company's rights, those instances are few and far between. In the vast majority of cases the existing system works -- and works very well -- because (1) companies and employers have gone to great lengths to make their arbitration programs fair, even to the point of giving consumers the unfettered and unconditional right to reject arbitration when they enter into the transaction; (2) the leading national arbitration administrators, such as the American Arbitration Association ("AAA") and the National Arbitration Forum ("NAF"), have adopted consumer due process protocols and consumer procedures and fee schedules which ensure that the consumer will be treated fairly and that arbitration will be affordable to the consumer; and (3) the courts have rigorously struck down arbitration agreements that they have found to be overreaching, unfair or abusive to consumers, while enforcing those that are legally and equitably sound. This existing

"check and balance" system operates dynamically and very successfully within the framework of the FAA to protect the rights of all parties to the consumer arbitration agreement.

EMPIRICAL STUDIES CONFIRM THAT CONSUMER ARBITRATION IS FAIR

It is my opinion that the present system of checks and balances in the area of consumer arbitration has never been more robust or more protective of consumers' rights. But you do not have to take just my word for it. There are a considerable number of empirical studies that have documented the success that consumers and employees have had in arbitration and the satisfaction that the majority of consumers and employees have expressed in the arbitration process. Those studies (some of which are attached as exhibits) include:

i. A synopsis of independent studies and surveys concerning the benefits of pre-dispute consumer arbitration was published by the NAF in 2004. See "Effective and Affordable Access to Justice by Consumers -- Empirical Studies & Survey Results." [Attached as Exhibit A]. The results were summarized as follows:

(1) Seventy-eight percent of trial attorneys find arbitration faster than lawsuits (ABA, 2003)

(2) Eighty-six percent of trial attorneys find arbitration costs are equal to or less expensive than lawsuits (ABA, 2003)

(3) Seventy-eight percent of business attorneys find that arbitration provides faster recovery than lawsuits (Corporate Legal Times, 2004)

(4) Eighty-three percent of business attorneys find arbitration to be equally or more fair than lawsuits (Corporate Legal Times, 2004)

(5) Individuals prevail at least slightly more often in arbitration than through lawsuits (Delikat & Kleiner, 2003)

(6) Monetary relief for individuals is slightly higher in arbitration than in lawsuits (Delikat & Kleiner, 2003)

(7) Arbitration is approximately 36% faster than a lawsuit (Delikat & Kleiner, 2003)

(8) Individuals receive a greater percentage of the relief they ask for in arbitration versus lawsuits (Maltby, 1999)

(9) Ninety-three percent of consumers using arbitration find it to be fair (Perino, 2003)

(10) Consumers prevail 20% more often in arbitration than in court (Perino, 2003)

(11) In securities actions, consumers prevail in arbitration 16% more than they do in court (U.S. General Accounting Office, 1992)

(12) Sixty-four percent of American consumers would choose arbitration over a lawsuit for monetary damages (Roper Survey, 2003)

ii. In December 2004, Ernst & Young issued a study ("Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases") examining the outcomes of contractual arbitration in lending-related, consumer-initiated cases. [Attached as Exhibit B]. The study, based on consumer arbitration data from January 2000 to January 2004 from the NAF, observed that:

(1) Consumers prevailed more often than businesses in cases that went to an arbitration hearing, with 55% of the cases that faced an arbitration decision being resolved in favor of the consumer. This is the exact same win-rate for consumers as exists in state court. See Contract Trials and Verdicts in Large Counties, 1996, p.5 (April, 2000), Bureau of Justice Statistics, http://www.ojp.usdoj.gov/bjs/pub/pdf/ctvlc96.pdf.

(2) Consumers obtained favorable results in 79% of the cases that were reviewed. Favorable results include results from arbitration decisions, as well as settlements satisfactory to the consumer and cases that were dismissed at the claimant's request.

(3) 40% of consumers who brought claims actually got their "day in court" to tell their stories (see p. 9 table 3, with 97 of 226 cases resulting in an arbitration decision). Compare this to the fact that only 2.8% of cases in state court ever reach trial. Examining the Work of State Courts, p. 29 (1999-2000), National Center for State Courts. http://www.ncsonline.org/D_Research/csp/1999-2000_Files/1999-2000_Tort-Contract_Section.pdf.

(4) 69% of consumers surveyed indicated that they were very satisfied with the arbitration process.

iii. In April 2005, Harris Interactive released the results of an extensive survey of arbitration participants sponsored by the Institute for Legal Reform at the U.S. Chamber of Commerce. [Attached as Exhibit C]. The survey was conducted online among 609 adults who participated in a

binding arbitration case (voluntarily, due to contract language or with strong urging by the Court, but not a court order) that reached a decision. The major findings were:

(1) Arbitration is widely seen as faster (74%), simpler (63%), and cheaper (51%) than going to court.

(2) Two-thirds (66%) of participants say they would be likely to use arbitration again with nearly half (48%) saying they are extremely likely.

a. Even among those who lost, one-third say they are at least somewhat likely to use arbitration again.

(3) Most participants are very satisfied with the arbitrator's performance, the confidentiality of the process and its length.

(4) Predictably, winners found the process and outcome very fair and the losers found the outcome much less fair. However, 40% of those who lost were moderately to highly satisfied with the fairness of the process and 21% were moderately to highly satisfied with the outcome.

(5) While one in five of the participants were required by contract to go to arbitration, the remainder were voluntary – suggested by one of the parties, one of the lawyers, or the court.

(6) Two-thirds of the participants were represented by lawyers.

iv. RoperASW, 2003 Legal Dispute Study (Apr. 2003). [Attached as Exhibit D]. The survey concluded that 64% of individuals would choose arbitration over court litigation, 67% believe court litigation takes too long and 32% believe court litigation costs too much.

v. One study dealing with AAA employment arbitration found that employees won 73% of the arbitrations they initiated and 64% of all employment arbitrations (including those initiated by employers). See Lisa B. Bingham, Is There a Bias in Arbitration of Nonunion Employment Disputes? An analysis of Active Cases and Outcomes, 6 Int'l J. Conflict Management 369, 378 (1995).

vi. A study which compared the results in employment arbitration with the results in federal court during the same period of time found that 63% of employees won in arbitration compared to 15% of employees who won in federal court. Awards to employees in arbitration were on average 18% of the amount demanded versus 10.4% of the amount demanded in court. The study also demonstrated that while arbitration awards to employees are on average lower than judgments to employees in court, the outcome

for employees is still better in arbitration because of their higher win-rates of arbitration and the shorter duration of arbitration compared to court proceedings. See Lewis L. Maltby, Private Justice: Employment Arbitration and Civil Rights, 30 Colum. Hum. Rights L. Rev. 29, 46-48 (1998).

vii. In yet another study, it was reported that employees won 51% of arbitrations, while the EEOC won 24% of cases in federal court. See George W. Baxter, Arbitration in Litigation for Employment Civil Rights?, 2 Vol. of Individual Employee Rights 19 (1993-94).

viii. Another study reported that employees won 68% of the time before the AAA as contrasted with only 28% of the time in litigation. See William M. Howard, Arbitrating Claims of Employment Discrimination, Disp. Res. J. Oct-Dec 1995, at 40-43.

ix. See Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure, California Dispute Resolution Institute (August 2004). The report appears at HTTP://www.mediate.com/cdri/cdri_print_Aug_6.pdf. The report concluded that consumers prevailed 71% of the time.

x. Theodore Eisenberg and Elizabeth Hill, Arbitration and Litigation of Employment Claims: An Empirical Comparison, Disp. Resol. J. Nov. 2003 – Jan. 2004, at 44. Higher-compensated employees (*i.e.*, those with annual incomes of $60,000 or more) obtained slightly higher awards in arbitration before the AAA than in court. There was insufficient court data to make a similar comparison for employees with less than $60,000 of annual income, thus proving that such employees have difficulty finding lawyers who will represent them in court.

xi. Michael Delikat and Morris M. Kleiner, An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?, Disp. Resol. J. Nov. 2003 – Jan. 2004, at 56. The study compared the results of employment discrimination cases filed and resolved between 1997 and 2001 in the S.D.N.Y. versus with the NASD and NYSE. Employees prevailed 33.6% of the time in court versus 46% of the time in arbitration. The median damages award was $95,554 in court versus $100,000 in arbitration. The median duration was 25 months in court versus 16½ months in arbitration. They also found that of over 3,000 cases filed in court, only 125 (2.8%) went to trial, thus undermining the perceived importance that consumer advocates place on the right to trial by jury.

xii. Gary Tidwell, et al., Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations (Aug 1999), available at http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitrati

on/nasdw_009528.pdf. In surveying individual participants in NASD-sponsored arbitration for 1997 to 1999, over 93% agreed that their claims were handled "fairly and without bias."

xiii. Lisa B. Bingham, Is there a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Actual Cases and Outcomes, 6 Int'l J. of Conflict Mgmt. 369 (1995). In a study of 171 employment arbitration cases filed with the AAA in 1992, Bingham concluded that "employee claimants are more likely than employer claimants to recover a larger proportion of the amount of damages claimed when the arbitrator is paid a fee, recovering almost fourfold what employers recover ...." She concluded that her results "contradict the theory that employment arbitrators will be biased against individual employees . . . ." She opined that arbitrators want to "be acceptable to other parties, not just the repeat player involved in that case."

BRIEF BACKGROUND OF THE FAA

The FAA was enacted in 1925. At its heart is Section 2 of the FAA, 9 U.S.C. §2, which provides that:

> "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

Thus, by its plain terms, the FAA makes enforceable both pre-dispute arbitration agreements ("a controversy thereafter arising") as well as post-dispute arbitration agreements ("an existing controversy"). Countless millions of consumer arbitration agreements have been entered into in reliance on this language, creating a body of settled expectations among companies and consumers alike.

The application of the FAA to consumer transactions increased significantly during the past two decades, due largely to a series of landmark United States Supreme Court rulings which confirmed that parties are as free to enter into arbitration agreements as they are to

enter into any other type of contract, even though some states purported to prohibit pre-dispute arbitration agreements and some courts refused to enforce them. The Supreme Court held that:

- The FAA creates a body of federal substantive law of arbitrability which is applicable to arbitration agreements in contracts involving interstate commerce. Perry v. Thomas, 482 U.S. 483, 489 (1987).
- Interstate commerce is to be interpreted broadly. Citizens Bank v. Alafabco, Inc., 539 U.S. 52, 56 (2003) ("[w]e have interpreted the term 'involving commerce' in the FAA as the functional equivalent of the more familiar term 'affecting commerce' -- words of art that ordinarily signal the broadest permissible exercise of Congress' Commerce Clause power").
- The FAA "revers[ed] the longstanding judicial hostility to arbitration agreements ... and place[d] arbitration agreements upon the same footing as other contracts." Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 225-26 (1987).
- Federal law strongly favors the arbitration of disputes and requires that courts rigorously enforce arbitration agreements. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).
- State laws that directly or indirectly undermine enforcement of the terms of private arbitration agreements or that single out arbitration for special treatment are preempted by the FAA. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996); Southland Corp. v. Keating, 465 U.S. 1 (1984).

- "Congress, when enacting this law [the FAA], had the needs of consumers, as well as others, in mind …." Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 280 (1995);
- The FAA "ensur[es] that private agreements to arbitrate are enforced according to their terms." Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford, Jr. Univ., 489 U.S. 468, 479 (1989).

But the FAA does not totally displace state law. Section 2 of the FAA reserves to the state and federal courts the authority to invalidate or restrict arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract." Therefore, state law contract defenses such as lack of assent and unconscionability can be asserted by consumers who believe that a pre-dispute arbitration agreement should not be enforced. Perry v. Thomas, 482 U.S. 483, 492 n. 9 (1987).

CONSUMER ARBITRATION AGREEMENTS ARE DRAFTED FAIRLY

The existing system of "checks and balances" works well because the vast majority of companies and employers draft arbitration agreements that are intended to be fair to consumers and employees. My partners and I routinely counsel clients to draft arbitration agreements that contain the following provisions, among others:

1. Give Consumer the Right to Reject Arbitration. To ensure that consumers have truly "agreed" to arbitrate, we advise companies to give consumers the unfettered and unconditional right to reject the arbitration provision at the time they enter into the contract or within a reasonable period of time thereafter and to prominently disclose that right. Several courts, in enforcing consumer arbitration agreements, have emphasized the fairness inherent in providing such an opt-out right. See, e.g., Circuit City Stores, Inc. v. Ahmed, 283 F.3d 1198 (9th

Cir. 2002); Circuit City Stores, Inc. v. Najd, 294 F.3d 1104, 1108 (9th Cir. 2002); Providian National Bank v. Screws, 2003 Ala. LEXIS 298 (Ala. Oct. 3, 2003); Tsadilas v. Providian Nat'l Bank, 13 A.D. 3d 190, 786 N.Y.S. 2d 478 (1st Dep't. 2004).

2. Require the Arbitrator to Apply Applicable Substantive Law, Including Fee-Shifting Statutes Which Give the Consumer the Right to Recover His or Her Counsel Fees If He or She Prevails in the Arbitration. We uniformly counsel companies to specify in their arbitration clauses that the arbitrator must apply applicable substantive law and award the same remedies (including punitive damages and equitable relief) that would be available to the consumer had the matter proceeded in court. In particular, our arbitration agreements preserve the consumer's right to recover attorneys' fees and costs from the company if provided by applicable law. (Most federal and state consumer protection statutes require such fee-shifting). That way, the consumer does not lose the benefit of any statutory remedies such as treble damages or fee-shifting by proceeding to arbitration. In some cases, our clients even provide by contract to bear the consumer's legal costs if the consumer prevails, whether or not the governing statute requires the company to bear such costs.

3. Avoid "Carve-Outs" from Arbitration that Unilaterally Favor the Company. For the most part, the arbitration agreement, as matter of fairness, should operate to bind both the company and the consumer. (There are, however, some notable exceptions to this principle. Numerous courts have enforced arbitration provisions in mortgage loan agreements that except foreclosure proceedings from the scope of the arbitration provision because foreclosure in court offers numerous statutory protections to consumers that are not easily

transferable to arbitration.[4] In addition, numerous courts have enforced arbitration agreements that permit the consumer to bring an action in small claims court rather than in arbitration;[5] in fact, the AAA will not administer an arbitration if the consumer was not given this option -- see Exhibit E attached hereto).

4. Arbitration Administrator. Most companies implementing arbitration on a widespread basis choose to utilize the services of a national arbitration organization with established rules and infrastructure. Major national administrators include the AAA and NAF. Companies use established arbitration organizations because: (a) it is more efficient administratively; (b) courts are already familiar with the major organizations and their arbitration clauses have frequently been subjected to judicial scrutiny and interpretation; (c) the organizations have adopted standard procedural rules which specify the mechanics of the arbitration process, the selection of arbitrators, and so forth. We advise companies to identify more than one potential arbitration administrator in the arbitration agreement and then give the consumer the right to choose which organization to use.

5. Arbitration Costs. We generally counsel companies to provide in their arbitration clauses that if the consumer requests, the company will pay all or substantially all of the consumer's arbitration filing, administrative and hearing fees and not seek to recover them even if the consumer loses. Some companies provide that the company will "advance" the consumer's arbitration costs, and let the arbitrator determine at the end who should ultimately be

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4 See, e.g., Delta Funding Corp. v. Harris, 2006 WL 2277984 (N.J. Aug. 9, 2006); Salley v. Option One Mortgage Corp., No. 50 EAP 2005, 2007 Pa. LEXIS 1195 (Pa. May 31, 2007).

5 See, e.g., Jenkins v. First American Cash Advance of Georgia, Inc., 400 F.3d 868 (11th Cir. 2005), cert. denied, 126 S. Ct. 1457 (2006).

responsible, subject to proviso that in no event will the consumer be responsible for more than what his or her court costs would have been had the matter been litigated in court. That is also fair because the consumer pays no more than what he or she would have paid in court.

6. Location of Hearing. Our arbitration agreements (and most other arbitration agreements) provide that any hearing will be in a location near the consumer's residence so that the consumer is not burdened with traveling a long distance or incurring extra costs.

7. Disclosures. We always advise companies to make sure that the differences between arbitration and litigation are clearly and conspicuously explained to the consumer in the arbitration agreement and related loan documents. We also counsel them to highlight the fact that the consumer has the right to reject the arbitration provision without any adverse effect on his or her account. Companies do value their customers' business and want them to make an informed choice.

THE MAJOR NATIONAL ARBITRATION ADMINISTRATORS HAVE ADOPTED STANDARDS AND PROCEDURES THAT ENSURE FAIRNESS TO CONSUMERS

The most widely used national arbitration administrators, including the AAA and the NAF, have committed themselves in writing to protecting the rights of consumers to a fair arbitration.

For example, the AAA has adopted a Consumer Due Process Protocol that must be complied with by companies which wish to use the AAA as an arbitration administrator. Numerous consumer advocates and governmental groups were members of the Advisory Committee that formulated the Protocol. The Protocol was adopted by the AAA in April 1998 to ensure that arbitration agreements between consumers and the companies they deal with are endowed with "fundamental fairness." The AAA has also adopted Supplementary Consumer

Rules for use in arbitrations between consumers and businesses and a special schedule of arbitration fees that caps the fee to the consumer on a claim of $10,000 or less at $125. All other arbitration fees are paid by the company. An impoverished consumer can also apply to the AAA for a waiver of all arbitration costs. [AAA materials are attached as Exhibit E].

The NAF has adopted a Code of Procedure which, among other things (1) requires that arbitrators be "neutral and independent" and (2) provides a procedure for disqualifying arbitrators "if circumstances exist that create a conflict of interest or cause the Arbitrator to be unfair or biased." The NAF has also issued a Code of Conduct for Arbitrators and an Arbitration Bill of Rights. As set forth therein, each NAF arbitrator is a former judge, practicing attorney or law professor with at least 15 years of experience; each arbitrator is an independent contractor with the NAF and not an NAF employee; and an arbitrator who has a conflict of interest or is unfair or biased cannot decide a case. Like the AAA, the NAF also has a reduced fee schedule for consumers and permits impoverished consumers to seek a waiver of fees altogether. [NAF materials are attached as Exhibit F].

Both the AAA[6] and the NAF[7] have been recognized by courts as reasonable, fair, cost-effective and impartial forums. Significantly, U.S. Supreme Court Justice Ruth Bader

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[6] See, e.g., Olson v. AAA, 876 F. Supp. 850, 852 (N.D. Tex.), aff'd without op., 71 F.3d 877 (5th Cir. 1995); MCI v. Matrix Comm. Corp., 135 F.3d 27, 36-37 (1st Cir. 1998), cert. denied, 524 U.S. 953 (1998); Doctor's Assoc., Inc. v. Stuart, 85 F.3d 975, 981 (2d Cir. 1996); LLT Int'l, Inc. v. MCI Telecomm. Corp., 18 F. Supp. 2d 349, 354 (S.D.N.Y. 1998).

[7] See, e.g., Marsh v. First USA Bank, 103 F. Supp. 2d 909, 925 (N.D. Tex. 2000) ("[The NAF] boasts an impressive assembly of qualified arbitrators .... All legal remedies and injunctive relief are available to the parties .... The filing fee structure is clearly stated and reasonably based on the amount of the claim .... The Court is satisfied that NAF will provide a reasonable, fair, and impartial forum within which Plaintiffs may seek redress for their grievances."); BankOne, N.A. v. Coates, 125 F. Supp. 2d 819, 836 (S.D. Miss. 2001), aff'd, 34 Fed. Appx. 964, 2002 WL 663804 (5th Cir. Apr. 5, 2002) (given the

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Ginsburg characterized the AAA and NAF provisions limiting fees in consumer cases as a "model[] for fair cost and fee allocation." Green Tree Financial Corp.-Ala. v. Randolph, 531 U.S. 79, 95 (2000) (Ginsburg, J., concurring)

COURTS RIGOROUSLY PROTECT CONSUMERS FROM UNFAIR ARBITRATION AGREEMENTS

The FAA itself ensures that if a company attempts to enforce an arbitration agreement that the consumer believes is unfair, a court will hear the parties and determine

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NAF's fairness "safeguards" -- including the availability of all legal remedies and injunctive relief and the ability to request a written opinion -- "the court is not persuaded that there ... exists any basis for finding the agreement unconscionable"); In re Currency Conversion Fee Antitrust Litig., 265 F. Supp. 2d 385, 412 (S.D.N.Y. 2003) (noting that the "fee schedule in the NAF Code has been upheld as adequate and fair by numerous courts" and rejecting plaintiffs' argument that "the NAF Code unreasonably subjects them to a 'loser pays' cost-shifting provision" because the "plaintiffs are in no worse a position under the NAF Code then they would be in federal court"); Bellavia v. First USA Bank, N.A., No. 02-C-3971, 2003 U.S. Dist. LEXIS 18907, *8 (N.D. Ill. Oct. 20, 2003) (rejecting allegation that the NAF is biased and emphasizing that the NAF rules allow the parties to select an arbitrator who has no affiliation with the NAF); Bank One N.A. v. Williams, No. 3:01CV24-D, 2002 U.S. Dist. LEXIS 27217 at *10-11 (N.D. Miss. April 29, 2002) (compelling arbitration and noting that "federal courts within the Fifth Circuit have repeatedly enforced arbitration provisions where the parties agreed to arbitrate pursuant to the NAF rules"); Hale v. First USA Bank, N.A., No. 00 Civ. 5406, 2001 U.S. Dist. LEXIS 8045 at *11-12 (S.D.N.Y. June 12, 2001) ("numerous courts have found the NAF to be an adequate and fair arbitral forum and have upheld arbitration provisions requiring arbitration in the NAF"); Vera v. First USA Bank, No. Civ. A. 00-89-GMS, 2001 WL 640979 (D. Del. April 19, 2001) (the "NAF is a model for fair cost and fee allocation"); Smith v. EquiFirst Corp., 117 F. Supp.2d 557, 564 (S.D. Miss. 2000) (holding that NAF "fees provisions do not foreclose plaintiffs' access to an arbitration forum that compares favorably to a judicial forum" and compelling arbitration); ITT Comm. Fin. Corp. v. Wangerin, No. C9-95-163, 1995 WL 434459, at *2 (Minn. Ct. App. July 25, 1995) (rejecting argument that NAF arbitrators were biased due to NAF's receipt of substantial business from ITT and holding that "by itself, no level of Forum business coming from respondent would indicate partiality of the arbitrator"). In sum, there is "no persuasive evidence that the National Arbitration Forum is anything but neutral and efficient." Lloyd v. MBNA Am. Bank, N.A., 2001 U.S. Dist. LEXIS 8279, *9 (D. Del. Feb 22, 2001), aff'd, No. 01-1752, 2002 U.S. App. LEXIS 1027 (3d Cir. Jan. 7, 2002).

whether the agreement is enforceable. Pursuant to Sections 3 and 4 of the FAA, 9 U.S.C. §§3, 4,[8] the court determines the existence, enforceability and scope of the arbitration agreement.

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[8] Those sections provide, respectively, as follows:

> "Section 3. Stay of proceedings where issue therein referable to arbitration
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> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."
>
> "Section 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination
>
> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the

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See, e.g., Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 94 (2002) (court determines whether a particular dispute falls within the scope of an arbitration clause and whether the clause is enforceable); Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 452 (2003) (court determines "the validity of the arbitration clause [and] its applicability to the underlying dispute between the parties").

Proof that this system adequately safeguards the rights of consumers may be found in the numerous court opinions concerning class action waivers in consumer arbitration agreements. In order to keep arbitration simple, inexpensive and speedy, many consumer arbitration agreements provide that neither party has the right to bring a class action or representative suit in court or in arbitration with respect to claims that are subject to the arbitration agreement. Although consumers' lawyers often allege that class action waivers are unconscionable, the vast majority of federal courts, and most state courts, have enforced such waivers on the grounds that (1) a class action is a mere procedural right that parties may waive;[9]

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> party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof."

[9] See, e.g., Lloyd v. MBNA America Bank, N.A., 27 Fed. Appx. 82, 2002 U.S. App. LEXIS 1027 (3d Cir. Jan. 7, 2002) (unpublished), affirming 2001 U.S. Dist. LEXIS 8279 (D. Del. Feb. 22, 2001) (holding in consumer dispute brought against credit card issuer under the common law and federal statutes that the right to a class action is "merely procedural" and may be waived); Thompson v. Illinois Title Loans, Inc., No. 99 C 3952, (continued...)

(2) as long as the arbitration agreement preserves the consumer's substantive rights, including the right to recover attorneys' fees and costs if he or she prevails in the arbitration, the class action waiver does not hinder the prosecution of the consumer's individual claims, impede the retention of an attorney to represent the consumer on an individual basis or exculpate the company from liability;[10] and (3) even without a class action, companies remain subject to

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2000 WL 45493, at *4 (N.D. Ill. Jan. 11, 2000) (waiver by arbitration agreement); Sanders v. Robinson Humphrey/American Express, Inc., 634 F. Supp. 1048, 1065 (N.D. Ga. 1986) (class action rule a mere "procedural device"), aff'd in part and rev'd in part on different grounds, 827 F.2d 718 (11th Cir. 1987), cert. denied, 485 U.S. 959 (1988); Dienese v. McKenzie Check Advance of Wis., LLC, No. 99-C-50, 2000 U.S. Dist. LEXIS 20389, at *24 (E.D. Wis. Dec. 11, 2000) (enforcing arbitration clause barring class actions since "consumers are not signing away a substantive right"); Caudle v. American Arb. Ass'n, 230 F.3d 920, 921 (7th Cir. 2000) ("[a] procedural device aggregating multiple persons' claims in litigation does not entitle anyone to be in litigation"); Zawikowski v. Beneficial National Bank, No. 98 C 2178, 1999 WL 35304 (N.D. Ill. Jan. 11, 1999, at *2 ("[n]othing prevents the Plaintiffs from contracting away their right to a class action").

10 See, e.g., Johnson v. West Suburban Bank, 225 F.3d 366 (3d Cir. 2000), cert. denied, 531 U.S. 1145 (2001) (enforcing class action waiver in action against payday lender alleging violations of Truth in Lending Act ("TILA")); Cappalli v. National Bank of the Great Lakes, 281 F.3d 219 (3d Cir. 2001) (unpublished) (enforcing class action waiver in action alleging violation of federal usury statutes, even though plaintiff's individual claim was only $33.02); Sagal v. First USA Bank, N.A., 254 F.3d 1078 (3d Cir. 2001) (unpublished), affirming 69 F. Supp. 2d 627 (D. Del. 1999) (compelling arbitration of TILA, Delaware Consumer Fraud Act and common law claims against credit card issuer even though a class action would not be available in arbitration); Lloyd v. MBNA America Bank, N.A., 27 Fed. Appx. 82, 2002 U.S. App. LEXIS 1027 (3d Cir. Jan. 7, 2002) (unpublished), affirming 2001 U.S. Dist. LEXIS 8279 (D. Del. Feb. 22, 2001) (in consumer dispute brought against credit card issuer under the common law and federal statutes, court enforced arbitration agreement that contained a class action waiver and rejected argument that agreement was unconscionable); Jenkins v. First American Cash Advance of Ga., Inc., 400 F.3d 868 (11th Cir. 2005) (court enforced class action waiver in arbitration agreement between consumer and payday lender, holding that where arbitration agreement permits fee shifting if allowed by applicable law and preserves the parties' substantive remedies, lawyers will be willing to represent the consumer on an individual basis and the company will not be immunized against unlawful conduct), cert. denied, 126 S. Ct. 1457 (2006); Gipson v. Cross Country Bank, 294 F. Supp. 2d 1251, 1261-62 (M.D. Ala. 2003) (rejecting argument that class action was necessary for

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plaintiff to vindicate her statutory rights because plaintiff could recover her attorneys' fees if successful in the arbitration); Snowden v. CheckPoint Check Cashing, 290 F.3d 631, 638-39 (4th Cir. 2002) (rejecting argument that plaintiff "will be unable to maintain her legal representation given the small amount of her individual damages" where statute permitted fee-shifting), cert. denied, 537 U.S. 1087 (2002); Ornelas v. Sonic-Denver T, Inc., No. 06-cv-00253, 2007 WL 274738, at *5-7 (D. Colo. Jan. 20, 2007) (enforcing class action waiver where statutes permitted fee-shifting and following the "numerous courts [that] have recognized that [class action waivers] are valid and fully enforceable"); Galbraith v. Resurgent Capital Services, No. Civ. S. 05-2133 KJM, 2006 WL 2990163 (E.D. Cal. Oct. 19, 2006) (class action waiver not unconscionable where plaintiff could recover attorneys' fees if successful); Carter v. Countrywide Credit Indus., Inc., 362 F.3d 294 (5th Cir. 2004); Iberia Credit Bureau, Inc. v. Cingular Wireless LLC, 379 F.3d 159 (5th Cir. 2004); Burden v. Check into Cash of Kentucky, LLC, 267 F.3d 483 (6th Cir. 2001); Bowen v. First Family Financial Services, Inc., 233 F.3d 1331 (11th Cir. 2000); Randolph v. Green Tree Fin. Corp. - Ala., 244 F.3d 1149 (11th Cir. 2001); Baron v. Best Buy Co., Inc., 260 F.3d 625 (11th Cir. 2001); Chalk v. T-Mobile USA, Inc., No. 06-CV-158-BR, 2006 WL 2599506 (D. Or.) (Sept. 7, 2006); Miller v. Equifirst Corp. of W. Va., Civil Action No. 2:00-0335, 2006 WL 2571634 (S.D.W. Va. Sept. 5, 2006); Rains v. Foundation Health Systems Life & Health, No. 99CA2398, 2001 Colo. App. LEXIS 580 (Ct. App. Colo. Mar. 29, 2001); Forrest v. Verizon Communications, Inc., 805 A.2d 1007 (D.C. Ct. App. Aug. 29, 2002); America Online, Inc. v. Booker, Case No. 3D00-2020, 2001 Fla. App. LEXIS 1079 (Ct. App. 3d Dist. Feb. 7, 2001); Fonte v. AT&T Wireless Services, Inc., 903 So. 2d 1019 (Fla. Ct. App. 4th Dist. 2005), app. denied, 918 So. 2d 292 (Fla. 2005); Wilson v. Mike Steven Motors, Inc., 111 P.3d 1076 (Kan. Ct. App. 2005); Walther v. Sovereign Bank, 386 Md. 412, 872 A.2d 735 (2005); Ranieri v. Bell Atlantic Mobile, 304 A.D. 2d 353, 759 N.Y.S. 2d 448 (App. Div. 1st Dep't 2003), leave denied, 1 N.Y. 3d 502 (2003); Brower v. Gateway, 246 App. Div. 2d 246, 676 N.Y.S.2d 569 (N.Y. 1st Dep't 1998); Tsadilas v. Providian National Bank, 13 A.D. 3d 190, 786 N.Y.S. 2d 478 (App. Div. 1st Dep't 2004), reargument denied, 2005 N.Y. App. Div. LEXIS 247 (Mar. 8, 2005), appeal denied, 5 N.Y.3d 702 (2005); Johnson v. Chase Manhattan Bank, N.A., 784 N.Y.S. 2d 921 (table), 2004 WL 413213, at *5 & n.2 (N.Y. Sup. Ct. Feb. 27, 2004), aff'd, 786 N.Y.S. 2d 302 (N.Y. App. Div. 2004); Strand v. U.S. Nat'l Bank, N.A., No. 20040068, 2005 ND 68, 693 N.W. 2d 918 (N.D. March 31, 2005); Pyburn v. Bill Heard Chevrolet, 63 S.W. 3d 351 (Tenn. Ct. App. 2001); AutoNation USA Corp. v. Leroy, 105 S.W. 3d 190 (Tex. 2003); Stein v. Geonerco, Inc., 105 Wash. App. 41, 17 P.3d 1266 (2001); Heaphy v. State Farm Mut. Auto. Ins. Co., 117 Wash. App. 438, 72 P.3d 220 (2003), review denied, 150 Wash. 2d 1037, 84 P.3d 1230 (2004); Tillman v. Commercial Credit Loans, Inc., 629 S.E.2d 865 (N.C. Ct. App. 2006).

individual actions by consumers and to enforcement actions by state and federal governmental administrative agencies such as attorney general offices, departments of banking and the Federal Trade Commission.[11]

Indeed, there is statistical proof that consumers are able to find attorneys to represent them on an individual basis in small dollar claims where the consumer, if successful, can recover attorneys' fees and costs. The overwhelming majority of TILA lawsuits filed each year are individual, not class action, lawsuits, even though the vast majority of suits involve small dollar claims[12] and class actions are permitted under TILA. TILA permits successful plaintiffs to recover their attorneys' fees and costs. 15 U.S.C. §1640(a). According to computer searches of the LexisNexis CourtLink® database, 688 TILA cases, of which only 17 were class actions, were filed in the federal courts in 2006; 492 TILA cases, of which only 19 were class actions, were filed in the federal courts in 2005; 574 TILA cases, including only 20 class actions, were filed in 2004; 513 TILA cases, of which only 39 were class actions, were filed in 2003; and 576 TILA cases, of which only 37 were class actions, were filed in 2002.

While some courts have concluded, based on the particular facts of the cases before them, that the class action waiver in question was unconscionable under state law, most of those cases involved arbitration clauses that also impaired the consumer's substantive rights, imposed unreasonable costs or were one-sided in favor of the company. See, e.g., ACORN v.

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11 Johnson v. West Suburban Bank, 225 F.3d 366, 375-76 (3d Cir. 2000), cert. denied, 531 U.S. 1145 (2001); accord, Randolph v. Green Tree Fin. Corp. - Ala., 244 F.3d 1149 (11th Cir. 2001).

12 TILA provides for statutory damages, typically ranging from $100 to $2,000, plus actual damages and attorneys' fees. 15 U.S.C. §1640(a). Actual damages are nearly impossible to prove because plaintiffs must show detrimental reliance. Turner v. Beneficial Corp., 242 F.3d 1023 (11th Cir. 2001) (citing cases), cert. denied, 534 U.S. 820 (2001).

Household Int'l, Inc., 211 F. Supp. 2d 1160 (N.D. Cal. 2002) (arbitration agreement exempted collection proceedings brought by lender against consumer from arbitration and cost of arbitration would be ten times the cost of court action); Luna v. Household Fin. Corp., 236 F. Supp. 2d 1166 (W.D. Wash. 2002) (company, but not consumer, reserved right to go to court rather than arbitrate); Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003) (agreement limited damages in cases of fraud and other intentional torts and imposed thousands of dollars in arbitration fees); Kinkel v. Cingular Wireless LLC, 223 Ill. 2d 1, 857 N.E.2d 250 (2006) (contract did not inform customer of the costs of arbitration and did not provide a cost-effective means for resolving the claim).

Class action waivers are an important part of a properly functioning consumer arbitration program because such programs can substantially lower litigation costs and the cost savings are passed through to consumers, in whole or in part, in the form of lower prices for goods and services. Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements,* 2001 J. Disp. Resol. 89, 91-93; Richard A. Posner, Economic Analysis of Law 7 (6th ed. 2003).

In any event, my intent here is not to debate whether class actions are good for consumers or whether class action waivers should be enforced, but rather to emphasize that there is presently an effective system in place to hear consumers' complaints about arbitration clauses and independently determine whether an arbitration should take place. To the extent courts have declined to enforce an arbitration agreement, that shows that the system is working. It should not be viewed as an indictment of all consumer arbitration agreements, the vast majority of which comply with federal and state law and are enforced by the courts.

CONCLUSION

For all of the foregoing reasons, it is my opinion that the rights of consumers are well protected by the FAA as presently enacted, by the careful drafting of arbitration agreements, by the widely used national arbitration administrators and by the federal and state courts. Thank you for your consideration of my views.

Ms. SÁNCHEZ. Thank you, Mr. Levin.
Ms. Fogal, you are up next.

TESTIMONY OF JORDAN FOGAL, POLITICAL ACTIVIST, HOUSTON, TX

Ms. FOGAL. On April 15, we moved into what was going to be our last home. It had all the eye candy, even an elevator. The children told everybody at school that their grandmother had an elevator. We are senior citizens. We had a 30-year mortgage, 6 percent interest rate. We could afford our payments. We had an elevator in case our knees went. We had a medical center close by, and a funeral home three blocks away.

The first night in our new home, my husband tried out new Jacuzzi tub on the third floor. When he pulled the plug, 100 gallons of water crashed through our dining room ceiling into the dining room. This was not one overlooked plumbing connection, as my husband and I so desperately wanted to believe. It was a preview of coming attractions.

For 29 months, we begged our builder to fix our house. They would come in and seal up the windows inside so the water wouldn't run in, and then they would seal up the crack on the outside in the stucco so the water couldn't run out. So the house just filled up with water, and the mold grew. An accredited laboratory said they had never seen toxic readings that high in an inhabited dwelling.

Our doctor told us to move out immediately. We sent the reports to the builder. He lied under oath, saying that he never received it, and the engineer received it that day, his engineer. We moved out. We had estimates for over $150,000 and our new home did not last 29 months.

After we exhausted all other remedies, I began protesting my builder's new property. I felt foolish standing on a street corner holding up a sign because it was the only option left to me. We did not file on our builder an arbitration. Our builder filed on us for taking advantage of the only thing we had left, our first amendment rights.

He warned me that his attorneys would take care of me in arbitration. Two weeks after I stepped out on that corner, we received our arbitration papers. The builder filed a fast-track to dispose of us more expediently than regular arbitration.

We couldn't afford a lawyer anymore. We were paying for our new house, moving costs, deposits on the apartment, storage for our things. We had to keep the insurance and lights on in our new house, even if we couldn't live there, because the builder said that we had caused the damage. We knew that he was not going to buy it back. He told us he only sold houses. He didn't buy them.

We also called the mortgage company and sent them the reports. After never being late with one payment, we allowed our home to go into foreclosure. We felt ashamed. At the same time, we also were paying for engineering, moisture, infrared, mold and air quality testing, and our builder knew that all of this was unnecessary.

In arbitration, all the burden of proof is on the homeowner. The builder lets you do all the work and pay for it, and he sit there smugly knowing all the while that you will run out of money, shut

up, go away, or he will win in arbitration. We did everything right. We had our house inspected. We hired a licensed realtor. We paid $3,400 a year for homeowners insurance, but substandard construction and builder defects are not covered by homeowners insurance. We were not in good hands with Allstate.

We paid good money for an uninhabitable house and had no recourse. We were constantly tormented by the American Arbitration Association and billed a $6,000 counterclaim fee that got us out of fast-track and into regular arbitration. We were billed for case service fees, arbitration fees, even for the rent on the room. After receiving hardship, our case was dismissed due to failure of payment of fees by both parties.

Now, we could finally file in court and charge the builder with fraud. We were dragged through 10 hearings before the judge ordered us to return to arbitration. Once again in arbitration, 2 years passed. We have not had a Christmas tree. We have not grilled out. We have not planted a flower. We have not had company. Our grandchildren have no place to stay with us. We live in a small third-story apartment, a temporary situation because surely justice was going to come soon.

After successfully proving fraud, my net award, including my attorney fees, is $26,000. I had to pay $1,690 for a study after arbitration was over before the arbitrator would issue her award. They do not have to face you when they render their verdicts. I feel an overwhelming responsibility as I sit here before you today because I feel like I have to represent the hundreds of families I have talked to over the years and the hundreds of thousands that I have never met who have suffered so much more than I have.

Please don't tell us that our houses would cost more if they were built correctly, or tell us that arbitration works so well. If it worked so well, why does it have to be mandatory? By mandatory arbitration, we have lost our seventh amendment rights to a trial by jury, and maybe a fight to getting their first amendment rights due to the abuses and harassment from arbitrators and unethical corporations.

In closing, I would like to quote our second president: "Representative government and a trial by jury are the heart and lungs of liberty. Without them, we have no other fortification against being ridden like horses, fleeced like sheep, worked like cattle, and fed and clothed like swine." Mr. Adams must have had a premonition about the privatization of the justice system we now refer to as arbitration.

Thank you.

[The prepared statement of Ms. Fogal follows:]

PREPARED STATEMENT OF JORDAN FOGAL

Written Testimony Submitted by Jordan Fogal

To the

The Subcommittee on Commercial and Administrative Law

"Mandatory Binding Arbitration Agreements: Are They Fair For Consumers?"

Tuesday, June 12, 2007, 10:30 a.m.

Washington, DC

I would like to humbly thank you for your invitation to speak on the subject of defective housing and arbitration clauses. Those two terms have become tantamount.

There are a lot of people depending on me today, because I am a writer, to find the right words and to speak for them. I am charged with communicating their frustration, hopelessness, and the abandonment that they feel. They are not here; but I am, for all of them. There are hundreds of thousands of us, and we are in every state. We realize that everyone thinks their issue is the most important; but when an issue, that affects hundreds of thousands, maybe millions of Americans, goes unmentioned, we feel like subjects instead of citizens.

Since your invitation, I have realized something about you and myself. I could not do your job. The responsibility I feel just being here is overwhelming. To handle the mental anguish of people's pain and suffering, and have to live and work under the constant stress of trying to figure out how to make things right is an unimaginable burden. I would not make a good politician. I have only been doing this for four years and sometimes I become absolutely ill listening to peoples' stories day after day. However, I have not felt responsible for them, other than being someone to talk to who understood, someone who would listen, and tell them they were not alone. By your invitation, you have make me feel that now, I am also personally charged with that responsibility of making things right. My words must convey the feelings of so many families – families living in motel rooms (some in only one room) with children and sick elderly parents, even their pets.

Veterans, even those totally disabled, living in deplorable conditions in new houses; young married couples suffering in shock; senior citizens... all have lost their homes, their savings, their credit, and their lives as they have know them (or ever dreamed they would be). Their futures are ruined, and their families are destroyed. Most will never recover. Some are at the end of their ropes and have even said they wanted to die. It is one thing to be made homeless by an act of God, like Katrina; but it is totally different when it is caused by an unconscionable act of greed.

I listened to Hispanics and African Americans saying they were being targeted at the State Affairs Committee in Texas, where hundreds of us testified for over twelve hours... Different ethic groups are not being targeted. These builders only see one color, green. We have houses that cost over a million dollars, compliments of my builder with $300,000 dollars in foundation damage; and we have patio homes starting at $120,000 with numerous defects. These are equal-opportunity crooks. They have awakened a sleeping lion called arbitration. They figured out a way to use it to build homes that are shameful and will never make the historical register. Arbitration is their get-out-of-jail free card; greedy builders play it every time they build a substandard, defective house. As Thomas Jefferson said, he will cheat without scruples, who can cheat without fear.

The pain that builders create for American families goes beyond the obvious. Foreclosure rates escalate, and no one mentions the two reasons that we know: bad builders and arbitration clauses. In Texas, we have had over 156,876 foreclosures, and these figures are not accurate. They do not count those who lost their homes but chose to make deals with scumbag investors. Investors, for the price of your power of attorney, will save your credit. Many have accepted

these offers, since they have been posted for foreclosure and are going to lose their home and money. These investors then go our mortgage companies and negotiate deals to buy these defective houses (deals that the mortgage companies will not make with us). These investors then cover up defects and dump them on other consumers. They do not have to disclose defects on foreclosed properties. My builder says he does not have to disclose defects on new properties. When he was asked - he said, "Why would I?"

Only the sub-primes are ever mentioned. If the figures are correct, over 2.4 million more people will lose their homes this year. In 2005, there were 1.2 million. The states with the highest foreclosure rates were: Georgia, Colorado, Florida, California, Michigan, Indiana, Ohio, Utah, Tennessee, and Nevada.

Foreclosure rates are in the news almost every day, but bad builders and arbitration clauses don't make the news. The majority of us have no voice. We are threatened with arbitration, and most are confused and afraid. Some homeowners patch up their new houses and dump them on the next unsuspecting buyer. Some houses in my neighborhood have had as many as five owners. Previous owners are being sued by new owners. We can sue each other for non-disclosure, but the builders are above the law.

Arbitration is an atrocity; and until you experience it or see the aftermath of its devastation, you cannot even imagine. Yet, some people still believe the "spin" that arbitration is as fair, cheaper, and faster than going to court. Arbitration is not fair; it is not cheaper; but sometimes, it is a whole lot faster. I have known people who were filed on by their builder, shoved through "fast track" arbitration; and came out the other side in less than 90 days owing the builder money!

Arbitration companies will tell you don't need to have a lawyer, but the builders have a stable of them. In our case, our builder's law firm has an arbitrator as a partner. Would you like to have the partner of my builder's henchman arbitrate your case?

Builders already have a contractual agreement with the arbitration company. Our builder has chosen AAA, the American Arbitration Association. This is a conflict of interest because they have already established a partnership, a symbiotic relationship. Arbitrators' salaries depend on pleasing their repeat customers - the builders. Homeowners who go through arbitration will probably never be able to own another home. Many of them end up in foreclosure, bankruptcy, homeless, and living with family members. Why does no one mention this crisis? Why aren't we all outraged? Homeowners are trapped by arbitration. They cannot afford the astronomical repairs to their new homes. Even more distressing is, they cannot afford arbitration either.

Arms interest rates are expected to reach at least 10 %. Peoples' house payments are going to grow out of their reach. Many times, you have big builders with ties to their own mortgage companies. Imagine what effect this is going to have on the US economy.

Only the FBI has addressed one of the growing problems in Houston - Mortgage fraud. It is so rampant, they have had to set up a special task force.

On April 15, 2002, we moved into what was to be our final home. It had all of the eye candy, even an elevator. The grandchildren told everybody at school their grandmother's house had an elevator. They were all so excited, we took them over before we moved in to give them a ride.

We are senior citizens; we had an elevator, in case our knees went; we were near the medical center and three blocks from a funeral home. We had a 30-year mortgage, 6% interest rate, and could afford our payments. We thought we had all our bases covered. We were not a sub-prime. Nevertheless, we were forced to let our house go into foreclosure. The foreclosure rate in our neighborhood of 44 homes is nearing 25%. Our house has been empty for almost three years.

The first night in our new home, my husband decided to try out his new Jacuzzi tub on the third floor. When he pulled the plug, one hundred gallons of water crashed through our dining room ceiling. My husband tried to calm me by saying, connecting the plumbing drains was probably just one slipup the builder had overlooked. We sopped up water that ran down the columns and through the hardwood floors, even into the garage below; water pooled in the chandelier. Our builder's salesman, not a licensed realtor, laughingly commented later..."that was just new construction; it happened all the time."

Well, this was not **one** overlooked plumbing connection, as my husband so desperately wanted to believe. It was a preview of coming attractions. Rainwater, from outside, sprayed us at the kitchen table. – The windows were installed upside down (our builder finally admitted this after three years). Our floors buckled and black spider-webs of mold crawled up our walls; the smell grew worse; then shower wall fell out and little puffballs grew out of the carpet. All the while, we had begged our builder to please fix our house.

We had the mold tested by an accredited laboratory, and they said they had never seen toxic readings that high in an inhabited dwelling. Prior to this, we had not mentioned the nosebleeds, headaches, the swollen eyes, and the sinus infections because we had seen how people were treated. Their defects were dismissed because the homebuyers were crazy hypochondriacs. My builder said everyone has mold and it doesn't bother anybody. Yet, he takes allergy shots. People have told me, and I have heard testimony, of children's eardrums bursting, babies vomiting up blood, and even the family cat suddenly dying. Stachybotrys and Chaetomium will make you deathly ill. We took the reports to our family doctor. She told us to move out of the house immediately. We sent the report to our builder. He lied under oath, said he never received it, yet he sent it to his engineer the same day; and the engineer was sitting right there in the room with our emails. Some were hand written, and I noticed them. He was asked by our attorney to read them and to read where he had gotten them and the date. We swore to tell the truth in arbitration. Are only homebuyers bound by this oath?

When does lying become perjury? When does the civil become criminal?

We moved out of our home. We had gotten estimates for repairs, and they were all $150,000 or more. Our builder kept telling the media it would only cost about 2 to 5 thousand dollars to fix our house, and that was all they wanted to do.

In the article in Mother Jones magazine, the builder's lawyer, Mr. Chesney, tells the reporter we are the only ones in the neighborhood with problems. Yet, when we referred this reporter to the lawyer handling some of our neighbor's lawsuits, my neighbors' lawyer called him a liar; and showed the reporter the papers signed by the same Mr. Chesney.

This builder had built our home incorrectly in the first place. They had attempted to repair it before we ever saw it, and they said they fixed it twice while we lived there. They would seal up the windows on the inside so the water wouldn't come in, and then they would seal up the cracks in the outside stucco so the water wouldn't run out. So, the walls just filled up with water.

The final insult came when we discovered the builder had filed suit on his own roofer and used not only my letters, but our house as their example of the most defective. Their sworn testimony said that our house was leaking so badly they had to remove the insulation in the attic and the shower, and redo the walls.

They had committed fraud, and we could prove they were guilty with their own sworn statements; but we could not go to court. The other houses did not have arbitration clauses. Many of my neighbors were able to sue the builder. Our builder knew how defective our house was, so they took out some insurance. They added an arbitration clause to our earnest money contract.

We did not file on our builder in arbitration. Most don't, the builders file on the homeowners. Now that is backwards. The perpetrator files on the victim. If the homeowner misses a deadline or doesn't pay up in arbitration, they are ruled on in absentia. Moreover, there are constant deadlines. AAA arbitration does not give you one comprehensive bill. They nickel and dime you to death, so you don't really know what it is actually going to cost. They will bill you first for filing fees; so you get a check, go to the post office, and mail it certified mail. Then you get a bill for case management fees, and you run to the post office. Then they bill you for the room, and you are back at the post office sending these payments certified because every bill comes with a deadline for payment. AAA will make you crazy running to the post office, trying to meet their deadlines, and keeping up with all their demands. They will not give you a direct or straight answer. They say they are merely the facilitator. Which sounds like, something out of the Godfather to me.

We knew better than to file against our builder. We had heard horror stories about other homeowners, who our builder had disposed of. We read their stories and saw the pictures on the Internet. One person had just spent $100,000; his house was a wreck; his dog's hair had fallen out; he developed serious lung problems, and finally moved out of the state. His wife let me in, when she was packing, so I could see their house. The deck and front was off the house. She told me, "He can't talk to you." He was under a gag order, or as the arbitration companies prefer to call it, a secrecy agreement. Many of the houses in his subdivision had and have problems.

Our subdivision of 44 units is near downtown Houston ... 37 are severely defective according to my builder's sworn testimony. My builder, Jorge Casimiro said, "project damages includes roofing systems... resulting in water damage penetration to interior of the units. The interior units' damage includes sheet rock, insulation, wall studding, electric wiring and boxes, plumbing,

A/C duck work, flooring... both wood and carpet, and interior painting." Knowing all these things, this "Hispanic Man of the Year" and member of the Harris County Housing Authority, sold us our house with no disclosure. He patched it so well that without destructive testing, we could not have known. Can you imagine asking a builder of a new home if you can do a little destructive testing while you check out the house?

Our new home lasted not-even two years. So many new homes will not live out the term of their mortgages.

After we had exhausted all other remedies, I began to protest my builder's new property. He had warned me that his attorneys would take care of me in arbitration. Since all the houses had sold in our neighborhood, it made more sense for me to protest at the new property. His new property of condos had 76 units. The same moisture control company was called in, by my builder, when that property began to leak ... This was the same man we had hired for our reports and testing. [When he drilled a hole in our home, water ran out.] Mr. Risdon, from moisture control, told me our builder's new property already had 49 units leaking and over $200,000 in damage. Only a handful had been sold. So, I decided to protest there. I felt so foolish and lost, finding out that standing on the corner holding up a sign was the only option left to me. Two weeks after I stepped onto the corner, we received the arbitration papers. The builder had filed on us in "Fast Track" to dispose of us much quicker than regular arbitration.

What good would it have done us, even if by some miracle, we won the entire $75,000 (the maximum allowed in fast track)? We would have been out the costs for arbitration AND any judgment {if we could ever collect} would still not cover even half of the repairs our house needed. Our house cost $360,000; the lot was $87 thousand, so we had a 273 thousand dollar home that needed over $150,000 worth of repairs. Where would we live while it was being repaired? We would have to pay for our things to be moved out, back in, and for storage.

There was nothing left to do but let the house go. We were never going to be able to sell it, and I would never want anyone else to be tricked into living in it. I told my husband, it made no sense to continue to throw more money into that **money pit**. Our money would be put to better use burned in the fireplace; at least it would put out some heat.

We could not afford a lawyer anymore. At that time, we were paying not only for our new house; but we were paying: moving costs, deposits for an apartment, and storage rooms for our things. We had to keep insurance and lights and water on in our new house even if we didn't live there, or the builders would say we were the cause of the damage. After some serious soul-searching, we realized our builder would never be able to be trusted (or have the competency) to fix our house, if it indeed was repairable. We also knew that he was not going to buy it back. He said he sold houses; he didn't buy them. So, we called the mortgage company and sent them the reports; and after never being late with a payment, we allowed our home to go into foreclosure. We felt ashamed. At the same time, we were also having to pay for engineers' reports, moisture reports, infrared water testing, mold testing, and air-quality index testing. All the while, our builder knew this testing was unnecessary. He knew exactly what was wrong with our house. Our house had a terribly defective roof, and flashings were installed improperly. This caused the water to be diverted into the walls and not off the roof. Yet, he said nothing.

All the burden of proof is on the homeowner. The builder lets you do all the work and pay for it. He just sits there smugly, knowing all the while that you will run out of money, give up, shut up, go away, or he will win in arbitration. They were going to prepare an eviction notice, and we told them that was not necessary. We posted, in the front window of our home, a statement that we had vacated, the date; and that our possessions had been removed. The mortgage company was accustomed to having to evict people who tried to stay in their homes while not paying, but we had already moved out. They waited to foreclose on us for 6 months because they saw all the paper work we sent them; and at the time, the builder had also signed with the Better Business Bureau that he would go to arbitration with them. So for a while, I was doing the paper work for both arbitration at the BBB as well as AAA. The Better Business Bureau finally threw out our builder when they discovered that they had been using shadow companies under one registration and denying that they had built the houses that complaints had been filed on for years.

While this was all going on... since Texas is one of the 31 "Right-to-Cure" states... you cannot file an arbitration proceeding or a court proceeding without first going through the Texas Residential Construction Commission (TRCC), which is mockingly referred to as tricky. I wrote them and filed my paperwork as instructed. I was informed that I had to send all the reports on my house and the complaint, by certified mail, to the builder. I went to the Post Office as directed and mailed the information. It was received by our builder, signed for, then placed unopened in an envelope and mailed back to me. They were proceeding with conference calls, and bills were pouring in from AAA. I asked how they could be allowed to circumvent state law. I asked for help from the TRCC. My file is over 3-inches thick trying to get them to help us. They called our builder in to investigate; but did not notify us. The builder's lawyer told the commission they had notified our lawyers, but we had failed to respond. The builder's word is golden; the homeowner has to prove everything.

At first, our own family did not understand. Friends would look at our pictures and say, "I bet you sued the hell out of those creeps." We could only say, "No, we can't sue them." Our friends would look at us as if we were demented and say, "Of course you can; you can sue anybody." Other people said, "Oh you should have used a licensed realtor." Well, we did. Or they would say, "You should have had your house inspected; I would just never have bought a house without an inspection"... And, we would tell them, we did. Some of our friends asked us why we didn't sue our realtor and our inspector. We politely told them, "Why should we? They did not build or knowingly sell us a defective property. We went to our insurance company. We paid $3400 a year to make sure we had coverage for everything. But, we didn't. We were not in good hands with Allstate. Substandard construction and builder defects are not covered by Homeowner's insurance. Our learning curve continued. How could this happen to us? We are good people. Now we have paid good money for an uninhabitable house, and we have no recourse.

Then we find out our Homebuyer's warranty does not cover habitability. While all this is going on, we are being tormented by the American Arbitration Association. We found out that the only way to get out of fast track was to file a counter claim. So, I decided to file a counter claim, to pay off the note on the house, our medical bills, the upgrades we had done, and the amount of appreciation our home should have had. Then I found out it would cost 6,000 dollars to file a counter claim, and the résumés they were sending me for arbitrators were between 300 and 475

dollars per hour. We would have to pay a case service fee of $2500, for room rent and expert testimony, and even pay for subpoenas to be served.

We finally got an arbitrator who said she would graciously give one day's arbitration. She was assigned. My builder's lawyer had never turned in anything, even though deadlines are given by AAA for everything... not an arbitrator's list, not a witness list, nothing. Yet, I was jumping through hoops answering every email, taking each threat from AAA, and the builder's lawyers seriously. I also knew when they called each other by their first names on the conference calls (Bill and Becky, and I was referred to as Ms. Fogal) that I was in deep trouble. After the pro bono arbitrator, Marcy Higbee, was assigned by AAA; and the deadline for any more discussion of arbitrators had passed, my builder's lawyer changed his mind. When he had me in fast track he said he could dispose of me in one day. But now, that we were out of fast track; and I had a pro bono arbitrator, he said that he would hold us hostage in arbitration for at least 5 days. He also wanted three arbitrators. We had already run through the retainer that we had for our first attorney, and had to let him go. We could see that the builder's attorneys had the game down pat. They would just write letters and do things that required your lawyers' time and eat up your retainer. As my builder said, they had much deeper pockets. So we were trapped. We could not pay all the money AAA was demanding, so we offered to make payments of 200.00 a month, until we paid it. AAA said they might accept that ... if we qualified for hardship. Then I had the indignity of turning over all our bills, W2's, tax information, everything but our firstborn child to qualify for hardship. Afterward, they would not tell us if we had been granted hardship or not. They just kept sending me blank credit card authorizations for us to fill out our credit card information, so they could just charge arbitration costs to us as they accrued. When questioned, they refused to give me an answer as to how much it would cost. They don't even know; they don't know how many hours an arbitrator will bill for pre and post study. If you stay in the room after a certain time, they charge more rent; it just keeps adding up. I would write; and they would say they had made a determination on our hardship, but they wouldn't tell me what it was. Over and over, they demanded money and sent bills by mail and email, and sent blank credit card authorizations like some kind of a demented collections agency. This went on for months. Finally, after much harangue, they said I had qualified for hardship. At last, we thought we had crossed one hurdle.

After all that... what their hardship plan got us was a payment of $750.00 before arbitration, and a balloon note for the **exact, entire amount** at the close of arbitration. Where were we supposed to get that kind of money, that fast? No one cared. We'd just better have it. When we saw in one of the arbitrator's disclosures that my builder had three other cases going on at that time (one he had managed to take from arbitration, **back** to the courts), we knew it was hopeless. These were big-time players. We wrote a letter and said we could not commit to choosing an arbitrator, that we could not pay. During a conference call with the builders' lawyer, William S. Chesney III, Esquire, and Ms. Becky Bays, I was threatened by Mr. Chesney. He said that, I would chose an arbitrator or **he** would go to the courts and have one appointed outside of AAA. He said he had done it many times before, and it most certainly would not be pro bono. I finally chose an arbitrator because I felt I had no choice, but wrote to AAA. I told them that I would not have the money to pay the arbitrator, as I had told them many times. Again, I got the credit card authorization form. All this time, every Saturday and Sunday, I stood on the corner in front of the builder's new property. I was harassed by the employees and taunted. They called the police

on me six times, but the police were always nice. Once when the builder tried to tow my car, I was so glad they had also called the police, because the police stopped them from towing my car from city property. I could not stop them; I was just one person. They were a big builder.

In the meantime, one of the Vice presidents of AAA, Mr. Richard Naimark was in Houston. I managed to go to a meeting with him with two members of HADD, Homeowners Against Defective Dwellings. I showed him all the correspondence, the pictures, and expert testing that had been done on my house. I told him AAA was being used by the builders as "an out" for unethical and despicable behavior. I also gave him other cases where the rulings were horrible injustices and asked him to read them on his way back to New York City. Two days later, I received a dismissal from arbitration. Neither Mr. Chesney nor I had paid the arbitrator, so he simply said, "Case dismissed due to failure to pay arbitration fees by both parties."

I was so happy. After nearly 8 months of torment, I thought that I had my rights back. Now I could go to court. But, it was not to be. We filed in court, charging the builder with fraud. His attorneys dragged us through 10 hearings before the judge ordered us to return to arbitration and said that we must file a counter claim {which is much more expensive than a regular claim}. The judge said no matter what his personal feelings, the legislature favored arbitration; and he could not rule from the bench.

Well, here we are again in arbitration. I wonder how many times they can force us to go there, against our will. One good thing has happened; I have met two wonderful young lawyers, the age of my sons; and they still believe if they keep on trying, they will eventually find justice. We have an agreement. We pay the expenses and they get 40% of whatever we get. This last year, arbitration cost us over $30,000 dollars. Three years have passed. We have not had a Christmas tree; we have not grilled out; we have no garage; we have not planted a flower; we have not had company. Our grandchildren have no place to stay with us; we live in a small third-story apartment. It was to be a temporary situation because, **surely justice would come soon**.

We have now completed our second stint in arbitration; it was again a nightmare. Our lawyers had 187 documents, pictures, a PowerPoint presentation, expert witnesses, and a witness who lived in my neighborhood before I bought my house. She had thought her house was the only defective one, and they were living in one room that wasn't flooded on the first floor. She, therefore, had gone to the other few houses that were still available, including my unit, to see if maybe the builder would just swap houses with her. She took pictures of my house before I ever saw it, with mold, the walls torn out, and the back of the house ripped off. She had pictures of the defects to my house, which were irrefutable proof of fraud.

The builders and their lawyers walked in, joking with one witness and holding a little white binder of thirty-seven pages.

As I said, we are once again free of arbitration process. We have our award. Why do they call it that? It is just a piece of paper that means nothing. Award - like a surprise or something wonderful. It is just a piece of paper. It says that our builder committed common fraud, but **we** are supposed to pay their attorneys' fees for trying to get into court because we knew they

committed fraud. It says we were in breach of contract by filing a lawsuit so we have to pay $14, 597.50 in attorney fees and $146.10 in expenses to the builder.

Arbitrator's Determination:

- Residential Construction Litigation Act (RCLA): Stature / Tremont's offers of repair were unreasonable and even admitted by the builder
- Fogals were not granted statutory fraud, only common fraud.
- Deceptive Trade Practices Act (DTPA): **Fogals' claim is denied**.
- Fogals' request for attorney's fees under the Texas Residential Construction and Liability Act (RCLA): **is denied** as there was a prior order in the first arbitration that stated expenses... would be incurred by each party.
- **Claim of alter-ego is denied** (even though proven by the Better Business Bureau) Stature Construction Company dba Tremont Homes.

Fogals are awarded $40,832.00; the net result is that Stature shall pay to the Fogals $26,088.40.

It is so ordered on this thirtieth day of October 2006, by the most Honorable Vickie L. Pinak.

This amount will not even cover the cost of arbitration; this amount will not cover the down payment on my house; this amount is an insult after this arbitrator admitted they committed fraud.

We also were billed (and had to pay) $1687.50 for post study after arbitration was over, before the arbitrator would issue her award. Arbitrators do not have to face you when they render their verdict. They don't have to look you in the eye. Our arbitrator had 30 days to issue her "award"; she took every one of them, while we waited. After all this time, we have this absurd "award". This was neither a gift nor was it a surprise. This is what happens everyday in this land of pay and play, called arbitration. In a way, I guess we should consider ourselves lucky; so many people come out of arbitration owing their builders. I will never understand that.

We should quit, get on with our lives, and salvage what we can. We should forget what was done to us. We should forget all the other people who have lived through this nightmare; but we cannot! When someone does this to you, it is as if they have robbed you, which they have; and shamed and ridiculed you, which they do. It is something you never forget, and you never get over. Most days you can't even believe it could happen in this county. You just want to wake up in your beautiful new home and have this all just to have been a terribly bad dream.

These builders have wounded the American public in a sinister way; they have destroyed the American Dream. These builders should have to wear a sign on their backs, like a Surgeon General's warning on a pack of cigarettes, saying **Buyer Beware**. We have been treated worse than dogs and forced to chase our tails in a circuitous route to nowhere.

Arbitration is the most disheartening, disgusting, and disillusioning thing we have ever been through; and we were forced to participate in this farce, not once but twice. Arbitration is like a metastasizing cancer, spreading throughout this county, infecting our lives and our families.

I have received two phone calls while I worked on this testimony - one from Mississippi and the other from Marietta, Ga. How can so many people be affected, and there is no central number they can **all** call? They call Homeowners Against Defective Dwellings (HADD) and HomeOwners for Better Building (HOBB). These two grassroots organizations, each with one woman at the helm, are overwhelmed by the numbers of people being preyed upon, reaching out to them in desperation; but these two courageous women still keep trying to do the impossible. Why can't our government just have a toll free number, with no red tape, no convoluted paperwork, just a place that people could call, and at least be counted? I once thought that there were hundreds of us, then hundreds of thousands, and now I am afraid there are more than I ever imagined.

I wanted to understand. I even went to the university here and met with a professor of ethics. I asked her how these people could live in their own skins. She said, "That is why you see them donating money to charities and worthy causes, to somehow justify their transgressions and make themselves appear to be pillars of the community and good people." – I call it simply trying to buy your way out of hell. These builders have nothing but contempt for the homeowners. This is a clear case of the haves and the have-nots; those who matter and those who do not.

Please don't tell us that houses would cost more money, if they were built correctly and did not have arbitration clauses. I actually heard a man from a homebuilder's association selling this theory that home prices would rise. He gave statistics that an unbelievable number of people who would be robbed of homeownership. – We are already being robbed. All I could think of, was a line from Shakespeare, "the devil can cite Scripture for his purpose."

Conversely, it is our contention that homes could cost much LESS:
A) We propose that the **time** builders spend in "Kangaroo Courts" could be better used supervising their projects.
B) The increase in the prices of homes could be nullified if the builders would not expend money on arbitration fees and their gang of high-priced lawyers.

These wealthy builders are into winning, at any cost.

Please don't tell us how arbitrations works so well, not tying up our court system. If things are allowed to continue status quo, soon we will have no need for a court system. In some way, we are all bound by arbitration already. Consumer confidence is already at an all-time low. Arbitration is a contract of adhesion. If you do not give up your rights, you are denied the services. You cannot buy a home, a car, have a credit card, bank account, or even a cell phone. All the big businesses have adopted this cursed clause. The arbitration companies have more power over us than the Supreme Court. How did it come to this? – Spins and incomplete information.

Huge awards, given by juries, have always made the headlines. Unfortunately, the amounts these people actually collect are never mentioned. There is no big headline, following up on the previous 'story'. It is just onto the next story. This is what I call drive-by journalism; it is not good investigative journalism.

Remember the McDonald's lady who spilled coffee on herself (you know that poor woman that everyone's heard about, and refers to as the prime example of frivolous lawsuits)? Do you recall her name? It was Stella Liebeck. This woman suffered third degree burns, was hospitalized for 8 days, had skin grafting and permanent scaring, and was disabled for more than two years. How frivolous does that really sound? No one reported that McDonald's sold their coffee at 180 to 190 degrees, and had caused over 700 burns since 1982. The jury awarded Ms. Liebeck $2.7 million, the amount of coffee sales for two days at McDonald's. Some of the arrogance and shocking testimony given at that trial was unbelievable.

The jury system has numerous safeguards to overturn any verdict, including this one, if it is excessive. In arbitration, there are no safeguards. This case was a boon to arbitration. What was wrong with having corporate responsibility? Big companies rarely pay awarded damages. Our builders are not worried for the same reasons. Their lawyers told me, if we to get a judgment, then they would have fun showing us the power of negotiations. These lawyers are arrogant, rude, hateful, and intimidating; and they <u>are paid to be</u>.

We have always voted and taught our children to take this privilege seriously. My husband has served on jury duty and even grand juries. Would you believe, after being denied our right to a trial by jury and being in the middle of arbitration, we both received jury summons. We are good enough to serve on the juries but not good enough to get a trial of our own.

The effects of arbitration clauses are proven to be a failed system. Consumer Reports reported in Jan 2004, 15% of the new homes built each year were defective. Two years later, they raised that percentage to 17% with two or more serious defects. Houses are constantly being built more poorly, because arbitration clauses make it so profitable.

"All truth passes through three phases: **First**, it is ridiculed. **Second**, it is violently opposed; and **third**, it is accepted as self-evident."
Arthur Schopenhauer

Those of us who have lived through arbitration feel as if we have become characters in some sort of a John Gresham novel except – unfortunately for us, this is not fiction.

"Representative government and Trial by Jury are the heart and lungs of liberty. Without them, we have no other fortification against being ridden like horses, fleeced like sheep, worked like cattle, and fed and clothed like swine."
John Adams

Mr. Adams must have had a premonition of the arbitration atrocity to come. As an American, I believe liberty, freedom, and patriotism still ring in our hearts, but no longer in our laws.

Ms. SÁNCHEZ. Thank you, Ms. Fogal.
Mr. Schwartz, please proceed with your testimony.

TESTIMONY OF DAVID S. SCHWARTZ, UNIVERSITY OF WISCONSIN LAW SCHOOL, MADISON, WI

Mr. SCHWARTZ. Chairman Sánchez and Members of the Committee, thank you so much for inviting me to testify today at this hearing.

I would like to emphasize four brief points. First, the most basic principle of fairness in any dispute resolution system is never let one part to a dispute make the rules. The second basic principle of fairness in any dispute resolution system is never let one party to a dispute choose the decision maker.

Mandatory arbitration violates both of these fundamental principles. It gives the company writing the contract—the bank, the credit card company, the employer—the sole and exclusive say about whether its disputes against consumers or employees will go to arbitration or go to court.

Second, a basic pre-dispute arbitration agreement—and that is what we are talking about here, agreements to arbitrate before the dispute has arisen—one that simply picks arbitration over a court is unfair enough for the reasons that you heard from the previous witnesses, Ms. Fogal and Mr. Bland. It deprives consumers of needed procedural rights like discovery, that is the right to get information from the other side and the right to appeal.

Many large businesses push the envelope by trying to deprive consumers not only of their access to courts, but also a crucial remedy that the law affords them: compensatory and punitive damages, attorneys fees, and particularly class actions. The class action remedy is vital to consumer protection.

I believe that the primary goal of many companies that use mandatory arbitration clauses is to gain immunity from class actions, which can become in effect immunity from liability for widespread, but small-dollar per capita, consumer frauds and wage and hour violations.

Third, the surest way to tell that arbitration is unfair to consumers is to look at the behavior of the people involved. Who endorses mandatory arbitration?: The banking industry, the Chamber of Commerce, large employers, and their lawyers. Do any bona fide consumer groups endorse mandatory arbitration? No.

Mandatory arbitration boosters argue that mandatory arbitration produces fair results indistinguishable from court, maybe even better than court, but that is false. There is not one reputable, impartial study showing that mandatory arbitration produces fair results for consumers.

There are a handful of studies commissioned by pro-mandatory arbitration partisans—the banking industry, large employers and the attorneys who represent them—that claim that arbitration produces fair results, but those studies I am afraid to say are junk social science. They are based on very small samples and very biased samples of cases to study. They are not valid research.

If arbitration is a good deal for both sides, if it really is faster, cheaper, but equally fair, then both sides would choose it after they have a dispute. The only reason for businesses to opt for manda-

tory pre-dispute arbitration is because they believe, with good reason, that they will get better results because they will reduce their overall liability. In effect, they view mandatory arbitration as do-it-yourself tort reform.

Fourth, the Federal Arbitration Act has been interpreted to displace State law. This is a seriously mistaken Supreme Court ruling that has thrown the lower courts across the country into wide confusion about how much State law is in fact preempted, essentially nullified by the Federal Arbitration Act.

Business defenders today are increasingly arguing in court that the Federal Arbitration Act nullifies various State consumer protection laws. Since most consumer protection law is still State law in the United States, this doctrine of Federal Arbitration Act preemption poses a serious threat of creating a consumer protection gap that could only be filled by new Federal regulations.

To conclude, the Federal Arbitration Act was not intended by Congress to apply to consumer or employment claims. It was not intended to preempt or nullify any State laws. We are in this mess because of a serious of legally incorrect and misguided court interpretations of the FAA. Unfortunately, the courts are not going to correct their own mistakes because they find that the caseload-reducing effect of arbitration, of mandatory arbitration, is an irresistible temptation.

It is time for Congress to step in and clean up this mess. Thank you.

[The prepared statement of Mr. Schwartz follows:]

PREPARED STATEMENT OF DAVID S. SCHWARTZ

Mandatory Arbitration: Do-it-yourself Court Reform Becomes Do-it-yourself Tort Reform

by
David S. Schwartz
Associate Professor of Law
University of Wisconsin Law School

In 1995, Justice Sandra Day O'Connor wrote: "over the past decade, the [Supreme] Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation."[1] Justice O'Connor was absolutely right. Starting in the mid-1980s, the Supreme Court dusted off the Federal Arbitration Act ("FAA")[2] – an obscure procedural statute that had been the subject of only half a dozen or so Supreme Court decisions in 60 years – and transformed it into something bearing little relation to the law considered and enacted by Congress in 1925. Concerned with the workload of the federal courts, the Supreme Court discovered that the FAA could be used as an extensive docket-clearing device to move large numbers of cases out of the court system and into a system of private dispute resolution. The cases cleared out of the court system under the judicially re-tooled FAA have been disproportionately the claims of consumers, employees and small-business owners.

The real winners under the modern system of FAA arbitration are large companies who decide to write arbitration clauses into their "take-it-or-leave-it" contracts. Also benefitting from the modern FAA are the arbitration-providers and individual arbitrators who find a huge increase

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[1]Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 283 (1995) (O'Connor, J., concurring).

[2]9 U.S.C. § 1, et seq. The statute is also known as the "United States Arbitration Act."

in demand for their services. What is, for the courts, a system of "do-it-yourself court reform" has increasingly become a system of "do-it-yourself tort reform" for regulated business entities seeking to avoid liability for wrongs done to consumers, employees and small-business franchise owners. It is time for Congress to act by amending the FAA to make pre-dispute arbitration agreements unenforceable in consumer, employee and franchise contracts.

The testimony that follows is concerned with so-called "mandatory arbitration," a specific subcategory of arbitration covered by the FAA. "Mandatory arbitration" means arbitration pursuant to a pre-dispute arbitration agreement, which is entered into before a dispute arises. Mandatory arbitration is troublesome in the situations of consumers, employees and franchisees – I'll refer to these groups collectively as "consumers," because their situations are essentially similar – because the contracts in question inevitably involve large disparities of bargaining power and transactional knowledge, placing the consumer at a great disadvantage. The consumer typically has no say in whether the arbitration agreement will be part of the contract, which is presented on a "take-it-or-leave-it" basis. And it is significant that the relationship giving rise to the contract is highly regulated – by consumer protection, employment and franchise laws – precisely because businesses in those contract situations have a demonstrated history of taking undue advantage of their superior bargaining position.

I. Legal Background: Current Court Interpretations Violate the Original Intent of Congress

The Federal Arbitration Act was enacted in 1925 as an alternative forum to resolve

disputes "between businessmen."[3] Historically, courts had treated arbitration agreements as unenforceable; the FAA was intended to eliminate this targeted unfavorable treatment and "make[s] arbitration agreements as enforceable as other contracts but not more so."[4]

Employment disputes were expressly excluded from the act. It was also believed that statutory, "public policy" claims were not subject to so-called "mandatory" arbitration – compelled arbitration pursuant to a pre-dispute agreement. Therefore consumer claims were not within the intended coverage of the act.

For the next 60 years after the FAA's enactment, courts consistently held that statutory causes of action reflecting "important public policies," could not be sent into compelled arbitration under the FAA.[5] Cases applying this "public policy exception" to FAA enforcement were animated by a constellation of concerns that arbitration was an inadequate forum for public policy claims. Significantly, all of the "public policy" claims involved causes of action under a private attorney general model, in which injured plaintiffs are viewed as a vehicle for

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[3]*See* 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, 73-81; Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N. C. L. Rev.931, 994 (1999). The history is described in detail at pp. 969-94.

[4]Prima Paint Corp. v. Flood & Conklin Mfg. Co. 88 U.S. 395, 404 n.12 (1967). With passage of the FAA, "an arbitration agreement is placed upon the same footing as other contracts, where it belongs." H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924)

[5]*See* Wilko v. Swan, 346 U.S. 427 (1953), *overruled by* Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989) (holding that a predispute agreement was ineffective to compel arbitration of claims under the 1933 Securities Act); American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968) (Sherman Antitrust Act not suitable for resolution in arbitration); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 655-56 (1985) (Stevens, J., dissenting) (citing cases from seven circuits following *American Safety*). *See also* Alexander v. Gardner Denver Co., 415 U.S. 36 (1974) (pre-dispute arbitration agreement did not prevent party from litigating claim under Title VII of the Civil Rights Act of 1964); Schwartz, *Enforcing Small Print*, supra, at 92-94 & n. 242.

enforcement of important regulatory policies and are encouraged by attorneys fee-shifting. And the regulations under these statutes are, for the most part, efforts at redressing market failures resulting from power imbalances and overreaching by the stronger party in a contract setting. The public policy cases viewed pre-dispute arbitration agreements as another example of the stronger, drafting party to an adhesion contract attempting to extract a pre-dispute waiver of a "substantial" right – here, the right to a judicial forum. In that sense, pre-dispute arbitration clauses in "adhesion" or "take-it-or-leave-it" contracts were no different from pre-dispute rights waivers generally, a sort of contract term long disfavored by the courts.

But in a series of decision between 1985 and 1991, the Supreme Court reversed course and dismantled the public policy exception.[6] Under current doctrine, any statutory claim is subject to compelled arbitration, absent an express rejection of pre-dispute arbitration by Congress. The Court also misconstrued the FAA to apply to employment cases. In sweeping language, the Court went well beyond the intent of Congress to make arbitration agreements "as enforceable as other contracts" by claiming that the FAA creates "a national policy favoring arbitration agreements."[7] While states may regulate other contracts under consumer protection and other state laws, the Supreme Court has (mistakenly) held that the FAA preempts many state laws, despite clear legislative history that the FAA was never intended to preempt any state

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[6]In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 655-56 (1985), the Court overruled the *American Safety* doctrine by holding that antitrust claims were arbitrable, and in subsequent decisions, the Court overruled *Wilko* as to securities claims. Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989); Shearson/American Express, Inc. v McMahon, 482 U.S. 220 (1987). *Gilmer v. Interstate Johnson Lane Corp.*, 500 U.S. 20 (1991) upheld mandatory arbitration of a federal age discrimination claim.

[7]Southland Corp. v. Keating, 465 U.S. 1, 10 (1984).

laws.[8] The Supreme Court has gone a long way toward suggesting that mandatory arbitration can be used as a form of immunity from state consumer protection laws. The Court has made arbitration agreements more enforceable than any other kind of contract.

Legal commentators and even dissenting Supreme Court justices have recognized that "the [Supreme] Court's interpretation of the Act has given it a scope far beyond the expectations of the Congress that enacted it."[9] What is the reason for Court's overly broad interpretations? Significantly, the judicial reinvention of the FAA coincided with the emergence of interest in "alternative dispute resolution" or ADR while at the same time the Chief Justices (Burger and later Rehnquist) began expressing alarm at the caseload of the federal judiciary. While no judicial opinions would admit this, the FAA offered the Supreme Court an opportunity to reduce its caseload through judicial fiat rather than awaiting Congressional action to heed the Chief Justice's call for more federal judges. Unfortuately, the price for this "do-it-yourself court reform" falls most heavily on consumers, employees and small businesses who lose their access to the courts.

II. How Arbitration Works Against Consumers, Employees and Small Businesses – and the Public

To understand how arbitration works against consumers, employees, small businesses, and the public, its important to distinguish between what I call "basic" and "remedy-stripping" arbitration agreements. "Basic" arbitration – a simple agreement to submit disputes to

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[8]Southland Corp. v. Keating, 465 U.S. 1, 10 (1984).

[9]Circuit City Stores v. Adams, 535 U.S. 105, 132 (Stevens, J., dissenting).

arbitration rather than court – is by nature unfair in most pre-dispute consumer and employment agreements. "Remedy-stripping" arbitration agreements are even worse, and represent an express attempt by regulated businesses to avoid or undermine consumer protection laws and force consumers to waive remedies. Under the current legal interpretations of the FAA, consumers are faced with the problems of both basic and remedy-stripping agreements.

A. Basic arbitration agreements: putting consumers at a disadvantage

Arbitration can be a fast and efficient alternative to litigation. The advantage of traditional arbitration is that there are very few, if any, legally required rules and procedures, and the parties can make up their own. Where parties have relatively equal bargaining power in a pre-dispute contracting situation, or where a dispute has already arisen and both sides are represented by counsel, the parties can use arbitration as a tailor-made dispute resolution process to meet their needs. And because the procedural rules arise out of bargaining, they are likely to be fair to both sides.[10]

Problems with arbitration agreements arise in pre-dispute consumer situations: that is, contract situations where the contract is written by the business and presented on a "take-it-or-leave-it," non-negotiable basis to the consumer, employee or small-business franchisee. The business in these situations has a great disparity in bargaining power and transactional knowledge on its side, which is exactly why these transactions are regulated by consumer and employee protection laws. And under normal contracting behavior, the party with the stronger bargaining position will press for advantageous terms.

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[10]Arbitration under collective bargaining agreements falls into this category and is therefore sufficiently fair to be unobjectionable.

If arbitration is better for both parties – faster and cheaper – then why wouldn't parties agree to it after a dispute has arisen? The reason that business entities write arbitration clauses into their contracts is because they believe it places them at an advantage relative to litigation in their disputes with customers and employees. The two fundamental sources of advantage for employers are discovery limitations and market/repeat player effects. Additional procedural attributes of arbitration can discourage consumer claims, again, to the benefit of the would-be business defendant.

1. Discovery Restrictions

In the great majority of consumer and employment cases, the consumer or employee is the claimant and the law places the burden of proof on him or her. A claimant's failure to produce critical proof in the possession of the defendant can lead to a failure to meet the burden of proof, thereby resulting in the loss of the claim. At the same time, in most such cases, the defendant business entity possesses some or most of the information needed to prove the case. In litigation, this is not a huge problem for the consumer or employee plaintiff, because liberal discovery rules mandate full disclosure of relevant information by all parties and enable plaintiffs to conduct an adequate investigation of the witnesses and documents controlled by the corporate defendant.

But in traditional arbitration, there is no rule requiring pre-hearing disclosure of evidence and little if any ability of consumers to investigate their cases. Reform efforts by arbitration providers have changed this situation somewhat. Consumer arbitrations conducted by the American Arbitration Association, for instance, give the arbitrator discretion to order pre-hearing

discovery or disclosure that the arbitrator deems necessary.[11] But what is "necessary" disclosure is left entirely up to the discretion of the arbitrator, and there are no rules to protect the consumer if the arbitrator takes an unduly restrictive view of necessary disclosure.

Moreover, since one of the longstanding selling points of arbitration is that it cuts down on pre-trial litigation costs, which are primarily the costs of conducting discovery and investigation. This cultural norm of arbitration will tend to make arbitrators reluctant to give consumers leeway to conduct discovery of the defendant's information that is comparable to what would be available in a court case.

In sum, arbitration's limitations on discovery place consumers and employees – the parties with less information but a higher burden of proof – at a significant disadvantage.

2. Market and repeat player effects

Because arbitration is provided in the private marketplace, arbitrators and arbitration providers have a strong incentive to please their customers. The corporate defendant, as the drafter of the non-negotiable contract, has the sole right to decide whether to impose predispute arbitration or not; therefore, the corporate defendant is the "customers" of arbitration in this sense. In contrast, if consumer arbitrations were subject only to fully voluntary agreements made after the dispute arises, the market incentives for arbitrators and providers would be more even handed: arbitration would have to be an attractive choice to both parties.

This market effect is borne out by empirical research documenting a "repeat player

[11] "The arbitrator shall have the authority to order such discovery, by way of deposition, interrogatory, document production, or otherwise, as the arbitrator considers necessary to a full and fair exploration of the issues in dispute, consistent with the expedited nature of arbitration." American Arbitration Association, Employment Arbitration Rules § 9, available at www.adr.org.

effect" in the employment arbitration context, in which employers who have repeat arbitration cases win markedly better results than employees and small employers who do not regularly appear in arbitration.[12] Reliable empirical analysis comparing arbitration and litigation results remains sparse and hard to come by. Until recently, arbitration awards were not made public by arbitration providers, and difficulties in determining the "true value" of a plaintiff's claim to compare to the result in arbitration or litigation, plus difficulties in tracking results of cases that settle before judgment or arbitration award, make results analysis exceedingly complex.

It may be that the best empirical evidence we now have, and will ever have, about the fairness of arbitration is the behavior of the defendants who draft the clauses. It is fair to assume that large companies who adopt arbitration regimes and stick with them over a period of years are rational actors who have information about their costs. Sticking with arbitration is rational only if it saves money.

How is this money savings attained? Arbitration proponents claim that savings results because arbitration is procedurally faster and cheaper – the savings are all in procedural costs, that is to say, attorneys fees. But arbitration proponents will also tell you that arbitration's speed and procedural informality "helps the little guy," by making it easier for consumers and employees to bring claims. If this were true – if the costs of litigation were a deterrent to consumers and employees – then we would expect to see more consumer and employee claims brought against companies that used arbitration clauses. This would mean that the procedural cost savings to companies from choosing arbitration over litigation would be largely offset by

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[12]*See* Steven E. Abraham and Paula B. Voos, The Ramifications of the Gilmer Decision for Firm Profitability, 4 Employee Rights & Employment Policy Journal 341 (2000); Lisa B. Bingham, *Employment Arbitration: the Repeat Player Effect*, 1 Employee Rights & Employment Policy Journal 189 (1997); Schwartz, *Enforcing Small Print, supra*,1997 Wis. L. Rev. at 64-66.

paying out more claims – unless the payouts themselves were lower in arbitration than in litigation. In short, it would likely be irrational for companies to choose arbitration over litigation unless the liability awards were systematically lower than in litigation, to offset the larger number of claims. And that is indeed how arbitration is frequently marketed to businesses.[13]

3. Other procedural attributes

The notion that arbitration is faster and cheaper for consumers and employees is a myth in many cases. Compared to court filing fees of around $150, administrative filing fees in arbitration can be ten times that amount. And while judges are not paid by the hour by litigants, arbitrators are, commanding hourly rates comparable to those of well-paid attorneys and legal consultants. To be sure, litigants in court incur attorneys fees and costs, but in the majority of consumer and employment claims these are borne by the attorneys on a contingency fee ("no win/ no pay") contract, payable only out of a settlement or judgment; or, where pro-bono attorneys are representing the consumer, are not charged to the client. Thus, arbitration costs can be a significant deterrent compared to litigation in court, and in its only decision on the matter, the Supreme Court made it more difficult for consumers to prove that arbitration costs have a deterrent effect on their claims.[14]

A hallmark of arbitration is the exceedingly limited right to appeal the arbitrator's award.

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[13]Schwartz, *Enforcing Small Print, supra,* 1997 Wis. L. Rev. at 63-64.

[14]In *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000), the Supreme Court held that a consumer had to submit evidence the he himself was deterred from filing an arbitration due to excessive costs in his particular case. This creates a near impossible catch-22, since the consumer cannot prove that point without having a case and a lawyer representing him. Those who were deterred from filing claims will never be heard from in court.

Other than pretrial discovery, the other major contributor to the time and cost of litigation is the appeals process, and arbitration virtually cuts that out. In general, arbitration awards cannot be overturned for errors in applying substantive law, now matter how egregious.[15] The bases for appeal are limited to demonstrable bias on the part of the arbitrator and a handful other other narrow grounds.[16] By sacrificing the safety valve of an appeals process in order to gain speed and efficiency, arbitration places virtually unreviewable power in the hands of a private arbitrator. This can be a powerful deterrent to a risk averse consumer, who may fear the ruinous effect of a 4- or 5- figure arbitrator award against her in the event she loses her claim and the arbitrator awards fees and costs to the defendant – with no effective right to appeal that decision.

Finally, traditional arbitration makes no requirement that arbitrators provide written statements of reasons for their decisions. This requirement, which applies to judges in court cases, has beneficial effects for both the litigants and the public. It promotes fairness by forcing the judge to make a good faith effort to fairly confront and consider all the evidence and arguments presented. And it benefits the public by creating precedents that develop the law. These benefits are lost to cases sent into arbitration.

B. Remedy-stripping arbitration agreements

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[15]Schwartz, *Enforcing Small Print, supra,* 1997 Wis. L. Rev. at notes 50-51. It is well-established that arbitration awards are not subject to judicial review for mere errors of law. They may be vacated for "manifest disregard" of the law, but only if it is clear from the face of the record that the arbitrator "recognized the applicable law - and then ignored it." Advest, Inc. v. McCarthy, 914 F.2d 6, 9 (1st Cir. 1990). Thus, if the arbitrator declines to make a written statement of reasons, even this narrow ground of appeal vanishes. An award will be upheld against a "manifest disregard" challenge if the arbitrator "even arguably" applied the applicable law. *See, e.g., id.,* at 9.

[16]FAA, 9 U.S.C. § 9.

1. In general

A classic example of an unfair consumer contract is one that forces the consumer to waive remedies as a condition of doing business. Contract clauses that to try to force consumers to waive their rights to compensatory and punitive damages, attorneys fees, class actions and other remedies to which they would be entitled by statute have long been held unenforceable under state consumer protection laws. So have contract terms that try to make it more difficult for consumers to bring claims: requirements that claims be filed in a distant and inconvenient location, or that drastically shorten the time in which a claim may be filed, are common examples. Contract terms that try to limit liability for one's own wrongful acts have traditionally been held "void as against public policy," and many consumer protection laws expressly state that contractual remedies waivers are prohibited and unenforceable.

Yet the magic of the "national policy favoring arbitration" threatens to change all that. With the courts' broad encouragement of arbitration clauses in general, many companies have aggressively experimented with arbitration clauses that add additional terms to the basic arbitration agreement to extract waivers of other remedies. While these "remedy stripping" terms would be plainly unenforceable under normal circumstances, many courts have enforced such terms when they are packaged in arbitration agreements.

2. Class Actions

Class actions are a vital remedy for consumer and employment claims. It is well known that "the policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action

prosecuting his or her rights."[17] A systematic consumer fraud by a credit card company overbilling twenty thousand customers by $50 each might not result in even one lawsuit, since the amount is too small to justify the time and expense of filing a claim; the class action is essential to remedy and deter such abuse. Many consumer claims, as well as employee wage and hour violations, fall into this category.

Businesses have had some success in using arbitration clauses to rid themselves of class actions. They have argued that an arbitration agreement necessarily implies individual, not classwide, dispute resolution; and some business have written express class action prohibitions into their arbitration agreements. There is no doubt that many businesses find arbitration agreements attractive precisely because they creates the possibility of immunity from class action suits. Alan S. Kaplinsky, a leading mandatory arbitration spokesman and attorney representing financial services institutions, has claimed that "Arbitration is a powerful deterrent to class-action lawsuits against lenders ... . Stripped of the threat of a class action, plaintiffs' lawyers have much less incentive to sue."[18] Kaplinsky asserts that

> the "class action waiver" has matured into a commonplace feature of consumer arbitration agreements. Such waivers typically provide that neither party will have the right in court or in an arbitration proceeding to participate in a class action, either as a class representative or class member, act as a private attorney general or join or consolidate claims with claims of any other person. ***Once rare, class action waivers are today included in millions of credit card and other financial services agreements nationwide.*** They have been upheld by the vast majority of

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[17]Amchem Prods. v. Windsor, 521 U.S. 591, 617 (1997) (internal quotations omitted); see Jean R. Sternlight, As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?, 42 Wm. & Mary L. Rev. 1, 28-33 (2000).

[18]Paul Wenske, Some Cardholders are Signing Away Their Right to Sue, Kan. City Star, April, 3, 2000, available at http://www.kcstar.com/projects/carddebt/2side.htm (last accessed Oct. 27, 2003).

federal courts and most (but not all) state courts.[19]

Not all courts have enforced class action bans, and the Supreme Court has not yet ruled on the issue.[20] However, it is fair to say that this possibility of using arbitration clauses to gain immunity from class actions represents the greatest threat posed by the FAA to the viability of consumer protection law.

III. FAA Preemption: A Violation of Federalism and a Threat to Consumer Protection

A. The problem of FAA preemption

Most consumer protection law is state law. State contract principles such as "unconscionability" together with state consumer protection statutes, provide the bulk of protections for consumers against overreaching by businesses.[21] The FAA, properly interpreted, should have no impact on those laws, because section 2 of the FAA recognizes that arbitration agreements may be held unenforceable "on such grounds as exist at law or in equity for the revocation of any contract,"[22] language that should include state consumer protection regulations. However, the FAA has been held by the Supreme Court to preempt at least some state law, and the decisions in this area have been sufficiently unclear to create widespread

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[19]Alan S. Kaplinsky, *Consumer Financial Services Law: Is Jams in a Jam over its Policy Regarding Class Action Waivers in Consumer Arbitration Agreements?*, The Business Lawyer, vol. 61, p. 923 (2006) (emphasis added).

[20]*See, e.g.*, Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003) (holding class action ban was unenforceable). The Supreme Court considered, but declined to decide the issue, in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003). Three justices argued that the arbitration agreement should have prohibited class actions.

[21]*See, e.g.*, Wisconsin Consumer Act Wisconsin Consumer Act, Wis. Stat. §§ 421.101 et seq.; California Business & Professions Code § 17200 (prohibiting unfair trade practices).

[22]FAA, 9 U.S.C. § 2.

confusion in the lower courts as to just how much state law is nullified by the FAA. Some corporate defendants have argued that an arbitration agreement can effectively immunize them from all state consumer protection laws.

In *Southland Corp v. Keating*,[23] Supreme Court held that the FAA preempted a state law that would have denied enforcement to an arbitration agreement in a 7-Eleven franchise contract. "In enacting § 2 of the [Federal Arbitration] Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."[24]

Southland was a poorly reasoned decision reaching the wrong result. As is well documented both in dissenting opinions and legal scholarship, Congress intended the FAA as a procedural rule to apply only in federal courts, not as substantive law binding on the states.[25] In reaching the decision, the Court ignored its own precedents and principles regarding federalism and the proper interpretation of statutes. The Supreme Court, in other cases, has long applied a "presumption against preemption," according to which an act of Congress will not be construed to preempt state law absent clear expression of congressional intent to displace state regulation.[26] Moreover, arbitration agreements are an aspect of contract law, and contracts are an area of

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[23]465 U.S. 1 (1984).

[24]465 U.S. at 10.

[25]*Southland*, 465 U.S. at 22-31 (O'Connor, J., dissenting); *Allied-Bruce*, 513 U.S. at 285-95 (Thomas, J., dissenting); *see* David S. Schwartz, *The Federal Arbitration Act and the Power of Congress over State Courts*, 83 Ore. L. Rev. 541 (2004); *id.* at 542 n. 7 (citing commentary criticizing *Southland*).

[26]"[W]here ... the field which congress is said to have preempted includes areas that have been traditionally occupied by the States, congressional intent to supersede state laws must be clear and manifest." English v. General Electric Co., 496 U.S. 72, 78-79 (1990).

traditional state regulation, which federal courts should be "reluctant to federalize."[27] *Southland* ignored these and other legal principles to reach a result aimed at expanding the scope of the FAA and the number of cases that could be subject to mandatory arbitration.

B. The uncertain scope of FAA preemption

How much state law is preempted by the FAA? Clearly, the FAA, as construed by *Southland* and later cases, preempts state laws that expressly "single out" arbitration clauses as subjects of restrictive or "hostile" regulation.[28] But whether FAA preemption extends further remains a subject of argument. The Supreme Court has made few efforts to clarify matters, and those few have been unhelpful: for example, the Court stated that "a state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue" is preempted.[29]

The Supreme Court's confusing pronouncements on FAA preemption have given rise to sweeping arguments by corporate defendants suggesting that state consumer protection laws are voided by the FAA. The Supreme Court doctrine has filtered down to us with the ambiguous phrases that what the FAA saves from preemption is regulation of "contracts generally" or

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[27]Patterson v. McLean Credit Union, 491 U.S. 164, 183 (1989),.

[28]See, e.g., Doctor's Assocs., Inc. v. Casarotto, 517 U.S.681, 687 (1996) (stating that the FAA "precludes States from singling out arbitration provisions for suspect status"); Ting v. AT&T, 319 F.3d 1126, 1152 (9th Cir. 2003) (stating that the FAA preempts laws that are "hostile" to arbitration)

[29] *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987); *see also* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995), which tells us:

> States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. 2 (emphasis added). What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause.

"general contract law."[30] This has given rise to the argument that targeted contract laws, even though they do not specifically regulate arbitration clauses, are preempted as applied to arbitration clauses. Corporate defendants have also begun to argue that the FAA creates a substantive federal right to have one's arbitration agreement "enforced as written," notwithstanding any state law which may vary the effect or meaning of specified terms.[31]

These preemption arguments threaten to turn arbitration agreements into blanket exemptions from consumer protection and other statutes aimed at preventing contractual overreaching. A corporate drafter could write an arbitration agreement to mandate a waiver of injunctive relief, compensatory damages, or attorney fees guaranteed by a state consumer or antidiscrimination statute. As a defendant in litigation, that drafting party now has two arguments to defend the provision. First, the federal "enforce as written rule" arguably preempts any state law that would vary the written terms of an arbitration agreement. Second, because the regulatory statutes involve subcategories of contracts -- only consumer contracts -- they are not "general contract law" and are preempted by the FAA.[32]

Southland makes the FAA into one of the more extensive regimes of federal preemption,

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[30]*See, e.g.*, Perry v. Thomas, 482 U.S. 483, 492 n. 9 (1987) ("States may regulate contracts, including arbitration clauses, under general contract law principles").

[31]For a more detailed discussion and critique of the source of this argument, *see* Schwartz, *Power of Congress*, supra, at 563-68.

[32]See, for example, *Bradley v. Harris Research*, 275 F.3d 884 (9th Cir. 2001) (in which the court held that the California law barring unfair venue provisions in franchise agreements was preempted by the FAA because the franchise statue was not "general" contract law.

preempting dozens of state substantive and procedural laws.[33] This is problematic, not merely because of abstract federalism concerns, but very practical ones. By making the interpretation of every arbitration agreement at least arguably a question of federal law, the *Southland* doctrine of FAA preemption creates great confusion in the lower courts about when state law applies, multiplying the number of issues, and creating uncertainty about the vitality of state contract regulation. Worse, if state consumer protection laws are preempted on a large scale by judicial interpretation, then consumers will either be left without protection or else will have to rely on increased federal oversight for consumer regulation.

IV. The Unfairness of the FAA as "Do-it-yourself Court Reform" and the need for Cougressional Action

A. Mandatory arbitration violates the fundamental principles of equal access to the federal courts

A fundamental feature of a fair justice system is that both sides to a dispute have equal access to that system. Since the beginning of the republic, Congress has embraced the fundamental principle that both the plaintiff and the defendant in a civil case have equal access to federal court. Where federal and state courts have concurrent jurisdiction, which is the rule for most civil actions in which federal district courts have original jurisdiction, the plaintiff has the option to file the case in federal court. If the plaintiff chooses to file in state court, that choice is not binding on the defendant: federal law has always given the defendant the right to "remove"

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[33]Between January 2002 and April 2004, almost fifty state laws were held preempted. David S. Schwartz, *State Judges as Guardians of Federalism: Resisting the Federal Arbitration Act's Encroachment on State Law*, 16 Wash. U. J.L. & Pol'y 129, 154-59, app. A (2004)

the case to federal court.[34] Thus, removal jurisdiction ensures that both the plaintiff and defendant have the right of access to federal court.

The FAA – as applied to consumer, employee and franchisee cases – violates this fundamental principle by giving the defendant the sole right to determine whether a case will be heard in federal court. Large businesses that sell to consumers, employ a workforce, or franchise their brands to small business owners invariably do business through non-negotiable "adhesion" contracts, as stated above. The seller/employer/franchisor has the exclusive right to decide whether to include a pre-dispute arbitration clause among its "take-it-or-leave-it" contract terms. Because the FAA calls for rigorous enforcement of such pre-dispute arbitration agreements, the seller thereby gains the exclusive right to determine whether future disputes against it can be heard in court or not. This violates the fundamental principle of an equal right of access to federal court.

B. Can arbitration proceedings be made more fair?

Mandatory arbitration proponents argue that the problems raised above can all be solved by making arbitration more fair. They point to changes in arbitration procedural rules undertaken by arbitration providers like the American Arbitration Association that have already occurred, and argue that further procedural reforms could be made. The checklist of potential improvements includes: liberalized discovery rules providing more pre-hearing disclosure of

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[34] *See* 28 U.S.C. § 1441(a), which provides: "any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending." The First Congress provided for removal in the Judiciary Act of 1789, ch. 20, § 12, 1 Stat. 73, 79 (codified as amended in scattered sections of 28 U.S.C.); *see generally* 14B CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE §, § 3721, at 288-89.

information, including depositions, document production demands, and other discovery tools used in litigation; a requirement of written statements of reasons for arbitrator's awards, and publication of awards; a requirement that corporate defendants pay the forum and arbitrator fees; increased rights to appeal arbitrators' decisions, including appeals for erroneous legal rulings; rules prohibiting "remedy-stripping" arbitration agreements; and more stringent regulations of arbitrators to ensure their neutrality and ethics.

Such proposals should be scrutinized with care. What is striking about them is that they all make mandatory arbitration more and more like going to court. They trade off the speed, efficiency and simplicity of classic arbitration to make it more expensive, time-consuming and rule-bound. In theory, these procedural improvements will promote fairness. But in practice, they may well serve primarily to make arbitration much less attractive to the businesses that now write arbitration agreements into their contracts, since those businesses are less concerned about fairness than about cost-containment. A better solution may be, not to make arbitration more like court, but rather to take the consumer, employment and franchise cases that would benefit from court-like procedures out of the mandatory arbitration system.

C. Is this any way to reform a court system?

The fixes proposed by arbitration supporters to the unfairness of mandatory arbitration all require increased regulation that makes it abundantly clear that mandatory is not a voluntary alternative to litigation, but rather an alternative court system: a system of public justice outsourced to private providers. What sort of way is this to bring about judicial reform?

The FAA's mandatory arbitration regime violates a fundamental principle of democratic government. As reinterpreted by the modern Supreme Court, the FAA diverts entire categories of

cases – consumer, employment and franchise cases – into a separate and private justice system with a different set of rules from those in the public court system. This represents a major reform of the court system. But reform of judicial procedure and the court system is a core function of the legislative branch. While the legislative process is not always perfect, it is nevertheless fundamental that Congress will hear from all interested parties before undertaking major judicial reform. That process has been entirely short-circuited in the case of the modern FAA. No consumer, employee or franchise interests were heard from in the hearings leading up to the enactment of the FAA because it was not contemplated that the statute would affect such groups. Instead, 60 years after enactment, the Supreme Court changed the coverage of the statute to include consumer, employment and franchise claims, thereby giving one set of interests – the corporate defendants in such disputes – the sole and exclusive right to determine whether to avail themselves of arbitration. The interests of consumers, employees and franchisees have thus been left out of this court reform process.

D. The Need for Congressional Action

It has become crystal clear that the courts cannot or will not correct their errors in interpreting the FAA; only Congress can do that now. Mandatory arbitration gets many cases out of the court system, and is therefore too attractive to judges for them to give it up voluntarily. The Supreme Court has reaffirmed its erroneous decisions too many times, and *stare decisis* – the rule that the Court will normally adhere to its precedents, particularly in statutory interpretation cases – is an important factor. Nor does the current Court majority see that an error has been made. The Supreme Court has repeatedly cited the lack of congressional action to

limit the reach of the FAA as a justification for declining to reconsider its position.[35] Justice O'Connor expressly observed, "It remains now for Congress to correct" the Supreme Court's interpretation of the FAA.[36]

The proper course is to amend the FAA to overrule the Supreme Court by removing consumer, employee and franchise contracts from the coverage of the statute and by providing that pre-dispute arbitration agreements in such contracts will not be enforced.

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[35]*See, e.g.*, Circuit City Stores v. Adams, 535 U.S. 105, 122 (2001) ("Congress has not moved to overturn" *Southland* decision); Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 272 (1995)

[36]Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 284 (1995) (O'Connor, J., concurring).

Ms. SÁNCHEZ. Thank you, Mr. Schwartz, for your testimony.

We will now begin a series of question rounds. I would like to recognize myself for 5 minutes for questions. I would like to start with Ms. Fogal.

In your testimony, which is very compelling, I must say, for this hearing, you describe your experience in having gone through the arbitration process, and you indicate that you feel like you are representing other consumers who may have been in a similar situation.

I am wondering, how many other people have you spoken with who had a similar experience with arbitration or a better or worse experience with arbitration?

Ms. FOGAL. There are two consumer groups that track this information: HOBB, which is Homeowners for Better Building, and HADD, which is Homeowners Against Defective Dwellings. They did statistics every week and get phone calls. I talked to these people. I talked to people who would call me and ask me, what can we do? And all I can tell them is, I don't know.

Ms. SÁNCHEZ. I don't mean to interrupt you.

Ms. FOGAL. That is okay.

Ms. SÁNCHEZ. Do you find that people's experience with arbitration has been about as bad as yours has been, or better, or worse?

Ms. FOGAL. What I found is that they are usually horrible, if they can talk about them, but when you come out of arbitration, a lot of people are under secrecy agreements. Like, I can go to their houses and see that their houses are still in horrible condition, but they can't talk to me.

Ms. SÁNCHEZ. Okay. One of the many arguments that have been used to advance arbitration is that it is less costly than litigating in a traditional court system. Have you personally found arbitration to be less costly than what you would expect to pay if you took your claim to court?

Ms. FOGAL. What I really hate is when they say "arbitration costs," because first you have arbitration costs paid to the arbitration company itself, and then you have costs of arbitration, which is like being on a trial. So you have the same trial costs of getting witnesses, testimony. You even have to pay to send out your own subpoenas for $50. You have all the costs of a trial and you better put on a good one, or it really didn't matter. You have all the same costs. Sometimes it is worse.

Ms. SÁNCHEZ. Okay.

Mr. Schwartz, how did mandatory binding arbitration between equal commercial entities expand into the consumer business realm where the parties generally are not on equal footing?

Mr. SCHWARTZ. Well, basically for 60 years, from 1925 until the mid-1980's, the courts uniformly correctly interpreted the Federal Arbitration Act to apply only, as you said in your opening statement, in business-to-business kinds of disputes. And then suddenly in the 1980's, the Supreme Court essentially surprised everybody with a series of decisions saying, oh, we have this new view of arbitration. It is much better than we previously realized.

They don't come out and say this in their court opinions, but that happened to correspond with the views of the chief justice then, Warren Burger, and subsequently the views of Chief Justice

Rehnquist, that there are too many cases in Federal courts and too few judges. Whether that is true or not, it doesn't seem that the way to reform the Federal caseload is to place the cost of it onto consumers and employees who have no say in whether they are going to arbitrate or not.

Ms. SÁNCHEZ. Thank you. I have several questions for you. Are mandatory binding arbitration agreements really mandatory, because we have heard the argument that if a consumer is unhappy with an arbitration agreement, they can simply refuse the agreement and take their business to a competitor. What is your response to that?

Mr. SCHWARTZ. There are two problems with that argument. The first is that for a lot of businesses, there are no competitors who give you a choice. Every cell phone company and every credit card company today—and those are perfect examples—has an arbitration agreement. So you cannot get a credit card or a cell phone without agreeing to that. It is becoming more and more true in the healthcare situation.

Second of all, with a lot of situations, do people really have the freedom to go do something else? If somebody has looked for several months to find a job and they desperately need a job, and that employment agreements says, okay, here is a mandatory arbitration agreement if you want to come to work for us. Is a person going to refuse the job because of some possibility that they might down the road have a dispute with that person?

Ms. SÁNCHEZ. Along that same vein, I was thinking of examples in my life where I have seen actual arbitration agreements that you have to sign. I am a sophisticated consumer here. I am an attorney and I am a Member of Congress, but I can remember, and probably never even realized that my credit card and cell phone had mandatory arbitration agreements.

But I do remember one time I broke a tooth and went to the dentist. And before I got service from the dentist, I was asked to sign a binding arbitration agreement. It seemed to me that I was in so much pain that had I even really thought about it, because I will quite honestly tell you I was in so much pain that I signed it. I would have signed anything in order to get the services that I needed in order to not feel that pain.

So I understand perfectly what you are saying and I appreciate your testimony.

My time has expired, so at this time I would like to allow the Ranking Member, Mr. Cannon, 5 minutes for questions.

Mr. CANNON. Thank you, Madam Chair.

Ms. Fogal, I empathize with what you are saying. I decided after my last building experience that I would never, ever build anything again in the future because builders are very difficult. They control the facts of their world, and quality is iffy.

I am wondering, as I listened to you, if there isn't some other kind of way to deal with the problem. You had a very intense experience with a very big issue, a house, as opposed to, say, for instance, cell phones. Cell phones have arbitration clauses, but they tend to be small amounts of money. And cell phone companies tend to compete.

On the other hand, in the same vein, if cell phones have arbitrary elements to their contracts, people would tend to move away from one company with their cell phone and go to a company that is better. So I am wondering if there isn't a way that we could have a kind of quality assurance like you have on eBay so that people can understand who the good builders are and who aren't.

In other words, you had a terrible problem with a builder who was a jerk, apparently. I don't know this guy so I am not maligning him.

Ms. FOGAL. He was.

Mr. CANNON. And you don't necessarily need to go there. The short of it is he was in business and you weren't.

Ms. FOGAL. Right.

Mr. CANNON. And you ended up with a house and all the burdens of a house and a mortgage, and he just had the relatively minor costs of opposing you. That is a very different environment, it occurs to me. But I don't know if you built or if you just bought from a builder, but wouldn't you have liked to have known something about his quality and all the other houses he built and all the other people who have lived in the houses that he built?

Ms. FOGAL. Yes. That is why you go to the Better Business Bureau and he had a perfectly legitimate rating with the Better Business Bureau. Because he had operated under so many different names, when they would complain under one name, he would just change it.

So after we went there, and he was the fourth-largest builder in Houston, and I did see other houses he had built. So I felt like, oh, very nice. But I also, after all this started happening, found out that he could build $1.3 million with $300,000 worth of foundation damage, or $120,000 that was uninhabitable. So you know, he was kind of an equal-opportunity crook.

Mr. CANNON. Would your problem be somewhat lessened if there was a world in which you could identify your builder, having been able to identify your builder, and found out that other people had rated him and he was poorly rated.

Ms. FOGAL. Yes, that might have helped, but I also thought that anybody that was going to build a house, why would they need an arbitration agreement? Why wouldn't they build a house that they believed in enough that they didn't have to have me sign that? In Texas, you can't buy a new house without an arbitration agreement. It is a contract of adhesion. You either buy it or you don't get one.

Mr. CANNON. The nice thing is you can rent, but that is a different issue, I suppose. There are alternatives.

Ms. FOGAL. Well, there goes your homeownership.

Mr. CANNON. It is not really adhesion because you have lot of options in life.

Mr. Schwartz, would you address the point of the difference between a cell phone company that has an arbitration clause in a highly competitive environment, and, say, the problem that Ms. Fogal had?

Mr. SCHWARTZ. Yes, they are both bad for different reasons. With the cell phone company, their goal is to avoid class actions because they figure that most of the disputes they are going to have are

going to be for small dollar amounts. They could rip off 50,000 customers for $50 each and no one is going to sue them individually because it is too costly to bring an individual case. What you need is a class action.

So I think the goal of the cell phone company——

Mr. CANNON. The key probably is a better cell phone provider. In other words, I see the distinction of where you are headed, but the market needs to be a little robust.

In fact, Mr. Bland, you have dealt with class actions. How many class action settlements are you aware of where individual plaintiffs recover even 20 percent of the economic damages they were seeking?

Mr. BLAND. Actually, there is a study that was done a few years ago by the head of a periodical called Class Action Report. He was sort of a green eyeshade guy and he collected every class action settlement anywhere in the country that he could find. He found that across the board, collectively in the aggregate for consumer class actions that about 80 percent of the economic value went to the consumers.

Now, there are some really bad abusive settlements. I personally have objected to bad settlements where most of the money goes toward——

Mr. CANNON. This guy died. When did he stop collecting data?

Mr. BLAND. He died 2 years ago in an accident.

Mr. CANNON. I have had like dozens of invitations to join class actions over the last 10 years. They are all frivolous. They are all flaky.

Mr. BLAND. Sir, if I can give you an example. I just settled a case as a class action where a bank promised people that they would never charge them more than 24 percent interest, then it broke that promise and charged people 30 percent interest. The individual damages to people were $100 at the most. We settled that case for $16 million and we have sent out checks, or we are in the process of sending out checks to 280,000 people. Plus, we fixed everybody's credit records.

There are bad class action settlements, but that is not the majority of it. I feel very proud about the case that I just handled.

Mr. CANNON. My time has expired, Madam Chair. Would the Chair indulge me to just ask what your fees on that case were?

Mr. BLAND. The fees were 20 percent of the amount that was recovered.

Mr. CANNON. So it was $4 million?

Mr. BLAND. About $4 million.

Ms. SÁNCHEZ. We may have time for a second and possibly even a third round of questions. I would like to give everybody an opportunity in this round, so I will recognize Mr. Johnson for 5 minutes of questions.

Mr. JOHNSON. A 20 percent contingent fee is definitely a reasonable fee in a situation like that. I don't know who could argue with the fact that attorneys serving a public purpose should not be fairly compensated for the work that they do.

But let me ask you, Mr. Levin, do you agree generally with the principle that whoever is paying the piper calls the tune?

Mr. LEVIN. No, I do not.

Mr. JOHNSON. Do you disagree with that generally?

Mr. LEVIN. Well, if by that you mean that if a company is paying the cost of arbitration, they are going to be favored. Is that your question?

Mr. JOHNSON. My question is generally, just taking it away from legalities. Whoever is paying the piper generally is calling the tune, is telling the piper what tune to play. Is that not a general——

Mr. LEVIN. I disagree with that. I think the major arbitration organizations such as the American Arbitration Association and the National Arbitration Forum have put their rules and their procedures in writing. Their arbitrators are sworn to uphold those rules. The rules call for neutrality and fairness at every stage of the procedure. The rules give each side the right to strike arbitrators. I think there is a difference between saying——

Mr. JOHNSON. You are not really answering my question.

Mr. LEVIN. I am sorry. Maybe I misunderstood your question.

Mr. JOHNSON. I asked you this question.

Mr. LEVIN. Okay.

Mr. JOHNSON. In your statement, you have written that in the vast majority of cases the existing system works and works well. That is this arbitration.

Mr. LEVIN. Yes.

Mr. JOHNSON. Because companies and employers have gone to great lengths to make arbitration programs fair, to the point of giving the consumers unfettered and unconditional rights to reject arbitration when they enter into the transaction. Can you cite some specific instances of that statement?

Mr. LEVIN. All of the arbitration agreements that I have had a hand in working on, drafting, providing legal comment on for the past several years have included a right to reject arbitration.

Mr. JOHNSON. Now, I want you to hold up right there.

Mr. LEVIN. Yes.

Mr. JOHNSON. Mr. Bland, how would you respond to that assertion?

Mr. BLAND. I have seen that type of clause in maybe eight banks' contracts. I have never seen an opt-out right in a nursing home contract, a car sale, a cell phone, or employment or any other type of contract. But there are some banks that are doing it. The problem with it—if I can just quickly add—is that it is in the fine print of a contract, usually and literally like the seven-size font. I am physically incapable of reading these things. It is in legalese that is very hard to follow.

The typical sentence in some of these contracts will be over 200 words, and people just don't even know it is there. No one opts out. They opt-out rate is like 1 percent or less. It is like .01 percent. Nobody reads the fine print of contracts. There is a word in America for people who read every word of the fine print of their contracts. It is "paranoid."

How many people in this room know whether their cell phone company chose the National Arbitration Forum or the American Arbitration Association? How many people know whether their cell phone contract requires them to do their case here or there? Nobody in this room knows those things.

Mr. JOHNSON. All right. I understand. All right.

Mr. Levin, you were champing at the bit wanting to get back in there.

Mr. LEVIN. Yes, thank you, Congressman.

Certainly with respect to the arbitration agreements that I am familiar with on behalf of consumer financial services companies, such as banks and credit card companies, we make sure that we do not——

Mr. JOHNSON. Mr. Bland said he has seen eight in his——

Mr. LEVIN. Well, but he also said that they were buried in small type, but certainly——

Mr. JOHNSON. I am just talking about the opportunity for people to actually reject arbitration when they enter into their various agreements.

Mr. LEVIN. Yes. We make——

Mr. JOHNSON. Mr. Bland says he has seen it eight times in his 20-year career. How many times have you seen it?

Mr. LEVIN. A lot more than that. I can't give you an exact number, but that represents agreements that may be in the hands of millions of people, because these credit card companies and banks have a lot of customers. The right to opt out of arbitration we always make sure is in boldface type, put right at the beginning, even before it describes our——

Mr. JOHNSON. By "we," who are you referring to?

Mr. LEVIN. As a lawyer, advising a client.

Mr. JOHNSON. Your law firm?

Mr. LEVIN. As a lawyer advising a client how to structure an arbitration agreement. We urge them to put the right to reject right up front, distinguished by either capital or boldface letters.

Mr. JOHNSON. Okay. Well, let me ask you——

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

Mr. JOHNSON. All right. Thank you.

Ms. SÁNCHEZ. I am sorry to say. It goes quickly.

Mr. Jordan is recognized for 5 minutes of questions.

Mr. JORDAN. Thank you, Madam Chair.

Mr. Levin, you said in your work, your presentation, you thought the judicial review process was pretty good. So elaborate on that. Try to help me understand the sharp contrasts out there, and how the review process does in fact work.

Mr. LEVIN. Well, I think what Mr. Bland is saying is that once you get outside the court system in to any alternative dispute resolution program, in a sense you are operating "technically outside the law," because there is not a court involved.

But in fact, the United States Supreme Court and the vast majority of courts in this country, both State and Federal, have recognized arbitration as a very valuable and significant way of making sure that everyone has access to justice and making sure that the courts do not get overburdened and that the costs of reducing costs for both consumers and companies are reduced by reducing litigation costs.

The companies try to write their arbitration agreements in a very fair and equitable way. They try to write them so that they will be enforced by arbitration organizations which have adopted formal due process standards and protocols and standards of fairness for consumers.

As I mentioned in my introductory remarks, the consumer protocols that were prepared by the American Arbitration Association were done so with the input and very active involvement of many, many consumer advocate groups to make sure that what came out was something that satisfied everyone involved in this process.

The courts also provide an important check and balance by making sure that if someone claims that an arbitration agreement is unfair, that agreement is scrutinized and scrutinized very intensely. If a court rejects an arbitration agreement, that to me shows that due process is working because it has gone through court review. Again, there is court review going in and some amount of court review coming out.

But I think it is all of these elements coming together and coalescing that produces a system which, in the vast, vast majority of cases, works and works very well. I am sympathetic to Ms. Fogal's comments. I can't comment on them. I have no personal knowledge of them.

But I can say in the vast majority of cases, the system does work and arbitration does produce fair results, and it has been endorsed by not only the vast majority of courts, but by virtually every State. Virtually every State has its own Uniform Arbitration Act, which is another system of arbitration in addition to the Federal Arbitration Act.

Mr. JORDAN. Mr. Bland, does your organization represent folks in arbitration cases situation or just in the courtroom?

Mr. BLAND. We have done some cases in arbitration.

Mr. JORDAN. As a public interest group, do you do a fair amount of educational work with consumers out there about the dangers of arbitration? Tell me about your——

Mr. BLAND. Mostly what we do is we provide training information to consumer lawyers and employment lawyers where they get an arbitration clause that in addition to sending you to arbitration, adds some other provision like it strips you of some of your rights under some statute or something like that, which is very common. We try and train lawyers in how to respond to those.

A lot of consumers come to us because of what they googled on different issues relating to arbitration. They find us and come to us, so we spend a lot of time talking to individual consumers over the phone or who come into our office, but we don't have a true educational program.

Mr. JORDAN. Thank you, Madam Chair.

Ms. SÁNCHEZ. Thank you. The gentleman yields back his time. Thank you.

The gentleman from Massachusetts, Mr. Delahunt, is recognized.

Mr. DELAHUNT. Thank you, Madam Chair.

This is a very interesting discussion, but let me go back to a point I think that was raised by Mr. Bland. We can talk about the size of the font. We can talk about national arbitration groups, whether it is the American Arbitration Society, et cetera. But I think we have to deal in the real world.

I think the point that you made, Mr. Bland, was how many people actually read the solicitation or the credit card agreement, 1 percent? I dare say it would be far less than 1 percent. I mean, substantially less than 1 percent.

So we can talk about due process. We can talk about the nuances and the rules of arbitration, the right to appeal, et cetera. But in the end, a credit card agreement is an adhesion contract between the parties. You either get a credit card or you don't, particularly when all of the credit card issuers have these clauses within them.

It really comes down to, I believe, a public policy issue which, you know, I think is really worthy of great debate, but to talk, I mean, is there a Member on this panel that has ever read—Mr. Jordan? Mr. Cannon? Mr. Johnson? Ms. Sánchez?—have you ever read your credit card statement?

Mr. CANNON. Absolutely not. [Laughter.]

Mr. DELAHUNT. Is there anybody in the audience—please raise your hand? So, three.

Mr. CANNON. Probably lawyers.

Mr. DELAHUNT. I am a lawyer. I have never read that.

Mr. CANNON. Paid to read it; paid to read it.

Mr. DELAHUNT. Thank you. I will pay you. [Laughter.]

I mean, the reality is that we are dealing with a subject that is esoteric at best; that simply creates a situation where, I don't know what the precise definition of an adhesion contract is, but it fits my definition.

Then I think it is an issue of what we do as a Committee, as a Congress, where it is documented, where if it can be documented by solid studies that implicate a scientific methodology, that there are abuses relative to consumers.

And by the way, small businesses dealing, and I would even go so far as to say the business-to-business arbitration issue ought to be reviewed. I dare say there are a lot of small businesses that don't have many options other than to accept a binding arbitration agreement from some single-source supplier. Is it fair to, you know, everyone in the business community? It really comes down to a question of fairness.

I am sure, Mr. Levin, the documents that you draft are fair, are balanced, and the font is huge. It is right at the beginning, and it is probably in glaring red, but I have to tell you, nobody is reading it. That is the real world that we are dealing with.

Mr. CANNON. Would the gentleman yield?

Mr. DELAHUNT. I yield.

Mr. CANNON. The question is really actually very interesting. This Committee certainly has jurisdiction over it. One of the problems is where we see a proliferation of standardized contracts. So for instance, have you ever bought software online and read the agreement that you have to say you read?

Mr. DELAHUNT. Of course not.

Mr. CANNON. Absolutely not. [Laughter.]

And may I suggest that what I think Mr. Levin is saying and others is that there are procedures that help protect consumers in the process.

Mr. DELAHUNT. I would ask the Chair for an additional 2 minutes.

Ms. SÁNCHEZ. The Chair will be generous and grant the gentleman from Massachusetts 2 minutes

Mr. DELAHUNT. I thank the Chair for her generosity.

Ms. SÁNCHEZ. Although I might add, it seems that there is enough interest to do a second round of questions, so perhaps that might be a better way to tackle that.

Mr. DELAHUNT. I will defer to whatever the Chair rules.

Mr. CANNON. If the gentleman would continue to yield, one of the really interesting things to do here, and our role is to be part of that process for creating a system that can work.

Mr. DELAHUNT. Reclaiming my time.

Mr. Levin, would you object to, you know, the choice of the arbiter, I think, is significant. How would you feel about legislation dealing with credit cards that would allow the consumer to select the arbiter? How would you feel about that?

Ms. SÁNCHEZ. The time of the gentleman has expired, but I will allow Mr. Levin to answer that before we move on to our second round of 5-minute questions.

Mr. LEVIN. In fact, I believe that National Arbitration Forum rules permit the parties to select an arbitrator who is not with the National Arbitration Forum.

Mr. DELAHUNT. No, no, I am saying how would you feel about legislation that would allow, that would mandate in binding arbitration agreements by the credit card industry that the arbitrator will be selected by the credit card holder, by the issuer, not by the credit card company?

Mr. LEVIN. All the agreements that our firm participates in drafting give the consumer the right. Now, we do identify the major national organizations because they have promulgated standards of fairness that we have confidence in. But we give them the right to choose which organization they would like. We are not trying to force them to choose one or the other.

That is true even if the company initiates arbitration, we give the consumer the right to choose which organization. Once you are within that organization, there are all sorts of internal procedures that are in the organization's rules for choosing specific arbitrators, but we do try to give the consumer the right to do that.

I think in terms of legislation, it would have to be drafted very carefully because it is a contract. You do want both sides, and this is something that both sides are supposed to agree upon. So the reason the company's names the AAA or the NAF is because you can get a copy of their rules; you know what they are supposed to stand for; and you can understand what is going to happen to you in arbitration.

But within that context, we always give the consumer the right to choose.

Ms. SÁNCHEZ. Thank you, Mr. Levin.

We are now going to move on to our second round of 5-minute questions. I get to start. I have a couple of questions I have been dying to ask.

Mr. Bland, according to proponents of mandatory arbitration, the courts rigorously protect consumers from unfair arbitration agreements. Are they correct? Can we not just depend on the courts to protect consumers from unfair arbitration clauses?

Mr. BLAND. If a company just has the arbitration clause that I talked about at the beginning, where they pick the arbitration firm who is going to give you basically a defense lawyer, I mean, that

industry, as your decision maker and there is no judicial review other than the incredibly limited review, that is always enforceable.

Now, if a company gets greedy and they start tacking on other things, not only do you have to go to arbitration instead of court, but also we are going to repeal the consumer protection laws of your State—which, by the way, is shocking, and a shocking number of companies do. Then you can go to court and fight it.

I mean, my career is basically finding cases where we have been able to get some courts to strike down companies that added on these unfair bells and whistles to the arbitration clauses.

Some courts are striking them down. A lot of courts aren't. There are some courts in this country where they think there is such a strong Federal policy in favor of arbitration that they would enforce an arbitration clause of anything short of a gun to the head of somebody.

The Connecticut Supreme Court upheld an arbitration clause that required this guy to arbitrate a case against an accounting firm where the arbitrators were partners in the accounting firm. And they said, well you know, just because the arbitrator might rule for the guy, they would each only have to pay $1,200 themselves, so they would never be biased by that.

Can you imagine when they start offering judges $1,200 to rule for me? And the Connecticut Supreme Court unanimously said, no problem with that. I thought that was like the unlosable case. So yes, we win some cases when companies really rig the system. It is not like my entire career is going around losing cases, but there are a lot of cases where courts will uphold things that are shocking.

Ms. SÁNCHEZ. The point is well-taken.

Mr. Levin, if I could ask you, you are counsel and you deal with arbitration clauses. Do you ever urge corporations to select arbitration companies which structure arbitration rules in a way that favors the corporate clients that you have?

Mr. LEVIN. No. There are really only a few major national organizations, so those are the ones we tend to think of because they have the published protocols, rules and procedures. Certainly, in our own clients' interests, we want to make sure that whatever rules we are suggesting are fair to both sides. So to the extent, do we look at whether it protects the company? Yes, but we also look to see whether it protects the consumer. It should be——

Ms. SÁNCHEZ. Do you believe that they are absolutely equally balanced?

Mr. LEVIN. I do.

Ms. SÁNCHEZ. Ms. Fogal, I wanted to give you an opportunity, and I wanted to recognize something—as some of my colleagues here have talked about—consumers educating themselves about services that they may be buying and going to other places. I want to touch on that, but I also want to recognize that you have made a concerted effort to try to inform other future consumers about the bad experiences that you had with somebody.

I appreciate that because I think a lot of people here would have just felt so defeated that they would have just walked away and kept their mouth shut. So I really do want to recognize the work that you are doing in terms of trying to help other people avoid that pitfall.

Ms. FOGAL. Thank you.

Ms. SÁNCHEZ. Let's talk about the Houston housing market. I think you made a statement that all homebuilders in Houston have the arbitration agreements, so if you want to buy a home——

Ms. FOGAL. A new home.

Ms. SÁNCHEZ.—a new home, you don't really have a choice of declining one because he has a mandatory arbitration agreement, and selecting some other new homebuilder. Am I correct in that statement?

Ms. FOGAL. Yes. Now, if you buy a home from someone else that is not a builder, or an older home, you can sue them. You can sue each other. You just can't sue a builder.

Ms. SÁNCHEZ. Right.

Ms. FOGAL. That is how it is equal.

Ms. SÁNCHEZ. So in that particular market, there really isn't another option. If you want to purchase a new home——

Ms. FOGAL. No. We had a representative from our State try to buy one and she couldn't find one.

Ms. SÁNCHEZ. I am assuming, and I heard in your testimony—and I don't want to add facts that are not in evidence——

Ms. FOGAL. That is okay.

Ms. SÁNCHEZ. You talked about being senior citizens and wanting a home with an elevator and sort of looking ahead prospectively to the future. I have to imagine that probably one of the considerations that you put into buying a home was that you wanted a newer home that perhaps would not have the maintenance costs of an older home.

Ms. FOGAL. Exactly. No repairs.

Ms. SÁNCHEZ. Unfortunately, you ended up in the exact worst-case scenario of that.

I think I have finished my questioning, so I will now turn to Mr. Cannon for 5 minutes of questions.

Mr. CANNON. Thank you, Madam Chair.

Just following up on our discussion with Mr. Delahunt, let me just point out that one of the possibilities that we ought to consider as a Committee is standardized language that we put in statute, and then require people to explain the variations from that standardized language. Now, you might end up with lots and lots of explanations, but it is something we may want to consider as a Committee.

I just wanted to follow up. The question about your attorney fees, I don't ask that to question the value of your services or the fees, but only to put into contrast the fact that there are huge attorneys' fees here. How much was the average benefit to each of the members of the class?

Mr. BLAND. The cash that the individual class members, because there were so many claims, the average is going to be a little over $25. Some people are going to get over $1,000, depending on what their damages were, but for most people it is going to be like $25.

Now, the injunctive relief by cleaning everybody's credit reports and getting false information off, that is going to lower people's interest rate, so people are going to actually make a lot more money in terms of savings. But the cash is relatively low per person compared to the attorney fees, no doubt about it.

Mr. CANNON. And that really is the core of the issue of what we are dealing with here. Is it better and, granted, for attorneys that are bringing these lawsuits, there is a loss, but is the system better off if people get robust and we have a market where people can understand what they are getting into and decide which bank or which cell phone company they want to use, or which builder.

I had a builder that I actually thought I had blackballed because I reported his failures. And 3 years later, I saw him driving around in a truck with a new name. So we have to have some identifiers, especially on the high-end activity.

But it just seems to me that the cost of the lawyering in these cases, the cost of the defense to companies, is great, but obviously in the particular case you mention, you got what sounds like a clear violation—24 percent promised, 30 percent charged—and people are getting money. I suspect that the effect of those costs in some of those cases where people had their credit smashed because they started bouncing checks because they didn't expect the higher interest rate.

I have a very young son who just experienced his first cascading effect of overdrawing his account, $350 in fees later and a problem with his credit report, which I think we solved. He realized that a little mistake redounds to huge benefits to banks.

This is not a defense of banks. It is not even a criticism of lawyers or the way you do business. As a society, are we better off with devices and methods and processes to protect us from the big fraud artists who build houses that are hundreds of thousands of dollars on the one hand, and protect us from companies who might cheat us by $50 here or there?

But again, with those companies that cheat on cell phones, if you have a robust market, how much is it worth to a bank to cheat somebody out of $25 with a little higher interest rate? When people find out that they were being charged 30 percent, they tell all their friends that that bank is creepy, or that my cell phone was bumped up because of something I don't agree with and therefore—and we have all had I think some experiences for instance with texting and how the texting system works.

At least I have had experience with my kids over texting. And you go with the $5 plan it doesn't cost you anything, but you don't do the $5 plan, you are at $400 or something like that.

So we have all these pickups in the market, but what happens when you starting saying, I don't like this cell phone company, because they hurt me by charging this horrendous amount. Well, that hurts the company more than I think the $25 they gained in your case, or the $50 that you mentioned, Mr. Schwartz, in the case of cell phone companies.

Our question is: How do we actually solve this problem in a way that doesn't enrich a class of lawyers, for instance, and a much higher cost to society by litigation which is expensive, which may have merit, but which for any individual who has only $25, as I said earlier, I have had dozens of—maybe not dozens, but it seems like dozens—of requests to join a class where there might be something like, you know, I look at it a and say how much could I have possibly lost, if I really lost something here, $25, $10, $2?

So it seems to me that what we are dealing with here transcends the narrow parochial interests in how we structure ourselves so that we actually make this all work, because I don't think anybody on the panel is going to disagree that these costs get passed back onto consumers.

Mr. Bland, is this not going to be a matter of disagreement?

Mr. BLAND. Actually, I do disagree because I think that what a lot of class actions do is a company will promise one thing and then charge something that is quite a bit higher. If you bring a successful class action, it forces them to keep to their promise to actually lower their prices back to what they originally promised.

I think that Public Citizen, an organization, did a report last year around the successful tort reform bill to federalize all class actions, where they went through a series of industries and found that class actions actually lowered the prices of a lot of goods, because what was happening is you had bait-and-switch types of things where a company would promise one price, then charge something higher, and they already had the consumer on the hook. The class action caused them to go back to their honest price.

Ms. SÁNCHEZ. The time of the gentleman has expired. I am sorry.

Mr. CANNON. I yield back.

Ms. SÁNCHEZ. The gentleman from Georgia, Mr. Johnson, is recognized for 5 minutes.

Mr. JOHNSON. Thank you.

Mr. Levin, I hate to pick on you, but you provide me with some interesting material here, particularly the fact that your paper seems to be weighted down with information about empirical studies that have been conducted which would tend to support arbitration as being consumer-friendly and basically something that is pretty benign and fair.

Yet, it appears that the firms that called for the studies to be done were actually from the business community that uses the arbitration clauses, and then the results seem to substantiate the version that you would expect that they would want to hear, and that is arbitration is a good thing.

How could you respond to the assertion I believe, and I am not sure if it was Mr. Schwartz or Mr. Bland made about the selective samples that were used, the definitions that perhaps people use when they say "winning," that kind of thing? How can you justify who paid for the studies and whether or not those studies were actually done in a way that would pass muster as far as a statistician is concerned?

Mr. LEVIN. I think that the fact that a study might have been commissioned by a business does not mean that the outcome of that study was in any way influenced by the fact that it was commissioned. Businesses are frankly used to hearing the kinds of comments that Mr. Bland and Professor Schwartz have made, and are interested in trying to gather factual information.

Mr. JOHNSON. You don't think that it would perhaps be biased?

Mr. LEVIN. I would hope not. I think they are undertaken in good faith.

Mr. JOHNSON. And you also don't think that who pays the arbitrators, who selects them and gives them their business, would probably be favored by the arbitrators themselves?

Mr. LEVIN. No, I don't, because there is a difference between an arbitration organization and an individual arbitrator deciding a case.

Mr. JOHNSON. Where does the arbitrator get their assignment from? Don't they get their assignment from the arbitration company?

Mr. LEVIN. There are usually panels of arbitrators' names and the parties through a process of give-and-take settle upon one.

Mr. JOHNSON. And the arbitration company pretty much is free to decide who the individual arbitrators might be?

Mr. LEVIN. They have their own ways of doing that.

Mr. JOHNSON. And if the arbitration company is owned by, say, the brother-in-law of the company that writes the contract imposing the arbitration agreement, don't you think that that brother-in-law is going to make sure that all of the arbitrators are friendly toward those who are paying the bills?

Mr. LEVIN. I certainly don't know that to be the case, but there are safeguards built into the selection process for an arbitrator where disclosures have to be made. Most of these arbitrators, a lot of them are retired judges. A lot of them are very experienced lawyers on both sides of the fence.

Mr. JOHNSON. Let me ask Mr. Schwartz to respond to that.

Mr. SCHWARTZ. I would just repeat the statement that Mr. Bland made. I think he is absolutely correct, that there is going to be a preponderance of industry lawyers as panels of arbitrators. Yes, the American Arbitration Association and these other companies have their system of choosing the seven arbitrators that you can pick from, and one is going to be worst than the next.

The thing that I don't understand is that we hear from folks like Mr. Levin that arbitration is fair, it is fast, it is cheap, it is efficient, it is the greatest thing since sliced bread. What I have never understood to this day, in the more than a decade that I have been studying these, if arbitration is so great, then why do the companies have to say it is so great for you, Mr. Consumer, that we are going to force you whether you like it or not to accept it.

Mr. JOHNSON. Now, let me stop you at that point and ask Ms. Fogal. Ma'am, when you first saw this home plan and thought it was so beautiful, you were so happy.

Ms. FOGAL. Right.

Mr. JOHNSON. And then you went and signed the contract. Do you feel like you had a choice at that time of rejecting arbitration?

Ms. FOGAL. It was in my earnest money contract, and I could have not purchased the house. I could have not purchased a new home in Houston. My builder was on the Harris County Housing Authority, so I assumed he knew what he was doing.

Mr. JOHNSON. Could you have purchased a house through any other builder in Houston?

Ms. FOGAL. Not without signing an arbitration clause.

Mr. JOHNSON. Because all of the builders in Houston insist on arbitration clauses——

Ms. FOGAL. Arbitration clauses.

Mr. JOHNSON.—and are mandatory in their agreements?

Ms. FOGAL. That is correct, sir.

Mr. JOHNSON. Thank you.

Ms. FOGAL. You are welcome.

Mr. DELAHUNT. [Presiding.] I am not Congresswoman Sánchez, but let me take the gavel and recognize the gentleman from Illinois, Mr. Jordan, for his time.

Mr. JORDAN. I am from the Midwest, but Ohio. [Laughter.]

Mr. DELAHUNT. Anything west of Boston is west. [Laughter.]

Mr. JORDAN. Mr. Chairman, I went to college close to Illinois. In fact, I will start with Professor Schwartz because I was a University of Wisconsin undergraduate.

Let me just ask this, and last night, my staff was together, and the 6,437 letters we have sent out for the best part of this year. They break it down by category, and we had hundreds of letters on immigration, on the Iraq war, several dozen letters on gas prices, as you might guess, but not one single letter, and I scan through the pages of the categories, and not one was on binding arbitration out of one of our constituents.

I appreciate and am sympathetic to Ms. Fogal, but just tell me how big a concern this really is? I mean, none of the constituents in God's country that I represent in west central and north central Ohio have taken the time to call their congressman about this. We have evidence suggesting consumers are pretty happy with arbitration when in fact they go there. So tell me a little bit more, professor.

Mr. SCHWARTZ. Thank you. I have to point out that I am always told that I live in Michigan, even though it is Wisconsin. I am in one of the "M" states in the Midwest.

I think it is a very large problem. I think, as the Chairwoman cited a study at the beginning of her remarks suggesting that up to one-third of consumer contracts now have arbitration agreements. But it is one of those low——

Mr. JORDAN. If the contract has it, are consumers expressing frustration with it? Are they saying, "Yes, this is terrible; I got a bad deal"? I have not heard it again, in letters and things we are sent. I have not heard it from our constituents.

Mr. SCHWARTZ. We hear it in the cases. The thing is that litigation and arbitration both talk about things going wrong. You have a consumer transaction or an employment situation that has broken down and gone wrong. So that is not going to be every consumer transaction or every employment situation. But there are large numbers of them, and we hear about them through the cases that we study.

The studies that suggest consumer satisfaction, the one that I am aware of from the Harris Interactive Group, which is cited to say that consumers are very satisfied with arbitration, it turns out that they mixed up both consumers and business arbitrations and they excluded from their sample any cases where a party was ordered into arbitration by a court. So again, you have a skewed sample that doesn't really deal with mandatory, compelled arbitration.

The problem isn't necessarily a consumer who has a horrific experience like Ms. Fogal did. The problem could be the consumers who simply walk away from their cases. A small-dollar amount fraud that is going on on a massive scale will go unremedied because no one is going to pursue that claim and a class action is not allowed because of the arbitration clause.

Mr. JORDAN. I recognize that, and maybe that exists. But you would think at some point it would rise to the level that they would let their public officials know that, look, this is not a big deal; I didn't press it; but I got a bum deal. You would think that I would have heard about it. I just have not.

Mr. SCHWARTZ. I think the way that you would hear about it, the problem is that they haven't pursued the arbitration because the dollar amount was small so they didn't pursue a case and have a bad experience. The problem is they are going to have experience with is my credit card company ripped me off, and there is nothing I can do about it.

Now, I don't know if you have been getting letters in your office with people complaining about banks and credit card companies and cell phones for small dollar amount rip-offs. If you haven't heard it, it may be the same problem there, that the effort of writing a congressman is not going to be sparked by the small dollar amounts, and yet you have a problem on a wide scale that just kind of stays at this low level of public awareness.

Mr. JORDAN. Thank you.

Ms. SÁNCHEZ. [Presiding.] Thank you, Mr. Jordan.

The gentleman from Massachusetts, Mr. Delahunt, is recognized for 5 minutes.

Mr. DELAHUNT. To pursue the line of questioning that Mr. Jordan had undertaken, let me submit an opinion and see whether you agree. I think part of it is we discussed earlier that people are unaware of the availability of arbitration.

I think as you indicate, Professor Schwartz, in most cases it is a small-dollar item and it is not sufficient to pursue, to provoke that kind of interest. I dare say that if you are a member of the local government, if you serve on the city council or if you are a State legislator, the chances are that that is where you are going to hear it because it is very much something that is local in nature.

But the question does I think go to another issue that I would like to explore—the relationship between the FAA and State law. I have a real concern about the federalization, if you will, the preemption of State consumer protection laws. I happen to be a conservative, a real conservative, one that embraces the concept of devolution and States' rights.

I believe that when the Federal Government inserts itself in matters that are particularly local—and I am not suggesting that that was the case with you, Ms. Fogal—but please describe for us the relationship between the FAA—and I will start with you, Mr. Bland—and State law.

Mr. BLAND. The Supreme Court has held a number of times that the Federal Arbitration Act strikes down any State law that would limit the enforcement of arbitration clauses. There are literally 100 court decision or more in which courts, particularly Federal courts, have struck down a variety of different State consumer protection laws, State franchise laws that protect small business franchises and that kind of thing, provisions of them.

In fact, there are splits between some courts in which some courts will find that the FAA reaches even further, but there are just a ton of cases out there in which courts have struck down——

Mr. DELAHUNT. Let me ask your opinion in terms of, isn't it time that we have a revolution in this country and respect States' rights, and acknowledge that——

Mr. BLAND. Can I give you an extreme example of this?

Mr. DELAHUNT. Sure.

Mr. BLAND. I had my first case in the Supreme Court 1 1/2 years ago. I lost. What the case was about was a case involving a payday lender and they were charging 500 percent to up to 1,300 percent interest. We had a client that had 1,300 percent interest rate. Under Florida law——

Mr. DELAHUNT. That is not its interest. [Laughter.]

Mr. BLAND. Right. They were wearing suits, as Tony does, but they were operating a storefront so it is different in that respect from the Sopranos. But it was a crime under Florida law, loansharking. Anything that high was considered criminal loansharking.

Under Florida law, the Florida Supreme Court said that any contract whose principal purpose is criminal, any agreement whose principal purpose is criminal doesn't form a contract, so you don't have an arbitration clause because it is embedded in this thing that is a criminal agreement.

The Supreme Court struck this down. I lost. In the oral argument, Chief Justice Roberts said to the lawyer for the payday lender, gee, what if you had a murder-for-hire contract, some guy hires someone to go kill his wife, and it had an arbitration provision. Are you saying that Federal law would require you to enforce that?

And the guy said, oh, well, that is very unlikely; how many murder-for-hires have contracts—you know, this kind of thing. He said, but yes, that is our answer; yes, that is our answer; yes, that is the answer. And that was what the Supreme Court did under Federal law. They wiped away basic contract law, contract law that is true in every single State was wiped away.

Mr. DELAHUNT. Let me direct this to the Chair of the Committee. I think what we are hearing here is an encroachment on State contract law, consumer protection laws, that I dare say Congress has a responsibility to review, to examine, to see whether it is time to review the Federal Arbitration Act itself, and start to limit its encroachment on State policy.

With that, I will yield back, unless you want to get into this, Mr. Levin.

Mr. LEVIN. May I add just one comment, Congressman? Section 2 of the FAA does preserve State law, because it permits a party to refuse to arbitrate or to oppose a motion to arbitrate on any ground that exists at law or in equity for the revocation of any contract, which means that if you think that——

Mr. DELAHUNT. If you are aware that you have an arbitration clause.

Mr. LEVIN. No. What the FAA says is that any State contract defense that is applicable to contracts generally can be used to defend against an arbitration clause. As for people being——

Mr. DELAHUNT. But you still have to go to binding arbitration.

Mr. LEVIN. Well, not necessarily because you oppose that, for example, if a company files a motion in court to compel arbitration of a lawsuit that someone has filed, the judge will look at the de-

fense of whether there are State law contract grounds that can be used to defeat the arbitration agreement. If the court—and several have—decided that this arbitration clause on some basis that arises out of State contract law is an unconscionable contract——

Mr. DELAHUNT. I think I have an additional minute. Let me go back to Mr. Bland or Professor Schwartz.

You have the position of the statement by Mr. Levin. Do you agree with the statement, and if you disagree with the statement, do we need to clarify the language in the FAA to accomplish what he is suggesting?

Mr. BLAND. If the courts—I am sorry. I was just going to say, if you believe in that, you know the phase "the half-truce"? That was like a one-tenth truce. Yes, there are certain State laws that the Federal Arbitration Act doesn't override, so if you have an arbitration clause it adds a bunch of things separate from arbitration, like a ban on punitive damages or repeal of the Consumer Protection Act or whatever. Then you have a good argument against that.

But the basic core problem is Federal law overrides any States that deal with them. Yes, the Federal Arbitration Act completely squashes all kinds of State consumer protection laws. There are a few general contract laws that come out. That is basically what my jobs is, is finding the few places where you can get State law to beat an arbitration clause. But there are so many injustices that you can't touch, that it is outrageous.

Ms. SÁNCHEZ. I believe the question was for Mr. Schwartz, so I want to give him a chance to respond.

Mr. BLAND. I am sorry.

Ms. SÁNCHEZ. Your time has expired, Mr. Delahunt. I want you to know that.

Mr. DELAHUNT. Again, I want to extend my gratitude for your generosity.

Ms. SÁNCHEZ. Mr. Schwartz?

Mr. SCHWARTZ. The courts have done a terrible job protecting State laws from preemption by the Federal Arbitration Act, a dismal job. So bad, in fact, that Justice O'Connor said, "I am throwing up my hands." She wrote an opinion that Congress has to correct a mistake that we have made. She said that in a 1995 case. Things have not gotten any better. They have only gotten worse. More and more State laws are being preempted.

As I said earlier, what is going to happen is there is going to be a major consumer protection gap because State consumer protection law is going to have huge holes in it if things continue to go in the direction that the courts are taking them now in interpreting the Federal Arbitration Act. You will either have unprotected consumers or you have the Federal Congress having to step in and fill this gap.

Ms. SÁNCHEZ. Thank you, Mr. Schwartz.

I am going to yield to my colleague, the Ranking Member, Mr. Cannon.

Mr. CANNON. Thank you, Madam Chair.

I just ask unanimous consent that we introduce four items into the record. One is a statement—I will just give a brief identification—on consumer arbitration; the second is State court enforcement of arbitration agreements; the third is a Harris study; and

the fourth is called Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases.

If we could have those introduced in the record, I would appreciate it.

Ms. SÁNCHEZ. Without objection, so ordered.

I would like to thank all of our witnesses for their testimony today.

Without objection, Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses. We ask that you answer those written questions as promptly as you can because they will be made a part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any additional material.

Again, I want to thank everybody for their time and their patience.

This hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 12:12 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

Responses of Paul Bland to Questions from the U.S. House Subcommittee on Commercial and Administrative Law of the House Judiciary Committee Following June 12, 2007 Hearing on Mandatory Arbitration in Consumer Contracts

QUESTION 1: 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?

First, in my experience, since 2003 nearly every mandatory arbitration clause that I have seen – and this is literally more than 1,000 different arbitration clauses – has included a provision barring individuals (consumers, employees, whomever) from bringing cases on a class action basis. These provisions are not inherent to arbitration in the abstract (the U.S. Supreme Court said in 2003 in the *Bazzle* case that class actions can be pursued in arbitration), but in my experience the corporations drafting arbitration clauses nearly always put these terms into their contracts.

Second, while many types of disputes are not appropriate for class action treatment, there are a number of types of corporate abuses where class actions offer the only meaningful remedy for cheated consumers. In cases where a corporation violates some law in a way that affects a large number of consumers in precisely the same way, but the individual sums at issue are small, and the average consumer will not notice that they have had their rights violated or would not be likely to take the affirmative steps to protect their rights, and where any legal action – whether in an individual case or otherwise – would be complicated, a ban on class actions becomes a true "Get Out of Jail Free Card." Many courts have recognized that, in legal terms, class action bans effectively become "exculpatory clauses" – provisions that immunize a corporation from any liability or legal accountability without respect to whether they have broken the law.

The class action bans that are written into arbitration clauses are simply a means of trying to ensure that corporations cannot be held accountable if they break the law. They strip consumers of rights that can be crucial.

QUESTION 2: In Mr. Levin's written testimony for the June 12, 2007 hearing, he stated that he advises his clients to give the consumer the right to reject arbitration. This would seem to negate the argument that arbitration is mandatory for consumers. A consumer could just take their business elsewhere instead of accepting the arbitration clause. Would not the free market soon dispense with mandatory arbitration agreements imposed on consumers?

Mr. Levin's supposed "option" for consumers is a cynical ploy to sidestep state court decisions that have struck down class action bans embedded in arbitration clauses as unconscionable and unenforceable.

The "opt outs" that corporations offer consumers are virtually always buried in fine-print legalese disclosures in a tiny font, in legal documents that come with things like credit cards or computers. EVERYONE who has any knowledge of marketing acknowledges the well-recognized reality that only a tiny percentage of normal American consumers (far less than 1% of Americans) read the fine print of every document that is sent to them. Unfortunately, the truth is that the vast majority of Americans unwisely assume that courts would protect them from unfair terms in fine print contracts. Consumers are not being lazy or ignorant when they don't read these disclosures – it is an unreasonable demand to insist that consumers read through thousands of words that are generally written at a graduate degree level, in complex sentences. Real people don't have time to read through lengthy legal documents, and everyone knows it. As I recall, even Representative Cannon acknowledged in the June 12th hearing that he does not personally read this sort of document. As one academic wrote, there is a word in America for the person who reads through every word of every fine print document sent to them, and the word is "paranoid." So Mr. Levin's claim that his clients are giving consumers an "option" is phony on its face – Mr. Levin knows for a fact that more than 99% of consumers will never understand or know of this option.

In any case, the opt outs are typically burdened. Consumers must opt out in a short time (typically 30 days), consumers often must send registered letters to opt out, etc.

Moreover, I have encountered several consumers who DID exercise their right to opt out of contracts and they have not had those opt outs respected. MBNA's credit card agreement offered consumers an opt-out right, but on two (2) separate occasions I have seen documentation that consumers opted out of MBNA's arbitration clause, and nonetheless been successfully (!!) pursued in arbitration before the National Arbitration Forum. It's an amazing statement about the way that the National Arbitration Forum operates that even in cases where consumers have proven that they opted out of arbitration (which, as Mr. Levin's testimony establishes, is the supposed rationale for MBNA's claim that its arbitration clause is actually voluntary), that the NAF STILL enters its usual award for the lender on the full amount of its claim.

One of Mr. Levin's partners has repeatedly given speeches to business audiences, in my presence, where he sets forth the legal strategy underlying the "opt out" clauses. A growing number of courts have struck down class action bans embedded in arbitration clauses in individual cases as unconscionable and unenforceable, which undermines the principal purpose of the arbitration clause (to ban class actions) for lenders. In most states, however, for a court to strike a contract term as unconscionable, the term must be both "procedurally" unconscionable (which goes to how the contract was formed) and "substantively" unconscionable (which goes to the fairness of the actual terms of the contract). What Mr. Levin and lenders hope is that if a contract is ostensibly an "opt out" contract, that a court will decide that it is not truly a "take-it-or-leave-it" contract (or a "contract of adhesion," in legal jargon), and enforce the contract even if the contract's substantive terms are so unfair that they would be substantively unconscionable.

Mr. Levin's "opt out" advice is merely a cynical ploy to circumvent state contract law and

consumer protection laws.

QUESTION 3: Are there alternatives to mandatory binding arbitration that you would find fair for consumers and businesses. If yes, what are they? Are the ways to alter mandatory binding arbitration agreements that you would find fair for consumers and businesses? If yes, what are they?

The best alternative to mandatory binding arbitration is to have post-dispute arbitration. If arbitration really is fairer and cheaper and so forth, then individuals will have no reason not to choose it AFTER a dispute arises. Moreover, if arbitrators could not get work unless BOTH parties chose to go to arbitration after a dispute arises, then arbitrators would not have the incentive that they currently have to stack the deck in support of one side.

I do not see a way to "fix" mandatory pre-dispute binding arbitration in the consumer setting. So long as the stronger party is writing the contract terms (which is always true in consumer settings), and thus choosing which arbitration company will be deciding cases, the arbitration companies will have a strong incentive to please the party who chooses them. This seems inherent to the system. Making general statements like "arbitrators have to be fair," and "arbitration must be reasonably priced," will not get at the fundamental problem of the stronger party writing the contracts.

QUESTION 4: If Congress legislated away mandatory arbitration for consumers, how would that affect businesses? Have not businesses designed their operations around having arbitration clauses in their contracts with consumers?

The business community's argument that banning mandatory arbitration would harm the economy is palpably false. Prior to 1999, I believe that only two (2) credit card issuers in the U.S. had mandatory arbitration clauses. In that year and the next year, for some reason, basically the entire industry adopted arbitration clauses. That has led to a great deal of abuse, certainly, as credit card companies feel free to completely ignore consumer protection laws. But I have never seen any evidence or even heard someone make a serious argument that it was not a very profitable business to issue credit cards prior to 1999. The "lack" of mandatory arbitration clauses did not lead to any great suffering among lenders.

Essentially, until a 1995 U.S. Supreme Court decision, almost no one – lawyers, judges, business people, academics or consumers – thought that the Federal Arbitration Act applied to consumer transactions, and only a tiny number of American businesses had arbitration clauses in their consumer contracts. This unbelievable spread of contracts stripping consumers of their legal rights is a recent phenomenon. There is no evidence whatsoever that American businesses or the American economy have suddenly begun to thrive now that they are increasingly free to ignore and violate consumer protection laws. Indeed, when consumer protection laws are wiped away, that simply harms honest businesses by giving an advantage to dishonest businesses.

QUESTION 5: How do you respond to the argument that mandatory arbitration is less costly than going to court?

In court, the parties do not have to pay the judge for her or his time. Judges are paid for by the taxpayer, and they do their job of hearing and deciding cases without billing parties. In arbitration, the arbitrators (as private judges) DO bill for their time, and in large cities their rates are often $400 or $500 an hour. I have represented a number of individuals with consumer disputes who were charged literally tens of thousands of dollars in arbitration fees. I have never seen anything like this from a judge in the civil justice system in any state or federal court in the United States. I have represented a number of individuals who were faced with arbitration fees that were literally larger than the amounts at issue in their cases. I have never seen anything like this in court.

The argument that arbitration is cheaper assumes several things that may be true in cases between two sophisticated commercial parties, but which are not true of cases between corporations and consumers. First, the "arbitration is cheaper" argument assumes that arbitration will permit less discovery. In consumer cases, though, consumers generally do not begin a dispute with any access to the documents showing how or why a corporation did what it did. Bearing the burden of proof, consumers often cannot prove their case without discovery. If arbitration is "cheaper" by barring consumers from proving their cases, it is a false saving (at least from the consumer perspective; the corporation is "saving" money largely because it is benefitting from a playing field tilted in its direction).

Second, the "arbitration is cheaper" argument assumes that in arbitration (where many procedural protections such as evidence rules and so forth are not required) that parties can proceed to resolve many disputes without lawyers at all. In consumer cases, very few consumers can protect their rights on a pro se basis. In my experience, very few consumers have ever heard of the basic consumer protection statutes, much less say what those statutes provide. Few if any clients have ever come to my office knowing in advance that a lender violated the Truth in Lending Act or the Fair Credit Reporting Act, for example. The idea that large numbers of consumers can effectively vindicate their rights without a lawyer (which is the core assumption fo the "arbitration is cheaper" argument) is simply not true.

QUESTION 6: A fair arbitration process includes neutral arbitrators. Who are generally the arbitrators hearing disputes? Are they equally representative of plaintiff's and defendant's attorneys? Are there some arbitrators that seem to rule favorably for consumers or businesses all of the time?

The panels of arbitrators offered by the major arbitration forums that are written into the vast majority of consumer contracts are overwhelmingly tilted towards defense lawyers. Again and again, every name or nearly every name on the panels of arbitrators offered to consumers is of a lawyer who principally relies upon defense work for her or his living. While there are a few consumer-side lawyers who are ostensibly listed as potential arbitrators by these companies,

many of those lawyers have told me that they never or very rarely get contacted to hear cases. It is not even close.

Public Citizen's remarkable report on every single one of the National Arbitration Forum's cases in California provides amazing statistical proof of what consumer lawyers and consumers have been telling me for years: the NAF funnels the overwhelming majority of its cases to a small handful of "reliable" arbitrators who nearly always rule for the corporation. The NAF's oft-repeated boast that it has 1,500 arbitrators, many of whom are former judges, etc., is belied by the fact that more than 90% of its cases in California were heard by less than 30 people.

MINORITY QUESTIONS

Question 1: Our economy works best, and consumers benefit most, when consumers are fully informed and free to contract as they see fit. If there's a problem with the use of mandatory binding arbitration clauses, why isn't the right solution to that simply more information for consumers in the marketplace – for example, information provided vigorously by organizations such as your own – rather than paternalistic restrictions osn consumers' freedom of contract?

In the hearing on June 12th, Mr. Cannon himself acknowledged that he does not read the fine print of the consumer contracts that govern his personal commercial affairs. In this respect, Representative Cannon is like 99+% of the American public. Simply put, as I've explained in my answer to the Majority's second question above, almost no Americans actually read the fine print of these contracts. Accordingly, the assumption that consumers are "fully informed" about what's in those contracts is plainly untrue. In any case, the contracts are generally written so that consumers will not understand them. I worked on a case recently where the first sentence of the arbitration clause was an amazing 256 words! No one could make sense of it, including veteran lawyers. These are documents that are designed not to be read.

In any case, entire industries have all adopted essentially identical mandatory arbitration clauses. Good luck to any member of Congress who decides to get a credit card or a cell phone or buy a new computer or but or rent a car or put a loved one in a nursing home without having to sign a mandatory arbitration clause. In this landscape, even if consumers all began to read every word of every contract that was put before them, they would still not be "free to contract as they see fit." Instead, they would have options such as "don't buy a car or give up your constitutional rights," or "don't get any nursing care for your elderly parents or give up their constitutional rights."

My law firm, which has about ten lawyers, litigates cases. Our annual budget would be dwarfed by a few ads run on national TV by credit card issuers. The idea that we could educate consumers about the details of the fine print contracts that they sign with our very limited resources, so that they would be able to find a corporation that doesn't have an arbitration clause, is simply absurd.

QUESTION 2: Similarly, why wouldn't it be a better solution for organizations like yours to expand into representing consumers in arbitration, rather than paternalistically advocating that consumers have fewer choices in deciding how to resolve their disputes, and offering only litigation services yourselves?

In appropriate cases, we have and will represent consumers in arbitration. In the vast majority of cases, however, our best judgment is that the best way to represent our clients' legal rights and interests is to pursue their claims in the civil justice system rather than in mandatory arbitration, because (among other reasons) (a) the judges in the civil justice system are not

selected by the corporation who has cheated our client, unlike the mandatory arbitration system; (b) our clients don't have to pay the judges hundreds of dollars an hour for their time in the civil justice system; and (c) if the judges, who are human, make a mistake in the civil justice system, we can pursue a meaningful appeal, but if arbitrators make even egregious errors of law or fact, those errors are not appealable. While we appreciate the Minority's suggestion, our professional judgment is that our consumer clients will often be better off in the publicly chosen and accountable constitutionally created civil justice system over a corporate controlled secretive mandatory arbitration system.

QUESTION 3: You claim in your written testimony that arbitrators who rule against companies sometimes are "blackballed"so that they never handle those companies' cases again. We all have heard of forum shopping, though, in which organizations like your own seek to bring litigation in judicial districts or circuits thought to be predisposed towards your clients and their claims. Why do you think these companies are blackballing arbitrators, rather than just looking for fairer decision-makers, as your organizatiaon would itself? And why do you want to restrict dispute resolution to the courts, in which organizations like yours can forum shop?

It is a matter of proven public record that a number of arbitrators have ruled against a corporation a single time, and then have never worked again as arbitrators. I cited a body of evidence for this proposition in my written testimony.

Generally speaking, if my clients wish to bring a claim in court, they bring it where they live. Accordingly, their choices for forums in the civil justice system are limited to state courts where they live, or (if they have federal claims or there is another basis for federal jurisdiction) federal courts. And, generally, if my clients would prefer to be in state court but they are asserting federal claims, the corporate defendant has the power to remove the case to federal court. The upshot, in my experience, is that my clients have very limited power over judicial forums. A consumer who lives in Texas might feel that the courts would be more favorable to him in Minnesota, but she or he has no choice to bring the case there. Forum shopping as a tool in individual consumer cases is wildly overrated. People live where they live, and when their rights under consumer protection statutes are violated, that's where they end up litigating as well.

After the Congress passed the Class Action Fairness Act, corporations are now generally in a position to ensure that all class actions are filed in federal court. That, of course, was the principal reason that corporations supported the Class Action Fairness Act. So the forum shopping has already been handled for class actions, by federal law.

One last point should be noted here: in the public civil justice system, where judges issue written decisions that are published, and where secrecy about outcomes and reasons is forbidden, both sides operate on the same playing field. In the secretive world of arbitration, where there are no written decisions and where consumers generally cannot learn what arbitrators did in similar cases, forum shopping only helps one side.

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July 20, 2007

VIA E-MAIL

United States House of Representatives
Subcommittee on Commercial and Administrative Law
Rayburn House Office Building
Washington DC 20515-6216
Attn: Norberto Salinas

Re June 12, 2007 Hearing on the "Mandatory Binding Arbitration Agreements: Are They Fair for Consumers?"

To the Honorable Members of the Subcommittee:

I appreciate the opportunity to respond to the questions submitted to me by the Majority and Minority Judiciary Committee. These answers reflect my own views on the subject of consumer arbitration, and my law firm and I are not being compensated in any fashion for my answers. My opinions do not necessarily reflect the opinions of any of my firm's clients.

Majority Questions for Mark J. Levin, Partner, Ballard Spahr Andrews and Ingersoll, LLP:

1. In your 1998 article, "Excuse Me, But Who's the Predator?," you wrote that "arbitration is a powerful deterrent to class action lawsuits . . . stripped of the threat of a class action, plaintiffs' lawyers have much less incentive to sue." Use the example by Mr. David Schwartz at the hearing, that a business "could rip off 50,000 customers for $50 each and no one is going to sue them individually because it is too costly to bring an individual case [so we] need a class action." Does not the business benefit from overcharging everyone, knowing full well that the overcharges will not be challenged, because the business has taken your advice and included in its mandatory arbitration clause that no class action lawsuits are allowed?

Answer: In context, the referenced article was intended to refer to abusive class actions in which plaintiffs with marginal or even frivolous claims bring class actions in forums notoriously hostile to the lending industry and rely upon the *in terrorem* threats of costly and drawn-out litigation to pressure companies (in the words of the article) "to pay substantial amounts in settlement for reasons having nothing to do with the actual merits of the dispute." Congress recognized the potential for class action abuse in enacting the securities reform act several years ago and in more recently enacting the Class Action Fairness Act of 2005. Courts have also acknowledged this issue. See, e.g., Coopers & Lyrand v. Liveasay, 437 U.S. 463, 476

(1978) ("[c]ertification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense"); Newton v. Merrill Lynch, 259 F.3d 154, 164 (3d Cir. 2001) (class certification "places inordinate or hydraulic pressure on defendants to settle"); In re Rhone-Poulenc Rorer, Inc., 51 F.3d 293, 299 (7th Cir. 1995) (class certification may require defendants to "stake their companies on the outcome of a single jury trial"). At the time of the referenced article I had been involved in state court cases in which plaintiffs' attorneys obtained class certification orders *ex parte* from a judge and my client was served with a court order provisionally certifying a plaintiff class at the same time it was served with the summons and complaint in the action. So, that is the context and spirit of the article you refer to.

In addition, Mr. Schwartz's example mistakenly assumes that alleged misconduct by a company will not be challenged absent a class action. As I pointed out at length in my testimony, a class action waiver in a consumer arbitration agreement does *not* immunize the company from alleged wrongful conduct because (a) arbitration agreements typically provide that a prevailing plaintiff shall recover attorney's fees and costs if applicable law permits (as virtually all federal and state consumer protection states do) and thus provide an incentive for plaintiffs' attorneys to handle small dollar consumer claims against the company on an individnal basis and (b) companies remain subject to sanctions issued by federal and state administrative governmental authorities (such as the Federal Trade Commission, the Federal Deposit Insurance Corporation and state attorneys general and banking commissioners) which are potentially more draconian than class actions because the authorities are not subject to the rigors of Federal Rule of Civil Procedure 23 (which contains many criteria which must be satisfied before a class may be certified) and, in addition to obtaining restitution for aggrieved consumers, may cause a company to lose its charter or license.

There is compelling empirical proof that consumers *do* sue companies for small dollar claims without bringing the lawsuits as a class action. As I noted in my testimony, the overwhelming majority of federal Truth in Lending Act ("TILA") lawsuits filed each year are *individual*, not class action, lawsuits, even though the vast majority of suits involve small dollar claims[1] and class actions are permitted under TILA. TILA permits successful plaintiffs to recover their attorneys' fees and costs. 15 U.S.C. §1640(a). According to computer searches of the LexisNexis CourtLink® database, 688 TILA cases, of which only 17 were class actions, were filed in the federal courts in 2006; 492 TILA cases, of which only 19 were class actions, were filed in the federal courts in 2005; 574 TILA cases, including only 20 class actions, were filed in 2004; 513 TILA cases, of which only 39 were class actions, were filed in 2003; and 576 TILA cases, of which only 37 were class actions, were filed in 2002.

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[1] TILA provides for statutory damages, typically ranging from $100 to $1,000 ($2,000 for residential mortgage loans), plus actual damages and attorneys' fees. 15 U.S.C. §1640(a). Actual damages are nearly impossible to prove because plaintiffs must show detrimental reliance. Turner v. Beneficial Corp., 242 F.3d 1023 (11th Cir. 2001) (citing cases), cert. denied, 534 U.S. 820 (2001).

In addition, there are many examples of non-TILA cases in which a sizeable attorneys' fee was awarded even though the plaintiff's individual recovery was relatively small. See, e.g., Dee v. Sweet, 218 Ga. App. 18, 460 S.E.2d 110 (1995) (awarding $258,360 in attorneys' fees and $1.00 in actual damages); Ex parte Edwards, 601 So. 2d 82 (Ala. 1992) ($43,000 in attorneys' fees regarding $2,544 note); Johnson v. Eaton, 958 F. Supp. 261, 264 (M.D. La. 1997) ($13,410 fee award, nearly 27 times damage award); Ratner v. Chemical Bank N.Y. Trust Co., 54 F.R.D. 412, 416 (S.D.N.Y. 1972) ($20,000 attorney fee; $0 actual damages and $100 of statutory damages). See also Christopher R. Drahozal, Arbitration Costs and Contingent Fee Contracts, 59 Vand. L. Rev. 729, 772 (2006) ("[C]ourts should take into account the applicability of fee shifting statutes in determining whether a claim is economical to bring in arbitration .... The prospect of a fee recovery may make even a case seeking small monetary damages attractive to an attorney. Thus, in evaluating the amount at stake in arbitration (and thus whether the claim is economical to bring), a court must consider not only the damages sought by the claimant but also any possible attorneys' fee recovery."). (A copy of Professor Drahozal's article is appended hereto as Attachment 1).

These statistics demonstrate that Professor Schwartz is flat-out wrong when he asserts that a business "could [allegedly] rip off 50,000 customers for $50 each and no one is going to sue them individually because it is too costly to bring an individual case [so we] need a class action."

2. During your testimony at the June 12, 2007 hearing, you answered several questions from Rep. Hank Johnson about the opportunity for persons to opt-out of arbitration clauses when they enter into various agreements. Please provide examples and total number of opportunities of which you are aware for persons to opt-out of arbitration in the consumer context, in the employment context, and in any other areas.

Answer: Although I do not believe it would be appropriate to identify specific clients for which my firm and I have performed arbitration agreement drafting services, we have recommended the inclusion of an opt-out right to scores of financial services clients and virtually every one has accepted that recommendation. That means that millions of consumers serviced by those clients have been given the unfettered right to opt out of arbitration without having any negative effect on their account.

An example of the type of language that is used to provide the opt-out right is as follows. First, the consumer is clearly and conspicuously advised at the very beginning of the arbitration agreement that he or she has the right to opt out:

> **"PLEASE READ THIS ARBITRATION AGREEMENT. IF YOU DON'T REJECT IT IN ACCORDANCE WITH PARAGRAPH 1 BELOW, IT WILL BECOME PART OF YOUR APPLICATION AND LOAN AGREEMENT AND HAVE A SUBSTANTIAL IMPACT ON THE WAY IN WHICH YOU OR WE RESOLVE ANY CLAIM WHICH YOU OR WE HAVE AGAINST EACH OTHER NOW OR IN THE FUTURE.**

The opt-out right is then conspicuously set forth in full in the body of the agreement:

> **"RIGHT TO REJECT ARBITRATION. If you do not want this Arbitration Agreement to apply, you may reject it by mailing to us, so that we receive it within 30 days after the date of the Loan Agreement at [name and address of company], a written rejection notice which describes the Loan Agreement and tells us that you are rejecting it. If you want proof of when we received such notice, you should send the notice by "certified mail, return receipt requested." If you use such a method, we will reimburse you for the postage upon your request. Your rejection of arbitration will not affect your right to credit or how much credit you receive or any of the other terms of your loan. If you do not reject this Arbitration Agreement, then it shall be deemed to be effective as of the date we made the loan to you."**

Recent examples of arbitration opt-out rights which have been publicized on the Internet involve arbitration agreements offered by Comcast Cable Corp., DST Systems, Inc. and H&R Block. See documents appended hereto as Attachment 2.

Numerous courts, in enforcing employment and consumer financial services arbitration agreements, have emphasized the fairness inherent in providing such an opt-out right to the employee or consumer. See, e.g., Circuit City Stores, Inc. v. Ahmed, 283 F.3d 1198 (9th Cir. 2002); Circuit City Stores, Inc. v. Najd, 294 F.3d 1104, 1108 (9th Cir. 2002); Providian National Bank v. Screws, 2003 Ala. LEXIS 298 (Ala. Oct. 3, 2003); Tsadilas v. Providian Nat'l Bank, 13 A.D. 3d 190, 786 N.Y.S. 2d 478 (1st Dep't. 2004). Indeed, just last month the federal district court in Marley v. Macy's South, No. CV 405-227, 2007 WL 1745619, at *3 (S.D. Ga. June 18, 2007), enforced an arbitration clause in an employment agreement because "[w]hile Ms. Marley states that she did not have a choice to enter the arbitration process because she was 'in jeopardy of losing [her] job' if she did not, the record indicates that each employee was mailed an election form to opt-out of the program at their home address").

3. One of the initial reasons arbitration was used and encouraged was because it was less costly for the parties involved. Anecdotal stories, such as that of Ms. Jordan Fogal's at the hearing, reflect that cost is prohibitive now for consumers to participate in the arbitration process. Consumers still have to pay fees, they still have to get a lawyer. So how do you respond to Ms. Fogal and others who argue that arbitration from the consumer perspective is not less costly than going to court, especially when the costs of going through arbitration continue to rise for consumers?

Answer: I cannot comment specifically on Ms. Fogal's testimony because I have only seen her anecdotal side of the story and have not seen any of the actual documents or testimony from her case, including the arbitration agreement. I sympathize with her plight, but based on what I have seen I cannot conclude that "arbitration" was the cause of it. Certainly with respect to the arbitration agreements that my partners and I draft for our clients, there is no

question about arbitration costs being prohibitive. The consumer's portion of the arbitration costs is typically either paid for entirely by the company, capped by the arbitration administrator at $125 or limited to the cost of the otherwise applicable court filing fee. As I pointed out at the hearing, even Justice Ginsburg has acknowledged that the consumer fees charged by the NAF and the AAA are fair. And, as discussed above and in my testimony, lawyers are quick to represent consumers individually on a contingent fee basis when applicable law permits prevailing plaintiffs to recover their attorneys' fees and costs (as virtually all federal and state consumer protection statutes do).

Consumers also recoup substantial costs saved through arbitration in numerous ways. For example:

(a) Consumers save substantial money and time because of the way arbitrations are scheduled and conducted. Arbitrations hearings are scheduled for a set day and for a specific amount of time. The day is selected based upon the availability of the consumer and his or her lawyer, as well as the other party and lawyer; and the parties and their lawyers determine how long they need to try their case. So, the consumer knows the exact date of the arbitration and knows how long they need to attend. This allows them to precisely schedule their time away from work and home saving them lost pay or having to pay for unnecessary day care. This also assures them they will not have to waste time waiting day after day for a calendar call in court or for litigation cases to proceed or settle before their case will be heard.

(b) Consumers save time because arbitration hearings are shorter than court trials. Consumers save a lot of money and resources by having their case heard much more quickly than litigated cases and just as fairly.

(c) Consumers have to pay their lawyers less because the lawyers do not have to work as long in preparing for and presenting an arbitration case. Consumers who pay their lawyers by the hour save a lot of money; and lawyers who charge a contingent fee percentage can charge a lower rate because the time spent on a case is significantly less.

4. With the problems associated with mandatory arbitration imposed on consumers, why not just encourage your clients to enter into more non-binding mediation programs? Or more post-dispute voluntary arbitration programs?

Answer: In fact, not because of any "problems" associated with mandatory arbitration but in order to provide even a greater range of alternative dispute resolution options, many companies are encouraging employees and other consumers to mediate or otherwise attempt to informally resolve disputes before litigation or arbitration is commenced. As to the second question, limiting consumer arbitration to just post-dispute controversies would severely curtail consumer arbitration because once a dispute has arisen, one side or the other, or both, inevitably use the *in terrorem* "threat" of expensive and prolonged litigation as a negotiating tool. That tactic is eliminated if the parties have agreed to arbitrate the dispute prior to the dispute arising. Included in my written materials was a study that concluded that post-dispute arbitration is a theory that sounds superficially appealing but fails in real life. The study cites

both empirical evidence as well as the opinion of a former president of the American Bar Association. See Exhibit A to Levin written materials, pp. 12-14.

5. How does mandatory binding arbitration benefit consumers? Are the costs saved through mandatory arbitration passed on to consumers? If yes, please provide examples.

Answer: As to the first part of this question, it has been recognized since the enactment of the Federal Arbitration Act ("FAA") in 1925 that arbitration is faster, less costly and more efficient than litigation: "[T]he Act [FAA], by avoiding 'the delay and expense of litigation,' will appeal 'to big business and little business alike, corporate interests [and] individuals.' Indeed, arbitration's advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation." Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 280 (1995) (citations omitted). More specifically, arbitration provides consumers with affordable and accessible civil justice. For example:

(a) Arbitration entitles consumers to pursue all their legal rights and remedies against businesses. It is through arbitration that consumers can readily vindicate their rights. Litigation is unavailable to most Americans who cannot afford to litigate or who cannot find a trial lawyer to represent them. Arbitration has become the preferred way for consumers to fully enforce their legal remedies.

(b) Arbitration allows consumers to hold businesses accountable to comply with consumer laws. Through inexpensive and readily available arbitration proceedings, arbitrators can and do hold businesses responsible for any legal damages they cause consumers.

(c) Arbitration makes it very affordable for consumers to file legal claims. Businesses will pay or have to pay for most or all of the consumer arbitration costs. The current law protects consumers and requires companies to usually pay for all but a small fraction of the costs of the arbitration proceedings.

(d) Arbitration resolves consumer legal disputes quickly. The average consumer arbitration case is over in a matter of months, from beginning to end. Litigation takes years to resolve similar disputes. Consumers do not -- and should not -- have to wait long to find out if they have been injured and how much those damages total.

(e) Arbitration saves consumers a lot of time and money because it is very accessible and available. It is nowhere near as complicated or time consuming as litigation. And consumers can use -- but do not need -- a lawyer to represent them. Most Americans are locked out of the court system because they need a lawyer to sue and they can't find one or can't afford one. With arbitration consumers can help themselves or more easily find a lawyer to represent them.

(f) Arbitration allows consumers to readily defend their legal disputes with businesses. There will be cases brought by businesses against consumers, and arbitration permits the consumer to easily defend these cases. There is usually no fee for a consumer to

respond to an arbitration claim, and a consumer can bring a counter-claim against the business if one exists. These proceedings are simpler and easier for the consumer to present their factual and legal defenses.

(g) Arbitration schedules convenient hearings for consumers. Arbitrating parties have a lot of flexibility regarding the type and timing of hearings. A consumer has a right to appear in person at a hearing and give testimony, or a party can usually elect to appear by telephone. These hearings can be set for a specific day and time at a nearby location when the consumer is available. That way the consumer can avoid lost and wasted time. In addition, the parties can usually choose a document hearing and submit their position and documents in writing to the arbitrator.

(h) Arbitration involves a neutral arbitrator who must follow the law. Arbitrators decide cases on their merits. A neutral arbitrator is selected who must apply the law to the facts. This results in fair and correct awards in a manner that is faster, more economical and more efficient than litigation.

(i) Arbitration rules and procedures provide consumers with their due process rights which courts protect by reviewing arbitration rules, procedures and awards and hearing objections a consumer may have to arbitration.

(j) Arbitration helps parties settle and mediate disputes. Because arbitration is far less combative than litigation, parties can better talk about settlement or agree on a mediator to help them settle their dispute. A goal of arbitration is to help preserve relationships between disputing parties, and that goal can result in more satisfying endings.

(k) Arbitration avoids expensive, time consuming and painful litigation. Litigation often gets out of hand and causes parties to fight, waste money and dislike each other. Parties can suffer for years litigating. Arbitration reduces these problems by encouraging parties to agree on proceedings and avoids wasting their valuable time.

(l) Opponents to arbitration offer no alternative to arbitration. They would force consumers to return to the former litigation system that regularly and routinely denied most consumers civil justice. Arbitration allows all consumers who have been injured to recover their full damages, and not just those who have suffered significant injuries.

(m) Since the beginning of the American legal system, arbitration has been available to the rich, to companies and to those with retained lawyers. Today, arbitration is available to all Americans and not just those with money.

Numerous empirical studies confirm that arbitration is beneficial to consumers and employees. They were discussed at length in my written testimony but it is worthwhile to re-summarize them here:

(i) A synopsis of independent studies and surveys concerning the benefits of pre-dispute consumer arbitration was published by the NAF in 2004. See

"Effective and Affordable Access to Justice by Consumers -- Empirical Studies & Survey Results." The results were summarized as follows:

(1) Seventy-eight percent of trial attorneys find arbitration faster than lawsuits (ABA, 2003)

(2) Eighty-six percent of trial attorneys find arbitration costs are equal to or less expensive than lawsuits (ABA, 2003)

(3) Seventy-eight percent of business attorneys find that arbitration provides faster recovery than lawsuits (Corporate Legal Times, 2004)

(4) Eighty-three percent of business attorneys find arbitration to be equally or more fair than lawsuits (Corporate Legal Times, 2004)

(5) Individuals prevail at least slightly more often in arbitration than through lawsuits (Delikat & Kleiner, 2003)

(6) Monetary relief for individuals is slightly higher in arbitration than in lawsuits (Delikat & Kleiner, 2003)

(7) Arbitration is approximately 36% faster than a lawsuit (Delikat & Kleiner, 2003)

(8) Individuals receive a greater percentage of the relief they ask for in arbitration versus lawsuits (Maltby, 1999)

(9) Ninety-three percent of consumers using arbitration find it to be fair (Perino, 2003)

(10) Consumers prevail 20% more often in arbitration than in court (Perino, 2003)

(11) In securities actions, consumers prevail in arbitration 16% more than they do in court (U.S. General Accounting Office, 1992)

(12) Sixty-four percent of American consumers would choose arbitration over a lawsuit for monetary damages (Roper Survey, 2003)

(ii) In December 2004, Ernst & Young issued a study ("Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases") examining the outcomes of contractual arbitration in lending-related, consumer-initiated cases. The study, based on consumer arbitration data from January 2000 to January 2004 from the NAF, observed that:

(1) Consumers prevailed more often than businesses in cases that went to an arbitration hearing, with 55% of the cases that faced an arbitration decision being resolved in favor of the consumer. This is the exact same win-rate for consumers as exists in state court. See Contract Trials and Verdicts in Large Counties, 1996, p.5 (April, 2000), Bureau of Justice Statistics, http://www.ojp.usdoj.gov/bjs/pub/pdf/ctvlc96.pdf.

(2) Consumers obtained favorable results in 79% of the cases that were reviewed. Favorable results include results from arbitration decisions, as well as settlements satisfactory to the consumer and cases that were dismissed at the claimant's request.

(3) 40% of consumers who brought claims actually got their "day in court" to tell their stories (see p. 9 table 3, with 97 of 226 cases resulting in an arbitration decision). Compare this to the fact that only 2.8% of cases in state court ever reach trial. Examining the Work of State Courts, p. 29 (1999-2000), National Center for State Courts. http://www.ncsonline.org/D_Research/csp/1999-2000_Files/1999-2000_Tort-Contract_Section.pdf.

(4) 69% of consumers surveyed indicated that they were very satisfied with the arbitration process.

(iii) In April 2005, Harris Interactive released the results of an extensive survey of arbitration participants sponsored by the Institute for Legal Reform at the U.S. Chamber of Commerce. The survey was conducted online among 609 adults who participated in a binding arbitration case (voluntarily, due to contract language or with strong urging by the Court, but not a court order) that reached a decision. The major findings were:

(1) Arbitration is widely seen as faster (74%), simpler (63%), and cheaper (51%) than going to court.

(2) Two-thirds (66%) of participants say they would be likely to use arbitration again with nearly half (48%) saying they are extremely likely.

a. Even among those who lost, one-third say they are at least somewhat likely to use arbitration again.

(3) Most participants are very satisfied with the arbitrator's performance, the confidentiality of the process and its length.

(4) Predictably, winners found the process and outcome very fair and the losers found the outcome much less fair. However, 40% of

those who lost were moderately to highly satisfied with the fairness of the process and 21% were moderately to highly satisfied with the outcome.

(5) While one in five of the participants were required by contract to go to arbitration, the remainder were voluntary – suggested by one of the parties, one of the lawyers, or the court.

(6) Two-thirds of the participants were represented by lawyers.

(iv) RoperASW, 2003 Legal Dispute Study (Apr. 2003). The survey concluded that 64% of individuals would choose arbitration over court litigation, 67% believe court litigation takes too long and 32% believe court litigation costs too much.

(v) One study dealing with AAA employment arbitration found that employees won 73% of the arbitrations they initiated and 64% of all employment arbitrations (including those initiated by employers). See Lisa B. Bingham, Is There a Bias in Arbitration of Nonunion Employment Disputes? An analysis of Active Cases and Outcomes, 6 Int'l J. Conflict Management 369, 378 (1995).

(vi) A study which compared the results in employment arbitration with the results in federal court during the same period of time found that 63% of employees won in arbitration compared to 15% of employees who won in federal court. Awards to employees in arbitration were on average 18% of the amount demanded versus 10.4% of the amount demanded in court. The study also demonstrated that while arbitration awards to employees are on average lower than judgments to employees in court, the outcome for employees is still better in arbitration because of their higher win-rates of arbitration and the shorter duration of arbitration compared to court proceedings. See Lewis L. Maltby, Private Justice: Employment Arbitration and Civil Rights, 30 Colum. Hum. Rights L. Rev. 29, 46-48 (1998).

(vii) In yet another study, it was reported that employees won 51% of arbitrations, while the EEOC won 24% of cases in federal court. See George W. Baxter, Arbitration in Litigation for Employment Civil Rights?, 2 Vol. of Individual Employee Rights 19 (1993-94).

(viii) Another study reported that employees won 68% of the time before the AAA as contrasted with only 28% of the time in litigation. See William M. Howard, Arbitrating Claims of Employment Discrimination, Disp. Res. J. Oct-Dec 1995, at 40-43.

(ix) See Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure, California Dispute Resolution Institute (August 2004). The report appears at HTTP://www.mediate.com/cdri/cdri_print_Aug_6.pdf. The report concluded that consumers prevailed 71% of the time.

(x) Theodore Eisenberg and Elizabeth Hill, Arbitration and Litigation of Employment Claims: An Empirical Comparison, Disp. Resol. J. Nov. 2003 – Jan. 2004, at 44. Higher-compensated employees (*i.e.*, those with annual incomes of $60,000 or more) obtained slightly higher awards in arbitration before the AAA than in court. There was insufficient court data to make a similar comparison for employees with less than $60,000 of annual income, thus proving that such employees have difficulty finding lawyers who will represent them in court.

(xi) Michael Delikat and Morris M. Kleiner, An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?, Disp. Resol. J. Nov. 2003 – Jan. 2004, at 56. The study compared the results of employment discrimination cases filed and resolved between 1997 and 2001 in the S.D.N.Y. versus with the NASD and NYSE. Employees prevailed 33.6% of the time in court versus 46% of the time in arbitration. The median damages award was $95,554 in court versus $100,000 in arbitration. The median duration was 25 months in court versus 16½ months in arbitration. They also found that of over 3,000 cases filed in court, only 125 (2.8%) went to trial, thus undermining the perceived importance that consumer advocates place on the right to trial by jury.

(xii) Gary Tidwell, et al., Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations (Aug 1999), available at http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_009528.pdf. In surveying individual participants in NASD-sponsored arbitration for 1997 to 1999, over 93% agreed that their claims were handled "fairly and without bias."

(xiii) Lisa B. Bingham, Is there a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Actual Cases and Outcomes, 6 Int'l J. of Conflict Mgmt. 369 (1995). In a study of 171 employment arbitration cases filed with the AAA in 1992, Bingham concluded that "employee claimants are more likely than employer claimants to recover a larger proportion of the amount of damages claimed when the arbitrator is paid a fee, recovering almost fourfold what employers recover ...." She concluded that her results "contradict the theory that employment arbitrators will be biased against individual employees . . . ." She opined that arbitrators want to "be acceptable to other parties, not just the repeat player involved in that case."

As to the second part of this question, arbitration programs substantially lower litigation costs and the cost savings are passed through to consumers, in whole or in part, in the form of lower prices for goods and services. See Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. Disp. Resol. 89, 91-93; Richard A. Posner, Economic Analysis of Law 7 (6th ed. 2003). (A copy of Professor Ware's article is appended hereto as Attachment 3). Numerous courts have also recognized the economic benefit of arbitration to consumers. See also Metro East v. Quest, 294 F.3d 294 (The "benefits of arbitration are reflected in a lower cost of doing business that is passed along to customers. That is because by limiting discovery and dealing with individual rather than class claims it "curtails the cost of the proceedings and allows swift resolution of small disputes."); Provencher v. Dell, 409 F. Supp. 2d 1196 (C.D. Cal. 2006) ("it is likely that consumers actually benefit in the form of less expensive computers reflecting Dell's savings from inclusion of the arbitration clause in its contracts"); Carnival Cruise Lines v. Shute, 499 U.S. 585 (1991) ("it stands to reason that passengers containing a forum clause … benefit in the form of reduced fares …"). In addition, the NAF has compiled data, based upon the New Jersey budget for the judiciary, which shows in actual dollars how much it costs the State to dispose of civil cases and, therefore, how much arbitration is saving the court system (and taxpayers) by reducing the caseload of the courts. (See Attachment 4 hereto).

6. How do you respond to consumer advocates who argue that businesses reap the benefits of arbitration in part due to the repeat player phenomenon?

Answer: First of all, such generalized and speculative allegations have been around for a long time but have been uniformly rejected by the courts along with other allegations of institutional bias on the part of arbitration administrators such as the NAF and the American Arbitration Association ("AAA"). See, e.g., Marsh v. First USA Bank, 103 F. Supp. 2d 909, 925 (N.D. Tex. 2000) ("[The NAF] boasts an impressive assembly of qualified arbitrators …. All legal remedies and injunctive relief are available to the parties …. The filing fee structure is clearly stated and reasonably based on the amount of the claim …. The Court is satisfied that NAF will provide a reasonable, fair, and impartial forum within which Plaintiffs may seek redress for their grievances."); BankOne, N.A. v. Coates, 125 F. Supp. 2d 819, 836 (S.D. Miss. 2001), aff'd, 34 Fed. Appx. 964, 2002 WL 663804 (5th Cir. Apr. 5, 2002) (given the NAF's fairness "safeguards" -- including the availability of all legal remedies and injunctive relief and the ability to request a written opinion -- "the court is not persuaded that there … exists any basis for finding the agreement unconscionable"); In re Currency Conversion Fee Antitrust Litig., 265 F. Supp. 2d 385, 412 (S.D.N.Y. 2003) (noting that the "fee schedule in the NAF Code has been upheld as adequate and fair by numerous courts" and rejecting plaintiffs' argument that "the NAF Code unreasonably subjects them to a 'loser pays' cost-shifting provision" because the "plaintiffs are in no worse a position under the NAF Code then they would be in federal court"); Bellavia v. First USA Bank, N.A., No. 02-C-3971, 2003 U.S. Dist. LEXIS 18907, *8 (N.D. Ill. Oct. 20, 2003) (rejecting allegation that the NAF is biased and emphasizing that the NAF rules allow the parties to select an arbitrator who has no affiliation with the NAF); Bank One N.A. v. Williams, No. 3:01CV24-D, 2002 U.S. Dist. LEXIS 27217 at *10-11 (N.D. Miss. April 29, 2002) (compelling arbitration and noting that "federal courts within the Fifth Circuit have repeatedly enforced arbitration provisions where the parties agreed to arbitrate pursuant to the

NAF rules"); Hale v. First USA Bank, N.A., No. 00 Civ. 5406, 2001 U.S. Dist. LEXIS 8045 at *11-12 (S.D.N.Y. June 12, 2001) ("numerous courts have found the NAF to be an adequate and fair arbitral forum and have upheld arbitration provisions requiring arbitration in the NAF"); Vera v. First USA Bank, No. Civ. A. 00-89-GMS, 2001 WL 640979 (D. Del. April 19, 2001) (the "NAF is a model for fair cost and fee allocation"); Smith v. EquiFirst Corp., 117 F. Supp.2d 557, 564 (S.D. Miss. 2000) (holding that NAF "fees provisions do not foreclose plaintiffs' access to an arbitration forum that compares favorably to a judicial forum" and compelling arbitration); ITT Comm. Fin. Corp. v. Wangerin, No. C9-95-163, 1995 WL 434459, at *2 (Minn. Ct. App. July 25, 1995) (rejecting argument that NAF arbitrators were biased due to NAF's receipt of substantial business from ITT and holding that "by itself, no level of Forum business coming from respondent would indicate partiality of the arbitrator"). In sum, there is "no persuasive evidence that the National Arbitration Forum is anything but neutral and efficient." Lloyd v. MBNA Am. Bank, N.A., 2001 U.S. Dist. LEXIS 8279, *9 (D. Del. Feb 22, 2001), aff'd, No. 01-1752, 2002 U.S. App. LEXIS 1027 (3d Cir. Jan. 7, 2002).

I note that Mr. Bland's written testimony referred to an allegation that an NAF arbitrator ruled for the same bank in 80 out of 80 cases. I do not have first-hand knowledge to respond to this, but I thought the Committee would benefit from seeing the NAF's response. Accordingly, I asked the NAF to respond to Mr. Bland's allegation and have appended its response hereto as Attachment 5.

7. In your written testimony for the June 12, 2007 hearing, you state that "I have always counseled our clients that the fundamental principle in implementing a consumer arbitration program is to be fair to consumers." How do you respond to consumer advocates that say that requiring a consumer to travel a great distance to participate in an arbitration hearing is not fair? Or that paying arbitration fees which may exceed the amount in controversy is not fair?

Answer: The consumer arbitration clauses that my partners and I draft or comment on for clients uniformly provide that any arbitration hearing will take place at a location that is convenient for the consumer and that the consumer's share of arbitration fees is either paid entirely by the company or capped by the arbitration administrator's consumer fee schedule (which at most imposes a $125 fee) or by the amount of the relevant court filing fee. If a consumer is a party to an arbitration agreement that requires the consumer to travel a great distance to participate in the hearing or imposes excessive fees, the consumer can challenge those provisions in court and, if successful, the court will either sever the offending provision or refuse to enforce the entire arbitration agreement.

8. In your 1998 article, "Excuse Me, But Who's the Predator?," you state in essence that mandatory binding arbitration agreements are a defense against consumer litigation. How neutral are mandatory arbitration agreements if you consider such clauses a defense to consumer lawsuits?

Answer: See my Answer to Question 1 above, which is incorporated here by reference.

9. If arbitration is more favorable to consumers, according to the empirical studies you listed in your written testimony, what rational business would choose to arbitrate?

Answer: Companies need consumers in order to exist and do not view consumers as antagonists. The existence of an arbitration agreement is an acknowledgment that disputes can and sometimes do arise, but even then general business principles and natural market forces counsel companies to be as "consumer-friendly" as possible. Companies also put their products on sale even though they could make more money by charging more, but they want customers to do business with them and to continue doing business with them in the future. No one would accuse those companies of being irrational.

10. Attorneys have an ethical obligation of zealous representation to their clients. Would not attorneys representing businesses attempt to draft mandatory binding arbitration clauses which maximize the benefits (such as success rates in arbitration decisions and discouragement of filings of arbitration) to their clients at the expense of consumers?

Answer: No. It is not in a company's best interest to provide its customers with an arbitration agreement that is one-sided in favor of the company because the arbitration administrators will not handle the arbitrations and the courts will not enforce the arbitration agreement. It is in the company's best interest, both short-term and long-term, to provide an agreement that is fair to *both* parties since that is the only way the clause will pass muster with the courts and the only way the company will be able to retain its customers' goodwill.

Minority Questions for Mark Levin, Partner, Ballard Spahr Andrews and Ingersoll, LLP:

1. If arbitration options were reduced, wouldn't that tend to hurt consumers by driving up the costs of litigation and, as a result, the costs of consumer products and services, under the classic laws of supply and demand?

Answer: Yes. If arbitration options were reduced, the costs of litigation, particularly class action litigation, would undoubtedly increase substantially and be passed through to consumers in the form of higher costs for goods and services. Arbitration enables companies to reduce the costs of dispute resolution which, in turn, inures to the benefit of consumers. See Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. Disp. Resol. 89, 91-93; Richard A. Posner, Economic Analysis of Law 7 (6th ed. 2003). (A copy of Professor Ware's article is appended hereto as Attachment 3). Numerous courts have also recognized the economic benefit of arbitration to consumers. See also Metro East v. Quest, 294 F.3d 294 (The "benefits of arbitration are reflected in a lower cost of doing business that is passed along to customers. That is because by limiting discovery and dealing with individual rather than class claims it "curtails the cost of the proceedings and allows swift resolution of small disputes."); Provencher v. Dell, 409 F. Supp. 2d 1196 (C.D. Cal. 2006) ("it is likely that consumers actually benefit in the form of less expensive computers reflecting Dell's savings from inclusion of the arbitration clause in its contracts"); Carnival Cruise Lines v. Shute, 499 U.S. 585 (1991) ("it stands to reason that passengers containing a forum clause … benefit in the form of reduced fares …").

2. Under that same logic, who would be more likely to benefit from reduced alternative dispute resolution options for consumers - the consumers themselves, or the trial lawyers and public interest litigation firms who bring the litigation that competes with arbitration?

Answer: Trial lawyers and public interest litigation forms would be the real beneficiaries if dispute resolution options for consumers were reduced. Consumers would clearly be on the losing end. It is important to remember that the named plaintiff in a class action does not recover any more "damages" than if he or she had brought an individual suit. It is the plaintiff's lawyers who receive enormous fees for serving as class counsel. The ability of plaintiffs' lawyers to recover windfall fees in a class action -- even while the class members receive only nominal damages or simply paper coupons -- has eviscerated the salutary public policies underlying class actions and resulted in gross abuses of the class action process. Congress itself has sought to remedy class action abuses in enacting the Class Action Fairness Act of 2005 and the securities reform legislatiou several years earlier. In many cases class certification results in a payment of huge fees to the plaintiff's lawyers, but less to the named plaintiff than if he or she had pursued his or her individual claims in arbitration or small claims court. See, e.g., Parrish v. Blazer Fin. Servs., Inc., 2003 Ala. LEXIS 168 (Ala. May 30, 2003) (Alabama Supreme Court affirmed trial court's decertification of Truth in Lending Act class because, inter alia, even if the largest possible class recovery of $500,000 were obtained, each of the thousands of class members would receive less than $1, whereas individuals seeking to vindicate their own rights under TILA could potentially recover as much as $1,000 plus attorneys' fees and costs); Spikings v. Cost Plus, Inc., No. CV 06-8125-JFW, at 6 (C.D. Cal. May 25, 2007) ("a class action would not be the superior method for the fair and efficient

adjudication of the controversy in a [Fair Credit Reporting Act] case such as this one because it could possibly open the potential for abuse by the attorneys in such a class action"); Najarian v. Charlotte Russe, Inc., No. CV 07-501-RGK, at 4 (C.D. Cal. June 12, 2007) (same).

3. The empirical evidence you cite in your written statement shows that consumers do better in arbitration than they do in court, and that they do better faster. Isn't that powerful evidence that the market is actually doing its best to achieve fair results for consumers, and that we shouldn't trap consumers with the monopolies of the trial lawyers and the courts?

Answer: Absolutely. This empirical evidence is very powerful and directly refutes the anecdotal allegations by Mr. Bland and Professor Schwartz that arbitration is not fair to consumers. Given its importance, I re-summarized the empirical evidence in responding to the Majority's question number 5. Empirical evidence such as this clearly shows that free market forces and the check and balance system described in my testimony are in fact working to ensure that arbitration is fair to consumers. All of the substantial benefits of arbitration would be lost to consumers if litigation were required instead of arbitration.

4. If consumer arbitration is fair, why should it be limited to just post-dispute commitments to arbitrate? Why shouldn't consumers be able to make both post-dispute and pre-dispute commitments to arbitration?

Answer: The Federal Arbitration Act applies to arbitration agreements that encompass both pre-dispute and post-dispute controversies, and consumers clearly should have the right to submit *both* types of controversies to arbitration. Limiting consumer arbitration to just post-dispute controversies would severely curtail consumer arbitration because once a dispute has arisen, one side or the other, or both, inevitably use the *in terrorem* "threat" of litigation as a negotiating tool. That tactic is eliminated if the parties have agreed to arbitrate the dispute prior to the dispute arising. Included in my written materials was a study that concluded that post-dispute arbitration is a theory that sounds superficially appealing but fails in real life. The study cites both empirical evidence as well as the opinion of a former president of the American Bar Association. See Exhibit A to Levin written materials, pp. 12-14.

5. Do you think consumers are likely to know of and try to negotiate for the benefits of arbitration on their own, by *sua sponte* seeking arbitration clauses in their consumer contracts? If not, why should companies be restricted in offering arbitration mechanisms to consumers? Isn't that the best way of ensuring that the arbitration option is on the table?

Answer: It is highly unlikely that consumers, on their own, will try to add an arbitration clause to a contract that does not include one because most consumers automatically assume that disputes must be resolved in court. The trial lawyers and public interest group lawyers do little to dispel that misconception. In my written materials, I included reference to an ABA Section of Litigation Task Force of ADR Effectiveness survey showing that only 4.2% of litigators always recommended post-dispute arbitration to their clients. The only realistic way to inform and educate millions of consumers about the benefits of arbitration is to include arbitration provisions in consumer contracts so that the consumer can study and ask questions about arbitration and understand its numerous benefits. As I emphasized in my testimony,

numerous companies offer the consumer the unfettered right to opt-out of the arbitration provision if they do not wish to be bound by it without having any adverse effect on the remainder of the contract. That way, consumers can be educated about arbitration by having the provision presented to them, but they are free to reject it if they conclude they would rather remain in the court system notwithstanding the expense, delay and inefficiency of litigation.

6. In any consumer transaction, there are always likely to be checks and balances between the buyer and the seller. But in the arbitration context there are also checks and balances provided by the courts, the arbitration services and the statutory backdrop of the Federal Arbitration Act. Isn't that a potent set of checks and balances, the effectiveness of which is borne out by the empirical evidence showing that arbitration delivers fair results for the consumer?

Answer: That is absolutely the case. As I pointed out in my testimony, there is a very potent check and balance system emanating from (1) the FAA itself, (2) the companies whose contracts contain arbitration agreements which are drafted to be fair, (3) the neutral third-party arbitration administrators who typically administer companies' arbitration programs and who will not deal with companies whose arbitration agreements are unfair and (4) the state and federal courts which rigorously enforce the FAA and applicable state laws to ensure that the process is fair. There is an ever-growing body of empirical evidence showing that arbitration delivers fair results to consumers. I have re-summarized that empirical evidence in responding to the Majority's question number 5.

7. Companies and consumers have widely different levels of knowledge about the availability and benefits of arbitration. It's important that the arbitration option be on the table in consumer contracts, for the benefit of both consumers and companies. Doesn't the increasing use of mandatory binding arbitration clauses with provisions such as opt-out provisions and small-claims off-ramps show that the market is reaching the right balance here on its own?

Answer: Yes. Such provisions give the consumer additional options for resolving their claims as well as additional time to learn about the differences between litigation and arbitration. Please see my answer to question 5 above.

8. In fact, hasn't it been just those checks and balances and those market forces that have driven the introduction and increasing use of "fair clauses," opt-out provisions and small-claims off-ramps in the mandatory binding arbitration context? Shouldn't these developments increase our confidence that we should rely on the market to continue to shape the use of mandatory binding arbitration?

Answer: Yes, as I pointed out in detail in my testimony, there is a unique check and balance system involving the FAA, the companies which draft arbitration clauses, the arbitration administrators and the courts that ensures fairness in consumer arbitration agreements. The need to be fair (in order to have the administrator accept an arbitration and in order to have a court enforce the arbitration agreement) has led to opt-out provisions and small claims court carve-outs in consumer arbitration agreements. What could be more fair than giving consumers

the unfettered right to reject the arbitration clause without having any negative effect on his or her account?

9. One of the witnesses testifying against mandatory binding arbitration clauses was a home buyer, isn't the home-purchase setting one in which the prospective customer has the most time, the most incentive and the most negotiating power to either obtain a fair, mutually agreeable dispute resolution clause or walk away from the transaction?

Answer: Yes. I cannot comment specifically on Ms. Fogal's testimony because I have only seen her anecdotal side of the story and have not seen any of the actual documents or testimony from her case, including the arbitration agreement. I sympathize with her plight, but based on what I have seen I cannot conclude that "arbitration" was the cause of it. I would agree that a home buyer has considerable time, incentive and negotiating power to either obtain a fair, mutually agreeable dispute resolution clause or walk away from the transaction, particularly today when home builders are providing all kinds of concessions to stimulate sales.

10. Some argue that companies are able to use their repeat experience and expertise in arbitration to abuse and manipulate the arbitration process, to consumers' detriment. Isn't a company that's savvy enough to do that likely to be savvy enough to abuse and manipulate the litigation process to consumers' detriment?

Answer: Logically that would be the case. But I question the premise of your question that companies use their "repeat" experience to abuse and manipulate the arbitration process to the detriment of consumers. That is pure speculation which has been uniformly rejected by the courts on numerous occasions. See my answer to Majority question number 6 above.

11. Courts have ruled that arbitration is a procedural right, not a substantive one. It is also a faster and cheaper procedure. Don't both parties to a transaction stand to benefit from the procedures afforded by arbitration? If so, why should an arbitration option be taken away from consumers and companies?

Answer: The option to arbitrate should *not* be taken away from companies and consumers. The fact that *both* parties benefit from arbitration has been an underpinning of the FAA since its inception. "[T]he Act [FAA], by avoiding 'the delay and expense of litigation,' will appeal 'to big business and little business alike, corporate interests [and] individuals.' Indeed, arbitration's advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation." Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 280 (1995) (citations omitted). Because of all the checks and balances that operate to ensure that arbitration is fair to consumers, companies and businesses should be free to contract as they wish. That is one of the hallmarks of our democratic society.

12. Which do you think an informed consumer would be more likely to pursue in a common consumer dispute - a quick and efficient individual arbitration, or a laborious and unwieldy class action? If you think that individuals won't pursue arbitration for small claims, doesn't the use of small-claims exceptions to mandatory binding arbitration clauses ensure that

consumers will still be able effectively to bring disputes over small claims? And isn't the market already encouraging the use of such small-claims off-ramps?

Answer: A rational consumer would clearly prefer a quick and efficient individual arbitration over a laborious and unwieldy class action. To reiterate an important point made above, the named plaintiff in a class action does not recover any more "damages" than if he or she had brought an individual suit. It is the plaintiff's lawyers who receive enormous fees for serving as class counsel. In many cases class certification results in a payment of huge fees to the plaintiff's lawyers, but far less to the named plaintiff than if he or she had pursued his or her individual claims in arbitration. See, e.g., Parrish v. Blazer Fin. Servs., Inc., 2003 Ala. LEXIS 168 (Ala. May 30, 2003) (Alabama Supreme Court affirmed trial court's decertification of Truth in Lending Act class because, inter alia, even if the largest possible class recovery of $500,000 were obtained, each of the thousands of class members would receive less than $1, whereas individuals seeking to vindicate their own rights under TILA could potentially recover as much as $1,000 plus attorneys' fees and costs). As discussed in my answer to Majority question number 1 above, the vast majority of small-dollar TILA claims are brought as individual lawsuits, not as class actions.

13. Are there academic articles not yet cited to the Subcommittee that support the argument that arbitration is fair to consumers and should be freely available to them?

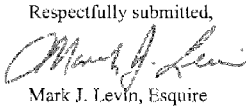
Answer: Yes. Please see Attachments 1 and 3 hereto.

14. At the hearing, a number of other issues were raised or addressed by Members and/or witnesses. If you have additional views or information that could help the Subcommittee better understand those issues, could you please share those views or that information with the Subcommittee at this time?

Answer: Yes. At page 11 of his written testimony, Mr. Bland discusses what he describes as "two publicly disclosed episodes of arbitrators who were handling cases for the … NAF being blackballed after ruling against NAF's most prominent client, MBNA Bank." These allegations concern Elizabeth Bartholet and Richard Neely. Since I do not have first-hand knowledge of these situations, I took the liberty of asking the NAF for its response to these allegations so that the Committee would have the benefit of hearing both sides of the story. I have attached the response I received as Attachment 6 hereto.

Thank you again for the opportunity to respond to your questions. If I can be of any further assistance, please let me know.

Respectfully submitted,



Mark J. Levin, Esquire

ATTACHMENT 1

April, 2006

59 Vand. L. Rev. 729

LENGTH: 22291 words

ARTICLE: Arbitration Costs and Contingent Fee Contracts

NAME: Christopher R. Drahozal*

BIO: * John M. Rounds Professor of Law, University of Kansas School of Law. I appreciate helpful discussions with and comments from Bob Bailey, Rick Bales, Myriam Gilles, Bruce Johnsen, Eric Rasmusen, Richard Reuben, Jean Sternlight, and Steve Ware, and helpful comments from participants at the Annual Meeting of the Midwestern Law & Economics Association and faculty workshops at Syracuse University College of Law, the University of Missouri-Columbia College of Law, and George Mason University School of Law. I appreciate financial support from the University of Kansas School of Law and the University of Kansas General Research Fund, as well as research assistance of Sean McGivern, David Roby, and Angie Welter.

SUMMARY:
... In a widely publicized report, The Costs of Arbitration, the consumer advocacy group Public Citizen concluded that high upfront costs in arbitration "have a deterrent effect, often preventing a claimant from even filing a case. ... " Reginald Alleyne explained that "even when arbitration litigation costs less than judicial litigation, the timing of some required arbitration costs, such as upfront fees for the arbitrator, can make it likely that the arbitration-plaintiff will be unable to proceed in that forum. ... By entering into a contingent fee contract, claimants are able to defer not only payment of attorneys' fees, but also payment of other litigation costs, because attorneys may advance such costs on behalf of their clients. ... Third, for small claims, the consumer pays no administrative fee. ... Under both the expected value model and the option model, as described above, a claimant considers the total costs of arbitration, not merely the upfront costs, in deciding whether to file a claim. ... The Sixth Circuit in Morrison reasoned that contingent fee contracts enable claimants to avoid most, if not all, upfront costs in litigation, but that claimants must pay arbitration costs upfront regardless of whether they have a contingent fee contract with their attorney. ... Even if a class claim has a negative expected value in arbitration, however, that should not provide a legal basis for challenging the arbitration agreement on cost grounds. ...

TEXT:
[*730]

I. Introduction

In a widely publicized report, The Costs of Arbitration, the consumer advocacy group Public Citizen concluded that high upfront costs in arbitration "have a deterrent effect, often preventing a claimant from even filing a case." n1 Indeed, according to Public Citizen, "few consumers have actually navigated the [arbitration] process - most individuals, when confronted by the costs, are forced to drop their claims." n2 Many commentators echo this cost-based criticism of arbitration. Mark Budnitz stated that "the costs of arbitration can be so high that they deny consumers access to a forum in which to air their disputes." n3 Charles Knapp asserted that "where the claimant is an individual buyer of goods or services, an employee, a health-care patient, a bank customer, or even a small business attempting to pursue a claim against a much larger one, the cost of arbitrators' fees may be prohibitive." n4 Reginald Alleyne explained that "even when arbitration litigation costs less than judicial litigation, the timing of some required arbitration costs, such as upfront fees for the arbitrator, can make it likely that the arbitration-plaintiff will be unable to proceed in that forum." n5 The National Consumer Law Center concluded bluntly: "The upshot is that high arbitration costs favor companies and hurt consumers by deterring valid claims." n6

The upfront costs of arbitration provide a common ground on which consumers and employees challenge the enforceability of [*731] arbitration agreements in court as well. n7 The United States Supreme Court recognized the availability of such a challenge (in dicta) in Green Tree Financial Corp.-Alabama v. Randolph, n8 stating that "it may well be that the existence of large arbitration costs could prevent a litigant ... from effectively vindicating her federal statutory rights in the arbitral forum." n9 Federal courts typically evaluate cost-based challenges to arbitration agreements by comparing the upfront costs of arbitration to the upfront costs of litigation, taking into account the individual claimant's ability to pay. n10 For example, the Sixth Circuit in Morrison v. Circuit City Stores, Inc. n11 required that the costs of arbitration be compared to the costs of litigation "in a realistic manner," n12 by which the court evidently meant considering only the upfront forum costs of each. The court explained that "many litigants will face minimal costs in the judicial forum, as the attorney will cover most of the fees of litigation and advance the expenses incurred in discovery," while "in the arbitral forum, the litigant faces an additional expense-the arbitrator's fees and costs-which are never incurred in the judicial forum." n13 In determining whether this additional expense precludes claimants from proceeding in arbitration, a court "should take the actual plaintiff's income and resources as representative of [the ability of similarly situated litigants] to shoulder the costs of arbitration." n14

The cost-based criticisms and legal challenges are based on three, seemingly self-evident premises. First, upfront forum costs are higher in arbitration than in court. Unlike court litigation, which is subsidized by the government, the parties to arbitration proceedings must pay all the forum costs-that is, the arbitrator's fees and any administrative costs. Ordinarily, forum costs in arbitration increase as the amount of the claim increases, unlike court filing fees, which are a flat, low amount. n15 Moreover, arbitration rules typically require the claimant to pay administrative costs and to make a deposit of [*732] arbitrator's fees when the claim is filed. n16 As a result, Public Citizen concluded, "the cost to a plaintiff of initiating an arbitration is almost always higher than the cost of instituting a lawsuit"-an amount "up to five thousand percent higher in arbitration than in court litigation." n17

Second, at least some individuals cannot afford to pay the higher upfront costs in arbitration. The Public Citizen report illustrated this point largely with anecdotes. For example, the report described cases in which the claimant was an unemployed woman asserting a legal malpractice claim, a waitress seeking insurance coverage for chemotherapy and stem cell rescue treatment, and a retired optometrist who lost his entire retirement savings. n18 More generally, the report asserted that arbitration costs are likely to be beyond the means of "people of low-or moderate-income," particularly in cases in which an individual has lost his or her job or is unable to pay debts on time. n19

Third, the contingent fee system in litigation permits individual claimants to avoid paying other process costs-most notably attorneys' fees-upfront. Under contingent fee contracts, consumers and employees agree to pay their attorney a percentage of any recovery, thus enabling even low-income claimants to obtain representation. Moreover, as the court stated in Morrison, often attorneys are willing to "cover most of the fees of litigation and advance the expenses incurred in discovery." n20 Public Citizen contended that the "requirement of a large upfront filing fee and deposit toward arbitrator fees ... severely restricts, or eliminates, the advantage a consumer has under the contingency fee system." n21

This Article challenges the cost-based criticism of arbitration and argues that the approach to legal challenges taken by courts, like the Sixth Circuit in Morrison, is misguided. It certainly is not the first to take issue with the criticisms of arbitration costs, particularly as set out in the Public Citizen report. n22 A common theme among the [*733] responses is that even if upfront forum costs are higher in arbitration than in court, as Public Citizen asserts, overall process costs-including attorneys' fees and other litigation expenses (such as discovery costs)-are lower. n23 As a result, these commentators conclude that, rather than reducing access to justice, arbitration enhances access to justice by permitting claimants to bring claims they could not afford to bring in court. n24 The Supreme Court echoed a form of this argument in Allied-Bruce Terminix Cos. v. Dobson, n25 stating that "arbitration's advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation." n26

But noticeably lacking from the defenses of arbitration is any response to the central premises of the cost-based criticism: that the upfront forum costs in arbitration can exceed the forum costs in court; that some individuals cannot afford to pay the upfront forum costs in arbitration; and that the contingent fee system permits individuals to avoid paying other upfront costs. The defenses of arbitration largely [*734] ignore those premises to focus on the total costs of arbitration. But in Public Citizen's critique, the total process costs of arbitration-whether higher or lower n27 -are largely irrelevant. Because of the contingent fee system, individuals do not need to come up with the money to pay those costs. Instead, the argument goes, it is only the upfront costs of arbitration that affect the individual's decision to file a claim. n28 The response-that the total process costs of arbitration are lower than in court-is thus non-responsive, or at least incomplete.

This Article argues that the contingent fee contract is the missing link in the arbitration defenders' chain of argument, providing a mechanism by which arbitration can enhance, rather than restrict, claimants' access to justice. Beginning with economic models of the decision to litigate (or arbitrate), n29 it shows first that, as a general matter, claimants consider the total cost of the dispute resolution process in evaluating whether to bring a claim, not merely the upfront costs. As an economic matter, then, arbitration costs would preclude claimants from asserting their claims when the expected total costs (not just the upfront costs) of arbitration exceed the expected value of the claim. Under these models, the upfront costs of arbitration are relevant only if the claimant lacks the resources to finance the litigation or is risk averse. The cost-based critique of arbitration thus necessarily is based on concerns about liquidity constraints and risk aversion of consumers and employees.

But that critique ignores the standard device in American litigation for providing financing and risk sharing: the contingent fee contract itself. By entering into a contingent fee contract, claimants are able to defer not only payment of attorneys' fees, but also payment of other litigation costs, because attorneys may advance such costs on behalf of their clients. n30 Moreover, attorneys only seek to recover the litigation expenses they advance from claimants who win their case, so that "the lawyer effectively insures the client for the expenses associated with pursuing a claim." n31 Thus, attorneys provide liquidity [*735] to finance their clients' litigation costs and share the risk of an unsuccessful claim.

Arbitration costs are simply another form of expense-like discovery costs, investigation costs, expert witness fees, and so on. Given that lawyers are willing to finance and insure against these other sorts of expenses, one would expect the same to be true for arbitration costs. Indeed, anecdotal evidence indicates that at least some contingent fee contracts include arbitration costs and arbitrators' fees in the definition of "costs" that the attorneys will advance. n32 To the extent lawyers do not treat arbitration costs the same as other costs, it may well be due to cases like Morrison. So long as attorneys can use the upfront costs of arbitration as a ground for challenging an arbitration agreement (enabling their client to bring his or her claim in court instead of in arbitration), attorneys have an incentive not to finance arbitration costs.

In short, Public Citizen's contention-that arbitration costs "severely restrict, or eliminate, the advantage a consumer has under the contingency fee system"-has it exactly backwards. Arbitration costs do not impair the functioning of the contingent fee system. Rather, the contingent fee mechanism provides a means for overcoming liquidity and risk aversion barriers to arbitration. As a result, even accepting the premises of the cost-based criticism, it does not follow that arbitration costs necessarily preclude individuals from bringing their claims in arbitration. Even if individual claimants cannot afford the forum costs of arbitration, at least some of those individuals-those with economically viable claims given the total costs of the dispute resolution process-should nonetheless be able to bring their claims.

Part II provides an overview of the cost structure of arbitration. Part III takes an in-depth look at current case law and legislation dealing with arbitration costs as a ground for challenging the enforceability of arbitration agreements, and reports the results of an empirical study of 163 post-Green Tree federal court cases. Part IV sets out the economic analysis, using both expected value and option models of the decision whether to file a claim. Part V reexamines the current case law in light of the economic analysis, suggesting significant changes in the legal doctrine. Continuing the empirical analysis, it also finds that in most reported cases, even those in which courts invalidated the arbitration agreement on cost grounds, arbitration costs do not appear to have been a barrier to asserting the claim in arbitration.

[*736]

II. The Cost Structure of Arbitration (as Compared to Litigation)

A party litigating or arbitrating a case faces three types of costs: attorneys' fees, other litigation expenses, and forum costs. n33 First, assuming a party does not proceed pro se, the party must pay its attorney. Consumers and employees often agree to pay their attorneys on a contingent fee basis, which enables individuals to defer payment until after the case is over (and avoid payment altogether unless they prevail). Second, the party must pay other litigation expenses, such as discovery costs, expert witness fees, and the like. It appears to be common practice for attorneys to advance those expenses on behalf of their contingent fee clients. n34 Third, the party (at least the plaintiff or claimant) must pay forum costs-a filing fee in court or the arbitrators' fees plus the fees charged by the institution (if any) administering the arbitration.

No definitive empirical evidence exists comparing attorneys' fees and other litigation costs incurred in litigation and arbitration. n35 But in many cases, forum costs are likely higher in arbitration than in litigation. To file suit in federal court, a plaintiff must pay only a flat filing fee of $ 250. n36 The filing fee is the same regardless of the amount at stake

or the length of time the claim takes to resolve. Even that filing fee may be waived by the court on a showing of financial hardship. n37 The rest of the forum costs are subsidized by the government. n38

By contrast, parties to arbitration proceedings ordinarily bear the full costs of the process. Arbitration is not subsidized by the government in the same way as the court system: "it's a private service provided on an individual basis and paid for case-by-case." n39 [*737] The rest of this Part describes the fee structure for arbitrations administered by the American Arbitration Association ("AAA"), which is illustrative of the characteristics of arbitration fees generally. It begins by looking at arbitrators' fees, then discusses the administrative fees charged under the AAA Commercial Arbitration Rules, and concludes by examining low-cost arbitrations under the AAA's Supplementary Procedures for Consumer Arbitrations. n40 Of course, the parties need not use administrative services provided by institutions such as the AAA. Instead, the arbitrators themselves may handle the administrative duties. If so, presumably the arbitrators' fees would increase to some extent (although it is uncertain whether the increase would be more or less than the administrative fees avoided).

Unlike litigation, in which the government pays the judge's salary, the parties in arbitration must pay the arbitrators. The AAA Commercial Rules do not establish a uniform fee for arbitrators but permit the arbitrators to set their own fees. n41 Table 1 summarizes data collected by the AAA on arbitrators' fees, which reveal mean and median arbitrators' fees in the sample of well over $ 1000 per day (and up to $ 5000 per day for at least one commercial arbitrator). n42 [*738] Although the arbitrators earn their fees by doing work over the course of the case, Rule R-52 of the AAA Rules permits the AAA to require the parties to make a deposit prior to any hearing to cover anticipated arbitrators' fees. n43 As an alternative for low-income claimants, according to the AAA, it has "thousands of arbitrators" on its panel who are willing to serve for one hearing day on a pro bono basis. n44 The AAA indicates that it will seek to appoint an arbitrator who will serve pro bono when the claimant qualifies for a waiver of the AAA's administrative fees, as discussed below, n45 and when arbitrators' fees may preclude the claimant from bringing his or her case. A party may request a pro bono arbitrator even if the AAA does not grant a fee waiver. The AAA makes clear that it "cannot guarantee the appointment of a pro bono or reduced rate arbitrator," but that it will "make every effort to accommodate the request." n46

Table 1. Arbitrators' Fees in AAA Arbitrations

	AAA Panel	Mean (per day)	Median (per day)	Range (per day)	n
Chicago, IL	Commercial	$ 1800	$ 1698	$ 750-$ 5000	60
Colorado	Commercial	$ 1442	$ 1500	$ 600-$ 2500	38
Hamilton County, OH	Commercial	$ 1468	$ 1400	$ 600-$ 2100	31
Indiana	Commercial	$ 1308	$ 1225	$ 700-$ 1800	26
VA, NC, MD, DC	Employment	$ 1403	$ 1500	$ 700-$ 2000	15

In addition to the arbitrators' fees, the AAA charges administrative fees "to compensate it for the cost of providing [*739] administrative services." n47 Under the AAA's Commercial Arbitration Rules, the administrative fees consist of a filing fee and what the AAA calls a "case service fee," n48 both of which increase as the amount of the claim increases. n49 Claimants (or counter-claimants) must advance the filing fee at the time they file the claim. n50 The case service fee is payable when the first hearing in the case is scheduled, subject to being refunded if no hearing takes place. n51 Table 2 summarizes the fee schedule under the AAA Commercial Arbitration Rules. n52 As discussed in more detail below, consumer claims are governed by the AAA's Supplementary Procedures for Consumer-Related Disputes, which alters the fees consumers pay (among other things). n53

Table 2. Fee Schedule - AAA Commercial Arbitration Rules

Amount of Claim	Initial Filing Fee	Case Service Fee
Above $ 0 to $ 10,000	$ 750	$ 200
Above $ 10,000 to $ 75,000	$ 950	$ 300
Above $ 75,000 to $ 150,000	$ 1800	$ 750

Above S 150,000 to S 300,000	S 2750	$ 1250
Above S 300,000 to S 500,000	S 4250	$ 1750
Above S 500,000 to S 1,000,000	S 6000	$ 2500
Above S 1,000,000 to S 5,000,000	S 8000	$ 3250
Above S 5,000,000 to S 10,000,000	S 10,000	$ 4000
Above S 10,000,000	S 12,500 plns .01% of the claim amount above S 10,000,000 (capped at $ 65,000)	$ 6000
Nonmonetary Claims	S 3250	$ 1250

[*740] Like the court system, the AAA Rules permit low-income claimants to seek a waiver of the administrative fees. Rule R-49 provides that "the AAA may, in the event of extreme hardship on the part of any party, defer or reduce the administrative fees." n54 According to the AAA, it will consider waiving or deferring its administrative fee for parties whose gross annual income is below 200% of the federal poverty guidelines. n55 In addition to annual income, the AAA may take into account past income, potential future income, and assets in deciding whether to waive its fees. n56 All claimants must file an affidavit of hardship when seeking a fee waiver. The bottom line is that the determination is within the AAA's discretion. As the AAA explains, "since every hardship request is unique and involves many variables, the AAA reserves the right to deny or grant any request based on the information given by the requesting party." n57 Note that even if the AAA waives its administrative fees, the waiver does not include arbitrators' fees. It is the arbitrators' decision whether to serve on a pro bono basis, as discussed above. n58

Finally, under the AAA Commercial Arbitration Rules, the parties share the costs of arbitration equally (except for the expenses of their own witnesses), unless they agree otherwise or "unless the arbitrator in the award assesses such expenses or any part thereof against any specified party or parties." n59 The costs that may be reallocated include "required travel and other expenses of the arbitrator, AAA representatives, and any witness and the cost of proof produced at the request of the arbitrator." n60 Likewise, while claimants must pay the AAA's administrative fees in advance, those fees are "subject to final apportionment by the arbitrator in the award." n61 Thus, a successful claimant ultimately may be able to recover its arbitration costs, but only at the discretion of the arbitrator at the end of the proceeding. Some arbitration clauses override this default rule and specify that the parties are to share arbitration costs equally [*741] without regard to the arbitrators' usual power to reallocate those costs in the award. n62

The discussion so far has focused on the AAA's Commercial Arbitration Rules. But for arbitration agreements in standard form contracts between businesses and consumers, the AAA supplements the Commercial Arbitration Rules with its Supplementary Procedures for Consumer-Related Disputes. n63 The AAA's Consumer Procedures treat costs differently than its Commercial Arbitration Rules in several respects. n64

First, the Consumer Procedures cap arbitrators' fees for small claims, that is, "cases in which no claim exceeds $ 75,000." n65 For a desk arbitration (i.e., an arbitration based solely on the parties' paper submissions with no oral hearing), the arbitrator is paid $ 250. For a telephone hearing, the arbitrator is to receive S 750 per day. For claims over S 75,000, arbitrators continue to be compensated at their standard rate. n66

Second, for small claims, the consumer and the business share the arbitrator's fees. For claims less than S 10,000, the consumer must pay one-half of the arbitrator's fee, but no more than S 125. For claims between $ 10,000 and S 75,000, the consumer must pay one-half of the arbitrator's fee, but no more than $ 375. For claims over S 75,000, the consumer must make a deposit of one-half the arbitrator's fee. n67 In all cases, the business is to pay the remainder of the arbitrator's fee to the extent not paid by the consumer. n68

Third, for small claims, the consumer pays no administrative fee. n69 Instead, the business is responsible for all administrative fees. [*742] As set out in the Consumer Procedures, for claims under S 10,000, the business must pay an administrative fee of S 750 and, if the case goes to hearing, a Case Service Fee of S 200. For claims between $ 10,000 and $ 75,000, the administrative fee is S 950 and the Case Service Fee in the event of a hearing is S 300. Only

for claims over $ 75,000 is the consumer responsible for paying administrative fees, determined under the AAA Commercial Rules as described above. n70

In short, the forum costs faced by consumers under the AAA Consumer Procedures for small claims are similar to the forum costs they would face in court. Other arbitration institutions likewise have instituted low-cost arbitration schemes for consumer claims. n71 Thus, concerns about upfront costs precluding claimants from asserting claims in arbitration, at present, seem limited to claims over $ 75,000 (in institutional arbitrations) and to claims in arbitrations not administered by an arbitration institution with a low-cost arbitration scheme.

III. Costs as a Ground for Challenging Arbitration Agreements

Claimants commonly rely on the upfront costs of arbitration as a ground for challenging the enforceability of arbitration agreements. The legal theories used are twofold. The first theory, applicable to cases in which a claimant seeks to assert a federal statutory claim, is that the upfront costs of arbitration prevent the claimant from vindicating his or her federal statutory rights. n72 The second theory, more generally applicable, is that arbitration agreements with high upfront costs are unconscionable.

[*743] Although the theories differ, the underlying analysis is similar. Courts first compare the upfront costs of arbitration to the (usually lower) upfront costs of litigation and then evaluate whether the claimant can afford to pay the additional costs based on his or her assets and income. n73 Thus, courts typically take an ex post rather than an ex ante approach to cost-based challenges; they do not look at the claimant's financial situation at the time the contract was entered into, but rather his or her financial situation at the time the claim is filed. n74 The burden is on the claimant to show both the expected costs of arbitration and that those costs are likely to preclude him or her from asserting the claim. If the claimant carries that burden, the court will invalidate the arbitration agreement in whole or in part. n75 Cost-based challenges to arbitration agreements are frequently raised but rarely successful-although the rate of success varies widely across the circuits.

In addition to court challenges, several state legislatures have adopted statutes that regulate arbitration costs. The legal effect of such legislation has not yet been widely tested. Federal statutes addressing arbitration costs have been introduced in the U.S. Congress but have not yet been enacted.

A. Court Challenges: "Vindication-of-Statutory-Rights" Theory n76

Since the 1970s, the Supreme Court has held repeatedly that claims arising under federal statutes can be arbitrated based on the assumption that claimants are not giving up their legal rights by [*744] going to arbitration. n77 In Gilmer v. Interstate/Johnson Lane Corp., n78 for example, the Court explained that "so long as the prospective litigant effectively may vindicate his or her statutory cause of action in the arbitral forum," the federal statute (there the Age Discrimination in Employment Act) would continue to serve its purpose. n79 Implicit in the Court's statement is that if, for some reason, a claimant may not "effectively ... vindicate" his or her statutory rights in arbitration, the federal statutory claim may be resolved in court. n80 One such reason asserted by claimants is cost. This Part first discusses the Green Tree case (the governing Supreme Court precedent) n81 and then examines how the circuits have dealt with cost-based challenges since Green Tree.

1. Green Tree

In the leading case, Green Tree Financial Corp.-Alabama v. Randolph, n82 the Supreme Court rejected a cost-based challenge to a consumer arbitration agreement. n83 The claimant in Green Tree, Larketta Randolph, financed her purchase of a mobile home through a loan from Green Tree Financial Corporation. Included in her contract with Green Tree was an arbitration clause that neither contained any provision addressing the costs of arbitration nor specified a governing set of institutional arbitration rules. n84

[*745] Randolph thereafter filed a class action in federal court against Green Tree asserting that Green Tree violated the Truth in Lending Act ("TILA") n85 by failing to include the cost of required insurance as a finance charge. n86 Randolph sought to recover statutory damages (equal to twice the finance charge on the loan n87) and attorneys' fees, for herself and on behalf of a class of similarly situated borrowers. n88

The district court granted Green Tree's motion to compel arbitration, but the Eleventh Circuit reversed. n89 The court of appeals focused on the fact that the arbitration agreement was completely silent as to costs. Nothing in the agreement addressed how much arbitration would cost or who would bear those costs. Nor did the arbitration agreement

specify a set of rules, such as those promulgated by the AAA, n90 that contained provisions on arbitration costs. Although Randolph presented some limited evidence on possible arbitration costs in her rehearing petition before the district [*746] court, n91 the court of appeals did not rely on that evidence. Instead, the court concluded that because the agreement was silent on the costs of arbitration, Randolph faced a risk that arbitration costs would preclude her from vindicating her statutory rights. n92 On the basis of that risk, the court invalidated the arbitration agreement.

The Supreme Court granted certiorari n93 and reversed. It began (after reciting as background its cases dealing with the arbitrability of federal statutory claims) by acknowledging that "it may well be that the existence of large arbitration costs could preclude a litigant such as Randolph from effectively vindicating her federal statutory rights in the arbitral forum." n94 But it concluded that there was no evidence in the record that Randolph would bear prohibitive arbitration costs. Indeed, the Court stated, the record "contains hardly any information on the matter." n95 In a footnote, the Court recited the limited evidence (an estimate of the AAA filing fee of $ 500 for claims in the amount of that brought by Randolph and an article reciting average arbitrators' fees of $ 700 per day n96) and dismissed those estimates as based "entirely on unfounded assumptions"-that the AAA would administer her arbitration and that, if it did, it would charge her the fees she indicated. According to the Court, "these unsupported statements provide no basis on which to ascertain the actual costs and fees to which she would be subject in arbitration." n97 Similarly, the Court found the Eleventh Circuit's rationale for invalidating the arbitration agreement - the agreement's silence on the matter of costs - "plainly insufficient to render [the arbitration agreement] unenforceable." n98

Thus, the Court's holding essentially is a negative one: that an arbitration agreement is silent on costs is not a sufficient basis on which to invalidate the agreement. As such, Green Tree provides little guidance on what sort of showing is needed for a court to invalidate an arbitration agreement on cost grounds. The Court did state that the claimant challenging the arbitration agreement "bears the burden of [*747] showing the likelihood" that he or she will incur prohibitive arbitration costs. n99 But the Court gave no indication "how detailed the showing of prohibitive expense must be before the party seeking arbitration must come forward with contrary evidence." n100

2. The Circuits after Green Tree

Since Green Tree, the circuits have taken differing approaches to determining what sort of showing the claimant must make to carry its burden. n101 Virtually every circuit to have addressed the question [*748] since Green Tree has adopted a case-by-case approach to cost-based challenges. n102 But the specifics of the case-by-case approaches vary among the circuits. n103 Comparing the Fourth Circuit's decision in Bradford v. Rockwell Semiconductor Systems, Inc. n104 with the Sixth Circuit's decision in Morrison n105 illustrates the point.

The Fourth Circuit in Bradford was the first court of appeals after Green Tree to address the question of the showing required of claimants. The claimant, John Bradford, filed a demand for arbitration before going to court, asserting identical age discrimination and breach of contract claims in both arbitration and court. The arbitration hearing occurred (with Bradford presenting witnesses) prior to the district court's rejection of Bradford's argument [*749] that a fee-sharing provision in the arbitration agreement (i.e., a provision that required the parties to "share equally the fees and costs of the arbitrator") prevented him from vindicating his statutory rights in arbitration. In affirming the district court's decision, the Fourth Circuit set out a "case-by case analysis" focusing on three factors: (1) "the claimant's ability to pay the arbitration fees and costs"; (2) "the expected cost differential between arbitration and litigation"; and (3) "whether that cost differential is so substantial as to deter the bringing of claims." n106 On the facts of the case, the Fourth Circuit rejected the cost-based challenge, in large part because Bradford was not in fact deterred from arbitrating his claim. n107

The Sixth Circuit in Morrison expressly rejected the Fourth Circuit's approach, adopting a more favorable standard for claimants. The Sixth Circuit cited two failings of the Bradford approach. First, it "asks too much" of claimants "to come forward with concrete estimates of anticipated or expected costs of arbitration" at an early phase of the case. n108 Second, it focuses solely on the individual bringing the challenge rather than "other similarly situated individuals" who also might be deterred by upfront arbitration costs. n109 The Sixth Circuit described its "revised case-by-case approach" as requiring claimants "to demonstrate that the potential costs of arbitration are great enough to deter them and similarly situated individuals from seeking to vindicate their federal statutory rights in the arbitral forum." n110 One key difference, as identified by the court, is that under Morrison the Sixth Circuit will look to the circumstances of potential claimants "similarly situated" to the claimant raising the cost challenge. Thus, a court should take the claimant's personal financial resources "as representative of this larger class's ability to shoulder the costs of arbitration." n111 Moreover, the claimant need not show the actual arbitration costs he or she is likely to incur in this particular case; instead, evidence of "average or typical arbitration costs" is enough. n112 Nor should the court consider the possibility of the

arbitrator awarding the claimant his or her arbitration costs in the final award because claimants are risk averse ("inclined to err on the side of [*750] caution," in the Sixth Circuit's words). n113 According to the Morrison court, for low-level employees, "this standard will render cost-splitting provisions unenforceable in many, if not most, cases." n114

Central to the Sixth Circuit's analysis was its view of contingent fee contracts. According to the court of appeals, most employees with federal statutory claims (particularly Title VII claims) are represented by counsel on a contingent fee basis. As a result, "many litigants will face minimal costs in the judicial forum, as the attorney will cover most of the fees of litigation and advance the expenses incurred in discovery." n115 But in arbitration, according to the court, claimants must pay arbitrators' fees and administrative costs, expenses "which are never incurred in the judicial forum." n116 The court never considered the possibility that the attorney would advance those costs as well, just like the other litigation expenses in court. Indeed, even under the Fourth Circuit's approach, as noted above, a key factor is "the claimant's ability to pay the arbitration fees and costs," which does not seem to consider the possibility that costs may be advanced by the attorney.

B. Court Challenges: Unconscionability

In addition to a vindication-of-statutory-rights theory, claimants also raise cost-based challenges to the enforceability of arbitration agreements under the doctrine of unconscionability. n117 Unconscionability is the principal theory for challenging arbitration agreements on cost grounds in state court n118 but is relied upon in federal court cases as well. n119 Although derived from a different [*751] doctrinal source, the analysis is very similar to that under the vindication-of-statutory rights theory. n120

This theory was advanced in Brower v. Gateway 2000, Inc., n121 decided by the Appellate Division of the New York Supreme Court. A computer user filed a class action against Gateway 2000, Inc. alleging claims for breach of contract, breach of warranty, fraud, and unfair trade practices due to Gateway's alleged failure to provide promised service for computers it sold. Gateway sought to compel arbitration, relying on an arbitration clause in its Standard Forms and Conditions n122 that provided for arbitration under the Rules of Arbitration of the International Chamber of Commerce ("ICC"). n123 According to the court, "a claim of less than $ 50,000 required advance fees of $ 4,000 (more than the cost of most Gateway products)." n124 The court held the cost provision unconscionable, reasoning that "the excessive cost factor that is necessarily entailed in arbitrating before the ICC is unreasonable and surely serves to deter the individual consumer from invoking the process." n125 Based on Gateway's willingness to arbitrate before the AAA rather than the ICC, however, the court remanded the case to the trial court to determine whether the AAA's costs of arbitration were so excessive as to be unconscionable.

More recent is the Ninth Circuit's opinion in Ferguson v. Countrywide Credit Industries, Inc., n126 one in a line of cost-based unconscionability challenges adjudicated in the Ninth Circuit. n127 The [*752] claimant filed suit against her employer, Countrywide, alleging various claims, including a claim for sexual harassment under Title VII of the Civil Rights Act of 1964. n128 The district court refused to compel arbitration, and the Ninth Circuit affirmed. Relying on California law, particularly the California Supreme Court's decision in Armendariz v. Foundation Health Psychcare Services, Inc., n129 the court of appeals concluded that the arbitration clause was unconscionable. The arbitration clause contained three provisions the court found objectionable: the clause (1) excluded certain claims from arbitration; (2) provided that the parties would share all arbitration costs (other than the $ 125 initial filing fee, which the claimant would pay, and the fee for the first day of any hearing, which the employer would pay); and (3) imposed more stringent limitations on the employee's discovery of the employer than on the employer's discovery of the employee. Applying California law, the Ninth Circuit held all three provisions unconscionable and, finding them not severable, invalidated the entire arbitration clause. The court stated in dicta that "the only valid fee provision is one in which an employee is not required to bear any expense beyond what would be required to bring the action in court." n130 Subsequent Ninth Circuit cases have echoed this language in striking down arbitration agreements as unconscionable, at least in part, on cost grounds. n131

C. An Empirical Study of Cost-Based Challenges in Federal Court

While the previous Sections examined particular cases, this Section takes a more general perspective, summarizing some key characteristics of the reported n132 federal court decisions adjudicating cost-based challenges to arbitration agreements from December 11, 2000, to June 30, 2005. n133 The Supreme Court decided Green Tree Financial Corp. - Alabama v. Randolph on December 11, 2000, n134 so the cases studied are limited to post-Green Tree decisions. Included [*753] are both court of appeals decisions and district court decisions, although the description of the results

below sometimes distinguishes the two. Each case is included only once, either at the district court level or at the court of appeals level. If, for example, the court of appeals reversed the district court's decision on the cost issue, only the court of appeals' decision is included, and the case is characterized accordingly.

One important caveat needs to be noted: reported court cases are subject to various selection biases making generalizing from the results problematic. First, the sample of cases arising under arbitration clauses is affected by "ex ante selection"-selection due to parties deciding whether to agree to pre-dispute arbitration agreements. n135 Second, selection occurs when claimants decide whether to assert their claims in arbitration. This sort of "ex post selection" bias may be particularly problematic here, where the cases in which arbitration costs preclude a party from asserting his or her claim might be precisely those that never make it to court. Third, the parties-either the plaintiff by filing suit or the defendant by removing the case-select between federal court and state court. Fourth, selection occurs when the parties settle their dispute prior to the resolution of any challenge to the arbitration agreement. n136 As Joel Waldfogel said: "any model of the settlement decision is also at least implicitly a model of the selection of cases for trial." n137 Fifth, judges select among cases when they identify the cases in which to issue written opinions and designate those opinions as published or unpublished. Moreover, the facts of the cases, and particularly the evidence introduced by claimants to show their inability to pay [*754] arbitration costs, vary by case. There is no reason to assume that the different courts are dealing with comparable cases. Accordingly, the results below are presented simply as descriptive of the reported cases.

Federal courts issued opinions in 163 cases involving cost-based challenges to arbitration agreements during the roughly four-and-one-half-year period studied. Of those cases, 31 (19%) gave rise to an opinion in the court of appeals, while the other 132 (81%) were resolved by a district court with no evidence of an appeal on the cost issue. n138 Not surprisingly, given that the cases were brought in federal court, the most common theory discussed in the opinions was the vindication-of-statutory-rights theory, relying on Green Tree: 85 (52.1%) of the opinions addressed only the vindication-of-rights theory, while another 11 (6.7%) discussed that theory along with another. In 65 cases (39.9%), the court addressed unconscionability as the sole doctrinal basis for the cost-based challenge. n139 In many of those cases, the argument that the arbitration agreement was unconscionable closely tracked the vindication-of-rights theory and included a citation to Green Tree.

Many of the cases involved employees suing their employer (or former employer): 81 of 163 (or 49.7%) were employment cases. Most of the rest (47 of 163, or 28.8%) involved consumer borrowers suing lenders (banks, credit card issuers, etc.). n140 The substantial majority of the cases (121 of 163, or 74.2%) were brought by individuals suing on their own behalf, while the remainder (42 of 163, or 25.8%) were filed on a class basis. n141 The distribution of class versus individual relief by type of claimant (consumer versus employee) is summarized in Table 3.

[*755]

Table 3. Cost-Based Challenges in Individual and Class Actions

Type of Claimant	Individual Action	Class Action
Consumer	41	32
Employee*	73	8
Other	7	2
Total	121	42

* One claim involved an employee suing an insurer

A large proportion of claimants asserted at least one federal statutory claim, again not surprising given that the cases were in federal court. The most common claims asserted were Title VII employment discrimination claims (44 of 163, or 27%) and claims under the Truth in Lending Act (31 of 163, or 19%). Other federal statutory claims asserted by claimants (in cases in which they did not raise a Title VII or TILA claim n142) included claims under the federal antitrust laws, the Magnuson-Moss Warranty Act ("MMWA"), the Age Discrimination in Employment Act ("ADEA"), the Americans with Disabilities Act ("ADA"), the Fair Labor Standards Act ("FLSA"), the Fair Credit Reporting Act ("FCRA"), the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and the Real Estate Settlement Procedures Act ("RESPA"). In 37 of 163 cases (or 22.3%), the claimant apparently did not assert any claim based on federal law.

Overall, the vast majority of cost-based challenges to arbitration agreements were unsuccessful. Of the 163 cases studied, courts rejected the challenge and upheld the arbitration clause in 122 (or 74.8%). The success rate varied sig-

nificantly by circuit. Claimants in courts in the First, Fifth, Eleventh, and D.C. Circuits never successfully challenged an arbitration agreement on cost grounds after Green Tree, while claimants in courts in the Ninth Circuit succeeded in having the clause invalidated in whole, or in part, in 12 of 20 cases (or 60%). n143 Table 4 summarizes the outcomes by circuit, breaking down the outcomes between courts of appeals and district courts.

[*756]

Table 4. Outcomes in Cost-Based Challenges by Circuit

	Clause Upheld	Struck Down	Provision Severed	Case Remanded	Total
First Circuit	4	0	0	0	4
	(100%)	(0%)	(0%)	(0%)	
Court of Appeals	1	0	0	0	1
District Court	3	0	0		3
Second Circuit	13	1	0	0	14
	(92.9%)	(7.1%)	(0%)	(0%)	
Court of Appeals	0	0	0	0	0
District Court	13	1	0		14
Third Circuit	16	3	2	2	23
	(69.6%)	(13%)	(8.7%)	(8.7%)	
Court of Appeals	2	1	1	2	6
District Court	14	2	1		17
Fourth Circuit	6	1	0	0	7
	(85.7%)	(14.3%)	(0%)	(0%)	
Court of Appeals	3	0	0	0	3
District Court	3	1	0		4
Fifth Circuit	17	0	0	0	17
	(100%)	(0%)	(0%)	(0%)	
Court of Appeals	3	0	0	0	3
District Court	14	0	0		14
Sixth Circuit	9	0	6	2	17
	(52.9%)	(0%)	(35.3%)	(11.8%)	
Court of Appeals	0	0	1	2	3
District Court	9	0	5		14
Seventh	16	4	0	0	20
Circuit	(80%)	(20%)	(0%)	(0%)	
Court of Appeals	1	0	0	0	1
District Court	15	4	0		19
Eighth Circuit	4	1	2	1	8
	(50%)	(12.5%)	(25%)	(12.5%)	
Court of Appeals	2	0	0	1	3
District Court	2	1	2	0	5
Ninth Circuit	8	11	1	0	20
	(40%)	(55%)	(5%)	(0%)	
Court of Appeals	0	5	1	0	6

District Court	8	6	0		14
Tenth Circuit	6	4	0	0	10
	(60%)	(40%)	(0%)	(0%)	
Court of Appeals	0	0	0	0	0
District Court*	6	4	0		10
Eleventh Circuit	19	0	0	0	19
	(100%)	(0%)	(0%)	(0%)	
Court of Appeals	4	0	0	0	4
District Court	15	0	0	0	15
D.C. Circuit	4	0	0	0	4
	(100%)	(0%)	(0%)	(0%)	
Court of Appeals	1	0	0	0	1
District Court	3	0	0	0	3
Totals	122	25	11	5	163
	(74.8%)	(15.3%)	(6.7%)	(3.1%)	
Court of Appeals	17	6	3	5	31
District Court	105	19	8		132

* Includes one Bankruptcy Court opinion

[*757]

D. Legislation

In addition to the courts, several state legislatures have enacted statutes seeking to regulate arbitration costs. As part of a series of laws regulating consumer arbitration enacted in 2002, n144 the California legislature enacted what is now Section 1284.3 of the California Code of Civil Procedure. n145 Section 1284.3 regulates in various ways the costs and fees that can be charged to a consumer by a "private arbitration company," including arbitration institutions such as the AAA. Subsection (a) prohibits a private arbitration company or neutral arbitrator from administering a consumer arbitration under an agreement that provides for costs to be shifted to the consumer in the event the consumer loses in the arbitration. n146 Subsection (b) requires a private arbitration company to waive "all fees and costs charged to or assessed upon a consumer party ... exclusive of arbitrator fees" for an "indigent consumer," which the statute defines as "a person having a gross monthly income that is less than 300 percent of the federal poverty guidelines." n147 The arbitration institution must provide written notice of the availability of this option to consumers, and the only evidence it can require in support of a [*758] request for waiver is a sworn declaration by the consumer of his or her monthly income and the number of persons in the household. n148 The California statute, by its terms, does not provide for the invalidation of a consumer arbitration agreement due to excessive cost. But in Gutierrez v. Autowest, Inc., n149 the California Court of Appeal relied on Section 1284.3(b) in part in permitting claimants to "resist enforcement of an arbitration agreement that imposes unaffordable fees." n150

New Mexico took a different approach to regulating arbitration costs when it enacted the Revised Uniform Arbitration Act ("RUAA") in 2001. n151 The New Mexico non-uniform version of RUAA defines a "disabling civil dispute clause" as a clause that modifies or limits "procedural rights necessary or useful to a consumer, borrower, tenant or employee in the enforcement of substantive rights against a party drafting a standard form contract or lease." n152 The definition specifically lists as an example a clause requiring a consumer to "assert a claim against the party who prepared the form in a forum that is ... more costly ... than a judicial forum established in this state for resolution of the dispute." n153 Section 44-7A-5 of the New Mexico Act then provides that in a consumer or employment arbitration, such a clause "is unenforceable against and voidable by the consumer, borrower, tenant or employee." n154 The Section adds that "if the enforcement of such a clause is at issue as a preliminary matter in connection with arbitration, the consumer, borrower, tenant or employee may seek judicial relief to have the clause declared unenforceable in a court having personal jurisdiction of the parties and subject matter jurisdiction of the issue." n155 The provision has not yet been applied in any reported cases. n156

[*759] The United States Congress has considered at least one bill that would regulate arbitration costs, but it has not enacted the bill into law. n157 The Arbitration Fairness Act of 2002 would have authorized arbitrators or arbitration institutions to:

(A) provide for reimbursement of arbitration fees to the claimant, in whole or in part, as part of the remedy in accordance with applicable law or in the interests of justice; and

(B) waive, defer, or reduce any fee or charge due from the claimant in the event of extreme hardship. n158

Neither of those provisions would add much to typical institutional arbitration rules, although presumably they would preclude parties from contracting for a different rule. n159

These legal approaches, both by courts and legislatures, are based, to varying degrees, on the assumption that arbitration costs pose a serious barrier to individual claimants seeking to vindicate their legal rights. The next Part explores that assumption from an economic perspective.

[*760]

IV. Economic Analysis of Arbitration Costs

This Part takes an economic approach to analyzing when the upfront costs of arbitration might preclude a party from asserting a claim. n160 It relies principally on the expected value model of litigation (and arbitration) but also considers insights from a real options approach. The central conclusion is that rather than arbitration costs interfering with the workings of the contingent fee system, as some arbitration critics have asserted, the contingent fee system provides a means for overcoming possible liquidity and risk aversion barriers to arbitration.

A. Expected Value Model

Under the expected value model of litigation, a prospective claimant decides whether to file suit in court by comparing the costs and benefits of litigation. n161 The benefits of litigation are the expected award by the decisionmaker (Jp), either a judge or jury. n162 The costs of litigation (Cp) include forum costs, other litigation expenses, and attorneys' fees. n163 Under the expected value model, a claimant will file suit when the expected recovery is greater than the expected litigation costs-in other words, when Jp - Cp > 0. If Jp - Cp < 0, the claimant will not proceed with the suit. n164

The decision to file a claim in arbitration is analogous to the decision to file suit, although the expected award (J<prime>p) and the expected costs (C<prime>p) in arbitration may differ from the expected judgment and the expected costs in court (in other words, J<prime>p may be [*761] more or less than Jp, and C<prime>p may be more or less than Cp). n165 The party will assert its claim in arbitration so long as the expected arbitration award is greater than the expected cost of the arbitration process (J<prime>p > C<prime>p). The party will not assert its claim in the converse case: when the expected cost is greater than the expected award (J<prime>p < C<prime>p).

Lawsuits that are not economically viable under this model are known as negative expected value suits (or in arbitration, presumably, negative expected value claims). As defined by Lucian Bebchuk, "[a] negative expected value suit is one in which the plaintiff would obtain a negative expected return from pursuing the suit all the way to judgment-that is, one in which the plaintiff's expected total litigation costs would exceed the expected judgment." n166 Actually, an extensive literature exists identifying a variety of circumstances in which claimants have the incentive to assert claims with a negative expected value. n167 In other words, even the fact that a claim has a negative expected value does not necessarily mean that the claimant will not bring the claim in court (or in arbitration). Nevertheless, to the extent it is useful to try and give an economic content to the idea that arbitration costs may be a barrier to a claimant asserting a claim, a negative expected value claim seems like a reasonable shorthand for such a claim (even though an overbroad one).

[*762] It should be clear that the mere fact that a claimant prefers to bring his or her claim in court does not show that the claim has a negative expected value in arbitration. A claimant may for any number of reasons prefer litigation over arbitration ex post, despite having agreed to arbitrate ex ante. n168 Indeed, under the simple expected value model

described above, once a dispute arises, a claimant will prefer to be in court instead of arbitration so long as expected value of the claim in court is greater than its expected value in arbitration ((Jp - Cp) > (J<prime>p - C<prime>p)). n169 This condition certainly can be satisfied in cases in which the claim is not a negative expected value claim in arbitration (i.e., when J<prime>p - C<prime>p > 0).

Of course, the fact that a claim has a negative expected value in arbitration does not necessarily mean that it has a positive expected value in litigation. Indeed, one would expect that most claims that are not cost justified to pursue in arbitration also are not cost justified to pursue in litigation. Thus, for costs to preclude a claimant from asserting a claim in arbitration, the claim must have a positive expected value in court.

Finally, note that in the expected value model, what matters to the claimant's decision whether to file a claim in arbitration is the expected award and the expected costs-the total costs, not merely the upfront costs. A claim has a negative expected value if the entire expected cost of the process (including attorneys' fees and other litigation expenses, not just arbitrator's fees and administrative fees) exceeds the expected award. Thus, the expected value model seems consistent with those who have defended arbitration against cost-based challenges by arguing that the total process costs are lower in arbitration. n170 Likewise, the claimant's personal financial condition plays no role in the decision whether to file a claim under this model. What matters are the characteristics of the claim-its value (the expected award) and the resources it will take to obtain that value (the expected cost).

B. Option Theory and Arbitration

The expected value model assumes that the claimant faces a one-time decision whether to file a claim and makes that decision by [*763] comparing the expected costs and benefits. Bradford Cornell described the assumptions underlying the expected value model as follows:

In deciding whether to sue or whether to settle, the litigants consider the costs and benefits under the assumption that they must either settle promptly or go to trial. There are no intermediate decisions to be made along the way. Under these conditions, the discounted cash flow model can be used to analyze litigation investments. n171

This assumption, of course, is overly simplistic. At a number of points during the litigation (or arbitration) process, claimants obtain new information and can decide whether to continue with or drop a claim. As a result, it is increasingly common to model the litigation process as involving a series of options, with the claimant deciding at the appropriate time whether to exercise each option (pay his or her lawyer to continue with the case) or not (and simply drop the claim). n172

Under the option model, a claimant will file suit when the option value of the case is greater than the exercise price (or strike price) of the option-the costs of proceeding to the next decision point. While seemingly just a restatement of the requirements for positive expected value claims under the expected value model, in fact there are important differences between the two models. Most fundamentally, the option value of a case will never be lower, and may well be higher, than its expected value. n173 This reality has several implications for the problem of arbitration costs.

First, the option model provides another set of circumstances in which it may make economic sense to assert a negative expected value claim. Because the option value of a claim may exceed its expected value, the claimant may have an incentive to file a claim with a negative expected value in court (or in arbitration). n174 Although the expected value is negative, the option value may still exceed the exercise price of the option. The intuition is straightforward. At the time of filing, a case has a range of possible outcomes - some positive, some negative. Because filing does not commit the claimant to litigate the case to judgment, the claimant might file even a claim with a negative expected value. As information is revealed during the litigation process, the claimant can simply drop the claim if it proves to have a negative outcome without incurring the cost of litigating the [*764] matter all the way to judgment. n175 As a result, the option value even of negative expected value claims can be positive. Thus, as stated above, using negative expected value as a proxy overstates the number of cases in which arbitration costs truly are a barrier to asserting a claim.

Second, the option model suggests another reason why claimants may have an ex post preference for litigation over arbitration-in other words, another reason why claimants may have an incentive to challenge the enforceability of arbitration clauses in court. n176 Under the expected value model, the variance of the expected award and the expected costs are immaterial to whether risk neutral claimants will file a claim or which forum they prefer. What matters is the

mean, not the variance. By contrast, increased variance is highly material to the option value of a claim. As Joseph Grundfest and Peter Huang stated, "a lawsuit's variance can be important because it reflects the value of the ability to adjust to newly learned information independently of the litigants' attitudes toward risk." n177 The greater the variance of a claim, the more upside it has. If the upside does not pan out, the claimant simply drops the claim-i.e., declines to exercise the next option. Thus, cases with a higher variance have a higher option value. If, as some evidence suggests, jury decisions have a higher variance than decisions by arbitrators, n178 the option value of a case will be higher in court than in arbitration, giving the claimant added incentive to try to avoid arbitration.

Third, the option model highlights a possible economic effect of upfront arbitration costs on a claimant's decision to file a claim. Under the expected value model, arbitration may have higher expected costs than litigation-even assuming total process costs are the same-by changing the timing of those costs. Costs incurred earlier in the process have a higher discounted present value. Under the option model, even if the mean expected costs are identical, the [*765] timing of those costs can have a significant affect on the option value of the claim. According to Grundfest and Huang, "all other factors constant, a rule that causes litigation costs to be front-loaded will tend to reduce a lawsuit's option settlement value because a plaintiff must then incur larger expenses before gaining the advantage of the information that is disclosed" later in the case. n179 By increasing the cost of filing a claim-i.e., by increasing the costs a claimant must incur before obtaining information about the case after filing-arbitration reduces the option value of the claim, making it less likely that the claim will be economical to assert.

At bottom, however, the inquiry under the option model is conceptually the same as under the expected value model. A claimant will assert a claim when the value of the option exceeds the cost of exercising that option. The values are different but the comparison is the same. Notably, under both theories it is not just the upfront costs of arbitration that affect the parties' decision whether to arbitrate, but the total costs of the process. n180 In addition, under neither theory-in this simple model-does the wealth of the claimant enter into the determination. Thus, the option model, like the expected value model, raises questions about the legal analysis of cost-based challenges in the courts.

C. Liquidity, Risk Aversion, and Contingent Fee Contracts

Under both the expected value model and the option model, as described above, a claimant considers the total costs of arbitration, not merely the upfront costs, in deciding whether to file a claim. Similarly, it is the value of the claim (relative to the total costs) on which the decision to file is based, not the wealth or financial condition of the claimant. But the simple models described above implicitly (if not explicitly) assume claimants are risk neutral. They also assume away any liquidity constraints a claimant might have in financing the litigation. If, however, claimants are risk averse n181 or face liquidity constraints, upfront costs might preclude a claimant from asserting his or her claim in arbitration.

For a claimant in arbitration, the prospect of obtaining an award is an uncertain event: there is only a probability that the [*766] arbitrator will find in the claimant's favor, and then a range of possible amounts the arbitrator might award. By comparison, arbitration costs are a (relatively) certain amount that the claimant must pay upfront in order to bring the claim. n182 To the extent claimants are risk averse, they may be unwilling to incur the certain upfront cost in an attempt to obtain an uncertain recovery. As a result, even if the claim otherwise is economically viable, the upfront costs of arbitration may deter a risk averse claimant from asserting the claim. n183

In addition, legal claims are not freely transferable among parties, which limits the ability of claimants to finance litigation (or arbitration) by using their claim as collateral for a loan. n184 To the extent individuals cannot obtain financing from outside sources, they must rely on their own income and assets to finance the case. If individuals face serious liquidity constraints in arbitrating their claims, then the upfront costs of arbitration might preclude them from filing a claim in the first place. Moreover, in such a case, the extent of the claimant's income and assets certainly would be relevant in evaluating the extent of the liquidity constraint.

Indeed, at least some courts and commentators appear to recognize that risk aversion and liquidity constraints of individuals are central to the cost-based criticisms of arbitration. The Sixth Circuit in Morrison v. Circuit City Stores, Inc. n185 noted the importance of risk aversion when it asserted that claimants may be "inclined to err on the side of caution" in deciding whether to file a claim in arbitration. n186 In The Costs of Arbitration, Public Citizen cited the difficulty that low-income claimants may face in trying to raise the [*767] money needed to pay the upfront costs of arbitration. n187 Other courts and commentators, too, while not explicitly citing liquidity and risk aversion, necessarily assume that those barriers exist.

But while liquidity constraints and risk aversion are central to the cost-based criticism of arbitration, those same courts and commentators ignore the principal device used in American litigation for providing financing and risk man-

agement for individual claimants: the contingent fee contract. Contingent fees are widely used in American litigation, not only in personal injury cases but in a wide variety of cases. n188 Similarly, many claimants in arbitration are represented on a contingent fee basis. n189

A typical contingent fee contract provides that in exchange for the attorney's legal representation, the claimant will pay the attorney some percentage (often although not always 33%) of any recovery obtained in the case. n190 If the claimant recovers nothing, no fee is owed. Under a contingent fee contract, however, the claimant purchases more than merely legal services. As Herbert M. Kritzer explained:

The normal hourly fee or flat fee simply purchases the services of a lawyer. Under a contingency fee arrangement, the client also purchases additional services. The first is financing ... . By their nature, contingency fees are not normally collected until the matter is closed. Very often, lawyers also defer the collection of expenses until the close of a case. Thus, the contingency fee lawyer finances the litigation for the client while a case is pending.

The second additional service that the client purchases is a form of insurance. While in many states clients are liable for expenses regardless of the outcome of a case, the reality is that lawyers who pursue a case unsuccessfully on a contingency basis seldom collect those expenses (or even seek to collect them). Thus, the lawyer effectively insures the client for the expenses associated with pursuing a claim. n191

[*768] The contingent fee contract thus provides a mechanism to overcome both the liquidity and risk aversion constraints individuals face in litigating their claims.

As noted by Kritzer, a common practice in contingent fee cases is for the claimant's attorney to advance on behalf of the client the costs of litigating the case. Examples of costs that might be advanced include discovery costs, expert witness fees, and the like. If the claimant prevails, the attorney obtains repayment of the advances from the judgment or award. If the claimant does not prevail, the attorney rarely if ever seeks to recover the advance, a practice expressly approved by at least some states' ethics rules n192 and seemingly common regardless. n193 As a result, contingent fee contracts provide financing and insurance not only for attorneys' fees but other litigation expenses as well.

But forum costs, including arbitration costs, are simply another form of litigation costs. On the face of it, there is no reason to expect contingent fee contracts to treat arbitration costs differently than they treat other litigation expenses. One would expect lawyers to advance arbitration costs for their clients, just like any other litigation expense-provided that the claim is economically viable based on the expected award and the expected total costs of arbitration.

[*769] Indeed, some anecdotal evidence suggests that this is in fact the case. For example, the Missouri Bar's Sample Fee Agreement for contingent fee contracts provides that "Client agrees to pay for all costs and expenses paid or owed by Client in connection with this matter, or which have been advanced by Lawyer on Client's behalf." n194 The form contract goes on to state that "costs and expenses commonly include ... professional mediator, arbitrator and/or special master fees and similar other items." n195 A fee agreement for the Caruso Law Offices, P.C., available on the Internet, defines costs as "any expenditure, fee or charge which, at attorneys' discretion, may be incurred to prosecute Client's claim, including but not limited to ... mediation or arbitration fees." n196 The fee agreement (for premises liability cases) for Winer Menuela & Devens LLP likewise includes "arbitration costs" in its list of costs to "be reimbursed by the client(s) at the conclusion of the case," implying that the attorneys typically would advance those costs if necessary. n197

An additional anecdote comes from the federal district court's opinion in Mattox v. Decision One Mortgage Co. n198 The plaintiff in Mattox filed a class action against a bank and mortgage company asserting violations of the Real Estate Settlement Procedures Act. The district court rejected a cost-based challenge to the arbitration agreement, holding that the respondent's offer to pay all arbitration costs protected the claimant from having to bear excessive costs. Included as part of the evidence introduced by the claimant in support of the challenge was an affidavit by the claimant's attorney, in which the attorney stated that he "would not, as a matter of business discretion, advance arbitration fees on the claims at issue in this case, if the matter is referred to arbitration." n199 The affidavit is suggestive of a practice among at least some contingent fee attorneys of advancing arbitration costs, even if on the facts of this case the attorney would not do so. n200

[*770] This anecdotal evidence plainly is not conclusive, n201 but it is suggestive. Certainly more systematic empirical work would be useful. But even if such studies fail to find that attorneys regularly advance arbitration costs, n202 it may be due to cases like the Sixth Circuit's Morrison decision. Cases invalidating arbitration agreements on cost grounds provide a strong disincentive for lawyers to finance arbitration costs, because if the lawyers do so, they may deprive their clients of a possible ground for invalidating the arbitration agreement in court.

At bottom, then, Public Citizen and the Morrison court have it exactly backwards. Arbitration costs do not "severely restrict, or eliminate, the advantage a consumer has under the contingency fee system." n203 Instead, the contingent fee system provides a mechanism for overcoming possible liquidity and risk aversion constraints due to arbitration costs.

V. Reexamining the Legal Doctrine

The previous Part challenges the cost-based criticism of arbitration as misguided in a critical respect: instead of arbitration costs interfering with the workings of contingent fee contracts, contingent fee contracts provide a mechanism for overcoming possible liquidity and risk aversion constraints due to the upfront costs of arbitration. This Part suggests some doctrinal implications of that analysis and revisits the empirical study of federal court cases resolving cost-based challenges.

A. Analyzing Cost-Based Challenges to Arbitration Agreements

The analysis in Part IV has several implications for the analysis of cost-based challenges to arbitration agreements in the [*771] courts. First, as a case-by-case approach, it differs from what has been described as a per se standard used by the Ninth Circuit in holding arbitration clauses unconscionable on the basis of cost. The Ninth Circuit stated that (under both California and Washington law) an arbitration clause is unconscionable when it imposes higher costs than the otherwise applicable court filing fee. n204 The analysis here suggests that a case-by-case approach is preferable because in at least some cases the claimant's attorney may be able to advance the costs of arbitration on behalf of the claimant. In such cases, the upfront costs of arbitration will not be a barrier to claimants bringing a claim. n205

Second, the analysis raises serious questions about the holdings of courts, like the Sixth Circuit in Morrison, that are explicitly based on a misunderstanding of the relationship between contingent fee contracts and arbitration costs. The Sixth Circuit in Morrison reasoned that contingent fee contracts enable claimants to avoid most, if not all, upfront costs in litigation, but that claimants must pay arbitration costs upfront regardless of whether they have a contingent fee contract with their attorney. That view incorrectly treats arbitration costs as somehow different from other litigation expenses, when there is every reason to treat them the same. This fundamental misunderstanding suggests that the Sixth Circuit should revisit its approach to resolving cost-based challenges. Possible changes are discussed below.

Third, at least in cases in which the claimant is represented by counsel, any case-by-case approach for analyzing arbitration costs must consider the availability of possible sources of financing in addition to the claimant's personal income and assets. Courts that focus solely on the claimant's personal assets and income are taking too narrow of a view.

Beyond these general implications, stating the economic analysis is much easier than implementing it in the form of a legal test. Courts are not well suited to calculate the expected award in arbitration and to compare it to expected arbitration costs (much less to calculate the option value of a claim and to compare it to the exercise price). Cost-based challenges occur early in the case when [*772] little evidence on the merits may be available. Moreover, if in fact the arbitration agreement is enforceable, having a court make findings on the merits of the case would usurp the function of the arbitrator in adjudicating the parties' dispute.

A few proxies are available. First, the amount sought in the complaint provides some indication of the maximum expected value of the claim. Claimants have little incentive to minimize the amount they assert as damages (although this analysis might give them a reason to do so). n206 Of course, a large amount claimed does not necessarily mean that a claim has a large expected value (even from the claimant's perspective). While the amount sought may be large, the probability of recovery may be small.

Second, courts should take into account the applicability of fee shifting statutes in determining whether a claim is economical to bring in arbitration. As the Supreme Court stated in Pennsylvania v. Delaware Valley Citizens Council for Clean Air, n207 the purpose of fee-shifting statutes is to "enable private parties to obtain legal help in seeking redress for injuries resulting from the actual or threatened violation of specific federal laws." n208 The prospect of a fee recovery may make even a case seeking small monetary damages attractive to an attorney. n209 Thus, in evaluating the

amount at stake in arbitration (and thus whether the claim is economical to bring), a court must consider not only the damages sought by the claimant but also any possible attorneys' fee recovery. n210

Third, whether a claimant is represented by counsel is an important consideration. Certainly, if the claimant is proceeding pro se, the claimant does not have a lawyer to advance the costs of arbitration. In such a case, the central argument of this Article would be inapplicable. Conversely, however, the fact that a claimant currently is represented by counsel in court does not necessarily mean that the claim is a viable one if brought in arbitration. Some of the [*773] value of the claim in court may be due to the possibility that the court would invalidate the arbitration clause, permitting the claim to be resolved in court.

One possible approach would be to permit discovery into the fee arrangements between claimants and their attorneys. n211 If the fee agreement provides for the attorney to advance arbitration costs on behalf of the claimant, the court should reject the cost-based challenge. The problem with this approach is that it provides a strong incentive for strategic contracting between attorneys and their clients. Attorneys would only agree to advance arbitration costs for clients when they did not intend to challenge the arbitration agreement in court. n212 As a result, discovery is not likely to provide meaningful information. At the very least, however, courts should consider the possible availability of other financing sources, in particular the claimant's attorney, when ruling on cost-based challenges.

None of this is to deny that there may be cases in which upfront arbitration costs might preclude claimants from asserting claims. Cases with pro se claimants are of particular concern, as are claimants with small individual claims and no possible attorneys' fee recovery. But this analysis gives reason to doubt that such cases are as common as some have asserted and argues for taking a more critical view of cost-based challenges.

B. Revisiting the Cases

This Section revisits the empirical study in Part III.C in light of the preceding analysis. n213 It examines the sample of post-Green Tree federal court cases and finds little evidence that (1) arbitration costs would preclude claimants from bringing a claim in those cases; n214 or (2) that the cases in which courts invalidated arbitration clauses on cost grounds were more problematic than those cases in which the courts rejected the cost-based challenge.

[*774] Given the role that contingent fee contracts can play in overcoming liquidity and risk aversion barriers to arbitration, an important consideration is the extent to which the claimants are represented by counsel. Again, representation by counsel is not determinative, as a case might be economically viable in court solely because of the possibility that the court would invalidate the arbitration agreement. n215 Nonetheless, if a substantial proportion of claimants in litigated cases were proceeding pro se, it would cast serious doubt on the importance of contingent fee contracts as a means of mitigating the possible effects of arbitration costs.

Of the claimants in the 163 federal court cases listed in Appendix A, only one proceeded pro se; n216 the rest (161 of 162, or 99.4%) were represented by counsel. n217 Of the claimants represented by counsel, only eight (of 161, or 5.0%) were identified in the court's opinion as being represented solely by a law school clinic or non-profit public interest group. n218 Thus, most claimants who challenged arbitration agreements in federal court appear to have been represented by an attorney who was in a position to advance the costs of arbitration on behalf of the claimant.

Another consideration is the amount at stake in the case. All else being equal, claimants with small claims would seem at greater risk of being adversely affected by arbitration costs. For cases in which the only basis for federal court jurisdiction is diversity of citizenship (i.e., those involving only state court claims), the diversity statute requires that the minimum amount in controversy be at least $ 75,000. n219 For cases based on federal question jurisdiction, there is no minimum amount in controversy required. n220 Hence the dollar amounts of those claims could be quite small. Notably, however, most of the cases included claims under federal statutes that authorize the award of attorneys' fees to the prevailing party. n221 A substantial [*775] proportion of the cases-at least 78.1% (57 of 73) of those brought by individual employees n222 and 63.4% (26 of 41) of those brought by individual consumers, n223 as well as 83.3% (35 of 42) of the class claims n224 -included at least one federal claim permitting a successful claimant to recover attorneys' fees. n225 When a claimant has a claim for attorneys' fees, the stakes are much greater than simply the amount of the claimant's loss.

Class claims present some additional issues. In some class cases, particularly consumer cases, the individual amount at stake can be very small. The likely arbitration costs may greatly exceed the amount the individual claimant is likely to recover. Of course in many of the class cases studied here, the claimant has at least one claim under a federal

statute permitting recovery of attorneys' fees. Without such a statute, an individual's claim would appear to be a negative expected value claim. With such a statute, that is by no means clear.

Even if a class claim has a negative expected value in arbitration, however, that should not provide a legal basis for challenging the arbitration agreement on cost grounds. In such cases, it is the lack of a means of aggregating claims in arbitration that makes the claim a negative expected value claim, not higher costs in arbitration. The individual, non-aggregated claims would be no more [*776] economical to pursue in court than in arbitration. It is only because class relief generally is not available in arbitration that the claim has a negative expected value in arbitration.

As an economic matter, the lack of class relief in arbitration can have exactly the same effect as a difference in expected costs-it can turn positive expected value claims into negative expected value claims. But as a legal matter, the distinction can be a critical one. As the Supreme Court stated in Perry v. Thomas, n226 the Federal Arbitration Act ("FAA") precludes a court from "relying on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable," for example, because it would treat arbitration clauses differently than other contract provisions-which the FAA does not permit. n227 Accordingly, state law challenges to arbitration agreements cannot be based on unique characteristics of the arbitration process, such as the lack of class relief. n228

Indeed, many courts have rejected challenges to the enforceability of arbitration agreements based on the ground that class relief is (generally) unavailable in arbitration. n229 By recasting the challenges as based on arbitration costs, at least some claimants are seeking to do an end run around these cases. n230 Myriam Gilles described these sorts of cases as involving "second-wave challenges" to the lack of class relief in arbitration and concluded that "it is not clear to what extent these ... challenges will find traction in the federal courts." n231 These cases are not properly brought as cost-based [*777] challenges. If the lack of class relief in (at least some) arbitration proceedings is a problem, it should be addressed directly, not under the pretense of excessive arbitration costs.

Overall, the cases studied provide little evidence that the cases in which federal courts invalidated arbitration agreements on cost grounds are significantly different from the ones in which the courts upheld the agreements. Individual claims involving only state law claims (and hence with no federal fee-shifting statute involved) would seem to be potentially problematic on cost grounds. n232 Yet the courts upheld the arbitration agreement in 13 out of 14 such cases with consumer claimants (92.9%) and 9 out of 12 cases involving employee claimants (75%). Conversely, for class claims, in which the real objection is to non-cost characteristics of arbitration, the courts upheld the agreement in 25 of 32 cases with consumer claimants (78.1%) and in only 5 out of 8 cases involving employee claimants (62.5%).

A closer look at the cases in which federal courts invalidated arbitration agreements on cost grounds likewise provides little indication that they were particularly problematic under the analysis suggested here. In the 36 cases in which a federal court invalidated the arbitration agreement in whole, or in part, on cost grounds, the claimant was represented by counsel in every case (36 of 36, or 100%) and asserted a claim that permitted recovery of attorneys' fees in all but four (32 of 36, or 88.9%)-both above the percentages for the sample as a whole. The only contrary indication is that in 5 of the 36 (or 13.9%) cases the claimant was represented by a law school or public interest clinic-a much higher percentage than in the rest of the sample n233 -although in all of those cases the claimant asserted a claim under which attorneys' fees could be recovered. This evidence suggests that in a substantial majority of those reported cases in which courts invalidated the arbitration agreement on cost grounds, arbitration costs may well not have been a barrier to asserting the claim in arbitration.

Several caveats are in order. First, as discussed earlier, selection bias limits the inferences that can be drawn from the results. n234 Second, the study looks only at federal cases, not state cases. State cases may present a different picture of the nature of cost-based challenges. Third, the study does not purport to determine whether some claimants simply never file a claim either in arbitration [*778] or in court due to upfront arbitration costs. Nonetheless, the limited evidence presented suggests that while many circuits have properly taken a skeptical view of cost-based challenges, others may have been too willing to invalidate arbitration agreements on cost grounds.

VI. Conclusion

A common criticism of arbitration is that upfront costs deny claimants-particularly consumers and employees-a forum in which to assert their claims. Some have argued further that arbitration costs undercut the benefits to claimants of contingent fee contracts, which permit claimants to defer payment of attorneys' fees and litigation expenses until they prevail in the case (and if they do not prevail, avoid such costs altogether). This Article argues that this criticism has it exactly backwards. Rather than arbitration costs interfering with the workings of contingent fee contracts, contingent fee contracts provide a mechanism for overcoming possible liquidity and risk aversion problems caused by arbitration costs.

For this reason, much of the legal analysis of arbitration cost challenges is misdirected, focusing too much on the personal finances of the individual claimant and too little on the incentives for the attorney to take the case (such as the value of the claim and possible recovery under fee-shifting statutes). In the vast majority of federal court cases adjudicating cost-based challenges to arbitration agreements, the claimant is represented by counsel, and in most cases has asserted a claim that, if successful, would permit the recovery of attorneys' fees. This evidence is consistent with the fact that the substantial majority of federal court decisions (74.8%) since the Supreme Court's Green Tree case rejected the cost-based challenge. The decisions invalidating arbitration agreements on cost grounds are concentrated in only a few circuits. This analysis suggests that those circuits should reconsider their approaches.

[*779]

VII. Appendix Post-Green Tree Federal Court Cases Adjudicating Cost-Based Challenges to Arbitration Agreements [*780]

[SEE TABLE IN ORIGINAL]

Legal Topics:

For related research and practice materials, see the following legal topics:
Administrative LawAgency AdjudicationAlternative Dispute ResolutionCivil ProcedureAlternative Dispute ResolutionArbitrationsGeneral OverviewContracts LawContract Conditions & ProvisionsArbitration Clauses

FOOTNOTES:

n1. Public Citizen, The Costs of Arbitration 1 (2002), available at http://www.citizen.org/documents/ACF110A.PDF.

n2. Id. at 5. Public Citizen provides no empirical evidence to support this provocative statement, however, and it seems to be contradicted by the over 5,000 consumer and employment arbitrations reported by the AAA from January 1, 2005 through June 30, 2005 (as required by California law), many of which settled or resulted in an award. See American Arbitration Association, CCP Section 1281.96 Data Collection Requirements (July 1, 2005), www.adr .org/CDataQ2.pdf (last visited Apr. 30, 2006).

n3. Mark E. Budnitz, The High Cost of Mandatory Consumer Arbitration, 67 Law & Contemp. Probs. 133, 161 (2004).

n4. Charles L. Knapp, Taking Contracts Private: The Quiet Revolution in Contract Law, *71 Fordham L. Rev. 761, 781 (2002).*

n5. Reginald Alleyne, arbitrators' Fees: The Dagger in the Heart of Mandatory Arbitration for Statutory Discrimination Claims, *6 U. Pa. J. Lab. & Empl. L. 1, 30 (2003).*

n6. National Consumer Law Center, Consumer Arbitration Agreements: Enforceability and Other Topics 1.3.6, at 9 (4th ed. 2004); see also Dennis Nolan, Labor and Employment Arbitration: What's Justice Got to Do With It?, 53 Disp. Resol. J. 40, 47 (1998) ("Sharing the arbitrator's fees and expenses might prove an insurmountable barrier for the putative grievant.").

n7. See Michael H. LeRoy & Peter Feuille, When Is Cost an Unlawful Barrier to Alternative Dispute Resolution: The Ever Green Tree of Mandatory Employment Arbitration, *50 UCLA L. Rev. 143, 176-77 (2002)* (reporting results of empirical study of cost challenges).

n8. *531 U.S. 79 (2000).*

n9. *Id. at 90.* But the Court held in Green Tree that the plaintiff had failed to make a sufficient showing of the likely cost of arbitration (without indicating what showing would have been sufficient). See infra text accompanying notes 94-98.

n10. Budnitz, supra note 3, at 154-56; see also infra text accompanying notes 101-116.

n11. *317 F.3d 646, 664 (6th Cir. 2003)* (en banc).

n12. *Id. at 664;* see also *Cooper v. MRM Inv. Co., 367 F.3d 493 (6th Cir. 2004).*

n13. *Morrison, 317 F.3d at 664.*

n14. *Id. at 663.*

n15. See infra text accompanying notes 48-49.

n16. See infra text accompanying note 50.

n17. Public Citizen, supra note 1, at 1.

n18. Id. at 8, 21, 25. Not all of the arbitrations cited by Public Citizen involved low-income claimants. At issue in one arbitration, for example, were alleged defects in a $ 605,000 home. Id. at 16.

n19. Id. at 52.

n20. *Morrison v. Circuit City Stores, Inc., 317 F.3d 646, 664 (6th Cir. 2003)* (en banc).

n21. Public Citizen, supra note 1, at 65.

n22. See, e.g., Samuel Estreicher & Matt Ballard, Affordable Justice Through Arbitration: A Critique of Public Citizen's Jeremiad on the "Cost of Arbitration", Disp. Resol. J. 8, 10 (Nov. 2002/Jan. 2003) ("The Public Citizen report makes the faulty assumption that lower-income parties are otherwise being denied their "day in court' due to mandatory predispute arbitration agreements."); Eric J. Mogilnicki & Kirk D. Jensen, Arbitration and Unconscionability, *19 Ga. St. U.L. Rev. 761, 770 n.50 (2003)* ("Public Citizen's report fails to consider, however, the costs of legal representation in its analysis - costs that are often substantial."); News Release, Cato Institute, Public Citizen Arbitration Study Contains Errors, Half-Truths and Exaggerations, Scholar Says (May 3, 2002) ("Any honest comparison of arbitration and litigation must include the cost of legal fees, discovery and delay. Those costs are generally lower in arbitration, and Public Citizen offers no persuasive evidence to the contrary.") (quoting Professor Stephen J. Ware), available at http://www.cato.org /new/05-02/05-03-02r-2.html; American Arbitration Association, Fair Play: Perspectives from American Arbitration Association on Consumer and Employment Arbitration (Jan. 2003) [hereinafter AAA, Fair Play].

n23. E.g., AAA, Fair Play, supra note 22, at 23 (quoting Lewis L. Maltby):

Arbitration, because it is private, inherently requires those who use the system to pay the costs. The real question is, and has always been, whether the total cost to the employee/plaintiff is higher or lower in arbitration. An employee/plaintiff is far better off spending $ 2,000 on forum costs and $ 10,000 on legal fees in arbitration than virtually nothing on forum costs and $ 20,000 on legal fees in court.

n24. The available empirical evidence provides some support for this view. In a recent study of American Arbitration Association employment arbitrations, Theodore Eisenberg and Elizabeth Hill reported being "unable to compare litigation and arbitration results for lower-paid employees due to the lack of data about litigation commenced by employees in this economic group." Theodore Eisenberg & Elizabeth Hill, Arbitration and Litigation of Employment Claims: An Empirical Comparison, Disp. Resol. J., Nov. 2003/Jan. 2004, at 44, 45. In other words, while the lower-paid employees in their dataset were able to bring claims in arbitration, the employment cases in court (at least those not involving discrimination claims) were brought mostly by higher-paid employees. Eisenberg and Hill concluded that "lower-pay employees seem unable to attract the legal representation necessary for meaningful access to court." Id. at 61.

n25. *513 U.S. 265 (1995).*

n26. *Id. at 280;* see also *Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 123 (2001)* ("Arbitration agreements allow parties to avoid the costs of litigation, a benefit that may be of particular importance in employment litigation, which often involves smaller sums of money than disputes concerning commercial contracts.").

n27. Public Citizen argues as well that no evidence exists that total process costs are lower in arbitration than in court. Public Citizen, supra note 1, at 61.

n28. See supra text accompanying notes 20-21.

n29. See infra text accompanying notes 161-180.

n30. Herbert M. Kritzer, The Wages of Risk: The Returns of Contingency Fee Legal Practice, *48 DePaul L. Rev. 267, 270 (1998);* see also Richard A. Posner, Economic Analysis of Law 624 (5th ed. 1998) ("The solution to this liquidity problem is the contingent fee contract."); see infra text accompanying notes 190-191.

n31. Kritzer, supra note 30, at 270.

n32. See infra text accompanying notes 194-200.

n33. See, e.g., Public Citizen, supra note 1, at 4-5. In addition, losses due to the time value of money might also be classified as a cost (or benefit) of arbitration. See Matthew T. Bodie, Questions About the Efficiency of Employment Arbitration Agreements, *39 Ga. L. Rev. 1, 12 (2004)* (explaining that supporters of arbitration argue that "an arbitral award might have a higher expected value since it would be granted more quickly than a litigation award").

n34. See infra text accompanying notes 190-191.

n35. E.g., Herbert M. Kritzer & Jill K. Anderson, The Arbitration Alternative: A Comparative Analysis of Case Processing Time, Disposition Mode, and Cost in the American Arbitration Association and the Courts, 8 Justice Sys. J. 6 (1983). Case selection effects make carrying out such studies extremely difficult. See infra text accompanying notes 135-137.

n36. *28 U.S.C. 1914*(a) (2006).

n37. Id. 1915(a)(1).

n38. E.g., Posner, supra note 30, at 639-40; *Frank A. Sander, Varieties of Dispute Resolution, 79 F.R.D. 76, 125-26 (1976).*

n39. CPR Institute for Dispute Resolution, Defenders and Proponents Square Off on New Report, 20 Alt. to the High Costs of Litig. 91, 104 (2002) (quoting India Johnson, Vice President, American Arbitration Association). But see Jeffrey W. Stempel, Reflections on Judicial ADR and the Multi-Door Courthouse at Twenty: Fait Accompli, Failed Overture, or Fledgling Adulthood?, 11 Ohio St. J. on Disp. Resol. 297, 357-58 (1996) (arguing that private dispute resolution is subsidized to some extent by the government).

n40. For a comparison of the fees charged by the National Arbitration Forum and JAMS with the AAA fee structure, see Budnitz, supra note 3, at 138-43.

n41. See American Arbitration Association, Commercial Arbitration Rules, Rule R-51(a) (effective Sept. 15, 2005), available at http://www.adr.org/sp.asp?id=22440 ("Arbitrators shall be compensated at a rate consistent with the arbitrator's stated rate of compensation.") [hereinafter AAA Commercial Arbitration Rules]. By comparison, some international arbitration institutions set out a schedule for arbitrators' fees based on the amount in dispute. See, e.g., International Chamber of Commerce, Rules of Arbitration of the International Chamber of Commerce, App. III, Art. IV(B) (effective Jan. 1, 1998), available at http://www.jus.uio.no/lm/icc.arbitration .rules.1998.

n42. The sources for data in the table are the following: *Affidavit of Frank Zotto P 13, Phillips v. Associates Home Equity, Case No. 01 CH 1944* (N.D. Ill. July 9, 2001) (reporting results of "random sampling of 60 arbitrators on the Commercial Panel in the Chicago, Illinois area"); Affidavit of Frank Zotto P 10, Pope v. AutoNation USA, Case No. A-0001609 (Ohio Ct. Common Pleas Aug. 15, 2001) (reporting results of "sampling of 31 arbitrators on the Commercial Panel in Hamilton County, Ohio"); Affidavit of Christine Newhall P 6, Cowart v. Credit Counselors Corp., Inc., Case No. IP00-0701 (S.D. Ind. Apr. 18, 2001) (reporting on the results of "random sampling of 26 arbitrators on the Commercial Panel in the State of Indiana"); Affidavit of Frank Zotto P 9, Calvo v. PIA Merchandising Co., Case No. 2:OOcv873 (E.D. Va. Oct. 4, 2001) (reporting results of "sampling of 15 arbitrators on the Employment Panel in the Virginia, North Carolina, Washington, D.C. and Maryland area"); Affidavit of Frank Zotto P 7(h), Physicians Data, Inc. v. Quest Wireless, L.L.C., Case No. OOCV631 (Colo. Dist. Ct. June 28, 2001) (reporting results of "random sampling of 38 arbitrators on the Commercial Panel in the Denver, Colorado area"). All of the affidavits are included in the CD-ROM Appendix to National Consumer Law Center, supra note 6; see also *Ting v. AT&T, 182 F. Supp. 2d 902, 934 (N.D. Cal. 2002)* (citing "average daily rate of arbitrator compensation in Northern California" as $ 1899), aff'd in part and rev'd in part, *319 F.3d 1126 (9th Cir. 2003).*

n43. AAA Commercial Arbitration Rules, supra note 41, Rule R-52.

n44. American Arbitration Association, AAA Implements New Consumer Initiatives, Revises Consumer Rules, www.adr.org/sp.asp?id=21892 (last visited Apr. 30, 2006). Because more complex cases are likely to have longer hearings, one would expect the availability of arbitrators willing to serve pro bono would be more helpful to claimants with small claims than those with large claims.

n45. See infra text accompanying notes 54-58.

n46. American Arbitration Association, Administrative Fee Waivers and Pro Bono Arbitrators Services, http://www.adr.org/sp.asp?id=22040 (last visited Apr. 30, 2006) [hereinafter AAA Administrative Fee Waivers].

n47. AAA Commercial Arbitration Rules, supra note 41, Rule R-49.

n48. Id.

n49. Putting aside access issues, charging fees that vary with the amount of the claim has potential benefits for dispute resolution processes. See, e.g., Christopher R. Drahozal, A Behavioral Analysis of Private Judging, 67 Law & Contemp. Probs. 105, 129 (2004) (noting possible constraint on attorneys seeking to benefit from anchoring effects by claiming large amounts of damages).

n50. AAA Commercial Arbitration Rules, supra note 41, Rule R-4(a)(ii).

n51. Id. ("Fees").

n52. Id.

n53. See infra text accompanying notes 63-70. Employee claims are dealt with under the AAA's Employment Arbitration Rules, which contain similar provisions for low-cost arbitration of small claims.

n54. AAA Commercial Arbitration Rules, supra note 41, Rule R-49.

n55. AAA Administrative Fee Waivers, supra note 46. Those amounts range from $ 17,180 for a one-person family in the 48 contiguous United States and Washington D.C., to $ 74,380 for an eight-person family in Alaska. Id.

n56. Id. Although the potential proceeds from the claim involved in the arbitration might be characterized either as potential future income or an asset of the claimant, there is no indication that the AAA has used such an interpretation.

n57. Id.

n58. See supra text accompanying notes 44-46.

n59. AAA Commercial Arbitration Rules, supra note 41, Rule R-50.

n60. Id.

n61. Id. Rule R-49.

n62. See Linda J. Demaine & Deborah Hensler, "Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience, 67 Law & Contemp. Probs. 55, 70-71 (2004) (various consumer contracts); Christopher R. Drahozal, "Unfair" Arbitration Clauses, *2001 U. Ill. L. Rev. 695, 735-36* (franchise agreements).

n63. American Arbitration Association, Supplementary Procedures for Consumer-Related Disputes, http://www.adr.org/sp.asp?id=22014 (last visited Apr. 30, 2006) [hereinafter AAA Consumer Procedures]. More precisely, the AAA Consumer Procedures apply to any "agreement between a consumer and a business where the business has a standardized, systematic application of arbitration clauses with customers and where the terms and conditions of the purchase of standardized, consumable goods or services are non-negotiable or primarily non-negotiable in most or all of its terms, conditions, features, or choices," and when the product or service involved is "for personal or household use." Id. Rule C-1(a).

n64. The Consumer Procedures differ in a number of ways other than costs from the AAA Commercial Arbitration Rules, but those differences are not relevant here.

n65. AAA Consumer Procedures, supra note 63, Rule C-8 ("Arbitrator Fees").

n66. See supra text accompanying notes 41-42.

n67. AAA Consumer Procedures, supra note 63, Rule C-8 ("Fees and Deposits to be Paid by the Consumer").

n68. Id. ("Fees and Deposits to be Paid by the Business").

n69. Id. ("Fees and Deposits to be Paid by the Consumer").

n70. See supra text accompanying notes 41-62.

n71. E.g., National Arbitration Forum, Code of Procedure, "Fee Schedule" (effective Jan. 1, 2005), available at http://www.arb-forum.com/programs/code new/2005 fees.pdf. In addition, Rule 44(G) of the NAF Code of Procedure sets out a process whereby a consumer "who asserts that arbitration fees prevent the Consumer Party from effectively vindicating the Consumer's case in arbitration may ... prior to paying any filing fee" request the arbitrator to require "another Party or Parties [to] pay all or part of the arbitration fees" or declare the arbitration agreement "unenforceable." Id. Rule 44(G), available at http://www.arb-forum.com/programs/code new/2005 code.pdf. "If there is no agreement by the Parties," the arbitrator is directed to resolve the request "based on the applicable law." Id.

n72. Claimants sometimes make an analogous challenge based on a state law cause of action, asserting that an arbitration agreement is invalid because it precludes claimants from vindicating their state statutory rights. So long as the Federal Arbitration Act applies to the arbitration agreement (i.e., it is within the scope of Congress's Commerce power) such an argument likely is preempted by federal law. 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, 270-72 (2006).

n73. A preliminary legal question is whether a court even can make such determinations, or whether they are matters for the arbitrator. Given the Supreme Court's recent decisions in *Green Tree Financial Corp. v. Bazzle, 539 U.S. 444 (2003); PacificCare Health Systems v. Book, 538 U.S. 401 (2003);* and *Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79 (2002),* the question is an interesting one, but is beyond the scope of this paper. For a case that considers the question, see *Scovill v. WSYX/ABC, 425 F.3d 1012, 1019 (6th Cir. 2005).*

n74. For one exception, see *Pro Tech Indus., Inc. v. URS Corp., 377 F.3d 868, 873 (8th Cir. 2004)* ("Under Texas law, we only consider the circumstances at contract formation to determine if a contract is unconscionable, rendering Pro Tech's current inability to afford the costs of arbitration irrelevant to the conscionability de-

termination."). Cf. Ware, supra note 72, at 267-68 (stating that in applying unconscionability doctrine to arbitration clauses, "a court should assess the "values exchanged' as of the time the contract was formed, rather than as of a later time, such as the time of a dispute").

n75. This description is an overgeneralization; the approaches taken by the courts differ to some degree, as described in more detail in the following sections. But with only limited exceptions, it is clear that the claimant must show that cost precludes him or her from vindicating statutory rights, not merely that the claimant is worse off in arbitration than in litigation.

n76. See Budnitz, supra note 3, at 157.

n77. *Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991); Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989)* (overruling *Wilko v. Swan, 346 U.S. 427 (1953)); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985); Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974).*

n78. *Gilmer, 500* U.S. 20 (1991).

n79. Id. at 28 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 (1985)).*

n80. The theory seems to be that if a prospective waiver of statutory rights would be invalid, an arbitration clause that has the effect of a prospective waiver of statutory rights also should be invalid.

n81. Actually, the Supreme Court has decided two Green Tree cases: *Green Tree Financial Corp.-Alabama v. Randolph, 531 U.S. 79 (2000),* and *Green Tree Financial Corp. v. Bazzle, 539 U.S. 444 (2003).* The earlier case (Randolph) typically is known as "Green Tree," while the later case is known as "Bazzle."

n82. *531 U.S. 79 (2000).* Prior to Green Tree, the leading court of appeals case was *Cole v. Burns International Security Services, 105 F.3d 1465 (D.C. Cir. 1997),* which construed an assertedly ambiguous arbitration clause to require the employer to pay all arbitration costs.

n83. Also at issue in Green Tree was whether the court of appeals had jurisdiction to review the district court's order under *9 U.S.C. 16.* The Supreme Court held that the court of appeals' exercise of appellate jurisdiction was proper. *Green Tree Fin. Corp.-Alabama v. Randolph, 531 U.S. 79, 89 (2000).*

n84. The language of the arbitration clause, which is problematic in other respects, is in relevant part as follows:

All disputes, claims, or controversies arising from or relating to this Contract or the relationships which result from this Contract or the validity of this arbitration clause or the entire contract, shall be resolved by binding arbitration by one arbitrator selected by Assignee with the consent of Buyer(s). This arbitration Contract is made pursuant to a transaction in interstate commerce, and shall be governed by the Federal Arbitration Act at *9 U.S.C. Section 1.* Judgment upon the award may be entered in any court having jurisdiction. The parties agree and understand that they choose arbitration instead of litigation to resolve disputes. The parties understand that they have a right or opportunity to litigate disputes through a court, but that they prefer to resolve their disputes through arbitration. THE PARTIES VOLUNTARILY AND KNOWINGLY WAIVE ANY RIGHT THEY HAVE TO A JURY TRIAL EITHER PURSUANT TO ARBITRATION UNDER THIS CLAUSE OR

PURSUANT TO A COURT ACTION BY ASSIGNEE (AS PROVIDED HEREIN). The parties agree and understand that all disputes arising under case law, statutory law, and all other laws, including, but not limited to, contract, tort, and property disputes will be subject to binding arbitration in accord with this Contract. The parties agree and understand that the arbitrator shall have all powers provided by the law and the Contract.

Green Tree Fin. Corp.-Alabama v. Randolph, 531 U.S. 79, 83 n.1 (2000). One problem with the clause is its language on arbitrator selection, which provides that Green Tree shall select the arbitrator "with the consent of Buyer(s)." An important element of arbitration is that the arbitrator be neutral, with both sides involved in selection. In *Harris v. Green Tree Financial Corp., 183 F.3d 173 (3d Cir. 1999),* the Third Circuit rejected a challenge to the enforceability of the clause on the basis of the arbitrator selection language. *Id. at 183-84.*

n85. *15 U.S.C. 1601* et seq. (2006).

n86. Green Tree required Randolph to buy Vender's Single Interest insurance, which provided coverage for its expenses in the event Randolph defaulted on the loan. *Green Tree, 531 U.S. at 82.*

n87. *15 U.S.C. 1640* (2006).

n88. *Randolph v. Green Tree Fin. Corp., 991 F. Supp. 1410, 1415 (M.D. Ala. 1997).*

n89. *Randolph v. Green Tree Fin. Corp., 178 F.3d 1149 (11th Cir. 1999)* (reversing *Randolph v. Green Tree Fin. Corp., 991 F. Supp. 1410 (M.D. Ala. 1997)).*

n90. See supra text accompanying notes 40-70.

n91. As described by the Supreme Court, that evidence consisted of (1) a statement that the filing fee for AAA arbitration for claims under $ 10,000 would be $ 500 (not including arbitrators' fees or administrative fees); and (2) an article quoting an AAA executive that arbitrators' fees averaged $ 700 per day. *Green Tree Fin. Corp.-Alabama v. Randolph, 531 U.S. 79, 90 n.6 (2000).*

n92. *Randolph v. Green Tree Fin. Corp., 178 F.3d 1149, 1158 (11th Cir. 1999).*

n93. *Green Tree Fin. Corp.-Ala. v. Randolph, 529 U.S. 1052 (2000).*

n94. *531 U.S. at 90.*

n95. Id.

n96. Bureau of National Affairs, Labor Lawyers at ABA Session Debate Role of American Arbitration Association, Daily Labor Report, Feb. 15, 1996 (cited in *Green Tree Fin. Corp.-Alabama v. Randolph, 531 U.S. 79, 90 n.6 (2000)).*

n97. *531 U.S. at 90 n.6.*

n98. *Id. at 91.*

n99. *Id. at 92.*

n100. Id.

n101. The courts of appeals also appear to differ as to several other issues that arise in cost-based challenges. First, there appears to be some difference among the circuits as to the proper timing of the challenge. The circuits all seemingly permit claimants to challenge the enforceability of the arbitration agreement in court prior to the arbitration proceeding. See infra App. A. The Eleventh Circuit, however, while apparently willing to consider such challenges, has suggested that such challenges are unlikely to prevail because the claimant can challenge the arbitration award after it is made. See *Musnick v. King Motor Co., 325 F.3d 1255, 1261 (11th Cir. 2003)* (refusing to remand a cost-based challenge to the district court for further evidentiary development, concluding that "there is no record that could be made at this point" because the agreement permitted the prevailing party to recover the costs of arbitration, and if the claimant prevails "he will incur no fees at all... . In this event, obviously, he will not have been deprived of any statutory right or remedy by the mandatory arbitration"); see also *Summers v. Dillards, Inc., 351 F.3d 1100, 1101 (11th Cir. 2003)* (reversing a district court decision invalidating arbitration agreement on cost grounds as "too speculative"; "It is unclear at this time which party may prevail at arbitration and Summers may seek judicial review of an award if she feels that her available remedies were hindered."). By contrast, the en banc Sixth Circuit in *Morrison v. Circuit City Stores, Inc., 317 F.3d 646 (6th Cir. 2003)* (en banc), expressly rejected the adequacy of post-award challenges. *Id. at 662* (contending that claimant would be in a "Catch-22" because the fact that claimant obtained an arbitration award might be used to demonstrate that cost did not deter him or her from arbitrating the statutory claims).

Second, the circuits differ as to the effect of a post-dispute offer by the respondent to pay all arbitration costs. Such offers are common in the reported cases. See infra App. A (in 42 out of the 163 federal court cases studied, the court stated that the respondent had offered to pay the claimant's arbitration costs after a dispute arose). The courts are split on the relevance of such an offer-when it is rejected by the claimant-to the cost-based challenge. The Sixth Circuit in Morrison held that the respondent's offer should be disregarded, reasoning that "because the employer drafted the arbitration agreement, the employer is saddled with the consequences of the provision as drafted." *317 F. 3d at 677* (emphasis in original). A number of other courts, however, have concluded that such an offer effectively moots the cost-based challenge, presumably because arbitration costs cannot preclude a claimant from vindicating statutory rights when the claimant does not have to pay any costs. E.g., *Large v. Conseco Fin. Servicing Co., 292 F.3d 49, 56-57 (1st Cir. 2002).*

Third, the circuits differ as to the consequences of a successful challenge (although the differences may be due at least in part to differences among the challenged arbitration clauses). See *Booker v. Robert Half Int'l, Inc., 413 F.3d 77, 84 (D.C. Cir. 2005)* ("Decisions striking an arbitration clause entirely often involved agreements without a severability clause ... or agreements that did not contain merely one readily severable illegal provision, but were instead pervasively infected with illegality... . Decisions severing an illegal provision and compelling arbitration, on the other hand, typically considered agreements with a severability clause and discrete unenforceable provisions.") (Roberts, J.). In some cases, courts have held the cost provision severable from the arbitration clause, thus directing the parties to arbitrate while imposing the arbitration costs on the respondent. E.g., *Spinetti v. Service Corp. Int'l, 324 F.3d 212, 219-23 (3d Cir. 2003).* In other cases, the courts have held the cost provision not severable and invalidated the arbitration agreement in its entirety. E.g., *Alexander v. Anthony Int'l., L.P., 341 F.3d 256, 271 (3d Cir. 2003).* Such a result is more common when the claimant challenges the enforceability of other provisions of the arbitration agreement as well, such as a provision limiting the damages that can be recovered in arbitration. A third alternative would be to direct the parties to arbitrate all claims but the federal statutory claim at issue in the case. This alternative draws on the doctrinal basis for the vindication-of-statutory rights theory in the first place-that Congress intended to permit arbitration of federal statutory claims so long as the individual could vindicate his or her statutory rights in the arbitral forum. If the costs preclude the claimant from effectively vindicating federal statutory rights, then those claims-but not any others-should be resolved in court. Cf. *Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 217 (1985)* (holding that when claimant files suit raising both arbitrable claims and nonarbitrable claims, "the Arbitration Act requires district courts to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums"). Few if any courts seem to take this third approach, although the D.C. Circuit has relied on this reasoning to reject cost-based challenges in cases not raising federal claims. See *Brown v. Wheat First Sec., Inc., 257 F.3d 821 (D.C. Cir. 2001).*

n102. E.g., *Musnick v. King Motor Co. of Fort Lauderdale, 325 F.3d 1255, 1259 (11th Cir. 2003)* ("Since Green Tree, all but one of the other Circuits that have reconsidered this issue have applied a similar case-by-case approach."). The Musnick court cites the Ninth Circuit as adopting a per se rule. See *id. at 1259 n.3* (citing *Circuit City Stores, Inc. v. Adams, 279 F.3d 889, 894 (9th Cir. 2002)* (stating that a clause providing for the sharing of arbitration costs between claimants and respondents "alone would render an arbitration agreement unenforceable")). The Ninth Circuit's decisions, in Adams and other cases, are based on state law unconscionability grounds rather than a vindication-of-statutory-rights theory. Id.; see also *Al-Safin v. Circuit City Stores, Inc., 394 F.3d 1254, 1260-62 (9th Cir. 2005)* (Washington law); *Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1178-79 (9th Cir. 2003)* (California law); *Ting v. AT&T, 319 F.3d 1126, 1151 (9th Cir. 2002)* (California law). See generally infra text accompanying notes 104-116.

n103. See, e.g., Budnitz, supra note 3, at 154 ("Courts are split over what type of showing is required to prove that costs are so high as to bar access to justice. Interpretations of what Green Tree requires focus on three factors: the financial condition of the claimant, the absolute cost of arbitration, and the relative cost of arbitration when compared to court proceedings.").

n104. *238 F.3d 549 (4th Cir. 2001).*

n105. *317 F.3d 646 (6th Cir. 2003)* (en banc).

n106. *238 F.3d at 556.* The court of appeals noted that "parties to litigation in court often face costs that are not typically found in arbitration, such as the cost of longer proceedings and more complicated appeals on the merits." *Id. at 556 n.5.*

n107. *Id. at 558.*

n108. *317 F.3d at 660.*

n109. *Id. at 661.*

n110. *Id. at 663.*

n111. Id.

n112. *Id. at 664.*

n113. *Id. at 665.*

n114. Id. By contrast, "it will find, in many cases, that high-level managerial employees and others with substantial means can afford the costs of arbitration, thus making cost-splitting provisions in such cases enforceable." Id.

n115. *Id. at 664.*

n116. Id.

n117. See infra App. A.

n118. See, e.g., *Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669 (Cal. 2000)* (holding an arbitration agreement unconscionable); *Brower v. Gateway 2000, Inc., 676 N.Y.S. 2d 569 (N.Y. App. Div. 1998)* (holding an arbitration agreement unconscionable on cost grounds but remanding based on substitution of alternative institutional rules).

n119. Section 2 of the FAA makes arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *9 U.S.C. 2* (2006). Courts look to general contract defenses under state law for evaluating the enforceability of arbitration agreements. See *First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 944 (1995).* Unconscionability is one of the most commonly asserted such defenses. See, e.g., Susan Randall, Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability, *52 Buff. L. Rev. 185, 195-98 (2004)* (highlighting the resurgence in successful assertion of unconscionability claims against enforcement of arbitration agreements); Jeffrey W. Stempel, Arbitration, Unconscionability, and Equilibrium: The Return of Unconscionability Analysis as a Counterweight to Arbitration Formalism, 19 Ohio St. J. on Disp. Resol. 757, 799-803 (2004) (same).

n120. See National Consumer Law Center, supra note 6, 5.4.1, at 113:

If high fees are assessed to arbitrate a federal claim, the consumer can argue both that the fees conflict with the federal statute and that they make the clause unconscionable. If high fees are assessed to arbitrate a state statutory claim, however, the consumer should rely on an unconscionability argument or another argument that would apply to any contract term, such as the argument that the term is unenforceable as against public policy.

n121. *676 N.Y.S.2d 569 (N.Y. App. Div. 1998).*

n122. Gateway was the defendant in a series of cases involving challenges to the enforceability of the arbitration clause in the *Gateway Standard Terms and Conditions. E.g., Hill v. Gateway 2000, Inc., 105 F.3d 1147 (7th Cir. 1997),* cert. denied, *522 U.S. 808 (1997); Klocek v. Gateway, Inc. 104 F. Supp. 2d 1332 (D. Kan. 2000); Westendorf v. Gateway 2000, Inc., No. 16913, 2000 Del. Ch. LEXIS 54* (Del. Ch. March 16, 2000). Brower is unusual among those cases in the court's reliance on the doctrine of unconscionability. *676 N.Y.S.2d at 252-55.*

n123. *International Chamber of Commerce, supra* note 41, App. III.

n124. *Brower, 676 N.Y.S.2d at 571.*

n125. *Id. at 574.*

n126. *298 F.3d 778 (9th Cir. 2002).*

n127. E.g., *Al-Safin v. Circuit City Stores, Inc., 394 F.3d 1254 (9th Cir. 2005); Circuit City Stores, Inc. v. Mantor, 335 F.3d 1101 (9th Cir. 2003); Ingle v. Circuit City Stores, Inc., 328 F.3d 1165 (9th Cir. 2003); Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003); Circuit City Stores, Inc. v. Adams, 279 F.3d 889 (9th Cir. 2002).* Most of the decisions are based on California law and at least purport to rely on *Armendariz v. Foundation Health Psychcare Servs., Inc., 6 P.3d 669 (Cal. 2000),* the leading California Supreme Court case.

n128. *42 U.S.C. 2000e-2a,* 2000e-3 & 1981a(c) (2006).

n129. *6 P.3d 669 (Cal. 2000).*

n130. *298 F.3d at 786.*

n131. See supra note 127.

n132. I include the decision so long as it is available on LEXIS, even if the opinion is formally unpublished by the court.

n133. Other results are reported in Part V.B. The cases are listed infra in Appendix A.

n134. *531 U.S. 79 (2000).*

n135. Christopher R. Drahozal, Ex Ante Selection of Disputes for Litigation (Feburary 27, 2004) (Working Paper), available at http://papers.ssrn.com/sol3/papers.cfm? abstract id=510162.

n136. See George L. Priest & Benjamin Klein, The Selection of Disputes for Litigation, *13 J. Legal Stud. 1, 4-5 (1984)* (describing case selection by settlement). For additional studies of case selection by settlement, see Theodore Eisenberg, Testing the Selection Effect: A New Theoretical Framework with Empirical Tests, *19 J. Legal Stud. 337 (1990);* Daniel Kessler et al., Explaining Deviations from the Fifty-Percent Rule: A Multimodal Approach to the Selection of Cases for Litigation, *25 J. Legal Stud. 233, 235 (1996);* Joel Waldfogel, The Selection Hypothesis and the Relationship Between Trial and Plaintiff Victory, 103 J. Pol. Econ. 93 (1995); Peter Siegelman & John J. Donahue III, The Selection of Employment Discrimination Disputes for Litigation: Using Business Cycle Effects to Test the Priest-Klein Hypothesis, *24 J. Legal Stud. 427 (1996);* Donald Wittman, Is the Selection of Cases for Trial Biased?, *14 J. Legal Stud. 185 (1985);* Keith N. Hylton, Asymmetric Information and the Selection of Disputes for Litigation, *22 J. Legal Stud. 187, 188 (1993);* Luke Froeb, The Adverse Selection of Cases for Trial, 13 Int'l Rev. L. & Econ. 317, 317 (1993); Bruce H. Kobayashi, Case Selection, External Effects, and the Trial/Settlement Decision, in Dispute Resolution: Bridging the Settlement Gap 17 (David A. Anderson ed., 1996).

n137. Joel Waldfogel, Selection of Cases for Trial, in 3 The New Palgrave Dictionary of Economics and the Law 419, 419 (Peter Newman ed., 1998).

n138. In a handful of cases, the court of appeals issued an opinion that did not address the cost issue. In such cases, the district court opinion is used rather than the court of appeals' opinion.

n139. Two courts described the cost-based challenge as based on public policy.

n140. Other consumer claims were against companies such as debt collectors, brokerage firms, home builders, mobile home manufacturers, telephone companies, insurers, a payment service provider, and a fast food restaurant chain.

n141. Because the motion to compel arbitration was resolved before a class was certified, it is not possible to determine whether a class would have been certified. Thus, in characterizing these cases I rely solely on whether the claimant sought to proceed on a class basis.

n142. I did not attempt a comprehensive cataloguing of the types of claims asserted by claimants. Thus, so long as the claimant asserted either a Title VII claim or a TILA claim I saw no reason to examine the case further. Only in cases in which the claimant did not assert either a Title VII claim or a TILA claim did I collect information on what other federal law claim the claimant alleged, if any. Likewise, only if the claimant did not assert a federal law claim did I make note of what sort of state law claim the claimant asserted.

n143. Once again I emphasize that this differential does not necessarily reflect differences in approaches by the courts. Instead, it may merely reflect cases with different factual records being decided by the courts.

n144. See Ruth V. Glick, California Arbitration Reform: The Aftermath, *38 U.S.F. L. Rev. 119, 120-23 (2003)* (describing legislation).

n145. *Cal. Civ. Proc. Code 1284.3* (2006).

n146. Id. 1284.3(a).

n147. Id. 1284.3(b). In its fee waiver procedures, the American Arbitration Association identifies indigent consumers based on a maximum monthly income of 200 percent of the federal poverty standard. See supra text accompanying note 55. But for consumers in California, the fee waiver procedures expressly acknowledge and apply the California statutory definition. Id.

n148. Id. 1284.3(b)(3). The arbitration institution must keep all information received from the consumer confidential. Id. 1284(b)(4). But the arbitration institution "may not keep confidential the number of waiver requests received or granted, or the total amount of fees waived." Id.

n149. *114 Cal. App. 4th 77 (Ct. App. 2003).*

n150. *Id. at 98.*

n151. For an overview of RUAA, see Timothy J. Heinsz, The Revised Uniform Arbitration Act: Modernizing, Revising, and Clarifying Arbitration Law, *2001 J. Disp. Resol. 1.*

n152. *N.M. Stat. Ann. 44-7A-1* (2006).

n153. *Id. 44-7A-1*(b)(4)(a).

n154. *Id. 44-7A-5.*

n155. Id.

n156. Oklahoma has taken yet another approach in its version of RUAA. See 12 Okla. Stat. 1880 (2006):

B. In applying and construing the Uniform Arbitration Act, to the extent permitted by federal law, recognition shall be given to the following considerations as applicable:

1. Agreements to arbitrate are often included in standard forms prepared by one party and in a context where there is little or no ability to negotiate or change the terms of the agreement to arbitrate; and

2. In such cases, clauses providing ... for the expenses of arbitration ... and for other matters that may represent a serious disadvantage to the party or parties that did not prepare the form shall be closely reviewed for unconscionability based on unreasonable one-sidedness and understandable or unnoticeable language or lack of meaningful choice and for balance and fairness in accordance with reasonable standards of fair dealing.

n157. More generally, a number of bills have been introduced into Congress that would limit or restrict consumer or employment arbitration, either by excluding certain claims from arbitration or invalidating pre-dispute arbitration agreements in certain contracts. See, e.g., Jean R. Sternlight, Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to that of the Rest of the World, *56 U. Miami L. Rev. 831, 840 (2002).* Only one bill has been enacted into law, however: the Motor Vehicle Franchise Contract Arbitration Fairness Act makes pre-dispute arbitration agreements unenforceable in motor vehicle franchise agreements (i.e., franchise agreements between car manufacturers and car dealers). See *15 U.S.C. 1226*(a) (2006).

n158. S. 3026, 107th Cong. 2(b)(10) (Oct. 1, 2002).

n159. In his statement on introducing the bill, Senator Sessions touted the benefits of arbitration, asserting that "arbitration can give the consumer and employee a cost-effective forum in which to assert their claim," particularly for the "overwhelming majority of the people who could not afford a lawyer to litigate in court." 148 Cong. Rec S9721 (daily ed. Oct. 1, 2002) (statement of Sen. Sessions). He explained the arbitration cost provision as follows:

11. Expenses. The bill grants all parties the right to have an arbitrator provide for reimbursement of arbitration fees in the interests of justice and the reduction, deferral, or waiver of arbitration fees in cases of extreme hardship. It does little good to take a claim to arbitration if the consumer or employee cannot even afford the arbitration fee. This provision ensures that the arbitrator can waive or reduce the fee or make the company reimburse the consumer or employee for a fee if the interests of justice so require.

Id.

n160. Thus, I do not address whether consumers and employees are better off in arbitration than in court, although certainly whether they can assert their claim in arbitration is relevant to that inquiry.

n161. For overviews of the expected value model, see Robert G. Bone, Civil Procedure: The Economics of Civil Procedure (2003); Richard A. Posner, Economic Analysis of Law (6th ed. 2003); A. Mitchell Polinsky, An Introduction to Law and Economics (3d ed. 2003); Steven Shavell, Foundations of the Economic Analysis of Law (2004); Robert D. Cooter & Thomas S. Ulen, Law and Economics (4th ed. 2004); Bruce H. Kobayashi & Jeffrey S. Parker, Civil Procedure: General, in V The Encyclopedia of Law & Economics 1, 3-4 (Boudewijn Bouckaert & Garrit De Geest eds., 2000). For other writings on the subject, see William M. Landes, An Economic Analysis of the Courts, *14 J.L. & Econ. 61 (1971);* Richard A. Posner, An Economic Approach to Legal Procedure and Judicial Administration, *2 J. Legal Stud. 399 (1973).*

n162. Benefits also could include non-financial considerations. A more sophisticated model would focus on the settlement value of the case rather than the expected judgment. The more simplified model used here is sufficient for my purposes.

n163. See supra text accompanying notes 33-34.

n164. Keith N. Hylton, Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis, 8 Sup. Ct. Econ. Rev. 209, 226-27 (2000).

n165. I assume here that the parties have entered into a pre-dispute arbitration clause, so that the claimant's options after the claim arises are either to file a claim in arbitration or not to file a claim in arbitration. A third possibility, of course, is for the claimant to challenge the enforceability of the arbitration agreement in court, which I take up momentarily. For an economic analysis of the decision whether to enter into a pre-dispute arbitration agreement, see Hylton, supra note 164, at 223-28; Steven Shavell, Alternative Dispute Resolution: An Economic Analysis, *24 J. Legal Stud. 1 (1995).*

n166. Lucian Ayre Bebchuk, Suits with a Negative Expected Value, in 3 New Palgrave Dictionary of Economics and the Law 551-54 (Peter Newman ed., 1998). The fact that a claim has a negative expected value does not necessarily mean that it is a frivolous claim. It may be a meritorious claim but one that is so costly to litigate that a claimant cannot do so economically. Posner, supra note 30, at 632.

n167. See, e.g., Lucian Ayre Bebchuk, Suing Solely to Extract a Settlement Offer, *17 J. Legal Stud. 437 (1988)* (imperfect information); Avery Katz, The Effects of Frivolous Lawsuits on the Settlement of Litigation, 10 Int'l Rev. L. & Econ. 3 (1990) (imperfect information); David Rosenberg & Steven Shavell, A Model in Which Suits are Brought for their Nuisance Value, 5 Int'l Rev. L. & Econ. 3 (1985) (differences in the timing of litigation costs incurred by plaintiffs and defendants); David C. Croson & Robert H. Mnookin, Scaling the Stonewall: Retaining Lawyers to Bolster Credibility, 1 Harv. Negot. L. Rev. 165 (1996) (plaintiff's pre-commitment to pay his or her attorney part of the litigation costs); Amy Farmer & Paul Pecorino, A Reputation for Being a Nuisance: Frivolous Lawsuits and Fee Shifting in a Repeated Game, 18 Int'l Rev. L. & Econ. 147 (1998) (attorney who develops a reputation for bringing negative expected value claims); Lucian A. Bebchuk, A New Theory Concerning the Credibility and Success of Threats to Sue, *25 J. Legal Stud. 1 (1996)* (the possibility that the claimant can subdivide his or her litigation expenses).

n168. Drahozal, supra note 62, at 749-50.

n169. Moreover, the claimant will challenge the enforceability of the arbitration agreement in court so long as the expected cost of the challenge (c) is less than the expected benefit from the challenge (the probability of success (p) times the claimant's benefit from being in court (i.e., c < p((Jp - Cp) - (J<prime>p - C<prime>p))).

n170. See supra text accompanying notes 23-26.

n171. Bradford Cornell, The Incentive to Sue: An Option-Pricing Approach, *19 J. Legal Stud. 173, 173 (1990).*

n172. E.g., Cornell, supra note 171, at 173; Peter H. Huang, Lawsuit Abandonment Options in Possibly Frivolous Litigation Games, *23 Rev. Litig. 47 (2004);* Joseph A. Grundfest & Peter H. Huang, The Unexpected Value of Litigation, *58 Stan. L. Rev. 1267 (2006).*

n173. Cornell, supra note 171, at 176-82.

n174. Grundfest & Huang, supra note 172, 1277; Huang, supra note 172, at 63-64.

n175. The characterization is even stronger when viewed from the perspective of the plaintiff's attorney. As Kritzer explains, "the work of the contingency fee lawyer can best be viewed as the management of a portfolio of cases." Herbert M. Kritzer, Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States 11, 12-16 (2004). The attorney can have an incentive to bring (and finance) even negative expected value

cases as part of his or her portfolio because the attorney can drop the cases that prove to have poor outcomes while continuing to litigate the cases that prove to have favorable outcomes.

n176. See supra text accompanying notes 168-69.

n177. Grundfest & Huang, supra note 172, at 1276.

n178. Neil Vidmar, Medical Malpractice and the American Jury: Confronting the Myths About Jury Incompetence, Deep Pockets and Outrageous Damage Awards 221-35 (1995); Neil Vidmar & Jeffrey J. Rice, Assessments of Noneconomic Damage Awards in Medical Malpractice: A Comparison of Jurors with Legal Professionals, *78 Iowa L. Rev. 883, 891-92 (1993).*

n179. Grundfest & Huang, supra note 172, at 1312.

n180. Id. at 1275.

n181. A claimant is risk averse when he or she would prefer a smaller, certain amount to a larger, uncertain amount. For example, a claimant is risk averse if he or she would prefer a certain sum of $ 100 to a 50% chance of receiving $ 200. A claimant is risk neutral if he or she is indifferent between a certain sum of $ 100 and a 50% chance of receiving S 200.

n182. I say "relatively" certain because if the claimant prevails the arbitrator may require the respondent to reimburse the claimant for the upfront arbitration costs. See supra text accompanying notes 59-62.

n183. Under prospect theory, individuals are assumed to be risk averse as to gains but risk seekers as to losses. See Daniel Kahneman & Amos Tversky, Prospect Theory: An Analysis of Decision Under Risk, 47 Econometrica 263 (1979); see, e.g., Jeffrey J. Rachlinski, Gains, Losses, and the Psychology of Litigation, *70 S. Cal. L. Rev. 113 (1996);* Russell Korobkin, Aspirations and Settlement, *88 Cornell L. Rev. 1, 14 (2002);* Chris Guthrie, Framing Frivolous Litigation: A Psychological Theory, *67 U. Chi. L. Rev. 163 (2000).* If arbitration costs were framed as losses, then they might be less likely to deter claimants from arbitrating their claims.

n184. See Michael Abramowicz, On the Alienability of Legal Claims, *114 Yale L.J. 697, 700-01 (2005);* Richard W. Painter, Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty, *71 Chi-Kent L. Rev. 625 (1995).* Of course, if a claimant can obtain financing for his or her claim, then liquidity barriers would not be a reason for invalidating the arbitration clause.

n185. *317 F.3d 646 (6th Cir. 2003)* (en banc).

n186. *Id. at 665.*

n187. Public Citizen, supra note 1, at 52-53.

n188. Kritzer, supra note 175, at 36 (listing types of cases handled by lawyers on contingent fee basis); Painter, supra note 184, at 626 & n.3 (listing types of cases and noting that "ninety-five percent of personal injury cases are taken on a contingency").

n189. See Elizabeth Hill, AAA Employment Arbitration: A Fair Forum at Low Cost, Disp. Resol. J. 9, 12 (May-June 2003) (finding that in the sample of AAA employment arbitrations studied, "most lower-income employees have agreed to representation on a contingency basis").

n190. Kritzer, supra note 175, at 39.

n191. Herbert M. Kritzer, The Wages of Risk: The Returns of Contingency Fee Legal Practice, *47 DePaul L. Rev. 267, 270 (1998);* see also Posner, supra note 30, at 624 ("The solution to this liquidity problem is the contingent fee contract."); Alexander Tabarrok & Eric Helland, Two Cheers for Contingent Fees 6-7 (2005) (arguing that contingent-fee system results in "Improved Access to the Legal System" and "Risk Spreading"); Painter, supra note 184, at 653 (arguing that "[a] lawyer working on a contingent fee" is not only providing legal services, but also is providing "credit - postponing payment until the client collects on a judgment" and "insurance - agreeing to waive payment for legal services that do not achieve favorable results"); Ted Schneyer, Legal-Process Constraints on the Regulation of Lawyers' Contingent Fee Contracts, *47 DePaul L. Rev. 371, 376-77 (1998)* (citing four functions of contingent fee contracts: (1) expanding access to justice by enabling claimants to finance litigation; (2) providing a source of financial credit; (3) avoiding agency costs due to shirking by lawyers; and (4) "offering clients a form of legal expense insurance"); Murray L. Schwartz & Daniel J.B. Mitchell, An Economic Analysis of the Contingent Fee in Personal-Injury Litigation, *22 Stan. L. Rev. 1125, 1125* (1969-1970) (citing, among other "common justifications" given for contingent fees, that "the contingent fee allows the client to shift some of the risk inherent in his case to the lawyer" and "allows the client to borrow the lawyer's services in advance of settlement").

n192. Model Rules of Prof'l Conduct R. 1.8(e) (2006):

A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

n193. See Lester Brickman, Effective Hourly Rates of Contingency-Fee Lawyers: Competing Data and Non-Competitive Fees, *81 Wash U. L.Q. 653, 735 (2003)* ("Many firms make no effort to seek reimbursement of expenses if there is no recovery."); Kevin M. Clermont & John D. Currivan, Improving on the Contingent Fee, *63 Cornell L. Rev. 529, 532 n.3 (1978)* ("In event of defeat, the client theoretically must refund all of these litigation expenses advanced by the lawyer... . [In] actual practice, however, ... the client usually does not pay back these expenses."); Samuel R. Gross & Kent D. Syverud, Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial, *90 Mich. L. Rev. 319, 349 n.71 (1991)* ("In practice, attorneys rarely attempt to collect expenses from personal injury clients, both because it would be impractical and because such a practice might drive away future clients.").

n194. The Missouri Bar, Sample Fee Agreement: Forms & Comments 15 (Revised Apr. 2003), available at http://home.mobar.org/lpmonline/fdrsamples.pdf.

n195. Id.

n196. Caruso Law Offices, Agreement for Representation by Counsel, P 3 (copy on file with author). The agreement goes on to state that the "client is responsible for costs irrespective of outcome" and that "attorneys have the option to advance costs but are not required to do so." Id.

n197. Winer Mehuela & Devens LLP, Attorney Fee Agreement and Authorization (Premises Liability), http://www.pacificlaw.com/files/attorney fee-premises-f.pdf (last visited Apr. 30, 2006).

n198. No. 01-10657-*GAO, 2002 U.S. Dist. LEXIS 18066* (D. Mass. Sept. 26, 2002).

n199. Id. at 9-10.

n200. As noted above, the claimant sought to bring the suit as a class action in court, which likely would not have been permitted in arbitration. According to the claimant's attorney, the individual claims in arbitration likely would have provided a "relatively small recovery." Id. at 10.

n201. One possibility for some of the contracts is that the provisions were intended to deal with court-annexed arbitration, rather than contractual arbitration.

n202. See, e.g., Sprague v. Household Int'l, No. 04-0106-*CV-W-NKL, 2005 U.S. Dist. LEXIS 11694, at 21* (W.D. Mo. June 15, 2005):

During a teleconference with the parties on July 20, 2004, Household argued that the Plaintiffs would not be responsible for paying arbitration fees due to a contingency fee arrangement with their counsel. When the Plaintiffs denied that allegation, the Court ordered the Plaintiffs to submit their fee agreement under seal for in camera inspection. After reviewing the agreement, the Court determined that the agreement would require the Plaintiffs to bear all costs of arbitration, including the arbitration fees.

n203. Public Citizen, supra note 1, at 65.

n204. See *Al-Safin v. Circuit City Stores, Inc., 394 F.3d 1254, 1261-62 (9th Cir. 2005)* (Washington law); *Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1178-79 (9th Cir. 2003)* (California law); *Ting v. AT&T, 319 F.3d 1126, 1151 (9th Cir. 2002)* (California law); *Circuit City Stores, Inc. v. Adams, 279 F.3d 889, 894 (9th Cir. 2002)* (California law); see also *Musnick v. King Motor Co. of Fort Lauderdale, 325 F.3d 1255, 1259 n.3 (11th Cir. 2003)* (citing Ninth Circuit as applying per se standard to cost-based challenges).

n205. Indeed, the claimants might be better off in arbitration than in litigation if the total process costs in arbitration are less.

n206. In fact, claimants in court have an incentive to claim larger rather than smaller amounts of damages because of possible anchoring of jury awards on the amount sought by the plaintiff. Arbitration costs may constrain that incentive to some degree, as noted earlier. See supra note 49.

n207. *478 U.S. 546 (1986).*

n208. *Id. at 565.*

n209. See *Brief of Petitioners at 46-47, Green Tree Fin. Corp. v. Randolph, 531 U.S. 79 (2000)* (No. 99-1235) (citing attorneys' fee provision of TILA and stating that "given these incentives, it is no surprise that this Court has addressed numerous cases involving parties who brought individual lawsuits to vindicate their rights under TILA").

n210. See, e.g., *Snowden v. Checkpoint Check Cashing, 290 F.3d 631, 638-639 (4th Cir. 2002)*; Battels v. Discover Bank, No. 2:03cv238-A, *2004 U.S. Dist. LEXIS 28012, at 37* (M.D. Ala. Aug. 27, 2004).

n211. At least one court already has done so. Sprague v. Household Int'l, No. 04-0106-*CV-W-NKL, 2005 U.S. Dist. LEXIS 11694, at 21* (W.D. Mo. June 15, 2005).

n212. Indeed, there may already be a two-tiered market for legal services under contingent fee contracts. One tier of lawyers, willing to handle cases in arbitration, might routinely advance the costs of arbitration. Another tier of lawyers, who handle only cases in court, would not advance arbitration costs, instead relying on the possibility a claimant might incur prohibitive costs as a basis for challenging the enforceability of the arbitration agreement. The different tiers of lawyers might follow different business models, with lower-risk/lower-return firms in the first tier and higher-risk/higher-return firms in the second tier.

n213. See supra text accompanying notes 132-143.

n214. Of course, some claimants deterred from bringing claims might not challenge the enforceability of the arbitration agreement in federal court (or any court). The cases studied obviously provide no information about how many such cases exist.

n215. See supra text accompanying notes 210-211.

n216. See McBride v. St. Anthony Messenger Magazine, No. 2:02-cv-0237-*JDT-WTL, 2003 U.S. Dist. LEXIS 6449* (S.D. Ind. Feb. 6, 2003). The court in that case upheld the arbitration clause against the cost-based challenge.

n217. In one case, the opinion did not indicate whether either the plaintiff or the defendant was represented by counsel.

n218. In some cases, while counsel for the claimant was identified by name, no affiliation for the attorney was listed.

n219. *28 U.S.C. 1332*(a) (2006).

n220. Id. 1331.

n221. See, e.g., *42 U.S.C. 2000e-5*(k) (2006) (Title VII); *12 U.S.C. 2607*(d)(5) (2006) (Real Estate Settlement Practices Act); *15 U.S.C. 1640*(a)(3) (2006) (Truth in Lending Act); *29 U.S.C. 626*(b) (2006) (Age Discrimination in Employment Act); *15 U.S.C. 2310*(d)(2) (2006) (Magnuson-Moss Warranty Act).

n222. Of the cases brought by individual employees, forty-two included claims under Title VII, five included claims under the Age Discrimination in Employment Act, four included claims under the Americans with Disabilities Act, two included claims under the Family and Medical Leave Act, two included claims under the Fair Labor Standards Act, and two included civil rights claims under *42 U.S.C. 1981*. Twelve cases raised solely state claims, including claims under the D.C., Florida, and Virgin Islands Civil Rights Acts, and two others were described as involving a claim of discrimination and a claim of age discrimination respectively. Two case reports did not specify the claims at issue.

n223. Of the cases brought by individual consumers, eighteen included claims under the Truth in Lending Act, three included claims under the Fair Credit Reporting Act, two included claims under the Magnuson-Moss Warranty Act, two included RICO claims, and one included securities fraud claims. Fourteen cases raised solely state law claims, including a claim under the New Jersey Consumer Fraud Act and a claim under the Oregon Unfair Trade Practices Act. One case report did not specify the claims at issue in the case.

n224. Of the class cases, fourteen included claims under the Truth in Lending Act, five included claims under the Fair Labor Standards Act, four included claims under the Fair Credit Billing Act, three included claims under the federal antitrust laws, two included claims under Title VII, and one each included claims under the Real Estate Settlement Practices Act, the Equal Credit Opportunity Act, RICO, the Fair Credit Reporting Act, the Credit Repair Organizations Act, and the Fair Debt Collection Practices Act. One included unspecified federal claims. Five cases raised solely state law claims, one of which was a claim under the California Consumer Protection Act and one of which was a claim under the Illinois Consumer Fraud Act. Two case reports did not specify the claims at issue.

n225. The other cases may have included such a claim, but there was no indication from the court's opinion that they did.

n226. *482 U.S. 483 (1987).*

n227. *Id. at 492 n.9* (dicta).

n228. Christopher R. Drahozal, Federal Arbitration Act Preemption, *79 Ind. L.J. 393, 411 (2004).*

n229. See, e.g., *Randolph v. Green Tree Fin. Corp., 244 F.3d 814, 816-19 (11th Cir. 2001).* See generally Jean R. Sternlight, As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?, *42 Wm. & Mary L. Rev. 1 (2000).*

n230. See *Lloyd v. MBNA Am. Bank, N.A., No. 01-1752, 2002 U.S. App. LEXIS 1027 at 7* (3d Cir. Jan. 7, 2002) (unpublished) ("But *Johnson [v. West Suburban Bank, 225 F.3d 366 (3d Cir. 2000)]* makes clear that the TILA does not provide an unwaivable right to a class action. Lloyd may not attempt to end-run that holding by couching his claim in terms of unvindicated rights."); *Taylor v. First N. Am. Nat'l Bank, 325 F. Supp. 2d 1304, 1318 (M.D. Ala. 2004):*

The gist of her argument is that it does not make economic sense to bring individual TILA claims. This may be true as a matter of fact, but it is an argument that applies to claims litigated in federal court as much as to claims litigated before an arbitrator. Furthermore, to the extent that Taylor's argument is that the bad economics of individual lawsuits means that she should have a right to bring a class action as the only way to enforce her rights under TILA and the FCBA, that argument is exactly the one rejected by the court in Randolph [v. Green Tree].

n231. Myriam Gilles, Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action, *104 Mich. L. Rev. 373, 408 (2005).*

n232. Some of the state law claims, however, likely involved state fee-shifting statutes.

n233. Indeed, the court invalidated the arbitration agreement in five of the eight cases (62.5%) in which the opinion indicated the claimant was represented by a clinic.

n234. See supra text accompanying notes 135-137.

ATTACHMENT 2

Department of County Administration
Public Information
HOWARD COUNTY MARYLAND GOVERNMENT

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- News Archives
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- GTV Program Schedule

NEWS RELEASE

June 14, 2007

Media Contact:

Kevin Enright, Director, Office of Public Information, 410-313-2022

Howard County Advises Comcast Cable Subscribers to Understand Options before Signing "Opt-Out" Form

ELLICOTT CITY, MD – The Howard County Office of the Cable Administrator and the Office of Consumer Affairs want to advise Howard County residents who are Comcast Cable subscribers to carefully review their latest billing statement and the "Opt-Out" of Arbitration notice that is included.

The "Opt-Out" notification is contained in a pamphlet entitled "Arbitration Notice." Arbitration is an informal dispute resolution process that has been chosen by Comcast as its preferred method to resolve disputes with their customers. Per the "notice," the rules to be used in the arbitration process will be those of the Federal Arbitration Act. If subscribers do not "Opt-Out" either by sending an "Opt Out" letter which includes their name, address and account number stating that they wish to "Opt-Out" of arbitration or by going on-line to "Opt Out," they will have to resolve all disputes with Comcast through arbitration.

Stephen D. Hannan, Administrator of the Howard County Office of Consumer Affairs, urges Comcast subscribers to review this document and make a decision based upon its terms. Subscribers who do "Opt Out" will still be able to use the two venues that were designed for them to resolve disputes - Howard County's Office of the Cable Administrator and Howard County's Small Claims Court. The Small Claims Court is designed to be a less expensive formal means for consumers and merchants to settle complaints.

Customers who do wish to "Opt-Out" must send letters stating that they "do not wish to resolve disputes with Comcast through arbitration" within 30 days of receiving the notice. Letters should be mailed to Comcast, Attn: Legal Dept/Arbitration, 1500 Market Street, Philadelphia, PA 19102. Customers who have thrown away or lost their statements can also "opt out" on line at www.comcast.com/arbitrationoptout

For more information and to have any questions answered, please contact the Office of Consumer Affairs at 410-313-6420 or the Office of the Cable Administrator at 410 313-3318.

Careers
Job Openings
Diversity/Inclusion
Advancement
Training
Benefits
Arbitration Policy

Arbitration Policy

For employment-related legal disputes not resolved through our Open Door Policy or Equal Employment Opportunity (EEO) Policy, the Company has implemented the following Arbitration Policy. We believe the Arbitration Policy provides a fair, efficient, private, and accessible process to resolve employment disputes relating to legal rights. If any employee, former employee, or applicant (all referred to herein as "Associate") is not satisfied with the result of a complaint under the Open Door Policy and/or the Equal Employment Opportunity Policy, or if an Associate for any reason fails to pursue a complaint under those policies, any claim by the Associate related to legally-protected rights shall be subject to independent and neutral arbitration under the terms of this Arbitration Policy, unless the Associate has properly opted out of the policy by the deadline explained on page 18. This Policy also applies to claims by the Company against an Associate.

How Does the Arbitration Process Work?

The process will be administered by the American Arbitration Association (AAA) and conducted under AAA's National Rules for the Resolution of Employment Related Legal Claims existing at the time proceedings are initiated, except as modified by this policy. The rules and information about AAA may be found at www.adr.org. AAA is a not-for-profit public service organization. Over 4,000,000 workers are covered by various types of plans administered by the AAA.

The Company will pay the Arbitrator fees and the costs charged by AAA, except that the Associate must pay an initial $125.00 fee to AAA if the Associate initiates a claim. (If an Associate is indigent, he/she may file the claim without a fee, pending a decision by the Arbitrator on a request for fee waiver based on the law and applicable AAA Rules.) The Arbitrator shall be an independent, neutral, and licensed attorney selected from a list of all attorney members of the AAA Regional Employment Dispute Resolution Roster or any successor comparable AAA Roster who are: (1) former federal court judges and magistrates or former state court judges in appellate courts or trial courts of general jurisdiction; or (2) lawyers who have practiced law and/or served as Arbitrators in the field of employment law for at least 15 years and are rated "AV" by Martindale-Hubbell. The AV rating is for lawyers considered to have reached the height of professional excellence and recognized for the highest levels of skill and integrity. If the AAA Regional Roster for any reason does not provide the names of at least three Arbitrators who meet the qualifications of this policy, then additional qualified Arbitrators shall be added to the list from the AAA Regional Roster for the region that is closest geographically to the Associate's place of employment or prospective employment.

The Company first and then the Associate shall in turn alternately strike one name from the list until there is only one name remaining, who shall be the Arbitrator. On the fourth business day after the day on which the striking is completed, the Company and the Associate shall jointly inform AAA of the Arbitrator selection; however, prior to the fourth day and based on review of the importance and complexity of the case and/or the experience of the Arbitrator, either the Company or the Associate unilaterally may expand the number of Arbitrators from one to three by sending written notice to the other party. If either party elects to expand to three the number of Arbitrators, the additional two Arbitrators shall be the last two Arbitrators who were previously struck by the parties from the list of Arbitrators. The party electing to add two Arbitrators to the case shall be solely responsible for all fees and expenses of the two additional Arbitrators. In a case with three Arbitrators, the decision of the three Arbitrators must be unanimous. If only two of the three Arbitrators agree on a decision, they shall issue a written advisory decision which, if accepted in writing by both parties within ten calendar days, shall become a final and binding decision. If there is no unanimous decision or an advisory decision accepted in writing by both the Company and the Associate, the case shall be heard again before a new Arbitrator or Arbitrators under the terms of this policy except that if either the Associate or the Company elects to use three Arbitrators at the second hearing, two Arbitrators shall have the authority to issue a decision. In any case, the Associate and the Company also may agree on a mutually acceptable Arbitrator, and bypass the AAA arbitration selection and administration process.

The Arbitrator shall have the exclusive authority to resolve all disputes relating to the facts or the

law, including the authority to grant summary disposition of claims and the authority to grant all relief that a court of competent jurisdiction could grant based on the claims asserted. The Arbitrator shall decide the case in the same manner as a federal district court judge hearing the case without a jury and shall apply the federal rules of evidence. The Arbitrator shall issue a signed written decision stating the findings of all material facts and conclusions of law that provide the basis for the decision. The Federal Arbitration Act governs the enforcement of this Arbitration Policy and proceedings under the policy, other than as modified by this policy. If the Arbitration Policy is found not enforceable under the Federal Arbitration Act, applicable state law shall apply. Other than as provided in this policy, the substantive law applied to claims shall be the state or federal substantive law that would be applied by a federal district court judge sitting at the place of the Associate's employment or prospective employment.

The arbitration hearing shall be held in the community of the Associate's principal place of employment or prospective employment, unless another location is agreed to by the parties. Prior to the hearing, the parties shall be entitled to reasonable discovery as determined by the Arbitrator consistent with the objective of fairness, speed and economy, including at a minimum two depositions, ten interrogatories and ten document requests by each party. Associates at their expense may be represented by an attorney. The following persons may be present at the hearing: the Arbitrator and any recorder of the hearing; the Associate and his/her spouse, attorneys, experts, and witnesses; and the Company's attorneys, management, human resource personnel, experts, and witnesses. No one else may be present without good cause determined by the Arbitrator. The parties shall provide lists of the names and addresses of witnesses and copies of exhibits to each other at least 30 days prior to the hearing and may supplement this information up to 20 days prior to the hearing. The Arbitrator may resolve all discovery disputes, issue protective orders, and issue subpoenas pursuant to the law. Any party may arrange for a qualified court reporter to make a stenographic record of the hearing. The parties shall be entitled to file post-hearing briefs and proposed findings of fact and conclusions of law. The Arbitrator shall set a briefing schedule under which the party with the burden of proof files first, the opposing party files next, and the burden of proof party may file a reply.

The Arbitration decision shall be binding on the Company and the Associate, and it may be enforced by a court of competent jurisdiction, subject to available legal grounds for vacating an arbitration award. However, any party also may: (1) within 30 days after the decision file a reconsideration motion or other motion with the Arbitrator or Arbitrators; or (2) within 60 days after the decision or 30 days after a decision on a reconsideration motion or other post-decision motion, serve written notice of an Arbitration Appeal. If a party serves notice of an Arbitration Appeal, the selection of an Arbitrator or Arbitrators to decide the appeal shall be under the procedure of this Arbitration Policy. In an Arbitration Appeal, the Arbitrator or Arbitrators shall apply the standard of review that a court of appeals would apply to the decision of a trial judge sitting without a jury. The Arbitrator or Arbitrators in an Arbitration Appeal shall issue a written decision after considering written briefs and oral argument. If three Arbitrators are selected for an Arbitration Appeal, two Arbitrators shall have the authority to issue a decision. The Arbitration Appeal decision shall be subject to review by a court of competent jurisdiction for error of law or any other available legal grounds for vacating an arbitration award. If the Arbitration Appeal or court review results in the direction of a new hearing or other further proceedings, any party shall have the right to require that a new Arbitrator or Arbitrators be selected under this Arbitration Policy to handle such new hearing or other further proceedings.

How to Assert a Claim

An Associate who wishes to assert a claim must submit a written request for arbitration by Certified Mail/Return Receipt Requested to the Vice President of Human Resources, 333 W. 11th Street, Kansas City, Missouri 64105, within 300 days, or within any longer time period established by the applicable statute of limitations under the law, from the date of the alleged act giving rise to the claim. The written request should include supporting documentation and a thorough description of the facts, the nature of the claim, and the damages and/or other remedies sought. If the Company wishes to assert a claim against an Associate, it also must submit such a written request for arbitration with supporting documentation to the Associate by Certified Mail/Return Receipt requested within 300 days, or within any longer time period established by the applicable statute of limitations under the law, from the date of the alleged act giving rise to the claim. The claim is waived if the Associate or the Company fails to submit a timely and proper written request for arbitration. After a request for arbitration, the parties shall cooperate on a joint submission of the claim to AAA, with the Company paying all fees above $125.00 and, if the Associate asserts indigent status, the Company advancing the initial $125.00 fee on behalf of the Associate. The Associate does not need to pay the $125.00 fee if only the Company asserts a claim.

All claims must be asserted, heard, and resolved on a single Associate basis, unless otherwise agreed to by all parties. All related claims by a party must be asserted in the same arbitration or the unasserted claims are waived. The Company may not assert claims against multiple

Associates in the same arbitration. Claims by multiple Associates may not be joined together in the same arbitration. An Associate may not assert claims on behalf of multiple Associates or as a class action or collective action either in court or under this Arbitration Policy, and an Associate may not have a claim asserted on his or her behalf by another person as a class representative or otherwise. However, if a final court decision holds this prohibition on class action, collective action, and multiple Associate claims is invalid, the Arbitration Policy is modified as follows for the subsequent resolution of a class or collective action claim or a multiple Associate claim. If any Associate wishes to attempt to assert such a claim after a final court decision holding the prohibition invalid, the claim must first be filed in a court of competent jurisdiction. Under all applicable laws, rules, and procedures, the court shall determine the question of whether the claim should be certified to proceed as a class or collective action or otherwise proceed on behalf of multiple Associates. After a final judicial decision on certification or on multiple Associate status, including all appeals of a trial court ruling, the court then shall refer the claim to arbitration under this policy for a decision on the merits of the claim.

Coverage of Arbitration Policy

This Arbitration Policy covers all legal claims arising out of or relating to employment, application for employment, or termination of employment, except for claims specifically excluded under the terms of the policy. The claims covered by the policy include, but are not limited to, the following types of claims: wrongful discharge under statutory law or common law; employment discrimination, retaliation and sexual or other harassment based on federal, state or local statute, ordinance or governmental regulations; retaliatory discharge or other unlawful retaliatory action; overtime or other compensation disputes; leave of absence disputes; tortious conduct; defamation; violation of public policy; breach of contract; and other statutory or common law claims. It includes claims by an Associate against the Company and claims by an Associate against any fellow employee, supervisor, or manager based on alleged conduct within the scope of employment by the fellow employee, supervisor, or manager. It also includes claims based on events that occurred prior to the effective date of this policy or based on events that occur following the termination of employment. This Arbitration Policy also applies to any claims by the Company against an Associate.
The only claims excluded from this Arbitration Policy are claims by an Associate for workers' compensation benefits, unemployment compensation benefits, ERISA-related benefits provided under a Company sponsored benefit plan, or claims filed with the National Labor Relations Board. Additionally, either the Associate or the Company may file a court action seeking provisional equitable remedies available under the law, including but not limited to temporary or preliminary injunctive relief, either before the commencement of or during the arbitration process, to preserve the status quo or otherwise prevent damage or loss pending final resolution of the dispute pursuant to the terms of this Arbitration Policy. Also, this Arbitration Policy does not prevent or discourage an Associate from filing and pursuing an administrative proceeding before the Equal Employment Opportunity Commission or a state or local administrative agency; however, if an Associate chooses to pursue a legal claim in addition to and/or following completion of such administrative proceedings, or if there is some other legal proceeding related to the claim following completion of the administrative proceedings, the claim then shall be subject to the terms of this Arbitration Policy.

Agreeing to the Arbitration Policy

Effective March 12, 2007, the Company and each Associate who continues or starts employment after March 12, 2007 agree as a term and condition of employment, and as a binding contract, to resolve employment-related legal claims through this Arbitration Policy and not through a lawsuit with a judge or jury trial, unless the Associate timely exercises his or her right to voluntarily opt out of this Arbitration Policy by sending a letter by Certified Mail/Return Receipt Requested to the Vice President of Human Resources, DST Systems, Inc., 333 W. 11th Street, Kansas City, Missouri 64105, stating the desire to opt out of the policy. The letter may simply state the following: "I wish to opt out of the Company Arbitration Policy." For any Associate employed as of March 12, 2007, the opt out letter must be received by the Vice President of Human Resources on or before April 11, 2007. For any Associate who starts employment after March 12, 2007 or who is on leave of absence on March 12, 2007, the opt out letter must be received by the Vice President of Human Resources on or before the date 30 days after the Associate's first day of employment or 30 days after the Associate's first day back to work following the leave of absence. There will be no retaliation against any Associate for opting out of the Policy. Associates may contact the Director of Employee Relations or the Vice President of Human Resources at (816) 435-8695 to ask any questions or seek further information regarding this Arbitration Policy. We also encourage Associates, if they desire, to secure advice from an attorney regarding the voluntary opt out option and the Arbitration Policy. Any Associate who does not provide a timely opt out letter by Certified Mail/Return Receipt Requested by the deadline established under this policy is automatically covered by this Arbitration Policy and is required to arbitrate employment-related legal claims under the terms of the Policy.

This Arbitration Policy creates a contract that binds the Company and each Associate to arbitrate employment-related legal claims, unless an Associate properly and timely opts out of the Policy . The Arbitration Policy does not in any way modify the employment-at-will status of any Associate (see The Associate Handbook on page 5).

The provisions of this Arbitration Policy are severable. That means that if any provision is found invalid or unenforceable by a court, it shall not affect the application and enforcement of the rest of this Arbitration Policy. Also, whenever possible and consistent with the objective of this Arbitration Policy to arbitrate all covered claims, any otherwise invalid term should be reformed and enforced by a court.

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CLOSE WINDOW

Peace of Mind® Extended Service Plan

The Peace of Mind® Extended Service Plan (the "Plan") offered by H&R Block ("Block") is available only at participating Block offices at the time your return is completed, but no later than October 31 of the year of the return due date. The Plan is separate from, and in addition to, Block's Standard Guarantee that pays penalty and interest resulting from an error in tax preparation.

The Plan is effective when paid for and signed by you and, cannot be transferred by you to others. Subject to the exceptions noted below, the Plan provides you with the following benefits with respect to the individual federal and any individual state or local returns prepared and paid for on the date of this agreement.

If your return is audited, Block will provide you with a qualified person (but not an attorney) to represent you before the tax authority should such tax authority question the accuracy of your return.

If you owe additional taxes as a result of an error in tax preparation and the error is discovered by you, your representative or a tax authority, during the period of 3 years from the filing deadlines for such returns, not including extensions, Block will pay you for such taxes up to a cumulative total of $5,000 for all such returns. Such 3 year limitation applies to your federal and state returns, including returns for those states in which the "open" period to review returns is greater than 3 years. In some cases, the correction of a specific error will involve changes on multiple returns, including State or Local tax returns, which may result in an overpayment on one return and a balance due on another. In such cases, the overpayment and balance due will be netted in determining the amount Block will pay for additional taxes owed as a result of correction of the error. Block assumes no responsibility for payment of additional taxes to a tax authority. You are responsible for providing payment of additional taxes to the tax authority.

Before such payment, you must:

(a) notify Block of any government notice regarding such taxes within 60 days from the date of such notice;
(b) promptly provide Block with copies of such notices and other documents relating to or substantiating such additional taxes;
(c) provide Block with reasonable notice of and allow Block to attend an audit with you or as your representative with Power of Attorney;
(d) allow Block at its sole discretion and expense, to challenge the determination that additional taxes and penalties and interest are owed; and
(e) provide Block with your receipt as proof of your purchase of the Plan.

You may be required to include such payment as income on your return in an amount that will be indicated on any Form 1099 you receive from Block. Block is not responsible for the payment of any taxes you may owe on such income.

The Plan applies only to filed and accepted original individual resident tax returns prepared by Block for the year of the return and for which the balance due has been paid. You represent to us that you have reviewed the items on your return and that items or issues on such returns have not been, or are not currently, under examination by tax authorities as of the date of purchase indicated on your receipt that specifies the total purchase price for the Plan and which is incorporated herein.

The Plan does not apply to:

(a) amended returns; 1040-NR;
(b) non-individual returns such as employment (including taxes assessed on Form 4137 for income other than allocated tips), corporate, state and local small business, occupation tax, partnership, trust, estate, and gift tax returns;
(c) any returns used to file for tax credits or rebates such as property tax, homestead

or renters credits that are not filed in conjunction with a federal, state or local return;
(d) the calculation of estimated tax payment vouchers, additional taxes owed as a result of an erroneous refund of your estimated tax payments by the IRS or a State or Local taxing authority;
(e) any return for which, as of the date of such purchase, you have knowledge of additional taxes owed;
(f) any return for which you have received on or before the date of such purchase any notification from any tax authority of examination or audit;
(g) returns for which errors have been identified by Block prior to an assessment of additional taxes by tax authorities and can be corrected by Block within 30 days from Block's preparation of the return;
(h) any return relating to previous years;
(i) additional taxes, penalties and interest that are assessed as the result of (i) incorrect, incomplete, false or misleading information that you have given to Block in connection with its preparation of a return; (ii) the government's inability to obtain from you sufficient records to support deductions, credits and other items on your return; (iii) your failure to timely pay the taxes as shown to be due on your return; and (iv) additional taxes assessed as the result of your desire to take a position on your return that challenges current IRS or judicial tax law guidelines or interpretation. In the event you receive a refund of any assessment that Block has paid you under the Plan, you must reimburse Block for the amount of such refund; and
(j) assessments of additional taxes that occur after 3 years from the filing deadline for the return, not including extensions.

ARBITRATION IF A DISPUTE ARISES BETWEEN YOU AND H&R BLOCK

If a dispute arises between you and H&R Block, the dispute shall be settled through binding arbitration unless you opt-out of this arbitration provision using the process explained in bold type below. This alternative to traditional lawsuits does not necessarily require you to hire an attorney, and may cost you only $5 to have your dispute with H&R Block decided by a third party. This third party, known as the Arbitrator, is empowered to settle the matter with the same set of remedies available in court including compensatory, statutory, and punitive damages, injunctive and other equitable relief, and attorneys' fees and costs. However, arbitration requires you waive your rights to sue H&R Block in court before a judge and jury, and to waive any right to participate in any "class action" lawsuit against H&R Block regarding any issue that could otherwise be settled by arbitration. As used in this arbitration provision, "H&R Block" shall also include the officers, directors, agents and employees of the respective H&R Block companies referenced under "Professional Tax or Other Services."

Right to Opt-Out of This Arbitration Provision: H&R Block does not require you to accept arbitration even though you must sign this Client Service Agreement to receive service from us today. You may opt-out (reject) arbitration within the first 30 days after you sign this Agreement by calling 866-714-5502, by visiting our website at www.hrblock.com/goto/optout or by sending a signed letter to H&R Block Compliance Department, One H&R Block Way, Kansas City, MO 64105. The letter you send us should include your printed name, Social Security number of yourself and joint filer if any, the most recent date you were served by H&R Block, and the words "Reject Arbitration." Your electronic, telephoned or written opt-out letter will override your signature below regarding arbitration but no other provision of this document.

How Arbitration Works. If you have a complaint against H&R Block that you have been unable to solve by bringing it to the attention of the office that served you, you may contact either the American Arbitration Association (AAA) at 335 Madison Avenue, Floor 10, New York, NY 10017 or the National Arbitration Forum (NAF) at P.O. Box 50191, Minneapolis, MN 55405. Whichever organization you choose will appoint a neutral practicing attorney with more than ten years of tax law experience to hear your side and H&R Block's side of the issue, and make a decision that is binding on both you and H&R Block. The American Arbitration Association's rules of arbitration are available by mail from AAA or on the Internet at www.adr.org. The National Arbitration Forum's rules are available by mail from NAF or on the Internet at www.arbforum.com.

Arbitration Costs. You will be asked to pay a $5 fee, and H&R Block will pay all other filing, administrative, hearing and miscellaneous arbitration expenses up to $1,500. H&R Block may consider paying arbitration costs that exceed $1,500 but only if you win the arbitration.

Other Arbitration Terms & Information. Your arbitration will take place in the federal judicial district where you live. The Arbitrator's award will be final and not subject to appeal except as permitted by the Federal Arbitration Act. Except as required by law, neither you nor H&R Block nor the Arbitrator may disclose the existence, content or results of your arbitration without prior

written consent from the other two parties.

Note. This arbitration provision will not apply to any claims relating to the Peace of Mind Extended Service Plan, the subject matter of which is currently being asserted in any certified class action lawsuit pending against H&R Block as of August 29, 2006.

Satisfaction
If for any reason you are not satisfied with the terms of this Plan and want to rescind this Plan, you may obtain a full refund of the fee you paid for the Plan provided that within seven (7) days from the date of purchase you contact the district manager of the H&R Block office where your tax return was prepared and provide at that office the receipt for such payment.

Claim Process – Frequently Asked Questions:
I received an inquiry from a tax authority. How do I file a claim?

Take your tax authority notice and any related documents to your local H&R Block office. Your local H&R Block office will file a claim with the Peace of Mind Claims Department. The claim will be reviewed and processed. If the claim is approved, you will receive a check. If the claim is not approved, you will receive a letter explaining the reason for the denial.

How long will it take to process my claim?
It usually takes 4 – 6 weeks to reach a claim determination.

What else do I need to know?
Federal law states that if your tax liability is paid by someone else, the amount of that payment becomes taxable income to you. Therefore, you will need to include your Peace of Mind payment on your tax return next year. If the payment is $600 or more you will receive form 1099-MISC from H&R Block next year.

What about penalty and interest payments?
Payment of any penalty and interest assessed on the additional tax due may be processed separately under the conditions of H&R Block's Standard Guarantee and paid by your local office.

Who do I contact if I have more questions?
You should contact the H&R Block office where your claim was originally filed.

You can also speak to a client service representative by calling 1-800-HRBLOCK.

What if my claim is denied?
You may dispute the denial by calling 1-800-HRBlock and requesting a second review. Your claim will usually be reviewed within 2 – 5 days. You will receive the final determination in writing.
For New Hampshire Residents: In the event you do not receive satisfaction under this contract, you may contact the New Hampshire Insurance Department, Consumer Division, which provides oversight for consumer guaranty contracts, at 21 South Fruit Street, Suite 14, Concord NH 03301 or 603-271-2261.

ATTACHMENT 3

2001

2001 J. Disp. Resol. 89

LENGTH: 5081 words

SYMPOSIUM: Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements

NAME: Stephen J. Ware *

BIO:

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SUMMARY:
... These articles can be read as asserting that imperfect information causes consumer arbitration agreements to be too harsh to the consumer with respect to the arbitration clause and too favorable to the consumer with respect to price. ... So these articles may reflect a belief that price-reductions occur only when consumers "read, understand, and evaluate" the arbitration clause. ... Other cases, by contrast, have certified classwide arbitration, or allowed classwide litigation to proceed notwithstanding the arbitration clause. ... The Court said that "the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum," and this would presumably make the arbitration clause unenforceable. ...

TEXT:
[*89]

Arbitration clauses now appear in many of the form contracts through which consumers obtain goods, services and credit. n1 Why do so many businesses that deal with consumers choose arbitration? Relative to litigation, arbitration provides opportunities for a business to save on its dispute-resolution costs. If arbitration does, in fact, lower these costs then arbitration lowers the prices (and interest rates) consumers pay because competition forces businesses to pass their cost-savings on to consumers. n2

This pro-consumer aspect of arbitration is generally overlooked, n3 and the enforceability of consumer arbitration agreements is often criticized. n4 Not all consumer arbitration agreements are enforced. n5 Courts regulate consumer arbitration by enforcing arbitration clauses that have certain features, while refusing to enforce arbitration clauses that lack those features. n6 This judicial regulation of arbitration [*90] agreements increases the dispute-resolution costs of the businesses with which consumers deal. And this cost-increase, in turn, raises the prices consumers pay. In short, judicial regulation of consumer arbitration agreements imposes costs on consumers. Whether such regulation yields any benefits that outweigh these costs is a complex and controversial question. n7

I. Arbitration Clauses Lower Prices

A. Assumption: Arbitration Clauses Lower Business' Costs

Arbitration, like litigation, is a form of binding adjudication. n8 The process of arbitration, however, can be very different from the process of litigation. These differences can make arbitration attractive to businesses that deal with consumers. Relative to litigation, arbitration provides opportunities for such a business to save on its dispute-resolution costs.

First, arbitration does away with juries and, for that reason, is commonly thought to reduce the likelihood of high damages awards against businesses. n9 Second, arbitration's confidentiality "lessens the risk of adverse publicity" about

a business and its disputes. n10 Third, arbitration can resolve disputes "according to a nationally uniform set of procedures," n11 thus saving interstate businesses the costs of adapting to different procedural rules in different states. Fourth, arbitration's finality (near absence of appellate review) saves businesses the costs of appeals. n12 Fifth, arbitration can eliminate the possibility of class actions against businesses. n13 Sixth, arbitration can deter claims against businesses by requiring consumer-plaintiffs to pay arbitrator fees, as well as filing fees that exceed the filing fees in litigation. n14 Seventh, arbitration can reduce the amount of discovery available to consumer-plaintiffs, thus reducing the amount of time and money businesses must spend on the discovery process and also making it harder for consumers to prove their claims. n15 [*91]

The foregoing is a list of just some of the reasons why arbitration might enable a business to save on its disputeresolution costs. And these reasons have apparently led a number of businesses to include arbitration clauses in their consumer contracts. n16 There is not, however, any publicly-available study indicating whether arbitration clauses have in fact saved businesses money. A business using consumer arbitration agreements could study the effects of those agreements on the business' bottom line, n17 and it seems likely that some such businesses have done so. Nevertheless, research revealed no publicly-available studies of that sort. So this article will proceed on an assumption. The assumption, customary in economics, is that businesses generally act in their own interests, i.e., are "profit-maximizing." n18 This article will assume that those businesses that use consumer arbitration agreements are doing so because those businesses find that they benefit from those agreements, i.e., that those agreements lower their disputeresolution costs. n19

B. Competition Forces Businesses to Pass on Cost-Savings to Consumers

Assuming that consumer arbitration agreements lower the dispute-resolution costs of businesses that use them, competition will (over time) force these businesses to pass their costsavings to consumers. n20 This pass-on follows from a basic principle of economics, the rate-of-return equalization principle. As a standard economics text explains:

If the market price of a good is greater than the opportunity cost of producing it, suppliers will gain from an expansion in production. Profit-seeking entrepreneurs will be attracted to the industry. Investment capital will flow into the industry, and output (supply) will expand until the additional supply lowers the market price sufficiently to eliminate the profits. In contrast, if the market price is less than the good's opportunity cost of production, suppliers will lose money if they continue to produce the good. The losses will drive producers from the market and capital will flow away from the industry. Eventually the decline in supply and shrinkage in the capital base (durable productive assets) of the industry will push prices upward and eliminate the losses.

In a market economy, characterized by freedom of entry and exit, there will be a tendency for the after-tax rate of return on iuvestment to [*92] move toward a uniform rate, the competitive or normal-profit return. Neither abnormally high uor abnormally low after-tax returns will persist for loug periods of time. This tendency for returns on investment capital to move toward a uniform, normal rate is sometimes referred to as the rate-of-return equalization principle. n21

The rate-of-return equalization principle implies that whatever increases an industry's profits ultimately attracts additional capital to that industry, causing an increase in that industry's output and therefore a reduction in its price. Suppose, for example, that firms in the widget industry add arbitration clauses to their consumer contracts and that this causes a reduction in these firms' dispute-resolution costs and a corresponding increase in their profits. These above-normal profits will attract additioual capital to the widget industry, causing an increase iu the supply of widgets and therefore a reduction in the price of widgets.

Importantly, this process occurs regardless of whether consumers understand, or even notice, the arbitration clauses. n22 This process works to lower prices because investors and entrepreneurs are alert to above-normal profits, not because consumers are alert to the arbitration clauses which cause those profits. n23 The increase in output attracted by above-normal profits is what lowers prices. In other words, the fact that widget-buying consumers get arbitration clauses is what causes them to also get lower prices. This is 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. n24

The law-and-economics literature features debate about the existence of, and proper response to, the problem of imperfect iuformation causing unregulated form contract terms to be too harsh to the consumer with respect to terms about which consumers are often ignorant and (therefore) too favorable to the consumer with respect to those terms, such as price, about which consumers are typically knowledgeable. n25 Some articles opposing enforcement of consumer arbitration [*93] agreements cite this law-and-economics debate. n26 These articles can be read as asserting that imperfect iuformation causes consumer arbitration agreements to be too harsh to the consumer with respect to the arbi-

tration clause and too favorable to the consumer with respect to price. n27 These articles, however, lack an explicit acknowledgment that harsh terms yield lower prices. n28 So these articles may reflect a belief that price-reductions occur only when consumers "read, understand, and evaluate" the arbitration clause. n29 To reiterate, that belief clashes with the reasoning of this article's previous few paragraphs. n30

Those paragraphs began with the plausible assumption that enforceable consumer arbitration agreements lower the dispute-resolution costs of businesses that choose to use such agreements. These cost-savings lead, through competition among businesses for capital, to lower prices for consumers. The greater the cost-savings to business, the greater the price reduction for consumers. To put it another way, the more costly arbitration is to business, the more consumers pay for goods, services and credit. When arbitration law changes in a way that makes arbitration more costly to business, then arbitration law is raising prices paid by consumers. Attempts to make arbitration more favorable (or "fair") to consumers have a downside for consumers if the effect of those attempts is to raise businesses' arbitration costs.

The following section discusses recent judicial decisions likely to make arbitration more costly to business. To the extent these cases have that effect, they can be known as "price-raising cases" or simply "price-raisers."

II. Price-Raising Cases

A. Requiring Class Actions

First among the price-raisers are cases holding that arbitration agreements must allow for class actions. Businesses can incur substantial liability in consumer class actions, both in cases that provide significant relief to the class and in cases that provide insignificant relief to the class but significant fees to plaintiffs' lawyers. n31 [*94] Limiting consumer claims to individual actions would deter some of those claims that plaintiffs' lawyers find worth pursuing as part of a class action, but not as an individual action. n32 Accordingly, some businesses use arbitration clauses in the hope that courts will enforce these clauses to preclude class actions. n33 And many cases have done just that. n34 Other cases, by contrast, have certified classwide arbitration, n35 or allowed classwide litigation to proceed notwithstanding the arbitration clause. n36 These cases, by requiring that arbitration preserve the class action, raise the cost of arbitration to businesses and, therefore, raise prices to consumers. [*95]

B. Capping Consumer Fees

While litigation is subsidized by the taxpayer, the parties must pay the full costs of arbitration. It has long been customary in arbitration for the claimant to pay the filing fee charged by the arbitration organization n37 and for the parties to pay equal shares of the arbitrator's fee. Recent employment arbitration cases, however, have refused to enforce agreements requiring the employee-claimant to pay fees according to this custom. n38 These cases effectively require the business to subsidize the arbitration claim against it. Some employment cases go so far as to require the business to pay all or nearly all of the costs of arbitration. n39 Several lower courts have moved toward this approach in the consumer arbitration context. n40

The Supreme Court addressed this topic in a recent Truth in Lending Act case, Green Tree Financial Corp. v. Randolph. n41 The Court said that "the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum," n42 and this would presumably make the [*96] arbitration clause unenforceable. But the Randolph Court placed the burden of showing prohibitively high fees on the consumer:

Where, as here, a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs. Randolph did not meet that burden. How detailed the showing of prohibitive expense must be before the party seeking arbitration must come forward with contrary evidence is a matter we need not discuss; for in this case neither during discovery nor when the case was presented on the merits was there any timely showing at all on the point. The Court of Appeals therefore erred in deciding that the arbitration agreement's silence with respect to costs and fees rendered it unenforceable. n43

Justice Ginsburg's dissent in Randolph pointed out that "as a repeat player in the arbitration required by its form contract, Green Tree has superior information about the cost to consumers of pursuing arbitration." n44 The dissent added: "In these circumstances, it is hardly clear that Randolph should bear the burden of demonstrating up front the arbitral forum's inaccessibility, or that she should be required to submit to arbitration without knowing how much it will cost her." n45 The dissent "would remand for clarification of Green Tree's practice" (if any) of subsidizing the arbitration costs of its consumer-claimants. n46

Case law requiring a business to subsidize a consumer's arbitration claim would raise prices in two respects. First, it would make arbitration more costly to businesses by making businesses pay more in fees for each case. Second, it would make arbitration more costly to businesses by increasing the number of cases brought at all. It would do this by lowering the financial barrier to asserting a claim.

C. Requiring Substantial Discovery

"Limitations on discovery, particularly judicially initiated discovery, remain one of the hallmarks of American commercial arbitration." n47 An important employment arbitration case, however, indicates that arbitration agreements should not be enforced unless they provide for "more than minimal discovery." n48 And there are a [*97] few cases refusing to enforce employees' arbitration agreements because of, among other things, the courts' concerns about insufficient discovery. n49

It is not clear whether these precedents will be extended to consumer arbitration n50 or whether they require as much discovery as litigation has. If they require litigation-like discovery, they would raise the cost of arbitration to businesses and therefore raise prices to consumers. Litigation-like discovery would both increase the amount of time and money the business must spend on the discovery process and make it easier for consumers to prove their claims. n51

D. Prohibiting Carve-Outs

Some arbitration agreements require arbitration of the consumer's claims but permit the business to bring its claims in court. For example, some consumer credit agreements require arbitration of all claims except for: (1) collection actions; and (2) actions to preserve, repossess or foreclose on collateral. n52 These two "carve-outs" encompass nearly all the claims lenders assert against consumer-borrowers.

A lender may find that these carve-outs save it money. n53 Collection actions against consumers often result in default judgments, n54 so the challenge for the lenderplaintiff [*98] is not winning judgments but collecting them from often insolvent or judgment-proof debtors. Also, collection actions against consumers nearly always involve small amounts of money. The combination of these two facts makes collections practice an assembly line in which large numbers of small claims are processed at a low cost per claim. n55 Even a slight increase in the cost per claim can make a significantly higher percentage of debts effectively uncollectible. Arbitration of collection actions may increase the cost per claim because the lender must win an arbitration award and then get that award confirmed in court, n56 rather than simply win a default judgment in court. n57

The carve-out relating to collateral also seems well-suited to saving the lender money. A court order is a preliminary step to repossession of collateral by a sheriff n58 or to a judicial foreclosure sale of collateral. n59 Arbitration of lenders' claims relating to collateral would be an additional step the lender would have to take before going to court to get the necessary order. n60 [*99]

Some courts have refused to enforce arbitration agreements with one or both of these carve-outs, in part because of the carve-outs. n61 These courts do not purport to prohibit these carve-outs under all facts among all parties. But with respect to facts like those before them, these courts effectively require lenders to arbitrate collection actions and actions relating to collateral. By doing so, these cases make arbitration more costly to lenders. Therefore, these cases raise the interest rates consumers pay.

III. Conclusion: Is the Price Worth It?

The previous section of this article discussed judicial decisions that raise prices (and interest rates) by requiring arbitration to: (1) allow for class actions, (2) subsidize the consumer's fees, (3) include substantial discovery, and (4) encompass both parties' claims. Whether these price increases are worth incurring, i.e., whether the judicial decisions are good policy, plainly depends on a number of factors including the amount of the price increase caused by each category of judicial decision. And different observers will certainly have different views about the value of, for example, class actions and litigation-like discovery. This article makes no attempt to assess the merits of those different views. Rather it argues that any such assessment should consider the influence consumer arbitration law has on the prices consumers pay. n62 Failure to address price inevitably biases any assessment of consumer arbitration law. It is easy to insist upon "due process" in consumer arbitration, n63 indeed "due process" is as widelycherished as "mom and apple pie," [*100] but the hard thinking begins when one asks who pays the price of process and how much they pay.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureAlternative Dispute ResolutionArbitrationsGeneral OverviewCivil ProcedureAlternative Dispute ResolutionJudicial ReviewContracts LawContract Conditions & ProvisionsArbitration Clauses

FOOTNOTES:

n1 See Stephen J. Ware, Arbitration and Unconscionability after Doctor's Associates, Inc. v. Casarotto, *31 Wake Forest L. Rev. 1001, 1001 n.3 (1996).* Other form contracts frequently containing arbitration clauses include employment contracts, franchise agreements, and investor-brokerage agreements. While this article is worded in terms of consumer contracts, the reasoning generally applies to other form contracts as well. See, e.g., Stephen J. Ware, The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration, 16 Ohio St. J. on Disp. Resol. (forthcoming 2001).

n2 See infra Part I.B.

n3 But see Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 U. Ill. L. Rev. (forthcoming) (acknowledging possibility that arbitration lowers prices); Jeremy Senderowicz, Consumer Arbitration and Freedom of Contract: A Proposal to Facilitate Consumers' Informed Consent to Arbitration Clauses in Form Contracts, *32 Colum. J.L. & Soc. Probs. 275, 298-99 (1999)* ("The benefits of arbitration which accrue to consumers, include savings on legal fees by the company (some of which will inevitably be passed on to consumers in the form of lower costs) . . . ."); Stephen J. Ware, Consumer Arbitration as Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen), *29 McGeorge L. Rev. 195, 211-13 & n.95 (1998).*

n4 See F. Paul Bland, Jr., To Fight Arbitration Abuse, The Devil is in the Details, Trial, July, 2000, at 31; Paul D. Carrington, The Dark Side of Contract Law: Courts Are Increasingly Validating Standard Form Contracts That Eviscerate People's Rights; Trial Lawyers Must Fight the Trend, Trial, May 2000, at 73; Paul D. Carrington & Paul H. Haagen, Contract and Jurisdiction, *1996 Sup. Ct. Rev. 331;* R. Larson Frisby, Congress Considers Curbing Mandatory Arbitration, Disp. Resol. Mag., Summer 2000, at 32; Thomas J. Methvin, Alabama The Arbitration State, *62 Ala. Law. 48 (2001);* Jean Sternlight, Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration, *74 Wash. U. L.Q. 637, 642-43 (1996);* Katherine Van Wezel Stone, Rustic Justice: Community and Coercion under the Federal Arbitration Act, *77 N.C. L. Rev. 931 (1999);* David G. Wirtes, Jr., Suggestions for Defeating Arbitration, *24 Am. J. Trial Advoc. 111 (2000).*

n5 See cases cited infra notes 36 & 40. See also Drahozal quote infra note 56. See generally Stephen J. Ware, Alternative Dispute Resolution § § 2.25 & 2.28 (2001).

n6 Those features are identified and discussed infra Part II.

n7 See infra Part III.

n8 See Ware supra note 5, § 1.6(c).

n9 See Nancy J. Warren & Michael D. Young, Arbitration Sees Victories in U.S. Supreme Court, Nat'l L.J., Jan. 15, 2001, at B14.

For those who represent large companies, arbitration is also seen as an opportunity to avoid the unpredictability of juries. Arbitrators are generally viewed as more likely to render awards that bear a reasonable relationship to actual damages incurred, although large awards for noneconomic injury, as well as punitive damage awards, are not unheard of in arbitration.

Id. See also Alan S. Kaplinsky & Mark J. Levin, Alternative to Litigation Attracting Consumer Financial Services Companies, in Arbitration of Consumer Financial Services Disputes 845-48 (1999) (arbitration "eliminates irrational jury verdicts").

n10 Kaplinsky & Levin, supra note 9, at 845.

n11 Id.

n12 Id. See Ware, supra note 5, § 2.43 (courts rarely vacate arbitration awards).

n13 See infra Part II.A.

n14 See infra Part II.B.

n15 See infra Part II.C.

n16 See Kaplinsky & Levin, supra note 9, at 845-48.

n17 On the methodological issues surrounding such a study, see Ware, Effects of Gilmer, supra note 1.

n18 See James D. Gwartney & Richard L. Stroup, Economics: Private and Public Choice 532-39, 563-65 & 595-98 (7th ed. 1995) (profitmaximizing firms produce additional output so long as the marginal revenue of doing so exceeds the marginal cost).

n19 It is possible that businesses using arbitration agreements are acting against their own interests by doing so. Similarly, it is possible that businesses that choose not to use arbitration agreements are acting against their own interests. Given the variety of businesses and their situations, it seems likely that consumer arbitration agreements are in the interests of some businesses, but not others.

n20 The pass-on can be in the form of lower prices or some other change favoring consumers, such as a more generous warranty.

n21 Gwartney & Stroup, supra note 18, at 67-68 (emphasis in original).

n22 Ware, supra note 3, at 212 n.95.

n23 For this reason, one must be careful about assertions that "the competitive defense of form contracts depends on an assumption that consumers read, understand, and evaluate the cost of the binding arbitration clause being imposed by the seller." Sternlight, supra note 4, at 688. If the "competitive defense" refers to the contention that "benefits secured by sellers through imposition of an arbitration provision will be passed on to the consumers," Id. at 687, then the competitive defense, as explained in the text, does not depend on an assumption that consumers read or understand the arbitration clause.

n24 See Victor P. Goldberg, Institutional Change and the Quasi-Invisible Hand, *17 J.L. & Econ. 461, 485-87 (1974)* "Harsh terms will, . . . in equilibrium, yield lower prices." *Id. at 487.*

n25 See R. Ted Cruz & Jeffrey J. Hinck, Not My Brother's Keeper: The Inability of an Informed Minority to Correct for Imperfect Information, *47 Hastings L.J. 635 (1996);* Lee Goldman, My Way and the Highway: The Law and Economics of Choice of Forum Clauses in Consumer Form Contracts, *86 Nw. U. L. Rev. 700 (1992);* Michael I. Meyerson, The Efficient Consumer Form Contract: Law and Economics Meets the Real World, *24 Ga. L. Rev. 583 (1990);* Alan Schwartz & Louis L. Wilde, Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis, *127 U. Pa. L. Rev. 630 (1979);* Alan Schwartz & Louis L. Wilde, Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests, *69 Va. L. Rev. 1387, 1402-20 (1983);* M.J. Trebilcock & D.N. Dewees, Judicial Control of Standard Form Contracts, in The Economic Approach to Law 93-119 (Paul Burrows & Cento G. Veljanovski eds. 1981); M.J. Trebilcock, The Doctrine of Inequality of Bargaining Power: Post-Benthamite Economics in the House of Lords, *26 U. Toronto L. J. 359, 375-76 (1976).*

n26 Carrington, supra note 4, at 74-76; Sternlight, supra note 4, at 688.

n27 See Ware, supra note 3, at 212 n.95 (reading Sternlight's article that way).

n28 Carrington, supra note 4, at 74-76; Sternlight, supra note 4, at 688.

n29 Sternlight, supra note 4, at 688. See also Mark E. Budnitz, Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection, 10 Ohio St. J. on Disp. Resol. 267, 332 (1995) (describing "consumer advocates' " view that it is "unlikely the cost savings realized by arbitration would be passed on to consumers"); Carrington, supra note 4, at 74-76 (the market does not work to "assure[] fair value" because of the "profound disparity of information between parties when a dispute resolution clause is inserted into a standard form contract . . . ."); Jeffrey W. Stempel, Bootstrapping and Slouching Toward Gomorrah: Arbitral Infatuation and the Decline of Consent, *62 Brook. L. Rev. 1381, 1397 (1999)* ("no evidence to suggest any reduction in price flows from enforced arbitration").

n30 See supra text accompanying notes 20-24.

n31 Drahozal, supra note 3 ("class actions tend to be run by, and for the benefit of, the plaintiffs' attorneys"). See generally Bruce Hay & David Rosenberg, "Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy, *75 Notre Dame L. Rev. 1377 (2000);* Geoffrey P. Miller, Class Actions, in New Palgrave Dictionary of economics & the Law (Peter Newman ed., 1998).

n32 A few of these claims would not be deterred because the consumer would pursue the claim pro se, i.e., without a lawyer.

n33 See generally Jean R. Sternlight, As Mandatory Arbitration Meets the Class Action, Will the Class Action Survive?, *42 Wm. & Mary L. Rev. 1 (2000).*

n34 Cases enforcing arbitration agreements to preclude classwide relief include *Johnson v. West Suburban Bank, 225 F.3d 366 (3d Cir. 2000); Thompson v. Illinois Title Loans, Inc., 2000 WL 45493* (N.D. Ill. Jan. 11, 2000); *Brown v. Surety Finance Service, Inc., 2000 WL 528631* (N.D. Ill. Mar. 24, 2000); *Sagal v. First USA Bank, N.A., 69 F. Supp. 2d 627 (D. Del. 1999); Zawikowski v. Beneficial National Bank, 1999 WL 35304* (N.D. Ill. Jan. 11, 1999); *Howard v. Klynveld Peat Marwick Goerderler, 977 F. Supp. 654, 665 n.7 (S.D.N.Y. 1997); Doctor's Associates, Inc. v. Hollingsworth, 949 F. Supp. 77, 80-81 (D. Conn. 1996); Lopez v. Plaza Finance Co., 1996 WL 210073* (N.D. Ill. Apr. 25, 1996); *McCarthy v. Providential Corp., 1994 WL 387852* (N.D. Cal. July 19, 1994); *Meyers v. Univest Home Loan, Inc., 1993 WL 307747* (N.D. Cal. Aug. 4, 1993); *Erickson v. Painewebber, Inc., 1990 WL 104152* (N.D. Ill. July 13, 1990); *Perry v. Beneficial National Bank, 1998 WL 279174* (Ala. Cir. Ct. May 18, 1998); *Patterson v. ITT Consumer Financial Corp., 18 Cal. Rptr. 2d 563 (Cal. Ct. App. 1993).*

This issue is complicated in the securities arbitration context by a National Association of Securities Dealers rule. See, e.g., *Champ v. Siegel Trading Co., Inc., 55 F.3d 269 (7th Cir. 1995); Nielsen v. Piper, Jaffray & Hopwood, Inc., 66 F.3d 145 (7th Cir. 1995); In re Nasdaq Market-Makers Antitrust Litigation, 169 F.R.D. 493 (S.D.N.Y.1996); In re Regal Communications Corp. Secs. Litig., 1995 WL 550454* (E.D. Pa. Sept.14, 1995).

n35 *Blue Cross of California v. Superior Court, 78 Cal. Rptr. 2d 779, 785 (Cal. Ct. App. 1999); Lewis v. Prudential Bache Secs., Inc., 225 Cal. Rptr. 69 (Cal. Ct. App. 1986); Izzi v. Mesquite Country Club, 231 Cal. Rptr. 315 (Cal. Ct. App. 1986).* See also Sternlight, supra note 33, at 110 ("Thus far, while experiences with class action arbitration are scant, participants in the few classwide arbitrations that have been held have not voiced sharp criticism of the inefficiency of such arbitrations."). See generally Ian R. Macneil, Richard E. Speidel & Thomas J. Stipanowich, Federal Arbitration Law § 18.9 (1994 & Supp. 1996).

n36 See *Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087, 1105-06 (W.D. Mich. 2000)* (finding an arbitration provision is unconscionable in part because it waives class remedies allowable under Truth in Lending Act ("TILA"), as well as certain declaratory and injunctive relief under federal and state consumer protection laws); *Ramirez v. Circuit City Stores, 90 Cal. Rptr. 2d 916, 920-21 (Cal. Ct. App. 1999)* (finding arbitration clause in contract of employment voided as unconscionable, in part, because it would deprive arbitrator of authority to hear classwide claim), review granted and opinion superseded, *995 P.2d 137 (Cal. 2000); Powertel v. Bexley, 743 So. 2d 570, 577 (Fla. Ct. App. 1999)* (refusing to enforce arbitration clause as unconscionable in part because of its retroactive application to preexisting lawsuit and because one factor as to its substantive unconscionability was that it precluded the possibility of classwide relief).

The Supreme Court recently declined to address (because it was not properly raised in the lower courts) a consumer's argument that her arbitration agreement was unenforceable because it precludes pursuit of her Truth In Lending Act claim as a class action. *Green Tree Fin. Corp.-Alabama v. Randolph, 121 S. Ct. 513, 524 (2000).*

n37 See AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULE R4(a)(ii) & ADMINISTRATIVE FEES (1999).

n38 See *Shankle v. B-G Maintenance Mgmt. of Colorado, Inc., 163 F.3d 1230 (10th Cir. 1999).*

In this case, Mr. Shankle signed the Agreement as a condition of continued employment. The Agreement requires Mr. Shankle to arbitrate all disputes arising between he and his former employer. In order to invoke the procedure mandated by his employer, however, Mr. Shankle had to pay for one-half of the arbitrator's fees. Assuming Mr. Shankle's arbitration would have lasted an average length of time, he would have had to pay an arbitrator between $ 1,875 and $ 5,000 to resolve his claims. Mr. Shankle could not afford such a fee, and it is unlikely other similarly situated employees could either. The Agreement thus placed Mr. Shankle between the proverbial rock and a hard place--it prohibited use of the judicial forum, where a litigant is not required to pay for a judge's services, and the prohibitive cost substantially limited use of the arbitral forum. See *Cole v. Burns Int'l Sec. Serv., 105 F.3d 1465, 1484* (concluding employees would be unable to pursue statutory claims if required to pay for arbitrator fees in addition to the administrative costs and attorney fees, which accompany both arbitration and litigation). Essentially, B-G Maintenance required Mr. Shankle to agree to mandatory arbitration as a term of continued employment, yet failed to provide an accessible forum in which he could resolve his statutory rights. Such a result clearly undermines the remedial and deterrent functions of the federal anti-discrimination laws.

Id. at 1234-35. See also *Paladino v. Avnet Computer Technologies, Inc., 134 F.3d 1054, 1062 (11th Cir. 1998)* ("Because Avnet makes no promises to pay for an arbitrator, employees may be liable for at least half the hefty cost of an arbitration and must, according to the American Arbitration Association rules the clause explicitly adopts, pay steep filing fees (in this case $ 2000)."); *Cole, 105 F.3d at 1485* (interpreting agreement to hold that employer would pay fees and then enforcing agreement); *Armendariz v. Foundation Health Psychcare Servs., Inc., 99 Cal. Rptr. 2d 745, 765 (Cal. 2000)* ("When an employer imposes mandatory arbitration as a condition of employment, the arbitration agreement or arbitration process cannot generally require the employee to bear any type of expense that the employee would not be required to bear if he or she were free to bring the ac-

tion in court."). But see *Arakawa v. Japan Network Group, 56 F. Supp. 2d 349, 351 (S.D.N.Y. 1999)* (rejecting Paladino and comparing authorities from various courts).

n39 See cases cited supra note 38.

n40 See *Dobbins v. Hawk's Enters., 198 F.3d 715, 717 (8th Cir. 1999); Rollins, Inc. v. Foster, 991 F. Supp. 1426, 1439 (M.D. Ala. 1998); In re Knepp, 229 B.R. 821, 838 (Bankr. N.D. Ala. 1999); Patterson, 18 Cal. Rptr. 2d at 567;* Brower v. Gateway 2000 Inc., 676 N.Y.S.2d 569, 574 (N.Y. App. Div. 1998).

n41 *Green Tree Fin., 121 S. Ct. 513.*

n42 *Id. at 522.*

n43 *Id. at 522-23.* The Randolph Court seems to have overruled not only the Eleventh Circuit's decision in that case, but other cases placing on the defendant the burden of proof regarding fees. See *Baron v. Best Buy Co., 75 F. Supp. 2d 1368, 1370-71 (S.D. Fla. 1999)* (refusing to grant a defendant's motion to compel arbitration before the National Arbitration Forum because defendants "failed to demonstrate in this record that the National Arbitration Forum is a neutral, inexpensive, and efficient forum to determine these claims as required by law").

n44 *Green Tree Fin., 121 S. Ct. at 524-25* (Ginsburg, J., dissenting).

n45 *Id. at 525.*

n46 Id.

n47 Macneil, Speidel & Stipanowich, supra note 35, § 34.1.

n48 *Cole, 105 F.3d at 1482.* See also *Armendariz, 99 Cal. Rptr. 2d at 750* (agreement to arbitrate employment discrimination claims enforceable if "the arbitration meets certain minimum requirements, including neutrality of the arbitrator, the provision of adequate discovery, a written decision that will permit a limited form of judicial review, and limitations on the costs of arbitration").

n49 See *Kinney v. United Health Care Servs., Inc., 83 Cal. Rptr. 2d 348, 354-55 (Cal. Ct. App. 1999)* ("The unconscionable nature of the unilateral arbitral obligation is heightened by certain other terms of United's arbitration policy. Given that United is presumably in possession of the vast majority of evidence that would be relevant to employment-related claims against it, the limitations on discovery, although equally applicable to both parties, work to curtail the employee's ability to substantiate any claim against United."); *Gonzalez v. Hughes Aircraft Employees Fed. Credit Union, 83 Cal. Rptr. 2d 763, 766-67 (Cal. Ct. App. 1999),* review granted and opinion superseded, *978 P.2d 1 (Cal. 1999),* appeal dismissed per stipulation, *990 P.2d 504 (Cal. 1999); Hooters of America Inc. v. Phillips, 39 F. Supp. 2d 582, 614-15 (D.S.C. 1998)* (arbitration held unconscionable in part because procedural rules were biased against employee and in favor of company where company had total control over selection of arbitrators, employee had severely limited discovery, and witness disclosure and sequestration were one-sided), aff'd on other grounds, *173 F.3d 933 (4th Cir. 1999)* (holding employer had breached arbitration agreement by issuing biased rules).

n50 See Jean R. Sternlight, Drafting a "Bulletproof" Consumer Arbitration Agreement: Is It Possible?, in Arbitration of Consumer Financial Services Disputes, 763, 790 (1999) (courts "are likely to strike down clauses which . . . deny the consumer access to discovery which is necessary in order for the consumer to have a chance of prevailing").

n51 Paul H. Haagen, New Wineskins for New Wine: The Need to Encourage Fairness in Mandatory Arbitration, *40 Ariz. L. Rev. 1039, 1053* ("More restrictive discovery may leave a plaintiff with a meritorious claim unable to prove it."); Jean R. Sternlight, Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns, *72 Tul. L. Rev. 1, 89-90 (1997)* ("Where, for example, one party has substantially greater access to relevant witnesses and physical and documentary evidence, denying the other party any discovery will essentially deny them the opportunity to prevail in an arbitration.").

n52 See, e.g., *Lackey v. Green Tree Fin. Corp., 498 S.E.2d 898, 905 (S.C. Ct. App. 1998)* ("Green Tree retained the option to use judicial or non-judicial relief to enforce a security agreement relating to the manufactured home, to enforce the monetary obligations secured by the manufactured home, or to foreclose on the manufactured home.").

n53 Cf. Christopher R. Drahozal, Privatizing Civil Justice: Commercial Arbitration and the Civil Justice System, *9 Kan. J.L. & Pub. Pol'y. 578 (2000).*

n54 Yvonne W. Rosmarin, Consumers-R-Us: A Reality in the U.C.C. Article 2 Revision Process, *35 Wm. & Mary L. Rev. 1593, 1625-26 (1994)* (the author is an attorney with the National Consumer Law Center).

The prevalence of default judgments in collection actions likely explains why, in the case of a major credit card issuer, "not only has the company sought arbitration far more often than consumers, it has also won in 99.6 percent of the cases that went all the way to an arbitrator." Caroline E. Mayer, Win Some, Lose Rarely?; Arbitration Forum's Rulings Called One-Sided, Wash. Post, Mar. 1, 2000, at E1. See Matthew C. McDonald & Kirkland E. Reid, Arbitration Opponents Barking Up Wrong Branch, *62 Ala. Law. 56, 60 (2001)* ("Virtually all of these cases were collection cases filed by the bank against customers more than six months behind on their credit cards bills. Unquestionably, the result in collections court would have been the same.").

n55 See, e.g., Lawrence R. Peterson, The Beauties of Mechanization, Utah Bar J., Nov. 1998, at 11, 12 (describing collections practice as "mechanized" and "automated"); Duke Nordlinger Stern, Reducing Your Malpractice Risk, A.B.A. J., June 1986, at 52 ("A collections practice, on the other hand, generally involves a large volume of smaller matters. Effective and specialized management systems, which the average law firm would not necessarily use, are needed to avoid improper practices and to honor numerous deadlines.").

n56 *9 U.S.C. § 9* (1994). See Drahozal, supra note 3.

To enforce an arbitration award, a party will need to get it reduced to a court judgment, not a complicated requirement but an additional step nonetheless, before it can recover on the judgment. In simple disputes over money due it may be cheaper to skip that intermediate step by having a court enter judgment for the amount owed. Similar arguments may explain why foreclosure and eviction actions commonly are excluded from arbitration.

Id.

n57 On the other hand, arbitration agreements may lower the cost of collections. The costs of complying with the Fair Debt Collections Practices Act, *15 U.S.C. § § 1692* -1692(o) (1994), and similar state statutes may be higher when debts are collected through litigation than through arbitration. For instance, these statutes may prohibit a nationwide creditor from threatening suit until it has taken the costly step of engaging a lawyer with the present ability (local license) to sue. Cf. id. § 1692(e)(5). In contrast, these statutes may permit a nationwide creditor to threaten, and even bring, a collection action in arbitration without a local lawyer, or even any lawyer at all. Cf. Jonathan Sheldon & Carolyn L. Carter, National Consumer Law Center, Unfair and Deceptive Acts and Practices § 5.1.4a (Supp. 2000) ("The creditor mails or even e-mails minimal paper work to initiate an arbi-

tration collection action, and need not even involve an attorney."). See also Brad O. Nakamoto, Arbitration of Consumer Financial Services Disputes, in Arbitration of Consumer Financial Services Disputes 827 (1999).

n58 U.C. C. § 9-503 (1999) ("judicial process").

n59 Elizabeth Warren & Jay Lawrence Westbrook, The Law of Debtors and Creditors 66 (3d ed. 1996).

n60 See Drahozal quote supra note 56.

n61 *American General Fin., Inc. v. Branch, 2000 WL 1868516* (D. Ala. Dec. 22, 2000) (collection actions and, not relied upon by court, actions relating to collateral); *Showmethemoney Check Cashers, Inc. v. Williams, 27 S.W.3d 361, 367 (Ark. 2000)* (collection actions); *Iwen v. U.S. West Direct, 977 P.2d 989, 995-96 (Mont. 1999)* (same); *Arnold v. United Cos. Lending Corp., 511 S.E.2d 854, 858-61 (W. Va. 1998)* (collection actions and foreclosure). Cf. *Fritz v. Nationwide Mut. Ins. Co., 1990 WL 186448, *6* (Del. Ch. Nov. 26, 1990) (uninsured motorist arbitration).

Cases enforcing arbitration clauses with carve-outs include: *Harris v. Green Tree Financial Corp., 183 F.3d 173 (3d Cir. 1999);* We *Care Hair Development, Inc. v. Engen, 180 F.3d 838 (7th Cir. 1999); In re Pate, 198 B.R. 841, 844 (Bankr. S.D. Ga. 1996); Meyers, 1993 WL 307747; Green Tree Agency, Inc. v. White, 719 So. 2d 1179 (Ala. 1998); Sablosky v. Edward S. Gordon Co., 538 N.Y.S.2d 513, 516 (N.Y. 1989).*

n62 Cf. Drahozal, supra note 53 at 587-88.

I don't think I can really tell you whether consumer arbitration agreements should be enforced or not. What I do think important to keep in mind is that courts that decide not to enforce arbitration agreements, for whatever reason, perhaps justifiably, can impose costs on the parties. Courts can't just hold something unconscionable without consequences. Given that sophisticated parties find these arbitration agreements beneficial, it seems to me that there is evidence that they may be beneficial to unsophisticated parties as well. You should at least keep in mind that there may be costs to not enforcing them. The costs may be worth taking. It is not my place to tell you one way or the other, but there are costs there that need to be taken into account.

Id.

n63 Which is not to say that it is easy to get consensus about what constitutes due process. Many major arbitration organizations have promulgated procedures designed to ensure due process in consumer arbitration. See, e.g., American Arbitration Association, A Due Process Protocol for Mediation and Arbitration of Consumer Disputes, available at http://www.adr.org/education/ education/consumerprotocol.html (1998); National Arbitration Forum, Due Process Standard, available at http://www.arbforum.com/other/index.html (last visited April 30, 2001); JAMS, Minimum Standards of Procedural Fairness Policy on Financial Services Arbitrations, available at http://www.jamsadr.com/finmimmumstds.asp (June 2000). All three of these can be found in print in Arbitration of Consumer Financial Services Disputes (Practicing Law Institute 1999).

ATTACHMENT 4

NATIONAL ARBITRATION FORUM

A FORUM Dispute Management Organization

Attachment 4

Estimating the Costs of Resolving the Average Civil Case in State Court: The New Jersey Example

In order to estimate the amount of cost savings that is realized by state court budgets, state treasuries and, ultimately, by taxpayers for each civil case that is resolved in arbitration instead of in court, it is first necessary to calculate the amount of money that is allocated in a given state for the resolution of civil cases. The state of New Jersey makes the requisite budget information available and relevant figures are presented below.

2006 New Jersey Budget Information

In 2006, the State of New Jersey appropriated $571,750,000 towards the judiciary[1]. The figures below present the portion of that total allocation designated to resolve civil cases in the state's courts.

State allocation to civil courts	$ 95,274,000
Federal government allocation to civil courts	$ 1,990,000
Trial court services[2]	$ 21,433,000[3]
Court reporting	$ 2,384,000[4]
Information Services[5]	$ 4,875,495[6]
Management and Administration	$ 4,155,585[7]
Total Expenditures to Resolve Civil Cases	$ 130,112,080
Total Number of Civil Cases Resolved	100,332
Average Cost of Handling Each Civil Case[8]	**$ 1296.81**
Average Cost of Handling Disposed Cases[9]	**$ 3112.36[10]**

[1] Data Taken From http://www.state.nj.us/treasury/omb/publications/07budget/pdf/98.pdf

[2] Trial Court Services includes the Division of Trial Court Support Operations, which provides technical assistance to the statewide trial level courts in areas such as case management, management structure, interpreter and translation services, and coordination of volunteer services.

[3] The total state expenditure for trial court services is $72,506,000. There is no available data on Trial Court Services expenditures for the different types of courts (e.g. criminal, probate, tax, etc). The figure shown was computed based on the assumption that each type of court used Trial Court Services funds that were commensurate to the total funds allocated. The state allocated approximately 28% of court expenses towards the civil courts. Therefore, the civil courts would utilize 28% of the trial court funds and services.

[4] Same process as described in footnote 2.

[5] The Administrative Office of the Court, which is responsible for the collection and maintenance of data on court operations, including statistical analysis of reporting, records management, and management information services.

[6] Same process as described in footnote 2.

[7] Same process as described in footnote 2.

[8] Total Expenditures by Civil Court divided by Total Number of Cases Resolved

Conclusions

These figures reveal the substantial taxpayer savings derived from the resolution through contractual arbitration of cases that would otherwise be litigated. If judicial disposition of a civil case costs the State of New Jersey $3,112.36, then the taxpayers of New Jersey are saving that amount whenever a civil dispute is resolved through contractual arbitration.

It is worth noting that the $3,112.36 probably underestimates the state's ultimate costs for these types of cases because there are other costs that could not be included. For example, a larger judicial docket means more judges, clerks, and other state employees required to administer and support the courts. Eventually, many of these state employees retire and the state must pay retirement and health benefits. Although these figures are difficult to calculate, they are sure to be substantial, thus providing the state with "legacy costs" associated with large caseloads.

Also unaccounted for in these figures are the enormous costs associated with the additional courthouses, courtrooms, administrative offices, and other space and location expenses. These expenses, it is estimated, would include millions of more dollars that are saved.

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[9] This figure excludes the 66.6% of cases that involve minimal judicial action. Minimal judicial action includes Default Judgments (35%), Dismissed for Want of Prosecution (18%), Settled Without Judicial Action (12%), and Settled through ADR (1.6%). The figure includes the 33.4% of cases involving extensive judicial interaction; including Cases Transferred to Another Court (.2%), Jury Trials (.2%), Summary Judgment (.8%), Bench Trials (1.7%), Settlements with Judicial Action (5%), and Other Civil Dispositions (24%).

[10] It is estimated that 80% of judicial costs are expended on cases requiring significant judicial interaction, which includes 33.3% of the cases reported here, with those cases involving minimal judicial action accounting for 20% of the costs.

ATTACHMENT 5

NATIONAL ARBITRATION FORUM

A FORUM Dispute Management Organization

Attachment 5

Speculations and contrived theories describing a repeat player bias in arbitration have no basis in fact and have been uniformly rejected by state and federal courts. [1] Any repeat player phenomenon exists in litigation and administrative law cases to the same extent it would exist in arbitration. There is no evidence for such a phenomenon in arbitration or in court litigation.

Any such benefit experienced by repeat players would have to evidence itself in the results of arbitration cases when compared to litigation cases. That is, repeat players in arbitration would have received more favorable outcomes in arbitration than in litigation or administrative hearings. There is no data supporting that allegation. Indeed, the only reliable data that exists shows that the outcomes are the same in the different advocacy forums.

The cited example points to arbitration awards issued by one National Arbitration Forum ("FORUM") arbitrator during one three-month period and was painstakingly selected from among thousands of awards that the FORUM is required to disclose in California specifically to create the impression that the arbitrator was biased. In fact, this limited example does not constitute credible evidence of any bias whatsoever.

A recent Christian Science Monitor article based upon a review of the comprehensive body of FORUM California arbitration outcomes concluded that the reported arbitration

[1] *Provencher v. Dell, Inc.*, 409 F.Supp.2d 1196, 1198, 1202 (C.D. Cal. 2006) ("NAF...is without question an inexpensive, efficient and convenient forum for resolving commercial disputes."); *Marsh v. First USA Bank*, 103 F.Supp.2d 909, 925 (N.D. Tex. 2000) ("[The National Arbitration Forum] boasts an impressive assembly of qualified arbitrators. In addition to being required to apply applicable law in an arbitration hearing, each member of the arbitration panel must take an oath to follow the NAF Code of Procedure, the Code of Conduct, and the prevailing ethical and professional standards...The Court is satisfied that NAF will provide a reasonable, fair, and impartial forum within which Plaintiffs may seek redress for their grievances."); *Miller v. Equifirst Corp. of WV*, No. 2:00-0335, 2006 WL 2571634 (S.D.W. Va. Sep. 5, 2006) ("Plaintiffs' allegations of bias have been addressed in a number of reported decisions in which similar suggestions that the NAF or the arbitrators it provides are biased have been summarily dismissed."); *Dewberry v. Countrywide Home Loans*, No. 01-0088-CV-W-SOW-ECF, at 3 (W.D. Mo. Mar.8, 2001) ("Plaintiff has the same right [under the NAF Code of Procedure] to recover her attorney's fees as she would in this Court and the expenses associated with arbitration appear to be comparable to or less than litigating the case before this Court."); *Hale v. First USA Bank*, No. 00CIV5406JGK, 2001 WL 687371, at *4, *7, n.5 (S.D.N.Y. June 19, 2001) ("[N]umerous courts have found the NAF to be an adequate and fair arbitral forum and have upheld arbitration provisions requiring arbitration in the NAF..."); *Lloyd v. MBNA Bank, N.A.*, No. Civ.A. 00-109-SLR, 2001 WL 194300, at *3 (D. Del. Feb. 22, 2001) ("Plaintiff offers no persuasive evidence that the National Arbitration Forum is anything but neutral and efficient."); *Bank One v. Coates*, 125 F.Supp.2d 819, 834, 835 (S.D. Miss. 2001) ("[T]o safeguard fairness, [the NAF Code of Procedure] provides that each of the parties may exercise one peremptory strike of a proposed arbitrator and each has unlimited challenges for cause. All legal remedies and injunctive relief are available to the parties. Any party may request a written opinion of the arbitrator's ruling (citations omitted).").

outcomes "may be similar to outcomes in court."[2] The reality is that outcome statistics in the form of consumer or business "win rates" are extremely poor indicators of potential arbitrator bias where they contain no information about the nature of the underlying claims that were decided.

For example, where consumer parties fail to contest arbitration claims brought by businesses, FORUM arbitrators review the merits of the claims and issue an award based on the merits. Where the business makes a sufficient showing of the existence of a legitimate unpaid consumer debt that is in default, the business should be granted an arbitration award. If the same cases would have gone to a default judgment in court, the outcomes as measured by a "win rate" should be expected to be quite similar. If anything, the business's arbitration win rate should be somewhat lower than in court because the business does not need to make a showing on the merits to obtain a default judgment in court.

The FORUM aims to provide parties with the same outcome that they would have received in court if the dispute had been litigated instead of arbitrated. In order to produce the same outcomes, the FORUM requires its arbitrators to base their decisions on the substantive rules of law that govern the dispute. As a result, if a business brings a type of claim that is successful in court a very high percentage of the time, that type of claim should also be successful in arbitration.

For example, a well-documented claim for a liquidated consumer debt where the respondent offers no affirmative defenses is very likely to be won by the lender if brought to court. It should be expected that a claimant bringing such claims before an arbitrator will experience a similar success rate. This example illustrates that a motivated search of a large number of arbitration outcomes will reveal subsets of cases where claimants experience a very high rate of success. The most reasonable explanation for any observed "win rate" that favors one type of party over another is related to the underlying merits of the disputes and not to vague accusations of systematic bias on the part of the independent arbitrators who decide the cases.

And so it would be just as fair and accurate to state that a judicial judge or an administrative judge who found for one party 80 times in 80 cases over a specific period of time was something less than impartial and fair. That data simply would not support an inference of bias either. In fact, judges handle such repeated and routine cases for many businesses and do so as fairly as arbitrators do.

The most fundamental problem with the theory that "repeat players" benefit from a systematic bias in arbitration is that it presumes that the experienced legal professionals who serve as FORUM arbitrators would sacrifice their professional ethics and personal integrity in order to issue anything but purely impartial awards grounded in the merits of the disputes being decided. Such a presumption is plainly insulting to the FORUM's distinguished panel of arbitrators, many of whom are former state and federal judges.

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[2] Baribeau, Simone, *Consumer Advocates Slam Credit-Card Arbitration*, CHRISTIAN SCIENCE MONITOR, Boston, July 16, 2007, at 13.

Consumers have a safeguard from such a problem if it were to happen: our current court system. A consumer can challenge an arbitration award and seek to have it vacated or modified. A judge can easily review an award to determine if a consumer suffered any unfair disadvantage in a case with a party who is a frequent user of arbitration.

Consumers have had this right for decades, and there are no reported cases of the "repeat player phenomenon" ever having been litigated or determined by a court to exist. And if there were such cases, they would be proof that the current system works to ensure consumers receive fair and equal treatment.

ATTACHMENT 6

NATIONAL ARBITRATION FORUM

A FORUM Dispute Management Organization

Attachment 6

First, contrary to the terminology used in the Bland testimony, the National Arbitration Forum ("FORUM") has no "clients." We have parties who elect to use our services when the parties contract with one another. Nor do we have customers. All arbitration users have the same rights and remedies available to them under our *Code of Procedure*. Second, there are no "prominent" users of our services. We treat all arbitration parties fairly.

Rule 21 Removal

Rule 21 of the National Arbitration Forum Code of Procedure permits a party to request the removal of one arbitrator candidate without cause. Other major arbitration administrators and numerous state courts also permit this type of removal.[1] This limited right to remove or strike an arbitrator candidate is a reasonable and commonsense procedure intended to give the parties a modicum of flexibility in selecting the decision-maker who will resolve their dispute.

Rule 21 also operates in the same way peremptory challenges are used in jury trials in all state jurisdictions. Because arbitrators are finders of fact, it is proper and appropriate that parties have the right to remove an arbitrator without having to state a reason. This right is only available once to a party in a FORUM case. So, in much the same way a litigant can remove a prospective juror, a party can remove an arbitrator.

Former FORUM arbitrators Richard Neely and Elizabeth Bartholet report that they were "blackballed" by specific arbitration claimants through the use of repeated Rule 21 removals. These reported perceptions simply do not comport with the underlying facts. Richard Neely was never removed by a claimant in any FORUM arbitration. Elizabeth Bartholet arbitrated 20 cases and was removed three times.

The overall percentage of FORUM arbitration cases in which Rule 21 removal requests are submitted is infinitesimally small. There is no evidence that it is being misused. One reason why parties do not feel the need to use it is because of the consistent high quality and impartiality of available FORUM neutrals. The existing (extremely limited) use of this commonsense removal procedure simply does not rise to the level of a phenomenon that can be fairly labeled as "blackballing."

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[1] At least sixteen states permit limited judicial removal without cause. ALASKA STAT. § 22.20.022 (2006); CAL. CIV. PROC. § 170.6; IDAHO R. CIV. P. 40(d)(1); 735 ILL. COMP. STAT. 5/2-1001(3) (2006); IND. R. TRIAL PROC. 76(B) (effective Jan. 1, 2007); KAN. STAT. ANN. § 20-311d(a) (2006); MINN. STAT. § 542.16 (2005); MONT. CODE ANN. § 3-1-804 (2005); NEV. S. CT. R. 48.1; N.M. STAT. ANN. § 38-3-9 (2006); N.D. CENT. CODE § 29-15-21 (2006); OR. REV. STAT. §§ 14.260 (2006), 14.270; S.D. CODIFIED LAWS §§ 15-12-21-22, 24-27 (2006); WASH. REV. CODE ANN. § 3.34.110(2) (2006); WISC. STAT. ANN. § 799.205 (2006); WYO. R. CIV. P. 40.1(b)(1).

The FORUM initially contacted Mr. Neely and Ms. Bartholet and invited them to be on our neutral panel. They willingly agreed. Their work with the FORUM reflects the fairness provided parties and the integrity of the FORUM procedures. Ms. Bartholet states in her deposition that she issued decisions based on merits of the case by applying the FORUM rules and the law. And she also agrees that she was never pressured by the FORUM in any way regarding her decisions and understands that FORUM arbitrators decide cases fairly and impartially.

A closer examination of Neely and Bartholet's reported experiences illustrates an arbitration system operating as it should, with impartial arbitrators deciding cases under the appropriate legal and ethical standards. Importantly, even if an arbitration claimant were, hypothetically, to attempt to systematically remove a certain arbitrator, the party would achieve no unfair advantage by doing so. The reason is that the replacement arbitrator would be similarly qualified, similarly expert and experienced, and also explicitly obligated to decide the case according to the applicable substantive law.

Richard Neely

Former Chief Justice of the West Virginia Supreme Court of Appeals Richard Neely heard and decided two cases during his tenure as a FORUM arbitrator. Richard Neely was never removed by a party from any arbitration case administered by the FORUM. Neely's subjective perception that, after he refused to "award a bank the full amount of attorneys' fees it asked for . . . found himself barred from handling anymore cases" (as reported in the Bland testimony) simply has no basis in reality.

When Neely examined the bank's request for attorneys' fees, refused to award the full requested amount, and instead presumably awarded the amount permitted under the applicable law and the facts of the case, he was simply performing his professional obligation to decide cases as directed by the FORUM Code of Procedure. In many states, parties receiving default judgments in court are able to obtain excessive attorneys' fees because court rules do not provide for judicial review of default judgments. Consumers receive significant additional protection in FORUM arbitration because arbitrators are required to review and decide even uncontested cases and will reject excessive demands for attorneys' fees.

Elizabeth Bartholet

Harvard Law School professor Elizabeth Bartholet served as a FORUM neutral from 2003 through early 2005 and was deposed about her experiences in connection with a lawsuit filed in Illinois state court.[2] The deposition transcript has been made public and is cited in the Bland testimony. In it, Bartholet reports that, after she had ruled in favor of a credit card company claimant in 18 of her first 19 arbitration awards, she issued a significant counterclaim award in favor of a respondent consumer in her 20th case and

[2] *Carr v. Gateway, Inc.*, No. 03-L-1271, Illinois Third Judicial Circuit (Madison Co.).

subsequently found herself routinely "removed" by the credit card company from hearing additional cases.

Bartholet also states that the FORUM case coordinator assigned to the cases from which she was removed under FORUM Rule 21 sent out notice to the consumer respondents in those cases stating that the reason for Bartholet's removal was a scheduling conflict. In fact, erroneous notice documents were sent, but purely as the result of a clerical mistake. All of the incorrect documents were sent on the same day by the same case coordinator who was new to the FORUM. Fortunately, the proper documents notifying the parties that Bartholet had been removed as arbitrator by the claimant were also mailed to the appropriate parties. Bartholet also received copies of both the correct notice of removal and the incorrect cover letter.

Far from illustrating any systematic manipulation, the Bartholet deposition transcript simply reports that she was removed as an arbitrator under FORUM Rule 21(C) three times on April 20, 2004 – the sort of procedural maneuvering that has long been practiced in the courts – and that an incorrect notice document was sent to the responding parties by accident.

In fact, despite the negative inferences drawn by the Bland testimony based upon these isolated Rule 21(C) removals and inadvertent notice mistakes, much of the deposition testimony describes a system where dedicated arbitrators make impartial and fair decisions. For example, Bartholet reports that in all of her work as a neutral, she remained faithful to the FORUM's Arbitrator Code of Conduct, Canon One of which states that "an arbitrator should uphold the integrity and fairness of the dispute resolution process" and "treat all parties equally and conduct themselves in a way that is fair to all parties and should not be swayed by outside pressure, by public clamor, by fear of criticism or by self-interest."

Bartholet also acknowledges in the deposition that she felt no pressure from the FORUM to decide cases in a certain way, and that she was "sure [subsequent arbitrators] would be given instructions to decide cases fairly and impartially." And this is precisely the point. Even if a party routinely removed a particular arbitrator, the substitute arbitrator would be a similarly qualified arbiter – either a seasoned attorney or former judge – also bound to decide cases fairly and impartially and, most importantly, bound by personal and professional integrity to do so.

Conclusion

Rule 21 removals represent a standard procedure that the FORUM holds in common with the other major arbitration administrators and many state courts. Such removals are exercised only in a vanishingly small percentage of cases. Even when removals requests are filed, parties cannot use this limited arbitrator selection device to achieve any systematic advantage. Former Chief Justice Neely and Professor Bartholet's subjective perceptions and speculation to the contrary are simply belied by the facts.

Mr. Jordan Fogal
Questions for the Record

#1 Some businesses offer a hardship to consumers to assist them in paying the fees associated with arbitration. Does his not provide a solution to those consumers who argue they cannot pay the fees?

In my experience with AAA, the American Arbitration Association, there is a spin on just about everything to do with the process. When we were filed on the first time we were supporting two houses, one we could not live in and an apartment. We were paying for testing of all kinds on our house, moving, storage expenses and legal fees. We could not afford arbitration. During the process our credit was ruined and we could not borrow the money since we had been posted for foreclosure. Some of our credit cards automatically raised their interest rates because of that one adverse credit reporting. Discover Card was the first. We were told we could pay them off or assume a ridiculous interest rate. We had never been late with a payment or a house payment until all of this happened.

We ask for hardship, as we too had read their slick brochures. We had to fill out a raft of papers and give this omnipotent agency every shed of information about our financial crisis. It was demeaning.

After I filed for hardship, they would not tell me if it had been granted. Every time I asked I received blank credit card authorizations wanting my credit card information so they could charge their costs to me. After some time they finally admitted I had qualified. They said I could pay $750.00 up front, before arbitration began and the exact same amount, win or lose that I would have paid up front, as a balloon note at the end of arbitration just as if we had never had this exercise for hardship.

When we saw they could provide an arbitrator pro bono we applied for one. The builder was not participating in the process yet AAA had us jumping though hoops. We were afraid not too comply with everything AAA told us to do since this was supposed to take the place of court. We thought it was like being in contempt if we did not do everything they said. We thought they could put us in jail or rule against us because of something we did wrong. They sent out a list of arbitrators one of them, Marsha Higbee, had three on going cases with our builder. One case had been taken back to court from AAA for a ruling because the builder's lawyer was unhappy with her ruling during the process. It had not been ruled on so we chose her. All this was in her disclosure. We thought at least she would know what they were really like. We sent in our list on the appointed day. There was always a deadline for everything. We met every deadline. We chose Ms. Higbee. She was assigned and said she would give us one free day of arbitration, this was after our builders' lawyers said to AAA and to us that they could dispose of us in one day. A conference call was scheduled. Then a couple of days later, the builder's lawyers said, they did not want Ms. Higbee. They had changed their mind, now it might take three to five days and they wanted not one, but 3 arbitrators. So AAA thanked Ms Higbee for her offer and released her.

We were sent out notices again. This time the fees were so high per hour that I told them we could not pay $475 an hour for 6 to 8 hour for 3 to 5 days and for pre and post study for what ever length of time the arbitrator chose. I told them I could not in good conscious hire someone that I could not pay because it was dishonest. AAA knew we had no money so for the first time they denied the builders' lawyer's request for 3 arbitrators. AAA is a "non profit" agency. They are careful if they think they are not going to get their money. So they said only one arbitrator. They knew they could probably squeeze that much more out of what was left of us.

So the builders' lawyer, with our AAA solutions manager and myself on the phone told me I would chose or he would go to court and have an arbitrator appointed by the court, outside of AAA. He said that he had done it many times before and he could assure me it would not be free. I chose an arbitrator. Then I wrote the arbitrator and told him I could not pay him. I no longer owned the house by then. I did not pay the arbitrators fees but then neither did the builder. I was puzzled; the builders' lawyers told me if I did not pay they could go to arbitration without us and get a ruling in abstensia. I thought that was what was going to happen.

In the AAA rules, the more affluent party can pay both of the parties fees to force the process. The builder's lawyer said he was not paying my fees. So the arbitrator dismissed the case for non payment of fees by both parties.

We had gone though the process and been dismissed. So we mistakenly thought we had earned our right to a trial by jury finally and filed charges of fraud against the builder. After 8 hearings we were ordered back into arbitration. There are so many ins and outs in arbitration agencies. They do not give a direct answer they intimidate and harass and frighten you to death. This time they made us pay. We had been forced to pay off our credit cards so they said we could now afford to pay for arbitration. And pay we did. We paid $9,300.00 up front and then $1,687.00 for post study.

What no one seems to understand about this entire process is that you pay this out stretched handed agency and then pay to prepare to go to arbitration. AAA has their money.

#2 From a consumers perspective and someone who has lived though the process how would you change arbitration to make it fair to all parties to a dispute?

After what we went though and what I have been appalled to know after meeting and talking to not only the victims of my builder, but many others, I have seen nothing but flaws.

How can anything be upheld by the courts, if the rules of laws do not apply? How can we be taken behind closed doors and allowed to be humiliated and lied about and the evidence be ignored and this be called justice? How can it be fair when the builders

already are in a contractual agreement with the arbitration company? How can it be fair when the arbitrators are dependent on the builders to chose them again so they will have a constant stream of income? How can it be fair if there is no appeal? How can it be fair when people are frightened under gag orders and cannot even talk about what happened to them? I have been to people's houses who had repeated the mantra "we reached an amicable settlement with our builder." If that were true why is the house still falling apart, why is the owner sick and moving out of the state, why does his dog have no hair and why is his wife crying. This is amicable?

It is not more fair or cheaper and it is not in the consumers' best interest. We have all been sold a bill of goods. Many people just walk away from arbitration and their homes and move in with family members. Many are forced to live in deplorable conditions. The red tape and complicated procedure is something I have studied for 4 years and been a victim in arbitration twice. I have talked to people who actually came out of arbitration owing their builder. It is so unfair we feared that prospect. The arbitrator ruled that we should pay our builder's lawyers for breach of contract for trying to sue him in court for fraud. How can the perpetrator file on the victim? This is so backwards, it is upside down. A consumer has the right for small claims to go to small claims court. We do not need to pay an arbitrator. We have paid for a judge with our taxes. There is nothing redeeming about a middle man's cut as we seek truth and justice.

#3 In your testimony during June 12, 2007 hearing, you indicated that in Texas you can sue someone selling you an existing house. But you cannot sue someone selling you a new house, Please explain how you have come to understand this, including any research of the laws and regulations in Texas, and whether you have determined that persons in other states are similarly prohibited from suing new home builders?

In new home contracts the builders include mandatory arbitration clauses and will generally refuse to sell a home to a consumer who objects to such arbitration clauses. Moreover, builders typically select American Arbitration Association which requires very high financial burdens just to participate. In either case, the consumer will never have a true measure of justice.

With respect to homes purchased from subsequent owners, not builders- using standard TREC forms, an arbitration clause is completely optional.

In fact you can actually sue a builder in Texas, but the laws purchased by the builders from our Legislature make it so difficult and expensive that it is out of reach of all but the wealthy who have a standing relation with an attorney from the start of the transaction due to short time deadlines and intricate traps that a layman could not be expected to negotiate.

For comparison, let's first consider what a buyer can do if there are severe problems with a house he buys from an individual. Most individual home sales involve at least one licensed real estate broker/sales person and often two. The substantial majority of

licensed real estate brokers/sales people are knowledgeable, well-trained and want to do a good job for their client, be it the seller or the buyer. Even if a person sells their home without a broker/sales person, the seller must provide the buyer with a rather detailed Property Condition Disclosure promulgated by the Texas Real Estate Commission. It requires disclosure of a wide range of details with attention to past problems that have been remedied, current problems that need attention a number of specific representations. You can find the form at www.trec.state.tx.us/pdf/contracts/OP-H.pdf.

Most lawsuits against sellers involve allegations of misrepresentations in the Disclosure or failure to disclose material facts. The suit can be brought in the Justice of the Peace Court if for not more than $5,000; the County Civil Court at Law if for not more than $100,000; or in the District Court where there is no dollar limit on claims.
The cost is no more than any other lawsuit and a JP claim can be handled without a lawyer with reasonable success—providing that the other party doesn't have a lawyer.

To file a suit on a builder:

1. Make a warranty claim to your builder within the applicable warranty period (1 year for workmanship/materials is what most claims fall under. More serious claims have a two year warranty and the foundation has a ten year warranty). I will use a one year warranty claim in explaining this below.

2. If they don't respond/fix, send them a certified letter demanding repair in 30 days.

3. If they don't respond/fix, make a claim with TRCC (Texas Residential Construction Commission) within 30 days after the conclusion of your warranty period. The cost to file the complaint is $250. (As you can see, logistically you have to start this process WELL before the end of your 1 year warranty period. If your problem doesn't show up until close to the end of your warranty period you have a problem -- like when my my partner Victoria's floor went wonky 2 weeks before the end of her warranty). The TRCC complaint form must be filled out extremely carefully. If the problem is not described with adequate precision or you can lose that item since you cannot amend your complaint.

4. TRCC "claims" that you'll have your inspector and inspection completed within about 30 days. In reality it takes months. Remember, the inspector you get could be a builder or have no real inspection qualifications, and you have to go through a lengthy process to object and get a new inspector. However, I have met at least one TRCC inspector who was first class—but he is the only really good one I have seen.

5. If the inspector says in his report that there is a problem with any item (the report is done item by item) there is a problem then the builder can---- 1) offer to repair or 2) give you $ to repair. The builder gets to choose whether to repair or pay, not the homeowner. The builder has 15 days to make this determination after he receives the inspector's report and you have 25 days to accept whichever alternative the bulider chooses. (This is assuming no one appeals the inspectors report). If the owner rejects a reasonable offer

(reasonableness is determined later), then the owner's remedies are significantly curtailed. Should the case finally make it to trial (or arbitration), the inspector's report has a presumption of correctness with the burden on the owner to rebut/disprove the inspector's findings. (This is called a rebuttable presumption.)

6. Builder has 45 days to complete repairs. (Remember the same idiot who screwed it up the first time is coming in to fix his own mistakes. This is like having the doctor who left a pair of forceps inside of you during surgery have the opportunity to do the removal and repair.) The builder almost always chooses to repair it himself rather than offer a dollar sum to the owner so the owner can go hire another builder of his choice.

7. If the builder doesn't fix the problem (to the satisfaction of the original inspector) or doesn't offer to repair at all (or makes an unreasonable offer of repair) or give you money, only then you can sue.

8. If you DON'T do steps 1-6 then you are FOREVER BARRED from suing. If you file suit, your claim is dismissed with prejudice and there is a good chance the builder will seek sanctions against the owner and his attorney for filing a suit in bad faith. (if the statute of limitations is an issue then you can file suit and make your TRCC demand at the same time. The suit will be abated until the TRCC process is completed). Also remember that any photos. documents, expert reports, inspection reports and the like not handed over by the owner during the TRCC inspection may not be used at trial. The builder is not required to turn over his evidence.

8. BUT HER IS THE NEXT CATCH 22. If the Purchase Contract has a mandatory arbitration clause in it, and theY almost always do, you still don't get to sue. You have to arbitrate or just go away and drop your claim. IS THE OWNER TIRED AND BROKE YET? NO? THEN COMES—

9. File your arbitration demand with the American Arbitration Association (AAA) and pay their fee, which usually starts at $1200 or so. MOST builders include a provision that the Federal Arbitration Act applies so as to preempt any state arbitration laws that might be kinder to the owner. There are other arbitration groups, but the AAA is almost always the one the builder names in his contract. Remember, most builders are dues paying members of the AAA, but the AAA doesn't consider this a conflict of interest.

10. Go through arbitration. That is a separate nightmare that routinely costs more than litigation. And arbitration is routinely a secret procedure and the arbitrator is free not to follow the law, as a judge would have to do, but may substitute his judgment as to "what is right."

11. If you don't like the arbitrator's decision there is no right of appeal like there is in court.

12. You may have a shot at vacating the arbitrator's decision (called an "arbitrator's award") if you can prove that your arbitrator failed to disclose information regarding bias

(e.g.--the arbitrator has represented the builder; is his brother in law; or perhaps is the builder's golf partner). But, you have to file you Motion to Vacate within 90 days of the award. If you don't discover that the arbitrator didn't disclose what he should have until after the 90 days, there is NOTHING you can do. If your arbitrator failed to follow the law there is NOTHING you can do.

13. If your arbitrator acted "fraudulently", you can move to vacate the award. But you must do so within 90 days of discovery of the fraud. However, the cases reveal that NOTHING is fraud (not even ex parte communications—the other party talking to the arbitrator about the case without your presence or knowledge). Arbitrators are immune from suit and on a recent case from the 6th Court of Appeals in Texas, arbitrators have been given greater immunity that that of a judge. Remember, a judge can be appealed, grieved against to a state's judicial ethics commission or, if elected, voted out of office. The AAA is also immune from suit and has greater immunity than that of a judge, even though they perform no judicial function such as exercising discretion or interpreting the law. The AAA's only job is administrative, yet they are immune from suit for such acts. Even an arbitrator's administrative acts are immune. However, a judge is not immune from suit for administrative acts that are not considered judicial in nature.

So, can you sue a builder? Only maybe and it is going to be expensive. But if you do get the chance, you will already have spent months and countless amounts of money. And then you start with the same costs you would have if you had been allowed to sue in the first place.

The laws in other states are often just as oppressive, although California has enacted a new law that makes arbitration much closer to fair. And a boondoggle like the TRCC appears to be something that is "only in Texas".

In Texas an existing homeowner is required to fill out a "Seller's Disclosure" promulgated by the state which inquires about a number of aspects of the home, its current condition and any defects. You may sue on the disclosure or get out of the transaction if it contains false statements or material omissions. By contrast when suing the original builder or anyone repairing or performing work on your home you are subject to the Residential Construction Liability Act which preempts the Texas consumer protection law (Deceptive Trade Practices Act) and any common law claims. The act purports to apply only to "defects" in construction but as the builder can rarely be shown to have absolute knowledge of the problem, fraud, misrepresentation and breach of warranty are often subsumed under the heading "defect". The Legislature recently amended this statute so that it requires, as a prerequisite to litigation that a party must go through the newly formed residential construction commission (a state agency made up entirely of builders) before bringing any claim in state court or arbitration. In this process the state agency appoints a "third party inspector" who issues a finding about the alleged defect. If the finding is adverse to the builder, the builder can repair the defect and the existence of the defect remains confidential with the agency. If the builder does not make the appropriate repairs the agency can then decide if the inspector's finding are correct and issue a ruling with accompanying findings of fact and conclusions of law. Whatever

the ruling either side may appeal the judgment of the agency to a state Court (" or arbitrator if so agreed in the original contract") which must generally defer to the agency and the inspector on factual matters and which has the power to reverse the application of law to facts only if no legal theory supports the finding. Technically therefore a home purchaser does have resort to an arbitrator or court for the final appeal of any finding of the state agency but must overcome the ruling and factual findings of the board as found by the "third party inspector". As a practical matter therefore there are at least two levels of litigation through which a homeowner is required to proceed with limited opportunity to recover damages even in the face of facts which would otherwise support the award of additional damages for breach of warranty, deceptive trade practices or fraud.

Also, the National Association of Homebuilders, as set forth in their own mission statement, wants arbitration in all clauses in every state and the "right to cure" or "right to repair" in all states and there are 31 so far. The NAHB Research Center is a subsidiary of the National Association of Home Builders (NAHB). In their report titled: "Making the Quality Connection: Improving the Building Industry Insurance Situation Through Quality Assurance Programs" the Research Center lists one of their objectives as: To reform limits of liability, to limit the frequency of litigation, and reduce excessive punitive damage judgments while still providing consumer protection. Action steps recommended:

- Establish laws providing for the right to repair, or the right to cure construction defect claims in each state.
- Include binding arbitration clauses in all builder / trade contractor contracts.
- Provide written warranty that waives implied warranty laws (where allowed) in lieu of building industry adherence to strong performance standards."

This assures one more hoop for homeowners to jump though. It is a farce in Texas. You have to pay $360 to $650 and they say they give it back so I guess you could just say the homeowner has to lend them the money. My builder was not allowed by state law to do anything to us like court or arbitration it was against the law. They did it anyway by circumventing state law and our Texas residential Construction did not do anything about it. The builder said we did not qualify so even though the state said I did, the builder proceeded with arbitration not only at the American Arbitration Association but at the Better Business Bureau too all these things they did at once to confuse and frustrate us into silence. They were expelled from the Better Business Bureau for unethical practices and shadow companies.

I am not a lawyer nor do I give legal advice but I have done nothing but this for over 4 years. Since my name pops up often on the internet and I have been written about in national magazines, I get calls from all across this nation from people who have suffered or are suffering unbelievable harm because of bad builders and arbitration clauses. That is how I know they exist.

I can give you a rundown of the states people live in that I have personally had conversations with: Texas, at least a 100, Florida, numerous, Pennsylvania, Georgia,

Alabama, Nevada, New Jersey, these are just the latest. When people first started calling me I did not keep a record. I was just someone they could call that understood what they were talking about. I never gave advice other than to be very careful. I also told them if they could afford to pay to have the repairs done without abandoning their homes they needed to look at the road blocks ahead: its unbelievable cost, in money, time, energy and stress on their families. Then they would have a frightening choice to make. I keep in touch with many of them just because I know what they are feeling and I am so sorry I could not help them or send them somewhere that someone would or could. I always tell them to write their Representatives. Most do not feel they would matter. They are so upset. They think they are just one person and since they are ordinary people without war chests of money no one will listen. And we have seen money does talk and watched who listened.

No one seemed to hear us until now. There are so many more of us than you can imagine. My prayer is that soon someone will admit the housing bust was bought on by the greed of the boom and check on these foreclosures and how many were actually caused by arbitration and defective homes. We need a big change and I know it is going to be very difficult to meet the opposition of big business. Every day that passes more peoples homes are taken and their lives are destroyed. Most will never recover from what is done to them. But even if they do something has been taken away: their belief in this county, our laws and that we are a democratic society. We waver in our belief that tyranny has not over powered, we the people.
My father was on Pearl Harbor when it was bombed and wounded at Guadalcanal. He was one of the most patriot men I have ever known. My earliest recollections are singing "from the halls of Montezuma to the shores of Tripoli..." as we rode in the car. I was proud of his service to his country. Now we are at war in this county and the working class is losing. Give us our right to a trial by a jury. Like my father so many have given so much so we could live in a county founded on the principles of democracy. Arbitration is not a democratic process. It is promoted by big business out of pure unadulterated greed and it should be outlawed.

When I came there to speak before the congressional committee, I was awe struck. I crossed the Potomac and thought of George Washington, and drove by the Lincoln memorial and I thought my father would have been so proud that I was there at the seat of our government--fighting. Maybe I am just a naive, woman from Taylorville Alabama, but I believe in this county and most of all I believe in the constitution. And I believe we were all granted the right to a trial by jury.

David S. Schwartz
Associate Professor of Law

I. Responses to MAJORITY MEMBERS QUESTIONS

1. The spirit of arbitration is a purely voluntary alternative to the court system, one that holds out the promise of a simpler, faster and less expensive process. To maintain that spirit while also protecting the interests of consumers and businesses, I would propose making pre-dispute consumer, employee and franchise arbitration agreements unenforceable. The proposed Arbitration Fairness Act of 2007, H. 3010 (Johnson) and S. 1782 (Feingold) take the right approach. These bills would eliminate *involuntary* arbitration for consumers, employees and franchisees. Businesses that see arbitration as a way to keep costs down are still free to agree to arbitrate *after* a dispute has arisen.

2. I believe that certain Supreme Court justices feel that the federal judiciary is overburdened and that more federal judges need to be appointed to handle the current caseload. To these justices, endorsing mandatory arbitration has had the advantage of reducing the federal caseload. Is there really a "caseload crisis"? That issue is highly disputed. What is not disputed is that there has been a higher-than-usual rate of federal judicial vacancies dating back to the Clinton administration. If there are too many cases for the federal courts to handle, then the way to address that issue is not to endorse mandatory arbitration – and impose the costs of a solution on consumers and employees – but rather to undertake a fair and systematic study of the entire mix of federal cases, including federal criminal cases, to see whether there are some areas where case filings can be scaled back.

3. Pre-dispute mandatory binding arbitration agreements have not flourished outside the United States for the simple reason that other countries refuse to enforce those agreements when they are found in take-it-or-leave-it contracts between consumers or employees and businesses.

4. The Due Process Protocol of American Arbitration Association (AAA) is an ineffective band-aid on the problem of mandatory arbitration: it tries to make the best of a bad situation of forcing unwilling consumers or employees to arbitrate when they would prefer to exercise their right to go to court. The Protocol fails to address the fundamental problem raised in Mr. Bland's testimony that AAA has a market incentive to make arbitration attractive to businesses – since it is businesses who must sign up for mandatory arbitration by putting it into their consumer and employment contracts. No system of justice can be fair if one side of the dispute has a disproportionate say over the rules – as businesses do in the mandatory arbitration setting due to this market incentive. Furthermore, the Due Process Protocol only provides for limited discovery and appeal rights. But there is a problem with trying to "improve" the Protocol – any such improvements tend to make arbitration more like court, and the more court-like arbitration becomes, the less attractive it is as an alternative to litigation. Making the Protocol more

protective of consumer and employee rights will make arbitration diverge from its "spirit" of a simpler, faster and cheaper alternative. (See question #1.) Again, the best approach is to keep arbitration entirely voluntary.

II. Responses to MINORITY MEMBERS QUESTIONS

1. Few things, if any, are more important to United States citizens and residents than the First Amendment right to "petition the government for a redress of grievances." This fundamental right includes a right of access to the judicial branch of government – the courts. Any contract that tries to deprive someone of that fundamental right should be viewed with suspicion. Therefore, the burden should be on those who seek to enforce such contracts to prove that arbitration is fair, that consumers are "happy" with it, and that their agreement to arbitration is a fully knowing and voluntary waiver of this right, rather than a take-it-or-leave-it, fine-print contract term.

There is no empirical research even coming close to meeting that burden of proof. The "empirical evidence" citing consumer satisfaction actually did not survey consumers forced into arbitration under mandatory, pre-dispute arbitration clauses. The research suggesting that arbitration is fair to consumers was industry-sponsored, cooked-up research. To say it's "not robust" is an understatement – more to the point, it's not true. It's like the tobacco industry studies claiming that smoking doesn't contribute to cancer.

2. The more rigorous empirical research tends to show that mandatory arbitration favors companies over consumers. This makes sense: if it didn't, why would companies be so strongly in favor of it? Is it possible that repeat arbitration favors companies for some reason other than a stacked deck in their favor? Perhaps – as I said in my testimony, the empirical research has produced few definite and reliable conclusions. But that means that the companies have not met their burden of proving that arbitration is fair to consumers. (See response to question #1).

Statement on Consumer Arbitration by the American Arbitration Association

Submitted to the
Subcommittee on Commercial and Administrative Law Committee on the Judiciary
United States House of Representatives
Tuesday, June 19, 2007

These comments are being submitted to the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary of the United States House of Representatives ("Subcommittee") by the American Arbitration Association ("AAA") in connection with the Subcommittee's hearings on consumer arbitration, which took place on June 12, 2007. As the world's largest provider of alternative dispute resolution ("ADR") services, including arbitration, the AAA has pioneered the development of arbitration rules, protocols and codes of ethics and we would like to share our experience with the Subcommittee.

We have three main messages that we wish to share with the Subcommittee resulting from the AAA's decades of work in ADR:

- First, that arbitration, properly balanced, provides consumers access to justice for a large body of cases that they might otherwise not be able to pursue or afford;
- Second, that the AAA took a leadership role in establishing the National Consumer Dispute Advisory Committee, including consumer advocate organizations, that developed the *Consumer Due Process Protocol* ("Consumer Protocol"), which articulates a number of fundamental principles to enhance the fairness and efficiency of consumer ADR; and
- Third, as the use of ADR in consumer agreements has evolved, the Consumer Protocol has been incorporated into some of the AAA's procedures, and courts have used the principles contained in the Consumer Protocol as guidance for the enforceability of unfair consumer arbitration agreements. As a result, the AAA suggests that the Consumer Protocol would be the appropriate starting place for the examination of consumer arbitration.

Background on the American Arbitration Association

The AAA, founded in 1926, is a neutral, non-partisan not-for-profit public service organization with a long history of working with government, the courts, the public, private industry, consumer advocate organizations, and non-governmental

organizations on the appropriate use of ADR. The cornerstones of the AAA's mission, vision, and values are independence, neutrality, and integrity.

Federal, state, and local governments have often turned to the AAA to assist in the resolution and prevention of disputes as evidenced by the more than 300 federal and state statutes which directly reference the AAA.

Our Roster of over 7000 Arbitrators and Mediators includes former judges, public officials, lawyers, engineers, architects, and other professionals trained in arbitration, mediation, conciliation, and other forms of ADR.

ADR in Consumer Contracts

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.

To evaluate and address these concerns, in 1997 the AAA announced the establishment of the National Consumer Disputes Advisory Committee ("Advisory Committee"). The Advisory Committee was composed of consumer, government, legal, business and academic representatives – including the AARP, Consumers Union, Consumer Action, American Council on Consumer Interests, the Federal Trade Commission, National Association of Attorneys General, National Association of Consumer Agency Administrators, Fannie Mae, and Freddie Mac – as well as ADR providers. 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 its *Supplementary Procedures for Consumer-Related Disputes* ("Supplementary Procedures") for consumer cases – which in 2006 totaled 1,294 (or less than 1% of the AAA's caseload). Maximum fees for consumers are $125 for claims up to $10,000, and $375 for claims up to $75,000. 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.

We urge the Subcommittee to consider the Consumer Protocol in its efforts to address issues related to the use of arbitration in consumer agreements.

Fairness Provisions for Other AAA Caseloads Involving Individuals

The AAA has incorporated fairness and due process standards in a number of other caseloads with individuals involved in a dispute with a business. In 1995, the AAA announced the availability of the *Employment Due Process Protocol* ("Employment Protocol"), which was the work of the Task Force on Alternative Dispute Resolution in Employment. Again, the AAA adopted the Employment Protocol and will not administer cases resulting from employer promulgated plans that do not materially comply with the Employment Protocol. In 2006, the AAA received 1,527 cases resulting from employer promulgated plans.

In 2003, in response to the ruling of the United States Supreme Court in *Green Tree Financial Corp. v. Bazzle*, the AAA issued its *Supplementary Rules for Class Arbitrations* to govern proceedings brought as class arbitrations. While the AAA takes no position on class action waivers, the AAA is not accepting demands for class arbitration where the underlying agreement prohibits class claims unless the AAA is ordered by a court. Since the AAA's *Supplementary Rules for Class Arbitrations* were issued, the AAA has administered more than 180 class action arbitrations.

In 2007, the AAA announced new *Home Construction Arbitration Rules and Mediation Procedures*, developed specifically to address issues in the use of ADR to resolve residential construction disputes. The new rules incorporate the principles of the Consumer Protocol. In 2006, the AAA received 1,345 residential construction cases.

In addition, the AAA has developed, implemented, and administered a number of programs for states in a variety of fields, from automobile insurance claims to disaster recovery.

Conclusion

Appropriate application of ADR balances various goals to bring increased efficiency. The reality is that the vast majority of consumer and employee complainants lack access to justice in the courts. As one prominent plaintiff attorney explained, the great majority of the meritorious consumer and employment claims never receive legal representation because of the difficulty of financing the lawsuit. Arbitration, properly balanced, provides access to justice for a large body of cases that would not otherwise have access to redress, through reduced costs, limited, reasonable discovery, modest filing fees, short time frames, finality, and the option of documents-only cases, obviating the need for an in-person hearing where the parties do not wish to have a hearing. To paraphrase a former senior ACLU official: "I would much rather have a fair arbitration than a jury trial which never comes."

As this Subcommittee and Congress examine issues related to the use of ADR in consumer agreements, we urge you to consider and build on the previous efforts of the AAA and other organizations to develop and implement appropriate measures that balance the specific needs of consumers while retaining the advantages of alternative dispute resolution. The AAA stands ready to provide technical advice and expertise to assist Congress with this important matter.

Attachments

Consumer Due Process Protocol

GOVERNMENT AFFAIRS

Joseph M. Stanton
Chief Lobbyist

June 11, 2007

The Honorable Linda Sanchez
Chairman, House Judiciary Subcommittee on Commercial and Administrative Law
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Sanchez:

As you prepare for tomorrow's Commercial and Administrative Law Subcommittee hearing on "Mandatory Arbitration Agreements," I wish to share with you on behalf of the 235,000 members of the National Association of Home Builders (NAHB) our views on binding arbitration agreements in residential construction contracts.

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 an inefficient means to resolve construction defect disputes; it is expensive, time-consuming and unlikely to produce the desired result, which is having a problem repaired.

NAHB would strongly oppose any attempt to restrict the use of arbitration language in consumer contracts. Prohibiting builders and buyers from agreeing to arbitration clauses would only benefit the trial bar.

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. *Arbitration: Simpler, Cheaper and Faster than Litigation, U.S. Chamber Institute for Legal Reform, April, 2005.* 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.

For the builder, the ability to operate effectively in the home building industry and to price a home competitively depends on the degree to which the builder's overall costs are certain and predictable. The more confidence the builder has in pre- and post-construction costs directly corresponds with the builder's ability to pass those savings through to homebuyers. Use of mandatory arbitration agreements provides the builder with a degree of certainty that if a dispute arises, litigation costs will be contained. Precluding the use of mandatory arbitration will expose

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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.

Moreover, 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" Southland Corp. v. Keating, 465 U.S. 1, 10 (1984). NAHB members rely on this long standing public policy every day when they negotiate and enter into residential real estate contracts containing arbitration provisions.

Critics of arbitration are particularly concerned that consumers must enter into arbitration agreements before a dispute arises when a consumer buys or uses the services of a company. However, the inclusion of an arbitration clause in a contract for the purchase or construction of a new home does not make that clause one of adhesion. As the concurring opinion in Buecher v. Centex Homes, 18 S.W.2d 807 (Tex. App. – San Antonio March 31, 2000) recognized:

> 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.

Id. at 812 (Green, J. concurring). A person seeking a home has numerous options from which to choose when dealing with a builder who will not negotiate terms and conditions. A consumer may choose another builder from among the thousands of large and small builders in their state, or the consumer may opt for a preexisting home rather than new construction.

Critics have also argued that both parties can agree to arbitration after the dispute arises. However, it is doubtful that they will be able to achieve the benefits of arbitration by subsequent agreement because it is likely that strategic factors will cause one of the parties to refuse to arbitrate, even if the other makes a request. *See* Theodore Eisenberg and Geoffrey Miller, *The Flight From Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DePaul L. Rev. 335 (Winter 2007).

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. See John Townsend, *State Court Enforcement of Arbitration Agreements*, October 2006.

Moreover, private national ADR providers are also working to ensure that the arbitration provisions are fair to all parties. The American Arbitration Association (AAA) issued the Consumer Due Process Protocol in 1998 which identifies the type of provisions that encourage a fundamentally fair process when consumers sign arbitration agreements. Recommendations include: (1) access to information about the process; (2) independent and impartial neutrals including independent administration of the ADR process and consumer participation in neutral selection; (3) reasonable costs, location and time frames; (4) clear notice of all arbitration

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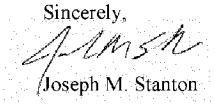
provisions; (5) confidentiality and unfettered access to small claims court in lieu of arbitration if the small claims court has jurisdiction; and, lastly, (6) the arbitration must afford the same remedies available in court.

NAHB appreciates the importance of the Congress taking an active oversight role to ensure that the real world use of binding arbitration clauses in consumer contracts is consistent with both the Federal Arbitration Act and the existing case law. Ultimately, we recognize that binding arbitration remains a viable ADR tool only if the process is fair to all parties, and we would welcome the opportunity to work with the Subcommittee to address any questions regarding the use of binding arbitration in residential construction contracts.

Thank you for considering our views.

Sincerely,



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STATEMENT ON
CONSUMER ARBITRATION

BY
THE CHAMBER OF COMMERCE OF THE UNITED STATES, THE U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, BUSINESS ROUNDTABLE, AMERICAN INSURANCE ASSOCIATION, NATIONAL ASSOCIATION OF HOMEBUILDERS, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, CTIA – THE WIRELESS ASSOCIATION, AND COUNCIL FOR EMPLOYMENT LAW EQUITY

SUBMITTED TO THE
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES
JUNE 12, 2007

I. Introduction

This statement for the record is being submitted on behalf of The U.S. Chamber of Commerce, the U.S. Chamber Institute for Legal Reform, Business Roundtable, American Insurance Association, National Association of Homebuilders, Securities Industry and Financial Markets Association, CTIA – the Wireless Association and the Council for Employment Law Equity. We appreciate the opportunity to submit testimony for the record before the Subcommittee and express our strong support for arbitration agreements and their value in consumer contracts.

First and most important, efforts that would undermine the use of either consumer or commercial arbitration agreements run counter to the basic principle that parties' private contractual agreements should be enforceable. By denying to parties the *ability* to include effective binding arbitration provisions in their contracts, Congress would be directly attacking perhaps the most fundamental principle of our commercial law, that parties should be allowed to enter the binding contracts they choose. Congress has historically recognized the vital principle

of the sanctity of contracts. By seeking to eliminate the use of arbitration in different sectors of the economy, Congress would be undermining voluntarily agreed upon contracts and ignoring the very axiom that, with narrow exceptions, parties should be allowed to enter into and be bound by the agreements they choose.

Second, eliminating the use of consumer arbitration agreements runs counter to the longstanding, uniform view of Congress, the executive branch, and the courts that Alternative Dispute Resolution (ADR) in general, and arbitration in particular, are important and encouraged means for parties to resolve their disputes. Legislative efforts designed to undo arbitration clauses in consumer agreements would undermine clear congressional intent to support the use of ADR. Furthermore, elimination of consumer arbitration clauses would exacerbate problems in the incredibly overburdened civil legal system, and harm not only the parties who have agreed to binding arbitration clauses, but also everyone who chose *not* to agree to arbitration.

The organizations submitting this testimony are strongly in favor of there being continued availability and enforceability of arbitration clauses in all contracts. Removing consumer arbitration clauses has little to do with protecting the little guy from the imagined evils of arbitration, and *everything* to do with allowing a party to a contract to ignore certain terms of that contract at will. Parties that are signatories to a writing purporting to be a contract generally should be bound by that writing and all its terms. To allow otherwise would countermand our collective interest in promoting the finality and certainty of contracts. Down this slippery slope lies increasing uncertainty from which only the plaintiffs' trial bar will prosper.

II. Congress has supported the use of Arbitration Agreements across all segments since passage of the Federal Arbitration Act in 1925

Congress enacted the Federal Arbitration Act (FAA) in recognition of the fact that

arbitration of disputes provides a benefit to consumers. In language remarkably similar to today's, the 68th Congress passed the FAA to give "parties weary of the ever-increasing 'costliness and delays of litigation'" another option.[1] The FAA embodies our "national policy favoring arbitration."[2] The FAA was designed specifically to "reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements on the same footing as other contracts."[3] But arbitration was by no means a new idea in 1925. In an article in the February, 2000 issue of the *Dispute Resolution Journal*, Judge Marjorie Rendell of the Third Circuit in Philadelphia quotes at length from George Washington's will. The father of this nation mandated, in language Judge Rendell correctly describes as eerily "prescient" to modern ADR provisions, that any dispute arising under that should be decided by three impartial arbitrators, two chosen by the parties and the third chosen by the first two.[4]

Our nation is in the midst of a litigation explosion. While there is no question that every American deserves to have legitimate grievances heard, the civil legal system is suffering– becoming more inefficient, less timely and more unpredictable than ever before. The old adage that "justice delayed is justice denied" is a concept that dates back to the Magna Carta.[5] Fortunately, however, we need not make the impossible choice between an increasingly inefficient civil justice system and the denial of a fair hearing for those who require it. The use of ADR to resolve conflicts alleviates some of the negative effects of the current litigation

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[1] *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 220 (1985), quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924).
[2] *Southland Corp.* v. *Keating*, 465 U.S. 1, 10 (1984).
3 *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 288 (2002) (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 204 (1991)).
[4] Rendell, *ADR Versus Litigation*, 55-Feb. DISP. RESOL. J. 69, 69 (2000).
[5] *See* 1 Holdsworth, A HISTORY OF ENGLISH LAW 57-58 (3rd ed. 1922).

explosion. Recognizing this, many industries have begun to include clauses in their contracts requiring the parties to submit to binding arbitration should a dispute arise[6]

Under the FAA, a contractual agreement to arbitrate is simply treated as any other enforceable contractual arrangement. In other words, under the FAA ***arbitration provisions just cannot be "singl[ed] out * * * for suspect status."***[7] Thus, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening" the FAA.[8] These classic exceptions to the enforcement of any contract serve to protect against abuse. But provisions mandating arbitration are no *more* likely to be abusive than any other–in fact, arguably less so, given the uniform federal support for arbitration over the past three quarters of a century.

III. Arbitration Benefits Both Consumers and Businesses

Contrary to the unfounded aspersions cast against arbitration by its opponents, the FAA is not an anti-consumer statute. It is precisely these contractually negotiated arbitration provisions that are critically necessary to help staunch the nation's rush to litigation. Rather, arbitration merely provides an alternative forum for resolving claims that the law has been violated. ADR typically is quicker, cheaper, and more predictable than civil litigation, and is

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[6] Binding arbitration clauses are currently used in a wide range of contracts, including contracts for employment, car and home purchase, service, credit, insurance, and other financial services. In all of these contexts, arbitration provides the parties with a way to avoid the vagaries of our current jackpot legal system by agreeing to submit to a contractually defined method of dispute resolution.

[7] *Doctors Associates, Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996) (citation omitted) (emphasis added). Since "arbitration under the Act is a matter of consent, not coercion," *Volt Info. Sciences, Inc.* v. *Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989), "'an arbitration agreement [must] be placed upon the same footing as other contracts, where it belongs.'" *Southland*, 465 U.S. 1, 15-16, quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924); see also *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 281 (1995).

[8] *Casarotto*, 517 U.S. at 686. As the Fourth Circuit said recently, "singl[ing] out arbitration agreements in standardized contracts [is], in effect, [to] declare their very formation to be unconscionable." *Saturn Distrib. Corp.* v. *Williams*, 905 F.2d 719, 726 (4th Cir. 1990). Barring enforceable arbitration agreements, despite having "no general contract law restricting nonnegotiable provisions in standardized contracts" evinces a "singular hostility" to arbitration fundamentally at odds with the theory of the FAA. *Ibid.*

much less easily abused in this litigation-as-lottery age than the lawsuits favored by the plaintiffs' bar.[9] Far from being inherently unfair, as the plaintiffs' bar sometimes asserts, arbitration provisions provide an invaluable alternative to having one's claim heard in court. Parties to a dispute may have a full and fair hearing of their grievances by presenting witnesses, evidence and case facts to a neutral third party in much the same manner as they would in a court of law. Unburdened by the often rigid rules of civil procedure, parties in arbitration are also free, in many cases, to customize the proceedings to address specific needs and devise the best method to resolve their dispute. Not only do consumers have a fair opportunity to vindicate their rights in arbitration, but government authorities also aggressively exercise the strong enforcement powers at their disposal to protect consumers.

Furthermore, federalism arguments that arbitration subverts state legislative policies fail for at least three reasons. First, it is simplistic to claim that arbitrators will ignore state statutory policies. While it is true that arbitrators frequently are–***by agreement of the parties***–free to balance the equities of a particular case so as to craft an appropriate remedy, it does not follow that arbitrators will always ignore certain statutory provisions. Rather, as would be expected in this more informal, agreed upon procedure, those statutes will be followed to the extent the selected arbitrators find them to be applicable given the details of the situation.

Second, the excessive litigation created by rescinding the validity of consumer arbitration agreements will impose costs broadly on the national economy–costs borne by individual

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[9] Mandatory arbitration clauses make it virtually impossible for some unscrupulous plaintiffs' trial lawyers to engage in many of the abuses that currently mar our civil justice system. Speculative litigation, forum-shopping, and exorbitant legal fees are easily eliminated if parties to a dispute agreed to binding arbitration rather than go to court. *See* Rogers, *Self-Interested Critics Only Spinning Truth About a Process that has been Approved by Congress*, 5-1 DISP. RES. MAG. 5, 6 (1998) (While "there are those who oppose arbitration on mistaken but principled grounds * * * there can be no question that among those who criticize arbitration are advocates who benefit from the unnecessary costs of the civil trial system [and its occasional allowance for] legalized blackmail.").

consumers, employees and shareholders. These costs will be avoided by enhancing the FAA's broad support for arbitration. For businesses to operate efficiently in today's national (and increasingly international) economy there need to be uniform rules in matters involving interstate commerce. As the U.S. Chamber of Commerce pointed out in the *amicus curiae* brief it submitted in the *Geier* case, "[t]he general economic interests of the Nation are increasingly being sacrificed on the altar of the parochial interests of particular states, as declared by local state judges and lay juries."[10] Undermining the preemptive effect of the FAA would continue that negative trend. Finally, all federally preemptive laws have a similar effect on state law, and Congress clearly has, and exercises, the authority to preempt state law under the Constitution's Commerce Clause.

Arbitration has distinct advantages, making it in many cases a highly desirable process.[11] Two parties should be allowed to decide for themselves whether voluntarily to submit their disputes to binding arbitration.[12] By undermining over seventy-five years of consistent congressional, administrative, and judicial support for voluntary arbitration, Congress would subvert settled expectations about the availability of arbitration for disputes. Rescinding the availability of arbitration would not merely lead to questions about the future enforceability of any arbitration provision; more fundamentally, it would lead to real questions about whether parties will be able to presume that *any* of their contracts will, in the future, be enforceable. Congress should insist on an extremely high showing of need before venturing down such a

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[10] Brief *amicus curiae* for the U.S. Chamber of Commerce at 20, *Geier* v. *American Honda Motor Co.*, 529 U.S. 861 (2000).

[11] The speed and affordability of arbitration are perhaps its most discussed benefits, but there are others as well. For example, the control parties have over the process of arbitration, the ability to have an "expert" decisionmaker rather than a generalist judge, and the ability of an arbitrator to craft remedies specific to a dispute are all distinct advantages of arbitration over litigation. See section 2, *infra*.

[12] The FAA's "central purpose" is "to ensure that private agreements to arbitrate are enforced according to their terms."

problematic path.

Opponents to consumer arbitration agreements focus on the fact that many arbitration provisions are contained in contracts drafted by one party, and presented to the other to accept or reject as a whole. Classic principles of contract law allow a party to repudiate a contract–whether it be a contract of adhesion or otherwise–for fraud, unconscionability or various other factors, and the FAA specifically recognizes this right.[13] But unless a contract including an arbitration provision is unconscionable, that arbitration provision should be enforced, just as other provisions of the contract are enforced. One party should not be free to parse out those elements of the contract that, in retrospect, appear to favor the other. As one commentator reminded us very recently, "Courts enforce adhesive contracts. Such contracts are not contrary to public policy."[14]

Given the realities of modern business in this litigious environment, detailed contracts are an unfortunate necessity. Only in instances of compelling need, however, do courts–or should a legislature–set aside or dictate contractual provisions. A party who disfavors arbitration can determine for itself how upsetting the other party's insistence on arbitration is, and weigh that factor in deciding whether to enter the contract that includes the arbitration provision. A statutory provision which revokes the ability of that other party to insist on arbitration *ex post*, however, would substitute the judgment of the legislature for the decisions of the parties.

IV. Empirical Studies Confirm the Public's Support of Arbitration

Empirical studies confirm that consumers gain from arbitration and prefer it to

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Mastrobuono v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (quotation omitted).

[13] Townsend, *State Court Enforcement of Arbitration* Agreements, October 2006. (copy attached).

[14] Orenstein, *Mandatory Arbitration: Alive and Well or Withering on the Vine?* 54-Aug DISPUTE RESOL. J. 57, 59 (1999). It is a commonplace that no contract is *ever* entered into by two people with exactly equal bargaining power.

litigation.[15] For example, in April 2005, Harris Interactive released the results of an extensive survey of arbitration participants sponsored by the U.S. Chamber Institute for Legal Reform.[16] The survey was conducted online among 609 adults who had participated in a binding arbitration case that culminated in a decision. The major findings were that: (1) arbitration was widely seen as faster (74%), simpler (63%) and cheaper (51%) than going to court; (2) two-thirds (66%) of the participants said they would be likely to use arbitration again, with nearly half (48%) saying they were extremely likely to do so; (3) even among those who lost, one-third said they were at least somewhat likely to do so; (4) most participants were very satisfied with the arbitrator's performance, the confidentiality of the process and its length; and (5) predictably, winners found the process and outcome very fair and losers found the outcome much less fair; however, 40% of those who lost were moderately to highly satisfied with the fairness of the process and 21% were moderately to highly satisfied with the outcome.

Similarly, in December 2004, Ernst & Young issued a study, titled "Outcomes of

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[15] Research examining arbitration in the securities industry provides a number of excellent examples. In 1999, West Point conducted an independent analysis of surveys submitted by NASD's arbitration forum's constituents finding that 93.49% of participants felt their cases were handled fairly and without bias. *See* G. Tidwell, K. Foster, and M. Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations* (Aug. 5, 1999), available at: http://www.nasd.com/web/group/med_arb/documents/mediation_arbitration/nasdw_009528.pdf. In the year 2000, the U.S. General Accounting Office recognized that one should not draw conclusions about the fairness of the arbitration process based on case outcome statistics, noting that a declining investor win rate "could indicate little or no change in the fairness of the arbitration processes." *See Actions Needed to Address Problem of Unpaid Awards*, at 4-5 (GAO/GGD-00-115, June 2000), available at: http://www.gao.gov/archive/2000/gg00115.pdf. Professor Michael A. Perino in 2002, conducted a study commissioned by the SEC on the adequacy of arbitrator conflict disclosure requirements at NASD and NYSE finding that available empirical evidence suggested that these arbitrations were fair and that investors perceived them to be fair. See M. Perinno, *Report to the SEC Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* (Nov. 4, 2002), available at: http://www.sec.gov/pdf/arbconflict.pdf. In 2005, the editors of the Securities Arbitration Commenter conducted an exhaustive statistical analysis of arbitration awards, testing for potential bias in investor win rates and whether there existed a pro-industry bias. The study found that there was not even any minimal support for a claim of industry bias. Available at: http://www.sec.gov/rules/sro/nasd/nasd2005094/rpryder091905.pdf. Finally, Securities Industry and Financial Markets Association CEO, Marc Lackritze, fully addressed concerns regarding the fairness of arbitration in securities arbitration disputes in testimony before a Congressional committee. Available at: http://www.sifma.org/legislative/testimony/archives/Lackritz3-17-05.html.

Arbitration: An Empirical Study of Consumer Lending Cases," which examined the outcomes of contractual arbitration in lending-related consumer-initiated cases.[17] The study, based on consumer arbitration data from January 2000 to January 2004 from the National Arbitration Forum, observed that: (1) consumers prevailed more often than businesses in cases that went to an arbitration hearing, with 55% of the cases that faced an arbitration decision being resolved in favor of the consumer;[18] (2) consumers obtained favorable results, i.e. results from arbitration decisions, as well as settlements satisfactory to the consumer and cases that were dismissed at the claimants request, in 79% of the cases that were reviewed; and (3) 69% of consumers surveyed indicated that they were very satisfied with the arbitration process.

V. Preventing Consumers and Businesses from using Arbitration Agreements Hurts All Involved

If industries are forced to litigate every dispute that arises out of routine business contracts, almost all parties will suffer. Businesses will spend more of their resources preventing and defending against litigation as opposed to developing and improving products and services; consumers will spend more in transaction costs for routine business matters; and, on the whole, society will bear the cost of managing a burgeoning civil justice system. From a broader standpoint, the availability of arbitration has fairly provided some much needed relief from the congestion of cases currently clogging the civil justice system. If provisions requiring arbitration in consumer contracts are eliminated we believe it could result in thousands of cases that would have otherwise been fairly and easily resolved through arbitration cascading into the

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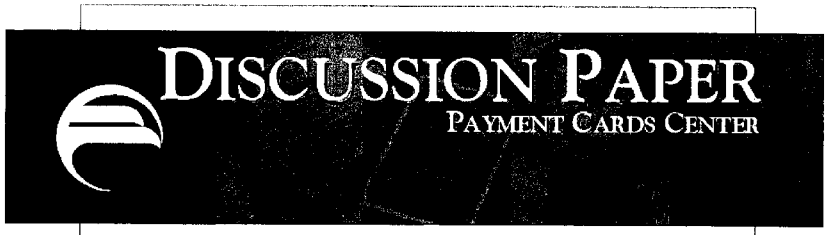
[16] *See* http://www.instituteforlegalreform.org/issues/docload.cfm?docId=489 (last visited June 8, 2007) (copy attached).
[17] *See* http://adrinstitute.com/edi/Feb_05/022105EYPressReleaseADR.htm (last visited June 8, 2007) (copy attached).
[18] This is the exact win-rate for consumers as exists in state court. *See* Contract Trials and Verdicts in Large Counties, 1996, pg. 5 (April 2000), Bureau of Justice Statistics, http://www.ojb.usdoj.gov/bjs/pub/pdf/ctvlc96.pdf.



Mandatory Arbitration Clauses in the Credit Card Industry*

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Summary: *On September 26, 2002, the Payment Cards Center of the Federal Reserve Bank of Philadelphia held a workshop that explored the use of mandatory arbitration clauses in credit card agreements between issuers and consumers. Leading the workshop was Alan S. Kaplinsky, chair of the Consumer Financial Services Group at Ballard Spahr Andrews & Ingersoll, LLP. A pioneer in the development of consumer arbitration clauses, Kaplinsky described the arbitration process as a conflict resolution mechanism in the payment cards industry. He also provided a contextual overview of the Federal Arbitration Act of 1925, subsequent legislative actions, and relevant court cases. This paper summarizes his presentation and the ensuing discussion with workshop participants.*

* The views expressed here are not necessarily those of this Reserve Bank or of the Federal Reserve System.

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Introduction

Over the past five years, credit card issuers have attempted to stem expensive class action litigation by introducing arbitration clauses into their contracts with cardholders. While seen by many as an efficient tool for resolving conflicts between consumers and issuers, the arbitration process itself has become the source of much litigation. In June 2002, the *American Banker,* in a special report on legal trends in banking, noted that "many of the cases drawing the attention of banking lawyers [today] involve the enforceability of arbitration clauses." With several high profile cases still pending, the future of arbitration as a permanent part of credit card issuers' agreements with cardholders remains uncertain. Motivated by the widespread adoption of arbitration by the card industry, the Center invited Alan S. Kaplinsky, chair of the Consumer Financial Services Group at Ballard Spahr Andrews & Ingersoll, LLP to lead a workshop discussion on this subject. This paper summarizes his presentation and highlights some of the ensuing discussion with workshop participants.

The Evolution of Arbitration in the U.S.

One of the well-established roles that U.S. courts play is that of settling disputes. When a disagreement arises between two parties, courts are often asked to examine relevant statutes and common law to settle the dispute. This process, however, can be resource intensive. Often, both parties must hire attorneys, appear before the court, engage in extensive discovery (i.e., a compulsory disclosure of facts and documents), adhere to a court-determined timeline, and explain highly technical processes and products to an unfamiliar judge or jury. In this way, litigation can be expensive and slow.

Arbitration is a response to these shortcomings and is deemed to be a less-expensive, more efficient alternative to a court dispute resolution. When two parties agree to arbitrate, they agree to ask an impartial third party, or "neutral," to review their case and resolve their dispute. The two parties can enter into an agreement to arbitrate before or after a dispute arises. If

arbitration is agreed to before a dispute arises, it can be part of the broader contract into which the two parties enter. Once a part of the contract, the arbitration provision becomes as enforceable as any other contractual provision.

Arbitration is not a new method of resolving conflicts. President George Washington offered a very good explanation of how it can, and in many cases does, work. In his last will and testament, written on July 9, 1799, Washington dictated that:

> All disputes [arising from his will] shall be decided by three impartial and intelligent men, known for their probity and good understanding; two to be chosen by the disputants, each having the choice of one, and the third by those two — which three men thus chosen, shall...declare their sense of the testator's intention; and such decision is, to all intents and purposes to be as binding on the parties as if it had been given in the Supreme Court of the United States.

It was not until Congress enacted the Federal Arbitration Act (FAA) in 1925, however, that arbitration became a widely used method of resolving disputes. Until that point, courts did not always look favorably upon arbitration because it effectively transferred power away from the court and into the hands of nonpublic entities. After the passage of the act, arbitration became a favored dispute resolution method of many businesses. It was particularly favored by those in the labor, securities, international trade, maritime, and construction industries.

The fundamental premise of the Federal Arbitration Act, Kaplinsky explained, is that parties can agree by contract to arbitrate their claims before or after a dispute arises. The act gives such arbitration agreements the same effect as any other part of a contract. In this way, these agreements can be invalidated only by a legal theory that can be used to invalidate any other type of contract (e.g., lack of capacity to enter into a contract, duress, lack of consideration, unconscionability, etc.). Arbitration can be invoked by a "motion to compel arbitration" in a case

already in court or by a separate lawsuit seeking to enforce arbitration in the state where arbitration is to be held. When such a motion or suit arises, the court must limit the scope of its decision to the applicability and validity of the arbitration agreement and maintain a heavy presumption in favor of enforcing it. The FAA also restricts the right of parties to appeal arbiters' decisions, allowing such appeals only in the case of arbiter bias, misconduct, or manifest disregard of the law.

For several decades after the enactment of the FAA, arbitration was not often used in contracts between consumers and businesses. This changed, however, in the mid-1990s. During his presentation, Alan Kaplinsky explained that two Supreme Court cases (*Allied-Bruce Terminex v. Dobson* in 1995 and *Doctor's Associates v. Casarotto* in 1996) federalized the law of arbitration and held that the FAA was binding in state courts. These two rulings, along with a legal environment that banks perceived as increasingly hostile, helped to spur the adoption of arbitration by banks and finance companies that issued credit cards.

The Adoption of Arbitration by the Credit Card Industry

Kaplinsky explained that in the years immediately preceding industry-wide adoption of arbitration clauses, there were significant increases in the volume and complexity of litigation filed against issuers. Card issuers claimed that an intricate web of evolving federal, state, and local laws made it difficult and expensive for them to avoid a disclosure or processing misstep. Issuers were also alarmed by an increasingly active plaintiffs' bar, hostile state courts and judges, and costly settlements that made issuers attractive targets for threatened litigation. Above all, Kaplinsky stated, issuers that perceived themselves as making a good faith effort to adhere to the rules were finding that their exposure to lawsuit risk was completely unpredictable.

In response to these perceived risks, Kaplinsky noted that card issuers introduced mandatory arbitration clauses into their contracts with cardholders. Issuers saw arbitration as a way of gaining control over legal budgets and represented a less expensive, more predictable,

faster, and uniform way of settling cardholder disputes. By limiting consumers' rights of appeal, prohibiting the formation of classes, and restricting discovery, arbitration significantly curtailed the amount of time and money issuers needed to allocate to its customers' legal claims.

Arbitration agreements, Kaplinsky explained, can cover a broad range of claims, including those that issuers most often face. Claim types that lend themselves to arbitration include:

- Breach of contract;
- Common law wrongs (e.g., fraud);
- Truth in Lending Act (Regulation Z) violations;
- Fair Credit Billing Act violations;
- Fair Debt Collection Practices Act violations; and
- Equal Credit Opportunity Act violations.

Arbitration can also be used to seek injunctive relief and can have retroactive application to claims that predate the effective date of the arbitration agreement.

While the cost savings of mandatory arbitration can be substantial, Kaplinsky said that the method has some drawbacks for issuers. Unlike decisions made by judges, decisions made by arbiters are not public and do not create a legal precedent for future claims. In this way, neither issuers nor potential claimants can rely on an arbiter's decision in a previous case to influence an arbiter's decision in a pending case. In addition, arbitration clauses can be expensive for issuers to implement, and the clause can often provoke litigation over enforceability. Finally, some courts (e.g., those in California) have permitted arbitration to proceed as a class action — one of the major actions that the clauses were intended to avert.

Despite these drawbacks, the benefits of arbitration have been sufficient to induce almost every major credit card issuer in the U S. to adopt mandatory arbitration clauses for their new and existing customers. Several early adopters introduced mandatory arbitration clauses into their cardholder agreements in the late 1990s, with most others following in the last few years. Since

that time, Kaplinsky noted, the clauses have been accepted in most courts, been seen by many observers as a fair and effective tool for resolving consumer claims, and have served to control issuers' legal expenses. At the same time, however, those that oppose the clauses have criticized arbitration as a less-than-fair way of resolving consumers' claims.

Attacks on Arbitration

Since the adoption of arbitration clauses by credit card issuers a few years ago, consumer advocates, attorneys, and legislators have argued that the application of arbitration to resolving consumer credit disputes is inherently unfair. Kaplinsky summarized some of the key arguments that opponents often assert:

- The clauses lack mutuality, since a few issuers allow themselves to seek redress in court for collections purposes but do not extend the same privilege to consumers;
- The clauses are "unconscionable" in that arbitration fees are higher than court fees, arbiters are biased toward issuers, arbitration procedures, including the limited right to conduct discovery and the general inability to prosecute class actions, hurt consumers, and/or arbitration forums are inconvenient;
- The clauses violate a consumer's right to a jury trial;
- The clauses violate a federal or state statute that either authorizes a consumer to go to court or to bring a class action; and
- The clauses are part of "take-it-or-leave-it" contracts (i.e., contracts of adhesion) of which consumers are not aware.

Kaplinsky said that he advises issuers who are drafting arbitration clauses to consider these issues and urges them to adopt a "fair" clause. A "fair" clause, in Kaplinsky's opinion, complies with the consumer due process protocols adopted by the major providers of arbitration services, allows both parties to invoke arbitration, has an exception for claims that can be made in

small claims court, may offer to pay the difference between court and arbitration fees, and considers requests from indigent consumers to pay the costs of arbitration.

Responding to allegations about overall fairness, Kaplinsky believes that empirical data will ultimately show that consumers do well in arbitration. He noted, however, that there is limited experience on which to base an analysis, since many of the major issuers did not adopt the clauses until recently. Nevertheless, he expects that in the next few years sufficient data will be available to conduct an impartial study of arbitration outcomes. On the basis of his own experience with a number of major issuers, Kaplinsky believes that the data will show that consumers prevail more often when they arbitrate their claims than when they go to court. To further substantiate this statement, he cited anecdotal evidence that suggests that in many cases arbiters will "split the baby" and provide some relief to a consumer even when, by strict legal standards, he or she may not have a valid claim.

Arbitration and Banking Regulation

During the discussion Kaplinsky addressed the fairness and appropriateness of arbitration in the banking environment by noting the role of government regulators. He asserted that arbitration is ideally suited for retail banking-related claims because federal agencies can essentially play the role that private attorneys general play in unregulated industries — that of deterring bad corporate conduct. He noted that government regulators have an advantage over attorneys who are representing a class in that they can more efficiently investigate and prosecute bad conduct of credit card lenders. Regulators are not constrained by the court's evidentiary processes, have better access to information through their involvement in the examination process, and are able to set priorities based on relative importance rather than the prospect of maximizing attorney's fees. In addition, regulators have other tools (e.g., guidance memos) to address systemic problems and effect changes without attracting lots of publicity.

Kaplinsky cited the $300 million settlement agreement that Providian reached with the Office of the Comptroller of the Currency in 2000 as a good example of how regulatory action can be preferable to class action lawsuits from a social welfare perspective. In that settlement, Providian agreed to enhance its disclosures, modify its marketing practices, and compensate customers who had been wronged. When consumer claims are settled in a class action, Kaplinsky explained, the result is often very different. First, less money is paid to those who experienced the loss because of the need to pay lawyers' fees. These fees can range from 25 to 50 percent of the amount awarded. Second, plaintiffs' attorneys may not insist to the same extent as government regulators that there be ongoing corrective actions. Finally, it generally takes much longer to resolve the dispute.

Kaplinsky also pointed out that federal banking agencies have the authority under section 8(b) of the Federal Deposit Insurance Act and section 5 of the Federal Trade Commission Act to investigate unfair or deceptive practices. With the power to resolve consumer complaints and target bank examinations based on unfair or deceptive conduct, federal agencies are in a better position than a certified class and its counsel to seek redress. Federal Reserve Chairman Alan Greenspan, in a recent letter to Representative John LaFalce, addressed the effectiveness of this authority under the FTC Act. He wrote, "Enforcement orders and agreements must be made public, and as a result would curtail similar unfair or deceptive practices by other banks." Kaplinsky believes that disincentives, such as enforcement orders and regulatory actions, are significant factors in further protecting consumer interests.

Critics of arbitration also contend that class action lawsuits help deter issuers from committing an act that has a very small injurious effect on many people. For example, the costs of individually arbitrating a wrongfully charged $29 late fee far exceed any damages that could likely be awarded to an offended consumer. If forced to choose between paying the fee and arbitrating, consumers would likely choose the former. A class action, however, bringing together thousands of such claims, would be more appropriate from a cost and efficiency perspective. In

cases like this, critics argue, it is only through a class action, and not through individual arbitration, that a just outcome can be achieved.

Kaplinsky's response to these critics is that individual cardholders with such small claims should either assert them in arbitration where the card issuer will likely pay all arbitration fees or in small claims court, or file a complaint with the appropriate federal banking agency.

Critics' arguments, Kaplinsky indicated, underscore the need for regulatory oversight and examination to identify and curtail any such wrongs. In the discussion, however, it was noted that the current trend in banking supervision is toward a risk-based examination approach. Examiners are doing less transaction-level auditing, in which they might more readily catch such irregularities, and are focusing their efforts on practices that represent the most risk to a bank's safety and soundness.

During the discussion it was noted that, in addition to a review of reported data on consumer complaints, a review of arbitration proceedings and cases might be helpful in identifying recurring violations. Kaplinsky explained that this is not currently possible. He noted that neither the records of arbitration proceedings nor aggregated data about the types of claims being brought to arbitration are public information. It may be possible, however, in the future to obtain aggregate information.

Conclusion

Overall, arbitration reduces the costs of resolving disputes for card issuers by eliminating class action lawsuits and unpredictable jury awards. In Kaplinsky's view, this lowers the cost of credit for consumers and returns more dollars to those who are wronged. These benefits will be realized and the system will be fair, he concluded, as long as federal banking agencies remain vigilant and exercise the enforcement powers granted to them by Congress.

Nevertheless, the use of arbitration in consumers' credit card agreements continues to be challenged. The plaintiffs' bar represents one level of vocal opposition, and there is a growing list

of state courts that are challenging the clauses. If arbitration is to remain a viable conflict resolution alternative to litigation in the credit card industry, it will be incumbent on card issuers to address arbitration's fairness and on regulators to provide appropriate oversight of issuers' practices. In addition, an empirical analysis of arbitration decisions would serve to diffuse much of the subjectivity that currently surrounds the debate.

PREPARED STATEMENT OF NCCNHR

Mandatory binding arbitration agreements are forcing American consumers in almost every avenue of commercial life to waive their constitutional right to seek redress in the courts when the products or services they purchase are defective and even dangerous. For thousands of American families with aging parents, mandatory arbitration agreements—included in the admissions contracts of nursing homes and assisted living facilities—compel them to agree to arbitrate the value of their mothers and fathers' lives if they are seriously injured or die from neglect or physical abuse by the facility's employees. Some admissions agreements even require families to waive their loved one's expectation of receiving the quality of services and safe environment that the nursing home contracted with the government to provide when it was certified for Medicare and Medicaid.[1]

Families usually have little choice in the matter and must accept the provider's terms. (Nursing home admissions, in particular, frequently occur after unexpected medical emergencies and under pressure from hospital discharge planners.) There are few options for long-term care in many rural communities, and options are often even scarcer for those who depend on Medicaid to pay part of their care. And just as options are limited when choosing a nursing home, there are often few or no good alternatives to transfer to if the quality of the care turns out to be bad.

In 2002 and 2005, NCCNHR members voted overwhelmingly to approve resolutions asking the federal government to prohibit long-term care facilities from including binding arbitration clauses in their admissions agreements. Support for the resolutions stemmed from strong concern among consumer advocates across the country that long-term care facilities in most states can neglect and even abuse residents with impunity if residents and their families are unable to take them to court. Countless government studies have found that in spite of improvements in nursing home regulation and enforcement in the past 20 years, state regulators still consistently under-cite the seriousness of deficiencies in which residents are harmed; levy fines that are little more than the cost of doing business for profitable corporations; and allow facilities to operate year-after-year with serious, repeat problems.[2] The nursing home industry regards mandatory arbitration agreements as mechanisms to protect nursing homes from juries, who are less lenient that regulators when presented with evidence that vulnerable elders were victims of avoidable neglect and preventable abuse.

A book published by NCCNHR in 2006, *The Faces of Neglect: Behind the Closed Doors of Nursing Homes,* documents the gross neglect of 36 long-term care residents in 10 states.[3] We were able to document these cases because they were litigated. Through the discovery process, their attorneys were able to show the failure of nursing homes and assisted living facilities to provide even the most basic care to prevent these men and women from suffering from:

- Multiple infected, painful pressure sores exposing muscle and bone, often leading to amputations;
- Malnutrition, dehydration, and severe weight loss;
- Head injuries;
- Bruises and fractures from a physical assault by another resident;

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[1] In addition to agreeing to mandatory arbitration, applicants for admission to many nursing homes are required to watch a video called "Setting Realistic Expectations." The video is intended to waive facilities' liability by treating injuries as normal, unavoidable occurrences and getting family members to acknowledge risk and accept responsibility. For example, by signing a statement that they have seen the video, applicants acknowledge they know that "residents are unsupervised a great deal of the day" and may wander "into a situation inside or outside the facility where there is a potential for injury." If residents refuse to eat because they don't like the food or are depressed, the facility will "courteously encourage" them to eat or drink but will not take responsibility for malnutrition or dehydration that occurs as a result—this responsibility once again rests on family members, who "need to accept full responsibility for any failure of the resident to eat properly or drink enough fluids." (Researchers estimate that 40 percent of nursing home residents are malnourished and that many do not receive fluids on a regular basis because of critical understaffing and high staff turnover.) Likewise, families are advised that their elders in the supposed safety of the nursing home could be at the same risk of physical or verbal assault, neglect, and theft that they would be in the community since "the nursing home simply cannot read the minds and consciences of all its employees" to ensure that they will not abuse their charges.

There is also a "Setting Realistic Expectations" video for assisted living.

[2] See the most recent Government Accountability Office report, *Nursing Homes: Efforts to Strengthen Federal Enforcement Have Not Deterred Some Homes from Repeatedly Harming Residents,* March 2007.

[3] *The Faces of Neglect: Behind the Closed Doors of Nursing Homes,* NCCNHR, April 2006.

- Renal failure from severe dehydration;
- Extreme and often untreated pain;
- Sexual assaults;
- Gangrene and osteomyelitis;
- Multiple lacerations, skin tears, and abrasions;
- Strangulation on a privacy curtain;
- Second degree burns, exposing nerve ends, from 140-degree bath water;
- Disfiguring and extremely painful contractures;
- Drowning;
- Broken leg; amputation of the leg; and broken neck because of staff negligence, all in the same resident;
- Suffocation by choking;
- MRSA infection and multiple urinary tract infections;
- Brain poisoning from untreated dehydration; and
- Usually, death.

When most families sign nursing home or assisted living admissions contracts, they have had no experience with how badly care can go wrong or how much suffering their parent or other loved one may experience. Many think that daily family visits, careful monitoring, and advocacy for their loved one will ensure good care, only to say later, as one California daughter did, "We were there every day, and we still couldn't make a difference."

Consumers might voluntarily choose to arbitrate the purchase of a defective cell phone. Few would voluntarily arbitrate the suffering and death of their mother or father, because almost always, their mission is to expose poor care and deter future abuse.

NCCNHR and its member groups are urging Congress to end the use of mandatory binding arbitration agreements in long-term care admissions contracts.