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

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

JULY 22, 2009

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

WEDNESDAY, JULY 22, 2009

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC POLICY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m. in room 2154, Rayburn House Office Building, Hon. Dennis J. Kucinich (chairman of the subcommittee) presiding.

Present: Representatives Kucinich, Cummings, Foster, Jordan, Mica, Schock, and Watson.

Also present: Representative Johnson.

Staff present: Jaron R. Bourke, staff director; Claire Coleman, counsel; Howard Schulman, Office of Representative Kucinich; Jean Gosa, clerk; Charisma Williams, staff assistant; Leneal Scott, information systems manager; Adam Hodge, deputy press secretary; Dan Blankenburg, minority director of outreach and senior advisor; Adam Fromm, minority chief clerk and Member liaison; Daniel Epstein and Mitchell Kominsky, minority counsels; and Katy Rother, minority staff assistant.

Mr. KUCINICH. The meeting will come to order.

Good afternoon and welcome. I am Congressman Dennis Kucinich, chairman of the Domestic Policy Subcommittee of the Oversight and Government Reform Committee.

I am joined today by the ranking member of the committee, Mr. Jordan of Ohio.

Our hearing today is, "Arbitration or Arbitrary: The Misuse of Mandatory Arbitration to Collect Consumer Debts." The subject of this hearing, the use of mandatory pre-dispute arbitrations as a method of obtaining judgments for consumer debts is not what we normally think of when we hear the terms arbitration or consumer arbitrations.

We are not talking about arbitrations brought by consumers against businesses, and we are not talking about individual arbitrations brought by businesses against consumers. We are talking about mass production arbitrations where businesses file thousands of claims against consumers to obtain judgments on credit card debt where the claims are assigned to arbitrators in batches of dozens, where the consumer almost never appears or even responds, and where the so-called hearing consists of nothing more

than the arbitrator looking at a statement written by the creditor and awarding the amount that the creditor requests.

Over the past few months, the Domestic Policy Subcommittee has conducted an investigation into the actual practices of the two largest providers of consumer arbitration services, the National Arbitration Forum [NAF], and the American Arbitration Association, the AAA. NAF is by far the No. 1 generator of arbitration awards against credit card customers. The AAA also administered consumer debt collection arbitrations and states that they have stopped doing this as of June 2009.

Subcommittee staff reviewed over 50,000 pages of documents, including hundreds of actual case files to determine how the claims were decided by the arbitrators. Our investigators have come to several deeply disturbing conclusions about the National Arbitration Forum's arbitration system.

Who wins or loses an NAF arbitration seems to depend solely on which arbitrator reviews the claim. As part of our review, subcommittee staff compared 228 nearly identical NAF consumer debt collections claims and we found that three arbitrators granted awards in favor of the debt collection firm nearly 100 percent of the time, while two arbitrators reviewing otherwise identical claims dismissed those claims nearly 100 percent of the time. Our review of these files found absolutely no reason in the case files to explain such inconsistent results.

We also found that some of NAF's arbitrators either don't know the rules they are supposed to follow or they don't follow them and nobody at NAF seems to care. One NAF rule establishes a limit to the amount of time between filing of the claim and service of notice on the consumer debtor. Our investigation found that NAF does not require its arbitrators to adhere to this rule. Out of a total of 172 consumer debt collection claims that could have been dismissed under those rules, none were. What is more, NAF is also violating a California law by refusing to publish the results of many of its arbitrations with residents of that State.

Our investigation further revealed that this violation is allowing at least one debt collection company to obtain awards of attorneys' fees that exceed legal limits.

The subcommittee staff's findings support a considerable body of evidence showing NAF's misuse of mandatory arbitration in debt collection cases. Last week, the attorney general of the State of Minnesota filed a lawsuit against the NAF alleging violations of Minnesota's consumer fraud statute and other claims based on NAF's concealment of its ties to creditors; its active solicitation of creditors based on promises of providing leverage over consumers; its direct financial affiliation with one of the country's largest debt collectors.

Remarkably, just this past Saturday the NAF agreed to a settlement with the Minnesota attorney general in which it would immediately stop all arbitration proceedings that are the subject of this hearing. The settlement does not admit wrongdoing, however. NAF still maintains that its arbitrations and arbitrators are fair and independent. Our investigation strongly suggests otherwise, and we will hear from the NAF, Public Justice, and from the attorney gen-

eral of Minnesota herself, the Honorable Ms. Lori Swanson, on the supposed neutrality of NAF arbitrations.

The hearing today will also address other systemic problems the subcommittee investigation found with this arbitration system, such as why the right to appeal a decision in consumer arbitration claims is limited to a finding of fraud or corruption; the lack of oversight of the claims process itself; and the bias built into arbitrations favoring the debt collection industry.

Now, defenders of this mass production arbitration system argue that abolishing it will only raise the cost of litigating debt collection cases. But consumers have rights and protections under the law that are not honored in the arbitration setting. Furthermore, the number of Americans who have experienced the suspension of their rights due to consumer arbitration has grown as the number of consumers with debt has exploded.

Today, the average adult carries over $4,000 of debt. To the debt collection industry and the alternative legal system that has been created around it can no longer be ignored by the Federal Government. Others seem to agree with us. There are a number of bills in Congress that would impose limits on the applicability of mandatory pre-dispute arbitration agreements, including one introduced by our colleague, Representative Hank Johnson.

Very significantly, Congressman Barney Frank, Chairman of the Financial Services Committee, has introduced a bill to establish a new consumer protection agency which would have the power to limit or ban mandatory pre-dispute consumer arbitration agreements, and the Federal Trade Commission is currently evaluating the entire system of debt collection, including arbitration practices with an eye toward the much-needed modernization of debt collection laws.

I hope this hearing will bring increased awareness to the problems of the mandatory consumer debt arbitration system; holds those accountable that have abused consumers' rights in the past; and explore solutions to improve the system so it is no longer a one-stop shop for debt collection agencies to obtain a binding legal judgment against the consumer. Our citizens deserve nothing less.

At this time, prior to recognizing Mr. Jordan, I just want to observe the presence of our colleague from Maryland, Mr. Cummings. Thank you for being here. And our colleague from California, Ms. Watson, thank you for being here.

And the Chair recognizes Mr. Jordan for his opening statement. You may proceed.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

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Opening Statement
Of
Dennis J. Kucinich, Chairman

Domestic Policy Subcommittee
Oversight and Government Reform Committee

Wednesday July 22, 2009
2154 Rayburn HOB
2:00 p.m.

"Arbitration or 'Arbitrary': The Misuse of Mandatory Arbitration to Collect Consumer Debts."

Good afternoon and welcome.

The subject of this hearing – the use of mandatory pre-dispute arbitrations as a method of obtaining judgments for consumer debts – is not what we normally think of when we hear the terms "arbitration" or "consumer arbitrations." We are not talking about arbitrations brought by consumers against businesses, and we are not talking about individual arbitrations brought by businesses against consumers. We are talking about mass-production arbitrations, where businesses file thousands of claims against consumers to obtain judgments on credit card debt; where the claims are assigned to arbitrators in "batches" of dozens; where the consumer almost never appears or even responds; and where the so-called hearing consists of nothing more than the arbitrator looking at a statement written by the creditor and awarding the amount that the creditor requests.

Over the past months, the Domestic Policy Subcommittee has conducted an investigation into the actual practices of the two largest providers of consumer arbitration services: the National Arbitration Forum ("NAF") and the American Arbitration Association ("AAA"). NAF is by far the number one generator of arbitration awards against credit card customers. The AAA also administered consumer debt collection arbitrations, and state that they have stopped doing so as of June, 2009. Subcommittee staff reviewed over 50,000 pages of documents, including hundreds of actual case files, to determine how the claims were decided by arbitrators.

Our investigators have come to several deeply disturbing conclusions about NAF's arbitration system:

Who wins or loses a NAF arbitration seems to depend solely on which arbitrator reviews the claim. As part of our review, Subcommittee staff compared 228 nearly identical NAF consumer debt collections claims, and we found that three arbitrators granted awards in favor of the debt collection firm nearly 100% of the time, while two arbitrators, reviewing otherwise identical claims, dismissed those claims nearly 100% of the time. Our review of these files found absolutely no reason in the case files to explain such inconsistent results.

We also found that some of NAF's arbitrators either don't know the rules they are supposed to follow, or they don't follow them, and nobody at NAF seems to care. One NAF rule establishes a limit to the amount of time between filing of the claim and service of notice on the consumer-debtor. Our investigation found that NAF does not require its arbitrators to adhere to this rule: out of a total of 172 consumer debt collection claims that could have been dismissed under those rules, none were.

What's more, NAF is also violating a California law by refusing to publish the results of many of its arbitrations with residents of that state. Our investigation further revealed that this violation is allowing at least one debt collection company to obtain awards of attorney's fees that exceed legal limits.

The Subcommittee staff's findings support a considerable body of evidence showing NAF's misuse of mandatory arbitration in debt collection cases. Last week, the Attorney General of the State of Minnesota filed a lawsuit against the NAF alleging violations of Minnesota's consumer-fraud statute and other claims based on NAF's concealment of its ties to creditors, its active solicitation of creditors based on promises of providing "leverage" over consumers, and its direct financial affiliation with one of the country's largest debt collectors. Remarkably, just this past Sunday the NAF agreed to a settlement with the Minnesota Attorney General in which it would immediately stop all arbitration proceedings that are the subject of this hearing. The settlement does not admit wrongdoing, however. NAF still maintains that its arbitrations and arbitrators are "fair and independent." Our investigation strongly suggests otherwise, and we will hear from the NAF, Public Justice, and from the Attorney General of Minnesota herself, Ms. Lori Swanson, on the supposed "neutrality" of NAF arbitrations at the hearing today.

The hearing will also address other systemic problems the Subcommittee investigation found with this arbitration system, such as: why the right to appeal a decision in consumer arbitration claims is limited to a finding of fraud or corruption; the lack of oversight of the claims process itself; and the bias built into the arbitrations favoring the debt-collection industry.

Defenders of this mass-production arbitration system argue that abolishing it will only raise the costs of litigating debt-collection cases. But consumers have rights and protections under the law that are not honored in the arbitration setting. Furthermore, the number of Americans who have experienced the suspension of their rights due to consumer arbitration has grown as the number of consumers with debt has exploded. Today, the average American adult carries over four thousand dollars of debt. The debt collection industry and the alternative legal system that has been created around it can no longer be ignored by the federal government. Others seem to agree with us. There are a number of bills in Congress that would impose limits on the applicability of mandatory, pre-dispute arbitration agreements, including one introduced by our colleague Representative Hank Johnson. Very significantly, Congressman Barney Frank, Chairman of the Financial Services Committee, has introduced a bill to establish a new consumer

protection agency which would have the power to limit or ban mandatory pre-dispute consumer arbitration agreements, and the Federal Trade Commission is currently evaluating the entire system of debt collection, including arbitration practices, with an eye toward the much-needed modernization of debt collection laws.

I hope this hearing will bring increased awareness to the problems of the mandatory consumer debt arbitration system, hold those accountable that have abused consumers' rights in the past, and explore solutions to improve the system so it is no longer a one-stop shop for debt-collection agencies to obtain a binding legal judgment against a consumer. Our citizens deserve nothing less.

Mr. JORDAN. Thank you, Mr. Chairman.

The challenges consumers face in troubled economic times only underscore the importance of this hearing. This particular hearing provides an excellent opportunity to discuss and debate mandatory arbitration clauses. This is an important matter and I look forward to having a productive discussion on the many issues surrounding consumer arbitration.

As we debate President Obama's proposed consumer financial protection agency, we must think hard about the way this new agency would operate. Mr. Obama's existing proposal is the latest of the administration's expanding its reach into the private sector. I am particularly concerned that under the new agency, the administration would have the authority to eliminate mandatory arbitration clauses. This is simply bad policy.

Well-respected academics and experts agree arbitration is fair, equitable and necessary. In 2007, Professor Peter Rutledge told the Senate Judiciary Committee that in a world without pre-dispute arbitration, consumers would face higher costs. Professor Rutledge explained the only people who with certainty benefit from the Arbitration Fairness Act are the lawyers. Frankly, it is the undisputed fact that this is primarily the trial lawyers that stand to benefit from the elimination of arbitration clauses.

During a House Judiciary markup, Representative Hank Johnson claimed mandatory pre-dispute binding arbitration clauses leave consumers without choices, but these choices have nothing to do with consumer rights as much as tactics for lawyers to make money. Representative Johnson stated, "You can't influence large corporations by being nice. You need a jury to get into their pocket."

Unfortunately, justice is sometimes the price you pay. In 2008, Mississippi lawyer Dickie Scruggs pleaded guilty to conspiring to bribe a judge and is currently serving a 7-year sentence in Federal prison. Bill Lerach and Mel Weiss are each serving time in jail for a criminal conspiracy of paying millions of dollars in illegal kickbacks to lead plaintiffs in class action lawsuits in order to help the lawyers win the race to the courtroom. Kentucky plaintiffs lawyers William Gallion and Shirley Cunningham, Jr., were jailed and ordered to pay disgorgement of the $30 million they scammed from their clients in the settlement over the diet drug fen-phen.

The point I am making is just because you have a few bad apples, you don't throw out the whole barrel. If it is true for lawyers, it is also true for arbitration. Today's oversight hearing is set to focus on consumer arbitration, not the evils of business. If, for example, credit card companies are harming consumers, then a separate hearing is needed. Statistics citing that consumers overwhelming lose in debt collection cases do not support the notion that arbitration is the enemy.

By way of example, the Federal Government wins nearly all of its cases to recover unpaid student loan debt. Is the Federal Government to blame when debtors lose? Is arbitration? Today's hearing should foster debate on policy directly related to mandatory arbitration. Whether or not arbitration was provided dispute resolution service is good or bad for consumers is an inquiry independent from whether debt collection as a business is bad for consumers.

Consumers have successfully used arbitration to resolve disputes with businesses. Debt collection may present serious problems to consumers, but the best evidence available would indicate that those problems are worse in litigation than in arbitration.

It is my hope that the Members here today can help our witnesses tailor this hearing to the empirical data available concerning debt collection in consumer cases. Only then can we make progress in providing remedies to consumers. A flat-out elimination of mandatory arbitration is not the answer. To that end, I hope today's discussions also examine feasible alternatives to remedy the issues at hand.

I am also concerned, Mr. Chairman, that three of the four witnesses called today by the majority have benefited from a lawsuit and successful settlement with the majority's fourth witness, the National Arbitration Forum. This may not prohibit us from having a productive hearing, but it is certainly a fact worth noting.

Thank you, Mr. Chairman, for holding this important hearing today. The issues not only affect our home State of Ohio, but also the entire United States. I look forward to hearing from our witnesses.

Mr. Chairman, I would also ask unanimous consent for the minority staff report be included in the record.

Mr. KUCINICH. Without objection.

Mr. JORDAN. Mr. Chairman, I would also ask for unanimous consent that a statement received from ACA International and an email be included in the hearing record as well.

Mr. KUCINICH. I would ask the gentleman, do we have the email?

Mr. JORDAN. Yes, we do right here.

Mr. KUCINICH. OK. Without objection.

Mr. JORDAN. Thank you, Mr. Chairman.

Mr. KUCINICH. And without objection, Members and witnesses may have 5 legislative days to submit a written statement or extraneous materials for the record.

Without objection, at some point we will welcome Representative Hank Johnson to the dais to make a statement if he comes in time, or receive testimony and participate in the questions.

And without objection, all Members will have 3 minutes opening statements, not to exceed 3 minutes.

And also without objection, Mr. Jordan, without objection we are also going to put the staff report of the Domestic Policy Subcommittee majority staff on arbitration abuse in the record.

[The information referred to follows:]

STAFF REPORT

of the

Domestic Policy Subcommittee Majority Staff
Oversight and Government Reform Committee
House of Representatives

Dennis J. Kucinich, Chairman

Arbitration Abuse: an Examination of Claims Files of the National Arbitration Forum

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Embargoed until 3 p.m.
July 21, 2009

EXECUTIVE SUMMARY

"Arbitration Abuse: an Examination of Claims Files of the National Arbitration Forum"

The Domestic Policy Subcommittee Majority staff reviewed hundreds of individual case files from the largest provider of arbitration for debt collection, the National Arbitration Forum (aka Forthright LLC). A summary of our findings follows:

1. Virtually all NAF "consumer arbitrations" are in fact debt collection actions brought by creditors or assignees of creditors, not by the consumers themselves, and almost all consumer arbitrations are decided in the creditor's favor.

2. Decisions in identical cases differed depending on the identity of the arbitrator to whom the claim was assigned (See Exhibit A, attached).

3. Arbitrators in most of claims ignored the absence of evidence of whether or not the claims were brought within the statute of limitations.

4. Arbitrators in most of the claims ignored the lack of specific evidence of who was actually served with the notice of the arbitration.

5. Where there was specific evidence of how the notice was served, it often showed that the signature on the receipt was illegible, was a name different from the person who was supposed to be served, or was on one occasion an "X" and on two occasions a "John Doe."

6. All of the arbitrators ignored evidence that should have resulted in dismissal of most of the claims (See Exhibit B, attached).

7. One Maine arbitrator, who did not ignore such evidence and did dismiss a lot of cases, ended up without any additional cases being assigned to him in Maine.

8. The NAF, itself, did not follow its own rules and sent claims to arbitrators despite the fact that those claims should have been dismissed for failure of the creditor to serve the notice or arbitration "promptly."

9. The NAF is violating California statutory law by refusing to publish the results of many of its California arbitrations.

10. The NAF's failure to publish the results of all of its California arbitrations is assisting at least one collection company in an illegal effort to obtain awards of attorney's fees in amounts that violate Delaware law.

I. Background

Congress passed the Federal Arbitration Act[1] in 1925. The original intention of the FAA was to overcome the reluctance of federal courts to entertain or to enforce arbitration clauses in contracts between commercial business entities. In 1984, the Supreme Court decided *Southland Corp. v. Keating*,[2] which characterized the FAA as declaring "a national policy favoring arbitration" in federal and state courts, and held that the FAA preempts all inconsistent state arbitration laws. Despite severe criticism of this holding, in the dissenting opinion of Justices O'Connor and Rehnquist and in numerous subsequent dissents,[3] the Supreme Court has consistently upheld both arbitration clauses and the authority of arbitrators[4] in the 25 years since its *Southland* decision.

The number of arbitrations has grown exponentially in the 25 years since the *Southland* decision. Virtually all consumer transactions with large businesses are now subject to pre-dispute, mandatory arbitration clauses. The pervasiveness of these arbitration "agreements" in consumer contracts has created a separate system of "justice" for consumers.

Several bills have been introduced, in this session and past sessions, to prohibit pre-dispute arbitration clauses in consumer transactions, employment agreements, franchise agreements and nursing home admissions.[5] The Subcommittee undertook to investigate the nature of pre-dispute mandatory arbitration and whether or not the process was producing fair results.

II. The Nature of Consumer Debt Collection Arbitration

Arbitration creates a third system of justice that operates parallel to the federal and state judicial systems. In the context for which the FAA was enacted, i.e., commercial disputes between businesses, arbitration can be more expeditious, less costly and as fair as the two other judicial systems. However, most "consumer arbitrations" present a totally different situation.

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[1] 9 U.S.C. § 1, *et seq.*

[2] 465 U.S. 1 (1984).

[3] *See, e.g., Allied-Bruce Terminix Cos. V. Dobson*, 513, U.S. 265, at 292 (1995)(Justices Thomas and Scalia dissenting).

[4] For example, the Supreme Court had held that the arbitrator, not a court, must decide whether the arbitration agreement precludes class actions, *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), and whether the credit agreement violates state usury laws, *Buckeye Check Cashing v. Cardegna*, 546 U.S. 440 (2005).

[5] *See, e.g.*, Arbitration Fairness Act of 2009, H.R.1020; Fairness in Nursing Home Arbitration Act of 2009, H.R.1237; Consumer Fairness Act of 2009, H.R.991.

The arbitrators in consumer claims are attorneys or retired judges and their decisions are, in most cases, based solely upon written statements made by the attorneys representing the creditor. The claims are sent to the arbitrator in batches by the arbitration provider. Responses by the consumer are very rare. Usually, the "hearing" is nothing more than a review by the arbitrator of the written statements provided by the creditor or its attorney, without physical appearances by either the creditor or the consumer.

Consumer arbitration lacks the safeguards that have been designed into our judicial system by our Constitution, by state and federal statutes, and by centuries of judicial decisions. The differences between the procedures in courts and in arbitrations can be seen in the following table:

Table A. Court and Arbitration: Comparison of Policies and Procedures

COURT	ARBITRATION
Consumer is served process by a court officer who has no interest in the proceeding	Consumer is served by the creditor, who has a financial incentive for the consumer not to appear
Case is randomly assigned to a judge who has no interest in the proceeding	Case is assigned 1) by a business entity that has a financial incentive to seek additional cases from the creditor, 2) to a sole-proprietor (the arbitrator) who has a financial incentive to seek additional cases from the creditor, and who is subject to removal at the whim of the creditor (under NAF rules w/ 10 days)
The entire proceeding is open and public	
The process is familiar to anyone who has watched television	The process is closed and secretive. Virtually nothing is publicly known, other than what California requires to be disclosed
Due process is required and is enforced by neutral parties	The process is unfamiliar and intimidating. The NAF advertises to collection companies that when you explain to debtors what arbitration is "they basically hand you the money"
Decisions must be based on reliable evidence	Due process is only enforced by an arbitrator who has a financial incentive to seek additional cases from the creditor
Consumer incurs virtually no cost	Decisions are usually based on hearsay and often double-hearsay
Judge must follow the law	Everything the consumer asks for comes only at an extra cost, including a hearing
Consumer can appeal any failure to follow law or facts	Arbitrator can ignore the law, and is not subject to any review
	No viable appeal of anything but fraud by the arbitrator

Almost all of these mass debt collection arbitrations are conducted by the National Arbitration Forum.[6] On July 14, 2009, the Attorney General of the State of Minnesota filed a lawsuit against the NAF in which she included detailed allegations of financial connections between the NAF and debt collection companies and law firms. Those allegations seem to show that the NAF is ultimately owned and controlled by the same business entities that own and control the three largest collection companies in the country, companies that file over half of the claims that are processed through the NAF. Those allegations also recite that the NAF, those three collection companies, and the business entities that now own and control them, all sought to conceal the existence of the relationship among them, in order to maintain the façade that the NAF was truly independent in its administration of the debt collection arbitrations that are filed by those three companies. On July 17, 2009, the NAF and the Minnesota Attorney General entered into a settlement agreement in which the NAF agreed to discontinue all consumer arbitrations.

III. The Domestic Policy Subcommittee Staff Investigation

The Subcommittee's staff began our investigation last fall, by assembling and reviewing all of the publicly-available literature and commentary on pre-dispute, mandatory arbitration clauses in all contexts, including consumer agreements and employment agreements. On March 18, 2009, Chairman Kucinich sent a document request to the three major providers of arbitration services,[7] asking for documents that related to all of the concerns that were discussed in the available literature. Staff reviewed over 50,000 pages of documents that were produced by the three services. That review led the Subcommittee to focus on the use of arbitration in consumer debt collection, because it appeared that different arbitrators might be issuing opposite decisions based on the same or similar facts. In order to determine if that was the case, the Subcommittee requested files in 159 claims administered in California by the NAF. All of these claims were filed by the same creditor at approximately the same time. Two arbitrators dismissed all of the 58 claims that were assigned to them. The third arbitrator issued awards to the creditor in every one of the claims assigned to him. The staff reviewed all of those files and could not discover any differences that would justify the different decisions, so the Subcommittee requested the files in 80 additional claims decided by two other arbitrators that had also issued awards to the same creditor. The findings recited below are the result of the Subcommittee's analysis of those files and other documents that have been reviewed.

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[6] The AAA has conducted one trial program (the "Encore/MCM" program) that ended in June of this year. In contrast, the NAF administered over 30,000 consumer debt collection arbitrations in California alone between January 1, 2003 and March 31, 2007.
[7] The American Arbitration Association (AAA), Judicial and Mediation Services (JAMS) and the National Arbitration Forum (NAF).

IV. Findings

Very few "consumer arbitrations" are filed by consumers. The only available data indicates that more than 99% of "consumer arbitrations" are debt collection claims filed by businesses, usually credit card companies or collection companies, against consumers, seeking to collect past due balances under arbitration "agreements" that were unilaterally imposed by the businesses.[8]

The claim files that the Subcommittee's staff examined were decided prior to the date on which the NAF rearranged its structure to become part of a debt collection conglomerate. Even before the consummation of that financial arrangement, the claim files showed the kind of problems that would occur in the administration of debt collection claims by an arbitration service that had close ties to the debt collection industry.

Our analysis of the claim files demonstrates that the absence of essential safeguards produces exactly the results that one would expect.

1. Service of process. Obviously, it is easier for a creditor to prevail if the consumer does not respond to the notice. In consumer debt collection arbitration, the notice is served and verified by the creditor. In the AAA/MCM case files, the arbitration notice was often delivered to addresses that differed from the billing address, and the delivery receipts were often signed with names that were illegible and/or differed from the name of the consumer on the bill. In one case, the receipt was signed "x." In three cases, the bills were in Spanish (indicating that the consumer was not an English speaker), but all of the arbitration notices were in English. In the NAF case files, delivery receipts were generally not provided. But, two verifications of delivery upon "John Doe" raise the same concerns.

2. Case assignment. NAF filings are assigned by NAF staff. The studies of the California NAF filings, by Public Citizen and by The Center for Responsible Lending, demonstrate that the vast majority of cases are assigned to a small number of arbitrators who routinely rule in favor of the creditors. The few arbitrators whose rulings are more favorable to consumers are given few cases or reduced numbers of cases. Our analysis of a more recent period of NAF filings found the same disproportionate distribution.[9] This disproportion may be

[8] The NAF produced records that show only 7 of 4,894 NAF arbitrations in West Virginia (0.14%), and only 79 of 14,408 in Minnesota (0.5%) were filed by consumers. The General Counsel of First USA Bank testified in an August, 1999 deposition that fewer than 10 of their 40,713 arbitrations after January of 1998 were filed by consumers.

[9] The Public Citizen data analyzed NAF California filings from Q1'03 through Q1'07. NAF provided the Subcommittee with its California filings through Q4'08 and has Q1'09 filings on its website.

augmented by the NAF's disqualification rule. When a case is assigned to an arbitrator whom the creditor considers unfavorable, the creditor can remove the arbitrator with a simple form letter, without any need to recite a justification.[10] This rule can greatly increase the likelihood of a creditor gaining the assignment of a favorable arbitrator. It also provides notice to an arbitrator that he/she will get fewer cases, and consequently reduced income, in the future if his/her decisions do not become more favorable to creditors. In Maine, one arbitrator who was actually following the NAF's rules, and dismissing cases that were deficient, found himself without any subsequent case assignments.[11]

3. Closed proceedings. Closed proceedings have at least two significant effects. First, they make it difficult, if not impossible, to evaluate the fairness of arbitration. California is the only state that requires reporting of results, and the information provided by the three organizations is incomplete.[12] We have no information on 46 states and only limited information from three others.[13] We discovered during the course of our investigation that the NAF was violating California law[14] and was not publishing the results of thousands of arbitrations filed by Columbia Credit Services and others. By concealing these files, the NAF was assisting Columbia (and possibly others) in seeking and obtaining awards of attorney's fees that violate Delaware law.[15] Second, closed proceedings produce arbitrary results, where different arbitrators produce diametrically-opposed decisions in the same cases or virtually identical cases.[16] The result the consumer gets depends on the arbitrator to whom the case is assigned. As shown in the preceding paragraph, NAF case assignment is not random and appears to be designed to maximize decisions favorable to the creditors.

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[10] The attorney for Columbia Credit Services, Inc. obtained the disqualification of one arbitrator merely by stating that the arbitrator "is prejudiced [sic] my client or me or my client's interest or my interest...."

[11] The NAF promulgated a written rule, the result of which was to stop sending Maine cases to that arbitrator, purportedly because he was not a Maine attorney. No prior written rule existed on that subject.

[12] We discovered during the course of our investigation that the NAF California filings are incomplete and do not disclose any cases filed by Columbia Credit Services, Inc. NAF did not disclose names of arbitrators in their Q4'08 filings and do not breakdown the components of the awards in any of its filings.

[13] NAF provided the Subcommittee with Excel spreadsheets of filings and decisions in ME, MN and WV, but the information provided was different in each spreadsheet and did not allow for a group analysis. Names of arbitrators were only provided in the ME spreadsheet.

[14] CAL. CIV. PROC. § 1281.96

[15] DEL. CODE ANN, tit. 10, § 3912

[16] In 230 cases filed by one creditor with NAF, two arbitrators dismissed all their cases, while the three other arbitrators ruled in the creditor's favor in all their cases in the full amount requested.

4. Due process. NAF has rules that, if enforced and followed, would provide some due process protections. However, the enforcement of these rules appears to be left in the hands of each individual arbitrator. It appears that the NAF does not care whether or not its rules are enforced. In the claims we reviewed, 70% of them should have been dismissed by the NAF, and not forwarded to arbitrators, because the delay in service of the notice violated NAF Rule 6 (See Exhibit B, attached). The NAF's lack of concern about due process is clearly shown by its disingenuous response to one consumer whose notice was served upon his landlord, with whom he was not speaking at the time. The NAF responded that "the adequacy of service in this case would be decided by the arbitrator hearing the case," ignoring the fact that specific information about service was not provided to the arbitrator.[17] Occasionally, there are arbitrators who enforce deficiencies of service, inadequacy of allegations, absence of sworn evidence, excessive requested attorney's fees, etc. In the case files we reviewed, and in the NAF reported cases, those arbitrators appear to be the exception and their decisions appear to result in their receiving fewer subsequent case assignments.

5. Standard of evidence. In a court, a creditor would have to submit admissible evidence of the amount of the debt, even if the debtor failed to respond to the suit. The awards we reviewed were based entirely on statements of the creditor, usually by the creditor's attorney, sometimes unsworn, sometimes made on the basis of "information and belief." The most documentary evidence that was provided was a "final bill" that recited the past due amount or the total amount owing, without any itemization of charges or any indication of when those charges were incurred. Since all of these claims were made by assignees of the original creditor, they were at least single hearsay, and probably double hearsay. The responses of the consumers, which had to have been based on the first-hand knowledge of the consumer, appeared to be given no weight.

6. Application of law. A judge must follow the law. If a judge does not follow the law, a court of appeals can reverse the incorrect decision. If two judges make rulings that are opposite, appeals can reverse the incorrect decision and guide all future decisions. That procedure does not exist in arbitration. The decision of the arbitrator is final and can only be reviewed on a very limited basis. There is no procedure to correct a decision that is against the law or a decision that totally different from another decision issued by that arbitrator or another arbitrator. Our review disclosed decisions that were totally opposite, depending on whether or not the arbitrator was concerned with deficiencies in the claim documents or ignored them entirely (See Exhibit A, attached).

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[17] In the files we reviewed, the only information given to the arbitrator was that service was made in compliance with NAF Rule 6. In 70% of the cases, that sworn statement was untrue, because the service was not "prompt" as required by NAF Rule 6.

V. Conclusion

Mass-production collection of consumer debts through arbitration is not "arbitration." It is debt collection made simpler, for the benefit of the creditor and to the detriment of consumers. While it is true that the vast majority of consumers default and do not appear when claims are brought against them in courts, there are consumers who have legitimate defenses to the claims against them or who have become victims of identity theft or mistaken identity. The arbitration system, as it is currently operated by NAF, does not provide protection for those consumers. The system is ripe for abuse, and it has been abused by the largest administrator of "consumer arbitrations."

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Exhibits

Exhibit A: Arbitrator Decisions in Claims Reviewed

Arbitrator:	Claims Reviewed	Awards Granted	Dismissals
Jennings	40	0	40
Krotinger	18	0	18
Tassopulos	44	44	0
Williams	31	31	0
Schneider	97	97	0

Consumer debt claims brought by Worldwide Asset Purchasing ("WAP") heard by NAF-assigned arbitrators. All claims originated from consumer credit card debt and assigned to WAP, and were otherwise identical except for date of default, amount of debt, and identity of respondent.

Exhibit B: Claims Violating NAF Rule 6 and Rule 41B(3)

Arbitrator:	Claims Reviewed	Total Dismissible Under NAF Rule 41B(3)	Total No. Dismissed Under NAF Rule 41B(3)
Jennings	40	39	39
Krotinger	18	9	9
Tassopulos	44	31	0
Williams	31	21	0
Schneider	97	60	0

NAF Code of Procedure Rule 6, "Service of Claims Responses, Requests and Documents" states that once a claim has been filed with the NAF, Claimant "shall promptly serve Respondent" with a copy of the initial claim documents. NAF Rule 41B(3) empowers an arbitrator to dismiss a claim if more than one hundred twenty (120) days have elapsed between the filing date of the claim and the date of service on the Respondent. However, of the 230 total claims reviewed, 160 were dismissible under Rule 41B(3) for failing to comply with Rule 6. Further, in 224 of 228 claims reviewed, there was no other evidence of service on any Respondent save for an affidavit of service stating that Respondent was served at his or her address.

Mr. KUCINICH. The Chair recognizes the gentleman from Maryland, Mr. Cummings, for a 3-minute statement.

Mr. CUMMINGS. Mr. Chairman, thank you for calling this hearing, and I will just submit a written statement. Thank you very much.

Mr. KUCINICH. I thank the gentleman.

The Chair recognizes Ms. Watson of California for an opening statement.

Ms. WATSON. Thank you, Mr. Chairman, for holding today's important hearing to evaluate whether consumer debt collection arbitration as currently administered produces results that are fair to both businesses and consumers.

Today, virtually all consumers often unknowingly enter into mandatory arbitration agreements forfeiting their right to regular court proceedings as part of the fine print of consumer, employment and franchise agreements. While some contend arbitration offers consumers a more cost-effective procedure with all the protections of a traditional litigation procedure, the investigation of this committee and the case brought by the attorney general of the State of Minnesota against the National Arbitration Forum, have revealed significant concerns about the neutrality of the arbitration process for consumer debt collection.

A June 5th cover story in Business Week magazine entitled, "Banks versus Consumers: Guess Who Wins," describes the business practice of the National Arbitration Forum, which dominates credit card arbitration and operates in a system in which it is exceedingly difficult for individuals to prevail.

I would like to enter this particular report to the record.

Mr. KUCINICH. Without objection.

[The information referred to follows:]

Bloomberg Businessweek
Available on the iPad

COVER STORY June 5, 2008, 5:00PM EST

Banks vs. Consumers (Guess Who Wins)

The business of resolving credit-card disputes is booming. But critics say the dominant firm favors creditors that are trying to collect from unsophisticated debtors

by Robert Berner and Brian Grow

What if a judge solicited cases from big corporations by offering them a business-friendly venue in which to pursue consumers who are behind on their bills? What if the judge tried to make this pitch more appealing by teaming up with the corporations' outside lawyers? And what if the same corporations helped pay the judge's salary?

It would, of course, amount to a conflict of interest and cast doubt on the fairness of proceedings before the judge.

Yet that's essentially how one of the country's largest private arbitration firms operates. The National Arbitration Forum (NAF), a for-profit company based in Minneapolis, specializes in resolving claims by banks, credit-card companies, and major retailers that contend consumers owe them money. Often without knowing it, individuals agree in the fine print of their credit-card applications to arbitrate any disputes over bills rather than have the cases go to court. What consumers also don't know is that NAF, which dominates credit-card arbitration, operates a system in which it is exceedingly difficult for individuals to prevail.

Some current and former NAF arbitrators say they make decisions in haste—sometimes in just a few minutes—based on scant information and rarely with debtor participation. Consumers who have been through the process complain that NAF spews baffling paperwork and fails to provide the hearings that it promises. Corporations seldom lose. In California, the one state where arbitration results are made public, creditors win 99.8% of the time in NAF cases that are decided by arbitrators on the merits, according to a lawsuit filed by the San Francisco city attorney against NAF.

"NAF is nothing more than an arm of the collection industry hiding behind a veneer of impartiality," says Richard Neely, a former justice of the West Virginia supreme court who as part of his private practice arbitrated several cases for NAF in 2004 and 2005.

A DIFFERENT REALITY

NAF presents its service in print and online advertising as quicker and less expensive than litigation but every bit as unbiased. Its Web site promotes "a fair, efficient, and effective system for the resolution of commercial and civil disputes in America and worldwide."

But internal NAF documents and interviews with people familiar with the firm reveal a different reality. Behind closed doors, NAF sells itself to lenders as an effective tool for collecting debts. The point of these pitches is to persuade the companies to use the firm to resolve clashes over delinquent accounts. JPMorgan Chase (JPM) and Bank of America (BAC) are among the large institutions that do so. A September, 2007, NAF PowerPoint presentation aimed at creditors and labeled "confidential" promises "marked increase in recovery rates over

existing collection methods." At times, NAF does this kind of marketing with the aid of law firms representing the very creditors it's trying to sign up as clients.

NAF, which is privately held, employs about 1,700 freelance arbitrators—mostly moonlighting lawyers and retired judges—who handle some 200,000 cases a year, most of them concerning consumer debt. Millions of credit-card accounts mandate the use of arbitration by NAF or one of its rivals. NAF also resolves disputes involving Internet domain names, auto insurance, and other matters. In 2006 it had net income of $10 million, a robust margin of 26% on revenue of $39 million, according to company documents.

NAF's success is part of a broader boom in arbitration dating back to the 1980s, when companies began introducing language into employment contracts requiring that disputes with workers be resolved out of court. Mandatory arbitration spread to other kinds of agreements, including those involving credit cards.

NUMEROUS LOYAL PATRONS

Now, with the economy stumbling, NAF's focus on consumer credit could prove even more lucrative. U.S. credit-card debt hit a record high of $957 billion in the first quarter of 2008, up 8% from the previous year, according to Federal Reserve data. People who had relied on home-equity loans are seeing that money evaporate in the mortgage crisis and are running up card balances. Card providers, meanwhile, are increasingly turning to arbitration to collect on delinquent accounts.

Even consumer advocates concede that most people accused of falling behind do owe money. But the amounts are often in dispute because of shifting interest rates, fees, and penalties. Sometimes billing mistakes or identity fraud lead to confusion. Plenty of acrimony surrounds the traditional collections process in which lenders' representatives or companies that buy debt at a discount pressure consumers to pay up. Arbitration is supposed to be different. Endorsed by federal law, it purports to offer something akin to the evenhanded justice of the court system. That's why state and federal judges overwhelmingly uphold arbitration awards challenged in their courtrooms. This confidence may be misplaced, however, at least in many cases that come before NAF. (Its main competitors—the nonprofit American Arbitration Assn. in New York and JAMS, a for-profit firm in Irvine, Calif.—tend to attract employment disputes and contractual fights between companies.)

NAF has numerous loyal patrons among the country's financial titans. Chase says in a statement that it "uses NAF almost exclusively in its collection-arbitration proceedings due to NAF's lower cost structure." Companies pay from $50 to several hundred dollars a case, depending on its complexity. "Many legal commentators have found arbitration to be fair, efficient, more consumer friendly, and faster than the court system," Chase adds. Roger Haydock, NAF's managing director, says: "This is like the *Field of Dreams*: Build a ballpark, and they will come."

Others argue that NAF umpires make calls that put debtors at a disadvantage. In March, Dennis J. Herrera, San Francisco's city attorney, sued the firm in California state court, accusing it of churning out awards for creditors without sufficient justification. The lawsuit cites state records showing that NAF handled 33,933 collection arbitrations in California from January, 2003, through March, 2007. Of the 18,075 that weren't dropped by creditors, otherwise dismissed, or settled, consumers won just 30, or 0.2%, the suit alleges. "NAF has done an end run around the law to strip consumers of their right to a fair collection process," Herrera says in an interview.

The firm counters in court papers that federal law intended to encourage arbitration precludes the suit. NAF's "neutral decision-makers constitute a system that satisfies or exceeds objective standards of fairness," the firm says in a press release. NAF adds in an e-mail that the suit obscures thousands of cases in which consumers prevail because creditors abandon their claims or the disputes are "otherwise terminated."

So far, the San Francisco litigation relies mostly on publicly available information about NAF. Internal documents and interviews provide a more detailed picture of the firm.

The September, 2007, marketing presentation, which NAF left with a prospective customer, boasts that creditors may request procedural maneuvers that can tilt arbitration in their favor. "Stays and dismissals of action requests available without fee when requested by Claimant—allows Claimant to control process and timeline," the talking points state.

A current NAF arbitrator speaking on condition of anonymity explains that the presentation reflects the firm's effort to attract companies, or "claimants," by pointing out that they can use delays and dismissals to manipulate arbitration cases. "It allows the [creditor] to file an action even if they are not prepared," the arbitrator says. "There doesn't have to be much due diligence put into the complaint. If there is no response [from the debtor], you're golden. If you get a problematic [debtor], then you can request a stay or dismissal." When some creditors fear an arbitrator isn't sympathetic, they drop the case and refile it, hoping to get one they like better, the arbitrator says.

The firm goes out of its way to tell creditors they probably won't have to tussle with debtors in arbitration. The September, 2007, NAF presentation informs companies that in cases in which an award or order is granted, 93.7% are decided without consumers ever responding. Only 0.3% of consumers ask for a hearing; 6% participate by mail.

NAF says in a statement that it legitimately markets its services. As for the evenhandedness of the process, it adds: "Arbitration procedures are quite flexible and make stays and adjournments available to both claimants and respondents."

Many arbitrators praise NAF. In response to *BusinessWeek*'s (MHP) inquiries, the firm sent an e-mail to a group of arbitrators asking for statements "demonstrating that you provide an invaluable service to the public by acting as a fair, independent, and unbiased Neutral." NAF passed along 10 testimonials. In one, Michael Doland, an arbitrator and attorney in Los Angeles, says: "The cynical view that arbitrators favor businesses over consumers is not correct with regards to the NAF. No communication, direct or indirect, from the NAF to myself as an arbitrator ever suggested such an approach." In an interview, Doland says: "If I ever thought this process was corrupt, that would be the day, the hour, that I would resign."

But other arbitrators have quit NAF for just that reason. Elizabeth Bartholet, a Harvard Law School professor and advocate for the poor, worked as an NAF arbitrator in 2003 and 2004 but resigned after handling 24 cases. NAF ran "an unfair, biased process," she said in a deposition in September, 2006, in an Illinois state court lawsuit. NAF isn't named as a defendant in the pending case, which challenges a computer maker's use of an NAF arbitration clause. Bartholet said that after she awarded a consumer $48,000 in damages in a collections case, the firm removed her from 11 other cases. "NAF ran a process that systematically serviced the interests of credit -card companies," she says in an interview.

In response, the firm says that both sides in each case have the right to object to one arbitrator suggested by NAF, based on the arbitrator's professional biography, which is provided to the parties. Creditors had simply exercised that option with the Harvard professor, NAF says.

SWIFT DECISIONS

Even arbitrators who speak highly of NAF say that the decision-making process often takes very little time. Anita Shapiro, a former Los Angeles superior court judge, says she has handled thousands of cases for the company over the past seven years. Creditors' lawyers have always assured her that consumers are informed by mail

when they are targeted in arbitration, as NAF rules require, she says. But in the majority of cases consumers don't respond. She assumes this is the consumers' choice. Shapiro says she usually takes only "four to five minutes per arbitration" and completes "10 to 12 an hour." She is paid $300 an hour by NAF. If she worked more slowly, she suspects the company would assign her fewer cases.

Asked about Shapiro's account, NAF says: "Arbiters alone determine the amount of time required to make their decisions." It adds that collections cases tried in court are often decided swiftly when consumers don't respond. NAF says its "arbitrators provide much greater access to justice for nonappearing consumer parties by ensuring that the [corporate] claimant submits sufficient evidence."

But some consumers, including those on whose behalf the city of San Francisco is suing, complain that they don't have a real opportunity to contest NAF arbitration cases. By design, arbitration rules are less formal than those of lawsuits. The target of an arbitration can be informed by mail rather than being served papers in person. Evidence can be introduced without authentication.

In March the law firm Wolpoff & Abramson settled a class action in federal court in Richmond, Va., alleging unfairness by the firm in NAF arbitrations. The suit, filed on behalf of 1,400 Virginia residents pursued by the credit-card giant MBNA, claimed that Wolpoff & Abramson, which represented the company, promised them in writing that they could appear at hearings before an NAF arbitrator but then failed to arrange for the hearings. NAF wasn't named as a defendant in the suit. Denying wrongdoing, Wolpoff & Abramson agreed to pay a total of $60,000 in damages. The firm, based in Rockville, Md., declines to comment. NAF denies that consumers were falsely promised hearings.

TROUBLING FORMS

Diane McIntyre, a 52-year-old legal assistant and one of two lead plaintiffs in the Virginia class action, says she was gradually paying down $9,000 she owed MBNA. She had reduced her debt to about $6,000 when she got word in May, 2005, from Wolpoff & Abramson of an arbitration award against her for $6,519, plus $977 in legal fees. She intended to contest the amount of the award and the fees at a hearing but never had a chance. "I wanted to pay the debt" but not all at once, she explains. As part of the class action settlement, Wolpoff & Abramson agreed to accept $4,000 from McIntyre.

A number of other NAF arbitrators*BusinessWeek* contacted independently say that even apart from the absence of debtors contesting most cases, NAF's procedures tend to favor creditors. What most troubled Neely, the former West Virginia supreme court justice, was that NAF provided him with an award form with the amount sought by the creditor already filled in. This encourages the arbitrator to "give creditors everything they wanted without having to think about it," says Neely.

In the three NAF cases he decided, Neely says he granted the credit-card companies the balances and interest they claimed but denied them administrative fees, which totaled about $300 per case. Neely says such fees wouldn't be available to creditors who filed suit in court. "It's a system set up to squeeze small sums of money out of desperately poor people," he asserts. Neely stopped receiving NAF assignments in 2006 after he published an article in a legal publication accusing the firm of favoring creditors.

NAF says that Neely's accusations lack "any shred of truth." The independence of its arbitrators ensures they will decide cases diligently, NAF adds. "Arbitrators are in no way discouraged from deviating from the [creditor's] requested relief."

Lewis Maltby, a lawyer in Princeton, N.J., decided six credit-card cases for NAF in 2005 and 2006 but says he stopped because, like Neely, he became "uncomfortable" with the process. Maltby runs a nonprofit group

promoting employee rights and has served as a director of the American Arbitration Assn. (AAA). Working for NAF, he was surprised at how little information he received to make his decisions. Files contained printouts purporting to summarize a consumer's debt and an unsigned, generic arbitration agreement, he says. "If you wanted free money, you could do [each case] in five minutes."

Maltby says the most difficult cases to decide were three claims by MBNA to which consumers did not respond. The files lacked any evidence that the consumer had been notified, he says. He ruled in MBNA's favor, having assumed that the debts were "probably" genuine. But he adds: "I would have liked to have been more confident that was the case." He did slice the fees requested by creditors' lawyers, because he thought they had expended little effort. He decided one other case for MBNA after the debtor conceded in writing that he owed money but couldn't afford to pay. MBNA withdrew another claim after the consumer said he had been the victim of identity theft, Maltby says.

In a statement, NAF says that *BusinessWeek* misrepresented Maltby's views. But Maltby later said he stands by all his comments. In a statement, Bank of America, which acquired MBNA in January, 2006, declines to comment because of the suit filed by San Francisco against NAF.

William A. Gould Jr., a Sacramento lawyer with a general private practice, says he stopped handling arbitrations for the company after doing several in 2003 and 2004 because the process "just seemed to be pretty one-sided." He says he didn't observe specific instances of bias but became concerned about the imbalance between creditors and their law firms—which were highly sophisticated about NAF procedures—and most consumers, who were naive and lacked legal representation. "The whole organizational mechanism was set up to effect collections," Gould says. Asked to respond, NAF says creditors and their attorneys are "no more sophisticated" about arbitration than they are about court procedures, and consumers are "no more naive."

Founded in 1986, NAF at first depended heavily on one customer, ITT Consumer Financial, the now-defunct lending arm of conglomerate ITT. (ITT) Milton Schober, then the general counsel of ITT Consumer Financial, says he opposed the relationship, fearing it could deny individuals the broader rights they enjoyed in court, such as greater latitude to appeal. Top officials of ITT Consumer Financial, which like NAF was based in Minneapolis, felt otherwise. "Management thought [NAF's] rules for arbitration favored creditors more," says Schober, who is now retired. "Shopping for justice: That's what it was." Neither NAF nor ITT, now a defense electronics manufacturer, would comment on Schober's assertions.

BUSINESS STRATEGY

Haydock, NAF's managing director, says that from the outset, it tried to familiarize corporations and their attorneys with the benefits of arbitration over court cases. NAF isn't alone in doing this. AAA and JAMS also place ads in legal publications and sponsor events at bar association meetings.

But NAF goes further. On some occasions, it tries to drum up business with the aid of law firms that represent creditors. Summaries of weekly NAF business development meetings from 2004 and 2005, which are labeled "confidential," show it enlisted Wolpoff & Abramson and another prominent debt collection law firm, Mann Bracken, to help win the business of companies such as GE's (GE) credit-card arm. When creditors succeed, the law firms seek fees of 15% or 20% of awards, which are added to judgments and billed to debtors. Atlanta-based Mann Bracken surfaces in a November, 2004, NAF document that states: "Work with Mann to begin its taking lead on GE as it relates to Mann running the program for it."

The same NAF document describes efforts to collaborate with Mann Bracken and Wolpoff & Abramson to recruit Sherman Financial Group as an arbitration customer. Sherman, based in Charleston, S.C., buys delinquent debt

from major credit-card companies at a discount and then tries to collect on it. Under the heading "Last Week's Single Sales Objective," the NAF document notes that Wolpoff & Abramson and Mann Bracken partner James D. Branton are to host a panel discussion with attorneys for Sherman Financial. "Follow-up w/ Branton and Wolpoff after conference," the document adds.

The strategy appears to have worked. Sherman confirms that Mann Bracken has represented it in collections cases before NAF. But Sherman denies that either law firm solicited its business on behalf of the arbitration firm.

A former NAF staff employee familiar with its business development efforts says: "It was well understood within NAF that working through established collection law firms was an effective way to develop business with creditors." Insisting on anonymity, the ex-employee explains that, since Wolpoff & Abramson and Mann Bracken had strong ties to major credit- card companies, the law firms could boost NAF's chances of getting creditors to use its services. All told, documents from four NAF business development meetings from October, 2004, through August, 2005, refer 36 times to Wolpoff & Abramson, Mann Bracken, and their attorneys in connection with pitches to credit-card providers and debt buyers.

An arbitration company collaborating with law firms to land business troubles some legal scholars. "Most people would be shocked," says Jean Sternlight, an arbitration expert at the University of Nevada, Las Vegas. "Our adversarial system has this idea built into it that the judge is supposed to be neutral, and NAF claims that it is," she adds. "But this certainly creates a great appearance, at a minimum, of impropriety, where the purportedly neutral entity is working closely with one of the adversaries to develop its business."

"STREAMLINING" THE PROCESS

Mann Bracken's Branton declines to discuss specific clients, citing confidentiality agreements. In an e-mail, he adds: "Mann Bracken frequently and openly works with arbitration administrators (including the National Arbitration Forum and the American Arbitration Assn.) to assist our clients in developing legal solutions tailored to their needs. This is very similar to the work we do with court clerks across the country in streamlining the litigation process for our clients."

NAF's rivals, AAA and JAMS, say they don't cooperate with debt collection law firms in this manner. "Those who inquire about filing cases with us, which include individuals, governmental entities, and businesses, often reach out to understand how to use our online filing process, which is available to all parties," says AAA spokesman Wayne Kessler. The firm says it handled 8,358 consumer arbitration cases in 2007, far fewer than NAF. JAMS says it doesn't handle such cases.

NAF arbitrators say they aren't familiar with all the ways the company markets itself. When told about the internal documents, however, several expressed concern. "Using a law firm to actually solicit business for [NAF] raises a question of the appearance, at least, of potential impropriety," says Edwin S. Kahn, a lawyer in Denver who advocates for low-income families and, as a sideline, has handled about 30 NAF cases and 50 AAA cases. Kahn says he is considering recusing himself from cases involving Mann Bracken and Wolpoff & Abramson: "I have learned something that might affect my objectivity."

NAF interprets Kahn's comments as showing that "he is very aware of his professional responsibility to remain entirely neutral." It adds that it has "been successful in completely isolating the independent arbitrators from educational and marketing efforts used to encourage the use of arbitration."

Edward C. Anderson, an NAF founder and past CEO, confirms that the company does "educate" creditors' lawyers on the benefits of arbitration in hopes that the lawyers' clients will purchase NAF's services. He sees no conflict of interest. "The documents that you have apparently relate to meetings with particular lawyers," he says.

"It looks to me like we pitched these lawyers on the efficacy of arbitration for their clients, and they have to decide what works for them." Mann Bracken and Wolpoff & Abramson decline to comment.

GE confirms that it employs Mann Bracken and says consumers may resolve disputes before NAF or AAA. Consumers also may opt out of GE's arbitration clause, although relatively few do. In a statement, GE spokeswoman Cristy F. Williams says that when the company initiates collection actions, "it has historically always filed in a court of appropriate jurisdiction." She adds that GE's arbitration clause referring to NAF was in place before the 2004 and 2005 references to Mann Bracken in the NAF documents. GE declines to respond to questions about the overall fairness of NAF arbitration or on Mann Bracken's role in aiding NAF to gain arbitration business.

EASING THE COURT'S LOAD

Most judges are favorably disposed toward arbitration as a way of alleviating the courts' litigation load. In one case in which customers questioned the use of an arbitration clause by credit-card issuer First USA Bank, a federal judge in Dallas ruled in 2000: "The court is satisfied that NAF will provide a reasonable, fair, impartial forum."

But some courts have found reason to question NAF awards. In May, 2005, a state judge in Oregon threw out a $16,642 arbitration judgment favoring MBNA. Judge Donald B. Bowerman didn't explain his reasoning, but the consumer in the case, Laurie A. Raymond, had appealed the award, saying she had been complaining to MBNA since 1990 that the charges attributed to her were the result of fraud or a mistake. Raymond, a 54-year-old family-law attorney in Portland, also told the court that she had never signed an arbitration agreement. Unlike most alleged debtors, Raymond energetically disputed NAF's jurisdiction. The credit-card company at certain points in the past had conceded that she didn't have to pay, she says. Nevertheless, in July, 2004, the arbitrator entered the award for the bank without holding the hearing Raymond says she had requested.

After Raymond got the award canceled, she sued MBNA for violations of debt collection and credit reporting laws. MBNA settled the suit on confidential terms. MBNA parent Bank of America declines to comment specifically, citing privacy obligations. "The referral to arbitration was consistent with the practices in place at the time," the bank says. "We believe arbitration can be an efficient and fair method of resolving disputes between our customers and the company."

NAF declines to comment on the Raymond case. But generally, the company adds: "Litigants, on either side, do not always see the facts, the law, or the process through an unbiased eye."

Raymond felt equipped to take on NAF and MBNA because of her legal training, she says. "One reason I went on with the process was that if [NAF] can do this to someone who understands this stuff, what are they doing to the little grandma next door?"

Cheryl C. Betts of Cary, N.C., was one layperson who felt overwhelmed. She learned that she'd been taken to arbitration in May, 2007, when Mann Bracken sent her a letter about $6,027 she owed on a Chase credit card. The letter informed her that she'd have to pay an additional $602 in legal fees related to arbitration but offered to settle for 75% of the total, or $4,972. Betts, a 55-year-old former administrative assistant for an energy company, says she always intended to pay her debt but didn't want to cough up nearly $5,000 at once. "I'm not a deadbeat," she says.

Betts says her troubles began after she was late with one $128 minimum payment in August, 2005. Chase lowered her credit limit from $6,000 to $4,900. Fees and penalty interest soon pushed her over that limit, setting

off a spiral of rising minimum- payment demands that she says she couldn't afford. Betts says she repeatedly contacted the bank to try to work out a payment plan. "This should never have happened," she says.

Chase declines to comment on particular credit disputes, citing customer privacy. The bank points to a 2000 opinion by U.S. Supreme Court Justice Ruth Bader Ginsburg saying that "national arbitration organizations have developed similar models for fair cost and fee allocation.... They include National Arbitration Forum provisions that limit small-claims consumer costs."

The May, 2007, letter to Betts from Mann Bracken announcing its intention to arbitrate set off a nine-month flurry of paperwork. In August, after she filed an 11-page response to the arbitration claim, Mann Bracken requested an adjournment, which was granted. Four months later, Betts fired off a long fax further disputing the case, and the law firm responded by seeking a 45-day extension. Betts thought she would have another opportunity to contest the case.

But on Feb. 15, 2008, the day after the extension expired, an NAF arbitrator issued a ruling ordering her to pay $5,575 to Chase. She has taken the case to a state court in Raleigh. "Many people," she says, "would have thrown in the towel because they don't have the time to pursue this, or they are just totally confused.... The only thing that kept me going was that I knew that I hadn't done anything wrong."

NAF declines to comment on the Betts case but reiterates that its procedures are fair. It adds that "parties can become confused about court procedures or about arbitration procedures.... "

Join a debate about regulating credit card rates.

Berner is a correspondent for BusinessWeek in Chicago. Grow is a correspondent in BusinessWeek's Atlanta bureau.

With Susann Rutledge

Ms. WATSON. Internal documents discussed in the article describe NAF's marketing pitches to credit card companies where they depict their arbitration services as favorable to businesses with a promised marked increase in recovery rates over existing collection methods.

Rather than providing the neutral resolution service they portray to the public, in these confidential documents, the NAF describes the benefits of pro-business hasty arbitration, with little to no mention of the rights or concerns of the consumer.

Elizabeth Bartholet, a Harvard Law School professor and former arbitrator for NAF, describes their practices as, "a process that systematically serves the interest of credit card companies."

So today's hearing comes at a very critical point. With unemployment at 9½ percent nationally and 11.4 percent in my district in Los Angeles, California, and $928 billion worth of outstanding credit card debt in the United States as of May 2009, it is imperative we gain meaningful insight into how we can improve this process and empower American consumers with the ability to fairly manage their consumer obligations.

So Mr. Chairman, I look forward to today's testimony, and I yield back.

Mr. KUCINICH. I thank the gentlelady.

The Chair recognizes Mr. Foster. You may proceed for 3 minutes.

Mr. FOSTER. Thank you, Mr. Chairman.

Today's hearing follows months of extensive investigation by this subcommittee into hundreds of cases of consumer debt collection arbitration, but it is timely coming less than 1 week after the National Arbitration Forum agreed to stop accepting all future consumer arbitrations.

The settlement in Minnesota is instructive, but it is not the end of the story. The authority for commercial arbitration originated in the Federal Arbitration Act, a 1925 law that may well be out of date and in need of significant improvement. It is this panel's duty to uncover and correct flaws in arbitration proceedings.

I look forward to hearing from all our witnesses on pragmatic solutions that will ensure consumers, as well as businesses, are dealt with fairly. And it is my hope that this committee will work swiftly to implement them.

It may also be useful to view today's hearing in the context of wider financial reform. The patters of collusion that we will hear about today seem not unlike the conflicts of interest that have emerged, for example, between credit rating agencies and the issuers of instruments that they rate. The challenge of this Congress will be devise fair and workable reforms to our financial system that ensure that neutral parties are in fact neutral, and to ensure that consumers, as well as businesses, are protected.

Thank you, Mr. Chairman, and I yield back.

Mr. KUCINICH. I thank the gentleman.

If there are no additional opening statements, the subcommittee will receive testimony from the witnesses before us today.

I want to start by introducing our panel. Ms. Lori Swanson, welcome, is the attorney general of the State of Minnesota. Ms. Swanson was elected attorney general of the State of Minnesota in 2006

and previously served as solicitor general and deputy attorney general from 1999 to 2006.

Attorney General Swanson's legal actions, legislative efforts and consumer advocacy have helped to level the playing field on behalf of ordinary citizens. She drafted and helped secure the enactment of a predatory mortgage lending law in 2007 that has been nationally heralded as a model for other States. She has sued cell phone companies, many of which use mandatory arbitration clauses for extending people's contracts without their permission, then charging hefty early cancellation penalties when they tried to cancel. She has also sued collection agencies for trying to trick citizens into paying debts they do not owe.

On July 14, 2009, Attorney General Swanson filed a lawsuit against the National Arbitration Forum, alleging that it misrepresented its independence and hid from consumers and the public its extensive ties to the collection industry. On July 17th, she entered into a landmark settlement with the National Arbitration Forum. She has publicly expressed concern about the growing use of mandatory arbitration clauses in credit card, cell phone and mortgage contracts.

Mr. Michael Kelly, welcome. Mr. Kelly was until recently the chief operating officer of the National Arbitration Forum, where he oversaw all operational and legal matters. He is now chief executive officer of Forthright, an entity spun off from the NAF in late 2007 which handles all administrative matters for the National Arbitration Forum.

Previously, he held executive positions with the Minnesota Vikings and Gander Mountain, and was a partner at the Minneapolis law firm Faegre and Benson. Mr. Kelly served for 8 years on the Edina, Minnesota City Council and was the Mayor Pro Tem and Vice Chair of the Housing and Redevelopment Authority. He has served on the board of the Minneapolis Downtown Council and the board of the Minnesota Opera.

Mr. Richard W. Naimark, welcome, Mr. Naimark. He is the senior vice president for the International Centre for Dispute Resolution, a division of the American Arbitration Association, where he has overall responsibility for international issues and government relations. He is the founder and former executive director of the Global Center for Dispute Resolution Research. Mr. Naimark is an experienced mediator and facilitator, having served as a neutral in a wide variety of business and organizational settings. His experience includes work with the United Nations, government, universities, corporate, construction, insurance and nonprofit areas.

Mr. F. Paul Bland, Mr. Bland, welcome. Mr. Bland has been a staff attorney at Public Justice since 1997 and is responsible for developing, handling and helping Public Justice's cooperating attorneys litigate a diverse docket of public interest cases. He has argued and won more than 20 cases that have led to reported decisions for consumers, employees or whistleblowers in four of the U.S. Courts of Appeals and the high courts of six different States. He is currently handling or assisting with appeals before the U.S. Court of Appeals for the 11th Circuit; the California, Florida, Kentucky and Nevada Supreme Courts; and the Maryland Court of Appeals.

Finally, Professor Christopher R. Drahozal. Welcome, Professor. Professor Drahozal is the John M. Rounds professor of law, University of Kansas School of Law. He is Chair of the Arbitration Task Force at the Searle Civil Justice Institute at Northwestern University School of Law. The professor has written extensively on the law and economics of arbitration. He has authored a casebook on commercial arbitration and co-edited a book on empirical research on international commercial arbitration. Prior to teaching, Professor Drahozal was in private law practice in Washington, DC, and served as a law clerk for the Iran-U.S. Claims Tribunal and the U.S. Supreme Court and the U.S. Court of Appeals for the Fifth Circuit.

I want to thank each and every one of our witnesses for appearing before our subcommittee today.

It is the policy of the Committee on Oversight and Government Reform to swear in all witnesses before they testify. I would ask at this time if you would rise and raise your right hands.

[Witnesses sworn.]

Mr. KUCINICH. Thank you very much. Let the record reflect that each of the witnesses answered in the affirmative.

I ask that each of the witnesses now give a brief summary of their testimony and to keep this summary under 5 minutes in duration. Bear in mind that your complete written statement will be included in the hearing record, so don't feel that you have to do a 10-minute speech in 5 minutes. I tried that once as a witness many years ago. It was not fun, but we will get all of your statement in the record.

Let's start the discussion right now. Attorney General Swanson, you are recognized for 5 minutes. Thank you.

STATEMENTS OF LORI SWANSON, ATTORNEY GENERAL, STATE OF MINNESOTA; MICHAEL KELLY, CHIEF OPERATING OFFICER, NATIONAL ARBITRATION FORUM; RICHARD NAIMARK, SENIOR VICE PRESIDENT, INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION, AMERICAN ARBITRATION ASSOCIATION; F. PAUL BLAND, STAFF ATTORNEY, PUBLIC JUSTICE; AND CHRISTOPHER R. DRAHOZAL, JOHN M. ROUNDS PROFESSOR OF LAW, UNIVERSITY OF KANSAS SCHOOL OF LAW

STATEMENT OF LORI SWANSON

Ms. SWANSON. Chairman Kucinich, Ranking Member Jordan, members of the committee, thank you for the opportunity to appear here before you on this very important topic of mandatory arbitrations.

You know, the right to have disputes resolved impartially is something that we as Americans value very much. Yet, millions of Americans are giving away that right without even knowing it. Credit card companies, cell phone companies, lenders routinely bury in the fine print of contracts that may run upwards of 25 or 30 pages long these mandatory pre-dispute arbitration clauses, and consumers don't know it. And oftentimes, the clauses come to the consumer not even in the initial agreement, but after the fact, maybe in an envelope stuffer. And even if the consumer doesn't see it, largely they are deemed to be bound to it.

We filed a lawsuit against the National Arbitration Forum in Minnesota. We attached a copy of the complaint to the testimony submitted, so I won't go through all of it. But the bottom line is that the National Arbitration Forum represented to the public, to consumers, to the courts, to the Government that it was independent and neutral and operated impartially and like a court system, when in fact it had ties to the very industry that brought claims before it.

And those ties really came two ways. The first way the ties came was what I would call backroom hustling, going to the credit card companies and the banks and so on and so forth, and asking the lenders to put into the fine print of these contracts mandatory arbitration clauses and paying executives commissions when they put clauses into those contracts, and then having other executives who were paid commissions to convince those very corporations to file claims against the consumer in the interest of the creditors against the interest of the consumer.

In addition, far from the impartiality represented to the consumers, marketing materials given to the credit card companies said things like, the customer doesn't know what to expect from arbitration and they are more willing to pay. Or in arbitration, they basically ask you what it is and then hand you the money.

In addition to that, we found evidence that the company in some cases drafted claims, the equivalent of a summons and complaint in a court of law, on behalf of the creditor to be filed against the consumer; that in some cases creditors were advised what their legal rights were when consumers weren't. In fact, we heard from employees who said that when consumers did call, people were instructed to really try to get them off the phone as quickly as possible, and even in some cases not to pass on a consumer's answer or information to the arbitrator.

We also heard from arbitrators who felt that they were de-selected, so that they had been appointed by the company to handle claims, but when they didn't rule for the creditor or give the creditor everything it wanted, or if they terminated, or in some cases ruled for the consumer, that they were de-selected or taken off the panel.

And then in addition to that, we found that the National Arbitration Forum is really part of one big debt collection conglomerate, that you have a New York hedge fund called Accretive that essentially owned a $42 million stake in the National Arbitration Forum outfit, and at the same time that it owned a debt collection law firm called Axiant which, in turn, owned and acquired the debt collection operations of a law firm called Mann Bracken, which is just about the biggest debt collection law firm in the country, so basically having this hedge fund controlling the two sides of the equation, or involved in the two sides of the equation, the debt collection side and then as well the arbitration side.

Something that we did learn in connection with the investigation that I find troubling and gets a bit far afield is that the Small Business Administration in 2004 gave Accretive $100 million, and in 2008, the Accretive Small Business Investment Corp. ended up purchasing about 7½ percent of Axiant. And then in 2009, it asked the Small Business Administration for permission to purchase even

more of Axiant, so essentially it appears, using Small Business Administration money to fund a debt collection enterprise that then treats consumers in an unfair fashion.

It is troubling to me if the Small Business Administration believes that its mission is to finance the acquisition of debt collectors who acquire bank debt from bailed-out national banks, and then use the fund to go after citizens through the types of questionable debt collection techniques we outlined in the complaint. We asked the Small Business Administration for records. They produced, after consulting with the hedge fund, 18 pages, largely blacked out. I couldn't get to the bottom of it. Maybe this Committee on Oversight can, and I would encourage you to followup on: Is SBA money going into this type of enterprise? They basically blacked out almost every meaningful word.

Mr. KUCINICH. Duly noted.

The gentlelady's time is expired.

Ms. SWANSON. OK. Thank you.

Mr. KUCINICH. Would you like to just wrap it up?

Ms. SWANSON. Just to wrap up, we interviewed over 100 consumers. The case and our concerns go beyond the National Arbitration Forum. There are real concerns with mandatory pre-dispute arbitration clauses and consumers forfeiting their rights without knowing it, and the repeat bias that comes in when corporations essentially select their judge.

Thank you.

[The prepared statement of Ms. Swanson follows:]

Testimony
Of
Lori Swanson
Minnesota Attorney General

Domestic Policy Subcommittee
Oversight and Government Reform
Wednesday, July 22, 2009
2154 Rayburn HOB
2:00 p.m.

"'Arbitration' or 'Arbitrary': The Misuse of Mandatory Arbitration to Collect Consumer Debts."

Good afternoon. Thank you for the opportunity to testify before the Committee on the important topic of mandatory arbitration in consumer disputes, which has the potential to affect virtually every American citizen.

I. Mandatory Arbitration in Consumer Disputes.

The right to have disputes resolved through an impartial judge or jury is deeply imbedded in our democracy and our values. In recent years, however, virtually every American consumer—in one contract or another—has been forced to contract away their right to have their day in court. Credit card companies, cell phone companies, banks, and other corporations frequently place—in the fine print of their consumer contracts—what are known as mandatory pre-dispute arbitration clauses. Through these clauses, the consumer waives—in advance—his or her right to have any dispute resolved in court and instead must resolve the dispute in arbitration by an arbitration administrator selected by the corporation. This is true even if the consumer does not see the arbitration clause. For example, if a credit card company sends the consumer an arbitration clause in an envelope stuffer, the consumer may be deemed to have agreed to arbitration just by keeping the card. In most cases, consumers are not even aware they waived their right to go to court.

The Federal Arbitration Act—passed in 1925—was originally designed to allow merchants of relatively equal bargaining power to agree to arbitration after a dispute arose to mutually select an arbitrator to resolve the dispute. Today, credit card and other companies have expanded arbitration to a wide range of consumer contracts where the consumer has no bargaining power. Through these clauses, which appear in millions of consumer contracts, hundreds of thousands of consumer disputes are resolved each year not in open court, but behind closed doors in a system of private arbitration.

II. National Arbitration Forum Lawsuit and Consent Judgment.

On July 14, 2009 our office filed a lawsuit against the National Arbitration Forum—the largest arbitration company in the country for consumer credit disputes—alleging that it misrepresented its independence and hid from consumers and the public its extensive ties to the collection industry. (A copy of the Complaint is attached as Exhibit A.)

The lawsuit alleged that the National Arbitration Forum deceptively represented to consumers and the public that it was independent and neutral, operated like an impartial court system, and was not affiliated with any party or took sides between parties.

The lawsuit alleged that the Forum worked behind the scenes—alongside creditors and against the interests of ordinary consumers—to convince credit card companies and other creditors to deprive consumers of their legal rights by inserting arbitration provisions in their customer agreements and then to appoint the Forum to decide the disputes. The lawsuit alleged that the Forum paid commissions to executives to convince creditors to put mandatory arbitration clauses in their customer agreements and to thereafter convince creditors to use the Forum to decide those claims, in order to generate arbitration filings in the Forum—and hence, revenue—for itself. In soliciting creditors to use its arbitration services, the Forum made representations that aligned itself against consumers, including, for example, that "[t]he customer does not know what to expect from Arbitration and is more willing to pay," that consumers "ask you to explain what Arbitration is then basically hand you the money," and that "[y]ou [the creditor] have all the leverage [in arbitration] and the customer really has little choice but to take care of this account." (A copy of the Forum's presentation is attached as Exhibit B.)

The lawsuit also alleged that the Forum had financial ties to the collection industry. Beginning in 2006 and through 2007, Accretive—a family of New York private equity funds—

engineered two transactions. In the first transaction, Accretive formed several equity funds under the name "Agora" (meaning "Forum" in Greek), which invested $42 million in the Forum and obtained governance rights in it. In the second transaction, three of the country's largest debt collection law firms—Mann Bracken of Georgia, Wolpoff & Abramson of Maryland, and Eskanos & Adler of California—merged into one large national law firm called Mann Bracken. Accretive then acquired the majority interest in a debt collection agency called Axiant, which acquired the collections operations of Mann Bracken. Through these transactions, Accretive took control of one of the country's largest debt collection enterprises and became affiliated with the Forum, the country's largest consumer collection arbitration company. The lawsuit alleged that, in 2006, the Forum processed just over 214,000 consumer collection arbitration claims, of which 125,000, or nearly 60 percent, were filed by these firms.

In the course of our year-long investigation, we heard from arbitrators who were "deselected"—or not given more cases—after ruling for the consumer or not awarding the credit card company any attorneys' fees. We heard from employees who were told to find arbitrators who were anti-consumer and not to assign additional cases to arbitrators who asked the creditors to provide evidence to support their claims. We also interviewed over 100 consumers who were confused by the process, were unaware they had agreed to arbitration, and did not feel they got a fair shake in arbitration.

On July 17, 2009 the company signed a Consent Judgment that resolves the lawsuit. Under the Consent Judgment, the company is barred from the business of arbitrating credit card and other consumer disputes and must stop accepting any new consumer arbitrations or in any manner participate in the processing or administering of new consumer arbitrations. This means that the company will permanently stop administering arbitrations involving consumer debt,

including credit cards, consumer loans, telecommunications, utilities, health care, and consumer leases.

The investigation and the lawsuit has uncovered an underlying problem with mandatory pre-dispute arbitration clauses in consumer contracts. As the problems highlighted by the lawsuit illustrate, it is more important than ever for Congress to meaningfully protect consumers from forced arbitration arising out of fine-print contracts. In the meantime, I hope that other arbitration companies like the American Arbitration Association (arguably the next biggest arbitration administrator of consumer disputes) will announce their intention not to exploit consumers by arbitrating claims arising out of fine-print consumer contracts.

III. The U.S. Government's Small Business Administration Apparently Finances One of the Biggest Debt Collection Enterprises in the Nation.

As I noted above, our investigation found that the National Arbitration Forum is owned in part by a hedge fund called Accretive, LLC of New York. Accretive also owns Axiant, LLC, one of the country's largest debt collectors, which in turn owns the collections operations of the Mann Bracken law firm, the largest debt collection law firm in the country.

During our investigation, it was determined that in 2004, the Small Business Administration issued a grant in the amount of $100 million to Accretive Investors SBIC, LP. (A copy of a website summarizing the grant is attached as Exhibit C.) The grant was issued under federal rules that require Accretive Investors SBIC to invest the money in small businesses whose operations are in the public interest. We determined that in 2008, Accretive Investors SBIC acquired 7.5 percent of Axiant, the debt collector which owns the collections operations of the Mann Bracken law firm. (*See* chart found in Exhibit A at 50.) Finally, we determined that in 2009 Accretive applied for and received permission from the SBA to make what we suspect to

be a very large investment in credit card debt through Axiant—its own downstream subsidiary. (A copy of the Federal Registry description of the application is attached as Exhibit D.)

On June 8, 2009, our office asked the SBA for documentation concerning the extent to which the federal grant money was utilized by Accretive and Axiant. Even though we are a law enforcement agency, the SBA—after consulting with the Accretive hedge fund—refused to produce unredacted records to us. Instead, on July 13, 2009, the SBA produced documents that were highly redacted and provided absolutely no information about how and the extent to which SBA money was used on this transaction. (The redacted documents produced by the SBA are attached as Exhibit E.)

It is troubling that the SBA apparently believes that its mission is to finance the acquisition of debt collectors who acquire bank debt from bailed-out national banks and then use the funds to harass citizens through questionable debt collection techniques. But this appears to be what occurred.

It is even more troubling that the SBA would apparently act in concert with the debt collector to hide information from a state law enforcement agency on how the money was spent. But this is also what apparently occurred.

I hope that this Committee will look into this matter and demand that the SBA produce information documenting the extent to which federal SBA money was used for the acquisition and collection of credit card debt or otherwise spent to finance this debt collection operation. I urge the Committee to require the SBA to provide it with this information.

IV. Problems with Forced Arbitration in Consumer Contracts.

Our interviews of consumers highlighted numerous problems with the arbitration of consumer disputes arising out of forced arbitration clauses in fine-print contracts. Mandatory

pre-dispute arbitration clauses that are hidden in the fine print of consumer contracts are fundamentally unfair to the consumer. I say this for several reasons:

First, mandatory pre-dispute arbitration agreements are nearly always the product of unequal bargaining power between the consumer and the business. In almost every interview we conducted of consumers, we found that the consumer was not aware of the arbitration provision. In most cases, the consumer never saw the provision. The consumer is given virtually no opportunity to negotiate or reject the provision. Yet, through these provisions, consumers give up their right to have their day in court.

Second, it is apparent from interviews with consumers, arbitrators, and employees of the Forum that arbitrators have a powerful incentive to favor the dominant party in an arbitration; namely, the corporation. Indeed, there is a term commonly used in the arbitration industry called "repeat player bias," describing the phenomena where an arbitrator is more likely to favor the party that is likely to send future cases. This bias does not exist in a court, where the judge is not reliant on a dominant player for his or her future income.

Third, credit card companies and other corporations select which arbitration companies they want to appoint to process their disputes, and arbitration companies compete for this lucrative business. If a particular corporation selects a particular arbitration company to resolve the corporation's disputes, the arbitration company makes money. If a particular arbitration company is not "friendly" enough to the corporation, the corporation can simply select another arbitration company to resolve its claims. Similarly, the arbitration company wields great power in selecting which arbitrators will be in its network. In the case of the National Arbitration Forum, arbitrators and employees told us that arbitrators who issued an award against the corporation, or who failed to award attorneys' fees against the consumer, were simply

"deselected" and not appointed to future proceedings. One retired state court justice told us that he was not assigned any more cases after he ruled that the credit card company was not entitled to attorneys' fees—fees that were not allowed under state law. Another arbitrator, a professor at a leading national law school, testified in Congress last year that she did not receive any more cases after ruling in favor of a consumer. Even if the arbitration company does not "deselect" arbitrators who rule for consumers, corporations who are repeat players know who those arbitrators are and can remove them from hearing the company's cases far more readily than they could remove a district court judge.

Fourth, because the consumer is unaware of the mandatory arbitration provision, in many cases the consumer does not recognize the significance of the arbitration notice served on them. Since they did not know that they agreed to arbitration, and were unfamiliar with the arbitration process or the arbitration administrator, consumers tell us they did not know they were obligated to respond to the arbitration notice.

Fifth, our interviews with consumers showed that they were unaware of their rights in arbitration, did not know they could submit exhibits or evidence, and were often not aware that there would only be a "document hearing" to resolve the case. For instance, victims of identity theft were not told to submit a copy of a police report, even though arbitrators were advised that, absent such documentation, the claim of identity theft should be ignored. By contrast, most district court judges generally will assist *pro se* litigants in articulating the facts that might help them prove their defense.

Sixth, due process protections found in court are often lacking in arbitration. For instance, consumers subject to a mandatory arbitration clause usually have no right to appeal to a court if there is an adverse arbitration ruling. Similarly, the arbitrator's decision is usually

not supported by a written order, so the consumer does not understand the basis for the decision and therefore questions the integrity of the process. Other limitations include the fact that discovery in arbitration proceedings is limited. Some consumers indicated that they never received notice of the proceeding, because service of process rules are not as precise as court.

In short, while our Consent Judgment with the National Arbitration Forum may have removed a problem company from the consumer arbitration marketplace, it did not and cannot solve the systemic problems with mandatory pre-dispute arbitration clauses in fine-print consumer contracts. The Federal Arbitration Act has been interpreted by the federal courts to prohibit state legislatures from meaningfully regulating these clauses. Therefore, Congress is the only governmental entity that can protect consumers from the placement of mandatory arbitration clauses in consumer contracts—and I strongly encourage it to do so.

Thank you for inviting me to this hearing.

STATE OF MINNESOTA | FILED FSL | DISTRICT COURT

COUNTY OF HENNEPIN | 08 JUL 14 AM 9:53 | FOURTH JUDICIAL DISTRICT

BY _____ DEPUTY
HENNEPIN COUNTY ADMINISTRATOR

Case Type: Other Civil
(Consumer Protection)

State of Minnesota by its Attorney General,
Lori Swanson,

Court File No. _____

Plaintiff,

vs.

COMPLAINT

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

Defendants.

The State of Minnesota, by its Attorney General, Lori Swanson, for its Complaint against defendants National Arbitration Forum, Inc., National Arbitration Forum, LLC, and Dispute Management Services, LLC, d/b/a Forthright (collectively, "National Arbitration Forum," "Forum," or "Defendants"), alleges as follows:

INTRODUCTION

1. Just about every American has a credit card. The credit card companies often require—deep in the fine print of the consumer agreement—that the consumer forfeit his or her right to have any dispute resolved by a judge or jury. Instead, the agreements often require that any disputes be resolved exclusively through a private system of binding arbitration—and frequently through the National Arbitration Forum. The Forum represents to the public, the courts, and consumers that it is independent, operates like an impartial court system, and is not affiliated with any party. The consumer does not know that the Forum works alongside creditors

behind the scenes—against the interests of consumers—to convince creditors to place mandatory pre-dispute arbitration clauses in their customer agreements and to appoint the Forum as the arbitrator of any disputes that may arise in the future. The Forum does this so that creditors will file arbitration claims against consumers in the Forum, thereby generating revenue for it.

2. The consumer also does not know—and the Forum hides from the public—that the Forum is financially affiliated with a New York hedge fund group that owns one of the country's major debt collection enterprises. Beginning in 2006 and through 2007, Accretive, LLC (a family of New York hedge funds under the control of an investment manager named J. Michael Cline and his associates), engineered two transactions. In the first transaction, Accretive formed several private equity funds under the name "Agora" (meaning "Forum" in Greek), which in turn invested $42 million in the National Arbitration Forum and obtained governance rights in it. In the second transaction, three of the country's largest debt collection law firms (Mann Bracken of Georgia, Wolpoff & Abramson of the District of Columbia, and Eskanos & Adler of California) merged into one large national law firm called Mann Bracken, LLP. Accretive then formed and funded (partly using federal money from the U.S. Small Business Administration) a debt collection agency called Axiant, LLC, which acquired the assets and collections operations of Mann Bracken.

3. Through these transactions, the Accretive hedge fund group simultaneously took control of one of the country's largest debt collectors and became affiliated with the Forum, the country's largest debt collection arbitration company. In 2006, the Forum processed 214,000 consumer debt collection arbitration claims, of which 125,000—or nearly 60 percent—were filed by the law firms listed above. The Forum conceals its affiliations with the collections industry

through extensive affirmative representations, material omissions, and layers of complex and opaque corporate structuring.

4. Consumers also do not know that—despite representing to the public that it has "no relationship with any party" and does not "counsel our users"—the Forum works closely with creditors behind the scenes to: (1) encourage them to file arbitration claims as an alternative way to collect debt from consumers; (2) draft arbitration clauses, advise creditors on arbitration legal trends, and in some cases, help them draft claims to be filed against consumers; and (3) refer them to debt collection law firms, which then file arbitration claims against consumers in the Forum. In soliciting creditors to use its arbitration services, the Forum makes representations that align itself against consumers, including, for example, that "[t]he customer does not know what to expect from Arbitration and is more willing to pay," that consumers "ask you to explain what arbitration is then basically hand you the money," and that "[y]ou [the creditor] have all the leverage [in arbitration] and the customer really has no choice but to take care of the account."

5. Through its conduct, the National Arbitration Forum has violated Minnesota's statutory prohibitions against consumer fraud, deceptive trade practices, and false advertising.

PARTIES

6. Lori Swanson, the Attorney General of the State of Minnesota, is authorized under Minn. Stat. Ch. 8, including Minn. Stat. §§ 8.01, 8.31, and 8.32, and under §§ 325.F.67 and 325F.70, and has common law authority, including *parens patriae* authority, to bring this action on behalf of the State of Minnesota and its citizens to enforce Minnesota law.

7. National Arbitration Forum, Inc. ("NAF, Inc.") is a privately held, for-profit Minnesota corporation. NAF, Inc.'s registered address and principal place of operations is 6465

Wayzata Boulevard, St. Louis Park, MN 55426. NAF, Inc. is the holder of the assumed name "National Arbitration Forum" and also does business under the names "National Arbitration Forum" and "Forum."

8. National Arbitration Forum, LLC ("NAF, LLC") is a privately held, for-profit Delaware limited liability company. NAF, LLC's registered address and principal place of operations is the same as NAF, Inc's: 6465 Wayzata Boulevard, St. Louis Park, MN 55426. NAF, LLC's registered agent is Michael Kelly. NAF, LLC also does business under the name "National Arbitration Forum."

9. Dispute Management Services, LLC, d/b/a Forthright ("Forthright") is a privately held, for-profit Delaware limited liability company. Forthright's registered address and principal place of operations is the same as NAF, Inc.'s and NAF, LLC's: 6465 Wayzata Boulevard, St. Louis Park, MN 55426. Forthright's registered agent is the same as NAF, LLC's: Michael Kelly.

JURISDICTION

10. This Court has jurisdiction over the subject matter of this action pursuant to Minn. Stat. §§ 8.01, 8.31, 8.32, subd. 2(a), 325F.67, and 325F.70 (2008).

11. This Court has personal jurisdiction over the National Arbitration Forum because the Forum does business in Minnesota, has agents and property in Minnesota, and has committed acts in Minnesota causing injury to consumers.

VENUE

12. Venue in Hennepin County is proper under Minn. Stat. § 542.09 (2008) because the National Arbitration Forum resides, and the cause of action arose, in part, in Hennepin County.

FACTUAL BACKGROUND

I. The National Arbitration Forum.

13. The National Arbitration Forum—headquartered in St. Louis Park, Minnesota—is comprised of three companies that effectively operate as one: defendants NAF, Inc., NAF, LLC, and Forthright.

14. The Forum is the nation's largest provider of consumer debt collection arbitrations. Most of the arbitrations conducted by the Forum involve claims by credit card companies, debt buyers, and other creditors against ordinary consumers.

15. Credit card and other companies often place language in the fine print of their customer agreements that requires consumers to arbitrate any future disputes—often in the Forum—thereby causing consumers to forfeit the right to have the dispute resolved by a judge or jury. When a company with a predispute mandatory arbitration clause in its customer agreement decides that the consumer owes a debt that cannot be collected through other means, it may initiate a consumer collection arbitration in the Forum, or it may sell the debt to a third party, who may initiate arbitration in the Forum. Regardless, these companies are often represented by outside debt collection law firms.

16. National credit card companies are some of the most prolific users of the National Arbitration Forum. Examples of credit card companies that have used the Forum to process consumer debt collection arbitrations under predispute mandatory arbitration clauses include MBNA/Bank of America, JP MorganChase, Citigroup, Discover Card, Deutsche Financial, and American Express, among others. Increasingly in recent years—in part as a result of the Forum's aggressive outreach to creditors—other industries have used the Forum's services to bring claims against ordinary consumers, including, for example, mortgage lenders, retailers who

lend money to consumers to buy their products, debt buyers, and cell phone companies. As set forth below, the Forum has actively encouraged credit card and other companies to place mandatory arbitration clauses in their customer agreements and has actively encouraged business clients to steer arbitration filings to the Forum.

17. The Forum is intimately involved in the arbitration process. Arbitrations conducted by the Forum are governed by a Code of Procedure (the "Code")—a Code drafted by the Forum. Under the Code, the Forum purports to act like a clerk of court and coordinates the arbitration process. The National Arbitration Forum dictates and controls the arbitration process. For example, the Forum handles important aspects of the arbitration process, including scheduling of hearings, selection of the arbitrator (unless the parties otherwise agree), and dismissal of claims or responses. The Forum charges fees to consumers to participate in arbitration. As described below, it markets to and assists companies in ways that would not be tolerated if done by a court of law.

18. The Forum claims that it has been appointed as the arbitrator in "hundreds of millions of contracts." The Forum resolves important claims that affect the lives of ordinary citizens. In 2006, it processed over 200,000 consumer collection arbitration claims. Its arbitration practices have been sharply criticized by consumer groups and consumers and have been the subject of numerous exposes and reports. One of the Forum's officers, Edward Anderson, claimed to the hedge fund managers who eventually acquired an interest in it that: "The FORUM is one of a kind; there is no competitor nor is there likely to be one....The barriers to entry border on being insurmountable...."

II. The National Arbitration Forum Promotes Itself as Independent, Neutral, and Not Affiliated with any Business that Uses Its Services.

19. In its marketing efforts and elsewhere, the National Arbitration Forum has deliberately created the widespread—but false—perception that it is not affiliated with or beholden to companies that use its services.

20. These claims are placed conspicuously on multiple websites associated with the National Arbitration Forum, including www.adrforum.com, www.forthrightsolutions.com, and www.arbitrationanswers.com. The Forum's false representations are also prominently displayed in other forms of advertisements, public statements, and elsewhere.

21. The following is a typical representation of independence and neutrality found on the National Arbitration Forum's website:

> Q: Is the FORUM affiliated with credit card companies or other businesses that use pre-dispute arbitration agreements?
>
> A: **No. The FORUM is an independent administrator of alternative dispute resolution services**.... The FORUM administers cases and ensures the cases proceed quickly and smoothly according [to] the rules of the arbitration or mediation agreement. Our dispute resolution processes are designed to provide both parties with an equal opportunity to prevail. **We are not beholden to any company or individual that utilizes our services**." (Emphasis added.)

22. Similar claims of the National Arbitration Forum's independence and neutrality abound on its website and elsewhere:

- "**Impartiality** and integrity. The FORUM is **independent and neutral**. It is **not affiliated** with any party." (Emphasis added.)
- "Our Statement of Principles illustrates how the FORUM, **as a neutral administrator of arbitration proceedings**, provides due process and remains neutral and fair." (Emphasis added.)
- "PRINCIPLE 4. INDEPENDENT ADMINISTRATION. **An arbitration should be administered by someone other than the arbitrator or the parties themselves**." (Emphasis added.)

- "The FORUM has **no contracts with any party** to any arbitration...." (Emphasis added.)

- "The FORUM...[has] no relationship with any party who uses our services."

- "Administrative Independence. Staff members of the National Arbitration Forum operate in a manner **analogous to court clerks and administrators**. They are **independent** of any party and have **no relationship of any type** with any arbitrating party...." (Emphasis added.)

- **"As one of the world's largest neutral administrators of arbitration services**, The Forum is setting a new standard for civil dispute resolution within the American justice system." (Emphasis added.)

23. In addition, the National Arbitration Forum claims that it is not affiliated or aligned with, owned by, and does not counsel any company that files an arbitration claim in the National Arbitration Forum:

- "**The FORUM is not affiliated with any party**. The FORUM is compensated on a case-by-case basis only for doing the work associated with administering mediations, arbitrations and other ADR proceedings." (Emphasis added.)

- "Who is the National Arbitration Forum? **The FORUM is not a party to an arbitration claim and is not affiliated with or owned by any party who files a claim with the FORUM**." (Emphasis added.)

- "As a **neutral** arbitration administrator, the Forum has no exclusive client relationships. **We do not contract with, represent or counsel our users, whether they are businesses or individuals**." (Emphasis added.)

- "**Far from being aligned with lenders and other business parties**, the NAF and its affiliated arbitrators provide **neutral** and unbiased dispute resolution services." (Emphasis added.) (Written comments submitted by NAF, LLC's managing director to the Federal Trade Commission dated August 13, 2007.)

24. Similarly, the National Arbitration Forum claims that it does not receive any money from any source, except for the fees paid for its arbitration services:

- "**The FORUM receives no funds from any source,** other than fees paid for dispute resolution services." (Emphasis added.)

- "Q: Why does the FORUM charge fees for its arbitration services? A: **The FORUM's revenue is derived solely from the fees we charge for our administrative services.** There are different fees for filing cases, commencing cases, arranging hearings, and processing requests and arbitration decisions. **We have no other source of revenue and we have no relationship with any party who uses our services.**" (Emphasis added.)

25. Furthermore, building on its claims of independence and neutrality, the National Arbitration Forum asserts that arbitration in the Forum is similar to or better than court:

- "One of the FORUM's dispute resolution services, arbitration, **is procedurally very similar to court.**" (Emphasis added.)

- "The core due process procedures that exist in FORUM arbitrations are identical or substantially similar to the due process procedures available in judicial and administrative law dispute resolution systems.... These arbitral procedures provide **truly excellent due process protections, and meet or exceed the rights parties would have in any court or before an administrative law judge.**" (Emphasis added.)

- "Alternative dispute resolution (ADR) is a **more efficient, predictable and amicable way to resolve conflicts and achieve legal decisions without the expense and inconvenience of going to court.**" (Emphasis added.)

- "**The FORUM resolves disputes in a manner that is faster, simpler, and less expensive** than traditional courtroom litigation." (Emphasis added.)

III. The National Arbitration Forum Is Affiliated with One of the Country's Major Debt Collection Enterprises.

26. There are a number of companies described in this Complaint that are not parties to the lawsuit. Their affiliation with the Forum, however—which began with discussions in 2006—plays an integral role in the violations alleged herein. These companies—Accretive, Agora, and Axiant—were all organized by an investment manager named J. Michael Cline of New York City.

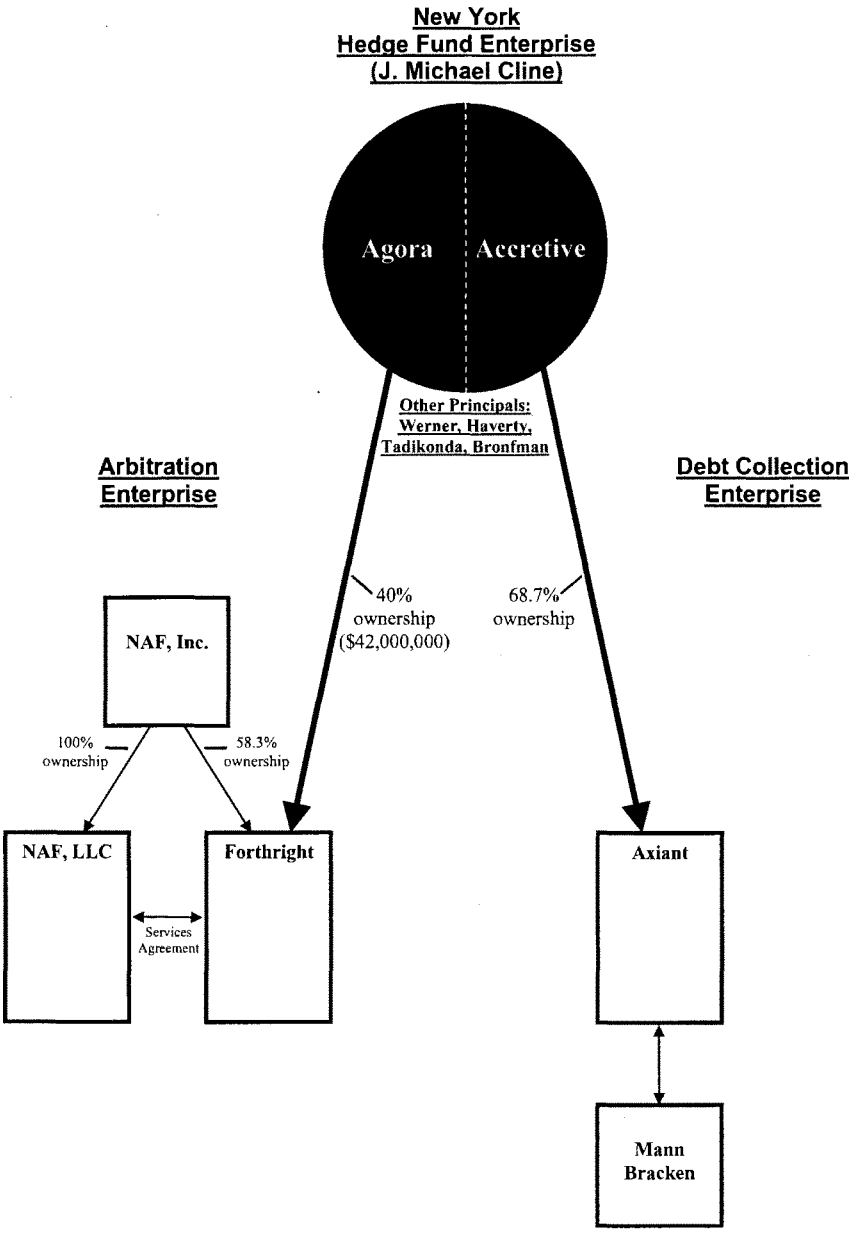
27. *Accretive* is a family of private equity funds based in New York City that operates under the control of Cline and his associates. A number of the Accretive entities were originally organized in 1999.

28. *Agora* is a family of private equity funds based in New York City that was created by Cline and his associates through the Accretive network. The Agora entities were formed in 2007 to acquire significant financial interests in the National Arbitration Forum.

29. *Axiant* is a debt collection agency in which Accretive has majority ownership and which was created by Accretive to acquire the assets of three large national debt collection law firms (Mann Bracken (based in Atlanta, Georgia), Wolpoff & Abramson (based in the District of Columbia), and Eskanos & Adler (based in California)), which eventually all merged into Mann Bracken.

30. Accretive, Agora, Axiant, the Forum, and Mann Bracken form a complex web of companies that compose some of the largest debt collectors and arbitrators of consumer credit card debt in the country. In 2006, the National Arbitration Forum arbitrated over 200,000 claims involving credit card and other debt issued by national banks and large corporations; in almost 60 percent of those cases, the banks, or the funds that purchased the consumer debt, were represented by Mann Bracken or Wolpoff & Abramson.

31. One document setting forth the business plan for Accretive's investment in the Forum describes the goal as placing the Forum "at the center of a broad arbitration ecosystem." These ties, which are further described below, are depicted in the following chart:


New York
Hedge Fund Enterprise
(J. Michael Cline)
Agora
Accretive
Other Principals:
Werner, Haverty,
Tadikonda, Bronfman
Arbitration
Enterprise
Debt Collection
Enterprise
40%
ownership
($42,000,000)
68.7%
ownership
NAF, Inc.
100%
ownership
58.3%
ownership
NAF, LLC
Forthright
Axiant
Services
Agreement
Mann
Bracken

A. The New York Hedge Fund Group Plans for the National Arbitration Forum to "Si[t] at the Center of a Broad Arbitration Ecosystem."

32. Beginning in 2006 and through 2007, there were a series of meetings involving Accretive (the family of New York private equity funds under control of Cline and his associates), the National Arbitration Forum, and three large national law firms: Mann Bracken, Wolpoff & Abramson, and Eskanos & Adler. As a result of these meetings, Accretive formed several equity funds under the name Agora, which in turn invested $42 million in the National Arbitration Forum and obtained governance rights in it. The three large national debt collection law firms then merged into Mann Bracken, which in turn sold its assets and collections operations to Axiant, a company formed and owned by Accretive. These transactions are further described below.

33. In June 2006, principals of Accretive, LLC met in Minnesota with Edward Anderson and Michael Kelly, officers of the National Arbitration Forum. Accretive told the Forum that it was "excited by the range of expansion opportunities" presented by a potential financial relationship between the fund and the Forum. In particular, the Accretive principals told the Forum that a relationship between Accretive and the Forum "could catalyze [a] major transformation in many of the biggest legal sub-markets." Among other things, Accretive promised the Forum that it could provide it with "[i]ntroduction to legal collections individuals" and stated that "we believe Accretive would be a great partner to help NAF become a billion-dollar company." An e-mail following up on the meeting was sent to the Forum from an Accretive e-mail address.

34. Thereafter, on August 28, 2006, J. Michael Cline—the managing member of Accretive, LLC—presented Forum executive Edward Anderson with a formal outline of a proposed "equity transaction" between Accretive, LLC and the Forum. The proposal—which is

on Accretive letterhead—states that, "We [Accretive] have spent considerable time researching the legal collections and arbitration markets and are very impressed by the NAF and the unique position you have created in the industry....We believe Accretive would make an ideal partner for the NAF team and that we can help significantly accelerate the creation of value for NAF." Under the proposal, Cline's company—Accretive, LLC—would acquire a 40 percent ownership interest in the Forum and the right to appoint two members to its board of directors. Accretive promised to play an "active role in landing new customers" and to "leverage [the] Accretive network for introductions" and set forth a plan in which:

- "NAF becomes the primary venue for resolution of high-volume, low-ticket disputes"
- "In established markets, such as credit card, NAF exploits clause placements and becomes the preferred collections tactic where speed and cost are critical considerations. Arbitration should capture at least 50% of the volume currently placed in litigation"
- "In new industries, such as healthcare, NAF Procedures are used early and consistently as the standard method for resolving payment disputes. By playing a prominent role, NAF fundamentally shapes the collections players and tactics that emerge in these industries"
- "NAF sits at the center of a broad arbitration ecosystem, giving rise to a range of specialist firms that serve as sources of cases or as post-award processors"
- "Arbitration expands to become a comprehensive, alternative legal system."

(Excerpts from the August 2006 proposal are attached as Exhibit 1) (*See* Complaint Exhibits at 001-003).

35. Accretive also promised to "launch" the Forum into new lines of business, such as arbitration of health care disputes between patients and hospitals, through Accretive Health, which provides collection services to hospitals.

B. The National Arbitration Forum Was Divided into Three Entities that Effectively Operate as One in Order to Camouflage the Significance of the Hedge Fund Ownership.

36. The Forum—aided by principals of Accretive—thereafter went to great lengths to concoct an elaborate corporate structure that conceals—but does not legitimize—the affiliations that undermine its claims of independence and neutrality.

37. For example, for most of its existence, defendant NAF, Inc. operated as a stand-alone company. As part of the transaction between the Forum and Accretive, both companies created new companies that would conceal the affiliation between them. The Forum formed Forthright, and Accretive formed Agora. As a result, at no time is Accretive publicly disclosed as an owner of the Forum.

38. Under the scheme, defendant Forthright purports to be the arbitration processing/marketing company and another defendant company, NAF, LLC, purports to retain the arbitrators. The third defendant (NAF, Inc.) has an ownership interest in the other two defendants.

39. In fact, the three defendants—NAF, Inc., NAF, LLC, and Forthright—effectively operate as one enterprise. As set forth below, NAF, Inc. and Forthright directly profit from the arbitrations conducted by the enterprise. The companies are closely interconnected, having, among other things, a common venture, common ownership, the same office space, common executive leadership, and the same registered agent. NAF, LLC and Forthright are also linked by an extensive Services Agreement (one which was required by the Accretive principals).

40. **Common office space**. As noted above, the three defendant corporations share office space at 6465 Wayzata Boulevard, St. Louis Park, MN 55426.

41. **Common ownership, officers, and directors.** NAF, Inc. owns 100 percent of NAF, LLC and 58.3 percent of Forthright. The three companies have key principals in common. For example:

- Michael Kelly is the CEO of NAF, Inc., the CEO of Forthright, and the registered agent of both NAF, LLC and Forthright.
- Edward Anderson is Chairman, CFO, a director and a shareholder of NAF, Inc. and Chairman, Executive Vice President, a director and a board member of Forthright.
- Roger Haydock is an officer, director, and shareholder of NAF, Inc. and the sole officer and a director of NAF, LLC.
- Edwin Sisam is a director and shareholder of NAF, Inc. and a director of NAF, LLC.
- Keith Kim is a director and shareholder of NAF, Inc. and a director of Forthright.
- William Franke is a director and shareholder of NAF, Inc. and a director of Forthright.

42. **Services Agreement.** Forthright and NAF, LLC entered into a Services Agreement dated June 27, 2007. A Restated Services Agreement, which amended the original, is dated July 1, 2007. The hedge fund managers helped to write the Services Agreement. Under the Restated Services Agreement, Forthright controls most aspects of the arbitration administration, including:

- *Finance and accounting.* Forthright performs all necessary bookkeeping and accounting services for NAF, LLC, including payroll, purchasing, financial reporting, billing, and collections.
- *Operational assistance and support.* Forthright provides the personnel, facilities, and equipment to perform all management and administrative functions of NAF, LLC.
- *Information technology.* Forthright provides and maintains all necessary IT systems necessary to support arbitrations.

- *Management consulting.* Forthright provides senior executive management services required by NAF, LLC, including strategic planning for business growth, business development, and acquisitions.

- *Marketing consulting.* Forthright provides all marketing resources, materials, and services for NAF, LLC.

- *Human resources administration.* Forthright provides all recruiting, interviewing, hiring, employment administration, labor contract negotiations and administration, and fringe benefits administration.

- *Legal and tax consulting.* Forthright provides all legal and tax consulting and coordinates all legal services.

- *Intellectual property.* Forthright provides all software, applications, databases, web products, trade secrets, trademarks, know how, and other proprietary information necessary for arbitrations.

43. The Services Agreement is for an initial period of five years and is automatically extended for subsequent five year periods (unless cancelled pursuant to its terms). NAF, LLC pays Forthright a substantial fee for its services. The fee is broken down into two parts: a monthly seven-figure fee and a "success fee" based on a formula related to the amount of revenue received by NAF, LLC. Thus, Forthright profits directly from the arbitrations conducted by the Forum (and so do the Accretive principals, as described below). One of the Accretive principals described the payments from NAF, LLC to Forthright under the Services Agreement this way: "95% of revenue [goes to Forthright] after direct-arbitrator (mediator) costs."

44. Many of those now working for Forthright have the same duties as when they worked for NAF, Inc. This is by design. Forthright states on its website that it "handles all arbitrations and mediation transaction processing and claims administration" for the Forum. The Forum states on its website that Forthright "serves as the exclusive provider of all necessary services to optimize the process and the administration of National Arbitration Forum arbitration and mediation claims." The Forum's internal announcement regarding the "restructuring" stated

that "current work will remain unchanged." For example, the job duties of the former in-house legal counsel to the National Arbitration Forum, who became the in-house legal counsel to Forthright, remained the same: "[Y]ou may have noticed that our company name and email address has changed as Forthright is now the authorized administrator for National Arbitration Forum. My job duties and other contact information remain the same." The Forum delayed issuing a news release about the creation of Forthright for about a year—and only did so after a reporter began to ask questions about the identity of the Forum's investors.

C. Agora/Accretive Buys Into Forthright.

45. As set forth below, Accretive, LLC—in addition to having Agora purchase a significant stake in the Forum—also created and is the majority owner of a major debt collection enterprise called Axiant, LLC—which it purchased along with the partners of the Mann Bracken, LLP law firm, one of the country's largest debt collection law firms.

46. In 2006, Forum executives recognized the problems that would arise if Accretive's investment in the Forum—and its ties to the Mann Bracken law firm—became public. Indeed, Forum executives emphasized that if there was the risk of public knowledge of the affiliation between the Forum and Accretive/Mann Bracken, the transaction should be unwound. As noted by Forum executive Michael Kelly on November 20, 2006:

> I cannot overstate our concern over the Mann Bracken relationship. Although I do not have any solutions off the top of my head, we should certainly plan for unwinding any deal in the event shared ownership becomes an acute issue.

(Attached as Exhibit 2 is a copy of Kelly's November 20, 2006 e-mail) (*See* Compl. Exs. at 004).

47. Kelly also proposed the "formation of a new fund [Agora] as the investment vehicle (no public information connecting Accretive with the fund that ultimately acquires and holds the minority interest in the Forum)." (*See* Exhibit 2 at 004.)

48. In order to conceal the conflicts inherent with the Accretive/Forum transaction, J. Michael Cline formed several new entities called "Agora."

49. As set forth below, through a series of agreements, Agora purchased a 40 percent interest in defendant Forthright. As a result of this ownership and the Services Agreement between NAF, LLC and Forthright, Agora (and the Accretive principals) profits directly from the arbitrations conducted by the Forum.

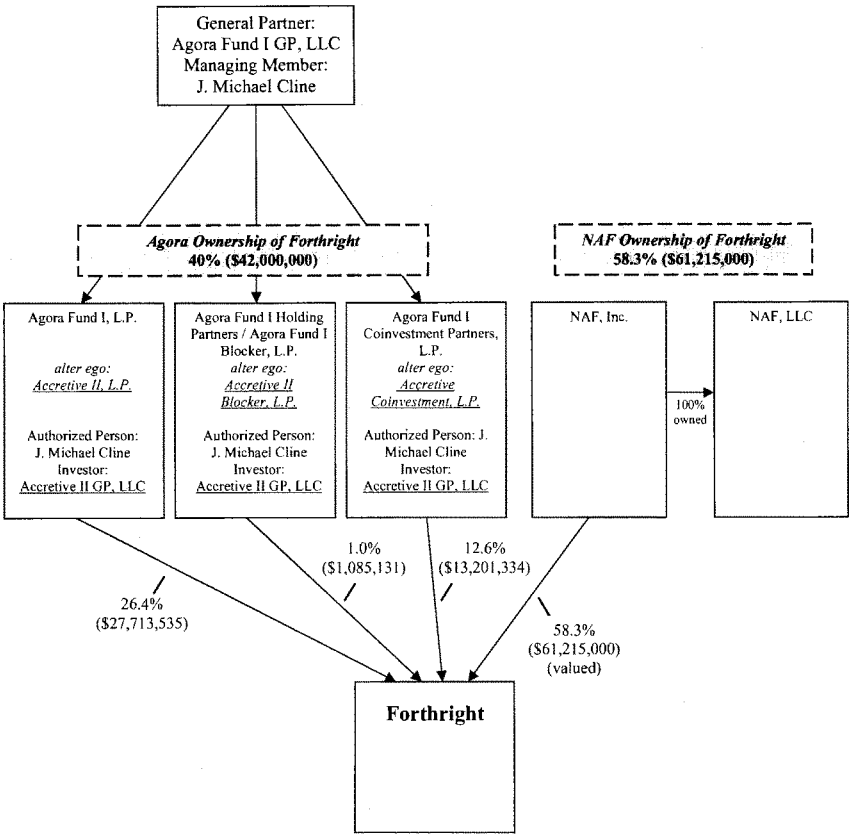
50. The first written agreement executed by the parties was a letter of intent signed on January 15, 2007 by Cline through which the yet-to-be-created "Agora Funds" was to buy a 40 percent ownership interest in the yet-to-be-created defendant Forthright. (Forthright was not created until June 2007.) A few weeks after the letter of intent was signed, Cline formed several Delaware companies bearing the Agora name. Beginning with the initial letter of intent, Agora began to dictate important terms of the Forum's operations. For example, Agora required at paragraph B(5) of the letter of intent that defendants NAF, LLC and Forthright enter into a services agreement "upon terms satisfactory to the Company [NAF, Inc.], Newco [Forthright] and the Investor [Agora]." As set forth above, NAF, LLC and Forthright entered into the Services Agreement on June 27, 2007. Through the Services Agreement, Forthright—and hence, Agora as an owner—profits from the arbitrations conducted by the Forum.

51. As part of the due diligence for the transaction, Defendants provided Agora with detailed information about virtually every aspect of its arbitration business, including but not limited to information about mandatory arbitration clause placement trends, claim volume and

revenue trends, customer calls, revenue, finances, personnel, judgment trends, arbitrator credentials, court rulings, and the like. Thus, even during the run-up to the transaction, the Agora/Accretive principals became privy to intimate and detailed information about virtually all the "ins and outs" of the Forum's arbitration services.

52. The transaction was consummated in June 2007. On June 27, 2007, three Agora entities entered into a Unit Purchase Agreement with NAF, Inc. and Forthright through which the Agora entities acquired 40 percent—or 400,000 Class A units—of Forthright for $42,000,000. These purchases were made by Agora Fund I, LP (263,938 Class A units at $27,713,535); Agora Fund I Coinvestment Partners, LP (125,727 Class A units at $13,201,334); and Agora Fund I Holding Partners (10,335 Class A units at $1,085,131). The following chart depicting Agora's ownership in Forthright:

Details of Forthright's Ownership



53. The Unit Purchase Agreement is signed by NAF, Inc. through Edward Anderson as Chairman and CFO and by Forthright through Michael Kelly as CEO. As noted above, Kelly and Anderson have overlapping roles with both organizations. Kelly is also CEO of NAF, Inc., which owns 100 percent of NAF, LLC, and the registered agent of NAF, LLC. Anderson is Chairman and an officer and director of Forthright.

54. Cline—the head of Accretive—signed the Unit Purchase Agreement as managing member of Agora Fund I GP, LLC—the general partner of all three Agora entities: Agora Fund I, LP, Agora Fund I Coinvestment Partners, LP, Agora Fund I Holding Partners. The three Agora entities, along with the general partner, Agora Fund I GP, LLC, were all formed by Cline in the State of Delaware on February 2, 2007—two weeks after the initial letter of intent was signed. The address for Agora Fund I GP, LLC is listed as 55 East 59th Street, 22nd Floor, New York, NY 10022, which was the address for Accretive.

55. On the same day they entered into the Unit Purchase Agreement, Agora and NAF, Inc./Forthright entered into an Investors Agreement.

56. The Investors Agreement identifies the investors in each of the Agora funds. (A redacted copy of this schedule is attached as Exhibit 3; it is redacted to delete the names of third-party investors who are not currently identified as having links to the debt collection enterprise described herein.) The chart of investors lists behind each Agora entity a functional Accretive *alter ego*:

- Agora Fund I, LP = Accretive II, LP
- Agora Fund I Coinvestment Partners, LP = Accretive II Coinvestment, LP
- Agora Fund I Blocker LP = Accretive II Blocker, LP

57. Like the Agora funds, each of the Accretive entities was formed in the State of Delaware by Cline. Each listed an address at 55 East 59th Street, 22nd floor, in New York City—the address of Agora. Each has the same general partner: Accretive II GP, LLC, a Delaware LLC, also formed by Cline and of which Cline is the managing member.

58. As shown in Exhibit 3, Accretive II GP, LLC—the general partner of each Accretive *alter ego*—invests in each Agora fund. Other investors in Agora Fund I Coinvestment

Partners, LP include JMC Holdings, LP and Edgar Bronfman, Jr. Bronfman is a general partner of Accretive, LLC. The "JMC" in JMC Holdings, LP stands for "J. Michael Cline."

59. Agora and Accretive share common office space and common principals, partners, and/or members, including but not limited to Cline, Werner, Jay Haverty, and Madhu Tadikonda, all of whom are or were affiliated with Accretive, LLC, the Delaware limited liability company formed by Cline. Cline is Accretive LLC's managing partner, Werner is a general partner, Tadikonda is or was a principal, and Haverty is or was an associate. Tellingly—and consistent with reality—e-mails provided by the National Arbitration Forum sometimes conflate Agora and Accretive, referring to the Agora principals, partners, and/or members as the "Accretive folks." Similarly, e-mails exchanged between Agora and the Forum about Forum business are sometimes sent to or from an Accretive e-mail address.

D. The Accretive Principals Participate in the Operations of Forthright.

60. Prior to the consummation of the transaction with the Forum, the Accretive principals made clear to the Forum that "[o]ur investors have entrusted us with their funds on an assumption that we maintain a high level of governance oversight over our portfolio companies."

61. To that end, among other documents, NAF, Inc. and the three Agora entities (through Cline) executed an Amended and Restated Limited Liability Company Agreement of Forthright (the "LLC Agreement") on June 27, 2007. Among other things, the LLC Agreement at paragraph 5.5 gives the Class A Units—(i.e., the ones held by Agora Funds)—the right to appoint two members of Forthright's five-person governing board.

62. Also on June 27, 2007, Agora exercised this right, appointing Cline and his associate, Werner, to the Forthright board. Cline and Werner served on Forthright's board from

June 27, 2007 to April 22, 2008. Two other Agora/Accretive principals—Tadikonda and Haverty—joined Cline and Werner in Forthright board meetings.

63. The Agora/Accretive principals have been substantially involved in Forthright's operations. At the January 15, 2008 board meeting, for example, Tadikonda agreed to provide Forthright CEO Kelly with resumes for potential chief financial and chief operating officers. At the same meeting, it was agreed that Werner would assist Kelly in "examin[ing] and review[ing] the current sales process, and review[ing] the strategy the company is using with each account."

64. Similarly, at the March 4, 2008 Forthright board meeting—again attended by Messrs. Cline, Werner, Tadikonda, and Haverty—the participants discussed "methods to increase the number of large batch claims being processed by arbitrators, and changes in the process that would provide filers access to working capital." The participants also discussed "various opportunities to go after debt (issuer, debt buyer, and filer all present opportunities to steer claims into arbitration)[.]"

65. Cline and Werner departed from the board in April 2008, around the time that a reporter began to ask questions about the affiliations between Defendants, Accretive, and Axiant. The departure was one of form rather than substance. As set forth in this Complaint, Agora/Accretive is far from a passive investor in Forthright; to the contrary, it has been active in its operations.

66. Cline, Werner, and other Agora/Accretive principals continued to be involved in key activities of the Forum's daily operations after Cline and Werner departed from the governing board. For example, in the spring of 2009 the Agora/Accretive principals developed a "Forthright—Accretive Priorities Focus." Among other things, Accretive was to help the Forum find "new growth opportunities," such as "expansion of arbitration services" into the service and

confirmation of arbitration filings and potential "small claims court administration for debt buyers." (A copy of the document is attached as Exhibit 4) (*See* Compl. Exs. at 006).

67. Also this year, the Forum has informed Cline and Werner of personnel decisions, Accretive principals have helped the Forum to identify and interview a business development officer, and the Agora/Accretive principals have helped the Forum craft bids for new arbitration business.

68. In 2008, after Cline and Werner left the board, the Agora/Accretive principals also helped craft the Forum's responses to media inquiries about its arbitration practices. This year, they helped the Forum devise "talking points" and a plan to lobby members of Congress on how to kill or weaken the proposed federal Arbitration Fairness Act, which would restrict the placement of mandatory arbitration clauses in "take-it-or-leave-it" consumer agreements—clauses from which the Forum and the Agora/Accretive principals derive substantial revenue.

69. In addition, Agora/Accretive has requested Forthright to submit to it detailed periodic reports about key aspects of its operations. Accretive has requested similar reports to be submitted by Mann Bracken about Axiant. As shown below, this relationship with Agora/Accretive ties the Forum to the debt collection industry. As a result, the Forum is not the independent and neutral arbitration company that it claims to be.

E. The Hedge Fund Group Run by Cline, Werner, and Associates, Along with the Partners of the Mann Bracken Law Firm, Own Axiant—One of the Country's Largest Debt Collection Enterprises.

70. As set forth below, the Accretive funds—run by Cline, Werner, *et al.*—own the majority interest in Axiant, LLC, one of the country's major debt collection enterprises. As further set forth below, principals of the Mann Bracken law firm own the remainder of Axiant, a Delaware LLC with headquarters in Georgia.

71. Accretive, LLC states on its website that "Axiant's customers include many of the nation's largest financial institutions and consumer debt purchasers." One consultant has described Accretive's acquisition of Axiant this way:

> Legal restrictions have typically prohibited the buying and selling of law firms between parties other than attorneys. These barriers have limited M&A activity in the collections law firm segment until very recently.
>
> In 2007, new ground was broken. A private equity fund in New York, Accretive LLC, effectively acquired the non-legal capabilities of three collection law firms: Mann Bracken, Atlanta, Georgia, Wolpoff & Abramson, Rockville, Maryland, and Eskanos & Adler, PC, Concord, California.
>
> Today, this group of companies, now called "Axiant", promises to become the largest and perhaps most profitable in the collection law firm industry. It boasts of blue chip customers, excellent margins, and high revenue growth rates, in addition to a wide national attorney network.

72. Mann Bracken described its relationship with Axiant in papers filed with state regulators as follows:

> In November 2006, [Mann Bracken] contributed the majority of its assets and liabilities related to its telephone collections services operations, including non-attorney personnel, to Axiant, LLC, formerly known as MB Solutions, LLC, which was a newly formed and wholly owned subsidiary of [Mann Bracken].

73. The law firm that represented Mann Bracken in connection with the transaction with Axiant describes the relationship between Axiant, Accretive, LLC and Mann Bracken this way:

> HortenCC represented Mann Bracken, LLC, one of the country's largest collections law firms, in the formation of Axiant, LLC, a joint venture debt collection business owned by the Mann Bracken partners and Accretive, LLC, a New York hedge fund. The transaction required the development of a complex legal structure to comply with the regulatory requirements to which law firms and collection agencies are subject. The transaction was a first in the legal industry in that it allowed the Mann Bracken partners to monetize their ownership interests in the law firm.

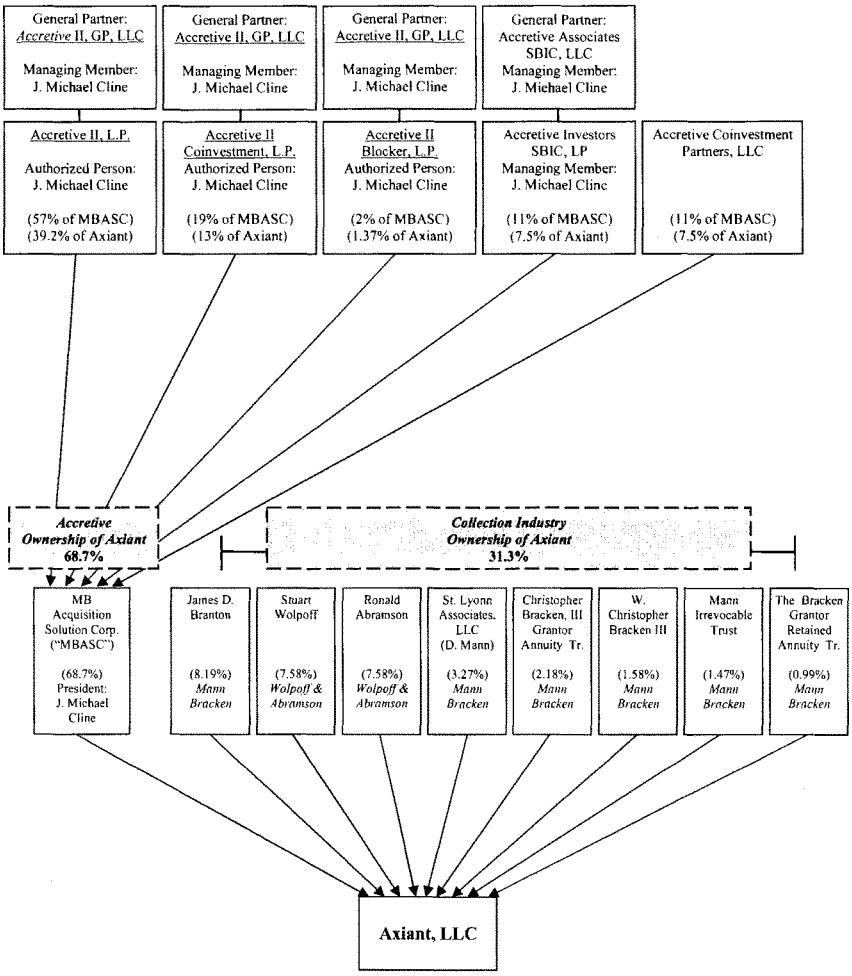
74. In filings submitted to state regulators, Axiant has stated that the Accretive group owns 68.7 percent of Axiant. The Accretive group invests in Axiant by owning and investing in a company called MB Acquisition Solution Corporation, of which Cline is President and Accretive, LLC's general counsel is Secretary. (Attached as Exhibit 5 (*See* Compl. Exs. at 007) is a chart filed by Axiant with state regulators outlining the Axiant ownership structure. It is redacted to delete Employer Identification and Social Security numbers.) Exhibit 5 lists major owners of MB Acquisition Solution Corporation—and hence, Axiant—as Accretive II, LP (the *alter ego* for Agora Fund I, LP) with 39.2 percent of Axiant; Accretive II Coinvestment, LP (the *alter ego* for Agora Fund I Coinvestment Partners, LP) with 13 percent of Axiant; and Accretive II Blocker, LP (the *alter ego* for Agora Fund I Blocker LP) with 1.37 percent of Axiant.

75. Other Accretive entities own the remainder of MB Acquisition Solution Corporation. For example, as of October, 2008, Accretive Investors SBIC, LP reported owning 7.5% of Axiant. (*See* Exhibit 5 at 007.) Accretive Investors SBIC, LP is a Small Business Investment Company—a privately owned investment fund authorized by the federal Small Business Administration ("SBA") to issue government financing to small businesses. In fiscal year 2004 Accretive Investors SBIC, LP obtained approval from the SBA to issue $100,500,000.00 in financing through the SBA's Small Business Investment Corporation program. In February 2009, Accretive Investors SBIC, LP sought approval from the SBA to provide additional "equity financing" to Axiant, LLC for purposes of operating capital and debt repurchase. The SBA's approval for the financing was required under federal conflict of interest regulations because Accretive is affiliated with Axiant. Through the investment, the federal government effectively distributed money to help fund the debt collection enterprise.

76. Axiant has told regulators that a variety of individuals and entities affiliated with the Mann Bracken law firm—one of the country's largest debt collection law firms and a filer of arbitration claims in the Forum—own the remaining 31.3 percent of the company. As shown in the chart below and Exhibit 5, numerous individuals connected to Mann Bracken and its predecessor law firms have ownership stakes in Axiant, including: James D. Branton (8.19%); Stuart Wolpoff (7.58%); Ronald Abramson (7.58%); Christopher Bracken, III Grantor Annuity Trust (2.18%); and W. Christopher Bracken III (1.58%). Each of these individuals are principals, partners, and/or members of Mann Bracken or its predecessors.

77. The following chart depicts this ownership structure:

Details of Axiant's Ownership



78. Members of Accretive's inner circle also sit on Axiant's board of directors. For example, Jeff Rodek, a senior advisor with Accretive, LLC, states on his resume that he is a

member of Axiant's board of directors. In addition, an unrelated company on whose board of directors Cline served states that Cline is or has been a director of Axiant.

79. Thus, the same Agora/Accretive principals who are involved with the Forum's arbitration business are simultaneously involved in Axiant's debt collection business.

F. Axiant and the Mann Bracken Law Firm Work Together to Collect Debt from Consumers and File Arbitration Claims in the Forum.

80. As noted above, Mann Bracken, LLP, a Delaware limited liability partnership with headquarters now in Maryland, was formed through a merger of three of the nation's top five collection law firms: Mann Bracken, LLC, Eskanos & Adler, PC, and Wolpoff & Abramson, LLP. In 2006 there were just over 214,000 consumer debt collection arbitration claims filed in the Forum; Mann Bracken and Wolpoff & Abramson filed over 125,000, or 58 percent, of those claims.

81. Mann Bracken has been at the forefront of promoting mandatory binding arbitration as a means of collecting debt from consumers. It claims that: "In 2001, we pioneered the use of arbitration in collection matters...." It has also stated that: "Mann Bracken is a recognized leader in national arbitration collections. The use of this alternative dispute resolution can be an effective and efficient means for a creditor or debt buyer to resolve matters whereby before the only alternative was legal."

82. Mann Bracken and Axiant work in tandem to fulfill a common purpose and joint mission. Axiant's website states that it offers "capabilities ranging from call center collections to national arbitration...through our strategic relationship with Mann Bracken, LLP...." It further states that its "strategic relationship with market-leading law firm, Mann Bracken LLP, enables Axiant to facilitate collections and recovery services to top issuers of an investors in debt products." It states that its clients are "market leading issuers of – and investors in – debt

products and portfolios" and that "Mann Bracken LLP and Axiant work in concert to serve our common clients." Under a section of its website itemizing its services, Axiant states that: "Axiant, in cooperation with Mann Bracken, LLP, a nationwide provider of legal collections and creditor's rights services" provides "national arbitration services through Mann Bracken, LLP."

83. Mann Bracken's website is substantially similar to Axiant's. On its website, Mann Bracken states that it has a "strategic relationship" with Axiant to collect debt from consumers and that Mann Bracken is "exclusively dedicated to providing services in concert with Axiant, LLC." Mann Bracken further indicates on its website that it is "[p]owered by Axiant" and is "able to tap into 'onlyAxiant' capabilities...." Further, Mann Bracken states that "Mann Bracken, LLP, in cooperating with its servicing partner, Axiant LLC, provides a broad range of financial services, legal collections and recovery management solutions for its clients," including "[n]ational arbitration filing and management services."

84. Mann Bracken has agreements with Axiant in which Mann Bracken receives management and professional services from Axiant and in turn provides "arbitration services" to Axiant. Mann Bracken described its agreements with Axiant in papers filed with state regulators:

> Subsequent to the contribution of assets and liabilities [to Axiant], [Mann Bracken] sold a majority and controlling interest in Axiant, LLC to outside investors. As such, to continue operations [Mann Bracken] has entered into an administrative services agreement whereby [Mann Bracken] receives certain management and professional services and leases office space and equipment from Axiant, LLC. Additionally, [Mann Bracken] has entered into a legal services retainer agreement with Axiant, LLC, whereby [Mann Bracken] provides arbitration and collection litigation services to Axiant, LLC.

85. Axiant and Mann Bracken are connected in numerous other ways. For instance, Mann Bracken and Axiant post joint job openings. In current job postings, Axiant/Mann Bracken describe Axiant as "one of the nation's premier debt collection and recovery

management organizations" and that that its capabilities range "from call center collections to national arbitration."

G. The National Arbitration Forum Hides Its Financial Ties to the Debt Collection Industry.

86. Concerned about exposure of its financial ties to the Accretive, the National Arbitration Forum conceals the relationship—a relationship that is at odds with the Forum's representations of independence, neutrality, similarity to a court, and lack of ties to parties that appear before it.

87. The Forum conceals these ties through the elaborate corporate structures described above, through its affirmative representations, and through its material omissions. As noted above, an e-mail from Forum executive Michael Kelly in November, 2006 emphasized that there should be "no public information" connecting Accretive with Agora and, hence, the Forum. Similarly, in 2008, when these ties came close to being uncovered by a reporter, the Forum discussed how to spin the press. The Director of Marketing for Forthright prepared a "key messages" document containing the following misleading talking points:

> Is there any relationship between Accretive and Forthright (between Accretive and the National Arbitration Forum)?
>
> Roger [Haydock]:
> This question is more appropriately directed to Mike Kelly, CEO of Forthright.
>
> Mike [Kelly]:
> No. (Follow up question - is there any relationship between Michael Cline - or insert other name that could be associated with Accretive and us in some way - and Forthright?) Questions about Accretive should be directed to the representatives from Accretive. (I'm not thrilled with this approach - but we can discuss.)

88. The National Arbitration Forum and Agora/Accretive consulted one another on how to respond to a question from a reporter about whether Accretive has an investment stake in

Forthright. Initially, the Director of Marketing for Forthright suggested that they respond by saying that Accretive had no stake in Forthright: "Since he asks if Accretive, LLC has an investment stake in Forthright Solutions[,] I believe our answer would be that Accretive, LLC does not." Ultimately the National Arbitration Forum gave the reporter an incomplete and misleading answer, layered in lawyer-speak:

> Following its spin-out from the FORUM, interested investors acquired a non-controlling, passive, minority position in Forthright. These several investors are primarily high net-worth individuals and endowments of major academic institutions. None of these minority investors has any control over the operations of the company. Confidentiality provisions prevent us from disclosing further information about them.

89. Agora/Accretive's investment in Forthright has never been publicly disclosed. By not disclosing these ties, Defendants have engaged in material omissions.

90. Similarly, in 2008 the Forum worked with the Chamber of Commerce and others on "independent reports" criticizing a report by Public Citizen that questioned the integrity of the Forum's arbitration practices. The Forum described the reports as "an independent effort" even though the Forum was involved in that effort:

- "Our role will be very background and not at all featured. This is a good thing as it will be best if no administrators are associated with ... [the report] and if the Chamber (and the Arbitration Coalition of industry supporters) are front and center on this."
- "[W]e need to be sure (although I also want to make sure [Forum executives] know[] how much work you all put into this and that it wouldn't be possible without you) that we are clear that this was an independent effort."

IV. The National Arbitration Forum Steers Corporations to Use the Forum's Services and Provides Assistance to Them—Even Though It Represents to Consumers and the Public that It is Neutral and Independent.

91. Despite representing to the public that it is independent and neutral and does not "contract with, represent or counsel our users," the National Arbitration Forum works alongside

creditors—and against the interests of consumers—to convince the creditors to include mandatory predispute arbitration clauses in their customer agreements and then file claims against consumers in the Forum. The Forum aggressively promotes its arbitration services to corporations as a collections tool, but conceals this from consumers. In some cases, the Forum assists businesses in drafting mandatory arbitration clauses, helps them in making arbitration claims, counsels them on legal trends affecting arbitration, and refers them to debt collection law firms, including Mann Bracken. With an already-dominant position in the consumer credit card arbitration market, the Forum has discussed with Accretive how to "go after" new lines of business—and pays commissions to executives who help to expand its arbitration services into new sectors of the economy, such as health care or auto financing.

A. The National Arbitration Forum Actively Solicits Companies to Steer Arbitration Business To It.

92. The National Arbitration Forum earns revenue when it convinces companies to place mandatory predispute arbitration agreements in their customer agreements and then to appoint the Forum to arbitrate any future disputes. The Forum actively tries to persuade corporations to include provisions in their consumer agreements that require binding arbitration of disputes in the National Arbitration Forum, thereby stripping consumers of their right to have a court resolve any disputes. The Forum employs a Vice President of Clause Placement and clause placement executives, who are partially compensated on a commission basis for convincing companies to place clauses in their customer agreements requiring arbitration of any disputes in the Forum. The Forum also employs a Vice President of Filer Business Development and business development executives, who similarly are partially compensated on a commission basis for convincing clients to file arbitration claims in the Forum. Bonuses are also paid for getting companies in new industries like health care and auto financing to file claims in the

Forum. This is part of the Forum's business plan of expanding its arbitration dominance beyond the credit card sector to other forms of consumer debt.

93. Solicitations by the Forum take many forms, including e-mail messages, PowerPoint presentations, and in-person meetings.

94. The National Arbitration Forum's solicitations to corporations often characterize the Forum's arbitration services as a collections tool:

- "[M]any credit card issuers are using arbitration as a collection tool for both pre-charge off and post-charge off debt." (E-mail to bank.)
- "The Arbitration Alternative: Using FORUM Arbitration in Collections." (PowerPoint presentation to bank.)
- "How is arbitration currently used as a part of the collections cycle?" (PowerPoint presentation to bank.)
- "How can arbitration benefit the collections?" (PowerPoint presentation to bank.)
- "Using Arbitration for Collections & Recovery - Why It's Effective." (PowerPoint presentation to retail financing company.)

95. The National Arbitration Forum's solicitations also claim that the Forum's arbitration services provide an efficient and less costly way to collect debts:

- "With filing fees starting at $25, FORUM arbitration can be a quicker, more cost effective way to resolve collection disputes than traditional litigation." (E-mail to bank.)
- "Finally, as I'm sure you are aware, more and more of the largest card issuers are using arbitration as an efficient, cost-effective tool to resolve disputes, including collection disputes." (E-mail to bank.)
- "[Benefits of arbitration include a] marked increase in recovery rates over existing collection efforts." (PowerPoint presentation to bank.)
- "Arbitration can save up to 66% of your collection costs. Arbitration can save your money and your time collecting delinquent accounts. Sixty-six percent, according to *Corporate Cashflow*. Saving the money you've been spending on court costs, attorney fees, and discovery." (Advertisement.)

96. Moreover, the National Arbitration Forum's solicitations emphasize the coercive power that an arbitration clause has over consumers. For example, a PowerPoint presentation to one financial services company contains a table entitled "Reactions to Arbitration As Told By Customer Service Representatives" and features the following observations about arbitration:

- "The customer does not know what to expect from Arbitration and is more willing to pay"
- "They [customers] ask you to explain what Arbitration is then basically hand you the money"
- "You have all the leverage and the customer really has little choice but to take care of this account"

97. As noted above, the Forum's attempts to convince businesses to require that consumers forfeit their right to go to court is so persuasive that the Forum has even employed a Vice President of Clause Placement. The Forum describes "clause placement" as follows:

> Clause Placement (CP) is a unique sales function that acquires new filing prospects by placing FORUM solutions [i.e., what is already productized] into contracts in strategically valuable territories from sales-driven marketing leads.

98. Further, as noted above, during Forthright board meetings, the members discussed "methods to increase the number of large batch claims being processed by arbitrators, and changes in the process that would provide filers access to working capital," as well as "various opportunities to go after debt (issuer, debt buyer, and filer all present opportunities to steer claims into arbitration)[.]"

B. The National Arbitration Forum Assists Corporations in Drafting Mandatory Arbitration Clauses and Claims for Arbitration.

99. Beyond solicitations, the National Arbitration Forum sometimes assists businesses in drafting the mandatory arbitration clauses that appear in consumer agreements and that result in business being generated for the Forum. The National Arbitration Forum

distributes drafting guides to corporations interested in including mandatory arbitration clauses into their consumer agreements. These guides provide information on the National Arbitration Forum, arbitration in general, drafting tips, and sample language, among other things.

100. One such guide distributed by the National Arbitration Forum is entitled "Drafting Mediation and Arbitration Clauses - Practical Tips and Sample Language." In this guide, the National Arbitration Forum advises corporations that mandatory arbitration clauses should be included in all consumer agreements, because consumers are unlikely to agree to arbitration once a dispute arises:

> The most effective way for parties to make sure that disputes will be mediated or arbitrated, rather than litigated, is by agreeing to do so at the outset of their relationship, before disputes arise. As a number of commentators have noted, it is unlikely that parties will agree to alternative dispute resolution (ADR) after a dispute arises. At that stage, one party or the other will perceive that litigation offers some advantage, an advantage they will not choose to relinquish by agreeing to ADR....
>
> By including a pre-dispute mediation and arbitration clause in contracts, parties can be assured that future disputes will be routed into efficient, fair, effective forums—mediation and arbitration—rather than the lawsuit system.

101. In addition, the National Arbitration Forum's drafting guides contain sample arbitration clauses for businesses to insert in their consumer agreements. For example, one "Standard Arbitration Clause" of the Forum reads as follows:

> The parties agree that any claim or dispute between them or against any agent, employee, successor, or assign of the other, whether related to this agreement or otherwise, and any claim or dispute related to this agreement or the relationship or duties contemplated under this contract, including the validity of this arbitration clause, shall be resolved by binding arbitration by the National Arbitration Forum, under the Code of Procedure then in effect. Any award of the arbitrator(s) may be entered as a judgment in any court having jurisdiction. In the event a court having jurisdiction finds any portion of this agreement unenforceable, that portion shall not be effective and the remainder of the agreement shall remain effective. Information may be obtained and claims may be filed at any office of the National Arbitration Forum, at www.adrforum.com, or by mail at P.O. Box 50191,

> Minneapolis, MN 55405. This agreement shall be governed by and interpreted under the Federal Arbitration Act, 9 U.S.C. Sections 1-16.

102. This and other sample arbitration clauses are made available by the National Arbitration Forum for corporations to insert into their consumer agreements.

103. The National Arbitration Forum also distributes "Arbitration Starter Kits" to corporations. In these kits, the Forum recommends that corporations include mandatory arbitration clauses in their agreements. The kits advise businesses to "Place a simple clause—an arbitration clause—in every contract."

104. In addition, the Starter Kits advise businesses that a mandatory arbitration clause will allow them to "take control of collections":

> The National Arbitration Forum's uniform Code of Procedure ensures that awards are fast, affordable, predictable and fair—wherever the dispute or claim arises—using the same rules and procedures for every case, every time. Starting with a simple clause—an arbitration clause—in your contracts, you take control of collections and claims...without a lawyer...from your own office.

105. The Starter Kits also emphasize the role that mandatory arbitration clauses have on managing the risks of collections, quoting the corporate counsel for Deutsche Financial Services, who states: "'We will not extend credit without an arbitration agreement. It's the only way to control the costs and manage the risks of lending and collection.'"

106. Moreover, the National Arbitration Forum offers direct assistance to corporations to draft mandatory arbitration clauses for their consumer agreements:

- "[I]f your organization is looking to revise its existing arbitration clause or is not yet using arbitration as a legal remedy, I would be more than happy to provide you with drafting tips and sample language as well as answer any questions you may have about the arbitration process." (E-mail to bank.)

- "Has [bank] considered using arbitration as a legal remedy? If so, I would be more than happy to provide you with best practices and answer any questions you may have about the arbitration process." (E-mail to bank.)

C. The National Arbitration Forum Provides Other Assistance to Companies.

107. The National Arbitration Forum sometimes offers assistance to companies in preparing arbitration claims—i.e., the equivalent of a summons and complaint in a court of law.

108. For example, in some cases, the National Arbitration Forum provides an Electronic Filer Liaison, who prepares draft claim forms for businesses or their lawyers. One such Liaison sent the following e-mail to a debt collection law firm regarding a claim for purchased Discover Card accounts:

> I have attached the initial draft of the claim form you will use on your purchased [D]iscover accounts. Please review this and make any changes necessary. Once we have agreed on the form and you have given approval I will set up this profile on our end. I will be sending you initial drafts for your other accounts shortly.

109. The referenced attachment includes a draft arbitration claim and notice of arbitration regarding an alleged credit card debt to be filed in the National Arbitration Forum.

110. The National Arbitration Forum has also counseled companies on legal trends affecting arbitration. For example, in an e-mail to a bank, Forthright informs the bank that it provides periodic updates on case law and legislative issues to businesses who use the Forum:

> I would appreciate receiving a copy of the arbitration clause for our records as we maintain a database of clauses in which FORUM is named. These are separated by industry and cross-referenced with case law and legislative updates that we are tracking. Should we notice a change that might impact the application of the clause, we can provide relevant information should you need to react.

111. The National Arbitration Forum also refers companies to debt collection law firms, including Mann Bracken. For example, in a PowerPoint presentation to a retailer's finance company, the Forum provides contact information for so-called "Arbitration Representatives," which includes contact information for the debt collection law firms Mann Bracken and Wolpoff & Abramson.

112. In short, the National Arbitration Forum reaches out to, and in some cases actively assists, the very corporations that may bring collection arbitrations against consumers—outreach that is at odds with the Forum's public image of independence, neutrality, similarity to a court, and lack of ties to parties that appear before it and that is not in the best interests of ordinary consumers. Defendants' failure to disclose these ties is also a material omission.

COUNT I
PREVENTION OF CONSUMER FRAUD ACT

113. Plaintiff re-alleges all prior paragraphs of this Complaint.

114. Minn. Stat. § 325F.69, subdivision 1 (2008) provides:

> The act, use, or employment by any person of any fraud, false pretense, false promise, misrepresentation, misleading statement or deceptive practice, with the intent that others rely thereon in connection with the sale of any merchandise, whether or not any person has in fact been misled, deceived, or damaged thereby, is enjoinable as provided in section 325F.70.

115. The term "merchandise" within the meaning of Minn. Stat. § 325F.69 includes services. *See* Minn. Stat. § 325F.68, subd. 2 (2008).

116. Defendants' conduct described above constitutes multiple, separate violations of Minn. Stat. § 325F.69, subd. 1. Defendants have engaged in deceptive and fraudulent practices, and have made false and misleading statements, with the intent that other rely thereon in connection with the sale of Defendants' services. By failing to disclose and omitting material facts, Defendants have further engaged in deceptive and fraudulent practices in violation of the Consumer Fraud Act.

COUNT II
UNIFORM DECEPTIVE TRADE PRACTICES ACT

117. Plaintiff re-alleges all prior paragraphs of this Complaint.

118. Minn. Stat. § 325D.44, subdivision 1 (2008) provides, in part:

A person engages in a deceptive trade practice when, in the course of business, vocation, or occupation, the person:

> (5) represents that goods or services have...characteristics...benefits...that they do not have...
>
> (7) represents that goods or services are of a particular standard, quality, or grade...if they are of another;...
>
> (9) advertises goods or services with intent not to sell them as advertised...
>
> (13) engages in any other conduct which similarly creates a likelihood of confusion or of misunderstanding.

119. Defendants' conduct described above constitutes multiple, separate violations of Minn. Stat. § 325D.44, subd. 1. Defendants have engaged in deceptive practices by representing that services have characteristics and benefits that they do not have; representing that services are of a particular standard, quality, or grade when they are of another; advertising services with intent not to sell them as advertised; and engaging in other conduct which similarly creates a likelihood of confusion or of misunderstanding. By failing to disclose and omitting material facts, Defendants have further engaged in deceptive and fraudulent practices in violation of the Uniform Deceptive Trade Practices Act.

COUNT III
FALSE STATEMENTS IN ADVERTISING ACT

120. Plaintiff re-alleges all prior paragraphs of this Complaint.

121. Minn. Stat. § 325F.67 (2008) provides, in part, that:

> Any person, firm, corporation, or association who, with intent to sell or in anywise dispose of merchandise, securities, service, or anything offered by such person, firm, corporation, or association, directly or indirectly, to the public, for sale or distribution, or with intent to increase the consumption thereof, or to induce the public in any manner to enter into any obligation relating thereto, or to acquire title thereto, or any interest therein, makes, publishes, disseminates, circulates, or places before the public, or causes, directly or indirectly, to be made, published, disseminated, circulated, or placed before the public, in this state, in a newspaper or other publication, or in the form of a book, notice, handbill, poster,

> bill, label, price tag, circular, pamphlet, program, or letter, or over any radio or television station, or in any other way, an advertisement of any sort regarding merchandise, securities, service, or anything so offered to the public for use, consumption, purchase, or sale, which advertisement contains any material assertion, representation, or statement of fact which is untrue, deceptive, or misleading, shall, whether or not pecuniary or other specific damage to any person occurs as a direct result thereof, be guilty of a misdemeanor, and any such act is declared to be a public nuisance and may be enjoined as such.

122. Defendants' conduct described above constitutes multiple, separate violations of Minn. Stat. § 325F.67. Defendants have placed before the public statements that are untrue, deceptive, and misleading, with intent to sell or increase the consumption of services. By failing to disclose and omitting material facts, Defendants have further made deceptive and fraudulent public statements in violation of the False Statements in Advertising Act.

RELIEF

WHEREFORE, the State of Minnesota, by its Attorney General, Lori Swanson, respectfully asks this Court to award judgment against Defendants as follows:

1. Declaring that Defendants' acts described in this Complaint constitute multiple, separate violations of Minn. Stat. §§ 325F.69, subd. 1; 325D.44, subd. 1; and 325F.67;

2. Enjoining Defendants' and their employees, officers, directors, agents, successors, assignees, affiliates, merged or acquired predecessors, parent or controlling entities, subsidiaries, and all other persons acting in concert or participation with them, from engaging in deceptive practices, or making false or misleading statements, in violation of Minn. Stat. §§ 325F.69, subd. 1; 325D.44, subd. 1; and 325F.67;

3. Awarding judgment against Defendants for civil penalties pursuant to Minn. Stat. §§ 8.31, subd. 3, for each separate violation of Minn. Stat. §§ 325F.69, subd. 1; 325D.44, subd. 1; and 325F.67;

4. Awarding Plaintiff its costs, including costs of investigation and attorneys' fees, as authorized by Minn. Stat. § 8.31, subd. 3a; and

5. Granting such further relief as provided by law and/or as the Court deems appropriate and just.

Dated: July 14, 2009

Respectfully submitted,

LORI SWANSON
Attorney General
State of Minnesota

ALAN GILBERT
Solicitor General

NATHAN BRENNAMAN
Assistant Attorney General

JEFFREY J. HARRINGTON
Assistant Attorney General
Atty. Reg. No. 0327980
445 Minnesota Street, Suite 1400
St. Paul, Minnesota 55101-2131
(651) 297-2730
(651) 297-7206 (TTY)

JACOB KRAUS
Assistant Attorney General
Atty. Reg. No. 0346597
445 Minnesota Street, Suite 900
St. Paul, Minnesota 55101-2131
(651) 215-6845
(651) 296-1410 (TTY)

ATTORNEYS FOR PLAINTIFF
STATE OF MINNESOTA

MINN. STAT. § 549.211 ACKNOWLEDGMENT

The party on whose behalf the attached document is served acknowledges through its undersigned counsel that sanctions, including reasonable attorney fees and other expenses, may be awarded to the opposite party or parties pursuant to Minn. Stat. § 549.211 (2008).

JEFFREY J. HARRINGTON

AG: #2474389-v1

ACCRETIVE

Accretive and NAF

August 2006

ac·cre·tive (ə · krē · tiv): the process of creating value through addition or inclusion

Proprietary & Confidential

ASSISTANCE TO NAF

Creative Thought Partnership

- Our view: A good partner pushes management's thinking on how to drive to desired outcomes and to resolve roadblocks. We focus on contributing to this dialogue through long experience and fact-based analysis
- We have a very strong track record developing creative ways to deliver value, to structure economic relationships, and to gain market acceptance

Enable management to pursue new strategic initiatives	Sales and marketing assistance
• Counsel to management based on deep market analysis • Domain expertise and rich relationships in selected industries • Dedicated Accretive team to explore acquisitions, adjacent markets, and niche opportunities • Capital to fund expansion	• Active role in landing new customers / partners – proven history from prior investments • Leverage Accretive network for introductions • Experience structuring landmark relationships in emerging market segments
Drive process excellence across the organization	**Help build a world-class organization**
• Extensive background in process re-engineering (six sigma) to improve efficiency and effectiveness • Apply "lessons learned" from a wide range of process-intensive businesses • Recruit operational specialists to focus on process improvements	• Recruit industry leaders and visionaries to Board • Augment management team, as required • Leverage powerful tools we have developed to assess the likelihood of success of a new hire

Proprietary & Confidential

NAF – STRATEGIC VISION

Accretive has an expansive view of NAF's potential:

- Arbitration expands to become a comprehensive, alternative legal system
- NAF becomes the primary venue for resolution of high-volume, low-ticket disputes
- NAF transforms the process by which payment issues are resolved:
  - In established markets, such as credit card, NAF exploits clause placements and becomes the preferred collections tactic where speed and cost are critical considerations. Arbitration should capture at least 50% of the volume currently placed in litigation
  - In new industries, such as healthcare, NAF Procedures are used early and consistently as the standard method for resolving payment disputes. By playing a prominent role, NAF fundamentally shapes the collections players and tactics that emerge in these industries
- NAF sits at the center of a broad arbitration ecosystem, giving rise to a range of specialist firms that serve as sources of cases or as post-award processors
- Through creativity and flexibility, NAF continually expands into new applications and potentially geographies.

From: Kelly, Mike
Sent: Monday, November 20, 2006 5:18 PM
To: 'Madhu Tadikonda'
Subject: Comps
Attachments: naf Comps vPHH.XLS

Madhu – I look forward to working with you too. I do see the synergies as well, which is in part why I wanted to get you and Michael in front of Ed in the first place. I hope we can reach an agreement. There are numerous interesting BD opportunities for us, as well as a couple of acquisition candidates to explore. The additional resources (capital and intellectual) that your team can bring will be most welcome. We do, however, have a long way to go in a short time and a considerable bridge to gap.

I will give you a call shortly to talk about all of this. I have been waiting to circle back with our corporate tax lawyers about corporate formation issues. We remain deeply concerned about walling any deal off any deal from Mann Bracken. The shared ownership issue concerns us on many levels. I wanted to put some additional thinking around the structural issues.

Due to time constraints, however, I thought it best to send you our threshold parameters:

1. No leveraging any assets of the Forum. This is a cash deal.
2. A non-refundable fee to take us off the market during negotiations – 5% of the value of the conveyed interest.
3. Formation of a new fund as the investment vehicle (no public information connecting Accretive with the fund that ultimately acquires and holds the minority interest in the Forum).
4. Confidentiality and non-compete provisions pre and post closing.
5. On-going Chinese wall between Mann Bracken and the Forum.
6. 10% equity into a pool for management.
7. Ed has set aside some cash on the books, which is not part of the deal – but I assume you are aware that you are not buying the cash.
8. It's unclear what Michael meant in his letter by "standard minority shareholder protections." The protections we would consider would be consistent with those of current minority shareholders relative to futures dispositions, dilutive acts, etc. We will not transfer control of business level decisions, such as P & L, personnel, etc.

I cannot overstate our concern over the Mann Bracken relationship. Although I do not have any solutions off the top of my head, we should certainly plan for unwinding any deal in the event shared ownership becomes an acute issue.

Assuming we can get past the threshold issues, I did want to get you the comps we have so that you can review them and circulate as appropriate. I pulled in as much free research as I could squeeze out of old clients and friends and focused on the attached comp's. The spreadsheet attached captures some companies that we believe mimic the kind of cost saving/"efficiency driving" attributes the Forum possesses. You will find that most of these businesses 1) are growing at the same rate as our projections, 2) are service companies and 3) are businesses that provide cost savings to their clients through best practices. Note the LTM EBITDA multiples of each of these businesses. For your background, the bankers I have spoken with advised not to talk to anyone unless the multiple offered starts with a 2.

I look forward to discussing these with you further.

Michael F. Kelly
Chief Operating Officer
National Arbitration Forum
6465 Wayzata Blvd., Suite 500

Fund and by Investor

AGORA FUND I LP (Accretive II, LP)

Accretive II GP, LLC

[redacted]

AGORA FUND I BLOCKER LP (Accretive II Blocker, LP)

Accretive II GP, LLC

[redacted]

AGORA FUND I COINVESTMENT LP (Accretive II Coinvestment, LP)

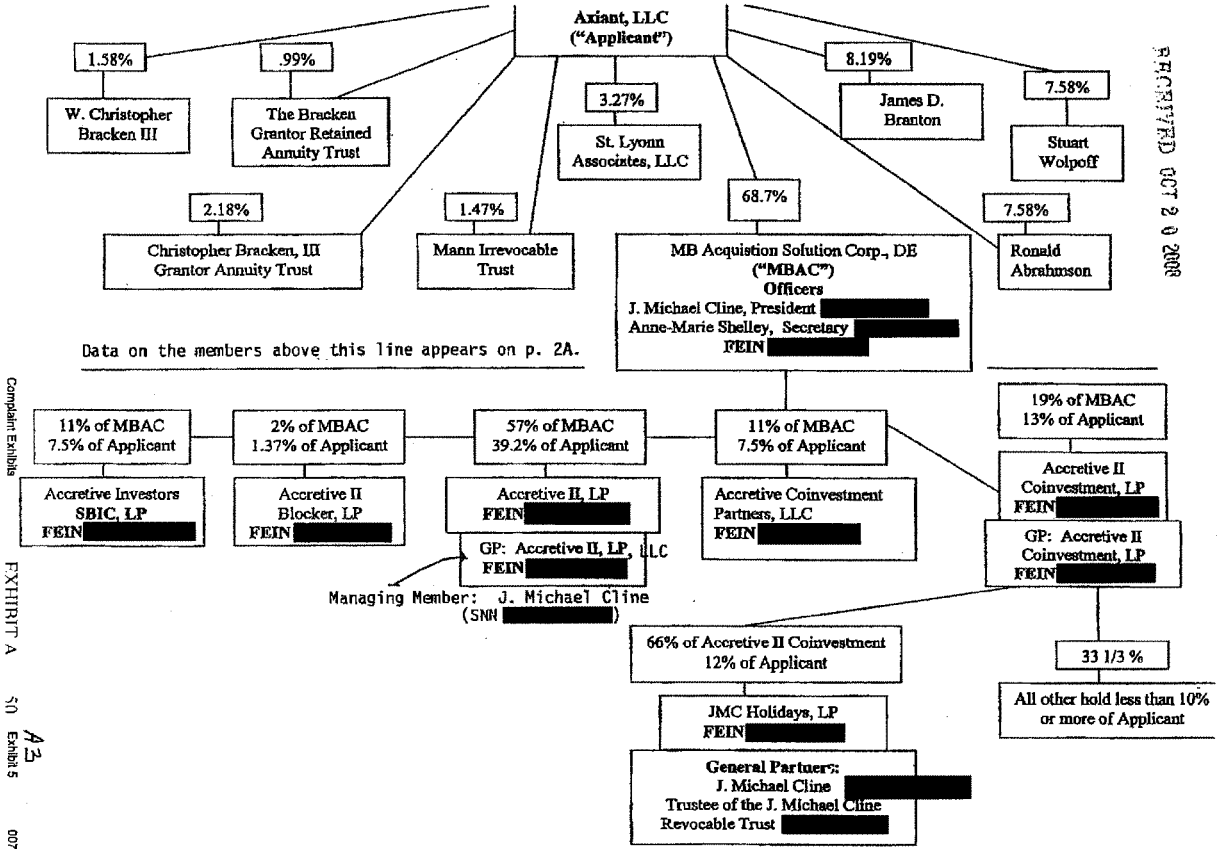
Accretive II GP, LLC
JMC Holdings, LP
Edgar Bronfman, Jr.
[redacted]

0003396

FORTHRIGHT – ACCRETIVE PRIORITIES FOCUS

Key Issue	Status	Next Steps	Accretive Priority
New Growth Opportunities	▪ Expansion of arbitration services – serving and confirmation ▪ Small claims court administration for debt buyers ▪ Expansion of PIP programs	▪ Launch pilots for expansion and small claims court ▪ Hire senior executive to build PIP business	▪ Monitor the expansion and small claims efforts ▪ Introduce Forthright to Axiant executives ▪ Axiant files in small claims court – different standards for filing / appearance when a corp is filing ▪ Develop profile for new hire
Chase Arbitration Volume	▪ Currently at 3K filings per month – prior to Chase cutting MB volume, was running at 5K	▪ Speak w/ Hanna / Zwicker to understand arb rates and whether they are using AAA / legal	▪ No change in Chase arbitration filling rates – Hanna / Zwicker may be working w/ AAA or doing legal
SF Lawsuit / MN AG inquiry	▪ In document discovery	▪ Work with MN AG to get public announcement to investigation has found no wrong-doing	▪ None
Congressional Inquiry	▪ In document discovery	▪ Continue to field inquiries	▪ None
AFA Legislation	▪ Bill introduced to Judiciary	▪ Waiting for bill to hit house floor ▪ Working w/ lobbyist to get alternative bill introduced – lining up advocates in House and Senate	▪ Mike K working on the package of amended language / alternative bill to send to us ▪ Monitor process – may be able to use Edgars
RIF	▪ Areas for RIF have been identified	▪ To be implemented by May	▪ Monitor

RECEIVED OCT 2 0 2008



A3

Reactions to Arbitration

As told by CSR's

Reaction	Example
How and in what way does possibility of arbitration carry weight in customers' eyes?	• "The Customer does not know what to expect from Arbitration and is more willing to pay" • "They ask you to explain what Arbitration is then basically hand you the money"
How does this help you as a CSR?	• "Because you are taken seriously in the customers' eyes and the calls flow more smoothly" • "You have all the leverage and the customer really has little choice but to take care of this account"
How has the Arbitration Team Benefited You as a CSR?	• "Much more relaxed working environment due to having more leverage and the feeling of teamwork" • "It made me a better negotiator"

NATIONAL ARBITRATION FORUM

Assistance to ACCRETIVE INVESTORS SBIC, LP in NY (FY 2004)

(MAP IT)

Search Criteria Used (More)		
Federal Fiscal Year	2004	GO
Level of Detail	Summary	GO
Type of Report Output	HTML	GO

Summary

Fiscal Year: 2004
Federal dollars: **$100,500,000**
Total number of recipients: **1**
Total number of transactions: **2**
Get list of recipients
Get list of transactions

Top 5 Known Congressional Districts where Recipients are Located

Invalid district:	$0

Top 10 Recipients

ACCRETIVE INVESTORS SBIC, LP	$100,500,000

Recipient Type

Individuals	$100,500,000
Nonprofits	$0
Other	$0
Higher Education	$0
Government	$0
For Profits	$0

Assistance Type

Loans (both direct and guaranteed)	$100,500,000
Other	$0
Insurance	$0
Grants and Cooperative Agreements	$0
Direct Payments (both specified and unrestricted)	$0

Expand all summaries to all values, not just top 5 or 10

END OF REPORT

This search was done on June 4, 2009.

The assistance database is compiled from government data last released on 04/01/2008

This search result was produced as a project of **OMB Watch**. The data was obtained from the U.S. Census Bureau's **Federal Assistance Award Data System** (FAADS).

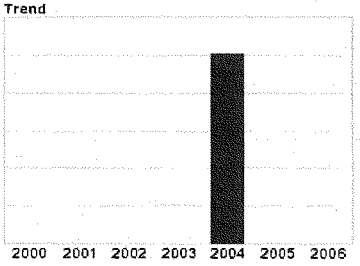
Top 5 Programs

59.011: Small Business Investment Companies	$100,500,000

Top 5 Agencies Providing Assistance

Small Business Administration	$100,500,000

Trend



2000	$0
2001	$0
2002	$0
2003	$0
2004	$100,500,000
2005	$0
2006	$0
2007 3Q *	$0

*Note: FY 2007 only includes first three quarters.

(MAP IT)

Search Criteria Used		
Federal Fiscal Year	2004	GO
Assigned Recipient ID	9748	
Sort By	No sort (summary only)	
Level of Detail	Summary	GO
Type of Report Output	HTML	GO

EXHIBIT C

Incident Period: 02/28/2009 and continuing.

Effective Date: 03/10/2009.

Physical Loan Application Deadline Date: 5/11/2009.

Economic Injury (EIDL) Loan Application Deadline Date: 12/10/2009.

ADDRESSES: Submit completed loan applications to: U.S. Small Business Administration, Processing And Disbursement Center, 14925 Kingsport Road, Fort Worth , TX 76155.

FOR FURTHER INFORMATION CONTACT: A Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street, SW., Suite 6050, Washington, DC 20416.

SUPPLEMENTARY INFORMATION: Notice is hereby given that as a result of the Administrator's disaster declaration, applications for disaster loans may be filed at the address listed above or other locally announced locations.

The following areas have been determined to be adversely affected by the disaster:

Primary Counties:

Bastrop.

Contiguous Counties: Texas.

Caldwell, Fayette, Lee, Travis, Williamson.

The Interest Rates are:

	Percent
Homeowners With Credit Available Elsewhere	4.375
Homeowners Without Credit Available Elsewhere	2.187
Businesses With Credit Available Elsewhere	6.000
Businesses & Small Agricultural Cooperatives Without Credit Available Elsewhere	4.000
Other (Including Non-Profit Organizations) With Credit Available Elsewhere;	4.500
Businesses And Non-Profit Organizations Without Credit Available Elsewhere	4.000

The number assigned to this disaster for physical damage is 11690 5 and for economic injury is 11691 0.

The States which received an EIDL Declaration # are Texas.

(Catalog of Federal Domestic Assistance Numbers 59002 and 59008)

Dated: March 10, 2009.

Darryl K. Hairston,

Acting Administrator.

[FR Doc. E9–5735 Filed 3–16–09; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

[License No. 02/72–0627]

Accretive Investors SBIC, L.P.; Notice Seeking Exemption Under Section 312 of the Small Business Investment Act, Conflicts of Interest

Notice is hereby given that Accretive Investors SBIC, L.P., 51 Madison Avenue, 31st Floor, New York, NY, 10010, a Federal Licensee under the Small Business Investment Act of 1958, as amended ("the Act"), in connection with the financing of a small concern, has sought an exemption under Section 312 of the Act and Section 107.730, Financings which Constitute Conflicts of Interest of the Small Business Administration ("SBA") Rules and Regulations (13 CFR 107.730). Accretive Investors SBIC, L.P. proposes to provide equity financing to Axiant, LLC, 2727 Paces Ferry Road, Atlanta, GA 30339. The financing is contemplated for working capital and debt repurchase.

The financing is brought within the purview of 107.730(a)(1) of the Regulations because Accretive II, LP; Accretive Blocker, LP; Accretive II Coinvestment Partners, LP and Accretive Coinvestment Partners, LLC, all Associates of Accretive Investors SBIC, L.P., in the aggregate own more than ten percent of Axiant, LLC.

Therefore, this transaction is considered a financing of an Associate requiring an exemption. Notice is hereby given that any interested person may submit written comments on the transaction within fifteen days of the date of this publication to the Acting Associate Administrator for Investment, U.S. Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

Dated: February 5, 2009.

Harry Haskins,

Acting Associate Administrator for Investment.

[FR Doc. E9–5738 Filed 3–16–09; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

Small Business Size Standards: Waiver of the Nonmanufacturer Rule

AGENCY: U.S. Small Business Administration.

ACTION: Notice to terminate the Nonmanufacturer Rule Class Waiver for Product Service Code (PSC) 3930, Warehouse Trucks and Tractors, Self-Propelled.

SUMMARY: The U.S. Small Business Administration (SBA) has terminated a waiver of the Nonmanufacturer Rule for PSC 3930, Warehouse Trucks and Tractors, Self-Propelled based on SBA's recent discovery of small business manufacturers. Terminating this waiver will require recipients of contracts set aside for small businesses, service-disabled veteran-owned small businesses, or participants in SBA's 8(a) Business Development (BD) Program to provide the products of small business manufacturers or processors on such contracts.

DATE: This waiver is effective April 1, 2009.

FOR FURTHER INFORMATION CONTACT: Ms. Edith G. Butler, by telephone at (202) 619–0422; by FAX at (202) 481–1788; or by e-mail at *edith.butler@sba.gov.*

SUPPLEMENTARY INFORMATION: Section 8(a)(17) of the Small Business Act (Act), 15 U.S.C. 637(a)(17), and SBA's implementing regulations require that recipients of Federal contracts set aside for small businesses, service-disabled veteran-owned small businesses, or participants in the SBA's 8(a) Business Development Program, provide the product of a small business manufacturer or processor, if the recipient is other than the actual manufacturer or processor of the product. This requirement is commonly referred to as the Nonmanufacturer Rule. 13 CFR 121.406(b), 125.15(c). Section 8(a)(17)(b)(iv) of the Act authorizes SBA to waive the Nonmanufacturer Rule for any "class of products" for which there are no small business manufacturers or processors available to participate in the Federal market.

In order to be considered available to participate in the Federal market for a class of products, a small business manufacturer must have submitted a proposal for a contract solicitation or received a contract from the Federal government within the last 24 months. 13 CFR 121.1202(c).

The SBA defines "class of products" based on a six digit coding system. The coding system is the Office of Management and Budget North American Industry Classification System (NAICS). In addition, SBA uses Product Service Codes (PSC) to identify particular products within the NAICS code to which a waiver would apply.

SBA announced its decision to grant the waiver for PSC 3930 in the **Federal Register** on September 13, 1990, 55 **Federal Register** 38313 (1990). SBA received a request on December 18, 2008, to terminate the waiver to the nonmanufacturer rule for Warehouse Trucks and Tractors, Self-Propelled, under PSC 3930. In response, on

EXHIBIT D

SENT VIA FACSIMILE AND U.S. MAIL

License No. 02/72-0627

FEB 17 2009

Mr. J. Michael Cline
Accretive Investors SBIC, LP
51 Madison Avenue – 31st Floor
New York, NY 10010

Dear Mr. Cline:

The U.S. Small Business Administration, Office of SBIC Operations ("SBA") has reviewed your letter dated January 26, 2009 requesting approval for Accretive Investors SBIC, LP ("Accretive" or "Licensee") to [redacted] The Licensee seeks approval to invest [redacted] in portfolio company Axiant, LLC ("Axiant" or "Company"). [redacted] The proposed financing also represents a Conflict of Interest financing as defined under Section 312 of the Small Business Investment Act ("Act") and §107.730 of the SBIC Regulations, in that Associates of the Licensee hold a direct financial interest in Axiant of greater than ten percent.

The Licensee and its Associates – Accretive II, LP; Accretive Blocker, LP; Accretive II Coinvestment Partners, LP and Accretive Coinvestment Partners, LLC (collectively "Accretive Associates") – own approximately [redacted]% of the Company's outstanding equity interests. The Accretive Associates own approximately [redacted]% of the Company's outstanding equity interests. Therefore, Axiant is an Associate of the Licensee as defined at §107.50, and this financing constitutes Financing an Associate under §107.730(a) of the SBIC Regulations. Because the Accretive Associates [redacted] of the SBIC Regulations.

The Licensee previously invested [redacted] in Axiant. The proposed investment would [redacted] The Regulatory Capital figure is adjusted per Section 107.740(a) of the regulations, which allows add backs of return of capital distributions made during the five years preceding the date of the proposed Overline financing. The Licensee [redacted]

Axiant is an IT service provider that enables consumer finance creditors and debt purchasers to optimize their legal collections efforts. The Company partners with regional law firms to pursue legal cases against defaulted accounts. You note that [redacted] the Company. First, [redacted] Second, the Company's [redacted] As a result, the Company [redacted]

[redacted]

Funding from the Licensee would have required SBA's prior approval [redacted], and you did not believe at the time that [redacted]

The funding [redacted]

In addition to [redacted] the [redacted] provided for [redacted] of working capital [redacted] You believe that [redacted] orking capital, [redacted]. You anticipate [redacted].

If approved, the proposed financing would be Accretive's [redacted]

Based on your representations and documentation, SBA grants approval for [redacted]

Also based on your representations and documentation, the proposed investment is consistent with the purposes of the SBIC program and equitable to all parties. Accordingly, SBA hereby grants the Licensee an exemption from Section 312 of the Act and Section 107.730(a)(1) of the SBIC Regulations for the proposed investment in Axiant. This exemption is specifically for this financing only. Given that the Licensee and the Accretive Associates [redacted].

As required in §107.730(g), SBA will publish notice of this transaction in the Federal Register. You are not required to wait for the Federal Register notice publication to proceed with this financing.

Public Note Requirement Waiver

Section §107.730(g) also requires that a Licensee publish notice of a Conflict of Interest transaction in a newspaper of general circulation in the locality most directly affected by the transaction before SBA will approve such a transaction. While changes to the Act have removed the mandatory Public Notice requirement for a Conflict of Interest investment, Section §107.730(g) does not yet reflect the changes to the Act and thus the existing language requiring a Licensee to publish Notice of a Conflict of Interest transaction still governs. Given the change to the Act, the SBA grants the Licensee a waiver from the Public Notice requirement in §107.730(g) for the proposed financing. This waiver applies only for this financing and should not be construed as a waiver for any future Conflict of Interest investments that the Licensee may contemplate.

If there are additional questions, please contact Lyn Womack at (202) 205-2416. Please keep Lyn apprised of the status of the [redacted] investment, including any changes to the terms of the investment, and the ongoing performance of Axiant.

Sincerely,

(signed) Harry E. Haskins

Harry Haskins
Acting Associate Administrator
for Investment

OSO:Womack:draft:2/5/2009:printed in final:mjg:2/9/09
cc:Area IV, Womack, Knott, Maddrie, Inv. 6-7, Chron, O/E – Giovanelli (New York)
Control No.01/09-069, Code:D-20, S:\Area IV\Womack\Accretive Investors SBIC [redacted] Approval Letter for Axiant – Feb 2009

Womack_____
Knott_____
Maddrie_____

EXHIBIT E 3

Accretive Investors SBIC, LP

1/26/2009

To: Mr. Steve Knott
Office of SBIC Operations
U.S. Small Business Administration
409 Third Street, S.W., Suite 6300
Washington, D.C. 20416

From: J. Michael Cline
Accretive, LLC
51 Madison Avenue, 31st Floor
New York, NY 10010

Re: Accretive Investors SBIC, LP
02/72-0627

Dear Mr. Knott:

Accretive Investors SBIC, LP (the "Licensee"), hereby requests that the SBA consent to Licensee's investment of [redacted] that holds direct equity interests in the operating company, Axiant, LLC, a Delaware limited liability company (the "Portfolio Company" or "Axiant"). This investment [redacted], when combined with Licensee's prior investments in the Portfolio Company [redacted], would result in [redacted] If this [redacted] is approved, [redacted]

Redacted
under
FOIA Exemption 4

Redacted
FOIA Exemption 4

To assist your review, the remainder of this letter addresses each component of [redacted]

A. **SBIC Financial Statements**

Licensee's Financial Statements (pages 2 through 4 of SBA Form 468) can be found in the attached documents.

B. **Schedule of All [redacted]**

The Licensee currently has no [redacted]

C. **Affiliation with Small Concerns**

The Portfolio Company is not an Affiliate of the Licensee pursuant to 13 CFR Section 121.103(b)(1). However, the First Accretive Investment Vehicle, the Accretive Investment Vehicle through which the Licensee initially invested in the Portfolio Company together the Second Accretive Investment Vehicle, are the holders of equity interests in the Portfolio Company with ownership of approximately [redacted]% of the outstanding equity interests of the Portfolio Company [redacted]. The Board of Directors of Portfolio Company is currently comprised of [redacted] directors, [redacted] of whom are designated by [redacted]. Moreover, a [redacted] outstanding equity interests of the Portfolio Company are required for [redacted] regarding the Portfolio Company. Therefore, [redacted]. Finally, the Accretive Investment Vehicles and the Accretive designees [redacted]

[redacted]

D. **Financial Statements of the Small Concerns**

Portfolio Company's Financial Statement can be found in the attached documents.

E. **Description of the Investment**

In the table below, please find a detailed schedule of investments made by the Licensee [redacted]

All investments [redacted] All shares [redacted] of Axiant, LLC [redacted]

Date	Amount Invested	No. of Shares Acquired	Cumulative Shares Acquired	Total Shares Outstanding	Percentage of Ownership
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Redacted

FOIA Exemption 4

F. Other Participants in the Financing

Redacted

FOIA Exemption 4

G. Reasons for [redacted] Investment

Redacted

FOIA Exemption 4

Redacted

FOIA Exemption 4

H. Financial Performance

Redacted

FOIA Exemption 4

I. **Anticipated Exit**

Accretive anticipates [redacted]

The Portfolio Company's unique national footprint and collections success with leading credit card issuers is expected to make [redacted] Accretive expects [redacted]

For these reasons, we request that the SBA consent to [redacted]) in Axiant on the terms and conditions described above. Please contact me at 646-282-3139 if you have questions with regard to the foregoing or require additional information to evaluate our [redacted] request.

Sincerely,

J Michael Cline
Managing Member

Axiant, LLC
(formerly MB Solutions, LLC)

Financial Statements
December 31, 2007

Redacted in entirety

Total : 21 pages

FOIA Exemption 4

McGladrey & Pullen
Certified Public Accountants

INFORMATION

SBA FORM 468
(PARTNERSHIP SBICs)

SHORT FORM

OMB Approval No 3245-0069
Expiration Date 10/31/2007

NAME OF LICENSEE:	Accretive Investors SBIC, LP	
LICENSE NUMBER:	02/72-0627	
STREET ADDRESS:	51 Madison Avenue, 31st Floor	
CITY, STATE, AND ZIP CODE:	New York, NY 10010	
COUNTY:	New York	
EMPLOYER ID NUMBER:	05-0568262	
FOR THE REPORTING PERIOD ENDED:	09/30/2008	MONTHS: 9

A - FUND FOCUS

B - OWNERSHIP PRIVATELY OWNED BY INDIVIDUALS

Redacted in Entirety
Total pages: 18
FOIA Exemption 4

Please Note: The estimated burden for completing this form is 15 hours per response. You will not be required to respond to this information collection if a valid OMB approval number is not displayed. If you have questions or comments concerning this estimate or other aspects of this information collection, please contact the US Small Business Administration, Chief, Administrative Information Branch, Washington, D.C. 20416 and/or Office of Management and Budget, Clearance Officer, Paperwork Reduction Project (3425-0063), Washington, D.C. 20503. PLEASE DO NOT SEND FORMS TO OMB.

Incident Period: 02/28/2009 and continuing.

Effective Date: 03/10/2009.

Physical Loan Application Deadline Date: 5/11/2009.

Economic Injury (EIDL) Loan Application Deadline Date: 12/10/2009.

ADDRESSES: Submit completed loan applications to: U.S. Small Business Administration, Processing And Disbursement Center, 14925 Kingsport Road, Fort Worth , TX 76155.

FOR FURTHER INFORMATION CONTACT: A Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street, SW., Suite 6050, Washington, DC 20416.

SUPPLEMENTARY INFORMATION: Notice is hereby given that as a result of the Administrator's disaster declaration, applications for disaster loans may be filed at the address listed above or other locally announced locations.

The following areas have been determined to be adversely affected by the disaster:

Primary Counties:

Bastrop.

Contiguous Counties: Texas.

Caldwell, Fayette, Lee, Travis, Williamson.

The Interest Rates are:

	Percent
Homeowners With Credit Available Elsewhere	4.375
Homeowners Without Credit Available Elsewhere	2.187
Businesses With Credit Available Elsewhere	6.000
Businesses & Small Agricultural Cooperatives Without Credit Available Elsewhere	4.000
Other (Including Non-Profit Organizations) With Credit Available Elsewhere;	4.500
Businesses And Non-Profit Organizations Without Credit Available Elsewhere	4.000

The number assigned to this disaster for physical damage is 11690 5 and for economic injury is 11691 0.

The States which received an EIDL Declaration # are Texas.

(Catalog of Federal Domestic Assistance Numbers 59002 and 59008)

Dated: March 10, 2009.

Darryl K. Hairston,

Acting Administrator.

[FR Doc. E9–5735 Filed 3–16–09; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

[License No. 02/72–0627]

Accretive Investors SBIC, L.P.; Notice Seeking Exemption Under Section 312 of the Small Business Investment Act, Conflicts of Interest

Notice is hereby given that Accretive Investors SBIC, L.P., 51 Madison Avenue, 31st Floor, New York, NY, 10010, a Federal Licensee under the Small Business Investment Act of 1958, as amended ("the Act"), in connection with the financing of a small concern, has sought an exemption under Section 312 of the Act and Section 107.730, Financings which Constitute Conflicts of Interest of the Small Business Administration ("SBA") Rules and Regulations (13 CFR 107.730). Accretive Investors SBIC, L.P. proposes to provide equity financing to Axiant, LLC, 2727 Paces Ferry Road, Atlanta, GA 30339. The financing is contemplated for working capital and debt repurchase.

The financing is brought within the purview of 107.730(a)(1) of the Regulations because Accretive II, LP; Accretive Blocker, LP; Accretive II Coinvestment Partners, LP and Accretive Coinvestment Partners, LLC, all Associates of Accretive Investors SBIC, L.P., in the aggregate own more than ten percent of Axiant, LLC.

Therefore, this transaction is considered a financing of an Associate requiring an exemption. Notice is hereby given that any interested person may submit written comments on the transaction within fifteen days of the date of this publication to the Acting Associate Administrator for Investment, U.S. Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

Dated: February 5, 2009.

Harry Haskins,

Acting Associate Administrator for Investment.

[FR Doc. E9–5738 Filed 3–16–09; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

Small Business Size Standards: Waiver of the Nonmanufacturer Rule

AGENCY: U.S. Small Business Administration.

ACTION: Notice to terminate the Nonmanufacturer Rule Class Waiver for Product Service Code (PSC) 3930, Warehouse Trucks and Tractors, Self-Propelled.

SUMMARY: The U.S. Small Business Administration (SBA) has terminated a waiver of the Nonmanufacturer Rule for PSC 3930, Warehouse Trucks and Tractors, Self-Propelled based on SBA's recent discovery of small business manufacturers. Terminating this waiver will require recipients of contracts set aside for small businesses, service-disabled veteran-owned small businesses, or participants in SBA's 8(a) Business Development (BD) Program to provide the products of small business manufacturers or processors on such contracts.

DATE: This waiver is effective April 1, 2009.

FOR FURTHER INFORMATION CONTACT: Ms. Edith G. Butler, by telephone at (202) 619–0422; by FAX at (202) 481–1788; or by e-mail at *edith.butler@sba.gov.*

SUPPLEMENTARY INFORMATION: Section 8(a)(17) of the Small Business Act (Act), 15 U.S.C. 637(a)(17), and SBA's implementing regulations require that recipients of Federal contracts set aside for small businesses, service-disabled veteran-owned small businesses, or participants in the SBA's 8(a) Business Development Program, provide the product of a small business manufacturer or processor, if the recipient is other than the actual manufacturer or processor of the product. This requirement is commonly referred to as the Nonmanufacturer Rule. 13 CFR 121.406(b), 125.15(c). Section 8(a)(17)(b)(iv) of the Act authorizes SBA to waive the Nonmanufacturer Rule for any "class of products" for which there are no small business manufacturers or processors available to participate in the Federal market.

In order to be considered available to participate in the Federal market for a class of products, a small business manufacturer must have submitted a proposal for a contract solicitation or received a contract from the Federal government within the last 24 months. 13 CFR 121.1202(c).

The SBA defines "class of products" based on a six digit coding system. The coding system is the Office of Management and Budget North American Industry Classification System (NAICS). In addition, SBA uses Product Service Codes (PSC) to identify particular products within the NAICS code to which a waiver would apply.

SBA announced its decision to grant the waiver for PSC 3930 in the Federal Register on September 13, 1990, 55 Federal Register 38313 (1990). SBA received a request on December 18, 2008, to terminate the waiver to the nonmanufacturer rule for Warehouse Trucks and Tractors, Self-Propelled, under PSC 3930. In response, on

U.S. SMALL BUSINESS ADMININSTRATION
WASHINGTON, D.C. 20416

Mailed on
JAN 6 09

License No: 02/72-0627

December 30, 2008

General Partner
Accretive Investors SBIC, L.P.
51 Madison Avenue, 31st Floor
New York, NY 10010

Dear General Partner:

The Small Business Administration, Office of SBIC Operations has reviewed the Examination Report dated December 30, 2008, issued on Accretive Investors SBIC, L.P. ("Licensee") for the 12 month period ended September 30, 2008. [redacted]

We appreciate your assistance during the examination. Should you have any questions, you may contact your Financial Analyst, Lyn F. Womack, at (202) 205-2416.

Sincerely,

(Signed) Steve Knott

Steven P. Knott
Chief, Area IV
Office of SBIC Operations

cc: Knott
Womack
Office of Examinations
Inv. 6-7
Code: D-18
Chron File

U.S. SMALL BUSINESS ADMINISTRATION
INVESTMENT DIVISION
OFFICE OF SBIC EXAMINATIONS

DATE: December 30, 2008

TO: Marja Maddrie
Director of SBIC Operations

FROM: David J. Giovanelli
Examinations Manager

SUBJECT: Accretive Investors SBIC, LP
New York, New York
License Number: 02/72-0627

We have completed our examination of Accretive Investors SBIC, LP (licensee), a Small Business Investment Company (SBIC) located in New York, New York. The purpose of the examination was to determine whether the licensee complied with the laws, rules and regulations, and established policies governing the SBIC program. [redacted]

Prior to the examination, we contacted the financial analyst to find out whether the Office of SBIC Operations had any concerns or outstanding issues to be addressed during the examination. [redacted]

The licensee's office is located at 51 Madison Avenue, New York, New York. Accretive Technology Partners, LLC, the licensee's investment advisor, manages the licensee pursuant to a management agreement approved by the Small Business Administration (SBA). The licensee's general partner is Accretive Associates SBIC, LLC. A schedule of the licensee's general and limited partners is included in this report as Exhibit 2.

During the current examination period, [redacted]. The licensee also [redacted] during the examination period, [redacted]. As of September 30, 2008, the licensee [redacted] An unaudited comparative balance sheet of the licensee, as of September 30, 2008 and September 30, 2007, is included in this report as Exhibit 1.

The licensee was examined for the 12-month period ending September 30, 2008. During this period, [redacted]. We reviewed all of these financing transactions. We completed the on-site phase of our review on December 10, 2008.

Our examination included reviews of cash on deposit, wire transfers, supporting documentation for disbursements and other financial records. In addition, we verified [redacted] as well as the ownership of the licensee's equity. Although we reviewed selected general ledger accounts, we did not perform a financial audit and, [redacted]

For the financings provided during the examination period, we reviewed the financing agreements, stock certificates, financial statements and supporting documentation, including background information on the small concerns and their principals. For selected small concerns, we obtained credit reports and requested verification of the financings by direct confirmation.

As part of our examination, we reviewed the licensee's internal controls over the safeguarding of securities. We also reviewed the licensee's valuation procedures, as well as supporting documentation for the valuation of its portfolio as of June 30, 2008.

Please provide me with a copy of your letter forwarding our report to the licensee, as well as any further correspondence pertaining to the report. If you would like to discuss the report, or need additional information, please contact me at (212) 264-2929.

Attachments

Exhibit 1: Unaudited Comparative Balance Sheet

Accretive Investors SBIC, LP

	As of	
Assets	**9/30/08**	**9/30/07**
Loans and Investments		
Equity interests	$ [redacted]	$ [redacted]
Unrealized appreciation (net of depr.)	[redacted]	[redacted]
Total	$ [redacted]	$ [redacted]
Cash	$ [redacted]	$ [redacted]
Invested idle funds	[redacted]	[redacted]
Other assets	[redacted]	[redacted]
Total Assets	$ [redacted]	$ [redacted]
Liabilities and Capital		
Liabilities		
Participating securities held or guaranteed by SBA	$ [redacted]	$ [redacted]
Accounts payable and accrued items	[redacted]	[redacted]
Other liabilities	[redacted]	[redacted]
Total Liabilities	$ [redacted]	$ [redacted]
Capital		
Partners' contributed capital	$ [redacted]	$ [redacted]
Syndication costs	[redacted]	[redacted]
Unrealized gain (loss) on securities held	[redacted]	[redacted]
Undistributed realized earnings (deficit)	[redacted]	[redacted]
Non-cash gains/income	[redacted]	[redacted]
Total Capital	$ [redacted]	$ [redacted]
Total Liabilities and Capital	$ [redacted]	$ [redacted]

Note: Prepared from trial balance provided by licensee.

Exhibit 2: Schedule of General and Limited Partners

Accretive Investors SBIC, LP

September 30, 2008

	[redacted]	[redacted]
General Partner		
Accretive Associates SBIC, LLC	$ [redacted]	[redacted]
Limited Partners		
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
Totals	$ [redacted]	[redacted]

DOCUMENTS EXEMPTED FROM DISCLOSUR FOIA)
Accretive Investors SBIC, LP

Document Name or Description	FOIA Exemption	No. of pages
Annual SBIC 468 & Commitment Review	Exemption #5 – intra agency deliberative pro	2
Preliminary Capital Impairment Worksheet for 12/31/2008	Exemption #5 – intra agency deliberative proc	1
Risk Rating Worksheet dated April 8, 2009	Exemption #5 – intra agency deliberative proce	1
SBA Form 468 as of 12/31/2008	Exemption #4 – commercial or financial informa obtained from a person/entity and privileged or confidential	42
Minutes of the meeting of the members of Accretive Associates SBIC, LLC	Exemption #4 – commercial or financial informat obtained from a person/entity and privileged or confidential	1
Written consent of the members of Accretive Associates SBIC, LLC as the General Partner of Accretive SBIC, LP	Exemption #4 – commercial or financial informati obtained from a person/entity and privileged or confidential	9
SBA Form 468 as of 3/31/2009	Exemption #4 – commercial or financial informatic obtained from a person/entity and privileged or confidential	19

Mr. KUCINICH. Thank you very much.

The Chair recognizes Mr. Kelly. You may proceed for 5 minutes. Thank you for being here.

STATEMENT OF MICHAEL KELLY

Mr. KELLY. Thank you, Chairman Kucinich, Ranking Member Jordan, members of the committee. I appreciate the opportunity to be here today.

I want to reiterate we have withdrawn the National Arbitration Forum from handling consumer arbitrations pursuant to an agreement with the attorney general. That being said, it is our continued belief that the Forum's exit from this business and the loss of consumer arbitration broadly would represent a significant loss to the consumers that you are seeking to protect.

The logical conclusion of this decision is that the consumer cases will all now be brought in court. Initially, I would like to explore the consequences of that prospect. For those who haven't been to Small Claims and Conciliation Court, which I have, it is not often a pleasant experience. In that case, the notice, the response, procedures can be very complicated. There is often no representation. Days off of work are required. You sit in a cattle call with hundreds of other people waiting for your opportunity to be heard. And your public finances and issues are revealed for all to see who are there in court.

It is not particularly a pleasant experience. It is one that was outlined and discussed significantly in a Boston Globe article in 2006, which I think is pertinent here. In that article, the Boston Globe found in Massachusetts that the courts were stacked against the average consumer.

If I can read from the article, it says that "Many small claims courts have effectively become accomplices of collection firms, routinely giving them the upper hand in court cases, while casually disregarding the rights and dignity of ordinary citizens. Collectors almost always win the lawsuits they file, without being asked for evidence that the debts they are chasing are actually owed. Debtors frequently receive no notice of the lawsuits against them. The disabled, elderly and working poor are often talked into repaying debts from government checks, which are by law protected from judgment."

"The creditors are all repeat players. They know exactly how the game works, said Elizabeth Warren, a Harvard Law School professor who studies consumer debt. We are watching a fight between two players, one a skilled repeat gladiator and one who's thrown into the ring for the first time and gets clubbed over the head before they even get a sense of what the rules are."

That is the court we are talking about. These cases don't go in front of juries. They go in front of small claim and conciliation courts.

Now, what is the difference with arbitration? I can only speak to the difference of arbitration before the Forum, as it was conducted. And these are some of the fundamental differences. Under the Forum rules, responses can be in simple, plain English in whatever form the consumer chooses. Hearings are flexible, on their own time of the consumers. They can be handled on paper, by tele-

phone, or by participatory hearing in the Federal jurisdiction in which they live. They are affordable. There is no cost to respond, and to file, the cost if only $19 to $40 on average.

They are fair. The cases are decided on the merits by retired judges and lawyers with approximately 15 years of experience. And on the merits, there is a critical distinction between the courts that we need to make. Cases in front of the Forum as they were conducted required the judge, regardless of whether the consumer is present, to look at the merits and decide the case on a matter of law. That is not the same as a default judgment in court. Decisions in arbitration are also confirmed by the court before they are binding, which again is a court of last instance.

The purpose of the comparison is to point out that there are very real and meaningful consequences to the elimination of consumer arbitration. We are no longer part of that fight. But I think it is important to note these consequences and the impact of reversing or changing over 80 years of law under the Federal Arbitration Act would have.

I would urge that the discussion should center around two very basic questions: First, why? And second, what are the true due process issues?

I say why, because from the results we have seen, from the studies we have seen, if the same subject matter is shown, and there are obviously people who can speak to this better than I, the results in court are the same as the results in arbitration. Due process is truly the heart of the matter. It needs to be studied. Due process protections should be made. The ground needs to be leveled for everyone who will practice in this field, but if that is evaluated by this committee and this Congress, we are confident that consumer arbitration will not be eliminated and should not be eliminated.

Choice should be provided to select arbitration or court, and due process measures should be allowed and made uniform so that everyone has equal access to affordable justice.

Thank you, Mr. Chair.

[The prepared statement of Mr. Kelly follows:]

Opening Statement
Of
Michael F. Kelly
CEO
Forthright

Domestic Policy Subcommittee
Oversight and Government Reform Committee

Wednesday, July 22, 2009
2154 Rayburn HOB
2:00 p.m.

Chairman Kucinich, Ranking Member Jordan, and members of the Committee, thank you for the opportunity to discuss the vital role that consumer arbitration can and should play in the U.S. justice system.

Arbitration is a simple, fair, and cost-effective way for consumers and businesses to resolve disputes outside of the traditional litigation system. American consumers benefit from arbitration in myriad ways that I will briefly outline for you in my remarks.

First, however, I want to relate to the Committee the National Arbitration Forum's recent announcement that it is no longer accepting consumer arbitration cases. In spite of this announcement, my belief remains strong that arbitration provides the superior access to justice to consumers and that arbitration is an excellent method of resolving consumer disputes.

Unfortunately, the FORUM lacks the necessary resources to defend against increasing challenges to arbitration leveled from all fronts, including from state Attorneys General and the class action trial bar.

Mounting legal costs, a challenging economic climate, and increased legislative uncertainty surrounding the future of arbitration have prompted the FORUM to announce that it will no longer accept consumer arbitration cases.

I want to emphasize that FORUM's exit from the consumer arbitration arena represents a significant loss for consumers. Without access to arbitration, consumers with smaller value claims will not be able to secure legal representation, and will be left to navigate the litigation system by themselves.

Arbitration provides consumers with several significant advantages compared with court litigation. These advantages include:

Consumer arbitration is simple. Consumers can submit and respond to arbitration claims in their own words, in plain English, and are not bound by the formalities of legal proceedings that could prevent them from telling their stories and proving their cases.

Consumer arbitration is accessible. Arbitration provides every consumer with access to justice, especially low- and middle-income consumers who often cannot afford lawyers or prolonged trials. Many lawyers will not even accept representation for smaller-value claims, such as those often settled in arbitration. Arbitration gives these consumers a full and fair opportunity to resolve disputes, and allows consumers to hold businesses accountable for mistakes.

Consumer arbitration is flexible. Consumers can elect to appear for a hearing in person, via telephone, or simply by submitting documents, which saves consumers the expense of missing work or travelling to a hearing. Alternatively, all parties have the right to retain an attorney to represent them in arbitration, though every consumer receives the same protections regardless of whether there is an attorney present.

Consumer arbitration is affordable. Filing fees at the National Arbitration Forum started at just $19 for claims up to $1,500, and fees did not climb above $40 until the size of the consumer claim exceeded $13,000. Low income consumers could have filing fees waived in arbitration and bring a claim against a business without paying anything. When fees prevented consumers from asserting a claim with the National Arbitration Forum, fees were shifted to the business party.

Consumer arbitration is fair. Consumers receive the same or better protections in arbitration as in court. National Arbitration Forum neutrals are independent legal experts who were bound by comprehensive rules, including the FORUM Arbitration Bill of Rights, Code of Conduct for Arbitrators, Statement of Principles, and Code of Procedure.

FORUM arbitrators were required to consider the merits of each case, apply the same laws that would apply in court, and empowered to issue all of the same remedies that can be awarded in court. In addition, courts enter default judgments against consumer parties that do not participate in litigation, whereas arbitrators independently consider the evidence for every claim and rule on the merits, regardless of the participation of the consumer.

Consumer arbitration decisions are confirmed by courts. To be legally enforceable, an arbitration decision must be confirmed by a court. Although courts do demonstrate respect for arbitral decisions, courts have shown that they are more than willing to overturn arbitration awards where the arbitrators exceeded his/her powers, demonstrated bias, or failed to provide due process to a party.

The National Arbitration Forum consumer protections, simple procedures, low fees, quick resolutions, and efficient administration meant that consumers could resolve disputes and obtain the same outcome they would have received in court.

Perhaps just as important as the FORUM's consumer protections was our continued commitment to *increasing* consumer protections in arbitration. Over the last twenty years, for example, consumer and judicial feedback have directly led to improvements in our arbitration process, such as: lower consumer filing fees, improved service rules, tightened restrictions on hearing

jurisdictions and arbitrator qualifications, a consumer liaison, a new educational website designed to help consumers navigate the arbitration process, and on and on.

Opponents of consumer arbitration often make scurrilous and baseless claims about the arbitration process, using anecdotes and misleading statistics to give the appearance of impropriety where there is none.

Arbitration opponents, including the trial bar and the advocacy group Public Citizen, cite apples-to-oranges comparisons of arbitration and litigation, and use ominous jargon like "repeat player effect" to try to demonstrate that consumers face a stacked deck in arbitration.

Data and outcomes research for similar cases confirm that win rates for consumers and businesses are the same in arbitration as in court.

- For example, consumers bringing arbitration claims against businesses prevailed 65.5 percent of the time in arbitration, and 61.5 percent of the time in court, according to the Bureau of Justice Statistics, U.S. Department of Justice. In other words, consumers prevailed an additional 4 percent of the time in arbitration versus the courts.

- Businesses bringing claims against consumers prevailed 77.7 percent of the time in arbitration, and 76.8 percent of the time in court, according to the same study – virtually identical results.

- In a study of consumer debt collection matters in particular, lenders prevailed against consumers in 93.8 percent of cases, compared to 96 percent of cases in court. That means that consumers in arbitration actually prevailed in 2.2 percent more cases than consumers in court, and at a lesser expense to the consumers.

Repeat users in arbitration obtain no better results than repeat users in court.

Claims made by arbitration opponents about the inherent bias of the arbitration system are simply not true. National Arbitration Forum consumer arbitration cases were decided by experienced, independent legal professionals. FORUM neutrals were former judges or experienced attorneys who are impartial, bound to a code of professional ethics, and decide cases outside of any influence from the FORUM or the other parties. Experienced FORUM neutrals would simply never jeopardize their considerable professional reputations or standing in the community by deciding an arbitration case on any basis other than the merits of that particular case.

Congress enacted the Federal Arbitration Act in 1925 to establish arbitration as an antidote to the "costliness and delays of litigation." For more than 80 years, arbitration has provided access to justice for millions of American consumers, and Congress and the U.S. Supreme Court have repeatedly endorsed consumer arbitration as an effective and fair alternative dispute resolution process.

Now, legislation currently before Congress, the Arbitration Fairness Act of 2009 (H.R. 1020), threatens to eliminate arbitration as an effective means of alternative dispute resolution, deny many consumers access to justice altogether, and clog state courts with thousands of additional cases at a time when state court systems face historic backlogs and budget crises.

The Arbitration Fairness Act will cause considerable harm to American consumers, the very group it is intended to protect. Middle- and low-income Americans will lose access to justice because they cannot afford lawyers, prolonged trials, or because attorneys often will not accept representation for smaller-value claims.

Consumers will no longer be able to force businesses to arbitrate claims, but will instead have to engage in complex, expensive and unpredictable litigation. For additional context, consider what the reality of dispute resolution through litigation – a reality that Newsweek recently referred to as "Litigation Hell" – means for consumers:

For even the most minor case, a consumer will have to hire an attorney, who bills at upwards of $100 per hour. The attorney will accumulate billable client hours for discovery, procedural motions, and jury selection – all of which are being further delayed by overcrowded court dockets and understaffed courts. In the end, a contingent fee attorney would need to receive a verdict for thousands of dollars to recover his/her billable fees. Claims of that size are not the reality for most consumers who use arbitration to resolve disputes. Litigation is great for lawyers, but not for consumers, as the costs of litigation would be prohibitive for all but the richest litigants.

Businesses can afford long and costly litigation, so consumers will again be disadvantaged, and the costs of litigation will simply pass to consumers in the form of increased prices for products and services, or decreased wages for employees.

Eliminating arbitration will also flood federal and state courts with consumer credit cases – which have roughly tripled in some jurisdictions since 2000 – at a time when budget cuts are forcing personnel reductions. States will be forced to hire additional judges and staff; build and furnish new courthouses; and implement more administration to manage the process – the cost of which will fall to American consumers in their role as taxpayer.

In fact, the only party that will benefit from the Arbitration Fairness Act is trial lawyers, because the legislation will increase legal fees, and force disputes that would otherwise be efficiently resolved in arbitration into lucrative and expensive class action lawsuits.

The answer to isolated abuses of the arbitration process by industry bad actors is not to eliminate arbitration.

The answer is to ensure that consumer due process protections are preserved in arbitration.

The answer is to codify industry best practices, including those that were employed by the National Arbitration Forum.

The answer is to continue to allow affordable access to arbitration, not only for corporations and the rich, but for all Americans.

The answer is to protect arbitration as the best option for consumers and businesses to resolve disputes outside of the court system.

Thank you.

Mr. KUCINICH. I thank the gentleman for his testimony.

The Chair recognizes Mr. Naimark. You may proceed.

STATEMENT OF RICHARD NAIMARK

Mr. NAIMARK. Thank you, Chairman Kucinich, Ranking Member Jordan, other Members of Congress and the committee.

First, I must stress, and I am sure you will understand, the American Arbitration Association is a not-for-profit service organization founded in 1926. We have been around for over 83 years. The AAA does not represent or speak for any other organization, but rather we speak only from our own experience over these 83 years.

From the beginning, the AAA has drafted rules and procedures for fair and balanced dispute resolution. Our many sets of rules and procedures have been scrutinized by the courts at all levels. As early as 1951, we established with the American Bar Association a series of codes of ethics for arbitrators which are still the standard in use today. We have pioneered many and perhaps most of the ethical and fair play standards recognized in the field today.

What we are talking about today is a very specific and difficult kind of case: consumer debt collection cases where creditors are attempting to extract small dollar debt from frequently unrepresented consumers who are often in desperate financial straits. In our discussions with the subcommittee, and most recently publicly, we indicated that we do not currently handle nor would we receive these cases at least until some standards are established that are satisfactory.

But I would like to suggest a way forward. About 10 years ago, we established consumer due process protocols to ensure balance in what was then a very young, growing field of arbitration, consumer arbitrations in particular. These protocols, these rules of fair play, were established, as with the earlier code of ethics for arbitrators, with individuals from a broad cross-section of society. We had consumer advocates. We had business advocates. We had regulators. We had academics, a wide variety of people giving in put to what was essentially consensus for some standards for fair play.

The consumer due process protocols are today the standard of fair play in the consumer dispute arena, as evidenced by our small consumer caseload outside this debt collection area. We do about 1,100 of those a year. Almost three-quarters of those cases are filed by consumers who are looking for redress, and they win about half of those and they settle many more of them ahead of time before any decision.

The due process protocols do common sense things. They do things like make sure the fees to the consumer are reasonable and that the process is accessible. They declare a right to both parties to have an impartial arbitrator. Very significantly, they provide that all remedies that would be available in court must be available in the arbitration process. And interestingly, there is a feature of the due process protocols where the parties may elect to opt out of the arbitration process and go into small claims court. Strikingly, almost no one elects to do so.

Why not? I think the reason is that consumers in these debt collection cases and the overwhelming majority of them don't partici-

pate in the process. They are no-shows. It is inevitable that if you don't participate in your legal proceeding, there is a high likelihood you will lose. So this presents an interesting and very important challenge that has not yet been resolved by the courts or in arbitration.

How do you construct a special set of due process protocols for these cases so that the rights of the consumer are protected even if they fail to participate? And I think that is the challenge before us.

We make some very specific recommendations in our written testimony, specific to these kinds of cases about notice issues, about arbitrator neutrality, about standards of proof for these cases, whether the parties attend or not. We proposed to convene a broad-based diverse working group to work toward balancing the process in this very specialized area, and building protection for the legal rights of parties.

This kind of broad community inputting process works, as evidenced by the existing due process protocols, and we would respectfully suggest that Congress should consider making such safeguards universal and mandatory by legislation so that all consumer debt collection arbitrations are properly conducted.

Arbitration is a tool. It is simply a tool. It can be adapted to special circumstances to provide for access to fairness and justice for all parties in a dispute. We need to work toward that end. And I have to say, it is very doable. We have conducted, for instance, no-fault insurance arbitrations for the Supreme Court and the people of Minnesota for three decades now. It is essentially a consumer arbitration process and it works very well. And I think they present a model for properly conducted consumer arbitrations here.

Thank you.

[The prepared statement of Mr. Naimark follows:]

Testimony
Of
Richard W. Naimark
On behalf of the American Arbitration Association

Domestic Policy Subcommittee
Oversight and Government Reform Committee
Wednesday, July 22, 2009
2154 Rayburn HOB
2:00 p.m.

"Arbitration or Arbitrary: The Misuse of Mandatory Arbitration to Collect Consumer Debts"

Thank you, Chairman Kucinich, Congressman Jordan and members of the Domestic Policy Subcommittee for the opportunity to present the views and experiences of the American Arbitration Association (AAA) on the important issues being considered by the Domestic Policy Subcommittee of the House Committee on Oversight and Government Reform.

I. Introduction

As the world's largest provider of alternative dispute resolution (ADR) services, the AAA has during its 83-year history taken a leadership role in the development of standards of fairness, ethics, and best practices. The AAA has pioneered the development of time and court tested arbitration rules, protocols and a Code of Ethics jointly authored with the American Bar Association. During the past eight decades, the AAA has administered over 2 million cases involving a wide range of subjects. Various governmental entities have also turned to the AAA to assist in the resolution of disputes through over 300 state and federal statutes and regulations. The AAA is a not-for-profit public service organization dedicated to the proper and ethical use of arbitration, mediation and other forms of alternative dispute resolution. However, the AAA is not an industry or trade organization and the AAA speaks here only from its own experience and viewpoint, and not for any other organizations.

While the AAA has not administered significant numbers of debt collection arbitrations relative to some other organizations, the AAA did process consumer debt collection arbitrations in a single high volume program. However, the AAA's administration of that program ended in June of this year and consequently at this time the AAA is not administering any debt collection programs.

As a result of the AAA's review and our experiences administering debt collection arbitrations, in addition to our consideration of a number of policy concerns that have been raised, it is the AAA's position that a series of important fairness and due process concerns must be addressed and resolved before we will proceed with the administration of any future debt collection arbitrations. Until such time, the AAA has placed a moratorium on the administration of any consumer debt collection arbitration programs. Further, we suggest that to the extent that the program improvements offered here are implemented, that they are done so not just within the AAA but as part of a broader debt collection arbitration reform.

Our testimony will begin with an exploration of the AAA's administration of consumer arbitrations generally, and will then move on to recommend changes for the administration debt collection arbitrations to accommodate some of the unique aspects of that caseload.

II. Consumer Arbitration

In recent years, the use of ADR and arbitration has grown to include consumer agreements. Often implemented through standardized contracts, the use of arbitration in consumer agreements for the purchase of goods and services has raised legitimate concerns regarding fairness, rights, and the ability of the parties to participate. The AAA's administration of consumer arbitrations is currently governed by the Consumer Due Process Protocol ("Consumer Protocol"), attached as Appendix A.

To evaluate and address concerns unique to consumer arbitration, the AAA convened the National Consumer Disputes Advisory Committee in 1997, which was composed of consumer, government, legal, business and academic experts, drawn from such organizations as the AARP, Consumers Union, Consumer Action, American Council on Consumer Interests, the Federal Trade Commission, the National Association of Attorneys General, the National Association of Consumer Agency Administrators, Fannie Mae, and Freddie Mac. One of the Advisory Committee's specific objectives was to have the Consumer Protocol influence state and federal laws governing consumer arbitration.

The stated mission of the Advisory Committee was:

> *To bring together a broad, diverse, representative national advisory committee to advise the American Arbitration Association in the development of standards and procedures for the equitable resolution of consumer disputes.*

The result of the Advisory Committee's deliberations was the Consumer Protocol, which articulates a number of fundamental principles to enhance the fairness and efficiency of consumer ADR. The Consumer Protocol constituted a voluntary set of standards and minimum requirements which the AAA has adopted, but which are not necessarily applied to arbitrations outside of AAA administration. The Consumer Protocol provides for common sense "fair play"

requirements, such as reasonable fees for the consumer, reasonably accessible locale, no limitation of any remedy that would be accessible in court, and access to small claims court. The AAA will not administer an arbitration that does not materially comply with the provisions of the Consumer Protocol.
The AAA applies the Consumer Protocol primarily through our *Supplementary Procedures for Consumer-Related Disputes* ("Supplementary Procedures"), attached as Appendix B, to consumer cases. The Supplementary Procedures also establish guidelines for consumers to request a deferral or waiver of fees, including requesting an arbitrator who will serve without charge. One unique aspect of the Supplementary Procedures is the "small claims opt out" which permits a consumer, whether they are a claimant or respondent in a case, to opt out of an arbitration and into a small claims court proceeding.

We bring the Consumer Protocol to the attention of the Subcommittee because it has had a meaningful and important impact on the AAA's administration of consumer arbitrations. We also believe that this collaborative approach represents the best avenue to establishing standards of fairness and balance to the specifics of the process of consumer debt collection arbitration. Evidence of the AAA's fidelity to the principles contained in the Consumer Protocol and the beneficial use of arbitration to resolve consumer disputes are reflected in a recent independent study conducted by the Searle Civil Justice Institute at Northwestern University Law School. The Executive Summary of the Searle Study is attached as Appendix C.[1] The Searle Study reviewed a representative sample of approximately 300 AAA consumer arbitration case files that were awarded between April and December of 2007. Among the most compelling findings in the Searle study are that:

- **The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.** In cases with claims seeking less than $10,000, consumer claimants paid an average of $96.
- **AAA consumer arbitration seems to be an expeditious way to resolve disputes.** The average time from filing to final award for the consumer arbitrations studied was 6.9 months.
- **No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.** Consumer claimants won some relief in 51.8% of cases against repeat businesses and 55.3% against non-repeat businesses.
- **Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.**

[1] The entire Searle Study, in addition to other information about the Searle Institute, can be found at http://www.searlearbitration.org.

- **A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.**
- **AAA's review of arbitration clauses for Protocol compliance was effective at identifying and responding to clauses with Protocol violations.** In 98.2% of cases in the sample subject to AAA Protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.
- **The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.**
- **As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.**

The Searle findings are clearly a reaffirmation of the effectiveness of the Consumer Protocol, the Supplementary Rules, the AAA's administration of consumer arbitrations, and the value that arbitration can bring in the resolution of small but nonetheless important disputes between consumers and businesses. The Consumer Protocol should be considered by the Subcommittee and others interested in arbitration policy as providing necessary and minimum fairness requirements that should be made a part of any consumer arbitration process. However, it should also be explicitly noted that the Searle study did *not* focus on consumer debt arbitration, which can fairly be viewed as a subset type of consumer arbitration and which requires some additional consideration. As a result, we turn to specific matters related to debt collection arbitrations that require additional attention beyond the issues addressed in the Consumer Protocol.

III. Consumer Debt Arbitrations

The AAA has implemented detailed procedures to ensure that consumer debt arbitrations are administered in a manner consistent with the Consumer Protocol, however, there are certain aspects of consumer debt arbitrations, each of which requires additional consideration. These same aspects of consumer debt collections are also factors in the context of litigation when similar cases proceed through the courts, as evidenced by the study *Debt Weight: The Consumer Credit Crisis in New York City and its Impact on the Working Poor,*[2] which was conducted by the Urban Justice Center. That study reviewed 600 of the 320,000 consumer debt litigations that were filed in New York City Civil Court in 2006 and found that: in 93.3% of those cases the defendant did not appear; defendants are virtually never represented by counsel; and that 80% of the cases result in default judgments against the consumer without requisite proof to establish the damages sought. Recognizing both the similarities and the differences of the litigation and the arbitration processes in matters of consumer debt arbitration, the AAA offers the following potential improvements and enhancements. With the implementation of these additional

[2] Available at http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf

changes, it is the AAA's expectation that the arbitral forum can provide an effective and meaningful alternative to litigating consumer debt arbitrations. This point is particularly important in light of the fact that if arbitration is no longer available for these disputes, a very large number of small dollar claims will be filed in our already overburdened courts. The AAA's position is that each one of the following issues is critical to the administration of debt collection, and that each must be further considered and improvements implemented before additional debt collection arbitrations should proceed.

A. Notice

One of the most difficult issues surrounding the consumer debt arbitration caseload is that consumers rarely appear or participate in the arbitration process. As a result, the arbitration proceeds in their absence in the same manner that a properly commenced litigation proceeds where a defendant does not appear. While it may be that some consumers do not participate as a result of a conscious decision not to do so, the fact is that large numbers of consumers do not appear in debt collection arbitrations. This raises a fair question whether the communications regarding the commencement of the arbitration are being received and understood by the respondents.

The AAA's various rules provide for more informal methods of service than those used in the context of a litigation. The rationale for this is that the parties through their contractual agreement have consented to a more informal method of service, which saves time and money. Consequently, the AAA's rules provide that notice of the commencement of an arbitration can be accomplished by serving notice by mail addressed to the party, or its representative at the last known address, or by personal service provided that reasonable opportunity to be heard with regard to the dispute has been granted to the party.

Notably, the AAA implemented a notice process for our debt collection arbitrations that greatly exceeded the requirements typically contained in our rules. Specifically, we required the claimant business party to serve the demand for arbitration in a manner that could be tracked, with the expectation that a signature would be obtained indicating the each demand had been received. In addition, the AAA's first communication to the consumer respondent was sent initially by certified mail, return receipt requested. After some time, also in an attempt to ensure a greater number of respondents received notice of an AAA arbitration proceeding, the AAA switched to a mailing method in which the United States Postal Service confirms the date and time that the communication was delivered to the addressee. Even after this change, the rate of non-appearance by the consumer remained high. The challenge, therefore, is to take appropriate steps to deliver demands for arbitration, and other arbitration related correspondence in a manner that is more likely to convey the importance of the documents that are being sent to encourage participation by the consumer.

Possible alternative steps that might be taken to address these concerns, include the following:

1. Consider a tiered method of communication for delivering initiation letters. If an initial communication is sent by regular mail and responded to by the consumer, no additional efforts would need to be made. However, if a letter is returned or not signed for when sent by certified mail, we could request that the claimant must confirm the correct address, or re-serve the individual in a manner specified for the service of process under relevant state or federal law.

2. Require service in a manner similar to a summons and complaint in litigation. It should be noted that this manner of services substantially increases the cost of the arbitration and delays the process and potentially impedes the use of arbitration as an informal method of resolving disputes.

3. Multiple methods of AAA communication should be contemplated. For example, if the AAA's initiating letter is sent by U.S. Postal Service with an acknowledgment of delivery, consideration should also be given to sending duplicate initiating letters by other means such as overnight mail or first-class mail. The claimants in these cases might also maintain respondents' e-mail addresses or faxes and if so, communicating via those methods should also be attempted.

4. Careful reemphasizing of the content of the AAA communications should take place so that consumers understand that the consequences of arbitration are serious and significant. Communications should also be tailored so that the arbitration process will appear less forbidding and more accessible.

B. Arbitrator Neutrality

AAA Arbitrators are carefully screened, trained and must go through a rigorous conflict of interest and disclosure process in each AAA arbitration. Nonetheless, it is argued that an appearance of bias might result from arbitrators hearing many cases involving the same business party. To address those concerns, the following steps should be implemented:

1. Limits on the number of cases that an arbitrator may hear involving one particular party should be implemented.
2. Communicate that limitation to the parties to address perceptions regarding arbitrator neutrality.
3. To the extent permissible under applicable law, eliminate the ability of businesses to disqualify arbitrators solely because of prior adverse rulings.
4. Automate arbitrator appointment for debt collection arbitrations so that arbitrators on the roster of debt collection arbitrations are appointed on a random or rotating basis.

C. Pleading and Evidentiary Standards

There are currently no specific rules regarding the documentation that is required to prove that a particular debt is owed. As a result, some claimants provide only limited information about the debt they claim is owed, such as a bill reflecting an outstanding balance. However, affidavits from persons knowledgeable of the debt owed, or other evidence that the debt claimed is owed in the amounts stated in the demands for arbitration is usually not provided. A related problem arises out of allegations that claimants in these types of matters seek attorneys' fees and interest in amounts that may exceed the amounts that can be permissibly recovered under applicable law. The following procedures are therefore suggested to address these concerns:

1. Implement supplemental requirements for consumer debt arbitrations which would specify the documentation and supporting evidence required for demands for arbitration.
2. Provide additional specialized arbitrator training so that arbitrators can identify and address issues regarding the appropriate amount of interest and attorneys' fees that may be awarded.
3. Reinforce the need for arbitrators to be satisfied with their understanding of the applicable law relevant to the particular case, as well as any other evidence submitted.

D. Respondents' Defenses or Counterclaims

In cases where the consumer does participate or make an appearance where they raise the issue that they were the victim of identity theft, or that they never contracted for the goods or service in question, such issues can be fact-intensive and may require a sizable amount of the arbitrator's time to fully consider. However, the relatively limited compensation available to arbitrators may not adequately cover the time required to fully consider those more complicated arbitrations. The following are possible actions that can be taken to address these concerns:

1. Change the administrative fee and arbitrator compensation structure to provide additional compensation to arbitrators in cases where defenses are raised that might require substantially more time to consider. Require that much or all of that additional expense be charged to the business claimant, a policy which is consistent with the AAA's administration of other consumer arbitrations.
   In cases that are contested for reasons such as identity theft, provide a hearing process that accommodates these more factually complex disputes.

E. Arbitrator Training and Recruitment

The AAA maintains a highly qualified and experienced roster of arbitrators who participate in ongoing professional training and education. Arbitrators serving on consumer debt collection cases also receive additional orientation specific to this type of case. Given AAA's brief experience with this particular caseload, we would substantially boost the orientation and training of consumer debt collection arbitrators to ensure focus on the important peculiarities of these cases. The following are the types of issues that would be included in arbitrator training.

1. Substantive law regarding consumer protection statutes and other applicable laws that are common to consumer debt arbitrations.
2. The AAA's procedures for consumer debt arbitration, including evidentiary standards.
3. Notice issues.
4. Identity theft issues.
5. Interest and attorneys' fees, and the extent that they can be awarded in consumer debt arbitrations.

F. Creation of a Consumer Debt Protocol Committee

Similar to the group that was convened to create the Consumer Due Process Protocol, the AAA recommends that a committee of individuals with expertise in the area of consumer debt and arbitration be convened to discuss the matters raised in this testimony and to determine whether these suggestions are viable. We believe that a platform of fair-play standards and safeguards can be arrived at by consensus and collaboration, as evidenced by our previous experience with such standards. Having such procedural safeguards in place will enhance consumer and legal community confidence in the fairness of the process.

G. Continued Publication of Results

The AAA currently maintains a database accessible to the public on our website of all consumer arbitrations of all types conducted nationwide by the AAA. This should continue as an expression of transparency and a source of information for parties subject to disputes. Also, the previously referenced Searle Institute study is an example of valuable insight to be gained through research by reputable, non-partisan organizations and individuals. The Searle Center plans additional studies in the area of consumer debt arbitration, which should provide additional valuable insight.

IV. Conclusion

The AAA appreciates the opportunity to present our thoughts and suggestions on consumer debt arbitration today. Based on our over 83 years of experience, and our recent experience with consumer debt arbitration, we believe that if properly executed and designed, arbitration can provide a prompt, effective and fair forum for the resolution of these disputes.

Mr. KUCINICH. I thank the gentleman.

The Chair recognizes Mr. Bland for 5 minutes. You may proceed.

STATEMENT OF F. PAUL BLAND

Mr. BLAND. Mr. Chairman, thank you so much for the leadership you have shown in this area, both in this hearing and for several years.

Going into last week, I think that the entire consumer and civil rights bar of America was just absolutely shocked. Our eyebrows were singed by the unbelievable revelations that came out of General Swanson's case. That filing was amazing to us, that it turned out that this National Arbitration Forum, which had been holding itself out as a neutral and deciding tens of thousands of cases in favor of debt collectors again and again, one after another, was actually largely owned or owned by 40 percent by the debt collectors themselves.

But as Michael Kinsley, the pundit, always says, the real scandal is what is already legal. And the scandal here is that for 10 years before General Swanson released these facts, you have had this company operating essentially a rogue system that has been completely tilted in favor of the creditor.

First of all, they have this incredible false humility whenever someone challenges them in court, in which they say, well, we are just the court clerks. We don't really make any decisions.

That is not true. They picked who the arbitrators are. Who the decisionmaker is means everything. If I could pick who the judges were in my cases, I would be the legal Michael Jordan sitting here. I would never lose a case. Who the judges are makes a huge difference.

So who do they pick? They do, they say, well we have 1,500 judges. Now, one of the things they got caught lying in a Federal court in West Virginia where they named a bunch of people who were supposedly NAF arbitrators, who were very prominent West Virginia lawyers who weren't, but they do have actually a big roster of a lot of important names. What they do, though, is that they sent cases out to the arbitrators; they figured out who was going to be ruling for the creditor nearly all the time; and they funnel more and more of the case to this small number of people.

So out of the 1,500 arbitrators, who decided the 34,000 cases that they publicly reported on in California? Over 90 percent of those cases were handled by two dozen arbitrators. You had one guy who was deciding something like 1,300 cases. You had people who were deciding 68 cases in a day, 40 cases in days again and again. I mean, that is not judging. That is rubber-stamping.

They were essentially blackballing anybody who ruled for the consumers, and they were funneling all the cases to people who they knew how they were going to rule. OK? That is not the same as small claims court, the unbelievable insults in all the small claims court judges of America. You go in and you get who you get by a random selection. Nobody at the corporation sat down and picked which small claims court you got. That is a big difference.

A second big difference is that there is no verification or substantiation or evidence required in the National Arbitration Forum before they give the creditor everything that they want. That is an

invitation to abuse and the invitation to abuse has been accepted, particularly by debt buyers. A lot of credit card companies sell the debts, frequently for only a few cents on the dollar, sometimes as little as 0.01 cent on the dollar, to debt buyers. And these debt buyers keep getting further and further away. They usually have no evidence by then. They don't have a copy of a contract. They don't have statements. They don't have anything that actually links. They have a name and they have an account number and the dollar figure at the end, and that is it, no verification.

And what they do is that they frequently then add all kinds of things on. Now, there is the idea here that, well, these people actually owe the debt, right? So since they owe the debt, they deserve to lose. Well, what we have seen again and again, literally in hundreds, if not thousands of cases that we have been able to document, again and again somebody will owe $1,500 or $1,000 or $2,000, and then a bunch of junk fees are added, interest on interest, which is illegal; attorneys fees which are not verified. Basically, the attorneys for the debt collector who are rubber-stamping something, and then they are getting $2,000 in attorney's fees, $1,000 in fees to the National Arbitration Forum. And what becomes a $1,500 debt suddenly becomes a $10,000, even a $15,000 or $20,000 debt.

And what happens is that they are rubberstamp arbitrators take those and again and again and again, they just give them 100 cents on what they want.

Now, with small claims court, that is in America, by and large, it is not. In most courts in America, and there are problems in small claims courts in some places. The Boston Globe story was a great story. By the way, the Boston Globe reporter would be taking my position if he was here, and the idea that Elizabeth Warren would be a fan of the National Arbitration Forum as opposed to small claims court is someone who has never met or spoken to Elizabeth Warren.

But what they do is they basically had a deal set up where these debt collectors would send in an email, because they have this interconnection. They don't even have to actually file anything. There is no affidavit with it. The only statement is the email says that our client actually gave it to us. They aren't even saying that it is actually true. They are just saying this is truly what our client gave us. And they send in an email with numbers in it. Then the NAF would take the email and they would turn it into the complaint.

So the consumer, the thing the consumer gets isn't even what there was actually filed. All that was filed were some numbers that were taken from a printout, and then the complaint is sent with an order for 100 cents on the dollar, and that order is signed off again and again by the arbitrator.

It is a joke. It is not the way small claims court goes. In small claims court, you get a default. That means you win. As you say, you win, but you don't get 100 cents on what you want. So you can't add on all these junk fees. You can't multiply debts in a crazy way.

What is going to happen to all these phony awards? So they have stopped operating as of Friday, but meanwhile there are hundreds

of thousands of people out there, hundreds of thousands of people with phony awards that have been entered in against them. Are those all just going to stand? Is that OK?

And then in the race to the bottom, who is going to replace them? Is the Chamber going to be OK with just sitting around and actually having, you know, more neutral arbitrators? Or is the son of NAF going to appear? Is Mr. Anderson going to run out and open up America's happiest consumer-friendly arbitration company in a week, and that will replace them? There is no reason why the banks can't do that.

[The prepared statement of Mr. Bland follows:]

Testimony
Of
F. Paul Bland, Jr.*
Staff Attorney
Public Justice

DOMESTIC POLICY SUBCOMMITTEE
OVERSIGHT AND GOVERNMENT REFORM COMMITTEE

Wednesday, July 22, 2009
2154 Rayburn HOB
2:00 p.m.

"Arbitration" or 'Arbitrary': The Misuse of Arbitration to Collect Consumer Debts

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* F. Paul Bland, Jr., is a Staff Attorney for Public Justice, where he handles precedent-setting complex civil litigation. He has argued or co-argued and won nearly twenty reported decisions from federal and state courts across the nation, including cases in the U.S. Courts of Appeal for the Third, Fourth, Fifth, Eighth and Ninth Circuits, and in the high courts of California, Florida (two cases), Maryland (five cases), New Mexico (two cases), Washington (two cases), and West Virginia. He is a co-author of a book entitled *Consumer Arbitration Agreements: Enforceability and Other Issues*, and numerous articles. For three years, he was a co-chair of the National Association of Consumer Advocates. He was named Maryland Trial Lawyer of the Year in 2009, and in 2006 he was named the "Vern Countryman" Award winner in 2006 by the National Consumer Law Center, which "honors the accomplishments of an exceptional consumer attorney who, through the practice of consumer law, has contributed significantly to the well being of vulnerable consumers." He also has won the San Francisco Trial Lawyer of the Year in 2002 and Maryland Trial Lawyer of the Year in both 2001 and 2009. Prior to coming to Public Justice, he was in private practice in Baltimore. In the late 1980s, he was Chief Nominations Counsel to the U.S. Senate Judiciary Committee. He graduated from Harvard Law School in 1986 and Georgetown University in 1983.

INTRODUCTION AND SUMMARY

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

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

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

This testimony will address the following issues:

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

BACKGROUND ON PUBLIC JUSTICE

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

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

experience with respect to abuses of mandatory arbitration, having litigated (often successfully) a large number of challenges to abuses of mandatory arbitration in state and federal courts around the nation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5. NAF enters awards with impermissible fees added on

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

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

CONCLUSION

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

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

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

[26] Michael Geist, *Fair.com? An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, 27 Brook. J. Int'l L. 903, 912 (2002).
[27] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[28] Chris Serres, *Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions?* Star Trib. (Minneapolis), May 11, 2008, at 1D.
[29] *Courting Big Business: The Supreme Court's Recent Decisions on Corporate Misconduct and Laws Regulating Corporations*, 110th Cong. (2008) (statement of Elizabeth Bartholet), *available at* http://judiciary.senate.gov/hearings/testimony.cfm?id=3485&wit_id=7313.
[30] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[31] Hillard M. Sterling & Philip G. Schrag, *Default Judgments Against Consumers: Has the System Failed?* 67 Denver U. L. Rev. 357 (1990).
[32] Jessica Silver-Greenberg, *Snagging Debt Collectors*, BusinessWeek, Dec. 1, 2008.
[33] Walter V. Robinson & Beth Healy, *Debt Collectors Hunt the Innocent*, Boston Globe, Sept. 13, 2006.
[34] Robert M. Hunt, *Overview of the Collections Industry*, available at http://www.ftc.gov/bcp/workshops/debtcollection/presentations/hunt.pdf.
[35] Jessica Silver-Greenberg, *Snagging Debt Collectors*, BusinessWeek, Dec. 1, 2008.
[36] *Miller v. Wolpoff & Abramson, LLP*, No. 1:06-CV-207-TS, 2007 WL 2694607, at *8 (N.D. Ind. Sept. 7, 2007).
[37] *Powers v. Hudson & Keyse, LLC*, 656 S.E.2d 578 (Ga. App. 2008).
[38] *See, e.g.*, *Creech v. MBNA Am. Bank, N.A.*, 250 S.W.3d 715 (Mo. Ct. App. 2008) ("In its argument in this Court, Appellant claims that the original agreement with Respondent probably had an agreement to arbitrate and was later amended to include an arbitration agreement. Appellant claims that the amendment was sent by mail to Respondent. Neither party filed with the trial court the original account agreement; instead, Respondent relies upon a copy of the 'amendment' which Appellant claims was mailed to Respondent a short time after the account was opened and which has never been acknowledged as received by Respondent.").
[39] Ind. Code § 34-37-1-7; Minn. Stat. § 600.09; N.Y. C.P.L.R. 2309(c) (McKinney).
[40] For examples of courts rejecting affidavits on this basis, see, e.g., *Palisades Collection L.L.C. v. Gonzalez*, 809 N.Y.S.2d 482 (Civ. Ct. 2005), *Luke v. Unifund CCR Partners*, 2007 WL 2460327 (Tex. App. Aug. 31, 2007).
[41] *See* Sheryl Harris, *Consumers Should Be Suspicious of Arbitration Clause*, Plain Dealer (Cleveland), Feb. 17, 2005, at C5. ("Even victims of identity theft have been wrestled into arbitration [with NAF] and held responsible for charges racked up by thieves.").
[42] Interview with Buddy Newsom and his attorney, Mark Pearson.
[43] Eileen Ambrose, *Read the Fine Print: Arbitration Clause Can Sting You*, Fort Wayne J. Gazette, Mar. 15, 2005, at 8.
[44] Gary Weiss, *Credit Card Arbitration* (Oct. 11, 2007), Forbes.com, http://www.forbes.com/2007/ 10/10/gary-weiss-credit- oped-cx_gw_1011weiss.html.
[45] *MBNA Am. Bank, N.A. v. Cornock*, No. O3-C-0018, slip. op. at 25 (N.H. Super Ct. Mar. 20, 2007) (emphasis added).
[46] Laura Rowley, *Stacking the Deck Against Consumers* (Oct. 17, 2007), Yahoo! Finance, http://finance.yahoo.com/ expert/article/moneyhappy/48748.
[47] *CACV of Colo., LLC v. Corda*, No. NNHCV054016053, 2005 WL 3664087 (Conn. Super. Ct. Dec. 16, 2005). *See also Asset Acceptance, LLC v. Wheeler*, --- S.E.2d ----, 2009 WL 71504, at *1 (Ga. Ct. App. Jan. 13, 2009) (affirming vacatur of NAF arbitration award where consumer had not received proper notice);

Mr. KUCINICH. I thank the gentleman for his testimony. Your time has expired.

The Chair recognizes Professor Drahozal. You may proceed, sir, for 5 minutes.

STATEMENT OF CHRISTOPHER R. DRAHOZAL

Mr. DRAHOZAL. Thank you, Mr. Chairman and Ranking Member Jordan, members of the subcommittee.

I am very pleased to have the opportunity here to talk to you today about at least what colloquially is known as debt collection arbitration. This world has changed dramatically in the last week, as we are all familiar with. It has been sort of fascinating to be an observer of it.

My experience in this area is as a scholar. It is not as a participant. And what we have been doing as part of the Searle Civil Justice Institute is looking at consumer arbitrations. The first phase of our study has been to look at AAA consumer arbitrations, not mass claims being filed by creditors, but individuals claims, most of which, as Mr. Naimark said, were filed by the consumers, but a number of which were also filed by the creditors.

The followup phase of that study I think is where I can be at least somewhat helpful here to the committee, because it seems to me the one question that we need to think about at this point in the process, given what has happened with consumer arbitration, is where do those claims go now? Or what happens in court if those claims end up being decided there instead?

And so what we have been doing in the next phase of our study is looking at consumer or business or creditors bringing debt collection cases in courts. We looked at several samples of courts and have some preliminary findings to share with the committee. What that means is it's an ongoing process. We have more courts we want to look at and more cases we want to look at, but we at least do have some preliminary results. And sort of broadly speaking, those results are as follows.

First of all, in the sample of cases we looked at, the creditors win the vast majority of these cases in court. Of all the judgments that we have examined in the courts in our sample, the creditors won 99.7 percent of the cases, basically all but one in each of the two court samples that we had looked at.

Now, compared to that to our individual American Arbitration Association results, where we found that the business claimants won more like 83 percent of the cases, some relief in those cases. I certainly wouldn't suggest that means the AAA is better for the consumers. I think a big part of the explanation here is different types of claims, but it is important to have something to compare it to. You can't just look at numbers in one setting and conclude that means a process is biased or unbiased.

Of these judgments being entered in court, virtually all of them were entered by default, 96 percent to 98 percent of these cases in court were resolved by default judgments in favor of the creditor. Basically, the consumers just didn't show up.

To the extent we have issues or questions about how you give notice to consumers, what that suggests to me is service of process by a process server is not a magic answer; that even in the court

setting, consumers don't show up. And not surprisingly when they don't show up, they lose.

Now, if you compare that to the AAA cases we looked at, again the individual cases brought by business claimants, rather than the mass arbitrations which we haven't had a chance to look at, under 40 percent of those cases were resolved without the consumer showing up. So again, this is not a matter of anything inherent in the arbitration process that consumers don't show up; that in fact, they can show up and in some settings do show up if it is in their interest to do so.

The third general conclusion that we have reached is in these cases where the creditors are winning, with respect to Mr. Bland, the creditors win 100 cents on the dollar; that essentially they win the entire amount of principal that they seek and the entire amount of interest they are seeking in 97 percent to 99 percent of the cases. All right, there is just a handful of cases where the creditor recovers less than the amount that is being sought.

Again, if you compare that to our AAA cases, there the creditors won 93 percent. And again, I am not suggesting this is necessarily that the consumer arbitration is a superior system. What is going on is these are types of claims where consumers don't show up to dispute them and when they are resolved by whichever venue, they are resolved almost entirely in the creditor's favor.

One final point is in consumer cases in court, there were no trials. I mean, the vast majority of them were default judgments. There were a few summary judgment motions. None of these things went to jury trial. None of them went to a judge trial. This is not a matter of these consumers otherwise would be having all these claims adjudicated in court because these cases never make it that far. And again, it is not court versus arbitration. It is just the nature of the claim.

So what does that suggest to me? Well, I just have two general conclusions. The first is it makes me question whether in fact consumers are not going to be better off if they are going to court rather than in arbitration because the results, I think, at least as far as the outcomes of the cases, look to me pretty much the same at best.

And then second, if you think more broadly about the implications for arbitration and evaluating arbitration, what these numbers to me suggest is you cannot find bias in a forum simply because it tends to rule one way. You have to compare it to something, and you have to compare arbitration not to consumer claimants, but you have to compare business claimants in arbitration to business claimants in court. And the claims and results look an awful lot the same to me, suggesting to me that it is not the venue that matters. It is the type of claim that matters.

Thank you.

[The prepared statement of Mr. Drahozal follows:]

Statement of Christopher R. Drahozal

John M. Rounds Professor of Law
University of Kansas School of Law

Chair, Consumer Arbitration Task Force
Searle Civil Justice Institute

July 22, 2009

House Committee on Oversight and Government Reform
Subcommittee on Domestic Policy

Hearing on
Arbitration or 'Arbitrary':
The Misuse of Arbitration to Collect Consumer Debts

Chairman Kucinich, Ranking Member Jordan, and Members of the Subcommittee: I appreciate the opportunity to testify on what is known colloquially as "debt collection arbitration" – arbitration claims brought by creditors seeking to recover amounts alleged to be owed by consumers. I am the John M. Rounds Professor of Law at the University of Kansas School of Law, and the Chair of the Consumer Arbitration Task Force of the Searle Civil Justice Institute. I also am an Associate Reporter for the Restatement, Third, of the U.S. Law of International Commercial Arbitration, and have written extensively on the law and economics of arbitration.

I. Overview

My testimony today addresses empirical evidence on two central issues arising out of debt collection arbitration: (1) how consumers fare, in particular relative to how consumers fare in similar cases in court; and (2) whether arbitration is biased in favor of repeat players – i.e., parties that appear more frequently in arbitration. Both critics and supporters of arbitration in consumer settings have come to recognize the importance of empirical evidence in making sound public policy decisions in the area.[1] Indeed, Professor Peter B. Rutledge has recently written that "there now appears to be a consensus that the future of arbitration should be decided by data, not anecdote."[2]

The empirical evidence I discuss is from an ongoing study by the Searle Civil Justice Institute of consumer arbitrations administered by the American Arbitration Association. The study is discussed in more detail below. Key findings from the study (including preliminary results from an examination of debt collection cases in court) are the following:

- In a sample of AAA consumer arbitrations, business claimants won some relief in 83.6% of awarded cases and in those cases recovered an average of 93.0% of the amount claimed. By comparison, in a sample of cases from Oklahoma state courts, business claimants bringing debt collection cases won some relief in 99.7% of the cases going to judgment, and in those cases were awarded 99.5% of the amount sought. Similarly, in a sample of cases in which the federal government sought to recover unpaid student loan debts in federal court, the government won some relief in 99.7% of the cases, and in those cases was awarded 99.3% of the amount sought.

- In addition, the study found mixed evidence as to whether a repeat-player effect exists in arbitration (i.e., whether repeat businesses fare better than non-repeat businesses in arbitration). Using a traditional definition of repeat-player business, the study found no

[1] Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. PUB. POL'Y 549, 589 (2008) (concluding that "[i]ncreased congressional attention" to consumer and employment arbitration "can be valuable, for it promotes discussion and study about this valuable dispute resolution tool" but also "can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study"); Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration 2 (2008), *available* at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf ("Rutledge concludes *Whither* with the warning that congressional scrutiny of arbitration 'can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study.' We agree.").

[2] Peter B. Rutledge, *Common Ground in the Arbitration Debate*, 1 Y.B. ARB. & MED. 1 (2009).

statistically significant repeat-player effect in arbitration. When an alternative definition was used, the study did find some evidence of a repeat-player effect, but the data suggest that any such effect is due to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims), rather than any bias in arbitration.

II. Creditors in AAA Consumer Arbitrations: Summary of Results from the Searle Study

In March 2009, the Consumer Arbitration Task Force of the Searle Civil Justice Institute – of which I serve as chair – released a Preliminary Report on *Consumer Arbitration Before the American Arbitration Association*.[3] The American Arbitration Association ("AAA") is a leading provider of arbitration services, including arbitrations between consumers and businesses. The study is the most comprehensive empirical research to date on consumer arbitration procedures and outcomes. Funding for the study comes exclusively from the initial grant establishing the Searle Center at Northwestern Law School from the late Daniel C. Searle, longtime philanthropist and Northwestern University trustee. A copy of the Executive Summary is appended at the end of this statement, and a full copy of the Preliminary Report is available at www.searlearbitration.org.

A. Empirical Methodology

The primary dataset studied by the Task Force consists of 301 AAA consumer arbitrations that were closed by an award between April and December 2007.[4] (The focus on cases closed by an award during this time period is based on the availability of the original case files.) Just over twenty percent (61 of 301, or 20.3%) of the cases in the sample involved claims brought by businesses against consumers, typically as creditors seeking to recover amounts allegedly owed by consumers for services rendered or goods supplied. The most common types of business claimants in the sample were law and accounting firms (20 of 61, or 32.8%), home builders (13 of 61, or 21.3%), and real estate brokers (12 of 61, or 19.7%). Credit card companies and other lenders made up another roughly fifteen percent of the business claimants in the sample.

The sample of cases was coded for approximately 200 variables describing various aspects of the arbitration process. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA. Prior to release, the report was reviewed by independent academic experts on arbitration and empirical studies, including both critics and supporters of consumer arbitration. It also was subject to

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[3] Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association (Mar. 2009), *available at* www.searlearbitration.org.

[4] Beginning in fall 2007, the AAA administered a number of arbitrations brought by a single buyer of consumer debt. Those cases were not covered by the Preliminary Report because no awards were issued until 2008 and insufficient data was available on those cases. We are currently in the process of studying the procedures and outcomes in those cases, and will report our findings when they become available.

review by the SCJI Board of Overseers, which consists of general counsels, plaintiffs' lawyers, defense lawyers, academics, and state and federal judges.

B. Outcomes

A central controversy in discussions of debt collection arbitration is how consumers fare. A number of empirical studies have examined the success rate of consumers in such arbitrations, focusing on claims against credit cardholders and using data on arbitrations administered by the National Arbitration Forum. The studies find a win-rate for business claimants (almost exclusively credit card issuers or their assigns) ranging from 67.9% to 99.6%.[5] Much of the variation in these results is due to differences in how the studies treat cases that are settled or dismissed before an award.

The Searle study, which instead looked at AAA arbitrations involving different types of business claimants, found that business claimants won some relief in 83.6% of the awarded cases and recovered an average of $20,648 in those cases – or 93.0% of the amount claimed. By comparison, consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255 in those cases, or 52.1% of the amount claimed.

These numbers do not in themselves show that arbitration is a biased means of resolving consumer disputes. Despite suggestions to the contrary, a high win-rate for business claimants by itself does not show bias. The win-rate is only meaningful in comparison to some baseline. A fifty percent win-rate for claimants may be extremely high if claimants bringing similar claims tend to win at a lower rate in court, or extremely low if claimants bringing similar claims tend to win at a higher rate in court. The same is true of a ninety-percent win-rate or even a ninety-nine percent win-rate.

Nor does comparing the win-rates of business claimants to the win-rates of consumer claimants provide evidence of bias in arbitration. As we explained in our Preliminary Report, the differing success rates for business claimants and consumer claimants appear to result from two factors, neither of which are evidence of bias.[6] First, the types of claims businesses in our sample bring differ from the types of claims consumers bring. Businesses tend to bring claims for amounts they are owed for services already rendered (the subject of this hearing). In such cases, the business faces fewer hurdles to establishing liability, and, when it does so, the amount

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[5] Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, METRO. CORP. COUNSEL, July 2006, at 32 (business claimants "prevail in 77.7% of the cases that reach a decision"); Jeff Nielsen et al., Navigant Consulting, National Arbitration Forum: California Consumer Arbitration Data 1 (July 11, 2008), *available at* http://www.instituteforlegalreform.com/index.php?option=com_ilr_docs&issue_code=ADR&doc_type=STU (businesses prevailed in 67.9% of NAF arbitrations either heard by an arbitrator or dismissed); Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers 15 (Sept. 2007), *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf ("In 19,294 cases in which an arbitrator was appointed, the business won in 18,091 (or 93.8%)"); Answers and Objections of First USA Bank, N.A. to Plaintiff's Second Set of Interrogatories, Ex. 1, Bownes v. First U.S.A. Bank, N.A. et al., Civ. Action No. 99-2479-PR (Ala. Circuit Ct. 2000), *available* at http://www.tlpj.org/briefs/McQuillan%20exhibits%2016-19%20(300dpi).pdf (last visited Dec. 10, 2008) (bank prevailed in 19,618 NAF arbitrations, while credit cardholder prevailed in 87).

[6] Searle Civil Justice Institute, *supra* note 3, at 70.

it should be awarded is relatively easy to calculate and prove. Consumers tend to bring claims alleging delivery of defective goods or improper performance of services. Such cases tend to present more difficult questions of proving both liability and damages. Accordingly, consumers tend to win less often in cases that make it to an award, and, when they do win, tend to recover a lower percentage of the damages they seek. Second, a number of business claims are resolved on an ex parte basis, because the consumer fails to respond to the demand for arbitration.[7] Conversely, the business respondent appeared in every case brought by a consumer. The greater number of defaults is another important factor in explaining the higher success rate of business claimants.

Instead, the proper comparison is between outcomes in cases in arbitration and outcomes in similar cases in court. In the next phase of the Searle study we are seeking to undertake such a comparison. Some preliminary results of that inquiry are reported in Part III of this statement.

C. Repeat-Arbitrator Bias

A related concern is so-called "repeat-arbitrator bias." Unlike judges, who get paid regardless of how many cases they decide, arbitrators get paid only when they are selected to decide a case. These differing compensation structures have given rise to fears that arbitrators will be biased in favor of "repeat players," parties that are more likely to be in a position to appoint the arbitrator in a future case.[8] In debt collection arbitrations, the creditor is a repeat player; consumers are unlikely to be repeat players, although their attorneys may be.

Prior academic studies have found some evidence of a "repeat-player effect" – that repeat players have higher win-rates in arbitration than non-repeat players. But the studies have generally attributed the repeat-player effect to better screening of cases by repeat players rather than bias by arbitrators.[9] The findings of the Searle study are similar.

First, the study found no statistically significant repeat-player effect using a traditional definition of repeat-player business. Consumer claimants won some relief in 51.8% of cases against businesses that appear more than once in the AAA dataset (repeat businesses) and 55.3% of cases against businesses that appear only once (non-repeat businesses) – a difference that is not statistically significant.

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[7] Of the sixty-one cases brought by business claimants, twenty-two (or 36.1%) were resolved on an ex parte basis – i.e., without the consumer appearing in the case. *Id.* at 70 n.59.

[8] *E.g.*, Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1256 (2001); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 60-61; *see also* Public Citizen, Arbitration Debate Trap, *supra* note 1, at 24-26.

[9] *E.g.*, Lisa B. Bingham, *Unequal Bargaining Power: An Alternative Account for the Repeat Player Effect in Employment Arbitration*, IRRA 50TH ANN. PROC. 33, 39-40 (1998); Lisa B. Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference*, *in* ALTERNATE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NEW YORK UNIVERSITY 53RD ANNUAL CONFERENCE ON LABOR 303, 323 tbl. 2 (Samuel Estreicher & David Sherwyn eds. 2004); Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, DISP. RESOL. J., May/July 2003, at 15.

Second, using an alternative definition of repeat player, the study found some evidence of a repeat-player effect. Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses (as defined based on the AAA's categorization of businesses in enforcing its Consumer Due Process Protocol) – a difference that is statistically significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that any repeat-player effect is attributable to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims) rather than arbitrator bias.

III. Creditors in Court: Preliminary Results

As noted above, the next phase of the Searle study is seeking to compare outcomes in the AAA consumer arbitration cases we studied to outcomes in similar court cases. That phase is underway, and we are able to report some preliminary results. These results are preliminary; that is, they are subject to further analysis and review. Although we do not expect them to change significantly, that remains a possibility. We also will be considering data from other courts than those described below, which may or may not give similar results. Nonetheless, the data below provide some insights into the outcomes of debt collection cases in court.

A. Federal Court Student Loan Cases

Data on federal court cases compiled by the Administrative Office of the U.S. Courts are widely used by researchers studying court outcomes. Included in the dataset are cases brought by the federal government that seek to recover amounts owed on unpaid student loans. In those cases, a creditor (i.e., the federal government) is seeking to recovery an amount (averaging just over $17,000) allegedly owed by a consumer. The cases are debt collection cases in federal court seeking an amount similar to the amount sought in the AAA consumer cases we studied.

We examined all federal court cases terminated between late 2006 and late 2007, the most recent period for which data is available, coded as involving unpaid student loans. Our sample consists of those cases in which a prevailing party and some amount demanded were recorded in the dataset, so that we could calculate win-rates and the percentage of the amount demanded that was recovered by a prevailing plaintiff.[10] To correct obvious coding errors in the data, we examined federal court docket sheets available on Westlaw, and, when necessary, the original court files using PACER.

[10] Because the cases all involved claims for unpaid loans, the amount sought likely is specified in the complaint filed in the case. We have no reason to believe that our focus on those cases in which the amount demanded was coded as a non-zero amount biases our results in any way.

Of the 382 cases in our sample, 286 (or 73.5%) were resolved by default judgment, and another 84 (22.0%) by consent judgment. Another 11 cases were adjudicated by pretrial motion (usually on summary judgment); the government won all 11 of those cases. No case made it to trial, by jury or by judge. In only one case (1 of 382, or 0.3%) did the defendant prevail.[11] Overall, then, excluding consent judgments, the government as creditor won in 297 out of 298 cases (99.7%), with 286 (or 96.0%) of those cases consisting of default judgments.

Moreover, the government recovered the entire amount sought (or more) in 96.6% (285 of 295[12]) cases in which it prevailed. Overall, the government recovered an average of 99.3% of the amount it sought.

B. Oklahoma State Court Cases

The vast majority of debt collection cases are brought in state court, rather than federal court.[13] Unfortunately, the availability of systematic data from state courts is much more limited. As part of the next phase of the Searle study, we collected data from a random sample of court files from cases in Oklahoma district courts for which complete case filings are available online.[14] The sample consists of 421 cases seeking less than $10,000 filed in Oklahoma district courts and closed between March 31, 2007, and December 31, 2007 (the dates covered by our AAA consumer cases).

Of those 421 cases, 419 were brought by creditors seeking to recover unpaid debts. (The other two were brought by consumers; both of the cases with consumer claimants settled). The majority of the creditor claims (245 of 419, or 58.5%) were brought by a party other than the original creditor, either a debt collection agency or debt buyer. This is not surprising, because Oklahoma law precludes such parties from suing in small claims court.[15]

Over two-thirds of the claims brought by creditors (282 of 421, or 67.0%) resulted in default judgments in favor of the creditor. Just over a quarter (108 of 421, or 25.7%) were dismissed (usually either because of a settlement or for inability to serve process, although it is difficult to be certain). An additional twenty-two cases (5.2% of the sample) resulted in agreed awards in favor of the creditor. Nine cases were decided on summary judgment; in eight of those

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[11] In that case, the court originally entered a default judgment against the consumer. Later, the default judgment was vacated and the case was dismissed, based on the parties' agreement that the consumer was not liable for the debt. Arguably, the case should not have been included in the sample at all, because the case was terminated in 2008, rather than in the sample period.

[12] Data on the amount recovered were missing in two of the cases. In a number of the cases, the damages awarded were more than the amount claimed, almost always because interest continued to accrue while the case was pending. In all of those cases, the creditor recovered the full amount of principal sought, and so accordingly we capped the recovery at 100% of the amount claimed.

[13] Federal Trade Commission, Collecting Consumer Debts: The Challenges of Change 55 (Feb. 2009).

[14] A number of states permit online access to court filings. Oklahoma courts are unusual, if not unique, in that they permit a user to search for cases closed in particular months or years. The sole reason we chose Oklahoma courts to study was the ability to search court files online in such a manner.

[15] 12 Okla. Stat. § 1751(B) ("No action may be brought under the small claims procedure by any collection agency, collection agent, or assignee of a claim ...."). We are also studying other divisions of the Oklahoma district courts (including the small claims division), but do not have yet have results to report.

cases the creditor prevailed. No case made it to trial, by jury or by judge. Overall, of the cases that made it to judgment (i.e., were not dismissed or settled), the creditor prevailed 99.7% (290 of 291) of the time, with 96.9% (282 of 291) of those judgments entered by default.

Of the cases in which the creditor had judgment entered in its favor (excluding agreed judgments), the creditor recovered at least 100% of the amount of damages claimed 98.6% (284 of 288 cases) of the time.[16] In the four cases (1.4% of the total judgments) in which the creditor recovered less than 100% of the amount sought, the percent recovered ranged from 30% to 97%.[17] Overall, creditors recovered on average 99.5% of the amount they sought in cases in which judgment was entered in their favor.

IV. Limitations and Conclusions

While the empirical results presented in the Searle study are the most comprehensive available, the study nonetheless has limitations. First, its findings on arbitration are limited to AAA consumer arbitration. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. That said, in setting national policy concerning arbitration, information on consumer arbitrations administered by the AAA, a leading provider of arbitration services, certainly is necessary for making an informed decision. Second, our preliminary findings on debt collection actions in court are, as stated, preliminary, and are limited to particular types of claims and specific courts. The study is ongoing: we are continuing to examine other courts and other types of claims, and any additional findings may vary. Third, cases are not selected into arbitration randomly; thus, finding truly comparable cases between court and arbitration is extremely difficult.

Despite these limitations, the preliminary findings nonetheless appear to be inconsistent with the argument that high win-rates for businesses in debt collection arbitrations show that arbitration is biased in favor of those businesses. Instead, the win-rates, while high in absolute terms and higher than win-rates for claims brought by consumers in arbitration, appear similar to win-rates for comparable claims brought in court. Thus, while the findings are only preliminary, they nonetheless suggest that business win-rates in debt collection cases may be due to the types of claims being brought and not to the forum in which they are adjudicated.

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[16] In two of the cases, the judgment document itself was not available in the online database. In a number of the cases, the damages awarded were more than the amount claimed, almost always because interest continued to accrue while the case was pending. In all of those cases, the creditor recovered the full amount of principal sought, and so accordingly we capped the recovery at 100% of the amount claimed.

[17] In the case in which the creditor recovered thirty percent of the amount sought, the creditor sought to recover the collateral for the loan as well. The difference between the amount sought and the amount recovered may reflect the value of the collateral.

NorthwesternLaw
Searle Center on Law, Regulation, and Economic Growth

Searle Civil Justice Institute

CONSUMER ARBITRATION BEFORE THE AMERICAN ARBITRATION ASSOCIATION

Executive Summary
March 2009

Issues and Background

Empirical evidence has become a central focus of the policy debate over consumer and employment arbitration. Both supporters and opponents of the proposed Arbitration Fairness Act, which would make pre-dispute arbitration clauses unenforceable in consumer and employment (and franchise) agreements, have recognized that empirical evidence on the fairness and integrity of consumer and employment arbitration proceedings is essential to making an informed decision on the bill. Yet the empirical record, particularly on consumer arbitration, has critical gaps.

One set of issues on which further empirical research would be helpful is the costs, speed, and outcomes of consumer arbitrations. How much do consumers pay to bring claims in arbitration? How long do consumer arbitrations take to resolve? How do consumers fare in arbitration, particularly against businesses that are repeat users of arbitrators and arbitration providers? While a number of important studies on employment arbitration have been provided, the empirical record on these issues in consumer arbitrations is sparse.

A second set of issues of interest involves the enforcement of arbitration due process protocols -- privately created standards setting out minimum requirements of procedural fairness for consumer and employment arbitrations. Due process protocols commonly require independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court. Leading arbitration providers have pledged not to administer arbitrations arising out of arbitration clauses that violate the protocols. But empirical evidence on the effectiveness of these private enforcement efforts is lacking.

Searle Civil Justice Institute Task Force on Consumer Arbitration

To shed light on these issues, the Searle Civil Justice Institute (SCJI) undertook a large-scale study of consumer arbitrations administered by the American Arbitration Association (AAA). The AAA is a leading provider of arbitration services, including arbitrations between consumers and businesses. SCJI commissioned a Task Force to advise and lead this study of consumer arbitrations. Although the study will ultimately examine many aspects of AAA consumer arbitrations, the initial research inquiries were directed at two topics:

1. *Costs, Speed, and Outcomes of AAA Consumer Arbitrations.* This aspect of the Preliminary Report assesses key characteristics of the AAA consumer arbitration process. In particular, it examines the following research questions:

    - General characteristics of AAA consumer arbitration cases including claimant type (i.e., consumer or business), types of businesses involved, and amounts claimed.
    - Costs of consumer arbitration (arbitrator fees plus AAA administrative fees), including the impact of the arbitrator's power to reallocate such fees in the award.
    - Speed of the arbitration process from filing to award, in the aggregate and by claimant type (i.e., consumer or business).
    - Various measures of outcomes such as win-rates, damages awarded, and evidence of as well as possible explanations for any repeat-player effects.

In addition to these broad research questions, SCJI also examined the extent to which consumer arbitrations are resolved ex parte; the frequency with which arbitrators award attorneys' fees, punitive damages, and interest; and results for consumers proceeding pro se.

2. *AAA Enforcement of the Consumer Due Process Protocol.* This aspect of the Preliminary Report provides an empirical analysis of how effectively the AAA enforces compliance with the Consumer Due Process Protocol. It considers a number of key research questions including:

    - To what extent do the consumer arbitration clauses comply, in their own right, with the Due Process Protocol?
    - How effective is AAA review of arbitration clauses for compliance with the Due Process Protocol?
    - To what extent does the AAA refuse to administer consumer cases because of the failure of businesses to comply with the Due Process Protocol?
    - How do businesses respond to AAA enforcement of the Protocol?

In addition to these research questions, SCJI examined several other issues that arise in connection with the Due Process Protocols.

Data and Methodology

SCJI reviewed a sample of AAA case files involving consumer arbitrations. The primary dataset consists of 301 AAA consumer arbitrations that were closed by an award between April and December of 2007. (The focus on cases closed by an award during this particular timeframe is based on the availability of the original case files.) This sample of cases was then coded for approximately 200 variables describing various aspects of the arbitration process, including a review of the arbitration clause in the file. In addition, when possible a broader AAA dataset comprising all consumer cases closed between 2005 and 2007 was utilized. The AAA maintains this dataset in the ordinary course of its business, collecting data for internal purposes but not

recording all variables of interest to SCJI. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA.

Key Findings – Costs, Speed, and Outcomes of AAA Consumer Arbitrations

The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.

In cases with claims seeking less than $10,000, consumer claimants paid an average of $96 ($1 administrative fees + $95 arbitrator fees). This amount increases to $219 ($15 administrative fees + $204 arbitrator fees) for claims between $10,000 and $75,000. These amounts fall below levels specified in the AAA fee schedule for low-cost arbitrations, and are a result of arbitrators reallocating consumer costs to businesses.

AAA consumer arbitration seems to be an expeditious way to resolve disputes.

The average time from filing to final award for the consumer arbitrations studied was 6.9 months. Cases with business claimants were resolved on average in 6.6 months and cases with consumer claimants were resolved on average in 7.0 months.

Consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255; business claimants won some relief in 83.6% of their cases and recovered an average of $20,648.

The average award to a successful consumer claimant in the sample was 52.1% of the amount claimed and to a successful business claimant was 93.0% of the amount claimed. This result appears to be driven by differences in types of claims initiated by consumers and business. Business claims are almost exclusively for payment of goods and services while consumer claims are seeking recovery for non-delivery, breach of warranty, and consumer protection violations.

No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.

Consumer claimants won some relief in 51.8% of cases against repeat businesses under a traditional definition (i.e., businesses who appear more than once in the AAA dataset) and 55.3% against non-repeat businesses – a difference that is not statistically significant.

Utilizing an alternative definition of repeat player, some evidence of a repeat-player effect was identified; the data suggests this result may be due to better case screening by repeat players.

Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses under an alternative definition (based on the AAA's categorization of businesses in enforcing the Consumer Due Process Protocol) – a difference that is statistically

significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that such effect is attributable to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims).

Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.

Consumer claimants sought to recover attorneys' fees in over 50% of the cases in which they were awarded damages and were awarded attorneys' fees in 63.1% of those cases. In those cases in which the award of attorneys' fees specified a dollar amount, the average attorneys' fee award was $14,574.

Key Findings – AAA Enforcement of the Due Process Protocol

A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.

Most arbitration clauses in consumer contracts that come before the AAA are consistent with the Consumer Due Process Protocol as applied by the AAA. The same is true for cases in which protocol compliance was a matter for the arbitrator to enforce.

AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations.

In 98.2% of cases in the sample subject to AAA protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.

In 2007, the AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases (9.4% of its consumer case load), because the business failed to comply with the Consumer Due Process Protocol. The most common reason for refusing to administer a case (55 of 129 cases, or 42.6%) was the business's failure to pay its share of the costs of arbitration rather than any problematic provision in the arbitration clause.

As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.

In response to AAA review, more than 150 businesses have either waived problematic provisions on an ongoing basis or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. This is in addition to the more than 1550 businesses identified

by the AAA as having arbitration clauses that comply with the Protocol. By comparison, AAA has identified 647 businesses for which it will not administer arbitrations because of Protocol violations.

Policy Implications and Next Steps

The empirical findings in the SCJI Preliminary Report on AAA consumer arbitrations have important implications for those interested in discussing and formulating public policy regarding arbitration.

1. Not all consumer arbitrations, arbitration providers, or arbitration clauses are alike. Differing results from empirical studies of arbitration may reflect variations associated with case mix, type of claimant, or provider review processes. This suggests the need for a nuanced approach to public policy concerning arbitration.

2. Private regulation complements existing public regulation of the fairness of consumer arbitration clauses. Policy makers should not ignore the role that arbitration providers can play in promoting fairness on behalf of consumers.

3. Courts could usefully reinforce the AAA's enforcement of the Consumer Due Process Protocol by declining to enforce an arbitration clause when the AAA has refused to administer an arbitration arising out of the clause or by otherwise reinforcing the role of the Due Process Protocol.

4. Arbitration may be less expensive for consumers than sometimes believed. For many consumers, the AAA arbitration process costs less than the amount specified in the AAA rules because arbitrators often shift some portion of the costs to businesses. Moreover, arbitrators award attorneys' fees to a substantial proportion of prevailing consumers in AAA consumer arbitrations.

5. Empirical studies have tended to find that repeat players fare better in arbitration than non-repeat players. To the extent such a repeat-player effect exists in arbitration, the critical policy question is what causes it. Our findings are consistent with prior studies in suggesting that any repeat-player effect is likely caused by better case screening by repeat players rather than arbitrator (or other) bias in favor of repeat players. A further as yet unresolved question is whether a repeat-player effect exists in litigation, and, if so, how litigation compares to arbitration in this regard.

While the empirical results presented in the SCJI Preliminary Report on Consumer Arbitration may usefully inform the policy debate on consumer arbitration, the Report nonetheless has limitations. First, its findings are limited to AAA consumer arbitrations. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. Second, its findings on the costs, speed, and outcomes of AAA consumer arbitrations are difficult to interpret without a baseline for comparison, such as the procedures and practices in traditional court proceedings. A future phase of this research project by the Searle Civil Justice

Institute's Task Force on Consumer Arbitration will undertake that comparison. It will seek to compare the procedures in AAA consumer arbitration with procedures available for consumers in court as well as comparing empirically key process characteristics of courts and arbitration.

Mr. KUCINICH. Thank you, Professor.

We are now going to proceed with questioning from members of our subcommittee. And I will start with my 5 minutes, and then continue alternating between Democratic Members of the panel and Republican Members of the panel.

I want to start with Mr. Kelly. I appreciate your being here. Now, in your testimony you claim that arbitration is fair to consumers. But when you are marketing your services to banks, you tell your service people, and I just want to put up a slide here, a slide of page 2 from a Forthright-created paper entitled, "Non-Mandatory Paper Education."

You tell your sales people to tell the banks that one of the benefits of arbitration is that it gives him control of the process. And in your marketing presentation to collection companies—I would like the next slide please—this is the way you describe the effect of arbitration on the consumer: "The consumer does not know what to expect from arbitration and is more willing to pay;" "They ask you to explain what arbitration is, and basically hand you the money;" "You have all the leverage and the customer really has little choice but to take care of his accounts."

Mr. Kelly, given the arbitrary and unfair results that our staff uncovered in its review of NAF claim files, and given the revelations by Attorney General Swanson in the complaint she filed against the NAF last week of the close financial relationship between the NAF and the debt collection industry, isn't it obvious that consumers have not been getting fair hearings in the NAF arbitrations?

Mr. KELLY. Chairman Kucinich, there were several questions in there. I will try to break them down. If I miss one, please——

Mr. KUCINICH. Start with fair hearings. Are consumers getting fair hearings when the marketing is slanted in that way?

Mr. KELLY. I will say that, I will note that the rest of that presentation does talk about due process protections and also discusses the fact that no outcomes are guaranteed and that the process is neutral and it does depend on the independence of the specific neutrals.

With respect to marketing, we don't shy away from explaining that we do market our services, and we market our services where the largest number of cases are. Frankly, in our civil justice system today, the majority of the cases are debt collection cases, and we market those services. We did, excuse me. I need to keep making that clear. We obviously don't any longer and won't.

But I will say that, you know, at the National Arbitration Forum, they were unabashed believers that arbitration was a superior alternative to court. It is cheaper. It is efficient. It is faster.

Now, in the case of collection of debt, it works the same. It would be cheaper. It would be effective and it would be faster.

Mr. KUCINICH. Well, you know, but I had some specific questions here. Now, isn't it true that your marketing statements describe the real character of consumer debt collection arbitration? It is intimidating to a consumer. It gives much more control and leverage to the creditor and it leaves the consumer with little choice but to pay. I mean, that is what you have said. Isn't that the true character of consumer debt collection arbitration?

Mr. KELLY. Well, obviously I can't deny the presence of this document. I believe it was back in 2003. I joined in 2006. I don't believe it is the most artfully drafted presentation by any means. But I will say it is the same. I mean, the process is difficult to work through, whether it is court or whether it is arbitration. We go back to the point that is it any different between court or arbitration? Is there any fundamental difference?

I believe that if there fundamental differences, they are in favor of arbitration.

Mr. KUCINICH. Well, you claim that the NAF has rules to protect the consumer, but our investigation finds that NAF doesn't follow those rules. The NAF has a Rule Six that says that the notice of arbitration must be served promptly. The word promptly is not defined in your code of procedure. But until August 1, 2008, NAF Rule 41(b)(3) said that any claim could be dismissed if more than 90 days passed between the filing of the claim and the proof of service of the notice of arbitration.

Now, the subcommittee staff looked at the forms that the NAF sends to the arbitrator with each batch of claims. They are called desk hearing lists. And each one contains a list of claims that the NAF was assigning in that batch, and it recites for each claim the date on which the claim was filed and the date on which the notice of arbitration was served. These desk hearing lists that we reviewed showed that 160 of 230, approximately 70 percent of the total, should have been dismissed by the NAF before they were even sent to the arbitrators because the notice was served more than 90 days, in some cases a lot more than 90 days after filing, but not one of those cases was dismissed.

You know, here is part of the desk hearing list sent to the Arbitrator Snyder. Let me put up this exhibit and then I will move on to the next questioner. It shows that NAF sent Arbitrator Snyder claims that were served more than a year after they were filed, clear violations of Rule Six. I mean, this, you know, doesn't it show that you don't really follow your own rules when those rules favor the consumer?

Mr. KELLY. I believe the discussion centers around Rule 41(b). What Rule 41(b) states is a claim or response may be dismissed by an arbitrator or the Forum at the request of a party, in accord with Rule 18 or on the initiative of the arbitrator, may—may is the key word in this case—the arbitrator has the discretion to make that determination if it is in the interest of justice. That is not for the Forum to make. It is for the arbitrator to make and it is made as purely discretionary.

Now, I will have to check this, but my recollection is that this is a fairly new rule as well. So I would have to look at whether this rule was in place.

Mr. KUCINICH. We are going to move on to Mr. Jordan, and you know, you can have 6½ minutes to match my time. I just want to say it may be 90 days. It may be a year. It may.

Mr. JORDAN. Mr. Kelly, what percentage of your business was debt collection arbitration? Was it a majority?

Mr. KELLY. I don't have a specific number, but yes, clearly the majority.

Mr. JORDAN. And what percentage of overall debt collection arbitration cases around the country did your company handle? The majority?

Mr. KELLY. I couldn't answer that question because I just don't know. Those statistics aren't publicly available, so I don't know what the universe is out there of arbitration. We are a major player, if that is your point; were.

Mr. JORDAN. Were you the largest player? Were you the largest player in this?

Mr. KELLY. I believe, I would believe we would be.

Mr. JORDAN. And as of last week, you are no longer in the business?

Mr. KELLY. That is correct.

Mr. JORDAN. We have heard testimony here about the court system, the difficulties there. I mean, maybe this should go to Mr. Naimark, or maybe to our attorney general on this, but now that you are out of the business, and you were the biggest player, are we going to be OK? I mean, Mr. Naimark, do you want to comment? Can we handle what is going to happen now?

Mr. NAIMARK. Well, we have announced that we will not receive these cases, at least at the present time, until there is some establishment of some establishment of additional standards of fair play like the due process protocols that we described.

Mr. JORDAN. So the whole motivation of this hearing is look out for consumers out there. So what is going to happen in this flux we are in or this interim period? Would the attorney general like to comment?

Ms. SWANSON. Sure, Mr. Chairman, Ranking Member Jordan. I think that is why it is important for Congress to act. You know, the National Arbitration Forum was, as I understand it, the dominant player in the consumer collection industry. There could be other companies, other arbitration companies right now that would take over these claims and could arbitrate them, or a whole new company could pop up tomorrow. And that is why I think this hearing is so important, and commend all of you for your leadership in holding it, and why I think it is important that Congress act to rein in these practices.

National Arbitration Forum was one company, but the underlying problems with mandatory pre-dispute arbitrations run across the industry and are systemic.

Mr. JORDAN. Attorney General, would you agree with what the professor had to say? I believe his comment was it is not the venue, it is the type of claim that is the determining factor here. Do you think that is an accurate statement?

Ms. SWANSON. Ranking Member Jordan, no, I don't. I think the venue is problematic with arbitration because you are essentially allowing the corporations who are litigants to hand pick the judge. You are letting the corporations select which arbitration company you want to adjudicate the claim.

And based on the interviews we have conducted of consumers, of arbitrators, of employees, there is tremendous pressure on the arbitration companies. It is a very, very lucrative and profitable business, and the corporations know that if the arbitration company isn't perceived to be friendly enough to corporate litigants, they can

simply move their business to a new company for all the reasons I described. So I think the venue is problematic.

Mr. JORDAN. Thank you.

Mr. Naimark, what is your response to what the professor said? I thought he laid out some good numbers in his statement about the venue versus the type of claim.

Mr. NAIMARK. Well, I think we see from the research and people's experience that there are similar problems in both court and arbitration. The real issue is nonparticipation by the individual debtor. It think it is a real problem. I think some how or other we need to build in some safeguards. We need to try to get their attention. We need to do better at communicating with them. And I think our civil justice system at large could stand some improvements in terms of due process protections. We could all use it.

Mr. JORDAN. Professor, I have been quoting you and haven't given you a chance to talk, so maybe you can elaborate on some of the numbers. I think you talked about the percentages found in favor of the consumer were actually roughly the same, if I remember your numbers—I didn't look at them very closely—in small claims court versus in arbitration. So if you could maybe elaborate on that. I have about a minute left.

Mr. DRAHOZAL. Yes, the courts we looked at were two. Actually, neither of them was a small claims court. One was claims that the Federal Government brings in Federal court against people alleged to still owe amounts on their student loans. And in those cases, the ones that make it to judgment, the Government wins 99.7 percent of the time.

We also looked at a sample of cases from Oklahoma, which has a fabulous online access to their court files for at least a number of the counties that we can actually use for research. I mean, our choice of what we studied, frankly, was totally due to access to the data. No other factors went into it, other than trying to find similar cases. And the courts that we looked at in Oklahoma were actually not the small claims court, but the sort of next up court which adjudicates claims of under $10,000.

And one difference in Oklahoma is those claims actually, the majority of those claims were brought by debt buyers. So it allows us to look at the results in those cases. And again, of the cases that made it to judgment, 99.7 percent were resolved in favor of the business, the creditor in that case.

Again, I can't sort of say arbitration is better or worse. I mean, the arbitration cases we looked at were AAA cases, not mass arbitrations, but ones adjudicated in the typical individual manner. And in those cases, the business won something in about 83 percent of the cases. And again, I don't tout that to say arbitration is better because consumers win more. What I would say is it seems to me that the reason for those differences is likely differences in the types of claims that are being brought.

And I guess one followup point is, in going through the AAA files and doing this research, we would see correspondence with both sides, businesses and with consumers who are unhappy. Not surprisingly, when people lose, they are unhappy with the party. And we saw no suggestion whatsoever of kowtowing to business interests or to consumer interests. I mean, the response was the same.

We administer these cases. The arbitrators make the decisions. And if you don't like it, you can go somewhere else if you want. But we are not going to skew the process in one party's favor or the other.

Mr. JORDAN. Thank you, Mr. Chairman.

Mr. KUCINICH. I thank the gentleman.

Mr. Cummings is recognized.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

I want to thank all of you for being here. I just listened here and I have to tell you, this is a mess. And a lot of the people who are getting ripped off are my constituents. I live in the inner, inner, inner city of Baltimore, and I have listened to this testimony, and I want to thank you, Ms. Swanson, for what you are doing and others of you who are trying to get to the bottom of this.

You know, as I was listening, I have been in those courts. I practiced law. I am a trial lawyer. And you know, it is one thing for somebody not to show up, and we can do some things probably in our district court systems, our lower court systems to let people know about the significance of getting certified mail and what it means, and they need to show up. It is another thing to go into a forum thinking that you are going to treated fair, and you are getting screwed. That is a whole other kind of situation and I think we need to think about that.

You know, Mr. Kelly, I just want to ask you, you know, the subcommittee staff looked at 230 claims filed by NAF, would be NAF by Worldwide Asset Purchasing. And in 40 cases, the NAF arbitrator Jennings dismissed the claims because Worldwide did not provide the dates of the last payment or any other information on which Jennings could determine whether the claims were filed within the California statute of limitations. In 18 claims, the NAF arbitrator Krotinger dismissed the claims because Worldwide did not provide him with any specific information about how the notice of arbitration was served.

However, in 172 identical claims, claims that didn't have any more statute of limitations evidence or any more evidence of service in the Jennings and Krotinger claims had, three other arbitrators apparently ignored those deficiencies and issued awards to Worldwide in exactly the amounts requested by Worldwide.

Doesn't it show that the results in your debt collection arbitrations depend more on who the arbitrator is than what the facts or the law are? I want to direct that to Mr. Bland.

Mr. BLAND. I think that is exactly right. I think that who the arbitrator is is incredibly decisive, and that is why focusing all of the cases on a handful of cases matter.

The idea that the data is the same between court and arbitration in front of the NAF is simply not true in several ways. First of all, Congresswoman Watson when she was here put the Business Week article in the record. Business Week discovered that debt buyers are willing to pay like twice as much money for old debts, particularly debts that are outside of the statute of limitations, if there was a National Arbitration Forum clause on it. The debt-buyer industry, they think it is worth a lot more money to have an old debt, a debt that is not good, in front of the NAF than they did in small claims court.

The idea that they could compare these types of really old debts in a credit card context with student loans is totally off the wall, to be honest, because student loans have no statute of limitations. You can be pursued on the student loan that you took out 70 years ago. The Supreme Court and Congress, because Congress wants student loans to be collected, that is a totally different set of rules than debt collections.

Also, I mean, the advertisements of the organization, they particularly wrote advertisements aimed at debt collectors that would say we will improve your bottom line, was one advertisement, or 66 percent better results was another advertisement we have seen.

Mr. CUMMINGS. Mr. Bland, thank you.

Now, I want to hear from Mr. Kelly, if you don't mind.

Mr. KELLY. And what was the specific question, Mr. Cummings?

Mr. CUMMINGS. You don't want me to repeat that long question.

Mr. KELLY. Well, do you want me to talk about this? Or do you want me to address Mr. Bland's comments?

Mr. CUMMINGS. Yes, you can go ahead and address his statement, and the question.

Mr. KELLY. First of all, once the cases are given to the arbitrators, the arbitrators are the finders of fact. Now, I am not a trial lawyer, but I was a corporate finance lawyer. I can tell you, I have gone with clients to court in certain venues in certain jurisdictions, and been crushed by judges on the same point of law that in other jurisdictions in front of other justices, we have prevailed on.

Mr. CUMMINGS. Can you arbitrate or shop? Can you arbitrate or shop?

Mr. KUCINICH. Will the gentleman yield?

Mr. CUMMINGS. Yes, of course.

Mr. KUCINICH. Is that why you go ahead and try to get the arbitrators who are going to give you a better decision?

Mr. CUMMINGS. Which is where I was going, Mr. Chairman.

Mr. KELLY. Would you like me to talk about how the arbitrators are actually assigned?

Mr. CUMMINGS. Yes. And I asked you, is it possible to arbitrate or shop? In other words, it is like you shop for a judge?

Mr. KELLY. There is a strike rule in the National Arbitration Forum rules similar to the strike rule in many courts. The State of Minnesota which is where the Forum was founded has a strike rule where each party, for any reason, can strike the arbitrator once. Now, the rules also provide that the parties can agree on an arbitrator as well. So that is the process that is employed.

Mr. KUCINICH. The gentleman's time has expired.

Mr. CUMMINGS. Thank you.

Mr. KUCINICH. The Chair recognizes Mr. Schock. You may proceed.

Mr. SCHOCK. Thank you, Mr. Chairman.

Thank you all for your testimony here today.

I guess I am interested specifically in where we go from here. Obviously, there seems to be some issues that were brought forward by Attorney General Swanson. I am sure some of these problems were not just specific to Minnesota. I live in Illinois. I am sure the other 48 States have similar problems.

That being said, I am not sure that I am ready to throw away the arbitration process. I am not convinced that all consumers would be better off going to the court of law, having to hire an attorney, having to incur those costs for what would otherwise be a small claims court item.

So I guess, if you could enlighten us through your work, Attorney General Swanson, on where you think the Congress ought to be looking to improve the arbitration process, unless in fact you believe we should do away with the process altogether.

Ms. SWANSON. Sure. Thank you, Congressman.

You know, the biggest problem I see from all of the interviews and discussions we have had is, again, this ability of the corporation who writes the clause into the contract to hand pick the arbitration company who is going to adjudicate the claims. That is not how it works in court. In court, you know, you file a lawsuit and you get the judge, and that is the judge of the case, and that judge is not dependent upon that corporation for the salary. The salary comes from the taxpayers.

I can speak to Minnesota. In Minnesota, we have a good small claims court. If you go into small claims court in Minnesota, the judges, even if the consumer doesn't show up in a default hearing they tend to scrutinize those cases. You know, does the consumer appear to owe them money? Did they actually incur the debt? Are the T's crossed and the I's dotted, such that before that judge issues a default judgment, that it looks like there is sufficient evidence to enter that judgment.

I think the problem is that, for example, when you look at these consumer due process protocols that have been discussed, NAF largely followed them, too, or had them supposedly, but yet it didn't stop a whole lot of consumers in Illinois—we have talked to Illinois people—and Ohio and around the whole country from getting hurt.

And so I think what Congress ought to do is say that in these kinds of situations where the consumer has no leverage; where the company is giving them contracts on a take it or leave it basis, the consumer has not seen the clause, that they ought not to be allowed in various credit card disputes, consumer disputes, cell phone contracts; that mandatory pre-dispute arbitration clauses shouldn't be allowed.

Mr. SCHOCK. So what should happen if I am a consumer and I refuse to pay my $100 bill, which now becomes $150 or what have you. You can fast forward down the line. What should happen?

Ms. SWANSON. Well, a couple things could happen. One could be after the fact the consumer could agree to arbitration. If pre-dispute arbitration clauses weren't allowed and the collection agency is pursuing the consumer to pay that bill, and if they actually owe the bill, they could agree after the fact to arbitrate in a forum that is mutually in both party's best interest. The creditor could file a claim in small claims court, which at least in Minnesota, is straightforward, moves quickly. People do have a right of appeal to a district court there. Those are a couple of ways.

And then certainly, the creditor has all of their other collection opportunities available, reporting to credit bureaus, etc.

Mr. SCHOCK. OK. Well, I find it interesting that even the Federal Government uses an arbitration process when we choose to collect

our debts, specifically student loans, in which arbitrators rule on behalf of the Federal Government nearly 99 percent of the time.

So I guess, Mr. Naimark, if you could speak to the claims that the arbitration organizations are unduly biased toward business. Would you like to respond to that?

Mr. NAIMARK. Sure. Let me approach it this way. I think the key issue here is the arbitrator who is the decisionmaker in the case. And you can do a number of things, which we do, to enhance the trust in the neutrality of the arbitrator.

First of all, a thorough review of the people who are put on the panel or the list of potential arbitrators, so that you are sure that you have people of the right kinds of background and history. We follow a very strict disclosure process, where any contact or issue that might be disclosable has to be disclosed to the parties, giving them an opportunity to object. Thorough training for the arbitrators, and I would suggest in the debt collection area that training needs to be beefed up to deal with some of the specific issues we are talking about today in terms of due process protection and the kinds of interest decisions and others so that you are sure that the arbitrators are familiar with those things.

We did one other thing for the short time we administered some of these cases. We had an internal operating process where we said if the consumer showed up and made an objection to an arbitrator, it was an automatic removal. And if the business objected, we would not remove them, and that way you don't get to stack the entire pool of arbitrators.

Mr. SCHOCK. Say that again. If the consumer objected to the arbitrator? In other words, the consumer——

Mr. KUCINICH. The gentleman's time has expired, but answer what he said.

Mr. NAIMARK. Yes, if the consumer objected, we would remove the arbitrator. If the business objected, we would not.

Mr. SCHOCK. And I don't mean to extend, but how would they object? They would just say, I think this arbitrator is biased? They have to fill our a form? What is involved with that?

Mr. KUCINICH. The gentleman's time has expired. You may be new to this committee, but I try to allow everybody plenty of time here, and we are going to go to Mr. Foster. We will come back for another round.

Mr. SCHOCK. OK. Thank you.

Mr. KUCINICH. Thank you.

Mr. FOSTER. I serve on the Financial Services Committee and we are in the process of marking up legislation on the Obama proposal. And I guess the relevant part for this discussion here is the proposal for a Consumer Financial Protection Agency.

And I was wondering if any of you could comment on, first off, whether the proposed grant of authority under this proposal would be sufficient to deal with this problem, frankly? And second, whether the suggestion of a Federal preemption as opposed to a Federal floor, with the States allowed to raise the bar for a higher level of protection, would be more appropriate for this level situation? Anyone who wants to pick up? Yes, Attorney General?

Ms. SWANSON. Well, certainly representing the State of Minnesota, and I think my colleagues in other States would agree that

we would be, certainly I would be strongly opposed to any type of Federal preemption of States' ability to do better to protect their citizens, their consumers.

I think our country right now is facing an economic meltdown that had we had more cops on the beat perhaps we would have been better served. And so I think if the Federal Government can pass a floor to protect consumers, I think that is a good thing. I think it is healthy to have multiple regulators on it, because hopefully if one is not acting, the other will.

But in terms of preempting States' ability to act, I think that would be misguided. As you know, we are seeing a trend away from that with a recent Supreme Court ruling of the U.S. Supreme Court allowing States to move more toward being able to enforce laws. I think that is a good thing.

Mr. FOSTER. Are you familiar enough with it to see holes in the grant of authority? Or would that have been sufficient to at least have the CFPA in principle act on this thing on a Federal level?

Ms. SWANSON. Congressman, I am not familiar enough with the actual language.

Mr. FOSTER. Mr. Bland.

Mr. BLAND. Congressman, I think that with respect to financial services, that the grant of authority that is in the statute, in the proposed statute, or proposed legislation would be enough to solve the problems of abusive mandatory arbitration. I think it would let the Federal Government come in and ban these clauses where they are being abused by payday lenders and sub-prime lenders and a variety of other ways. I think the language is broad enough.

Where it doesn't address is issues such as civil rights. I mean, there are a lot of employment cases that are being sent to arbitration where you end up with an arbitrator who defends companies against civil rights claims being the judge, and there are a lot of other areas like that it doesn't address. But for financial services, the language I think is very broad and would deal with the problem very well.

And with respect to the preemption issue, I think one of the things you would see if you read through some of the briefings in the most recent *Cuomo* v. *Clearing House* case, was that State regulators bring tons of cases against banks for deceptive practices, for racial discrimination in lending and so forth. And the Federal agencies, the OCC, the Office of Comptroller of Currency and the OTS, have done almost nothing.

And what happened in the last 8 years is you had the last administration dramatically change and rewrite the regulations so as to basically give banks a sort of get out of jail free card and wipe away State laws that State regulators used to enforce really vigorously.

So having the States have it be a floor rather than a ceiling would be a dramatic and really valuable change.

Mr. FOSTER. Do any of the other of you have comments about what is good, bad and ugly about these proposals?

OK. I yield back in that case.

Mr. KUCINICH. I thank the gentleman.

The Chair recognizes the gentleman from Georgia, Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman, for holding this very timely hearing and allowing me to be a part of it. I do appreciate it and I will say that H.R. 1020, which is a bill to ban pre-dispute mandatory arbitration clauses in consumer agreements, in employment agreements, and in franchise or franchisee agreements would be the ultimate fix of this problem. And the problem is that we are trying to outsource or privatize these kinds of resolutions, if you will, by sidestepping the civil process, you know, the courthouse, in other words.

And when you, you know, I have this vision in my mind of the courthouse on the square and there is like you can go around the courthouse in a circle, and then there are all these restaurants with great breakfasts and great lunches. And you can be there all day. I am thinking about a hot summer day with the fans just kind of twirling around lazily. It is a lazy afternoon and nothing else to do. I hung out on the porch since early morning, did a little fishing after that. Played some checkers thereafter. Got something to eat at lunch time.

And now I heard about this great lawyer that is trying this case over here in the courthouse. I will go over there. And you would spend your afternoons watching the lawyers. And at that same courthouse, if you want to know whether or not your neighbor is beating his wife, how many times that has beat his wife, you can go to the courthouse and find that. If you need to look at the adoption papers, you just adopted a child, you could find that at the courthouse. Your real estate deeds, your liens, how many people have sued you, how many convictions do you have, all of that information is at the courthouse.

And at the courthouse, you can't lie. You cannot lie because you will get charged with perjury or obstruction. And it is OK to lie to your neighbor across the fence telling them about that big fish that you caught or that hole in one that you hit. You know, you can lie about things like that, but you can't lie in the courthouse.

Now, arbitration is different. There is no place for a trial, a public trial where people can come and enjoy the proceedings. There are no public records to be viewed. In fact, most folks don't even, the public doesn't even know when there is an arbitration proceeding taking place. And then when the arbitrator rules and he or she even goes against the National Arbitration Forum rules, which are advisory, in my opinion, only, not binding in any way, then you have no meaningful right to appeal the decision.

And so the only thing that I can see that we need to do is what I have done with my Arbitration Fairness Act of 2008, and again in the 111th Congress, the H.R. 1020. And I am proud to announce that there are a number of members of this committee, including the chairman, who have signed on as cosponsors. I know Mr. Cummings is on that bill also. And that is the best way to solve this problem, is that the Sixth Amendment right to a civil trial in any endeavor or any dispute in excess of $20 needs to be adhered to.

Mr. KUCINICH. The gentleman's time has expired.

Mr. JOHNSON. I yield the balance of my time.

Mr. KUCINICH. Although I will say to the gentleman, and all the other Members are welcome to return in 1 hour. We are going to

recess for 1 hour for six votes on the floor of the House. After that 1 hour, I would ask that all Members of the panel return, assuming that you are able to do that.

And we will then go to one more round of questioning, and it will be brisk, and then we will conclude the business of this committee.

I want to thank you for your presence here, and this committee stands in recess for 1 hours.

[Recess.]

Mr. KUCINICH. The committee will come to order.

Thank you for waiting. The vagaries of business on Capitol Hill is that we are always subject to the activities on the floor of the House. And so we just completed business for the day.

I note that Attorney General Swanson is going to have to leave at 5 o'clock, so you will be permitted to leave at 5 p.m. in order to accommodate your flight back to Minnesota. And at 5 o'clock, you may leave. You know, we are grateful for your presence here, and the committee will be in touch with you regarding this matter. We appreciate that you are here. Thank you, Madam Attorney General. Thank you.

Mr. Kelly, you are required by California statute, California Code of Civil Procedure, section 1281.96 to publish the results of all your California consumer arbitrations. But the subcommittee's investigation reveals that you don't publish the results of all of your California arbitrations involving consumers. You only publish the results of some of them.

For example, you administered 2,331 California arbitrations filed against consumers by Columbia Credit Services. But you haven't published the results of any of those arbitrations. The explanation your representative gave our staff is that while California requires reporting of consumer arbitrations, it does not define the term consumer arbitrations.

Mr. Kelly, tell me, is there any way at all in which an arbitration filed by Columbia to collect on a consumer debt assigned by MBNA Bank is any less a consumer arbitration than an arbitration filed by Worldwide Asset Purchasing to collect on a consumer debt assigned by MBNA Bank?

Mr. KELLY. Chairman Kucinich, the circumstance you are describing is accurate. There is no definition in the statute. So you take a very hazardous course if you make a determination one way or another.

What we did in that circumstance is we relied on the filers to indicate what is a consumer case and what is not a consumer case. We didn't make an independent judgment, review the facts of the case, and frankly that, in and of itself, could argue against the neutrality of the process. So we left it alone. If the filer is designated as consumer, it was designated as a consumer.

I will point out that even some of our most vocal opponents have indicated on the record that our filing in California is far superior and far more complete to many of the other providers of neutral services, and we can provide that specific reference if you so choose.

Mr. KUCINICH. Well, I have to say respectfully that what you are saying defies credibility because contrary to your representative's explanations to us, in fact, Mr. Kelly, California does define the

term consumer arbitrations. This is a quote from section two, the definitions section of the California ethics standards for neutral arbitrators in contractual arbitration. I am going to put up the document. It is a pretty quick read, but what they do is they basically define consumer arbitration, and it is a pretty succinct definition.

Now, isn't it really true that all of the Columbia claims are consumer arbitrations? That is under the California act.

Mr. KELLY. Mr. Chairman, I have to admit I am not intimately familiar with the California law and the statutes there. Thankfully, the representative who you are referring to is here today, if you might give a moment.

Mr. KUCINICH. I am sorry. That what?

Mr. KELLY. The representative of our organization that you are referring to is here today.

Mr. KUCINICH. Do you want to confer with somebody?

Mr. KELLY. Yes, if I may.

Mr. KUCINICH. What we are going to do, I am going to ask staff to provide you with a definition of consumer arbitration. I would like you to look at it a moment. We will wait.

Mr. KELLY. Yes, sir. Thank you.

Mr. KUCINICH. Just take your time.

Mr. KELLY. Mr. Chairman, if I may.

Mr. KUCINICH. Yes, the gentleman may proceed. I started off by asking you a question, so we can frame this properly. What I said is that contrary to your representative's explanation to us, California does define the term consumer arbitration. We have just given you a copy of the definition. And I began to quote from section two, but since you have read it, I don't need to do that, and without objection, section two is going to be included in the record of this hearing.

[The information referred to follows:]

CALIFORNIA CODES
CODE OF **CIVIL PROCEDURE**
SECTION 1280-1280.2

1280. As used in this title:
(a) "Agreement" includes but is not limited to agreements providing for valuations, appraisals and similar proceedings and agreements between employers and employees or between their respective representatives.
(b) "Award" includes but is not limited to an award made pursuant to an agreement not in writing.
(c) "Controversy" means any question arising between parties to an agreement whether such question is one of law or of fact or both.
(d) "Neutral arbitrator" means an arbitrator who is (1) selected jointly by the parties or by the arbitrators selected by the parties or (2) appointed by the court when the parties or the arbitrators selected by the parties fail to select an arbitrator who was to be selected jointly by them.
(e) "Party to the **arbitration**" means a party to the **arbitration** agreement:
(1) Who seeks to arbitrate a controversy pursuant to the agreement;
(2) Against whom such **arbitration** is sought pursuant to the agreement; or
(3) Who is made a party to such **arbitration** by order of the neutral arbitrator upon such party's application, upon the application of any other party to the **arbitration** or upon the neutral arbitrator's own determination.
(f) "Written agreement" shall be deemed to include a written agreement which has been extended or renewed by an oral or implied agreement.

1280.2. Whenever reference is made in this title to any portion of the title or of any other law of this State, the reference applies to all amendments and additions thereto now or hereafter made.

Mr. KUCINICH. Now, again, Mr. Kelly, isn't it true that all of the Columbia claims are consumer arbitrations under this California definition?

Mr. KELLY. Under this definition, I couldn't tell you. This is the first time I have seen this definition. The definition, Mr. Chairman, is not the definition at issue.

Mr. KUCINICH. Bear with me on this. The contract is with a consumer party as defined in the standard. Isn't that right? Isn't it right?

Mr. KELLY. I am not following you, Mr. Chairman. I am sorry.

Mr. KUCINICH. The contract that we are talking about here is with a consumer party. Right?

Mr. KELLY. Which contract are you referring to?

Mr. KUCINICH. These are consumer arbitrations. The contract is with a consumer party. Right?

Mr. KELLY. I haven't looked at these specific cases.

Mr. KUCINICH. Are you familiar with the Columbia case, the Columbia cases? You are familiar with the Columbia cases?

Mr. KELLY. I am aware that Columbia cases are at issue in the San Francisco lawsuit.

Mr. KUCINICH. So we are going back to the definition of consumer arbitration in California, which is where we are focused here. The contract is with a consumer party in this, in the Columbia cases. The contract in which the debt is incurred is with a consumer party. Correct?

Mr. KELLY. I would disagree if what you are talking about is the reporting statute. The definition that you have presented here is not a definition in the statute. I mean, it is inappropriate to take a random definition of consumer in some unrelated statute.

Mr. KUCINICH. This is right from the California ethics standards for neutral arbitrators in contractual arbitration.

Mr. KELLY. But it is not——

Mr. KUCINICH. You know, you can argue with me. You can't argue with those words. This is right from that. We didn't make that up.

Mr. KELLY. I am not saying that, and I completely agree with you on that.

Mr. KUCINICH. Are you currently being prosecuted for violations of this statute?

Mr. KELLY. We are in suit in San Francisco. Yes.

Mr. KUCINICH. So I think it is clear that NAF is violating California law. But why?

Mr. KELLY. Well, that is an issue in the lawsuit and we would strongly disagree with it. And I am not sure I am making my point clear, but this is not the reporting statute at issue in the San Francisco case.

Mr. KUCINICH. The subcommittee staff obtained the case files of 48 NAF arbitrations filed by Columbia. And those files show that Columbia routinely asked arbitrators to add attorneys fees of 33 percent, despite the fact that the controlling Delaware statute places an upper limit of 20 percent on attorneys fees. In most of these cases, Columbia received attorneys fees that violated Delaware law. Now, isn't it true that your failure to publish the results

of your Columbia arbitrations in California assists Columbia in concealing its violations of Delaware law?

Mr. KELLY. Chairman Kucinich, we can certainly provide you the information necessary to respond to that. I can't tell you here today what the facts are or what the arbitrators decided in those cases. Frankly, that is a matter of law and not an issue that I am prepared to qualify here one way or another.

Mr. KUCINICH. Well, we are going to take your explanation. We are going to move on. Columbia is not—but I think that since we have other members of the committee who have not been able to come back for this second round, the committee is going to submit this question in writing and give you the opportunity to answer succinctly and with some detail in writing. So I want to move to that and make sure we send a letter to Mr. Kelly.

Mr. KELLY. We would appreciate that, Mr. Chairman. I apologize for the confusion.

Mr. KUCINICH. Well, we are not confused about this. You know, Columbia is not the only collection company whose California arbitration results you do not publish, in violation of California law. Your representative informed our staff that there are others. Do you know whether or not those other collection companies are also asking for and obtaining awards of attorney fees that violate Delaware laws?

Mr. KELLY. As we sit here, Mr. Chairman, I don't have personal knowledge of that.

Mr. KUCINICH. We are going to send you a written request and we are going to ask you to provide the committee with a list of companies whose California cases you have not published. And we appreciate your cooperation with this subcommittee.

Mr. KELLY. You will have the cooperation.

Mr. KUCINICH. Because I just, you know, we just had that discussion.

Now, Mr. Kelly, let's look at, for a minute I want to look at one reason why consumers—I am waiting for anybody from your side who wants to come. I will be glad to yield to them. I am going to go to a third round now.

Mr. Kelly, let's look for a minute at one reason why consumers may not have appeared at one of your consumer arbitrations. In all of the claim files that the NAF produced to our subcommittee staff, the only evidence that the consumer knew about the arbitration was a form statement by the creditor's attorney that the respondent was, "served with the initial documents required by Rule Six," and that "conforms to the requirements of Rule Six and applicable law." There is no evidence of who actually performed the service, who was served, or the documents were served.

Now, in each and every one of these cases, the NAF has absolutely no idea who actually received the service. Isn't that right?

Mr. KELLY. In response to that, I will say that our rules provide for service in a number of manners, and the rule is pretty clear on this. Certified mail can be delivered personally. Proof of that service must be provided in order for the case to proceed. The rules are consistent with those, as I understand it, in the Federal Rules of Civil Procedure.

I will note that in most small claims courts, all that needs to be done is regular mail. Our procedures are far more involved than that.

Mr. KUCINICH. You need an affidavit, but isn't it true that there is no return receipt showing the signature of who actually received the documents. Isn't that right?

Mr. KELLY. I would disagree with that.

Mr. KUCINICH. There is a return receipt?

Mr. KELLY. In the cases, I certainly can't speak for every case in the system, but by and large, we get, if there is certified mail, we by and large do get a return receipt, as far as I know. Now, obviously, we would need to go back and we need to look at the specific cases you are referring to, because I am not familiar with those specific cases.

Mr. KUCINICH. Am I correct that it is NAF's position that the adequacy of service is an issue for the arbitrator, and the arbitrator alone to decide?

Mr. KELLY. That is correct.

Mr. KUCINICH. Well, I want to see how this works in context. I am going to ask staff to hand to Mr. Kelly a complaint by a Mr. Benjamin Guzman who is a respondent in an arbitration handled by the NAF. He states that he never received any notice of arbitration and that the person alleged to have received the notice was his landlord, for whom Mr. Guzman was not on speaking terms at the time.

The NAF's official response written by your staff counsel, Mr. Ryan Chandley, was that the creditor filing the claim required a proof of service and that "the decision about the adequacy of service in this case would be decided by the arbitrator hearing the case."

I just want you to walk through this with me. You have the creditor filing the claim, serves Mr. Guzman's landlord, files a proof of service saying that the creditor served Mr. Guzman. Mr. Guzman, no notice of the claim because his landlord didn't tell him about it. Mr. Guzman does not appear at the hearing because he doesn't know about it. The arbitrator didn't know that Mr. Guzman was not served because the proof of service says Mr. Guzman was served.

So Mr. Kelly, how can the arbitrator make a decision about adequacy of service? He or she can't, can they? They don't have any time, they don't have any true information. The only information an arbitrator has is that Mr. Guzman actually was served.

So when the NAF response that "the decision about the adequacy of service would be decided by the arbitrator hearing the case," can you see how that would seem disingenuous?

Mr. KELLY. Mr. Chairman, if Mr. Guzman was not properly served, that is a defense that he can raise in the arbitration and a defense that he should raise with the arbitrator. That is a matter of law.

Mr. KUCINICH. OK. OK, let's stop right there. You know, these hearings don't have to be that formal. He doesn't know, get it? He doesn't even know about it. It went to his landlord who isn't talking to him.

Mr. KELLY. So run the string out.

Mr. KUCINICH. So how do you assert your rights if you don't even know that you were cast into some proceeding?

Mr. KELLY. So let's run the string out, then.

Mr. KUCINICH. Help me with this. I am interested.

Mr. KELLY. Eventually, presumably, Mr. Chandley is here and I can ask him about the specific case. But let's just run the logical string out on that. So Mr. Guzman doesn't know that he has been sued, right?

Mr. KUCINICH. OK.

Mr. KELLY. Which, by the way, the Boston Globe talks about routinely in small claims and conciliation court, because there only mail is required, not certified mail.

Mr. KUCINICH. We are talking arbitration, NAF arbitration.

Mr. KELLY. So let me get back. So then Mr. Guzman at some point presumably learns that judgment has been entered against him. Correct?

Mr. KUCINICH. How did that happen?

Mr. KELLY. I assume that some—I don't know, but I am just, I am speaking of a hypothetical now because this specific case——

Mr. KUCINICH. So you are saying at some point he is going to find out a judgment was entered against him, but the judgment occurs, one would assume, principally because he wasn't even in court, in this arbitration setting to defend himself.

Mr. KELLY. His opportunities are to reopen the case, to move to vacate the award, to move to amend. He also has an opportunity——

Mr. KUCINICH. How often does that happen?

Mr. KELLY. He also has an opportunity at the court hearing in district court when that arbitration award is going to be enforced to at that point move to set aside the arbitration award.

Mr. KUCINICH. Does that happen very often? And if people don't know enough to negotiate an arbitration, how are they going to know or have the resources to negotiate a court appeal?

Mr. KELLY. Well, it isn't a court appeal. All it is is a hearing to confirm the arbitration award. But I mean, then you get into your fundamental policy issue, Mr. Chairman.

Mr. KUCINICH. Well, let me ask you. You were talking about, you know, what he can do. How much time does Mr. Guzman have to set this decision aside?

Mr. KELLY. I would need to consult on that, if I may.

Mr. KUCINICH. How much? Yes, go ahead. Sure.

I yield myself such time as I may consume here.

Mr. KELLY. I am sorry. What was that?

Mr. KUCINICH. I was just, a committee formality saying we are going to continue.

Mr. KELLY. Mr. Chairman, I reiterate that I don't claim to be an expert in this area of the law. I am advised by the staff counsel that you spoke with that the time is generally 90 days, but there are exceptional circumstances which can be considered under the rules.

Mr. KUCINICH. And if the creditor doesn't file within 90 days and waits, what happens then to Mr. Guzman?

Mr. KELLY. Then it would fall under those exceptional circumstances I previously mentioned.

Mr. KUCINICH. Mr. Bland, would you like to comment on this?

Mr. BLAND. There is actually, it is a distressing thing about our court system right now, but there is actually a circuit split, as I understand it, among the different Federal circuits and also among the State courts about what happens if the arbitration award is entered, and the consumer has 90 days under the Federal Arbitration Act and under the vast majority of the State Arbitration Acts. If they don't move to vacate the judgment within the 90 days, for example, because they don't know about it, there are a number of courts which have actually said that they can't then come in and challenge any aspect of the award, even service. I mean, there are some courts that have this terrible catch 22.

Now, there are more courts sort of on the consumer side of this, but that actually has happened a number of times in courts in America where even identity theft victims who can prove that it was never their credit card or whatever have an arbitration award entered against them, don't find out about it until after the 90 days, and then when there's a confirmation proceeding, they can't defend.

Mr. KUCINICH. What happens then?

Mr. BLAND. I mean, it differs from court to court, but there are a lot of courts——

Mr. KUCINICH. OK, let's try to help answer the question that I asked Mr. Kelly. What happens after 90 days?

Mr. BLAND. It depends on what part of the country you are in, but in a lot of parts of the country, you are nailed down and stuck with it even if you never got notice. I mean, it depends. There are parts of the country where you can defend against the confirmation in court if you have a lawyer, but there are actually a lot of parts of the country where that sticks. It is incredibly unfair.

Mr. KUCINICH. You heard me lay out the case of Mr. Benjamin Guzman.

Mr. BLAND. Yes, sir.

Mr. KUCINICH. How many Benjamin Guzmans are out there, do you think?

Mr. BLAND. Well, there are tons. In my testimony at pages 18 to 20, we set out a whole bunch of examples of instances where there were terrible service of process, and we gave you a list of 9 or 10 consumer lawyers, not just us. I am not the only person in the world who says that there are a whole bunch of people who have come into my office and said, I never got service.

I did a case in the NAF that was a nursing home collections case where our client was in her 90's and she had Alzheimer's, and they served the house of one of her daughters where she had lived like four addresses before. I mean, it was incredibly ridiculous service and then they enter an award of $20,000.

Mr. KUCINICH. Mr. Bland, do you have any idea of how many people——

Mr. BLAND. Thousands.

Mr. KUCINICH [continuing]. Have had arbitration awards issued against them without ever receiving notice the arbitration was going to occur?

Mr. BLAND. It is going to be in the thousands. I mean, it would be impossible to give you an exact number, but it is going to be——

Mr. KUCINICH. Mr. Kelly, do you have a response to that? Is that possible that there could be thousands of people out there who have arbitration awards issued against them without ever receiving notice that an arbitration was going to occur?

Mr. KELLY. I couldn't begin to answer that.

Mr. KUCINICH. OK. I want to ask you, Mr. Kelly, about the relationship with the Accretive alleged in Minnesota's attorney general's suit. I know you have settled this case, but if I am asking any questions that may bring some new things and you are not sure, you do have a right not to testify. You would have to assert it.

You knew at or about the time of the reorganization of the NAF in which the Agora funds set up by Accretive acquired a 40 percent ownership interest in your company, that Accretive was acquiring or had acquired the three largest U.S. debt collection firms, speaking of Mann Bracken, Wolpoff and Abramson, and Eskanos and Adler.

And you knew that relationship had to be concealed in order to maintain the appearance that the NAF was an impartial body with no ties to the debt collection industry.

I want to show you a slide in which you clearly state your intent to conceal the true nature of your financial relationships. Put that slide up, OK? And we are going to give you a copy so you know exactly what we are talking.

Now, this is a memo from you to Madhu Tadikonda, dated Monday, November 20, 2006. And the relevant part of this memo, "Madhu, I look forward to working with you, too," and then you go on to say, "We remain deeply concerned about walling any deal off, any deal from Mann Bracken. The shared ownership issue concerns us on many levels."

And you go on to say in enumerated paragraph No. 3, that in parentheses, "No public information concerning Accretive with the fund that ultimately acquires and holds a minority interest in the Forum." And then in a later paragraph, you state, "I cannot overstate our concern over the Mann Bracken relationship, although I do not have any solutions off the top of my head," and this is highlighted, "We should certainly plan for unwinding any deal in the event shared ownership becomes an acute issue."

Now, if the public knew about the true nature of NAF's financial relationships to the largest debt collection companies in the country, do you think anyone would believe that the NAF was fair or independent or uncompromised?

Mr. KELLY. Well, let's be very clear about the structure here because I think there are some things in there that can be grossly misleading. Let me just say this.

Mr. KUCINICH. Well, clarify it for us.

Mr. KELLY. This is accurate. I will clarify. This is obviously accurate and I did have these concerns. Then I say in there, I want to put some additional thinking around the structural issues. So we did. I want to point out that there is no ownership——

Mr. KUCINICH. But you are saying you did, but that is not really reflected in this memo, is it?

Mr. KELLY. No, because there are subsequent—obviously, this was one of the very first memos in our transactional discussions.

Mr. KUCINICH. So as we go through this, you are saying that you have other documentation you could provide to this committee that you were trying to get to what point?

Mr. KELLY. We can certainly provide more information, but I can walk you through what was done. Actually, there is nothing particularly unusual or sinister about it. The first point is that the ownership of the National Arbitration Forum never changed. There is no corporate ownership of the National Arbitration Forum. The same individuals own that entity that always owned that entity.

Some of the assets of the National Arbitration Forum were conveyed to an entity Forthright, which I am not the CEO of. Forthright, not the National Arbitration Forum, did accept outside investors, a minority. So the first point that is important to note is this is a minority.

Mr. KUCINICH. Were they involved in debt collection?

Mr. KELLY. Well, let's qualify that. So that 40 percent was then sold to approximately 17, there are approximately 17 funds, not 1, 17, that were part of Agora, roughly 17. We can find you the specific number and provide that.

Mr. KUCINICH. Were you involved in helping to put this deal together?

Mr. KELLY. Of those 17, 1 fund was Accretive. All right? So one-seventeenth of those funds was Accretive that held a minority interest of 40 percent in an entity that was not the National Arbitration Forum, but that serviced the National Arbitration Forum.

Mr. KUCINICH. How did you end up with Accretive, then? If 16 out of 17 was not involved, then how did Accretive come in and how did they just so happen to be a debt collection company?

Mr. KELLY. Well, no. All those funds participated. Agora includes roughly 17 diverse funds, which include the endowment funds of four major universities, for example. We can provide you with that information. But Accretive is just one of those 17 funds in the 40 percent.

Mr. KUCINICH. Are you saying it is just coincidence that you had a partnership here with a debt collection company?

Mr. KELLY. No. There was no partnership with a debt collector. Accretive, which is 1 of the 17 funds that bought 40 percent of the servicing company also has an investment in a company that services——

Mr. KUCINICH. Did you know that? Was that a surprise to you that they were involved in debt collection?

Mr. KELLY. I am not sure we were aware at the time. I believe we were aware at the time that they had an investment, but keep in mind in private equity, it is not uncommon for private equity funds to have hundreds, in fact thousands of portfolio companies.

Mr. KUCINICH. I understand that. But you know what is interesting about this memo is that, well, you could have mentioned hundreds of different entities. You mention Mann Bracken.

Mr. KELLY. Well, this is the one—the other ones didn't cause any concern. This was the one that caused concern, and we went to great lengths to protect and build in structural systems.

Mr. KUCINICH. So you are saying you made every effort not to have any relationship with debt collection companies. Is that your testimony?

Mr. KELLY. I would say that is right. I would say that we did a lot of structural things in order to create Chinese walls and wall off that small fund from the entity, including after we did the split, we had a whole segregation team together which weighed all the practices, separated everything from data bases and phone lines, went through it. I did not sit on that segregation team.

Mr. KUCINICH. How do you explain this memo, though? Help me. What was going on?

Mr. KELLY. We had the largest law firm in Minneapolis review and do a full legal audit on the process.

Mr. KUCINICH. But you are here right now and I have your memo and I have your words.

Mr. KELLY. Correct.

Mr. KUCINICH. And I see you mention Mann Bracken, which was about to be acquired by Accretive, a big debt collection firm. You mention in your memo that you were concerned about walling any deal off, any deal from Mann Bracken. OK, we know what that means.

Then you mention you cannot overstate your concern about the Mann Bracken relationship, and you say that in the parentheses, "No public information connecting Accretive with the fund that ultimately acquires and holds a minority interest in the Forum."

Now, you know, anybody who reads that, it is a fair reading that you were just trying to keep this is a secret. I mean, what was going on in your mind? Why were you afraid of that?

Mr. KELLY. Actually, for competitive reasons, frankly. My concern was that we would have a difficult time marketing to other businesses and other entities. That was my concern.

Mr. KUCINICH. Because, play this out, why?

Mr. KELLY. Because there was this particular investment, which is why we protected against it fully to ensure that when we do make it public, we are able to say we have these protections in place and this is why it is fair, which is in fact what we did.

Mr. KUCINICH. What happens to the $42 million——

Mr. KELLY. In fact, it is—and it was public before this. I mean, we were required to make these disclosures in a number of States. This is not something that is, frankly, we didn't think that there was an issue with it, to be honest, and we still don't.

Mr. KUCINICH. Well, then what happens to the $42 million that the Agora fund has invested in Forthright and the NAF? What happens to that money?

Mr. KELLY. The money that is invested in Agora? The money Agora invested into Forthright?

Mr. KUCINICH. That the Agora funds invested in Forthright. What happens to that, well, the investment in Forthright and the NAF. What happens to the $42 million?

Mr. KELLY. Are you asking where that $42 million is?

Mr. KUCINICH. What happens to it?

Mr. KELLY. The $42 million by and large was distributed to the shareholders.

Mr. KUCINICH. $42 million distributed to the shareholders. Who are the shareholders?

Mr. KELLY. The shareholders of Forthright include NAF, Inc., the Agora Funds, and there is a management pool in there as well.

Mr. KUCINICH. And are there any other shareholder interests there that we are talking about that you are aware of?

Mr. KELLY. Not that I am aware, but we can provide that information to you.

Mr. KUCINICH. I would like you to provide to the committee all the shareholders receiving any of the distribution.

Mr. KELLY. We would be happy to do that. The information was freely provided to the attorney general as well. Be happy to provide that.

Mr. KUCINICH. OK.

Now, in Ms. Swanson's testimony, it was stated that the Small Business Administration was instrumental in the creation of the arbitration debt collection conglomerate that she brought charges against and stymied her investigation into the NAF. Just if you could help me here, Mr. Kelly. Can you think of any legitimate justification for using money from the Small Business Administration to finance the creation of Axiant, which joined together the three largest debt collection companies in the United States?

Mr. KELLY. Mr. Chairman, I can't answer that question because I have no—that question would have to be answered by Axiant or someone else. I can tell you that the SBA is not a participant in the Agora Fund. There is no SBA money. There is no SBA money in the Agora Fund.

Mr. KUCINICH. Did you have any communications with any representatives of the SBA in connection with their response to the investigation of the Minnesota attorney general?

Mr. KELLY. I in fact have never had any interaction that I am aware of with the SBA, and neither has anyone from Forthright.

Mr. KUCINICH. Anybody in your company that was directed to have contact with the SBA, if you didn't? Do you know anybody in your company who has?

Mr. KELLY. No, and again, as I said, I wouldn't imagine there ever would be because the SBA is not invested in Agora.

Mr. KUCINICH. Has anyone in NAF, Inc. had any contact with the SBA in connection with the——

Mr. KELLY. There is no investment by the SBA there. I think I can just clarify this. I mean, I don't mean to be confrontational. I don't intend to be. We are out of the business.

Mr. KUCINICH. Can I tell you, you know, I am not a confrontational person.

Mr. KELLY. But I will say I think you may misunderstand the SBA investment. Trust me, I hesitate to speak for the attorney general, but as I understand it the SBA investment is in a fund other than Agora. It is in another investment. That investment is, as far as I know, unrelated to——

Mr. KUCINICH. Unconnected to Axiant in any way?

Mr. KELLY. It may be, but that is the question I can't answer.

Mr. KUCINICH. So you are saying as far as the structure of it, you are not familiar.

Mr. KELLY. Yes, it is not in our structure.

Mr. KUCINICH. But that you never had any connection with, or meetings with any representatives of the SBA and no one connected with you in any of your capacities had any communication

with the SBA about the investigative matter at the Minnesota Attorney General's Office.

Mr. KELLY. That is correct, sir.

Mr. KUCINICH. I think that we have covered most of the territory that we can cover today. We have had a number of witnesses sit here while Mr. Kelly has had to do most of the work.

Is there anything you would like to say in conclusion? Do you want to make any final statements before we wrap this up?

Professor, do you want to say anything?

Mr. DRAHOZAL. I don't think I have anything to add from my opening statement, which is that the most important thing to me, it seems to me, is we are evaluating arbitration as a process, we can't do it in isolation, that we need to compare it to the alternatives. And I would sort of urge the committee to sort of take that into account.

Mr. KUCINICH. Thank you.

Mr. Bland.

Mr. BLAND. Congressman, I think you have the big picture here totally. If I could make one suggestion with respect to the California disclosures issues, I think that from the cases that have come into us and complaints we have gotten from California consumers and from contacts we have gotten from a bunch of California lawyers, that the disclosures that have been made leave out, apparently on purpose, two really important things. California was trying to figure out not just who won the case and how many cases were brought by certain companies, but they were trying to figure out if the arbitration fees were big in particular cases. And they were trying to figure out second whether there was a lot of attorneys fees being added in, because there are limits under the debt collection laws about the amount of attorneys fees that are going to be added in.

And what has happened in a bunch of cases that we have seen from consumers and other California consumer lawyers have seen is that a company, a debt collector will bring a claim, say, for $5,000. Then they have a $1,000 claim for attorneys fees and a $1,000 claim for arbitration fees. And then they get it all from the arbitrator. And what shows up on the internet in their disclosures is claim of $7,000, award $7,000, attorneys fees zero, arbitration fees zero.

And so it gets bundled in so that the answer a consumer gets, they get the impression that there is no arbitration fees. They get the impression that there is no attorneys fees. And the whole point of the statute asking the question is to get an honest answer to that.

And I think that if the committee is going to ask some written questions, I urge you to probe that, because we have gotten a lot of consumers complaining to us that they feel like the information that they have seen up there is not accurate.

Mr. KUCINICH. Your point is well taken. And there needs to be a sorting out of the various fees so we clearly understand which ones are being bundled in and described as being one thing when in fact they are the other. It is a point well taken, and in our followup questioning, we will do that.

Mr. Naimark.

Mr. NAIMARK. Only thank you for the opportunity to participate. We have no further comment.

Mr. KUCINICH. Thank you.

Mr. Kelly, you have been here a long time. You have been a very busy witness. Is there anything that you would like to say before we wrap this hearing up?

Mr. KELLY. No, Chairman Kucinich. Thank you for your time. And obviously, if there is any additional documents, we would be happy to provide it, as we have in the past.

Mr. KUCINICH. Well, I know that this has certainly been a difficult time for NAF. Occasionally, institutions in our society proceed in a way that sometimes they get the legal system at another point takes a different view of it, and then everything changes. And obviously, things are happening like that for NAF.

What we are trying to do with this committee is to look at how these practices in arbitration affect consumers with these mass debt collections. And if you put yourself in a position of a consumer who may not be getting proper information and may not really know what is going on, it is going to be a very tough time for a lot of people.

And then you get the issue of financial literacy, which is altogether a different issue which another committee takes up.

So this subcommittee is going to continue to be involved in this. We will continue to send you some inquiries that we would appreciate your cooperation in helping us find out what we can do to try to make this system work better for consumers. Certainly, with your experience, you are probably going to be someone who is in a position to tell us what can be done to make the system better.

And so we appreciate you taking this time. I want to thank each and every one of the witnesses here for their participation.

I am Dennis Kucinich, Chairman of the Domestic Policy Subcommittee. Today's hearing has dealt with the issue of arbitrations and the misuse of mandatory arbitration to collect consumer debts.

This committee stands adjourned.

[Whereupon, at 5:35 p.m. the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

EDOLPHUS TOWNS, NEW YORK,
CHAIRMAN

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Congress of the United States
House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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JASON CHAFFETZ, UTAH
AARON SCHOCK, ILLINOIS

July 30, 2009

Mr. Michael Kelly
Chief Operating Officer
National Arbitration Forum
Post Office Box 50191
Minneapolis, Minnesota 55405-0191

Dear Mr. Kelly:

In connection with the Domestic Policy Subcommittee of the Oversight and Government Reform Committee's hearing on July 22, 2009, "Arbitration or 'Arbitrary': the Misuse of Mandatory Arbitration in Consumer Debt Collection", the Subcommittee submits the following questions for the hearing record:

1) NAF provided documents to the Subcommittee showing that it administered at least 2,331 California arbitrations filed against consumers by Columbia Credit Services, but NAF has not published the results of any of those arbitrations as required by California statute. Please provide a copy of any and all California arbitration claims handled by NAF but not published, including all 2,331 arbitration claims filed by Columbia Credit Services. For each claim, please make sure that the following information is listed:

    a. The identity of the original creditor of the claim;

    b. The identity of the assignee(s) of the claim, if any;

    c. The original amount of the claim not including arbitration fees, attorneys fees, interest, etc.;

    d. The amount requested by the party seeking the arbitration award;

    e. The amount of attorneys fees requested by the party seeking the arbitration award;

    f. The amount awarded by the arbitrator;

g. The identity of the arbitrator.

h. A copy of the award and/or order.

2) Please provide a copy of all desk hearing lists that relate to the arbitrations requested above.

3) Please provide a list of all companies which have filed California debt collection arbitration claims with NAF.

4) Please provide documents that list all individuals or corporate entities that currently hold or previously held an ownership interest in Forthright, NAF, LLC or NAF, Inc. Provide documentation which lays out the financial, managerial, and ownership structure of Forthright, NAF, Inc. and NAF LLC.

5) Please provide a list of all shareholders in Forthright, NAF Inc. and NAF, LLC.

6) Please also provide a list of any and all shareholders receiving any of the distribution of the $42,000,000.00 Agora fund investment into NAF and the amounts each shareholder received.

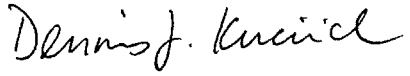
7) Please provide all documents that discuss the nature of the relationship, or concerns about the relationship, between a) NAF/Forthright, and b) Accretive, Axiant and/or Mann Bracken

The Oversight and Government Reform Committee is the principal oversight committee in the House of Representatives and has broad oversight jurisdiction as set forth in House Rule X. An attachment to this letter provides information on how to respond to the Subcommittee's request.

We request that you provide these documents as soon as possible, but in no case later than **5:00 p.m. on Thursday, August 13, 2009**.

If you have any questions regarding this request, please contact Jaron Bourke, Staff Director, at (202) 225-6427.

Sincerely,



Dennis J. Kucinich
Chairman
Domestic Policy Subcommittee

cc: Jim Jordan
Ranking Minority Member

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CHAIRMAN

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AARON SCHOCK, ILLINOIS

Domestic Policy Subcommittee Document Request Instruction Sheet

In responding to the document request from the Domestic Policy Subcommittee, Committee on Oversight and Government Reform, please apply the instructions and definitions set forth below.

Instructions

1. In complying with the request, you should produce all responsive documents in your possession, custody, or control.

2. Documents responsive to the request should not be destroyed, modified, removed, transferred, or otherwise made inaccessible to the Subcommittee.

3. In the event that any entity, organization, or individual denoted in the request has been, or is currently, known by any other name than that herein denoted, the request should be read also to include them under that alternative identification.

4. Each document produced should be produced in a form that renders the document capable of being copied.

5. When you produce documents, you should identify the paragraph or clause in the Subcommittee's request to which the documents respond.

6. Documents produced in response to this request should be produced together with copies of file labels, dividers, or identifying markers with which they were associated when this request was issued. To the extent that documents were not stored with file labels, dividers, or identifying markers, they should be organized into separate folders by subject matter prior to production.

7. Each folder and box should be numbered, and a description of the contents of each folder and box, including the paragraph or clause of the request to which the documents are responsive, should be provided in an accompanying index.

8. It is not a proper basis to refuse to produce a document that any other person or entity also possesses a nonidentical or identical copy of the same document.

9. If any of the requested information is available in machine-readable or electronic form (such as on a computer server, hard drive, CD, DVD, memory stick, or

computer backup tape), you should consult with Subcommittee staff to determine the appropriate format in which to produce the information.

10. The Committee accepts electronic documents in lieu of paper productions. Documents produced in electronic format should be organized, identified, and indexed electronically in a manner comparable to the organizational structure called for in (6) and (7) above. Electronic document productions should be prepared according to the following standards:

    (a) The production should consist of single page TIF files accompanied by a Concordance-format load file, an Opticon reference file, and a file defining the fields and character lengths of the load file.

    (b) Document numbers in the load file should match document Bates numbers and TIF file names.

    (c) If the production is completed through a series of multiple partial productions, field names and file order in all load files should match.

11. In the event that a responsive document is withheld on any basis, you should provide the following information concerning the document: (a) the reason the document is not being produced; (b) the type of document; (c) the general subject matter; (d) the date, author, and addressee; and (e) the relationship of the author and addressee to each other.

12. If any document responsive to this request was, but no longer is, in your possession, custody, or control, you should identify the document (stating its date, author, subject and recipients) and explain the circumstances by which the document ceased to be in your possession, custody, or control.

13. If a date or other descriptive detail set forth in this request referring to a document is inaccurate, but the actual date or other descriptive detail is known to you or is otherwise apparent from the context of the request, you should produce all documents which would be responsive as if the date or other descriptive detail were correct.

14. This request is continuing in nature and applies to any newly discovered document. Any document not produced because it has not been located or discovered by the return date should be produced immediately upon location or discovery subsequent thereto.

15. All documents should be bates-stamped sequentially and produced sequentially. In the cover letter, you should include a total page count for the entire production, including both hard copy and electronic documents.

16. For paper productions, four sets of documents should be delivered: two sets to the majority staff and two sets to the minority staff. For electronic productions, one dataset to the majority staff and one dataset to minority staff are sufficient.

Productions should be delivered to the majority staff in B-349B Rayburn House Office Building and the minority staff in B-350A Rayburn House Office Building. You should consult with Subcommittee staff regarding the method of delivery prior to sending any materials.

17. Upon completion of the document production, you should submit a written certification, signed by you or your counsel, stating that: (1) a diligent search has been completed of all documents in your possession, custody, or control which reasonably could contain responsive documents; and (2) all documents located during the search that are responsive have been produced to the Subcommittee or identified in a privilege log provided to the Subcommittee.

Definitions

1. The term "document" means any written, recorded, or graphic matter of any nature whatsoever, regardless of how recorded, and whether original or copy, including, but not limited to, the following: memoranda, reports, expense reports, books, manuals, instructions, financial reports, working papers, records notes, letters, notices, confirmations, telegrams, receipts, appraisals, pamphlets, magazines, newspapers, prospectuses, interoffice and intra-office communications, electronic mail (email), contracts, cables, notations of any type of conversation, telephone calls, meetings or other communications, bulletins, printed matter, computer printouts, teletypes, invoices, transcripts, diaries, analyses, returns, summaries, minutes, bills, accounts, estimates, projections, comparisons, messages, correspondence, press releases, circulars, financial statements, reviews, opinions, offers, studies and investigations, questionnaires and surveys, and work sheets (and all drafts, preliminary versions, alterations, modifications, revisions, changes, and amendments of any of the foregoing, as well as any attachments or appendices thereto). The term also means any graphic or oral records or representations of any kind (including without limitation, photographs, charts, graphs, voice mails, microfiche, microfilm, videotape, recordings and motion pictures), electronic and mechanical records or representations of any kind (including, without limitation, tapes, cassettes, disks, computer server files, computer hard drive files, CDs, DVDs, memory sticks, and recordings), and other written, printed, typed, or other graphic or recorded matter of any kind or nature, however produced or reproduced, and whether preserved in writing, film, tape, disk, videotape or otherwise. A document bearing any notation not a part of the original text is to be considered a separate document. A draft or non-identical copy is a separate document within the meaning of this term.

2. The term "documents in your possession, custody, or control" means (a) documents that are in your possession, custody, or control, whether held by you or your past or present agents, employees, or representatives acting on your behalf; (b) documents that you have a legal right to obtain, that you have a right to copy, or to which you have access; and (c) documents that you have placed in the temporary possession, custody, or control of any third party.

3. The term "communication" means each manner or means of disclosure or exchange of information, regardless of means utilized, whether oral, electronic, by document or otherwise, and whether face-to-face, in a meeting, by telephone, mail, telexes, discussions, releases, personal delivery, or otherwise.

4. The terms "and" and "or" shall be construed broadly and either conjunctively or disjunctively to bring within the scope of the request any information which might otherwise be construed to be outside its scope. The singular includes plural number, and vice versa. The masculine includes the feminine and neuter genders.

5. The terms "person" or "persons" means natural persons, firms, partnerships, associations, corporations, subsidiaries, divisions, departments, joint ventures,

proprietorships, syndicates, or other legal, business or government entities, and all subsidiaries, affiliates, divisions, departments, branches, and other units thereof.

6. The terms "referring" or "relating," with respect to any given subject, means anything that constitutes, contains, embodies, reflects, identifies, states, refers to, deals with, or is in any manner whatsoever pertinent to that subject.

THE BANK OF NEW YORK MELLON

Carl Krasik
General Counsel

August 20, 2009

By Fedex and Via Email

The Honorable Dennis J. Kucinich
Chairman
Domestic Policy Subcommittee
Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, D.C. 20515-6143

Re: The Bank of New York Mellon Corporation

Dear Chairman Kucinich,

I write on behalf of The Bank of New York Mellon Corporation ("BNY Mellon") in response to your July 30, 2009 letter addressed to Robert P. Kelly in his capacity as Chairman of BNY Mellon. In your letter, you request information concerning how BNY Mellon intends to respond, in the context of consumer debt collecton arbitration provisions, to the fact that the National Arbitration Forum has announced that it is abandoning the consumer debt arbitration business and the American Arbitration Association has announced a moritorium on conducting consumer debt arbitrations. As described below, BNY Mellon's business model and product mix is such that consumer debt collection arbitration is not a process we participate in as a matter of course.

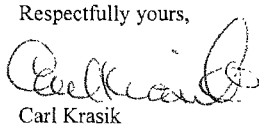
BNY Mellon was formed on July 1, 2007 by the merger of the Bank of New York Company, Inc. and Mellon Financial Corporation. Our business model differs from a traditional retail, commercial or investment bank in that we do not focus on the broad retail market or products such as mortgages, credit cards or auto loans. Known as a "bank for banks," BNY Mellon's focus is providing support to other financial institutions around the world. We invest mutual fund and pension monies and administer their complex "back-office" processes. We also provide critical infrastructure for the global financial markets by facilitating the movement of money and securities through the markets, and we provide some financing to other banks. In sum, BNY Mellon is a global leader in asset management and securities servicing and also has a significant presence in the wealth management and issuer, clearing and treasury services. BNY Mellon's global client base includes financial institutions, corporations, government agencies, pension funds, endowments, and foundations.

One Wall Street, 10th Floor, New York, NY 10286
T 212 635 1204 F 212 635 1070 carl.krasik@bnymellon.com

Given this specialized focus, BNY Mellon has virtually no "consumer debt" products. In particular, BNY Mellon does not issue credit or charge cards. BNY Mellon (through its private wealth management business) does interact with a relatively limited number of high-net-worth individual clients; however, extensions of credit to such clients contain no provisions concerning debt collection arbitration, and BNY Mellon does not intend to introduce such provisions in the future. [1]

Please call me at 212-635-1204, or Deputy General Counsel Matthew Biben at 212-635-1125, if you have any questions regarding the foregoing.

Respectfully yours,



Carl Krasik
General Counsel

cc: The Honorable Jim Jordan
Ranking Minority Member
Domestic Policy Subcommittee

[1] BNY Mellon often serves as indenture trustee on certain asset-backed securities ("ABS") issued by other financial institutions. Some of these ABS are backed by credit card or other consumer-loan receivables. BNY Mellon's powers are defined by the indenture agreement, strictly limited, and largely confined to ministerial duties, and we have no authority with respect to the underlying credit agreements between the consumer and the lending company.

American Arbitration Association
Dispute Resolution Services Worldwide

Submitted for the record by Richard Naimark

Consumer-Related Disputes Supplementary PROCEDURES

Effective September 15, 2005

About the AAA
The AAA's Consumer Rules
Availability of Mediation
Administrative Fees
Arbitrator's Fees
Glossary of Terms
Claimant
Respondent
ADR Process
Arbitration
Desk Arbitration
Telephone Hearing
In Person Hearing
Mediation
Neutral
Case Manager
ADR Agreement
ADR Program
Independent ADR Institution
Resolution of Consumer-Related Disputes Supplementary Procedures
C-1. Agreement of Parties and Applicability
C-2. Initiation Under an Arbitration Agreement
C-3. Initiation Under a Submission
C-4. Appointment of Arbitrator
C-5. Proceedings on Documents ("Desk Arbitration")
C-6. Expedited Hearing Procedures
C-7. The Award
C-8. Administrative Fees and Arbitrator Fees*
Administrative Fees
Arbitrator Fees
Fees and Deposits to be Paid by the Consumer:
Fees and Deposits to be Paid by the Business:

INTRODUCTION

Millions of consumer purchases take place each year. Occasionally, these transactions lead to disagreements between consumers and businesses. These disputes can be resolved by arbitration. Arbitration is usually faster and cheaper than going to court.

The AAA applies the Supplementary Procedures for Consumer-Related Disputes to arbitration clauses in agreements between individual consumers and businesses where the business has a standardized, systematic application of arbitration clauses with customers and where the terms and conditions of the purchase of standardized, consumable goods or services are non-negotiable or primarily non-negotiable in most or all of its terms, conditions, features, or choices. The product or service must be for personal or household use. The AAA will have the discretion to apply or not to apply the Supplementary Procedures and the parties will be able to bring any disputes concerning the application or non-application to the attention of the arbitrator. Consumers are not prohibited from seeking relief in a small claims court for disputes or claims within the scope of its jurisdiction, even in consumer arbitration cases filed by the business.

About the AAA
The American Arbitration Association (AAA) is a not-for-profit, private organization. We offer a broad range of conflict management services to businesses, organizations and individuals. We also provide education, training and publications focused on ways of settling disputes out of court.

The AAA's Consumer Rules
The AAA has developed the Supplementary Procedures for Consumer-Related Disputes for consumers and businesses that want to have their disagreements resolved by arbitrators. People throughout the world can make use of our services.

Availability of Mediation
Mediation is also available to help parties resolve their disputes. Mediations are handled under AAA's Commercial Mediation Procedures.

Administrative Fees
The Association charges a fee for its services under these rules. The costs to the consumer and business depend on the size and nature of the claims. A fee schedule is included at the end of this Supplement. In certain cases, fees paid by the consumer are fully refundable if the dispute is settled before the arbitrator takes any action.

Arbitrator's Fees
Arbitrators get paid for the time they spend resolving disputes. The arbitrator's fee depends on the type of proceeding that is used and the time it takes. The parties make deposits as outlined in the fee schedule at the end of this Supplement. Unused deposits are refunded at the end of the case.

GLOSSARY OF TERMS

Claimant
A Claimant is the party who files the claim or starts the arbitration. Either the consumer or the business may be the Claimant.

Respondent
A Respondent is the party against whom the claim is filed. If a Respondent states a claim in arbitration, it is called a counterclaim. Either the consumer or the business may be the Respondent.

ADR Process
An ADR (Alternative Dispute Resolution) Process is a method of resolving a dispute out of court. Mediation and Arbitration are the most widely used ADR processes.

Arbitration
In arbitration, the parties submit disputes to an impartial person (the arbitrator) for a decision. Each party can present evidence to the arbitrator. Arbitrators do not have to follow the Rules of Evidence used in court.
Arbitrators decide cases with written decisions or "awards." An award is usually binding on the parties. A court may enforce an arbitration award, but the court's review of arbitration awards is limited.

Desk Arbitration
In a Desk Arbitration, the parties submit their arguments and evidence to the arbitrator in writing. The arbitrator then makes an award based only on the documents. No hearing is held.

Telephone Hearing
In a Telephone Hearing, the parties have the opportunity to tell the arbitrator about their case during a conference call. Often this is done after the parties have sent in documents for the arbitrator to review. A Telephone Hearing can be cheaper and easier than an In Person Hearing.

In Person Hearing
During an In Person Hearing, the parties and the arbitrator meet in a conference room or office and the parties present their evidence in a process that is similar to going to court. However, an In Person Hearing is not as formal as going to court.

Mediation
In Mediation, an impartial person (the mediator) helps the parties try to settle their dispute by reaching an agreement together. A mediator's role is to help the parties come to an agreement. A mediator does not arbitrate or decide the outcome.

Neutral
A Neutral is a word that is used to describe someone who is a mediator, arbitrator, or other independent, impartial person selected to serve as the independent third party in an ADR process.

Case Manager
The Case Manager is the AAA's employee assigned to handle the administrative aspects of the case. He or she does not decide the case. He or she only manages the case's administrative steps, such as exchanging documents, matching schedules, and setting up hearings. The Case Manager is the parties' contact point for almost all aspects of the case outside of any hearings.

ADR Agreement
An ADR Agreement is an agreement between a business and a consumer to submit disputes to mediation, arbitration, or other ADR processes.

ADR Program
An ADR Program is any program or service set up or used by a business to resolve disputes out of court.

Independent ADR Institution
An Independent ADR Institution is an organization that provides independent and impartial administration of ADR programs for consumers and businesses. The American Arbitration Association is an Independent ADR Institution.

SUPPLEMENTARY PROCEDURES FOR THE RESOLUTION OF CONSUMER-RELATED DISPUTES

C-1. Agreement of Parties and Applicability
(a) The Commercial Dispute Resolution Procedures and these Supplementary Procedures for Consumer-Related Disputes shall apply whenever the American Arbitration Association (AAA) or its rules are used in an 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. The product or service must be for personal or household use. The AAA will have the discretion to apply or not to apply the Supplementary Procedures and the parties will be able to bring any disputes concerning the application or non-application to the attention of the arbitrator. The AAA's most current rules will be used when the arbitration is started. If there is a difference between the Commercial Dispute Resolution Procedures and the Supplementary Procedures, the Supplementary Procedures will be used. The Commercial Dispute Resolution Procedures may be found on our Web site. They may also be obtained from the Case Manager.

(b) The Expedited Procedures will be used unless there are three arbitrators. In such cases, the Commercial Dispute Resolution Procedures shall apply.

(c) The AAA may substitute another set of rules, such as the Real Estate or the Wireless Industry Arbitration Rules, for the Commercial Dispute Resolution Procedures in some cases.

(d) Parties can still take their claims to a small claims court.

C-2. Initiation Under an Arbitration Agreement
(a) The filing party (the "claimant") must notify the other party (the "respondent"), in writing, that it wishes to arbitrate a dispute. This notification is referred to as the "demand" for arbitration. The demand should:
' briefly explain the dispute,
' list the names and addresses of the consumer and the business,
' specify the amount of money involved,
' state what the claimant wants.

The claimant must also send two copies of the demand to the AAA at the time it sends the demand to the respondent. When sending a demand to the AAA, the claimant must attach a copy of the arbitration agreement from the consumer contract with the business. The claimant must also send the appropriate administrative fees and deposits. A fee schedule can be found in Section C-8 at the end of this Supplement.

(b) The AAA shall confirm receipt of the demand to the parties.

(c) The respondent may answer the demand and may also file a counterclaim. The answer must be sent to the AAA within ten calendar days after the AAA acknowledges receipt of claimant's demand. The answer must:
' be in writing,
' be sent, in duplicate, to the AAA,
' be sent to the claimant at the same time.
' If the respondent has a counterclaim, it must state the nature of the counterclaim, the amount involved, and the remedy sought.

(d) If no answer is filed within the stated time, the AAA will assume that the respondent denies the claim.

(e) The respondent must also send the appropriate administrative fees and deposits. A fee schedule can be found in Section C-8 at the end of this Supplement. Payment is due ten calendar days after the AAA acknowledges receipt of claimant's demand.

C-3. Initiation Under a Submission
Where no agreement to arbitrate exists in the contract between the consumer and the business, the parties may agree to arbitrate a dispute. To begin arbitration, the parties must send the AAA a submission agreement. The submission agreement must:
' be in writing,
' be signed by both parties,
' briefly explain the dispute,
' list the names and addresses of the consumer and the business,
' specify the amount of money involved,
' state the solution sought.
The parties should send two copies of the submission to the AAA. They must also send the administrative fees and deposits. A fee schedule can be found in Section C-8 at the end of this Supplement.

C-4. Appointment of Arbitrator
Immediately after the filing of the submission or the answer, or after the deadline for filing the answer, the AAA will appoint an arbitrator. The parties will have seven calendar days from the time the AAA notifies them, to submit any factual objections to that arbitrator's service.

C-5. Proceedings on Documents ("Desk Arbitration")
Where no claims or counterclaims exceed $10,000, the dispute shall be resolved by the submission of documents. Any party, however, may ask for a hearing. The arbitrator may also decide that a hearing is necessary.
The arbitrator will establish a fair process for submitting the documents. Documents must be sent to the AAA. These will be forwarded to the arbitrator.

C-6. Expedited Hearing Procedures
A party may request that the arbitrator hold a hearing. This hearing may be by telephone or in person. The hearing may occur even if the other party does not attend. A request for a hearing should be made in writing within ten calendar days after the AAA acknowledges receipt of a claimant's demand for arbitration. Requests received after that date will be allowed at the discretion of the arbitrator.

In a case where any party's claim exceeds $10,000, the arbitrator will conduct a hearing unless the parties agree not to have one.

Any hearings will be conducted in accordance with the Expedited Procedures of the Commercial Dispute Resolution Procedures. These procedures may be found on our Web site. They may also be obtained from the Case Manager.

C-7. The Award

(a) Unless the parties agree otherwise, the arbitrator must make his or her award within fourteen calendar days from the date of the closing of the hearing. For Desk Arbitrations, the arbitrator has fourteen calendar days from when the AAA sends the final documents to the arbitrator.

(b) Awards shall be in writing and shall be executed as required by law.

(c) In the award, the arbitrator should apply any identified pertinent contract terms, statutes, and legal precedents. The arbitrator may grant any remedy, relief or outcome that the parties could have received in court. The award shall be final and binding. The award is subject to review in accordance with applicable statutes governing arbitration awards.

C-8. Administrative Fees and Arbitrator Fees*

Administrative fees and arbitrator compensation deposits are due from the claimant at the time a case is filed. They are due from the respondent at the time the answer is due. The amounts paid by the consumer and the business are set forth below.

*Pursuant to Section 1284.3 of the California Code of Civil Procedure, consumers with a gross monthly income of less than 300% of the federal poverty guidelines are entitled to a waiver of arbitration fees and costs, exclusive of arbitrator fees. This law applies to all consumer agreements subject to the California Arbitration Act, and to all consumer arbitrations conducted in California. If you believe that you meet these requirements, you must submit to the AAA a declaration under of oath regarding your monthly income and the number of persons in your household. Please contact the AAA's Western Case Management Center at 1-877-528-0879, if you have any questions regarding the waiver of administrative fees. (Effective January 1, 2003)

Administrative Fees

Administrative fees are based on the size of the claim and counterclaim in a dispute. They are based only on the actual damages and not on any additional damages, such as attorneys' fees or punitive damages. Portions of these fees are refundable pursuant to the Commercial Fee Schedule.

Arbitrator Fees

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

Desk Arbitration or Telephone Hearing $250 for service on the case

In Person Hearing $750 per day of hearing

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

Fees and Deposits to be Paid by the Consumer:

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

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

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

Fees and Deposits to be Paid by the Business:

Administrative Fees:

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

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

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

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

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

For more information please contact our customer service department at 1-800-778-7879
Rules, forms, procedures and guides are subject to periodic change and updating.

American Arbitration Association
Dispute Resolution Services Worldwide

Submitted for the record
by Richard Naimark

Consumer Due Process PROTOCOL

Statement of Principles of the National Consumer Disputes Advisory Committee

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STATEMENT OF PRINCIPLES

PRINCIPLE 1. FUNDAMENTALLY-FAIR PROCESS

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

PRINCIPLE 2. ACCESS TO INFORMATION REGARDING ADR PROGRAM

Providers of goods or services should undertake reasonable measures to provide Consumers with full and accurate information regarding Consumer ADR Programs. At the time the Consumer contracts for goods or services, such measures should include (1) clear and adequate notice

regarding the ADR provisions, including a statement indicating whether participation in the ADR Program is mandatory or optional, and (2) reasonable means by which Consumers may obtain additional information regarding the ADR Program. After a dispute arises, Consumers should have access to all information necessary for effective participation in ADR.

PRINCIPLE 3. INDEPENDENT AND IMPARTIAL NEUTRAL; INDEPENDENT ADMINISTRATION

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

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

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

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

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

PRINCIPLE 4. QUALITY AND COMPETENCE OF NEUTRALS

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

PRINCIPLE 5. SMALL CLAIMS

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

PRINCIPLE 6. REASONABLE COST

1. *Reasonable Cost. Providers of goods and services should develop ADR programs which entail reasonable cost to Consumers based on the circumstances of the dispute, including, among other things, the size and nature of the claim, the nature of goods or services provided, and the ability of the Consumer to pay. In some cases, this may require the Provider to subsidize the process.*

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

PRINCIPLE 7. REASONABLY CONVENIENT LOCATION

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

PRINCIPLE 8. REASONABLE TIME LIMITS

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

PRINCIPLE 9. RIGHT TO REPRESENTATION

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

PRINCIPLE 10. MEDIATION

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

PRINCIPLE 11. AGREEMENTS TO ARBITRATE

Consumers should be given:

a. *clear and adequate notice of the arbitration provision and its consequences, including a statement of its mandatory or optional character;*
b. *reasonable access to information regarding the arbitration process, including basic distinctions between arbitration and court proceedings, related costs, and advice as to where they may obtain more complete information regarding arbitration procedures and arbitrator rosters;*
c. *notice of the option to make use of applicable small claims court procedures as an alternative to binding arbitration in appropriate cases; and,*
d. *a clear statement of the means by which the Consumer may exercise the option (if any) to submit disputes to arbitration or to court process.*

PRINCIPLE 12. ARBITRATION HEARINGS

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

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

PRINCIPLE 13. ACCESS TO INFORMATION

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

PRINCIPLE 14. ARBITRAL REMEDIES

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

PRINCIPLE 15. ARBITRATION AWARDS

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

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

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

INTRODUCTION: GENESIS OF THE ADVISORY COMMITTEE

Recent years have seen a pronounced trend toward incorporation of out-of-court conflict resolution processes in standardized agreements presented to consumers of goods and services. Some of these processes (such as mediation and non-binding evaluation) involve third party intervention in settlement negotiations; others involve adjudication (binding arbitration). Such processes have the potential to be of significant value in making dispute resolution quicker, less costly, and more satisfying. [1]

Yet because consumer contracts often do not involve arm's length negotiation of terms, and frequently consist of boilerplate language presented on a take-it-or-leave it basis by suppliers of goods or services, there are legitimate concerns regarding the fairness of consumer conflict resolution mechanisms required by suppliers. This is particularly true in the realm of binding arbitration, where the courts are displaced by private adjudication systems. In such cases, consumers are often unaware of their procedural rights and obligations until the realities of out-of-court arbitration are revealed to them after disputes have arisen. [2] While the results may be entirely satisfactory, they may also fall short of consumers' reasonable expectations of fairness [3] and have a significant impact on consumers' substantive rights and remedies. [4]

The use of mediation and other forms of alternative dispute resolution (ADR) by various state and federal courts has also raised concerns regarding quality, effectiveness and fairness. The response has been a number of national, state and local initiatives to establish standards for the guidance and information of courts. Until now, however, there has been no comparable national effort in the private consumer sphere.

In the spring of 1997, the American Arbitration Association (AAA) announced the establishment of a National Consumer Disputes Advisory Committee. The stated mission of the Advisory Committee is:

> *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.*

In light of its stated mission, the Advisory Committee's recommendations are likely to have a direct impact on the development of rules, procedures and policies for the resolution of consumer disputes under the auspices of the AAA.

The Advisory Committee's recommendations may also have a significant impact in the broader realm of consumer ADR. A Statement of Principles which is perceived as a broadly-based consensus regarding minimum requirements for mediation and arbitration programs for consumers of goods and services may influence the evolution of consumer rules generally and the development of state and federal laws governing consumer arbitration agreements. The standards may affect the drafting of statutes and influence judicial opinions addressing the enforceability of arbitration agreements pursuant to existing state or federal law. [5]

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1. See, *e.g.* , CPR Institute for Dispute Resolution, *ADR Cost Savings & Benefit Studies* (Catherine Cronin-Harris, ed. 1994) (summarizing some of the research findings on the relative advantages ADR may offer). Se also, *e.g.* , *Madden v. Kaiser Foundation Hosp.* , 17 Cal. 3d 699, 711, 552 P.2d 1178, 1186 (1976) ("The speed and economy of arbitration, in contrast to the expense and delay of a jury trial, could prove helpful to all parties....")

2. The arbitration agreement may be included in the "fine print" in a brochure of terms and conditions inside a box of goods. See, *e.g.* , *Hill v. Gateway 2000, Inc.* , 105 F.3d 1147 (7th Cir. 1997) (Customers agreed to computer company's contract terms, including arbitration agreement, by failing to return merchandise within 30 days). See *Age of Compelled Arbitration* , 1997, Wis. L. Rev33, 40-53 (Offering a "cautionary tale" regarding employment arbitration agreement.)

3. See Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection* , 10 Ohio St. J. On Disp. Res. 267 (1995) (discussing procedural limitations of arbitration in treating consumer disputes with banks and lenders); Schwartz, *supra* note 2 (discussing issues relating to adhesion contracts involving employees and consumers); 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 Tulane L. Rev. 1 (1997) (discussing due process concerns with binding arbitration under employment and consumer contracts). See, e.g., *Engalla V. Permanente Med. Grp.* , 938 P.2d 903 (Cal. 1997) (medical group may not compel arbitration where it administers own arbitration program, fraudulently misrepresents speed of arbitrator selection process, and the forces delays); *Broemmer V. Abortion Serv. of Phoenix* , 840 P.2d 1013 (Az. 1992) (refusing to

enforce agreement in "adhesion contract" where drafter inserted potentially self-serving term requiring sole arbitrator of medical malpractice claims to be licensed medical doctor).

4. See Schwartz, *supra* note 2, at 60-61 (discussing perceptions regarding relative damages awards in court and in arbitration), 64-66 (summarizing some statistics on arbitration awards). See also William W. Park, *When and Why Arbitration Matters* , in The Commercial Way to Justice 73, 75 (G.M. Beresfort Hartwell ed., 1997) (" *Who* interprets an...agreement will frequently be more significant than *what* the applicable law says about the agreement....").

5. See, e.g., *Cole v. Burns International Security Services* , 105 F.3d 1465 (D.C.Cir. 1997) (Citing Due Process Protocol for Employment Disputes). The consensus-based approach of the broadly constituted group reflects the "public interest" model espoused by Professor Speidel. See Richard E. Speidel, *Contract Theory and Securities Arbitration: Whither Consent?* , 62 Brook. L. Rev. 1335 (1996).

SCOPE OF THE CONSUMER DUE PROCESS PROTOCOL

The Consumer Due Process Protocol (Protocol) was developed to address the wide range of consumer transactions those involving the purchase or lease of goods or services for personal, family or household use. These include, among other things, transactions involving: banking, credit cards, home loans and other financial services; health care services; brokerage services; home construction and improvements; insurance; communications; and the purchase and lease of motor vehicles and other personal property.

Across this broad spectrum of consumer transactions, the Protocol applies to all possible conflicts from small claims to complex disputes. In light of these realities, the Advisory Committee sought to develop principles which would establish clear benchmarks for conflict resolution processes involving consumers, while recognizing that a process appropriate in one context may be inappropriate in another. Therefore, the Protocol embodies flexible standards which permit consideration of specific circumstances.

In some cases, the AAA is developing or has developed special dispute resolution policies and procedures governing particular transactional systems. A recent example is its current initiative with respect to ADR in contracts for health care services. Where the general principles set forth in this Protocol conflict with more specific standards developed under the auspices of the AAA or some other independent organization with relatively broad participation by affected parties, the latter should govern.

There are other transactions that share many of the features of consumer transactions, such as those involving small businesses and individual employment contracts. While the Protocol was not developed for specific application to such other transactions, there

may be circumstances in which the Protocol might be applied by analogy to ADR in those venues. The Principles articulated here are likely to have an impact on minimum standards of due process for other ADR systems involving persons of disparate bargaining power.

Each section of this document is devoted to treatment of a discrete topic concerning consumer ADR. It begins with a basic Principle that embodies the fundamental reasonable expectation of consumers as defined by the Advisory Committee. Each Principle is accompanied by Reporter's Comments that explain the rationale of the Advisory Committee in the context of other emerging standards. In addition, some Principles are supplemented by Practical Suggestions for putting the Principles into practice.

The specific mention of mediation and binding arbitration reflects the current emphasis on these processes in consumer conflict resolution. The Advisory Committee recognizes that a number of other approaches are being employed to resolve commercial and consumer disputes, and encourages their use in accordance with the spirit of the Protocol.

The signatories to this Protocol were designated by their respective organizations, but the Protocol reflects their personal views and should not be construed as representing the policy of the designating organizations. Although the following Principles reflect a remarkable degree of consensus, achieved during the course of several meetings of the entire Advisory Committee, subcommittee deliberations, exchanges of numerous memoranda and of five drafts of the Protocol, Advisory Committee members at times accepted compromise in the interest of arriving at a common ground. As was the case with the task force which developed the *Employment Due Process Protocol*, opinions regarding the appropriateness of binding pre-dispute arbitration agreements in consumer contracts were never fully reconciled. Like that group, however, the Advisory Committee was able to address standards for ADR processes within the given context.

GLOSSARY OF TERMS

Consumer
Consumer refers to an individual who purchases or leases goods or services, or contracts to purchase or lease goods or services, intended primarily for personal, family or household use.

Provider
Provider refers to a seller or lessor of goods or services to Consumers for personal, family or household use.

ADR Process
An ADR (Alternative Dispute Resolution) Process is a method for out-of-court

resolution of conflict through the intervention of third parties. Mediation and arbitration are two widely used ADR processes.

Mediation

Mediation refers to a range of processes in which an impartial person helps parties to a dispute to communicate and to make voluntary, informed choices in an effort to resolve their dispute. A mediator, unlike an arbitrator, does not issue a decision regarding the merits of the dispute, but instead facilitates a dialogue between the parties with the view of helping them arrive at a mutually agreeable settlement.

Arbitration

Arbitration is a process in which parties submit disputes to a neutral third person or persons for a decision on the merits. Each party has an opportunity to present evidence to the arbitrator(s) in writing or through witnesses. Arbitration proceedings tend to be more informal than court proceedings and adherence to judicial rules of evidence is not usually required. Arbitrators decide cases by issuing written decisions or "awards." An award may or may not be binding on the parties, depending on the agreement to arbitrate. A "binding" arbitration award may be enforced as a court judgment under the terms of federal or state statutes, but judicial review of arbitration awards is limited.

Neutral

A Neutral is a mediator, arbitrator, or other independent, impartial third party selected to intervene in a Consumer-Provider dispute.

ADR Agreement

An ADR Agreement is an agreement between a Provider and a Consumer to submit disputes to mediation, arbitration, or other ADR Processes. As used in this Statement, the term includes provisions (sometimes incorporated by reference) in standard contracts furnished by Providers which signify the assent of the Consumer and Provider to such processes (although the assent may only be the "generalized assent" typically given by Consumers to standard terms).

ADR Program

An ADR Program is any program or service established by or utilized by a Provider of goods and services for out-of-court resolution of Consumer disputes. The term includes ADR rules and procedures and implementation of administrative structures.

Independent ADR Institution

An Independent ADR Institution is an organization that provides independent and impartial administration of ADR Programs for Consumers and Providers, including, but not limited to, development and administration of ADR policies and procedures and the training and appointment of Neutrals.

MAJOR STANDARDS AND SOURCES

The Reporter's Comments accompanying these Principles cite a number of existing standards and sources relied upon by the Advisory Committee. The more frequently cited standards and sources are set forth below by their full title as well as the abbreviated title that appears in the Comments.

American Arbitration Association, *Commercial Arbitration Rules* , July 1, 1996 (AAA Commercial Rules)

American Arbitration Association, *Construction Industry Dispute Resolution Procedures* , Oct. 15, 1997 (AAA Construction Procedures)

American Arbitration Association, *Wireless Industry Arbitration Rules* , July 15, 1997 (AAA Wireless Rules)

American Arbitration Association & American Bar Association, *Code of Ethics for Arbitrators in Commercial Disputes* (1977) (Code of Ethics for Arbitrators)

Center for Dispute Settlement, Institute of Judicial Admin., *Standards for Court-Connected Mediation Programs* (Standards for Court-Connected Programs)

Council of Better Business Bureaus, Inc., *Arbitration (Binding)* (BBB Arbitration Rules)

CPR-Georgetown Commission on Ethics and Standards in ADR Working Group on Provider Organizations, *Principles for ADR Provider Organizations* (Draft of April 4, 1998) (Principles for ADR Provider Organizations)

Federal Arbitration Act , 9 U.S.C. " 1-16 (as amended and in effect July 1, 1992) (Federal Arbitration Act)

Blue-Ribbon Advisory Panel on Kaiser Permanente Arbitration, *The Kaiser Permanente Arbitration System: A Review and Recommendations for Improvement* 1 (1998) (Kaiser Permanente Review and Recommendations)

Joint Committee (American Arbitration Association, American Bar Association and Society of Professionals in Dispute Resolution) on Standards of Conduct, *Standards of Conduct for Mediators* (1994) (Joint Standards for Mediators)

Society of Professionals in Dispute Resolution (SPIDR) Commission on Qualifications, *Ensuring Competence and Quality in Dispute Resolution Practice* (Draft Report 1994)(SPIDR Report on Qualifications)

Society of Professionals in Dispute Resolution (SPIDR) Law and Public Policy Committee, *Mandated Participation and Settlement Coercion: Dispute Resolution as It Relates to the Courts* (1991) (SPIDR Report on Court-Mandated ADR)

Society of Professionals in Dispute Resolution (SPIDR) Commission on Qualifications, *Principles Concerning Qualifications* (1989) (SPIDR Principles)

Task Force on Alternative Dispute Resolution in Employment, *A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship* (1995) (Employment Due Process Protocol)

Uniform Arbitration Act , 7 U.A.A. 1 (1997) (Uniform Arbitration Act)

PRINCIPLE 1. FUNDAMENTALLY-FAIR PROCESS

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

Reporter's Comments

Users of ADR are entitled to a process that is fundamentally fair. Emerging standards governing consensual and court-connected ADR programs reflect pervasive concerns with fair process. *See, e.g.,* III Ian R. Macneil, Richard E. Speidel, & Thomas J. Stipanowich, *Federal Arbitration Law: Agreements, Awards & Remedies Under the Federal Arbitration Act* '32.2.1 (1994) [hereinafter *Federal Arbitration Law*] (noting "universal agreement" that arbitrators must provide parties with fundamentally-fair hearing). *See also Kaiser Permanente Review and Recommendations 1* ("As the sponsor of a mandatory system of arbitration, Kaiser Permanente must assure a fair system to their members, physicians and staff.")

Where conflict resolution processes are defined by a written contract, that writing is often viewed by courts as the primary indicator of the "procedural fairness" for which the parties bargained. As the Advisory Committee recognized, however, ADR agreements in most Consumer contracts are "take-it-or-leave-it" contracts which are not products of negotiation by Consumers. *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, 55-60 (discussing adhesion dimension of pre-dispute arbitration agreements in standardized contracts); *Kaiser Permanente Review and Recommendations 28 (noting that many members of a major HMO have no realistic alternative for medical care).* It is possible, therefore, that contracts to which they have generally assented contain ADR Agreements which fall so far short of Consumers' reasonable expectations that they would not have entered into the agreement had they been aware of the provisions. Thus, although these Principles attempt to enhance the likelihood that Consumers will have specific knowledge of ADR provisions at the time of contracting,

the Advisory Committee also believed it necessary to describe a baseline of reasonable expectations for ADR in Consumer transactions. These Principles identify specific minimum due process standards which embody the concept of fundamental fairness, including: informed consent; impartial and unbiased Neutrals; independent administration of ADR; qualified Neutrals; access to small claims court; reasonable costs (including, where appropriate, subsidized Provider-mandated procedures); convenient hearing locations; reasonable time limits; adequate representation; fair hearing procedures; access to sufficient information; confidentiality; availability of court remedies; application of legal principle and precedent by arbitrators; and the option to receive a statement of reasons for arbitration awards.

Where provisions in a standardized pre-dispute arbitration agreement fail to meet Consumers' reasonable expectations, there is authority for the principle that courts may properly refuse to enforce the arbitration agreement in whole or in part. *See Restatement (Second) of Contracts* ' 211 (1981); *Broemmer v. Abortion Services of Phoenix, Ltd* ., 173 Ariz. 148, 840 P.2d 1013 (1992)(standardized arbitration agreement was unenforceable where its terms fell beyond patient's reasonable expectations); *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165 (Cal. 1981)(arbitration clauses in adhesion contracts are unenforceable if they are contrary to the reasonable expectations of parties or unconscionable). *Cf. Cole v. Burns International Security Services* , 105 F.3d 1465 (D.C. Cir. 1997)(setting forth minimum due process standards for judicial enforcement of arbitration agreement in the context of a statutory employment discrimination claim where the employee was required to enter into the agreement as a condition of employment). Procedural fairness in Consumer arbitration agreements may also be policed under other principles. *See, e.g., Stirlen v. Supercuts* , 51 Cal. App. 4 th Supp. 1519, 60 Cal. Rptr.2d 138 (1997)(finding remedial limits in "adhesive" employment agreement unconscionable); *Engalla v. Permanente Med. Grp.*, 938 P.2d 903 (Cal. 1997)(arbitration agreement was unenforceable if there was substantial delay in arbitrator selection contrary to consumer's reasonable, fraudulently induced, contractual expectations).

Because the Principles in this Protocol represent a fundamental standard of fairness, waiver of any of these Principles in a pre-dispute agreement will naturally be subject to scrutiny as to conformity with the reasonable expectations of the parties and other judicial standards governing the enforceability of such contracts. Assuming they have sufficient specific knowledge and understanding of the rights they are waiving, however, Consumers may waive compliance with these Principles after a dispute has arisen.

PRINCIPLE 2. ACCESS TO INFORMATION REGARDING ADR PROGRAM

Providers of goods or services should undertake reasonable measures to provide Consumers with full and accurate information regarding Consumer ADR Programs. At the time the Consumer contracts for goods or services, such measures should include (1) clear and adequate notice

regarding the ADR provisions, including a statement indicating whether participation in the ADR Program is mandatory or optional, and (2) reasonable means by which Consumers may obtain additional information regarding the ADR Program. After a dispute arises, Consumers should have access to all information necessary for effective participation in ADR.

Reporter's Comments

See SPIDR Report on Qualifications at 9 ("Consumers are entitled to know what tasks the neutral...may perform and what tasks they are expected to perform in the course of a particular dispute resolution service.") *Cf. SPIDR Principles* at 6-7 ("It is the responsibility of...private programs offering dispute resolution services to define clearly the services they provide...[and provide information about the program and Neutrals to the parties.]"); *Kaiser Permanente Review and Recommendations 28* (provider of medical services has duty to provide users with "enough information and facts to allow them to understand the actual operation of the arbitration system"); *Principles for ADR Provider Organizations 2* . At a minimum, Consumers should be provided with (or have prompt access to) written information to explain the process. This should include general information describing each ADR process used and its distinctive features, including:

*the nature and purpose of the process, including the scope of ADR provisions;

*an indication of whether or not the Consumer has a choice regarding use of the process;

*the role of parties and attorneys, if any;

*procedures for selection of Neutrals;

*rules of conduct for Neutrals, and complaint procedures;

*fees and expenses;

*information regarding ADR Program operation, including locations, times of operation, and case processing procedures;

*the availability of special services for non-English speakers, and persons with disabilities; and,

*the availability of alternatives to ADR, including small claims court.

See, e.g., BBB Arbitration Rules (defining arbitration and the roles of various participants; providing "checklist" for Consumers preparing for arbitration; setting forth procedural rules). *Cf . Standards for Court-Connected Programs* ' 3.2.b. (listing information which

courts sponsoring mediation should provide to program users). *See also SPIDR Principles* at 6-7 (listing information which private programs should offer to parties regarding the program and participating Neutrals). Consumers should also be able to obtain a copy of pertinent rules and procedures. In the case of binding arbitration provisions, there should also be a straightforward explanation of the differences between arbitration and court process. See Principle 11 "Agreements to Arbitrate." Although the Provider of goods or services is charged with the responsibility for making certain that Consumers have access to appropriate information regarding ADR, the Independent ADR Institution has an important role in this area. The Independent ADR Institution must be prepared to communicate to the parties all information necessary for effective use of the ADR process(es), particularly after a dispute arises.

All materials should be prepared in plain straightforward language. As a rule, such information should be in the same language as the principal contract for goods or services. *See, e.g., N.Y. Pers. Prop. Law* ' 427 (McKinney 1997). *See also Standards for Court-Connected Programs* ' 3.2.b., Commentary, at 3-4 (If a significant percentage of the population served is monolingual in a particular language, the material should be available in that language.)

Practical Suggestions

An example of a creative approach to providing information about Consumer ADR is provided by a major university medical center's Health Care Dispute Resolution Program. The medical center provides prospective patients with a written explanation of mediation and arbitration procedures for resolution of health care-related disputes one month before they visit the center to complete the remaining paperwork. As the written materials explain, the program is voluntary; patients are not required to opt for the procedures as a condition to receiving treatment. Patients may contact the center for additional information regarding the processes.

For purposes of allowing Consumers access to information about dispute resolution programs, the AAA makes available an 800 customer service telephone number. In addition, the AAA, like some other Independent ADR Institutions, also has a World Wide Web site; it posts its rules and an explanation of its mediation and arbitration procedures on the Web site.

A panel proposing reforms to a major HMO-sponsored arbitration system recommended the creation of an "ombudsperson program to assist members in navigating the system of dispute resolution." *Kaiser Permanente Review and Recommendations 2.43.*

PRINCIPLE 3. INDEPENDENT AND IMPARTIAL NEUTRAL; INDEPENDENT ADMINISTRATION

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

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

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

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

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

Reporter's Comments

The concept of a fair, independent and impartial Neutral (or Neutral Panel) is enshrined in leading standards governing arbitration and mediation. *See Federal Arbitration Act* ' 10(a)(2); *Uniform Arbitration Act* ' 12(a)(2); *AAA Commercial Rules* 12, 13, 14, 19; *BBB Arbitration Rules* 6, 8. *The Joint Standards for Mediators* describe mediator impartiality as "central" to the mediation process and require mediators to conduct mediation in an impartial manner. *Joint Standards for Mediators* , Art. II; *Standards for Court-Connected Programs* ' 8.1.a. Similar policies animate standards requiring mediators to disclose conflicts of interest and to conduct the mediation in a fair manner. *Joint Standards for Mediators* , Arts. III, VI; *SPIDR Principles* , Principles 4.b., c., f.; 6.d., e., i.; *Standards for Court-Connected Programs* ' 8.1.b.

When Neutrals are appointed by a court or other organization, the appointing entity has an important obligation to ensure their impartiality. This obligation entails a reasonable level of oversight of Neutral performance. Comments to the *Joint Standards for Mediators* indicate that "[w]hen mediators are appointed by a court or institution, the appointing agency shall make reasonable efforts to ensure that mediators serve impartially." *Joint Standards for Mediators* , Art. II. The *Standards for Court-Connected Programs* therefore require courts to "adopt a code of ethical standards for mediators [covering, among other things, impartiality and conflict of interest], together with procedures to handle violations of the code." *Standards for Court-Connected Programs* ' 8.1. For these and other reasons, the integrity and impartiality of the administrative organization is also important; the growing use of arbitration and mediation in the Consumer context has also raised issues regarding the administration of such processes. *See, e.g., Engalla v. Permanente Med. Grp.,* 928 P.2d 903 (Cal. 1997). *See generally* Edward Dauer, *Engalla's Legacy to Arbitration* , ADR Currents, Summer 1997, at 1; *Principles for ADR Provider Organizations* (setting forth general principles of responsible practice for ADR Provider Organizations, "entities which hold themselves out as offering, brokering or administering dispute resolution services").

In addition to appointing Neutrals, administering institutions often perform many functions which have a direct impact on the conduct of the dispute resolution process, including functions sometimes performed by Neutrals. The consensus of the Advisory Committee was that the reality and perception of impartiality and fairness was as essential in the case of Independent ADR Institutions as it was in the case of individual Neutrals. Thus, the Advisory Committee concluded that when an ADR Agreement mandates that parties resort to mediation or arbitration, the administering Independent ADR Institution should be independent of either party and impartial . *See, e.g., Kaiser Permanente Review and Recommendations 31* (recommending, first and foremost, the "creation of an independent, accountable administrator" for the Kaiser Permanente arbitration system to counter "perception of bias" raised by "self-administration"). *See also Principles for ADR Provider Organizations* (draft standards for organizations providing ADR services). For this and other reasons, this Principle may be the single most significant contribution of the Protocol. In the long term, moreover, the independence of administering institutions may be the greatest challenge of Consumer ADR.

Broad disclosure of actual or potential conflicts of interest on the part of prospective Neutrals is critical to the real and perceived fairness of ADR. Although consenting parties have considerable freedom to choose Neutrals, including those with experience in a particular industry or profession, the key to informed consent is broad disclosure by prospective Neutrals. Therefore, a long line of authority under federal and state arbitration statutes establishes the principle that an arbitrator's failure to disclose certain relationships or other facts which raise issues of partiality may result in reversal of an arbitration award. *See generally* III *Federal Arbitration Law* Ch. 28 (discussing legal and

ethical rules governing arbitrator impartiality). The principle of disclosure is embodied in leading arbitration rules and ethical standards. *See AAA Commercial Rule* 19, *NASD Code* ' 10312; *BBB Arbitration Rules* 6, 8.

The *Joint Standards for Mediators* mandate disclosure of "all actual and potential conflicts of interest reasonably known to the mediator" including any "dealing or relationship that might create an impression of possible bias." *Joint Standards for Mediators* , Art. III. Thereafter, the mediator must await the parties' agreement to proceed with mediation. The same concerns require mediators to identify and avoid conflicts during (and even after) mediation. *Id. Cf. Employment Due Process Protocol* ' C.4. (mediators and arbitrators have a duty to disclose any relationship which might reasonably constitute or be perceived as a conflict of interest); *SPIDR Principles* , Principles 4.b., c., f.; 6.d.,e., i.; *Standards for Court-Connected Programs* ' 8.1.b.

Although they did not establish it as a requirement under these Principles, most members of the Advisory Committee endorsed the concept of a "list selection" process similar to that employed by the AAA. *See AAA Commercial Rule* 14. Under this process, the Independent ADR Institution provides each of the parties with lists of prospective Neutrals and invites the parties to identify and rank acceptable individuals. Mutually acceptable Neutrals are thereby identified. The AAA approach served as the model for other ADR standards. *See, e.g., Employment Due Process Protocol* ' C.3.; Securities Industry Conference on Arbitration, *List Selection Rule* (Final Draft, Sept. 18, 1997)(proposed by SICA as modification to Section 8 of the *Uniform Code of Arbitration*); Proposed Rule Change by National Association of Securities Dealers, File No. SR-NASD097 (proposed by NASD as modification to Rules 10310 and 10311 of the NASD Code of Arbitration Procedure). The concern was expressed that the list selection approach may create a financial tie between Neutrals in the pool and Providers, who will be "repeat players" in the ADR Program. Such considerations may mandate, among other things, a larger panel of Neutrals, rotating assignments, or disclosure of past awards rendered by arbitrators.

In the interest of informed selection, the Advisory Committee recommends that parties be provided with or have access to some information regarding recent ADR proceedings conducted by prospective Neutrals. *Cf. Employment Due Process Protocol* ' B.3 (recommending that parties be provided with names, addresses, and phone numbers of party representatives in a prospective arbitrator's six most recent cases to aid in selection).

The dictates of fairness also extend to the conduct of ADR sessions. Thus, for example, arbitrators generally are forbidden from communicating with parties outside of hearings. *See* III *Federal Arbitration Law* ' 32.4. Similarly, standards for mediator conduct demand impartiality. *See, e.g., Standards for Court-Connected Programs* ' 8.1.

Although the rules and procedures of an ADR Program and oversight by the Independent ADR Institution are important in assuring the impartiality of Neutrals, it is also essential that Neutrals be bound to perform in accordance with recognized ethical standards. In the case of arbitrators, the leading ethical standard is the *Code of Ethics for Arbitrators in Commercial Disputes* (current version). Similarly, ethical standards governing mediator eligibility also require impartiality. *See, e.g., Standards for Court-Connected Programs* ' 8.1. It is the responsibility of the Independent ADR Institution to develop or adopt ethical standards for Neutrals and to ensure that Neutrals understand and conform to applicable standards.

Some arbitration procedures provide for a "tripartite" panel in which each party appoints its own "party-arbitrator," and the two party-arbitrators select a third arbitrator to complete the panel. *See generally* III *Federal Arbitration Law* ' 28.4; *see also* Alan Scott Rau, *Integrity in Private Judging* , 38 S. Tex. L. Rev. 485, 505-08 (1997)(noting problems with party-arbitrator concept). For a number of reasons, the Advisory Committee believed such practices should be avoided in the Consumer sphere, and that all arbitrators should be neutral. *Cf. Kaiser Permanente Review and Recommendations* 42 (expressing serious concerns regarding tripartite panel approach).

Practical Suggestions

Independent ADR Institutions should develop procedures which are appropriate to each of the ADR Programs they administer. A helpful model for program administrators is the User Advisory Committee now being utilized by the AAA to establish procedures and policies for ADR in the areas of employment, construction, health care, and other transactional settings. *Cf. Kaiser Permanente Review and Recommendations* 32 (recommending "on-going, volunteer Advisory Committee" comprised of representatives of various interest groups, including "an appropriate consumer advocacy organization" to consult in development of arbitration program). Such entities should provide a forum in which representatives of Consumers and Providers cooperate in the development and implementation of policies and procedures governing an ADR program, including selection of Neutrals.

For selection of Neutrals, the Independent ADR Institution might utilize a list procedure similar to that used by the AAA. The list of prospective Neutrals should include pertinent biographical information, including the names of parties and representatives involved in recent arbitration proceedings handled by the prospective Neutral. *Cf. Employment Due Process Protocol* ' B.3 (recommending that parties be provided with names, addresses, and phone numbers of party representatives in a prospective arbitrator's six most recent cases to aid in selection). Each party should be afforded discretion to reject any candidate with or without cause. Failing agreement on a Neutral or panel of Neutrals in this fashion, the Neutral should be appointed by the Independent ADR Institution, subject to objection for good cause.

PRINCIPLE 4. QUALITY AND COMPETENCE OF NEUTRALS

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

Reporter's Comments

Organizations providing ADR services for Consumer transactions should have a continuing obligation to monitor the quality of the services they provide. This obligation requires that they establish and maintain standards for Neutrals within the program which are appropriate to the issues or disputes being addressed. The SPIDR Commission on Qualifications calls upon private as well as public programs offering ADR services to set and monitor program performance. *See SPIDR Principles* , Principle 6, at 3-4. Likewise, the *Standards for Court-Connected Programs* call upon courts to "ensure that the mediation programs to which they refer cases are monitored adequately...and evaluated [periodically]." *Standards for Court-Connected Programs* ' 6.0.

The most critical element in ADR quality control is the establishment and maintenance of standards of competence for Neutrals within the program. "Competence" refers to "the acquisition of skills, knowledge and...other attributes" deemed necessary to assist others in resolving disputes in a particular setting. *See SPIDR Report on Qualifications* at 6. In 1989, the SPIDR Commission on Qualifications published a list of general skills and areas of knowledge that should be considered by groups establishing competency standards. *See SPIDR Principles* , Principle 11, at 4-7.

While ensuring the competence of Neutrals is always important, it is particularly "critical in contexts where party choice over the process, program or neutral is limited" a reality of many Consumer ADR programs. *See SPIDR Report on Qualifications* at 5; *SPIDR Principles* , Principle 3 at 2 (extent to which Neutral qualifications are mandated should vary by degree of choice parties have over dispute resolution process, ADR Program, and Neutral). The SPIDR Commission on Qualifications requires private programs to, among other things, establish clear criteria for the selection and evaluation of Neutrals and conduct periodic performance evaluations. *SPIDR Principles* at 3. *See also SPIDR Report on Qualifications* at 6 (Neutrals, professional associations, programs and Consumers should all have responsibility for addressing and assessing Neutral performance); American Bar Ass'n Young Lawyers Div. & Special Comm. On Alternative Means of Dispute Resolution, *Resolving Disputes: An Alternative Approach, A Handbook for Establishment of Dispute Settlement Centers* 32 (1983) (noting importance of post-mediation evaluation by administering agency).

The Advisory Committee concluded that it would be inappropriate (and, probably, impossible) to set forth a set of universally applicable qualifications for Neutrals in Consumer disputes. The Advisory Committee's conclusions parallel those of other groups establishing broad standards for the conduct of ADR. *See, e.g. , SPIDR Report on Qualifications; SPIDR Principles* at 1, 2. As the SPIDR Commission on Qualifications determined, Neutral qualifications are best established by joint efforts of concerned "stakeholders" in specific contexts. *See, e.g., Kaiser Permanente Review and Recommendations* 35-36 (recommending involvement of advisory committee in development of arbitrator qualifications).

It is important for Consumers to have a voice in establishing and maintaining standards of competence and quality in ADR programs. The SPIDR Commission on Qualifications recently observed that "consumers...share a responsibility with programs, [Neutrals]...and associations to join in evaluating and reporting on the performance of [Neutrals]...and programs and contributing to the development of policies and standards on qualifications." *SPIDR Report on Qualifications* , ' G.2. at 9. *See also SPIDR Principles* , Principle 2 at 2 (private entities making judgments about neutral qualifications should be guided by groups that include representatives of consumers of services). Although Neutral expertise is traditionally a hallmark of arbitration, technical or professional experience often carries with it the perception if not the reality of bias. From the Consumer's perspective, therefore, an arbitrator who shares the professional or commercial background of a Provider may not be the ideal judge. *See, e.g. , Broemmer v. Abortion Serv. of Phoenix* , 840 P.2d 1013 (Ariz. 1992)(adhesion arbitration agreement provided by abortion clinic which, among other things, required arbitrator to be a licensed obstetrician/gynecologist, was unenforceable as beyond reasonable expectations of patient).

An Independent ADR Institution's responsibility for the qualifications of Neutrals in a particular Consumer ADR program dictates the development of an appropriate training program. Ideally, the training should include a mentoring program with experienced Neutrals as well as coverage of applicable principles of Consumer law. *See* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection* , 10 Ohio St. J. on Disp. Res. 267, 315 (arbitrators need special legal expertise to address statutory issues respecting consumer claims against financial institutions). Successful completion of such training should be reflected in the information on prospective Neutrals furnished to the parties prior to selection. *Cf. Employment Due Process Protocol* ' C.2.

The Advisory Committee generally supports the concept of broad choice in selection of Neutrals, and recognizes the right of Consumers and Providers to jointly select any Neutral in whom the parties have requisite trust, even one who does not possess all of the qualifications recommended by an ADR Program. *Cf. Employment Due Process Protocol* ' C.1.; *Standards for Court-Connected Programs* ' 13.4 ("Parties should have the

widest possible latitude in selecting mediators, consistent with public policy."). This assumes, of course, that both parties have a true choice in the matter, that they are duly informed about the background and qualifications of the Neutrals proposed, and that all such Neutrals have made full disclosure of possible conflicts of interest in accordance with Principle 3.

Practical Suggestions

Elements of effective quality control include the establishment of standards for Neutrals, the development of a training program, and a program of ongoing performance evaluation and feedback. Because the requirements of parties will vary with the circumstances, it will be necessary to establish standards for Neutrals in an ADR Program with due regard for the specific needs of users of the program. As noted in connection with Principle 3, a helpful model for program administrators is the User Advisory Committee now being utilized by the AAA to establish procedures and policies for ADR in the areas of employment, construction, health care, and other transactional settings. Such entities could bring Consumer and Provider representatives together to assist in the development and implementation of programs to train, qualify and monitor the performance of Neutrals.

PRINCIPLE 5. SMALL CLAIMS

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

Reporter's Comments

Disputes arising out of Consumer transactions often involve relatively small amounts of money. Such disputes may be well-suited to resolution by informal ADR processes and judicial small claims procedures.

Within the judicial system, the least expensive and most efficient alternative for resolution of claims for minor amounts of money often lies in small claims courts. These courts typically provide a convenient, less formal and relatively expeditious judicial forum for handling such disputes, and afford the benefit, where necessary, of the coercive powers of the judicial system. The Advisory Committee concluded that access to small claims tribunals is an important right of Consumers which should not be waived by a pre-dispute ADR Agreement.

Practical Suggestions

Because, for cases involving small amounts of money, parties retain the option of an oral hearing in small claims court, it may be reasonable for the ADR Agreement to provide for arbitration of small claims without a face-to-face hearing. Such alternatives may

include "desk arbitration," which involves the making of an arbitration award based on written submissions; proceedings conducted by telephone or electronic data transmission; and other options. *See* Principle 12.

Mediation conducted by telephone conference call has also proven effective in resolving Consumer disputes. At least one major auto manufacturer has successfully used this technique to resolve warranty claims.

PRINCIPLE 6. REASONABLE COST

1. Reasonable Cost. Providers of goods and services should develop ADR programs which entail reasonable cost to Consumers based on the circumstances of the dispute, including, among other things, the size and nature of the claim, the nature of goods or services provided, and the ability of the Consumer to pay. In some cases, this may require the Provider to subsidize the process.

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

Reporter's Comments

A fundamental principle of our civil justice system is that a person should never be denied access to a court due to an inability to pay court costs. The reality is that the public justice system is heavily subsidized, and that users pay only a small fraction of the actual cost of trial and related procedures. Moreover, indigent litigants may be afforded relief from even these small fees. This principle has been extended in many cases to court-connected ADR programs, in which courts defray all or part of the expenses of mediation or court-connected arbitration. *See Standards for Court-Connected Programs* , " 5.1.a, 13.0 ("[c]ourts should impose mandatory attendance only when the cost of mediation is publicly funded"; "[c]ourts should make mediation available to parties regardless of the parties' ability to pay"). According to data from the National Center for State Courts' ADR database, approximately 60% of programs did not depend upon the parties to pay mediator fees for contract and tort cases; no programs charged user fees for mediation of small claims. *See Standards for Court-Connected Programs* ' 13.2., Commentary, at 13-4.

Similar policies have prompted various private ADR tribunals to institute mechanisms for waiving filing fees and other administrative expenses in appropriate cases. *See, e.g., NASD Code* ' 10332 (permitting Director of Arbitration to waive fees or deposits for parties in securities arbitration); *Nazon v. Shearson Lehman Bros., Inc.*, 832 F. Supp. 1540, 1543 (S.D. Fla. 1993)(employee, although required to bear expenses of pursuing civil rights claim in arbitration, might seek waiver of fees under NASD rules). One federal court of appeals recently concluded that to be enforceable with respect to actions under statutes governing employment discrimination, an arbitration agreement must not

"require employees to pay either unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum ." *Cole v. Burns Int'l Security Serv.* , 105 F.3d 1465, 1482-84 (D.C. Cir. 1997).

Due to the wide range of transactions and the equally broad spectrum of conflict in the Consumer arena, it is inappropriate to mandate bright-line rules regarding ADR costs. In determining what is reasonable, consideration should be given to the nature of the conflict (including the size of monetary claims, if any), and the nature of goods or services provided. In some cases, it may be possible to fulfill the principle of reasonable cost by the use of the Internet, the telephone, other electronic media, or through written submissions. *See, e.g.*, Michael F. Altschul & Elizabeth S. Stong, *AAA Develops New Arbitration Rules to Resolve Wireless Disputes* , ADR Currents, Fall 1997, at 6. Abbreviated procedures may be particularly appropriate in the context of small monetary claims, where there is always the alternative of a face-to-face hearing in small claims court. *See* Principle 5.

In some cases, the need to ensure reasonable costs for the Consumer will require the Provider of goods or services to subsidize the costs of ADR which is mandated by the agreement. Indeed, many companies today deem it appropriate to pay most or all of the costs of ADR procedures for claims and disputes involving individual employees. *See* Mei L. Bickner, et al, *Developments in Employment Arbitration* , 52 Disp. Res. J. 8 (1997). The consensus of the Committee was that if participation in mediation is mandated by the ADR agreement, the Provider should pay the costs of the procedure, including mediator's fees and expenses. The Committee considered, and ultimately rejected, the alternative of establishing specific requirements for Provider subsidization of the cost of arbitration procedures, other than to conclude that the Provider of goods and services should ensure the consumer a basic minimum arbitration procedure appropriate to the circumstances.

In some cases, an arbitrator may find it appropriate to defray the cost of Consumer participation in arbitration by an award of costs. Some lemon laws provide for such relief. *See, e.g., Chrysler Corp. v. Maiocco* , 209 Conn. 579, 552 A.2d 1207 (1989)(applying Connecticut Lemon Law); *Walker v. General Motors Corp* ., 160 Misc.2d 903, 611 N.Y.S.2d 741 (1994)(applying provision of New York Lemon Law permitting "prevailing consumer" to receive award of attorney's fees); *General Motors Corp. v. Fischer* , 140 Misc.2d 243, 530 N.Y.S.2d 484 (1988)(same). In some cases, it may be appropriate for an arbitrator in a Consumer case to render an award of attorney's fees pursuant to statute or in other cases where a court might do so. Without such an award, however, the Committee does not support the proposition that Providers are required to subsidize Consumers' attorney's fees for ADR.

At the same time, there are legitimate concerns that having the Provider pay all or a substantial portion of neutral's fees and expenses may undermine the latter's

impartiality. For this reason, as observed in the *Employment Due Process Protocol* , "[i]mpartiality is best assured by the parties sharing the fees and expenses of the mediator and arbitrator." *Employment Due Process Protocol* ' 6. *See also* Stephen J. Ware, *Arbitration and Unconscionability After* Doctor's Associates, Inc. v. Casarotto, 31 Wake Forest L. Rev. 1001, 1023 (1996). *But see* Alan Scott Rau, *Integrity in Private Judging* , 38 S. Tex. L. Rev. 485, 528 (1997). Therefore, the Advisory Committee concludes that Consumers should have the option to share up to half of the Neutral's fees and expenses. In addition, unless the parties agree otherwise after a dispute arises, the handling of fee arrangements and the payment of fees should be conducted by the Independent ADR Institution. The latter, "by negotiating the parties' share of costs and collecting such fees, might be able to reduce the bias potential of disparate contributions by forwarding payment to the mediator and/or arbitrator without disclosing the parties' share therein ." *Employment Due Process Protocol* ' 6.

Some ADR Programs serving Consumers are staffed wholly or partly by unpaid volunteers. *See, e.g.* , *BBB Arbitration Rules* at 2. The use of such programs, including community dispute resolution centers, may be a satisfactory means of addressing cost concerns associated with Consumer ADR, particularly in cases involving low stakes. However, concerns have been expressed by some authorities regarding overdependence on volunteer Neutrals. *See Standards for Court-Connected Programs* ' 13.1, Commentary, at 13-2 (warning of dangers of exclusive reliance on volunteers in ADR programs). Care must be taken by those responsible for overseeing such programs to make certain that lower cost does not come at the expense of adequately qualified Neutrals.

Practical Suggestions

In the event that an ADR procedure is mandated by the Provider of goods and services and the Consumer demonstrates an inability to pay all or part of the costs of the procedure, the Provider should front such costs subject to allocation in the arbitration award or mediation settlement.

In some cases, it may be possible to fulfill the principle of reasonable cost by the use of the Internet, the telephone, other electronic media, or through written submissions. See, e.g., Michael F. Altschul & Elizabeth S. Stong, *AAA Develops New Arbitration Rules to Resolve Wireless Disputes* , ADR Currents, Fall 1997, at 6.

PRINCIPLE 7. REASONABLY CONVENIENT LOCATION

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

Reporter's Comments

The Advisory Committee concludes that ADR proceedings should take place at a location that is reasonably convenient to all parties.

Flexibility in choosing a hearing location is a theoretical advantage of consensual conflict resolution, permitting minimal cost and inconvenience to all parties. On the other hand, location terms may put one party at a great disadvantage, significantly increasing the cost and logistical complexity of dispute resolution. This is particularly true with regard to binding arbitration, which may involve the participation of multiple witnesses as well as the parties and their representatives. S *ee* III *Federal Arbitration Law* ' 32.8.3.

Typically, contractual agreements which provide that arbitration hearings will be conducted in a particular place are honored by the courts. *See, e.g., Management Recruiters Int'l, Inc. v. Bloor* , 129 F.3d 851 (6 th Cir. 1997)(under *Federal Arbitration Act* , forum expectations of parties in arbitration agreement are enforceable, and may not be upset by state law); *Bear Stearns & Co. v. Bennett* , 938 F.2d 31, 32 (2 nd Cir. 1991)(noting "prima facie validity" of forum-selection clauses, including those in arbitration agreements); *Snyder v. Smith* , 736 F.2d 409, 419 (7th Cir.), cert. denied, 469 U.S. 1037, 105 S. Ct. 513, 83 L. Ed.2d 403 (1984)(courts must give effect to freely-negotiated arbitration clause in commercial agreement). *See* II *Federal Arbitration Law* ' 24.2.3.4 (discussing *Federal Arbitration Act*). *Cf. Carnival Cruise Lines, Inc. v. Shute* , 449 U.S.585,111 S.Ct. 1522, 113 L. Ed. 2d 622 (1991)(judicial forum selection clause in terms on cruise ship passenger ticket enforceable); *M/S Bremen v. Zapata Off-Shore Co.* , 407 U.S. 1, 92 S. Ct. 1907. 32 L.Ed.2d (1972)(judicial forum selection clause is prima facie valid and should be enforced unless enforcement is shown by the resisting party to be unreasonable under the circumstances).

The same is true of cases where the parties agree to a process for selecting location, such as that provided by the *AAA Rules* . *See, e.g., AAA Commercial Rule* 11. There is authority for pre-award challenges to location selection mechanisms. *Aerojet-General Corp. v. AAA* , 478 F.2d 248 (9th Cir. 1973)(pre-award judicial review appropriate where choice of arbitration locale not made in good faith and one or more parties are faced with severe irreparable injury). Again, however, such action is likely to be deemed appropriate only in extreme cases. *See Seguro de Servicio de Salud v. McAuto Systems* , 878 F.2d 5, 9 n.6 (1st Cir. 1989); *S.J. Groves & Sons Co. v. AAA* , 452 F. Supp. 121, 124 (D. Minn. 1978).

Some courts, however, have identified limits on locational designations in judicial forum selection provisions. *See* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection* , 10 Ohio St. J. on Disp. Res. 267, 292; 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. 36, 121 n.366. Forum selection clauses may be overcome if it can be demonstrated that their incorporation in the contract was the result of fraud, undue influence, or an extreme disparity in bargaining power, or if the selected forum is so inconvenient that it would

effectively deprive a party of a day in court. *See, e.g., Kubis & Persyk Assoc., Inc. v. Sun Microsystems, Inc* ., 146 N.J. 176, 188-97, 680 A.2d 618, 624-29 (1996)(reviewing cases and recognizing limits on enforceability of forum selection clauses); *Moses v. Business Card Expr., Inc* ., 929 F.2d 1131, 1136-39 (6 th Cir.), cert. denied, 502 U.S. 821, 112 S. Ct. 81, 116 L.Ed.2d 54 (1991)(in considering change of venue motion, forum selection clause must be considered along with convenience of parties and witnesses and overall fairness); *Hoffman v. Minuteman Press Int'l, Inc.*, 747 F. Supp. 552 (W.D. Mo. 1990)(denying venue change in accordance with forum selection agreement on basis of extreme hardship and alleged fraud in the inducement); *Cutter v. Scott & Fetzer Co* ., 510 F. Supp. 905, 908 (E.D. Wis. 1981)(refusing to enforce forum selection clause on basis of state Fair Dealership Law, and observing that clause was not the subject of negotiation). *See also Restatement (Second) of Conflict of Laws* ' 80 (1969)(agreement regarding place of action will be given effect unless it is unfair or unreasonable); Benjamin Levin & Richard Morrison, Kubis *and the Changing Landscape of Forum Selection Clauses,* 16 Franchise. L.J. 97 (1997)(discussing trend to limit enforceability of forum selection clauses in franchise agreements by statute and case law); Donald B. Brenner, *There is a Developing Trend Among Courts of Making Choice of Forum Clauses in Franchise Agreements Presumptively Invalid* , 102 Com. L.J. 94 (1997)(same).

In the course of finding a judicial forum selection provision in a form franchise agreement presumptively invalid, the New Jersey Supreme Court recognized that the following factors may be relevant to enforceability: (1) whether the provision is the product of arm's length negotiations or is effectively imposed by a party with disproportionate bargaining power; and (2) whether the provision provides an "indirect benefit to...[the stronger party by making] litigation more costly and cumbersome for economically weaker...[parties] that often lack the sophistication and resources to litigate effectively a long distance from home." *Kubis* , 146 N.J. at 193-94, 680 A.2d at 626-27. *See also Model Choice of Forum Act* ' 3(4) Comment (1968)("A significant factor to be considered in determining whether there was an abuse of economic power or other unconscionable means' [sufficient to deny enforcement to a forum selection clause] is whether the choice of forum agreement was contained in an adhesion, or take-it-or-leave-it' contract.").

Such considerations may also affect the enforceability of an agreement to arbitrate. *See Patterson v. ITT Consumer Financial Corp.*, 14 Cal. App. 4 th , 1659, 18 Cal. Rptr.2d 563 (1993)(arbitration provisions in loan agreements requiring California consumers to arbitrate in Minnesota were unconscionable).

Similar concerns have led some states to enact laws placing geographical limitations on the situs of arbitration. *See, e.g. , Hambell v. Alphagraphics Franchising Inc.*, 779 F. Supp. 910 (E.D. Mich. 1991)(provision in franchise agreement for arbitration to take place outside state is void and unenforceable under Mich. Stat. Ann. ' 19.854(27)(f)(1984)); *Donmoor, Inc. v. Sturtevant* , 449 So.2d 869 (Fla. Ct. App. 1984)(clause in contract

providing for arbitration in another state is unenforceable). Of course, such laws may be preempted by federal substantive law within the scope of the *Federal Arbitration Act* . *See* Levin & Morrison, *supra* , at 115-16.

In light of concerns such as the foregoing which are also relevant in the consumer arena, the Advisory Committee concluded that contractual ADR provisions should include a commitment to conduct ADR at a "reasonably convenient location." Some members of the Advisory Committee favored setting an arbitrary mileage limit (i.e. "no more than 50 miles from the place where the transaction occurred") while others advocated the nearest large city. Others pointed out that parties sometimes relocate. There was general agreement, however, that an agreed-upon process for independent determination of the locale if the parties fail to agree would be fair and equitable to both parties. *See, e.g., AAA Rule* 11; *Uniform Code of Arbitration* ' 9; *NASD Code of Arbitration Procedure* ' 10315. A similar function may be performed by the arbitrator or other duly appointed Neutral. (The *AAA Rules* already accord arbitrators the authority to set specific sites for arbitration hearings. *See AAA Rule* 21.)

In many cases, it may be possible to minimize the need for long distance travel and attendant expenses through the use of telephonic communications and submission of documents. An example of the application of such devices is the Expedited Procedures of the *AAA Rules* , which are generally applied to claims of $50,000 or less. *See AAA Rules* 9, 53-57. *See also Uniform Code of Arbitration* ' 2. Telephonic mediation has long been a feature of some lemon law programs, and is currently being used in Consumer ADR by the National Futures Association (NFA). The National Association of Securities Dealers (NASD) is currently conducting a pilot program utilizing telephonic mediation.

Recent projects sponsored by the Better Business Bureau, the American Arbitration Association, and other organizations suggest the possibilities of online conflict resolution for online transactions as well as other kinds of disputes. *See generally* George H. Friedman, *Alternative Dispute Resolution and Emerging Online Technologies: Challenges and Opportunities* , 19 Hastings Comm. & Ent. L.J. 695 (1997).

If, as proposed, Consumers have the alternative of pursuing relief in a small claims court of competent jurisdiction, many concerns associated with long distance travel will be obviated with regard to small claims.

Practical Suggestions

Unless a convenient location can be specifically identified in the ADR agreement, the location should be left to the agreement of the parties after a dispute has arisen. The rules governing ADR under the agreement should establish a process for determination of the location by an independent party (such as a Neutral or the Independent ADR Institution) if the parties cannot agree on a location.

In some cases, it may be reasonable to conduct proceedings by telephone or electronic data transmission, with or without submission of documents. *See, e.g.,* Principle 12. Such options may be particularly desirable in the case of arbitration of small claims, since the parties have the choice of going to small claims court. *See* Principle 5.

PRINCIPLE 8. REASONABLE TIME LIMITS

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

Reporter's Comments

A primary impetus for conflict resolution outside the court system is the potential for relatively speedy and efficient resolution of disputes. From the Consumer's perspective, moreover, the expectation of a reasonably prompt conclusion is likely to be, along with cost savings, the leading perceived advantage of consensual mediation or arbitration. *See Madden v. Kaiser Foundation Hospitals* , 17 Cal.3d 699, 711, 131 Cal. Rptr. 882, 552 P.2d 1178 (1976)(speed and economy of arbitration, in contrast to the expense and delay of jury trial, could prove helpful to all parties).

The principle of relatively prompt, efficient conflict resolution underlies standards governing the conduct of Neutrals. Mediators are admonished that "[a] quality process requires a commitment by the mediator to diligence...." *Joint Standards for Mediators* , Art. VI. The *Joint Standards for Mediators* also comment that "[m]ediators should only accept cases when they can satisfy the reasonable expectations of the parties concerning the timing of the process." *Id.*

A basic requirement is that the rules governing ADR establish and further the basic principle of conflict resolution within a reasonable time. This means not only that the rules should set forth specific time periods for various steps in the ADR process, but that default rules come into play if a party fails to participate in the manner required by the rules after due notice. This principle is embodied in leading ADR standards, including the *AAA Commercial Rules* . *See, e.g.,* Rules 6, 8, 11, 13, 14, 15, 21, 35, 36, 41. *See also BBB Arbitration Rule* 27 ("BBB shall make every effort to obtain a final resolution of your complaint within 60 days, unless state or federal law provides otherwise. This time period may be extended at the request of the customer.").

Of course, it is not enough that the agreement places strict time limitations on procedural steps if these limitations are not effectively enforced a likely occurrence when an ADR Program is not independent of the Provider. Extreme disparity between stipulated time limits and actual practice under arbitration rules may render an arbitration agreement unenforceable, as discussed at length in a recent California

Supreme Court decision. *See generally Engalla v. Permanente Med. Grp., Inc.*, 938 P.2d 903 (Cal. 1997). The court pointedly observed,

[M]any large institutional users of arbitration, including most health maintenance organizations (HMO's), avoid the potential problems of delay in the selection of arbitrators by contracting with neutral third party organizations, such as the American Arbitration Association (AAA). These organizations will then assume responsibility for administering the claim from the time the arbitration demand is filed, and will ensure the arbitrator or arbitrators are chosen in a timely manner.

Id. at 975-76. In response to this decision, Kaiser appointed an advisory panel to propose reforms to its arbitration program. *See Kaiser Permanente Review and Recommendations 33-34* (recommending establishment of and adherence to stated arbitration process deadlines).

Similarly, courts interpreting state lemon laws have acknowledged the right of Consumers to forgo arbitration and sue in court when the statutory period for the lemon law remedy elapsed without a remedy through no fault of their own. *See, e.g., Harrison v. Nissan Motor Corp.*, 111 F.3d 343 (3 rd Cir. 1997)(court suit permissible where BBB failed to conduct arbitration within stipulated period); *Ford Motor Co. v. Ward* , 577 So.2d 641 (1991)(Consumer not required to exhaust arbitration procedures before bringing suit where dealer made it impossible for Consumer to arbitrate).

Practical Suggestions

When a Consumer dispute involves a small amount of money and relatively straightforward issues, it is reasonable to assume that an out-of-court resolution of such issues should be relatively quick. In such cases, it may be appropriate to develop expedited procedures and to set outside time limits on ADR Processes. Thus, for example, "Fast Track" arbitration procedures for construction disputes provide that "[t]he arbitration shall be completed by settlement or award within sixty (60) days of confirmation of the arbitrator's appointment, unless all parties agree otherwise or the arbitrator extends this time in extraordinary cases . . . ." *AAA Construction Procedures* , ' F-12. The rules also require the award to be rendered within seven days from the closing of the hearing. *See id.*, ' F-11.

Similarly, the *AAA Wireless Rules* set forth Fast Track procedures for matters involving less than $2,000 in claims or counterclaims. The Fast Track contemplates a "desk" arbitration procedure involving a hearing on documents; a limit of one seven-day extension on the time to respond to a claim or counterclaim; notice by telephone, electronic mail and other forms of electronic communication and by overnight mail, shortened time limits to select an arbitrator; no discovery except in extraordinary cases; a shortened time limit for rendition of award; and a time standard which sets a goal of 45 days from appointment of the arbitrator to award.

PRINCIPLE 9. RIGHT TO REPRESENTATION

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

Reporter's Comments

The right to be counseled by an attorney or other representative is an important one that is frequently reflected in standard rules governing ADR proceedings. *See, e.g. , AAA Commercial Rule* 22; *NASD Code* ' 10316; *BBB Arbitration Rule* 9.

The Advisory Committee adapted pertinent provisions of the *Employment Due Process Protocol* . *See Employment Due Process Protocol* ' B.1.

In the interest of full disclosure of potential conflicts of interest on the part of Neutrals, the Advisory Committee recommends that the names and affiliations of lawyers and other representatives of each party be communicated to prospective Neutrals and to all parties prior to selection of Neutrals.

As previously noted, the Advisory Committee recognizes that the cost of legal services should be borne by the parties who are receiving the services, and Providers should not be expected to subsidize the cost of legal representation for Consumers. There may, however, be situations where an arbitrator awards attorney's fees in circumstances where they would be available in court. *See* Commentary to Principle 6.

The Advisory Committee recognizes that the involvement of non-attorney representatives in some forms of binding arbitration has raised issues respecting the unauthorized practice of law. The Committee takes no position regarding these issues.

Practical Suggestions

Although the cost of legal services should be borne by the parties who are receiving the services, Independent ADR Institutions should provide Consumers with information regarding referral services and other institutions which might offer assistance in locating and securing competent spokespersons, such as bar associations, legal service associations, and Consumer organizations.

PRINCIPLE 10. MEDIATION

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

Reporter's Comments

The increasing popularity of mediation has been a primary impetus for the revolution in conflict resolution approaches. Mediation describes a range of processes in which an impartial person helps disputing parties to communicate and to make voluntary, informed choices in an effort to resolve their dispute. The rapid growth of mediation may be attributed to its informality, flexibility, and emphasis on the particular needs of disputing parties. For this reason, mediation is uniquely adaptable to a wide spectrum of controversies.

The widespread use of mediation in court-connected programs inspired the development of a set of national standards for such endeavors. *See generally Standards for Court-Connected Programs* .

Parallel developments are occurring in the private sphere. Recently, the leading standard construction industry contract was modified to require mediation as an element in project conflict resolution, necessitating modification of related AAA rules. *See AAA Construction Procedures* .

Advisory Committee members agreed that mediation should be encouraged as a valuable intervention strategy, but differed as to the propriety and reasonableness of Provider-drafted ADR Agreements in Consumer contracts which require Consumers to participate in mediation. Those unopposed to such provisions, a majority of Advisory Committee members, noted that mediation offers significant potential advantages and relatively few risks to participants. Particularly where the Provider subsidizes mediation, they reasoned, the prospective benefits to Consumers far outweigh the costs. Those expressing concerns regarding "mandatory" mediation adhere to the view that the choice to participate in settlement discussions should be made voluntarily, and only after conflict arises. Other concerns relate to the cost of mediation, the quality of mediators, the likelihood that not all disputes will be appropriate for mediation, and the lack of understanding of mediation processes (including an understanding of the role of the neutral intervener) on the part of many Consumers. *Cf. Standards for Court-Connected Programs* ' 5.0 (courts should impose mandatory attendance in court-connected mediation only when the cost of mediation is publicly funded, the mediation program is of high quality, and other requirements are met); *SPIDR Report on Court-Mandated ADR* at 2-3.

Encouragement of the use of mediation involves, among other things, educating Consumers and their attorneys about the process. *See* Principle 2 "Access to Information

Regarding ADR Program." *See also SPIDR Principles* at 6 ("It is the responsibility of...private programs offering dispute resolution services to define clearly the services they provide...[and provide information about the program and neutrals to the parties.]"). At a minimum, Consumers should be provided with (or have immediate access to) written information to explain mediation. As a rule, such information should be in the same language as the principal contract for goods or services. *Cf. Standards for Court-Connected Programs* ' 3.2.b., Commentary, at 3-4 (If a significant percentage of the population served is non-English-speaking, the material should be available in other languages as well.) *See* Principle 2.

Education of users should also include some treatment of the distinctive styles and strategies employed by mediators. Today, mediators handling commercial disputes sometimes employ a facilitative, non-directive approach to problem-solving; in other situations, a more directive approach may be employed. *See generally* Leonard L. Riskin, *Understanding Mediators' Orientations, Strategies, and Techniques: A Grid for the Perplexed* , 1 Harv. Negotiation L. Rev. 7 (1996)(providing a graphic tool for analyzing mediator approaches). Participants need to decide in advance of selection the approach they want a mediator to adopt. The Independent ADR Institution should advise the parties regarding the possibility of interviewing prospective mediators regarding qualifications and style, and help to arrange such interviews.

Practical Suggestions

As referenced in Principle 5, mediation conducted by telephone conference call has proven to be an effective, economical method of resolving Consumer disputes where in-person mediation may not be feasible.

SPECIAL PROVISIONS RELATING TO BINDING ARBITRATION

PRINCIPLE 11. AGREEMENTS TO ARBITRATE

Consumers should be given:

a. *clear and adequate notice of the arbitration provision and its consequences, including a statement of its mandatory or optional character;*
b. *reasonable access to information regarding the arbitration process, including basic distinctions between arbitration and court proceedings, related costs, and advice as to where they may obtain more complete information regarding arbitration procedures and arbitrator rosters;*
c. *notice of the option to make use of applicable small claims court procedures as an alternative to binding arbitration in appropriate cases; and,*
d. *a clear statement of the means by which the Consumer may exercise the option (if any) to submit disputes to arbitration or to court process.*

Reporter's Comments

In convening the Advisory Committee which developed this Protocol, the AAA requested that the Committee focus its attention upon due process standards for the conduct of Consumer ADR processes and not directly address the process of forming an agreement to mediate or to arbitrate. Committee deliberations revealed a range of opinions regarding the use of pre-dispute binding arbitration agreements in Consumer contracts. Without taking a position on the appropriateness of such agreements, the Committee developed Principle 11 with the intended purpose of providing guidance to the AAA and similar Independent ADR Institutions in the development of specific arbitration programs within the context of existing law enforcing pre-dispute arbitration agreements. Within this context, Principle 11 emphasizes the importance of knowing, informed assent to arbitration agreements.

Practical Suggestions

Consumers should have clear and adequate notice of the arbitration provision and basic information regarding the process at the time of assent. The appropriate method of giving notice and providing essential information will vary with the circumstances. For example, electronic transactions involving software licensure agreements require different notice procedures than face-to-face negotiations or paper transactions. In all cases, however, there should be some form of conspicuous notice of the agreement to arbitrate and its basic consequences (including comparison to court process, cost information, etc.). In addition, the Consumer should be given the opportunity to acquire additional information regarding the arbitration process. The latter might be obtainable through a mail or Web site address, an 800 number or other means for Consumers to obtain additional information regarding arbitration rules and procedures (such as a brochure available on request).

The following is an example of a possible notice. Ideally, the "notice box" would be sufficiently prominent in the contract document or electronic record so that a Consumer would readily notice it.

NOTICE OF ARBITRATION AGREEMENT:

This agreement provides that all disputes between you and [PROVIDER] will be resolved by BINDING ARBITRATION .

You thus GIVE UP YOUR RIGHT TO GO TO COURT to assert or defend your rights under this contract (EXCEPT for matters that may be taken to SMALL CLAIMS COURT).

*Your rights will be determined by a NEUTRAL ARBITRATOR and NOT a judge or

jury.

* You are entitled to a FAIR HEARING , BUT the arbitration procedures are SIMPLER AND MORE LIMITED THAN RULES APPLICABLE IN COURT.

*Arbitrator decisions are as enforceable as any court order and are subject to VERY LIMITED REVIEW BY A COURT.

FOR MORE DETAILS ,

*Review Section 6.2 above, OR

* Check our Arbitration Web Site @ ACMEADR.COM, OR

* Call 1-800-000-0000

Among other things, Consumers should have access to information regarding the initiation of the arbitration process. This may be accomplished, for example, by providing customers with a brochure outlining relevant arbitration procedures. If the Consumer has the option of choosing between arbitration or court process, either at the time of contracting or after disputes have arisen, the timing and means of electing the option should also be clearly stated in the notice.

PRINCIPLE 12. ARBITRATION HEARINGS

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

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

Reporter's Comments

There is universal agreement that parties to arbitration are entitled to a "fundamentally-fair hearing." *See* III *Federal Arbitration Law* ' 32.3.1.1. The language of subsection 1 closely follows the definition of a "fundamentally-fair hearing" set forth in *Bowles Financial Grp., Inc. v. Stifel, Nicolaus & Co .*, 22 F.3d 1010, 1013 (10 th Cir. 1994)(applying the *Federal*

Arbitration Act). Beyond these basic requirements, of course, "[a]rbitration need not follow all the niceties of...courts." *Grovner v. Georgia-Pacific Corp* ., 625 F.2d 1289, 1290 (5 th Cir. 1980). Moreover, the arbitrators have great leeway in conducting hearings, within the bounds of the parties' agreement. *See Federal Arbitration Law* , *supra* , " 32.1., 32.3.1.1.

Although authority is split on whether or not parties are guaranteed a face-to-face hearing before the arbitrators, *see id.* , the Advisory Committee concluded that while in some circumstances fundamental fairness may require a face-to-face hearing, in other cases the requirement may be satisfied by telephonic or electronic communications or submissions of documents. *See, e.g.* , *Construction Arbitration Procedures* ' F-9. *See, e.g.*, Michael F. Altschul & Elizabeth S. Stong, *AAA Develops New Arbitration Rules to Resolve Wireless Disputes* , ADR Currents, Fall 1997, at 6. In small claims cases, the requirement of these Principles that parties retain the option of going to small claims court may make it reasonable for the ADR agreement to provide alternatives to a face-to-face hearing.

Although confidentiality of hearings may be considered an advantage of arbitration, there is no absolute guarantee of confidentiality. *See id.* , ' 32.6.1. Unlike court proceedings, however, the general public has no right to attend arbitration proceedings; if the parties agree, moreover, attendance at hearings may be severely restricted. *See, e.g.* , *AAA Commercial Rule* 25 (directing arbitrators to "maintain the privacy of the hearings unless the law provides to the contrary"). Likewise, arbitrators should be mindful of evidentiary privileges and confidentiality rights available to its parties under applicable law and have discretion to issue protective orders respecting such rights.

The Advisory Committee recognized the dilemma posed by the tension between the desire for confidentiality in arbitration and the need to provide Consumers access to information regarding arbitrators and sponsoring Independent ADR Institutions, including case statistics, data on recent arbitrations and other pertinent information. *See, e.g.*, Alan Scott Rau, *Integrity in Private Judging* , 38 S. Tex. L. Rev. 485, 524-26 (1997)(discussing concerns with "asymmetry of information" regarding arbitrators when one party is an institutional "repeat player," and suggesting need for increased disclosure of information regarding past decisions by an arbitrator); Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection* , 10 Ohio St. J. on Disp. Res. 267, 293 (discussing disparity between "repeat players" and consumers with regard to knowledge of prospective arbitrators). Although the Advisory Committee did not address this issue, it recommends that the matter be the focus of serious study by the Committee or a similar advisory group, supported by appropriate independent research efforts.

Practical Suggestions

Because these Principles provide that parties should retain the option of an oral hearing in small claims court (Principle 5), it may be reasonable for the ADR agreement to

provide other means for small claims arbitration. Such alternatives may include a "desk arbitration" involving a decision on written submissions, participation in proceedings by telephone or electronic data transmission, and other options.

As is generally the case in commercial arbitration, arbitrators may undertake reasonable means to protect the privacy of the hearing.

PRINCIPLE 13. ACCESS TO INFORMATION

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

Reporter's Comments

It is understood that ADR sometimes represents a tradeoff between the concept of full discovery associated with court procedures and the efficiencies associated with minimal pretrial process. A hallmark of binding arbitration is the avoidance of the cost and delay associated with extensive pre-hearing discovery. *See* III *Federal Arbitration Law* ' 34.1. In recent years, however, the notion that arbitration means little or no discovery has moderated due to the widening range of cases submitted to arbitration and the increasing recognition that at least some pre-hearing exchange of information may be necessary and appropriate to meet the due process rights of participants and may in some cases reduce the overall length of the process. *See id.* , Ch. 34. *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. Res. 267, 283-84, 311, 314 (arguing that limits on discovery in arbitration hamper consumer claimants).

Addressing statutory disputes arising out of employment relationships, the *Employment Due Process Protocol* states that "[a]dequate but limited pre-trial discovery is to be encouraged and employees [and their representatives] should have access to all information reasonably relevant to mediation and/or arbitration of their claims." *Employment Due Process Protocol* ' B.3. The Committee supports the concept of limiting the exchange of information as much as possible while ensuring that Consumers and Providers each have access to information that is legally obtainable and relevant to their case. In most cases, this means that pre-hearing information exchange will consist of an exchange of documents as directed by the arbitrator, identification of witnesses and a summary of their expected testimony. Arbitrators should have the authority to require additional discovery when necessary, such as requiring the deposition of witnesses unable to appear at the hearing in order to preserve their testimony.

Although information exchange issues which cannot be handled by the agreement of the parties should generally be left to the discretion of the arbitrator, it may be appropriate

for advisory groups (including adequate consumer representation) to develop guidelines for information exchange in specific kinds of cases. *See, e.g.,* National Association of Securities Dealers, National Arbitration and Mediation Committee, *Report of the Drafting Subcommittee on The Discovery Guide* , Dec. 3, 1997 Draft.

Some Advisory Committee members also expressed concern about the forced production of privileged documents, and argued that arbitrators should be required to observe established privileges such as the attorney-client privilege and work-product privilege. *See* James H. Carter, *The Attorney-Client Privilege and Arbitration,* ADR Currents, Winter 1996-97, 1. As stated in Principle 12, arbitrators should "carefully consider claims of privilege and confidentiality when addressing evidentiary issues." Such protections may be addressed in the arbitration agreement (including incorporated arbitration procedures), and should be thoroughly treated, along with information exchange issues, in arbitrator training programs.

Practical Suggestions

In many cases, issues relating to information exchange may be addressed by the arbitrator(s) at a preliminary conference. *See, e.g., AAA Wireless Rules* " R-9, R-10. Some rules require that all exhibits be exchanged a certain number of days prior to hearings. *See id.,* R-10.

PRINCIPLE 14. ARBITRAL REMEDIES

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

Reporter's Comments

As a general rule, arbitrators have broad authority to fashion relief appropriate to the circumstances. *See* III *Federal Arbitration Law* ' 36.1.1. Their discretion is limited only by the agreement of the parties and the scope of the submission to arbitration. *See id.,* ' 36.1.2.

There are, however, a number of issues respecting the ability of arbitrators to award certain remedies which would be available in court. For example, although the trend under federal and state law is to acknowledge the authority of arbitrators to award punitive damages, a few state courts still take the opposing view. *See generally Federal Arbitration Law , supra ,* ' 36.3; Thomas J. Stipanowich, *Punitive Damages and the Consumerization of Arbitration,* 92 Nw. U. L. Rev. 1 (1998). And although courts may award attorney's fees where permitted by statute or by agreement of the parties, or where a party acts vexatiously or in bad faith, there is conflicting authority regarding the ability of arbitrators to take similar action. *See generally Federal Arbitration Law , supra ,* ' 36.8.

This provision incorporates language similar to that contained in the *Employment Due Process Protocol* , ' C.5. The intent is to make clear that arbitrators deriving their authority from Consumer contracts should enjoy the same authority courts have to fashion relief, including awarding attorney's fees and punitive damages in appropriate cases.

Contractual limitations of damages may limit the authority of arbitrators in the same fashion that they limit judicial remedies. It is possible that an award of damages in excess of a contractual limit would be vacated under pertinent statutory standards or common law principles. *See, e.g., FAA* ' 10(a)(4). *But see* Stipanowich, *Punitive Damages* , *supra,* at 33-36 (discussing public policy limitations on pre-dispute caps on punitive damages).

PRINCIPLE 15. ARBITRATION AWARDS

1. *Final and Binding Award; Limited Scope of Review. If provided in the agreement to arbitrate, the arbitrator's award should be final and binding, but subject to review in accordance with applicable statutes governing arbitration awards.*
2. *Standards to Guide Arbitrator Decision-Making. In making the award, the arbitrator should apply any identified, pertinent contract terms, statutes and legal precedents.*
3. *Explanation of Award. At the timely request of either party, the arbitrator should provide a brief written explanation of the basis for the award. To facilitate such requests, the arbitrator should discuss the matter with the parties prior to the arbitration hearing.*

Reporter's Comments

Review of arbitration awards is very limited under modern arbitration statutes. Courts are very reluctant to vacate awards, or to second-guess the decisions of arbitrators on matters of procedure or substance. *See generally* IV *Federal Arbitration Law* , ch. 40. "Arbitrators can misconstrue contracts, make erroneous decisions of fact, and misapply law, all without having their awards vacated." *See id.* , ' 40.6.1. While some members of the Advisory Committee expressed concerns regarding the current state of the law, it was generally agreed that finality was a primary objective of arbitration and that it would be inappropriate to recommend more rigorous judicial review for Consumer arbitration awards than for other arbitration awards. At the same time, however, the Advisory Committee concluded that the rules should specifically direct arbitrators to follow pertinent contract terms and legal principles. This requirement may have implications for qualifications and training of Neutrals pursuant to Principle 4.

Leading modern arbitration statutes do not require arbitrators to provide a written explanation or give reasons for their awards. *See generally* III *Federal Arbitration Law* ' 37.4.1. Similarly, some leading commercial arbitration rules do not require findings of fact or conclusions of law. *See, e.g., AAA Commercial Rules* . Those supporting "bare" awards argue that a written rationale will make it more likely that courts will inquire into the merits of the award, contrary to policies of finality underlying modern statutes.

They also observe that not being required to write an opinion simplifies the arbitral task and permits multi-member arbitration panels, like juries, to agree on a decision without concurring on a rationale. *See id.*

On the other hand, some other commercial arbitration rules call for a statement of the underlying rationale. *See, e.g., CPR Rules for Non-administered Arbitration of Business Disputes* , Rule 13.2. Those supporting awards with written rationales argue that a written rationale encourages more disciplined decision-making and enhances party satisfaction with the result. *See* Alan Scott Rau, *Integrity in Private Judging* , 38 S. Tex. L. Rev. 485, 529-39 (1997)(offering arguments in favor of "reasoned" awards). After considering the pros and cons of "reasoned " awards, the Advisory Committee concluded that arbitrators of Consumer disputes should provide at least a brief written explanation if requested to do so by any party.

As noted in the Comments accompanying Principle 12, the Advisory Committee recognized the dilemma posed by the tension between the desire for confidentiality in arbitration (including information regarding arbitration awards) and the need to provide Consumers access to information regarding arbitrators and sponsoring Independent ADR Institutions, including case statistics, data on recent arbitrations and other pertinent information. Although the Advisory Committee did not address this issue, it recommends that the matter be the focus of serious study by the Advisory Committee or a similar advisory group, supported by appropriate independent research efforts.

Practical Suggestions

To facilitate requests for reasoned awards, the arbitrator should raise the issue with the parties prior to the arbitration hearing. The matter should be addressed at the preliminary conference if one is conducted.

A DUE PROCESS PROTOCOL FOR MEDIATION AND ARBITRATION OF CONSUMER DISPUTES

Dated: April 17, 1998

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

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California Court of Appeal

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Executive Summary

Submitted for the record by Richard Naimark

Issues and Background

Empirical evidence has become a central focus of the policy debate over consumer and employment arbitration. Both supporters and opponents of the proposed Arbitration Fairness Act, which would make pre-dispute arbitration clauses unenforceable in consumer and employment (and franchise) agreements, have recognized that empirical evidence on the fairness and integrity of consumer and employment arbitration proceedings is essential to making an informed decision on the bill. Yet the empirical record, particularly on consumer arbitration, has critical gaps.

One set of issues on which further empirical research would be helpful is the costs, speed, and outcomes of consumer arbitrations. How much do consumers pay to bring claims in arbitration? How long do consumer arbitrations take to resolve? How do consumers fare in arbitration, particularly against businesses that are repeat users of arbitrators and arbitration providers? While a number of important studies on employment arbitration have been provided, the empirical record on these issues in consumer arbitrations is sparse.

A second set of issues of interest involves the enforcement of arbitration due process protocols -- privately created standards setting out minimum requirements of procedural fairness for consumer and employment arbitrations. Due process protocols commonly require independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court. Leading arbitration providers have pledged not to administer arbitrations arising out of arbitration clauses that violate the protocols. But empirical evidence on the effectiveness of these private enforcement efforts is lacking.

Searle Civil Justice Institute Task Force on Consumer Arbitration

To shed light on these issues, the Searle Civil Justice Institute (SCJI) undertook a large-scale study of consumer arbitrations administered by the American Arbitration Association (AAA). The AAA is a leading provider of arbitration services, including arbitrations between consumers and businesses. SCJI commissioned a Task Force to advise and lead this study of consumer arbitrations. Although the study will ultimately examine many aspects of AAA consumer arbitrations, the initial research inquiries were directed at two topics:

1. *Costs, Speed, and Outcomes of AAA Consumer Arbitrations.* This aspect of the Preliminary Report assesses key characteristics of the AAA consumer arbitration process. In particular, it examines the following research questions:

    - General characteristics of AAA consumer arbitration cases including claimant type (i.e., consumer or business), types of businesses involved, and amounts claimed.

- Costs of consumer arbitration (arbitrator fees plus AAA administrative fees), including the impact of the arbitrator's power to reallocate such fees in the award.
- Speed of the arbitration process from filing to award, in the aggregate and by claimant type (i.e., consumer or business).
- Various measures of outcomes such as win-rates, damages awarded, and evidence of as well as possible explanations for any repeat-player effects.

In addition to these broad research questions, SCJI also examined the extent to which consumer arbitrations are resolved ex parte; the frequency with which arbitrators award attorneys' fees, punitive damages, and interest; and results for consumers proceeding pro se.

2. *AAA Enforcement of the Consumer Due Process Protocol.* This aspect of the Preliminary Report provides an empirical analysis of how effectively the AAA enforces compliance with the Consumer Due Process Protocol. It considers a number of key research questions including:

    - To what extent do the consumer arbitration clauses comply, in their own right, with the Due Process Protocol?
    - How effective is AAA review of arbitration clauses for compliance with the Due Process Protocol?
    - To what extent does the AAA refuse to administer consumer cases because of the failure of businesses to comply with the Due Process Protocol?
    - How do businesses respond to AAA enforcement of the Protocol?

In addition to these research questions, SCJI examined several other issues that arise in connection with the Due Process Protocols.

Data and Methodology

SCJI reviewed a sample of AAA case files involving consumer arbitrations. The primary dataset consists of 301 AAA consumer arbitrations that were closed by an award between April and December of 2007. (The focus on cases closed by an award during this particular timeframe is based on the availability of the original case files.) This sample of cases was then coded for approximately 200 variables describing various aspects of the arbitration process, including a review of the arbitration clause in the file. In addition, when possible a broader AAA dataset comprising all consumer cases closed between 2005 and 2007 was utilized. The AAA maintains this dataset in the ordinary course of its business, collecting data for internal purposes but not recording all variables of interest to SCJI. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA.

Key Findings – Costs, Speed, and Outcomes of AAA Consumer Arbitrations

The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.

In cases with claims seeking less than $10,000, consumer claimants paid an average of $96 ($1 administrative fees + $95 arbitrator fees). This amount increases to $219 ($15 administrative fees + $204 arbitrator fees) for claims between $10,000 and $75,000. These amounts fall below levels specified in the AAA fee schedule for low-cost arbitrations, and are a result of arbitrators reallocating consumer costs to businesses.

AAA consumer arbitration seems to be an expeditious way to resolve disputes.

The average time from filing to final award for the consumer arbitrations studied was 6.9 months. Cases with business claimants were resolved on average in 6.6 months and cases with consumer claimants were resolved on average in 7.0 months.

Consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255; business claimants won some relief in 83.6% of their cases and recovered an average of $20,648.

The average award to a successful consumer claimant in the sample was 52.1% of the amount claimed and to a successful business claimant was 93.0% of the amount claimed. This result appears to be driven by differences in types of claims initiated by consumers and business. Business claims are almost exclusively for payment of goods and services while consumer claims are seeking recovery for non-delivery, breach of warranty, and consumer protection violations.

No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.

Consumer claimants won some relief in 51.8% of cases against repeat businesses under a traditional definition (i.e., businesses who appear more than once in the AAA dataset) and 55.3% against non-repeat businesses – a difference that is not statistically significant.

Utilizing an alternative definition of repeat player, some evidence of a repeat-player effect was identified; the data suggests this result may be due to better case screening by repeat players.

Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses under an alternative definition (based on the AAA's categorization of businesses in enforcing the Consumer Due Process Protocol) – a difference that is statistically significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that such effect is attributable to better

case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims).

Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.

Consumer claimants sought to recover attorneys' fees in over 50% of the cases in which they were awarded damages and were awarded attorneys' fees in 63.1% of those cases. In those cases in which the award of attorneys' fees specified a dollar amount, the average attorneys' fee award was $14,574.

Key Findings – AAA Enforcement of the Due Process Protocol

A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.

Most arbitration clauses in consumer contracts that come before the AAA are consistent with the Consumer Due Process Protocol as applied by the AAA. The same is true for cases in which protocol compliance was a matter for the arbitrator to enforce.

AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations.

In 98.2% of cases in the sample subject to AAA protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.

In 2007, the AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases (9.4% of its consumer case load), because the business failed to comply with the Consumer Due Process Protocol. The most common reason for refusing to administer a case (55 of 129 cases, or 42.6%) was the business's failure to pay its share of the costs of arbitration rather than any problematic provision in the arbitration clause.

As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.

In response to AAA review, more than 150 businesses have either waived problematic provisions on an ongoing basis or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. This is in addition to the more than 1550 businesses identified by the AAA as having arbitration clauses that comply with the Protocol. By comparison, AAA has identified 647 businesses for which it will not administer arbitrations because of Protocol violations.

Policy Implications and Next Steps

The empirical findings in the SCJI Preliminary Report on AAA consumer arbitrations have important implications for those interested in discussing and formulating public policy regarding arbitration.

1. Not all consumer arbitrations, arbitration providers, or arbitration clauses are alike. Differing results from empirical studies of arbitration may reflect variations associated with case mix, type of claimant, or provider review processes. This suggests the need for a nuanced approach to public policy concerning arbitration.

2. Private regulation complements existing public regulation of the fairness of consumer arbitration clauses. Policy makers should not ignore the role that arbitration providers can play in promoting fairness on behalf of consumers.

3. Courts could usefully reinforce the AAA's enforcement of the Consumer Due Process Protocol by declining to enforce an arbitration clause when the AAA has refused to administer an arbitration arising out of the clause or by otherwise reinforcing the role of the Due Process Protocol.

4. Arbitration may be less expensive for consumers than sometimes believed. For many consumers, the AAA arbitration process costs less than the amount specified in the AAA rules because arbitrators often shift some portion of the costs to businesses. Moreover, arbitrators award attorneys' fees to a substantial proportion of prevailing consumers in AAA consumer arbitrations.

5. Empirical studies have tended to find that repeat players fare better in arbitration than non-repeat players. To the extent such a repeat-player effect exists in arbitration, the critical policy question is what causes it. Our findings are consistent with prior studies in suggesting that any repeat-player effect is likely caused by better case screening by repeat players rather than arbitrator (or other) bias in favor of repeat players. A further as yet unresolved question is whether a repeat-player effect exists in litigation, and, if so, how litigation compares to arbitration in this regard.

While the empirical results presented in the SCJI Preliminary Report on Consumer Arbitration may usefully inform the policy debate on consumer arbitration, the Report nonetheless has limitations. First, its findings are limited to AAA consumer arbitrations. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. Second, its findings on the costs, speed, and outcomes of AAA consumer arbitrations are difficult to interpret without a baseline for comparison, such as the procedures and practices in traditional court proceedings. A future phase of this research project by the Searle Civil Justice Institute's Task Force on Consumer Arbitration will undertake that comparison. It will seek to compare the procedures in AAA consumer arbitration with procedures available for consumers in court as well as comparing empirically key process characteristics of courts and arbitration.

Submission of the Small Business Administration In Response to the Testimony of the Minnesota Attorney General Regarding Her Action Against the National Arbitration Forum

In her July 22, 2009, testimony before the Domestic Policy Subcommittee, Oversight and Government Reform, the Minnesota Attorney General demonstrated a complete misunderstanding of SBA's mission and the Small Business Investment Company ("SBIC") program. More importantly, she falsely characterized SBA's entirely appropriate handling of a general FOIA request made by one of her subordinates.

First, the Minnesota Attorney General asserted that SBA "believes that its mission is to finance the acquisition of debt collectors who acquire bank debt from bailed-out national banks and then use the funds to harass citizens through questionable debt collection techniques." [Minnesota Attorney General's Testimony, 7/22/09, at p.5] Second, the Minnesota Attorney General alleged that SBA "refused to produce unredacted records to her office," [Id.] and "acted in concert with the debt collector to hide information from a State law enforcement agency on how the money was spent." [Id.] These allegations are untrue, and the Agency respectfully requests that the record be corrected.

The Minnesota Attorney General's mischaracterization of SBA's mission is reckless and unfortunate. SBA's SBIC Program was established by Congress in 1958 in order to stimulate and supplement the flow of private equity capital and long-term loan funds which small businesses need for the sound financing of their business operations and for their growth, expansion, and modernization. In its 50 year history, the Program has assisted over 100,000 small businesses across the Nation and has helped to create or retain well over 1,000,000 jobs, including many in Minnesota.

Small Business Investment Companies, such as Accretive Investors SBIC, LP ("Accretive SBIC"), are private companies that are licensed by SBA to make debt financings and/or equity investments in small businesses. After raising at least $10 million of capital from private sources, an SBIC may receive guarantees from SBA that allow the company to obtain additional funds on favorable terms to expand the capital available for the financing of small businesses. The decision as to which eligible small businesses to invest in, and the form of investment, is made solely by the SBIC.

SBA did not choose Axiant as an investment; Accretive SBIC chose it. As required by federal regulations for the type of investment at issue, SBA published for public comment the fact that Accretive SBIC was proposing to make an additional investment in Axiant. The Minnesota Attorney General did not file an objection with SBA to this additional investment, nor did she inform SBA that she was investigating either Axiant or Accretive SBIC. In fact, neither Axiant nor Accretive SBIC is named as a defendant in the Minnesota Attorney General's complaint.

Notwithstanding the Minnesota Attorney General's misunderstanding of SBA's role in the SBIC program, her most serious allegation—that SBA conspired to withhold

information—is as untrue as it is inflammatory. It is false that SBA refused to cooperate with the Minnesota Attorney General's Office. By letter dated June 8, 2009, an attorney in the Minnesota Attorney General's Office made a FOIA request to a staff employee in SBA's Investment Division for SBA's "file" regarding Accretive SBIC without indicating the purpose of the request. After a discussion with the Investment Division staff, the Minnesota Attorney General's Office orally revised its initial request to seek only documents from 2009. Since these files contain personal financial information, such as tax returns of individuals, as well as confidential and proprietary business information, such as investment strategies, outside parties making general FOIA requests are given redacted information, after predisclosure notice to the subject of the FOIA request as prescribed by Federal law.

Subsequently, two SBA attorneys called the Minnesota Attorney General's Office separately to follow up. The requestor was specifically and expressly advised that if he wanted unredacted documents for a law-enforcement purpose the head of his office should make an official request. The requestor replied that he did not think that would be necessary "now" and that if he needed anything further he would get back to that SBA attorney. SBA's attorneys never heard anything further until the Minnesota Attorney General's public statement. If these unredacted documents were as important then as the Minnesota Attorney General claims now, then her office could have followed up with SBA's attorneys and taken the simple steps needed to obtain them without redactions.

For the Minnesota Attorney General to take this set of facts and state that the Agency was part of a conspiracy to conceal information is just plain irresponsible.

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