

**THE FEDERAL ARBITRATION ACT AND ACCESS  
TO JUSTICE: WILL RECENT SUPREME COURT  
DECISIONS UNDERMINE THE RIGHTS OF CON-  
SUMERS, WORKERS, AND SMALL BUSINESSES?**

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**HEARING**

BEFORE THE

**COMMITTEE ON THE JUDICIARY**

**UNITED STATES SENATE**

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

DECEMBER 17, 2013

**Serial No. J-113-44**

Printed for the use of the Committee on the Judiciary



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**THE FEDERAL ARBITRATION ACT AND ACCESS TO JUSTICE: WILL RECENT SUPREME COURT DECISIONS UNDERMINE THE RIGHTS OF CONSUMERS, WORKERS, AND SMALL BUSINESSES?**

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**TUESDAY, DECEMBER 17, 2013**

U.S. SENATE,  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The Committee met, pursuant to notice, at 2:30 p.m., in Room SD-226, Dirksen Senate Office Building, Hon. Al Franken, presiding.

Present: Senators Franken, Whitehouse, Klobuchar, Blumenthal, Hirono, Grassley, Hatch, and Lee.

**OPENING STATEMENT OF HON. AL FRANKEN, A U.S. SENATOR FROM THE STATE OF MINNESOTA**

Senator FRANKEN. This hearing will come to order.

In 1925, Congress passed the Federal Arbitration Act to facilitate the use of arbitration as a fair and efficient alternative to litigation in appropriate cases, typically those involving competing corporations of equal bargaining power.

In the hands of today's Supreme Court, however, the Federal Arbitration Act has been reshaped into something quite different. It has become a virtual grant of immunity for large corporations, which now can opt out of the criminal justice system.

I think that Alan Carlson, a small business owner who is with us today, puts it really well when he says in his written testimony, "In America, I thought we all had the right to pursue justice in court, but it turns out that Big Business gets to write its own rules."

This, in my view, has potentially disastrous consequences for workers, consumers, small businesses, and for middle-class Americans, and that is the focus of today's hearing. For me, this is all about making sure that there is access to justice when everyday people are cheated by giant corporations.

In 2011, I chaired a hearing on mandatory pre-dispute arbitration. What we learned in that hearing is that corporations make consumers and workers sign contracts with mandatory arbitration clauses as a condition to getting a product or a service or a job. The corporation can write the rules for the arbitration. The arbitrator often comes from the same industry as the corporate defendant.

Everything is done in secret. There are no public rulings and precedents like there are in courts. Discovery is limited, if there is any at all. So the plaintiff cannot always get the evidence that he or she needs to prove her case. And there is no meaningful judicial review, so there is not much an individual can do if the arbitrator just gets it all wrong.

But that is not all. My 2011 hearing followed on the heels of *AT&T v. Concepcion* in which the Supreme Court said that corporations can use their arbitration clauses to prohibit class actions, even if applicable State law says that these class action waivers are unconscionable. So under *Concepcion*, not only can a corporation force an individual into arbitration with all of its shortcomings, but the corporation can force the individual to go it alone. Just the prospect of a class action gives corporations a real incentive to follow the law. They know that there will be real consequences if they do not. *Concepcion* removed that important check on corporate power.

Not surprisingly, corporations are taking advantage of this new rule. Preliminary results from the Consumer Financial Protection Bureau's Arbitration Study indicate that nearly 100 percent of outstanding credit card loans and insured deposits now are subject to class action bans. As Mr. Parasharami, one of today's witnesses who is testifying in favor of mandatory pre-dispute arbitration, has written, "In light of *Concepcion* and subsequent developments in law, consumer and employment arbitration agreements are now more attractive to businesses than ever." Mr. Parasharami and I probably do not agree on much when it comes to arbitration law, but I do agree with him on that.

And just when you thought it could not get any worse, it did when the Supreme Court decided *American Express v. Italian Colors* during its last term.

Since at least the *Mitsubishi Motors* case in 1985, we have had something called the "effective vindication rule," which says that an arbitration clause is invalid if it is so bad that it prevents an individual from enforcing his or her federal rights. In other words, the effective vindication rule prevented a corporation from drafting its arbitration clause in a way that implicitly forced consumers, workers, and small businesses to waive their federal rights. But in the recent *Italian Colors* case, the Court did away with that rule, and the Court was not really shy about it either. Justice Scalia wrote that, "The FAA's command to enforce arbitration agreements trumps any interest in ensuring the prosecution of low-value claims."

In other words, in his opinion, corporate arbitration clauses simply are more important than the rights of consumers, workers, and small businesses.

I could not disagree more. The *Concepcion* and *Italian Colors* decisions stack the deck in favor of corporations and against consumers and workers, as if the deck were not stacked enough already. Giant corporations now can use arbitration clauses to stifle enforcement of federal laws, the antitrust laws, the minimum wage laws, the civil rights laws. You name it.

As the law has gotten worse, the need for reform has become more obvious and more urgent. I introduced the Arbitration Fair-

ness Act to undo some of the damage that we have seen to the civil justice system, and I would like to invite my colleagues to join me in this effort; 24 Members of the Senate and 71 Members of the House already have. The Arbitration Fairness Act would amend the Federal Arbitration Act to prohibit the use of mandatory pre-dispute arbitration clauses in civil rights, employment, consumer, and antitrust cases—cases in which one party has superior bargaining power and where adhesion contracts are common.

I want to be clear. The bill does not prohibit arbitration. If a consumer or a worker or a small business owner wants to take his claim into arbitration, then by all means he or she is free to do so, provided the corporation itself is willing to do so. But if the consumer or worker or small business wants to go to court, he or she will have that option available again.

This is not a radical proposal. The bill just restores the Federal Arbitration Act to its original purpose and scope. Simply put, this is about reopening the courthouse doors to workers, consumers, and small businesses because the courthouse doors never should have been closed in the first place.

I would like to thank Chairman Leahy for inviting me to hold this hearing. I know that this issue is important to him, and I understand that he has a statement, which I will submit for the record.

[The prepared statement of Chairman Leahy appears as a submission for the record.]

Senator FRANKEN. Ranking Member Grassley, it is a pleasure to serve in this capacity with you, and would you like to give any opening remarks.

**OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S.  
SENATOR FROM THE STATE OF IOWA**

Senator GRASSLEY. I am just going to refer to a small part of my statement and put the whole statement in the record.

I look forward to hearing from our witnesses today. Particularly I look forward to testimony explaining what we can expect following the Supreme Court decision in the *American Express* case. Absent class action provisions, will consumers really lack the ability to have their dispute adjudicated? And, also, what direction will we see arbitration clauses move going forward as a result of that decision? In the wake of *American Express* and the *AT&T Mobility* cases, I hope the witnesses can separate myth from reality and give us a clear picture of what is next.

I will put the rest of my statement in the record.

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

Senator HATCH. Mr. Chairman? Mr. Chairman?

Senator FRANKEN. Senator Hatch.

Senator HATCH. I would like to make a short statement.

Senator FRANKEN. Yes.

**OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S.  
SENATOR FROM THE STATE OF UTAH**

Senator HATCH. I have to leave, but I wanted to make just a short statement, and I appreciate your graciousness.

Mr. Chairman, I wish I could stay, but I am unable to. I did want to at least briefly stop by to say that this is a very important issue and to ask if I could submit written questions to the witnesses.

Senator FRANKEN. Without objection.

Senator HATCH. These questions emphasize that litigation is the alternative to arbitration. The bill before us would not only prohibit arbitration but actually terminate arbitration agreements that parties have already entered into. Before taking a dramatic step like that, we must consider whether the alternative of litigation would be even worse in various respects than what critics say about arbitration.

Is the case against arbitration so complete and the alternative of litigation so much better that we should prohibit arbitration clauses altogether?

I am very skeptical about the answer, but would want to explore that with the witnesses through the written questions I will submit, and I appreciate answers as quickly as you can.

[The questions and statement of Senator Hatch appear as a submission for the record.]

Senator HATCH. Thank you, Mr. Chairman. I appreciate you—

Senator FRANKEN. You are welcome, Senator Hatch. I have tremendous respect for you. I just want to just make it clear to everyone that there is no intention here to remove all arbitration clauses, just mandatory pre-dispute arbitration clauses, which are, I feel, in so many cases the cause of adhesion.

Senator HATCH. I understand.

Senator FRANKEN. And that is what today's hearing is about. There is no attempt here to ban arbitration at all, as I said in my opening.

Does anybody else want to make an opening statement? Then we will go to our first witness. I would ask that Deputy Assistant Attorney General Leslie Overton, who is here with us sitting at the witness table, stand and take the oath after I introduce her. So stay where you are because I am going to introduce you properly.

I am pleased that the Deputy Assistant Attorney General is here to see us today—Ms. Overton. She has served in her current position since the summer of 2011 following stints as counsel to the Assistant Attorney General and as a partner in Jones Day's Washington, D.C., office. Deputy Assistant Attorney General Overton has received several awards in recognition of her outstanding legal talents. She is one of several signatories to the Federal Government's amicus brief in the *Italian Colors* case, which we will be discussing today, and I have invited her here to discuss that brief with the Committee.

As is customary at the Senate Judiciary Committee, I will begin by administering the oath, so would you mind standing? Do you affirm that the testimony you are about to give the Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Ms. OVERTON. I do.

Senator FRANKEN. Thank you. Please be seated.

Deputy Assistant Attorney General Overton, welcome, and thank you for being here. I appreciate your taking the time out from your very busy schedule. Please go ahead with your opening statement.

**STATEMENT OF LESLIE C. OVERTON, DEPUTY ASSISTANT ATTORNEY GENERAL FOR CIVIL ENFORCEMENT, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC**

Ms. OVERTON. Thank you, Chairman. Chairman Franken, Senator Grassley, and distinguished members of the Committee, I appreciate this opportunity to share the United States' position in its amicus brief in the Supreme Court in *American Express v. Italian Colors Restaurant*.

The United States' brief reflects its concern that the effect of the mandatory arbitration agreement in the facts of that case would prevent the respondents, the merchants, from being able to effectively vindicate their rights under the antitrust laws.

My written testimony discusses the brief in detail, so I will now provide background and summarize the points the United States made.

In *Italian Colors*, the named plaintiffs in a consolidated set of putative class actions were merchants who accept American Express cards. The merchants alleged that Amex violated Section 1 of the Sherman Act by engaging in an unlawful tying arrangement using its market power in corporate and personal charge cards to compel the merchants to accept Amex's credit and debit cards at elevated merchant fee rates.

Amex's standard form contract for merchants governed the relationship. This card agreement required all disputes between the parties to be resolved by arbitration, precluded any right or authority for any claims to be arbitrated on a class action basis, barred multiple merchants' claims from being joined in one arbitration proceeding, did not permit the prevailing party to shift its costs to the other party, and prohibited disclosure of information obtained in arbitration. The class action complaints were consolidated, and Amex moved to compel arbitration.

The Federal district court held that the parties' dispute fell within the scope of the card agreement's mandatory arbitration clause, granted Amex's motion, and dismissed the suits.

The court of appeals reversed and remanded. The merchants presented expert evidence demonstrating that they would bear expert fees and expenses of at least several hundred thousand dollars and possibly more than \$1 million. However, the estimated damages for the merchant with the largest volume of Amex transactions amounted to \$12,850, the largest recovery only \$38,549 when trebled, as provided under the antitrust laws.

The court of appeals accordingly concluded that "the class action waiver in the Card Acceptance Agreement cannot be enforced in this case because to do so would grant [American Express] de facto immunity from antitrust liability by removing [the merchants'] only reasonably feasible means of recovery."

The United States' brief observed that under the Supreme Court's precedents, agreements to arbitrate federal statutory claims are enforceable if, but only if, "the prospective litigant effec-

tively may vindicate its statutory cause of action in the arbitral forum.”

While the Federal Arbitration Act establishes a generally applicable federal policy favoring the creation and enforcement of agreements to arbitrate, the effective vindication rule reconciles this policy with the policies of a wide range of federal statutes that confer substantive rights and authorize private suits by aggrieved persons. The rule allows contracting parties to agree that their disputes will be resolved by an alternative adjudicator, while denying enforcement of an arbitration agreement in circumstances where its function would be, in practical effect, a prospective waiver of substantive rights.

The brief explained that the arbitration agreement in *Italian Colors* effectively precluded the merchants from asserting their antitrust claims by making it prohibitively expensive for them to do so. No rational actor would attempt to bring a claim when a negative recovery is a certainty. Under these circumstances, an order compelling arbitration would preclude the merchants from effectively vindicating their federal claims.

The brief lays out the United States’ concern that companies could use a combination of class action and joinder prohibitions, confidentiality requirements, and other procedural restrictions to increase the likelihood that a plaintiff’s cost of arbitration would exceed the projected recovery. Companies could then require acceptance of such unwieldy procedures as a condition of doing business, getting hired, or purchasing products. That would deprive a range of federal statutes of their intended deterrent and compensatory effect.

This concludes my discussion of the United States’ brief. I am happy to answer questions.

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

Senator FRANKEN. Thank you, Deputy Assistant Attorney General, and thanks again for being here today.

The members will now have 7 minutes to ask their questions, and I will start.

Deputy Assistant Attorney General Overton, why did the Justice Department decide to get involved in the *Italian Colors* case lawsuit in the first place? What was the public’s interest here?

Ms. OVERTON. Thank you for your question. Private antitrust actions are a vital supplement to the Government’s civil enforcement efforts under the federal competition laws as well as our criminal enforcement. They are also an important component of a range of other statutory schemes, and the United States filed its brief because of our concern that the effect of the mandatory arbitration agreement in the facts of this case would prevent the respondents from being able to effectively vindicate their rights under the antitrust laws. And our brief also identifies the United States’ substantial interest in ensuring that arbitration agreements are not used in a way to prevent private parties from obtaining relief—

Senator FRANKEN. Can you just talk about how the *Italian Colors* decision undermines enforcement of our Nation’s antitrust laws?

Ms. OVERTON. The concern we expressed in our brief was that the incentives of companies could be impacted, that the effective vindication rule creates incentives for companies to craft arbitration agreements in a manner that allows realistically for small claims to be brought under the federal laws. However, we expressed concern in our brief that, absent that safety valve, companies could have incentives to craft arbitration agreements in a manner that effectively serves as a prospective waiver of substantive rights—

Senator FRANKEN. By making it so hard to recover, by making it so costly to arbitrate, by having to operate alone, that you cannot effectively vindicate yourself, you cannot have effective vindication, and that is what this is all about. This was overturning—that is what *Italian Colors* is about, overturning the precedent that had been in *Mitsubishi* about effective vindication, right?

Ms. OVERTON. We cited in our brief that the effective vindication rule had been recognized in *Mitsubishi* almost 30 years ago, in 1985, and had been reaffirmed by the Court since.

Senator FRANKEN. So Justice Kagan made the same argument in her dissent when she wrote that arbitration could be used to “block the vindication of meritorious federal claims and insulate wrongdoers from liability.”

Can you explain how the *Italian Colors* decision really just gives corporations license to use arbitration clauses to get consumers and workers and businesses to essentially waive their rights?

Ms. OVERTON. Well, the brief lays out our concerns that companies could use a combination of class action and joinder prohibitions, confidentiality requirements, and other procedural restrictions to increase the likelihood that a plaintiff’s cost of arbitration would exceed its projected recovery and would function as a prospective waiver, and prospective waivers are generally presumed to be invalid. So we were concerned about the incentives that could be created, and we noted that the effective vindication rule has created incentives for companies to have arbitration procedures that allow plaintiffs to bring—

Senator FRANKEN. To deprive the civil—

Ms. OVERTON. Exactly, to bring—

Senator FRANKEN [continuing]. Lawsuit. Now, which people on the other side of this will argue, well, you know, the Government can always step in to enforce the law. I think that argument is made by some of the witnesses here. But in its brief, the Government wrote, you wrote, “Private actions are a vital supplement to government enforcement not only under the antitrust laws but also under a wide range of other federal statutes.” Can you just elaborate on this and explain the role that private enforcement plays in this?

Ms. OVERTON. Yes, thank you, Chairman. Private enforcement under the antitrust laws as well as under a number of other statutes is a vital supplement to our Government enforcement efforts, and the federal antitrust laws are, as you are aware, enforced by the Department of Justice Antitrust Division as well as the Federal Trade Commission. But private antitrust suits add to the deterrent value and provide compensation for aggrieved persons. And we noted in our brief that there is a range of other statutes where pri-

vate enforcement is such a vital supplement to government enforcement, and we provided examples such as the Servicemembers Civil Relief Act, Title 7 of the Civil Rights Act of 1964, and the Fair Labor Standards Act, among others.

And we noted in our brief that while claims under such statutes may generate small damages for any particular plaintiff, these statutes offer important protection against practices that are broadly harmful. And we also noted in our brief that such statutes reflect congressional judgment that such private enforcement is an important part of the statutory scheme.

Senator FRANKEN. Well, that brings me to sort of the activism of this Court. This is another 5–4 decision, and this was—you know, can you give the Committee an overview of the precedents that establish the effective vindication rule?

Ms. OVERTON. We noted in our brief that the effective vindication rule was set out in the *Mitsubishi* case in 1985 and has been reaffirmed a number of times since.

Senator FRANKEN. It seems to me that in this case the Roberts Court once again went out of its way to overturn precedent in a way that actually benefits large corporations over consumers and small businesses and employers, because I am talking about *Italian Colors* here. I do not want you to comment on that. I just want to note that that has been a concern of mine since I came to the Senate.

I would like to thank you again for your service and for your testimony today. I know you have a busy schedule. I would like to turn it over to the Ranking Member.

Senator GRASSLEY. Thank you, Ms. Overton, for your testimony.

The Department of Justice brief in *American Express* noted at least one positive result from the *AT&T Mobility* decision. Specifically, companies have modified their agreements, which contain class action waivers, in order to encourage consumers to bring low-value claims into arbitration. Such modifications include cost and fee shifting. Page 29 of that Department brief noted that this leaves “consumers better off under their absolutely agreement than they would have been in class litigation.”

Question: Can arbitration be an effective way for individuals to have low-value claims adjudicated?

Ms. OVERTON. Thank you for your question, Senator Grassley. Our brief made the point that the effective vindication rule could reconcile the policies in a number of federal statutes that confer substantive rights and authorize private suits. And we noted that the effective vindication rule does create incentives for companies to craft arbitration agreements in a manner that allows for low-value claims to be brought, for persons to pursue those federal rights.

We expressed concern in our brief that when an arbitration agreement forecloses a plaintiff from seeking redress for those violations, the effect of the agreement would not result in arbitration pursuant to those procedures but would instead cause the plaintiff to abandon the claim.

Senator GRASSLEY. The Department’s brief in *American Express* argued that the mandatory arbitration agreement prevented the plaintiffs from being able to effectively vindicate their rights under

the antitrust laws. The brief argued that the restrictions contained in the arbitration agreement foreclosed alternative mechanisms such as cost sharing. As you know, the Court disagreed factually whether the American Express agreement prohibited alternative mechanisms like cost sharing.

Two questions. Does the Department agree with a point both the majority and the dissent made in the *American Express* case specifically that a class action is not the only way to vindicate claims; in other words, alternatives such as cost sharing can be effective?

Ms. OVERTON. Senator, in our brief we identified a number of mechanisms that in the context of that case might have been used by the plaintiffs to pursue their small claims, but our brief notes that those options were foreclosed to the plaintiffs. But we identified a number of options, and the card agreement in that case prohibited class action, arbitration, cost sharing, and had confidentiality agreements.

Senator GRASSLEY. Is it fair to say that at a minimum arbitration clauses prohibiting class actions must contain some mechanism for sharing or shifting costs? And if that is the case, then the Department would agree that a claim can be effectively vindicated?

Ms. OVERTON. Senator Grassley, we took the position in addressing the specific facts that were before us in the case of *Italian Colors*, and in that situation our concern was that the merchants did not have any opportunity before them, they did not have a realistic ability given the mandatory arbitration agreement and the procedural restrictions in place, they did not have a reasonable ability to pursue their statutory rights because the cost of arbitration would far exceed any recovery they could hope to obtain.

Senator GRASSLEY. I will yield back my time.

Senator FRANKEN. Thank you. And just in case there is any confusion, *Italian Colors* and *American Express* are the same case. It was *American Express v. Italian Colors* or vice versa, and we will be hearing from the proprietor, the chef, and owner of *Italian Colors* in the next panel.

Senator Whitehouse.

Senator WHITEHOUSE. Thank you very much, Chairman Franken, for holding this hearing. I have a statement. I would like to ask unanimous consent to put the whole statement in the record.

Senator FRANKEN. Absolutely.

Senator WHITEHOUSE. Thank you.

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

Senator WHITEHOUSE. The point that it makes is a fairly basic one, and it begins with, I think, an uncontroversial proposition that the civil jury as an institution was vitally important to the Founding Fathers. It was a core *casus belli* that led to the revolution when the English tried to limit rights to a jury, when the Crown tried to limit rights to a jury. And I think it is also noncontroversial that, dating back to William Blackstone, one of the functions of the jury, the reason that the Founding Fathers put the jury into our system of government as a government institution just like the executive branch, judicial branch, and legislative branch separation was that it stood as a protection for the individual, not just against the Government but also against wealthy and powerful citizens. In-

deed, Blackstone described the civil jury as specifically that, a way for people to be protected from the encroachments of wealthy and powerful citizens.

So now in America the most wealthy and powerful citizens are corporations, big corporations. And if you are a big corporation, you want no part of a jury. You want to go talk to the Governor whose campaign you have supported and surrounded by his lobbyists and friends. You want to go to Congress where your lobbyists prowl the hallways, your super PACs influence policy. The idea of standing as a big corporation on equal terms with a regular person in front of a civil jury? It is offensive to them. They do not like it. They fight back very hard, and there is an entire campaign by corporate America to deprecate and degrade the civil jury, and it would astound the Founding Fathers for whom this was such an important institution and such an important value.

I think it is important that we keep these arbitration agreements in mind in light of that corporate impulse. They would like very much to not ever have to answer to what in the old days would be called “12 good men and true” and now are more like “6 to 12 good men and women and true.” And the desire to kind of shunt as much as they can into arbitration avoids them having to meet the civil jury, dodges that institution of government. And in some cases, when I was Attorney General, the Attorney Generals went after one of the main arbitration organizations, filed an action against it because it was so one-sided, so fundamentally crooked, that it simply was not giving consumers a fair shake. And there are all sorts of problems baked into arbitration in terms of tending to be one-sided, tending to have, you know, people from the corporate world who come in every time and who—it was so bad, I think if—I am saying this from memory, so do not hold me to it, but I think it was so bad that the arbitrators would be stricken under the old rule if somebody objected to them. Well, who is going to object to an arbitrator? Not somebody who is there once. The person who is going to object is the credit card company that is there day after day after day after day. So by selectively striking arbitrators, they were able to cook up a panel that I think by the time the dust settled, 98 percent of the decisions went their way. Again, I am making up that number.

But I am really glad for all of these reasons that Chairman Franken has brought this issue to light, and my point is there is more here than just an injustice to the consumer. There is a real blow to the Constitution and to the constitutional structure that our forefathers fought, bled, and died for. And we need to keep that in mind.

So thank you very much, Chairman Franken.

Senator FRANKEN. Thank you, Senator Whitehouse.

Senator Lee.

Senator LEE. Thank you, Mr. Chairman, and thank you, Ms. Overton, for joining us today.

You stated in your written testimony today that the basis for the Department’s position in its amicus brief was that the arbitration agreements at issue in the *Amex* case violated the effective vindication rule due to the absence of some mechanism for sharing or

shifting costs. What do you think such a mechanism might look like if we were to put something like that in place?

Ms. OVERTON. Thank you, Senator. I am not in a position—with all due respect, I am not in a position to comment on policy that is the purview of Congress, but I would respectfully clarify that in our brief we noted a variety of restrictions, and so the contract agreement between American Express and its merchants required all the disputes to be resolved by arbitration, it precluded any class action adjudication, it barred joinder, it did not allow cost shifting, and it did not allow sharing of information in an arbitration hearing.

We identified several that might have potentially provided an opportunity for the merchants to reasonably, feasibly vindicate their federal claims had they not been foreclosed. We were concerned about the effects of the mandatory arbitration agreement in the facts of that case with all of those facts.

Senator LEE. So is it safe to say that the concerns expressed by the Department in the *Amex* case could perhaps be vindicated by a remedy short of just the wholesale invalidation of these kinds of agreements? It is theoretically possible, at least, that you could satisfy them by some means other than the wholesale invalidation of all such agreements?

Ms. OVERTON. Again, thank you, Senator. Again, I am not in a position to comment on any policy. I can only note, again, what we identified in the brief, in the context of that case, our concerns.

Senator LEE. Okay. To your knowledge, has the U.S. Department of Justice in this administration advocated for the validation of pre-dispute arbitration agreements generally?

Ms. OVERTON. I am not aware—the administration has not taken a position on—I am not aware.

Senator LEE. On what kind of reform might be necessary?

Ms. OVERTON. I am not aware of a position. Again, I am here testifying about our brief in the context of the antitrust laws and its impact and the concerns we expressed, but, of course, we remain happy to work with the Congress on issues.

Senator LEE. Okay. But to your knowledge, the Department of Justice has not endorsed any currently pending legislation that would limit the effect of these kinds of agreements?

Ms. OVERTON. I am not aware of such a position, no.

Senator LEE. Okay. Thank you very much, and thank you, Mr. Chairman.

Senator FRANKEN. I again want to thank you, Ms. Overton. I know you have—oh, I am sorry. That is terrible. I am awful. Thank you. Senator Hirono, excuse me. I am very sorry.

Senator HIRONO. Thank you very much, Mr. Chairman.

The general proposition in our country is that people should have the right to access our courts to seek redress and justice. So it is not the norm that all of these matters should be handled through arbitration clauses that basically head off consumers, head off small businesses, head off shareholders, and any other individuals or groups from seeking such redress in the courts. And I think the *American Express* case, basically the way I see this case, because it really goes far in saying these kinds of arbitration clauses are okay, even so far as to, in effect, preempt in this case federal anti-

trust law. Isn't that what the Court said? A private entity, American Express, can preempt federal law and the provisions in the federal law that allowed this small businessperson to seek redress?

Ms. OVERTON. Thank you. Thank you, Senator. The concerns that we expressed in our brief were that, under the circumstances of that case, the merchants could not advocate, they could not pursue their rights under the federal antitrust laws because the cost of doing so, given the mandatory arbitration agreement and other restrictions, would have been prohibitively expensive. It would have far exceeded the recovery that they could hope for.

Senator HIRONO. So, in effect—

Ms. OVERTON. The Supreme Court did not adopt our position.

Senator HIRONO. So, in effect, with this kind of a ruling, private entities can trump federal law. And you mentioned some other federal laws where there is a private cause of action alternatives that an individual or aggrieved parties could pursue. So you mentioned several examples of how other kinds of clauses could be put into arbitration clauses that would make it pretty tough for anyone to seek redress in our courts, which is, you know, the general proposition in our country, but for decisions like this—which, by the way, interpreted federal law, so since there is no constitutional right to arbitration, it behooves our Committee and the Congress to look at what is going on and making sure that there is a balance here.

I am not against arbitration clauses per se, but when they go this far basically to trump federal law, I think that we need to address the situation.

That was not a question.

Ms. OVERTON. Okay.

[Laughter.]

Senator HIRONO. Thank you, Mr. Chairman.

Senator FRANKEN. Thank you, Senator Hirono, and that is exactly why we are here today and what we are talking about today. In *American Express v. Italian Colors*, basically what I believe we saw was the Court overturned precedent, effective vindication, which is that in these mandatory arbitration clauses, when a plaintiff was absolutely by definition of the circumstances unable to recoup anywhere near their expenses because they are prohibited from joining with other plaintiffs or they were prevented from class action, where the expenses—they proved the expenses were going to be so much more than anything they would recoup, so it would become irrational to actually go into arbitration that there was no effective recourse, no effective vindication. And that is what this was. It was an overturning of a precedent. And we as Congress can do something about that, and that is what our discussion is about here today.

I want to thank you for your testimony, and the witness is now dismissed. Thank you.

Ms. OVERTON. Thank you.

Senator FRANKEN. All right. And, again, I apologize, Senator Hirono. I really do.

Senator FRANKEN. I would like to invite the witnesses on our second panel to come forward, and stay standing, I guess, because we are going to administer the oath, as is customary. Do you affirm

that the testimony you are about to give before the Committee will be the truth, the whole truth, and nothing but the truth?

Mr. CARLSON. I do.

Ms. GILLES. I do.

Mr. TESKE. I do.

Mr. PARASHARAMI. I do.

Mr. RUTLEDGE. I do.

Senator FRANKEN. Thank you. You may be seated. Welcome to each of you. I will introduce the witnesses, all of them, and then Mr. Carlson will begin his testimony.

The first witness is Alan Carlson, the owner of Italian Colors Restaurant in Oakland, California. Mr. Carlson has been in the restaurant business since he was a teenager when he washed dishes at a diner. He graduated from the Culinary Institute of America in 1979 and then traveled across the country working with chefs. Today Mr. Carlson is not only an outstanding chef, he is also a successful businessman operating several restaurants in the Bay Area.

Our next witness is Professor Myriam Gilles from Cardozo Law School. Before joining the faculty at Cardozo, Professor Gilles taught at Princeton and at the University of Virginia. Professor Gilles has written and spoken extensively on the Federal Arbitration Act and access to justice.

Our next witness is Vildan Teske. Ms. Teske is a partner at Crowder, Teske, Katz & Micko, PLLP, a Minneapolis-based law firm where she represents consumers and servicemembers. In addition to her duties at the firm, Ms. Teske also serves on the Steering Committee of the National Association of Consumer Advocates' Military Consumer Justice Project. Earlier this year, Ms. Teske received the Federal Bar Association's Robyn J. Spalter Outstanding Achievement Award in recognition of her tireless and effective advocacy for consumers.

Our next witness is Archis Parasharami, the head of the Consumer Litigation and Class Actions practice at Mayer Brown. Mr. Parasharami is the co-editor of Class Defense, a blog about key issues affecting class action law and policy. He represented AT&T in the *Concepcion* case, and he has received numerous awards for his work.

Our final witness is Professor Peter Rutledge, an associate dean and the Herman E. Talmadge Professor at the University of Georgia. Professor Rutledge has authored several books and academic articles on arbitration, and he has testified before Congress on arbitration issues before. He also was selected to participate in the American Arbitration Association's delegation to the United Nations Working Group on Arbitration.

I would like to ask each of you to give 5 minutes of testimony to make your opening statements. Your complete written testimony will be included in the record.

Mr. Carlson, we will start with you.

**STATEMENT OF ALAN S. CARLSON, OWNER, ITALIAN COLORS RESTAURANT, OAKLAND, CALIFORNIA**

Mr. CARLSON. Thank you, Chairman Franken, distinguished Committee members. My name is Alan Carlson. I am the chef and

owner of Italian Colors Restaurant, a small business located in Oakland, California. I was born in a suburban region of Detroit and have been working in the restaurant business in one way or another since I was 14 years old.

Twenty years ago I opened Italian Colors Restaurant with my wife, Diane Cohen Carlson, and business partner, Steven Montgomery. I am incredibly proud to say that 2 decades later, we are still open, serving our community and employing more than 30 people.

Like most restaurants, our profit margins are razor thin. We survive by fostering client loyalty, keeping prices low, cooking quality food, giving great service. We also operate in a credit card-driven world and could not survive without accepting credit cards as payment.

To customers, one form of payment is as good as another, but for small businesses, that is far from reality. A significant percentage of our earnings comes from customers who use American Express cards. American Express imposes special rules on small businesses who must accept their cards as payment. For example, in order to accept any American Express card, my restaurant has to accept all types of American Express cards—even cards that carry rates and fees that are higher than other forms of payment. American Express also does not allow me to offer cash discounts or to encourage customers to pay with a form of payment that actually works better for my business. I cannot encourage my customers to pay in cash or offer discounts or other incentives.

If I could offer discounts to my customers or be able to say which cards make sense for me to accept, without being forced to accept all cards, I would increase my earnings and be able to hire more employees. Being forced to make a decision that is bad for my business just is not right. After describing my situation to my friend and long-time customer and attorney, Edward Zusman, I learned that American Express may be violating our country's antitrust laws. When I started with American Express in the early 1990s, my first agreement did not have an arbitration clause. To this day, I have not actually seen an arbitration agreement, but I have been told by my attorney, Edward, that one was included in their contracts in the late 1990s.

Edward explained that forced arbitration means American Express cannot be held accountable in court and that I will not be able to join with other small business owners to help defray the costs of enforcing our rights. Instead, if I want to hold American Express accountable, I would have to do it in an individual, private arbitration designed by American Express.

Needless to say, I was shocked. And even if I knew the clause was in the fine print of the contract, American Express contracts are offered on a take-it-or-leave-it basis.

As we figured out how to move forward, we discovered that the cost of individual forced arbitration was so high that even if a small business won, it would lose. An expert economist explained that it would not be cost-effective for any small business owner in the same situation to pursue an individual arbitration claim against American Express. In fact, it would cost more to bring their claim than they could recover. In short, if I cannot be part of a

class action to enforce my rights against American Express, I have no way of enforcing those rights. I do not have the money to take on American Express by myself.

So you can imagine my disappointment and shock when the U.S. Supreme Court issued its decision in favor of American Express and forced arbitration. Essentially the Court said it did not matter that a small businessman could not pursue important rights against a big business.

Coming here today to testify before the Committee was difficult because I just opened a new restaurant 6 weeks ago. And reflecting on it, I realized how important it was for me to be here to speak on behalf of all small business owners who are struggling to stay in business and live the American dream.

This does not have to be the end of the story. Congress can act to help protect small businesses across America and ensure we have the same access to the justice system as large corporations.

Senator Franken's Arbitration Fairness Act would restore the rights of small businesses like mine to enforce our rights. Small businesses are the lifeblood of America, and we play an essential role in creating good jobs. Small businesses, our customers, and really, our neighborhoods and communities are the ones who lose when large corporations get to push us around.

Everyone in D.C. says that small businesses are important, and here is a real opportunity for Congress to actually do something to protect us.

Thank you for taking the time to listen to me today, and I look forward to answering any questions.

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

Senator FRANKEN. Thank you, Mr. Carlson. Thank you for making the trip all the way from Oakland, and good luck in the new restaurant.

Professor Gilles, please.

**STATEMENT OF MYRIAM GILLES, PROFESSOR OF LAW, BENJAMIN N. CARDOZO SCHOOL OF LAW, YESHIVA UNIVERSITY, NEW YORK, NEW YORK**

Ms. GILLES. Chairman Franken, other distinguished Members of the Senate, thank you so much for inviting me here today to talk about this issue that I have spent a lot of time over the past 8 years thinking and writing about—forced arbitration clauses which mandate one-on-one arbitration of all legal disputes and ban multiple claimants from pooling their claims. That is what we are talking about today.

These arbitration clauses, which we can now find in just about every kind of contract you can imagine, prevent consumers, workers, and small businesses from vindicating the rights that are guaranteed to them by the common law and by federal and State law, and they immunize companies from accountability for widely dispersed small-dollar injuries that they can inflict on people who have no choice, no voice, no bargaining power in the market.

For a long time, State and federal judges, Democrats and Republicans, in courts all around the country regularly struck down these arbitration clauses as unfair, finding them against public policy

where they prevented people from actually vindicating the rights legislatures have given them. But all that changed in 2011 with the *AT&T* decision that we have already talked about, and it has only gotten worse this past term with *American Express v. Italian Colors* because the Court there just broadly upheld the use of a remedy-stripping arbitration clause, rendering it really beyond legal challenge. It simply does not matter, as Justice Scalia wrote for the majority in *Concepcion*, that countless cases will “slip through the legal system.” It does not matter. All that matters for this very slim majority of the Supreme Court is that a 1925 statute is followed, that arbitration clauses are enforced exactly as companies have written them up.

As Justice Kagan wrote in her blistering dissent in the *American Express* case, the majority’s response to the public policy implications of enforcing these remedy-stripping arbitration clauses, the reality that no rational individual small business owner, consumer, or employee will ever seek to arbitrate one-on-one claims against massive and well-funded corporations, the majority’s response to that real-world implication is simply, “Too darn bad.” “Too darn bad.” So Congress enacted a remedial statute that gives you rights, but you cannot vindicate those rights? “Too darn bad.” That is basically the majority’s response.

Now, “too darn bad” might be a perfectly fine response for the Supreme Court when it is applying legal rules, but this body is doing policy. And so “too darn bad” just cannot be this body’s response to this decision. I think this body, this Congress, has already recognized the public policy implications of this debate. Congress has tried to outlaw mandatory arbitration clauses and payday loan and consumer credit contracts with military families and in residential mortgage agreements. If these groups deserve protection from mandatory forced arbitration, so do all consumers and employees.

And I think the Supreme Court’s decision has pretty much squarely put this issue here before you, before this body. The Court has repeatedly made clear they will rigorously enforce these remedy-stripping terms that companies insert into their arbitration clauses. Never mind the consequences unless the FAA is overridden by you, by Congress.

So the time is now, and honestly I cannot think of a better time, because these arbitration clauses are proliferating far beyond what any of us could have imagined just a few years ago.

The CFPB Arbitration Study, which was just released last Wednesday, makes clear that these clauses have become standard in credit card company contracts, checking account contracts, payday lenders use them, and those are just the groups that the CFPB studied. I mean, we are seeing these contracts in all sorts of other agreements, with insurance companies, airlines, landlords, gyms, rental car companies, parking facilities, schools, camps, shippers. Even HMOs and nursing homes regularly use these contracts. In fact, the nursing home industry is very straightforward about the fact that they all use mandatory forced arbitration in their contracts, basically making it impossible for individuals to bring individual claims in court or to band together to hold them responsible for systemic harms.

I think these remedy-stripping clauses are affecting everyone. All of us in this room are bound by one or more arbitration clauses that we may or may not know anything about. I want to tell you about one case. It is in my written testimony, but I wanted to just highlight it for you.

There is a young Florida man named Kevin Ferguson who enrolled in a medical assistant program in Miami, Florida, just trying to make his life better, trying to increase his opportunities for getting a job. And he enrolls in this course. It is offered by one of these for-profit educational groups, promising him the sun and moon and stars but, of course, misrepresented just about everything about the educational program, everything from their graduates' employment statistics to the ability to get financial aid to the actual quality of the program.

Kevin enrolls. He does really, really well. He graduates with great grades, but finds himself unable to get a job. He does some more investigation, and he talks to more graduates, and he realizes lots of people feel that they have been duped by this for-profit educational organization and that they have engaged in some pretty fraudulent recruitment practices over the years.

Kevin brings a claim, but get this? Kevin is not just suing for damages. Kevin is bringing what we call a "true private attorney general claim." He wants to bring a claim to have a court, a public court, declare that this educational group has been lying. They have been falsely advertising graduation statistics. They have been defrauding the public. He wants an injunction, and he wants some order stopping this group from continuing to engage in this horrible practice.

But Kevin's enrollment contract had an arbitration clause in it, so the district court, faced with the defendant's inevitable motion to compel arbitration to drag Kevin's claims out of the public court and into the private, sequestered universe of arbitration, the district court said, "Whoa, whoa, whoa, this is a public injunctive claim. So Kevin cannot arbitrate this claim. This claim belongs in a public court." Denied the motion to compel arbitration.

But then *Concepcion* and *American Express* were decided, and on appeal, the Ninth Circuit felt its hands were tied, and it reversed the district court. So now, you know, Kevin cannot get justice, but Kevin also cannot prevent injustice to others.

And so I think this is a really serious problem—

Senator FRANKEN. Professor, you are going to have to wrap up.

Ms. GILLES. Wrap up, I am. I had one paragraph left.

Senator FRANKEN. Okay.

Ms. GILLES. So that is just one of many examples. Forced arbitration is literally foreclosing millions of Americans from vindicating their rights. And as the remedial statutes enacted by this body and by the legislatures of the 50 States are thwarted, I think "too darn bad" is just not going to cut it. So I urge this body and this Congress to enact the Arbitration Fairness Act.

Thank you.

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

Senator FRANKEN. Thank you, Professor. I noticed you used air quotes on “for profit.” The air quotes do not belong around the “for profit.”

Ms. GILLES. “Educational.”

Senator FRANKEN. Yes.

[Laughter.]

Ms. GILLES. You are right. Sorry.

Senator FRANKEN. They are definitely “for profit.”

Ms. Teske.

**STATEMENT OF VILDAN A. TESKE, PARTNER, CROWDER, TESKE, KATZ & MICKO, PLLP, MINNEAPOLIS, MINNESOTA**

Ms. TESKE. Good afternoon, Chairman Franken, distinguished members of the Committee. Thank you for allowing me to testify today. I will share with you my perspective as an advocate representing consumers and servicemembers in individual and class action cases.

As a result of the recent Supreme Court decisions in *Concepcion* and *Italian Colors*, many of my clients are no longer able to bring their claims in a court of law using our country’s judicial system because of forced arbitration.

In my practice, I have had the privilege of representing our brave military men and women in matters dealing with consumer financial issues. Congress provided important, very strong protections for our servicemembers and their families through a federal law known as the Servicemembers Civil Relief Act, or SCRA. The explicit purpose of the law was to enable our servicemembers “to devote their entire energy to the defense needs of the Nation.”

With the large number of deployments over the past decade, the financial crisis our country has experienced in the last 6 years, and the reckless business practices violating servicemember rights, unfortunately SCRA claims have been more common than in previous years. My colleagues and I have brought several SCRA cases as class actions on behalf of a number of servicemembers. These servicemembers’ rights were violated by the same creditor in the same way.

In the past, we were able to recover millions of dollars for thousands of servicemembers who were able to join together to hold corporations accountable for violating their rights. Many of the hundreds of military class members that we have spoken with did not know their rights. The few that knew that their creditor was likely breaking the law did not have the time to pursue the claim or the resources to hire an attorney to take the case on.

Unfortunately such cases on behalf of classes of servicemembers are now almost impossible to bring due to the Supreme Court’s decisions and because of a number of underlying contracts out there that have forced arbitration clauses.

Consider my recent case representing a servicemember whose mortgage lender foreclosed on his home while he was on active duty serving our country. The lender held a sheriff’s sale and sold our client’s home in Minnesota while he was being deployed to Iraq, in violation of the SCRA requirements. Some months later, he learned he lost his home, but at the time he did not know he was protected by federal law from this unlawful foreclosure.

While investigating the facts of his case, we found a report that said that a review of a sample of foreclosures conducted by this same national lender revealed a number of other servicemembers that were subject to the protections of the SCRA. So our client made the decision to file his case as a class action and as a representative of all the other servicemembers to get justice for himself and the others.

Much to our client's surprise, the lender brought a motion to take the case out of our judicial system and force him to arbitrate. It turned out that in the thick stack of documents at the time of his closing years before, there was a forced arbitration clause with a class action ban. Based on the Supreme Court's rulings on arbitration clauses, he lost his right to his day in court, the ability to represent his military brothers and sisters, and his constitutionally guaranteed right to present the facts to a jury. One cannot escape the irony that while he was serving our country and protecting our freedoms, he had lost his freedoms and rights under our Constitution.

It is not sound public policy to require our armed forces members to submit to individual arbitrations that take time away from their service to our country and from their families in order to vindicate their rights. Yet this is exactly what has to happen when there is a class action ban in a consumer contract. Or more likely what would happen is that the servicemember has to forgo vindicating his rights altogether and the wrongdoer is not brought to justice. In fact, a 2006 Department of Defense report to Congress came to the same conclusion. In my practice I have seen time and again how forced arbitration harms the lives of American families and our Nation's servicemembers.

Another example is a case in California against a national lender that repossessed active-duty servicemembers' vehicles without court order, in direct violation of the SCRA. The National Guard sergeant was deployed to Iraq, and when—excuse me—he was in Iraq when his car was repossessed. Even after the military legal assistance office sent a letter to this lender and asked them to return the car, the lender refused. So he brought a class action on his behalf and on behalf of all the other servicemembers that this had happened to. But one can guess what happened next. There was a forced arbitration clause, and there could be no class action.

This, of course, meant that hundreds if not thousands of other servicemembers had their rights violated potentially, but they were left unprotected, and the company got away with breaking the law.

Unfortunately, with the proliferation of forced arbitration clauses, these scenarios will continue to play out for servicemembers as well as all other consumers.

Our servicemembers deserve better. Our American consumers deserve better. So do the employees, the investors, the small businesses, and seniors deserve better. They need access to justice in our public court system.

Thank you for inviting me to testify today, and I look forward to your questions.

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

Senator FRANKEN. Thank you, Ms. Teske.

Mr. Parasharami.

**STATEMENT OF ARCHIS A. PARASHARAMI, PARTNER & CO-CHAIR, CONSUMER LITIGATION AND CLASS ACTIONS PRACTICE, MAYER BROWN LLP, WASHINGTON, DC**

Mr. PARASHARAMI. Thank you, Mr. Chairman and distinguished members of the Committee. Good afternoon. My name is Archis Parasharami, and I am a partner in Mayer Brown LLP, where I am co-chair of the Consumer Litigation and Class Actions practice. I want to thank the Committee for giving me the opportunity to testify today, and I thank the Chairman for making my more extensive written statement part of the record.

My legal practice involves defending businesses against class action lawsuits in courts around the country. And, in addition, I counsel businesses on adopting fair arbitration programs, and I represent them in litigating over the enforceability of those arbitration programs. So I have firsthand experience with how arbitration agreements work and also how class actions function in reality.

Based on that experience, my view is that arbitration provides consumers and employees with a fair and accessible way of resolving their disputes, and it does so more effectively than litigation in court. Those benefits of arbitration, in my view, are the primary reason why the Arbitration Fairness Act should not be adopted.

Despite its title, the bill would effectively eliminate any realistic access to arbitration for consumers and employees with modest-sized claims. And for the ordinary consumer or employee, the elimination of arbitration will do more harm than good.

What does the evidence show? Empirical studies have repeatedly demonstrated that arbitration is at least as likely, if not more so, than litigation in court to bring benefits and more positive outcomes for consumers and employees. It is also more user friendly than litigating in court. Access to this fair, inexpensive, and simple system of dispute resolution is a significant benefit for consumers and employees.

Now, perhaps the most common objection to arbitration—and I think we have heard it from some of my colleagues today—is that arbitration typically takes place on an individual basis instead of through class actions. But these objections to arbitration rest on inaccurate, theoretical assumptions about how this alternative of class actions actually functions. And in reality, the bulk of class actions do not provide benefits for the vast majority of consumers and employees.

My firm recently conducted an empirical study of 148 class actions involving employee class actions and consumer class actions filed in federal court, and that is attached to my written testimony as Exhibit A. Here is what we learned from that study:

Most of these class actions were dismissed either by the courts or voluntarily by the named plaintiff who had sought to represent the class. Of the remainder, the relatively few cases that did settle, the available evidence about the distribution of benefits from those class actions showed that usually class actions resulted in little to no benefit to employee and consumer class members. In other words, class actions are not particularly effective at delivering relief. And I think that most people who have received a class action

notice or a \$2 check in the mail have had that experience, that they simply have not gotten a lot out of the class action of which they were a member.

By contrast, arbitration does afford consumers and employees an opportunity to pursue their claims effectively on an individual basis. We were lucky enough to have the Assistant Attorney General testify before, and I think that her testimony about the Government's brief was illuminating. And Justice Kagan's dissent in the *American Express v. Italian Colors* case really tracked the Government's arguments. And what Justice Kagan concluded, while disagreeing with the majority, was that still "non-class options abound" for pursuing claims in arbitration, pursuing federal anti-trust claims in arbitration.

In addition, arbitration agreements are increasingly becoming more favorable to individual consumers and employees. More and more companies are paying either all or most of the costs of arbitration. Often a consumer or employee pays nothing to arbitrate. Companies routinely select the nonprofit American Arbitration Association to serve as the arbitration administrator, and the AAA has set up due process mechanisms to ensure that impartial, unbiased arbitrators serve as the arbitrators and the neutral decision-makers and that arbitration procedures are simple and easy to use. We are now seeing increasing numbers of consumers and employees that are making use of arbitration.

The Chairman was kind enough to mention an article that I wrote at the start of the hearing, and one thing that I would like to mention is that that article urges companies, in order to have enforceable arbitration agreements, to adopt arbitration agreements that are consumer friendly, to adopt arbitration agreements that follow the model of the arbitration agreement considered in *Conception*, which the Court described as leaving consumers arguably better off than they would be in class actions.

Now, especially given these developments, in my view the elimination of arbitration would be bad for individual consumers and employees as well as businesses. Consumers and employees would be far worse off from losing the ability to pursue claims that they would have that are small and individualized, claims that could not be pursued in class action, and cannot practically be pursued in court because lawyers simply will not take those cases.

The primary beneficiaries of eliminating arbitration would be lawyers—lawyers on the plaintiff side, but also defense lawyers like me who receive large legal fees for defending companies in class actions. In short, the only clear winners of an increase in class action litigation and the elimination of arbitration are the lawyers.

Thank you again for the opportunity to testify before the Committee, and I look forward to answering your questions.

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

Senator FRANKEN. Thank you.  
Professor Rutledge.

**STATEMENT OF PETER B. RUTLEDGE, ASSOCIATE DEAN FOR  
FACULTY DEVELOPMENT, HERMAN E. TALMADGE CHAIR OF  
LAW, UNIVERSITY OF GEORGIA SCHOOL OF LAW, ATHENS,  
GEORGIA**

Mr. RUTLEDGE. Chairman Franken, Senator Hirono, Senator Lee, and members of the Committee, thank you for the opportunity to testify today, and thank you, Chairman Franken, for making my entire written statement part of the record.

In an abundance of caution, just to repeat one statement from that written remark, the views here expressed today are my own. One of my co-authors is a consultant to the Consumer Financial Protection Bureau, and it is important to me that everything that I say today be imputed only to me and not directly to him or indirectly to the CFPB.

With my written statement part of the record, let me make two brief points in the time that you have given me.

First, I wish to thank you and your fellow lawmakers for shifting the terms of the debate over arbitration away from legislation by anecdote and toward policymaking grounded in sound, empirical evidence. Earlier iterations of this debate risked reacting to particular cases, irrespective of whether those cases were representative of the system as a whole and irrespective of whether the reforms truly benefited those whom they were designed to protect. Now the debate is firmly anchored in empirical research and should remain so.

Just as an example, Chairman Franken, as you know from the 2011 hearing, one important contribution to that debate was the Searle study, with which you are quite familiar, that found, among other things, that the consumer win rate in arbitration was over 50 percent, that the disposition time from filing to conclusion of the arbitration was 6 months, a fraction of what it would be in our system of civil litigation, and that prevailing consumers who sought attorneys' fees received them over 60 percent of the time.

And to Senator Lee's question earlier, I would draw your attention to an initiative that the State Department has been involved in with the Organization for American States which is looking at the question of how to resolve cross-border disputes between consumers and businesses, and one of the proposals that is being considered by OAS at the suggestion of the United States is consumer arbitration. So the record is there. It is certainly not complete.

My second point, consistent with my first observation, is to approach with caution claims that in a flight to arbitration will follow a particular Supreme Court decision. Empirical research that I and others have undertaken does not validate those predictions. To elaborate, in working with your staffs, Chairman Franken and others, they asked me to speak, and I have appended to my testimony a recent article that I co-authored with Professor Drahozal entitled "Sticky Arbitration Clauses," where we tracked in the franchise industry the extent to which there was a flight to arbitration after the *Concepcion* decision. And what we found was that there was not. Depending on the relevant metric, the use of arbitration clauses has shifted from approximately 40 percent to 45 percent or from 62 percent to 63 percent.

And the recent preliminary results by the CFPB echo our findings. You have referred to them already, Chairman Franken, and that is, 17 percent of institutions issuing credit cards are using arbitration clauses, and 3 percent of credit unions are doing so.

Now, I acknowledge what we are about to talk about, Chairman Franken, is that part of the reason why that figure is currently low is because there was a period of time where a certain number of issuers refrained in using those arbitration clauses as pursuant to terms of settlement. That is about to expire. And I would recognize, too, that if that settlement were to go away, the number of issuers would go up. However, credit unions would continue not to use them.

Now, it is important, of course, to have an apples-to-apples discussion because, in addition, we cannot simply look at the use of arbitration clauses with respect to issuers. We can also look to it with respect to the amount of credit card debt, and perhaps we can elaborate on that in the hearing.

The last point I wish to make, Chairman Franken, is this: In my view, the flight to arbitration often predicted in connection with the Supreme Court decisions, including *Concepcion*, has not come to pass. While it is simply too early to predict the effect of the *Italian Colors* case given the recency of the decision, the historical disconnect between the rhetoric and the reality that Senator Grassley referred to earlier counsels caution.

Thank you for the opportunity to testify, Chairman Franken, and I would be happy to answer your and any other Committee member's questions.

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

Chairman FRANKEN. Thank you all.

Mr. Carlson, thanks for being here and for sharing your story with the Committee. I just want to be clear about something you mentioned in your opening statement. Did you have a choice to opt out of the arbitration clause that American Express had you sign?

Mr. CARLSON. No, I did not. I have never signed anything with American Express.

Senator FRANKEN. And did you have any say when it came to the rules of the arbitration?

Mr. CARLSON. No, I did not.

Senator FRANKEN. And then the Supreme Court concluded that you had no right to go to court, that you had no choice but to abide by the arbitration agreement, no say over the arbitration procedures, and no right to go to court. Correct? So what did you do when the Supreme Court ruled against you?

Mr. CARLSON. Business as normal, but, you know, I was saddened by it, but there was nothing I could do.

Senator FRANKEN. You withdrew the case.

Mr. CARLSON. Oh, yes, I withdrew the case, correct.

Senator FRANKEN. Right?

Mr. CARLSON. Right. Correct.

Senator FRANKEN. And when you say you never—I noticed in your testimony you never saw—you had been working with American Express, and they put this mandatory arbitration agreement in the contract like 10 years into your contract.

Mr. CARLSON. Correct.

Senator FRANKEN. And did they tell you they were doing that?

Mr. CARLSON. No, they never told me anything.

Senator FRANKEN. Okay. So you never had a chance to have your claims heard either in arbitration or in court. How would things have been different if you had the option to go to court, do you believe?

Mr. CARLSON. I think we could have gotten a group of other restaurateurs that are as unhappy with the situation as I am and gotten a class action together.

Senator FRANKEN. Okay. Well, that is what this is all about to me, is just having access to justice. Basically in this, you know, Justice Scalia said that it did not matter that you were not able to vindicate your claims, but the most you would have gotten is about triple the damages to you, which would have been \$30,000. But you had to individually arbitrate, which you proved would have cost you hundreds of thousands or maybe even a million dollars, right?

Mr. CARLSON. Correct.

Senator FRANKEN. Okay. Well, had my bill been law, you could have chosen to go to court where you could have joined forces with other small businesses, and your case could have been heard, and maybe this would be different.

Ms. Teske, one of the things I found remarkable in your written testimony—and you talked about it a little here—was the comparison you made between the way things used to be and the way things are now. Years ago you were able to recover millions of dollars for servicemembers whose rights had been violated. Today it seems like it is nearly impossible to bring cases to enforce laws that protect our men and women in uniform. Can you comment on this?

Ms. TESKE. Absolutely. The majority of the consumer financial contracts that servicemembers have entered into in the last few years—and I assume that will continue in the next few years—have these forced arbitration clauses. We have heard already about credit card contracts and the variety of other types of contracts, like cell phone services or car loan contracts. Whereas before we might have been able to get relief for the class members for violations of the Servicemembers Civil Relief Act as a class action, in those situations we are no longer able to. Each servicemember would have to file their own individual arbitration. They would, first of all, have to know the intricacies of the Servicemembers Civil Relief Act and know that there was a violation, then file their own individual arbitration, take the time and effort to do that, and they would not be able to bring a representative case to represent the hundreds if not thousands of other servicemembers that had the same thing happen to them. So it is night and day compared to before forced arbitration clauses and now.

Senator FRANKEN. Okay. You told one story in your testimony that really illustrates the problem. I went back and looked at some of the court documents for that case, and, frankly, I just think it shocks the conscience. The Servicemembers Civil Relief Act says, among other things, that banks cannot foreclose on servicemembers who are on active duty without first getting permission from a

judge. The idea is that we cannot expect our troops to fight the enemy abroad while fighting off bank foreclosures or an eviction notice at home.

I think we can all agree that that is a good law. Literally, we can all agree. This law passed by unanimous consent.

You testified about a soldier from Minnesota, from my State, who earned several honors during the course of his service, including the Army Commendation Medal. On the same day that this soldier was ordered to report for active duty, his lender initiated foreclosure proceedings against him.

So the soldier goes off to Iraq to serve his country, and meanwhile the bank is trying to take his house away from him without first going to a judge for permission. That is a blatant violation of law. And it gets worse.

The lender falsified an affidavit swearing under oath that the bank knew that this man was not in military service, which was completely untrue. Using that false affidavit, the lender got the sheriff to put the soldier's house up for sale, and the house was sold while the owner of the house was in Iraq, in Balad, at Camp Anaconda. Right? I have been to Camp Anaconda four times. It was called "Mortarville" because they got mortared so much.

Guess who ended up buying that house? The lender. The bank that foreclosed. It got a heck of a deal. It paid between a quarter and a third of the value of the house for the house that it foreclosed on illegally. Great deal for the bank. Not a good deal for our soldier in Balad.

Now, my understanding, Ms. Teske, is that the soldier wanted to file a Servicemembers Civil Relief Act case to seek justice not for himself but also for other soldiers who had been foreclosed upon by the same bank. And it was really important for him to know that other soldiers knew that they had legal rights and that those rights might have been violated. You mentioned in your testimony that there was some indication that your client was not alone, that there might have been other victims out there, so the soldier filed a case for himself and for other soldiers who had been foreclosed upon by this bank.

What happened next?

Ms. TESKE. He did not get his day in court. Because of the forced arbitration clause, the judge went ahead and ordered arbitration, and we ended up settling the case, and he was not able to represent the other servicemembers. So rather than having a class action that could go forward where others and he could get relief in our public court system, in the public eye, none of those things happened.

Senator FRANKEN. Okay. I am out of my time. We will come back. We are going to have a second round for anyone who wants to stick around. But that to me is just an outrage. That is an outrage.

We will go to Senator Lee.

Senator LEE. Thank you, Mr. Chairman, and thanks to all of you for joining us today.

Mr. Parasharami, I would like to ask you a couple of questions. The CFPB in its preliminary findings notes that it intends to "as-

sess the possible impact of arbitration clauses on the price of consumer financial products.”

I believe you indicated in your written testimony that consumers and employees might well benefit through the systematic reduction of litigation-related transaction costs which leads to lower prices and higher wages.

Can you explain for us sort of what you mean by that and where that comes from, how you get there?

Mr. PARASHARAMI. Sure, Senator. So class actions and litigation in court are not free. They come with a cost—and, in fact, massive costs. The costs of litigation are high. The costs of electronic discovery are high. The costs of paying plaintiff’s lawyers if the case settles are high. The costs of paying me and my colleagues and other law firms on the defense side to litigate the case, that happens in every case. So there are extraordinary legal costs associated with class actions and litigation in courts. Arbitration is a lot cheaper and quicker and more efficient, so the costs are lower.

Now, where do these costs go? You know, they do not just kind of vanish into the ether. A company that experiences these litigation costs in a competitive market will pass them along to consumers or reduce wages for employees or otherwise not hire more workers. These costs are passed along in some form or another, and typically in a consumer context, it is passed along in the form of—if you save those costs, they are passed along in the form of lower prices. If you can experience those cost savings, they are passed along by lowering prices.

So the point is that—and let me just say that scholars who have looked at this have said that it is simply a matter of basic economics, that cost savings that come from the use of arbitration are passed along in competitive markets to consumers.

Senator LEE. Okay. Another thing that you stated in your written testimony was that businesses are unlikely to offer post-dispute arbitration, meaning once the dispute arises, they are not likely to raise that as a possibility.

Why is that the case? Why is it the parties are rarely going to be entering into that kind of arrangement?

Mr. PARASHARAMI. So in the pre-dispute context, pre-dispute arbitration agreements, the ones that would be affected by this proposal, both sides, the consumer or employee and the business, are committing in advance to use arbitration. And so when a company implements an arbitration program, it commits to taking on a ton of incremental costs that it would not bear in court. Under most arbitration agreements, such as the ones that are governed by the American Arbitration Association’s consumer rules, a business will have to cover filing fees, these amount in consumer cases to \$1,500. And they also agree to pay the arbitrator’s compensation in full. And arbitration agreements like the ones that I advise companies to adopt often agree that they will pay even more substantial costs. Sometimes they will pay the full costs of arbitration.

The businesses agree to take on these high incremental costs because overall they experience the cost savings from reducing the litigation costs associated with class action litigation and litigation in court, the costs we just talked about. And because they save primarily on e-discovery costs and lawyer fees, the lawyers like me

and the lawyers like my colleagues on the other side, it benefits them to pay all of these incremental costs for an arbitration program.

But if you were in a regime where only post-dispute agreements were permitted, where either side could choose only after the dispute arises, then companies really would not want to have that two-track system because they would have to both pay the cost of maintaining an arbitration program as well as all the costs of maintaining the litigation system in court. And so they simply will not want to pay twice. It will not be realistic. If companies are only allowed to have post-dispute arbitration and are required to defend claims in court, they simply will not allow for arbitration. And this would actually be very detrimental to consumers and employees who would not have realistic claims to bring in court because if they cannot hire a lawyer because they have a small, individualized claim that will not lead to a class action, they are just out of luck.

Senator LEE. Okay. Mr. Rutledge, in your written testimony, you talk about the importance of relying on sound empirical research before proceeding with legislation in this area. What are the risks involved in legislating in this area without an adequate, robust, empirical basis for doing so?

Mr. RUTLEDGE. Thank you for the question, Senator. I would identify two.

The first would be the lack of a proper apples-to-apples comparison. So, for example, oftentimes arbitration is criticized and then the response becomes, "Compared to what?" So, for example, one of the frequent dynamics in the debate is that we should not have arbitration and in lieu of it should be class actions. And as I indicated in my testimony, a number of individuals have written, including my colleague at the University of Georgia, Jaime Dodge, that it is not clear that in the aggregate the class action apple is superior to the arbitration apple. For example, the settlement that the class action may generate may have a relatively low take rate, which is simply the rate at which the members who are brought into the class actually redeem the benefit. And at the same time, if they do not redeem the benefit, and yet they are bound by the decision in the class, they are effectively precluded from bringing their own claim at that point. So that would be the first concern.

The second concern would be that there may be instances in which the regulation goes on to harm the very individuals whom it is designed to protect.

So as you may be aware, one of the early iterations of incremental legislation that sought to invalidate pre-dispute arbitration agreements concerned contracts between automobile dealers and manufacturers. And many of the arguments that you hear today were raised in that debate. It turned out that there was one reported instance after that legislation was enacted where the dealer wanted to arbitrate and yet the legislation precluded the dealer from doing so.

And so those are the two risks that I would draw to your attention in the time that I have. Thank you.

Senator LEE. You seem to not believe that it is certain that we are going to have a flood of arbitral class waivers, we are not nec-

essarily going to see a mass migration to arbitral class waivers. Help us understand what factors influence that thinking.

Mr. RUTLEDGE. Sure, and I think it is important for me to clarify something in my testimony, because this is a complex issue. What my testimony is suggesting and what I think the CFPB preliminary report indicates at page 19, for example—excuse me, page 21, is that simply because the Supreme Court hands down a decision that seems to approve of a particular type of contracting practice in a given industry, that firms in that industry will not necessarily flock to that practice. In my paper that is attached to my testimony, that is the point we make about franchise contracts and I think in the CFPB report, again, taking into account the settlement that Senator Franken and I were sort of exchanging over a little while ago, at least at present for the credit card industry.

Now, I want to differentiate that from a different situation that I talk about in my testimony, which is the use of class waivers among those entities that do employ arbitration clauses. And here I wish to acknowledge that where the empirics lead us is that both in the franchise context and in the credit card context, for those companies that do use those clauses, that there is an increased incidence in the use of the class waiver.

My point is simply this: that the debate often occurs on sort of homogeneous terms, that industries can be sort of compared and that practices of firms within industries can be compared. And what I think the empirical research reveals is that is not necessarily true. There are certain industries, to the extent we have access to the data, where this is used more frequently than others, and there are certain firms within given industries where we have access to the data where the use appears more or less likely. And my point simply to you and your colleagues is to understand the dynamics that are driving those decisions before generalizing from a particular case or a particular firm's activity as to how an industry or how a particular set of firms is behaving.

Thank you.

Senator LEE. Thank you.

Senator FRANKEN. Thank you, Senator Lee.

I think part of the exchange that we had, which was me smiling at something you said, was talking about apples to apples. And I thought that when you were talking about some of the CFPB results, you were not comparing apples to apples. When you said 17 percent, only 17 percent of—I will get to that in some questioning, but I think that when we talk about sound empirical research, we should—the word “sound” is very important.

We will go to Senator Whitehouse.

Senator WHITEHOUSE. Thank you very much. First of all, Mr. Carlson, I am sorry for your experience, but I thank you for coming here to testify and to share your experience with us.

It strikes me that if the ability of individual consumers to aggregate their claims is eliminated, and whether that is done by Congress deciding that we are just not going to allow small claims to go forward, or whether that is done by the corporate malefactor sneaking something into a contract, a consumer contract that prevents them from exercising what would otherwise be their legal

rights, it strikes me that that creates a zone where fraud is encouraged, where it is basically given a free pass.

It is interesting that we should be here today, because this very morning we had the hearing on the patent troll legislation. In that case, in that hearing, the issue was the so-called patent trolls who engage in frivolous litigation and threaten companies, and the argument there is that the cost of litigating with the patent troll makes it irrational to fight back and so people concede to settlements. And the room was filled. Everybody was excited about that notion. And here we have legitimate victims of what somebody has found to be wrongful or fraudulent behavior who try to engage in legitimate litigation to vindicate their rights against the fraudster, and here the cost of litigating would make it irrational to fight back. And it is almost the flip side.

Let me ask you, Professor Gilles, what is your observation about what message corporate America would take from the ability to have no redress for low-dollar but large-scale frauds that they commit? Let us say that the telephone company figures out a way to put a bogus \$1 charge on every single bill that you make, and by the time you figure it out, you know, maybe for a year they did it, so you are owed 12 bucks. They cheat millions of people, so they earn millions of dollars. Who is going to stand up for them when the only possibility of return is 12 bucks back?

Ms. GILLES. Thank you for the question, Senator Whitehouse. No one is going to stand up for them.

Senator WHITEHOUSE. Stand up against them.

Ms. GILLES. Stand up against them. No one can be the voice of the consumer who is subject to a hidden cost, a fee that they do not even notice, you know, whether it is 1 month in or 12 months in, they do not even notice it; and when they do, it is of such a small value, such a small amount, that it is not worth it to them to arbitrate these claims.

Senator WHITEHOUSE. So if we allow the corporations themselves to put these tricks and traps into their consumer contracts, we are basically giving them open season for low-dollar, high-volume fraud on consumers.

Ms. GILLES. We are. That is exactly what we are doing. It is a mandate to violate the law, and—

Senator WHITEHOUSE. It is not a mandate. A permission.

Ms. GILLES. A permission, right. The Supreme Court's decisions I think are certainly a mandate.

And I do want to respond a little bit to what my colleagues at the end of the table said just a little bit ago. Mr. Parasharami noted, in response to Senator Lee, that the class actions have no value. Class actions, let us remember, everyone, that class actions desegregated schools. They made workplaces fair and equal. They have prohibited problematic police practices. They have uncovered and detected all sorts of consumer frauds. Class actions have done a tremendous amount of good, and I think that Mr. Parasharami's memo—I would not call it an empirical study because it is just 148 cherry-picked class actions that Mayer Brown thinks did not provide enough value to consumers. I think that is not a real study. The real study we have is the CFPB report, which really takes a

very good look at the number of arbitration clauses that we are seeing in these agreements.

And just again on Professor Rutledge's testimony, it is not—first of all, I think that 43 and 63 percent are quite high numbers to find in franchise agreements. But setting that aside, the CFPB finds that we are looking at 9 out of 10 contracts in the consumer finance area with these forced arbitration clauses, which means that consumers cannot bring these claims because these claims are inherently collective claims. So when Alan has a problem because he thinks that Amex is charging him too high a rate and he would like to get together and pool resources with other restaurateurs and small businesses, independent book stores, hardware stores, to bring a claim under the Sherman Act against American Express, the only way he can do that, the only way he can afford a \$1 million expert report on antitrust impact and injury is if he is able to bring it as a class.

So Amex, by putting this class action ban in their card acceptance agreement, is basically ensuring that they will never be held accountable under the Sherman Act. And this is really interesting for Amex, of course, because just last Friday Judge Gleason in the Southern District approved a settlement in a claim against Visa and MasterCard, a class action, for exactly the same behavior. So Visa and MasterCard are paying \$7 billion—so that is worthwhile class relief—\$7 billion, a record settlement. Amex is getting away without anything because they happened to put some magic words in their arbitration agreement. I think that is very unfair.

Senator WHITEHOUSE. As somebody who has now spent a term of 6 years in the Senate and begun to observe some of the behavior around here, I wonder what the response would be like if corporations in consumer contracts down in the fine print, in tricks and traps, instead of taking away consumer rights, particularly consumers' rights protected by the Seventh Amendment, were, say, taking away gun rights protected by the Second Amendment. I think you would have a completely different story, and that suggests to me—

Ms. GILLES. I think the room would look like it did this morning, right? It would be full.

Senator WHITEHOUSE. It would look very different, and you might actually see different positions taken by the different sides. I think a lot depends on whose ox is being gored here, and right now it is the consumer's.

Ms. GILLES. But the truth is that really there is nothing to keep a corporation from inserting all sorts of remedy-stripping terms in its arbitration provisions. The Supreme Court's language—

Senator WHITEHOUSE. The Supreme Court has announced no limit—

Ms. GILLES. No limit.

Senator WHITEHOUSE [continuing]. On what corporations can do—

Ms. GILLES. The FAA protects everything. It is sacrosanct. So if I am a corporation, I am going to put a lot of stuff in there.

Senator WHITEHOUSE. Go for it. Why not?

Ms. GILLES. I am going to violate Title VII. I am going to violate the ADA.

Senator WHITEHOUSE. Chairman, my time is——

Ms. GILLES. Sorry.

Senator WHITEHOUSE [continuing]. Concluded, so thank you very much.

Senator FRANKEN. You are doing so well.

Senator HIRONO.

Senator HIRONO. Thank you, Mr. Chairman.

My series of questions really related to the extent of these arbitration clauses because they are, I think, becoming more and more prevalent, and it seems to me that if you are a corporate lawyer or an in-house counsel, it would be practically malpractice not to advise your clients, your corporate clients, to have these kinds of remedy-stripping clauses in their contracts. Would you agree, Ms. Gilles?

Ms. GILLES. Absolutely, and obviously Mr. Parasharami can speak to this more than I can, but I think he——

Senator HIRONO. I think I heard him say he advised his clients——

Ms. GILLES. Yes, he probably does, and though he tells us in his testimony that he advises his clients, which are all, you know, Fortune 500 companies, to put fair, consumer-friendly arbitration clauses in their contracts, let us be clear. A class action ban is inherently not consumer friendly, because a consumer cannot bring a collective claim when there is a class action waiver.

So, really, it does not matter how many cost-shifting provisions, how many promises to pay a bounty or a premium are put in these arbitration provisions. The truth is Alan is not going to go arbitrate one on one against Amex. It would just be too expensive no matter what the company puts in the agreement.

So, yes, I think at this point the next interesting case to watch is the malpractice claim that is brought against a transactional attorney for failure to put one of these in a clause.

Senator HIRONO. Mr. Carlson, thank you very much for being here because you have been through a lot in pursuing your claims. We did hear testimony that arbitration clauses are good because they save money and these savings are passed on to consumers. But in your case, you wanted to pass on some discounts, et cetera, to your customers at your restaurant, but because of this tying arrangement, which is basically practically a per se antitrust violation, you did not have that freedom to do that, so your consumers, your customers suffered for that.

Mr. CARLSON. Was that a question there?

Senator HIRONO. I guess that may have been a rhetorical question.

I have another question for Professor Gilles. This bill that we are considering, basically, you know, the language says that no pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of an employment dispute, a consumer dispute, antitrust dispute, or civil rights dispute.

Now, what about shareholder disputes? Do you think that this language covers those kinds of disputes?

Ms. GILLES. I do. I think that investors are consumers, and I think that there is a lot of support out there for providing investors

with the opportunity to go to court as opposed to going to arbitration. So I think so.

Senator HIRONO. Well, I would not be so sure that consumers could be deemed—that investors could be deemed consumers. Perhaps we need to make sure, because I am holding letters from over 200 major domestic and foreign institutional investors who are very concerned that the SEC has not promulgated a rule that would disallow forced arbitration clauses in shareholder disputes. So perhaps we need to make that clear, because these 200 major entities include just about every State's retirement and pension funds. That is a lot of people. We are talking about some collectively managing assets that exceed \$4.9 trillion, and they are concerned that there are these forced arbitration clauses in their contracts with their brokers or whoever, and they cannot go to court.

Ms. GILLES. Well, you know, I think you could certainly clarify the language. I think of investors as consumers because when you are talking about these sort of public pension funds, you are talking about firefighters and teachers and other ordinary folks who look just like a lot of the other consumers that we are talking about today. But I applaud the Committee's effort here, and if you want to go further and be clearer that you are also covering investors, I think that would probably save a future court a lot of time.

Senator HIRONO. That would certainly make me feel a lot better knowing that there are so many different ways that these arbitration clauses can be written to head people off at the pass.

Thank you, Mr. Chairman.

Senator FRANKEN. Thank you, Senator.

Senator Blumenthal.

Senator BLUMENTHAL. Thank you, Mr. Chairman.

As you may have gathered, I think the majority of members of this panel who are here today agree that arbitration sometimes violates basic fairness and sometimes even constitutional rights. But the members of the panel who are not here might not be part of that consensus. And, likewise, Members of the Senate may not be in agreement that we need to change the law to restrict arbitration, although I have been a long-time advocate of making sure that consumers are protected from arbitration clauses that may not be clear or conspicuous, hidden in the fine print, as one of you observed.

So I think we have political obstacles to overcome here, and not the least of them are the interests of corporations that are loathe to go to court to be subjected to claims based on liability for violations of law related to financial practices or product defects or a range of violations of consumer rights.

But I think there is one area where there ought to be total and complete consensus, and that is that our servicemen and servicewomen should be protected not only in name and rhetoric, but also in reality, which, Ms. Teske, your testimony I think powerfully supports. And, in fact, regrettably, going back to reports from the Department of Defense and others since then, many servicemen and servicewomen have been victims of violations of rights, whether it is in foreclosure of their homes, repossession of vehicles or other personal property, protections against judgments, where they may not even have appeared, evictions. The whole idea is that when

they are on active duty they often cannot focus on these areas of life, not to mention appear in court or in proceedings preliminary to court proceedings or arbitration proceedings.

So I guess my question is whether there is a way to deal very specifically in a focused and targeted way with these violations of basic fairness that you outline in your testimony, a targeted way through the Servicemembers Civil Relief Act or through some other mechanisms, to make sure that we are protecting our men and women in uniform.

Ms. TESKE. Thank you for that question. There is. I mean, certainly there is precedent for that. In the Military Lending Act, there is a provision that for a narrow set of contracts you cannot have forced arbitration clauses. We could do the same through amendment of the Servicemembers Civil Relief Act to make clear that they cannot be forced into arbitration and that they do have the right to bring class actions in a court of law. And I think that would be a great step forward, at least for the servicemembers.

But one thing that I do want to point out in addition to that is that our servicemembers are also consumers, and they have a whole host of rights under scores of consumer protection statutes. By amending the Servicemembers Civil Relief Act, although that is a major step forward, we are still leaving them open to forced arbitration for all the other consumer protection violations that they are victims of.

So I would applaud any effort to provide protections, further protections for servicemembers under the Servicemembers Civil Relief Act, but I think we also cannot forget that the 2 million men and women that serve in our military are also consumers, and their families are consumers, and employees.

Senator BLUMENTHAL. I accept and I applaud that comment, and I agree completely with it that they ought to be viewed as consumers in those other contexts as well. But I am thinking about what is achievable strictly in raw political terms, because I have not been here as long as Senator Franken or Senator Whitehouse, but I do know that often we are frustrated in trying to achieve these kinds of reforms.

Mr. Parasharami, I wonder if I could ask you whether you would have the same objections that you have outlined in your testimony to that kind of focused and targeted bar on arbitration for our servicemen and servicewomen who may literally, physically, not have the ability to make use of these arbitration clauses?

Mr. PARASHARAMI. I suppose I do not think that it is a good idea, and, you know, I should say absolutely I respect our servicemembers. You know, what they do is so important, and I would not want to take anything away from them.

If the question is how can they realistically achieve resolution of most of the claims that they have, most people have consumer disputes that are small and individualized. Class actions just necessarily cannot help them because if a claim is individualized, it cannot be brought on a class basis.

And so then the question is: Well, which is better: going to court or going to arbitration? And it turns out that arbitration is cheaper in many instances because companies pay all of the costs of arbitration, and it is more flexible. You do not have to take a day off

work, and when you are servicemember, a day off work is impossible. You can do it remotely. You can do it by telephone. You can do it by mail. And in many cases now, e-mail is the preferred form of communication with arbitration organizations. So I think it is actually more realistic to resolve claims on an individual basis through arbitration than through court.

Senator BLUMENTHAL. What would you say to that, Ms. Teske?

Ms. TESKE. Thank you. I have been listening and just kind of shaking my head. It is not reality. It is just not reality to say that servicemembers are going to have a better chance going into arbitrating their claims. We have seen time and again that a very, very small number of consumers and probably a much smaller number of servicemembers are going to go and take their claims to arbitration. What is happening really here is claim suppression. The majority of servicemembers, (A) are not going to know their rights under the Servicemembers Civil Relief Act, and (B) they are not going to have the time or put forth the effort or the energy to be able to bring these individually.

So, yes, in some cases it is appropriate for an individual court action, and if they want to voluntarily take it to arbitration, I think that is great. But it has to be voluntary.

But in many cases, the corporation that is breaking the law, the Servicemembers Civil Relief Act, is doing it on a widespread basis. It is a corporate practice. Or they have not put into place procedures to comply with the SCRA protections. And so in those situations, a class action is the best vehicle to go forward, and we have seen that in cases already.

So to say that, no, we should not have the ability to bring class actions for our servicemembers and that they should be forced into arbitration because that is a better route for them I think is disingenuous.

Senator BLUMENTHAL. Thank you. My time has expired. I welcome and appreciate all of your testimony. It has been very, very helpful and important, and thank you for being here today.

Thank you, Mr. Chairman.

Senator FRANKEN. Thank you, Senator Blumenthal.

I have some more questions I would like to ask the panel, and so we will have a second round.

Professor Gilles, in his written testimony Professor Rutledge argues that we have not seen an explosion of arbitration clauses and class action waivers in franchise agreements. Then on page 11 of his written testimony, Professor Rutledge says, "last week's CFPB report of preliminary results told a similar story in several sectors of the consumer financial services industry."

My reading of the CFPB report was nearly the opposite, and I think this gets to the apples and oranges, because he was talking about 17 percent of, you know, I guess the companies that do this using these contracts. But an enormous percentage of the contracts have the clauses in actuality.

So can you speak to—I mean, what is your take on this? My reading was that the report indicates that arbitration agreements and class action bans are extremely prevalent among outstanding credit card loans, insured deposits, and pre-paid cards. When some-

one is saying we have got to compare apples to apples, isn't it incumbent upon you to do that? And just what is your take on this?

Ms. GILLES. I read the report the way you do. And I say that not just because you are chairing this hearing. I read the report, the CFPB report—and it really is the best empirical study we have out there. I read it as saying that basically 9 out of 10 companies are using these forced arbitration clauses, that we are seeing almost 100 percent penetration of class action waivers—class action bans inserted in arbitration clauses, and I do not think that Professor Rutledge is—I do not think his testimony is accurate on that point.

Now, he did try to clarify in his answer to—or in his opening statement that he does agree that we are seeing many more class action bans, so maybe we are all on the same page on that, and that saves this testimony.

Look, I think it would be crazy for a company not to insert a class ban in its arbitration clauses. I am sure Mr. Parasharami tells every client to do so, because to do so is to ensure, unlike what Mr. Parasharami has testified to, that they will actually not have to be held accountable for any violations of law because very few consumers, employees, small businesses will ever bring an arbitration. And certainly there will never be any arbitrations near the numbers and near the significance of a class action. And, furthermore, the thing about arbitration, let us just be clear about what we are talking about. Arbitrations are private, they are sequestered, they are individual. You can only bring a claim for yourself. So maybe you do bring a claim, maybe Alan does decide to bring a claim, so he gets some money back from Amex. But, you know, Alan will have no power to actually change Amex's policy vis-a-vis every other card acceptance contract. That is what class actions do.

Senator FRANKEN. Let us talk about just how this affects people's daily lives. Here we have a restaurant, a guy who went to culinary school, moves out west, opens a restaurant, has a few in Oakland. If I get out to Oakland, I am going to Italian Colors.

[Laughter.]

Senator FRANKEN. Because it has been successful a long time, I know the food is good there.

Okay. That is how he is affected by this. He cannot pass on savings to his customers. He is not allowed to tell them, "I will give you a little bit off if you use this card as opposed to this kind of American Express card. You can still use an American Express card. Just do not use this one that they make us do 5 or 6 percent on."

But let us just talk about everyday people. You, in your testimony, talked about a cable company—I think it was Time Warner—that added a modem—or did not add a modem, the modem was there. And suddenly, boom, \$4, \$3.95 is charged to every customer without any—they just added it. It is like a hidden fee. So that is what—you know, a hidden fee. We are talking about how this is going to save money.

Ms. GILLES. The thing that saves money for corporations is liability avoidance, which is what these clauses really result in, complete and utter avoidance of liability. So, yes, Time Warner, Comcast, Cox Cable, they can put in all sorts of hidden fees, and the consumer cannot do anything about it because the amount that they

are being overcharged is just so small that it is hardly worth, you know, staying on hold with customer service for half an hour, much less going into an individual arbitration to prove a claim that actually would be expensive to prove. So the only way these sorts of cases would ever get brought is in a class forum.

But to be honest, what I think your bill would do is it would actually return us to the status quo where corporations do not feel that they can engage in these widely dispersed, small-dollar harms because the class action threat, the deterrent threat is out there. I think that is what your bill would do.

Senator FRANKEN. And let us say there is actually a lot at stake in something. In 2011, I held a hearing on mandatory pre-dispute arbitration, and that is what we are talking about here. We are not talking about getting rid of arbitration. And I heard testimony from a doctor in a gender discrimination claim against her employer, a hospital, and the doctor showed—the doctor was forced into arbitration, and she testified how she showed up at the arbitrator’s office for the proceedings and saw shelves upon shelves of binders—she was the plaintiff—with the defendant’s name on it, clearly indicating that her arbitrator and the hospital had an ongoing business relationship. She lost the arbitration, and she left the proceeding feeling like she was not even really heard. She believed that the arbitrator was biased and did not give her a fair shake. This whole thing really undermined her trust in the system of justice.

Now, Professor Rutledge, in 2004, before you started working for the Chamber of Commerce, you actually wrote a fairly compelling argument about this sort of thing. You wrote, “Just as competition in the marketplace may provide some arbitrators independence, it may provide other arbitrators incentives to be beholden to particular parties or industries likely to nominate them.” You went on to say that arbitrators may “develop reputations with particular types of parties. For an example, an arbitrator may be perceived as industry friendly.” And you continued, “Through these activities designed to enhance their reputations, arbitrators generate business in the form of fees and hopefully future appointments.”

So I am curious. What would you say to that woman whose gender discrimination case was forced into arbitration and she came out believing that the fix was in?

Mr. RUTLEDGE. Senator, thank you for your question. Let me first begin by saying I do not know the details of the case that you are describing, so I am going to give the best answer that I can based on your description.

Senator FRANKEN. Sure. What would you say to her? I have related to you her testimony.

Mr. RUTLEDGE. I understand.

Senator FRANKEN. What would you say to her? That is the question.

Mr. RUTLEDGE. I understand.

Senator FRANKEN. What would you say to her?

Mr. RUTLEDGE. Senator, I think what I would say is that if you believed you were wronged and we can generate the evidence to demonstrate that you were wronged, we are going to find a way to get you relief. There are various ways in which that relief can be attained. It can be attained through litigation—

Senator FRANKEN. No, well, if you have a mandatory pre-dispute arbitration clause in it, no, they cannot. In fact, that is what this whole hearing is about. You just summed up the entire hearing. She cannot go to court.

Mr. RUTLEDGE. I understand, Senator.

Senator FRANKEN. So why did you say she could go to court? Isn't that what this is all about? I mean, isn't that what we are talking about? Isn't that what we have been doing for the last 2½ hours?

Mr. RUTLEDGE. Senator—

Senator FRANKEN. She cannot go to court.

Mr. RUTLEDGE. May I answer the question?

Senator FRANKEN. What would you say to the woman?

Mr. RUTLEDGE. We may go to litigation, that there are ways under current law whereby that arbitration clause can be challenged, and we will attempt to see whether that clause can be challenged. If it cannot be challenged, then we will go to arbitration, and there are upsides to arbitration, some of which Mr. Parasharami has referred to. And so, therefore, what I am trying to say, Senator, and what I tried to say to Senator Lee as well, is that, back to the point that you have made—and I agree with you—the apples-to-apples comparison is to try to discern which of these two systems is going to yield the better result for the aggrieved individual.

Can I make one other point just to—

Senator FRANKEN. Well, after I respond a little bit.

Mr. RUTLEDGE. Sure. I understand.

Senator FRANKEN. I asked you what to say to a woman who brought a gender discrimination suit to an arbitrator. She went in. The arbitrator had the name of the hospital—she was a doctor. No woman had been promoted in that practice, and she felt there was gender discrimination. She goes in; the guy in his office has folder after folder with the name of the hospital. She felt that the guy did not hear her. I asked you what you would say to her. The first thing you would say to her, “Well, I would go to court. You can go to court.” Well, no, you cannot go to court. Then the next thing you said, “Well, then we go to arbitration if we cannot go to court.” I told you she went to arbitration, and she felt that this guy—that the fix was in. And you yourself said—you yourself said in 2004—that arbitrators do this to get business. They develop reputations as friendly to industry. You said it. This is you. I read you back your own quote.

What would you tell her? “The fix is in, lady, ma’am. The fix is in.” And that is not our system of justice. Go ahead.

Mr. RUTLEDGE. Sure. Senator, there are two points that I am trying to make. One pertains to your question and one pertains to the apples-to-apples point from a moment ago.

What I am trying to say, as to this individual—and I apologize, Senator, if I misunderstood your question before. I had understood your question to be what I would say to her at the front end of the dispute, and I take it your question now concerns—

Senator FRANKEN. I asked you what would you say to this woman who testified here.

Mr. RUTLEDGE. I understand.

Senator FRANKEN. That is what I asked you.

Mr. RUTLEDGE. I understand, Senator. And I can understand that from her perspective that that result would be disappointing. And what I am saying, Senator, is that there are instances in which the civil litigation leaves people disappointed, too.

The second point that I just wish to make, Senator, because I am very much with you on the apples-to-apples comparison point, and I do not know if you have a copy of the CFPB report with you or can see it. To be very clear, Senator, if I could direct your attention to page 21 of the CFPB report?

Senator FRANKEN. I am there.

Mr. RUTLEDGE. This is the pie chart that you see. And what you see here in the sentence immediately below the pie chart, "Of the 393 credit card issuers, 67 issuers, or 17 percent, included arbitration clauses in their credit card contracts while 326 issuers, or 83 percent, did not."

That was the point that I was making about the low incidence of the use of arbitration clauses, and—

Senator FRANKEN. And my question about apples to apples and oranges to oranges was: What percent do those 17 percent have of the market?

Mr. RUTLEDGE. Absolutely, and to that, Senator, they have a large portion of the market. That is—

Senator FRANKEN. What percent would you say?

Mr. RUTLEDGE. Senator—

Senator FRANKEN. Do you think that is relevant?

Mr. RUTLEDGE. I understand—

Senator FRANKEN. Ms. Gilles, Professor Gilles, what percent of the market do they have?

Mr. RUTLEDGE. Senator, the answer is approximately 94 to 98 percent.

Senator FRANKEN. 94 to 98 percent.

Mr. RUTLEDGE. That is in a 2011 article that I published—

Senator FRANKEN. Okay. And you made the point—

Mr. RUTLEDGE [continuing]. And that is cited in my testimony.

Senator FRANKEN. Yes. So you made the point in your testimony that we need to compare apples to apples and oranges to oranges. And then you say that the CFPB report proves the point you have been trying to make today and uses your evidence that only 17 percent of credit card companies use these mandatory arbitration agreements without having the honesty, really, to say that, apples to apples, oranges to oranges, 94 to 98 percent of the market is that way.

Now, some credit union credit card company is not going to, you know, have any power over Mr. Carlson. That is the whole point of this. And when you talk about empirical evidence—and sound empirical evidence has to be done by objective people. That is what is sound empirical evidence.

By the way, you write in your testimony you cannot—I think I have said my piece on this. I just think that it is apples—I want to give Mr. Carlson the last word on this. You felt it was important enough to come here today across the country. This is a big deal. Why is this issue so important to you?

Mr. CARLSON. I think that is a terrific question. I was not doing this for money. I am trying to do it just to level the playing field

for all small business consumers so that they can make a fair living. You know, I got into this business not—I did not get into the restaurant business to get rich. That is not the industry I think you throw yourself into to say, “Oh, wow, I am going to work my ass off and make a fortune.” You do put in a lot of long hours, but for me the love and the passion comes from each guest that is satisfied, that you put a smile on their face. That is why I do it, and that is why I came here. I am just fighting for everybody else to have the same opportunity that I have been blessed with—that I have my own place. And it is not easy to do to try to find money to start a business and to grow. As a human, you know, you want to challenge yourself, and it is nice when people give you a handout and help a little bit, and that is all I am trying to achieve here. Thank you very much.

Senator FRANKEN. Thank you. I would like to thank you, and I would really like to thank all the witnesses for their testimony.

I would also like to submit letters and statements for the record from more than a dozen professors, advocates, and interested organizations. I was especially pleased to receive written testimony from Mike Rothman, Minnesota’s Commerce Commissioner, who is working hard to enforce the law in my State, and I would like to thank him for his service to Minnesota.

[The letters and statements referred to appear as submissions for the record.]

Senator FRANKEN. I think that the case for the Arbitration Fairness Act is pretty clear. I think we saw that when you come down to what this is. You cannot go to court. With *Concepcion* and *Italian Colors* on the books, the Federal Arbitration Act has become a tool that the big corporations can use to avoid their obligations under the law. As Mr. Carlson put it, we are basically at a point where big corporations can write their own rules. We have heard today this has had a profound impact on consumers, workers, and small businesses, and simply put, it is not fair. It is not fair that powerful corporations can cheat consumers out of their hard-earned money or that they can withhold wages or turn a blind eye to workplace discrimination and that they can overcharge small businesses, that they can falsify affidavits and foreclose on active-duty servicemembers who are overseas, that they can do all of this knowing all along that there is little, if anything, that the consumer, worker, small business, or soldier can do to make it right for those who have been harmed.

When I went to Walter Reed the first time and they ask you—I do a lot of USO tours, and they ask you to go to Walter Reed, and you think, “How am I going to cheer up somebody who has lost legs?” The first guy I met was from Anaconda. He lost two legs from a mortar. The Arbitration Fairness Act will restore access to justice for millions of Americans. I would urge my colleagues to join me in that effort.

We will hold the record open for 1 week for submission of questions for the witnesses and other materials.

The hearing is adjourned.

[Whereupon, at 4:45 p.m., the Committee was adjourned.]

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



# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Witness List

Hearing before the  
Senate Committee on the Judiciary

On

“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court  
Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”

Tuesday, December 17, 2013  
Dirksen Senate Office Building, Room 226  
2:00 p.m.

### Panel I

Leslie Overton  
Deputy Assistant Attorney General for Civil Enforcement, Antitrust Division  
U.S. Department of Justice  
Washington, DC

### Panel II

Alan Carlson  
Owner  
Italian Colors Restaurant  
Oakland, CA

Myriam Gilles  
Professor of Law  
Benjamin N. Cardozo School of Law  
New York, NY

Vildan Teske  
Partner  
Crowder, Teske, Katz, & Micko, PLLP  
Minneapolis, MN

Archis A. Parasharami  
Partner & Co-Chair, Consumer Litigation & Class Actions practice  
Mayer Brown LLP  
Washington, DC

Peter Bowman Rutledge  
Associate Dean for Faculty Development  
Herman E. Talmadge Chair of Law  
University of Georgia School of Law  
Athens, GA

PREPARED STATEMENT OF HON. CHUCK GRASSLEY

**Live Statement of Ranking Member Grassley of Iowa  
Senate Committee on the Judiciary,  
Senate Judiciary Committee Hearing "The Federal Arbitration Act and  
Access to Justice: Will Recent Supreme Court Decisions Undermine the  
Rights of Consumers, Workers, and Small Businesses?"  
Tuesday, December 16, 2013.**

Mr. Chairman, thank you for holding this hearing. It's always helpful to have experts in particular areas of the law come here to testify. I expect we'll learn a great deal today from our panel of witnesses.

The Federal Arbitration Act was enacted in 1925 "in response to widespread judicial hostility to arbitration agreements." Courts have held that the Federal Arbitration Act reflects the fundamental principle that arbitration is a matter of contract. And the Supreme Court, as we'll discuss today, has said that courts are to place arbitration agreements on equal footing with other contracts.

We find arbitration agreements in many consumer contracts. These form contracts used in cell phone service agreements or credit card agreements routinely include an arbitration clause. Sometimes we read these agreements; sometimes we don't. But then again, form contracts have long outnumbered custom drafted contracts. So this isn't something new.

As with anything, there are pros and cons to arbitration clauses. We'll hear about both today. I expect we'll also hear that businesses, in the wake of recent Supreme Court cases, still must decide whether to include arbitration clauses in their user agreements. Despite the predictions from some that arbitration clauses would become the default position.

I look forward to hearing from our witnesses today. Particularly, I look forward to testimony explaining what we can expect following the Supreme Court's decision in the *American Express* case. Absent class action provisions, will consumers really lack an ability to have their dispute adjudicated? Also, what direction will we see arbitration clauses move going forward?

In the wake of the *American Express* and *AT&T Mobility* cases, I hope the witnesses can separate myth from reality, today, and give us a clear picture of what's next.

Thank you again, Mr. Chairman. I look forward to this hearing.

PREPARED STATEMENT OF HON. ORRIN G. HATCH

Orrin G. Hatch

Mr. Chairman, I wish I could stay and engage with the fine witnesses before the committee, but I have other obligations.

I did want to at least briefly stop by to say that this is a very important issue and to ask if I could submit written questions to the witnesses.

Those questions emphasize that litigation is the alternative to arbitration.

The bill before us would not only prohibit arbitration, but actually terminate arbitration agreements that parties have already entered into.

Before taking a dramatic step like that, we must consider whether the alternative of litigation would be even worse in various respects than what critics say about arbitration.

Is the case against arbitration so complete, and the alternative of litigation so much better, than we should prohibit arbitration clauses altogether?

I am very skeptical about the answer but want to explore that with the witnesses through the written questions I will submit.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF HON. PATRICK LEAHY

**Statement of Senator Patrick Leahy (D-Vt.),  
Chairman, Senate Judiciary Committee  
Hearing on  
“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court  
Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”  
December 17, 2013**

Today’s hearing focuses on an important issue that has been before the Committee for too long: the use of mandatory arbitration clauses in contractual fine-print that routinely deny American workers, small businesses and consumers their day in court.

The Supreme Court’s recent decision in *American Express v. Italian Colors Restaurant* continued a troubling pattern that allows corporations to hide behind mandatory arbitration clauses that are inserted in contractual fine print that customers have no choice but to accept. In the 2011 case *ATT v. Concepcion*, customers who wished to join together to challenge their phone company’s conduct were barred from doing so because their cell phone contracts forced them to individually arbitrate all claims. In *American Express v. Italian Colors*, small businesses found themselves in the same position when they were prevented from bringing a class action against their credit service provider, even though each plaintiffs’ cost of individually arbitrating each claim would far exceed any potential recovery.

In each instance, the plaintiff was not only denied their Constitutional right to a jury trial; they were also found to have “waived” their right to bring their claims as a class action. The result gives corporations a free pass: since most victims’ claims are too small to warrant pursuing individually, their injury goes unaddressed and corporate bad conduct goes undeterred.

When Congress passed the Federal Arbitration Act, it was intended to give sophisticated business interests an alternative venue to resolve their disputes. It was not intended to become a shield for large corporations to use against their individual customers so they may never obtain justice. Unfortunately, the Supreme Court’s expansive rulings in these cases have done just that. Again and again, Americans are being denied their day in court or the power to bring their claims in a class action because of contractual clauses they have no choice but to accept. The Court has even held that State legislatures cannot act to prohibit such mandatory arbitration clauses, because they are preempted by the Federal Arbitration Act. In the financial services sector, corporations are using the same logic to challenge the Financial Industry Regulatory Authority (FINRA)’s effort to ban mandatory arbitration clauses, despite their clear impact on investors’ ability to enforce their rights.

Every American should have meaningful legal recourse to resolve disputes. Arbitration may achieve that goal in some cases, but it is appropriate only when consumers enter into it knowingly and with true consent. I am proud to cosponsor the Arbitration Fairness Act to promote this policy.

We must continue to focus on this important issue that undermines consumer choice and allows corporations to shield themselves from accountability. I thank Senator Franken

for chairing this hearing and for his leadership on this important issue to protect American workers, businesses and consumers.

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## PREPARED STATEMENT OF SHELDON WHITEHOUSE

**Statement for Judiciary Committee Hearing on “The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**  
**Senator Sheldon Whitehouse**

Thank you, Senator Franken, for chairing this important hearing and for giving me the opportunity to share my thoughts. This hearing comes at an important time—a time when corporate victories in the Supreme Court relating to arbitration, pleading, class actions, and punitive damages have made it harder for individuals to get to a civil jury, and harder for the civil jury to play its intended political function in our society.

I want to start by addressing the topic of this hearing: the effect of recent Supreme Court decisions interpreting the Federal Arbitration Act on access to justice. For a long time, the Supreme Court interpreted the 1925 law, which provides guidance to courts applying commercial arbitration agreements, narrowly. This began to change in the 1980s and 1990s, and in 2001, the Court expanded the Act’s coverage of employees involved in “interstate commerce.” More recently, the Court has gone further—even holding, in *Rent-A-Center v. Jackson*, that arbitrators may adjudicate whether arbitration clauses, which bring them business, are unconscionable. Since the Court’s decisions in *AT&T Mobility v. Concepcion* and *American Express v. Italian Colors*, moreover, mandatory arbitration clauses can deprive consumers and small businesses of access to class action litigation. Taken together, the recent case law has established a presumption in favor of arbitration that tips the balance the wrong way. Often, defendants benefit from hidden evidence, secret proceedings, limited or no review, and prohibitive costs for injured parties. With the jury removed from the picture, there is no longer a role in these cases for American citizens to apply and uphold our laws, protect the rights of individuals, and hold the powerful accountable. As a result, we are changing from a society where all parties must stand equal before a jury to one in which injured parties must seek relief directly from the corporations who injured them or through corporate-funded dispute resolution systems. As Justice Kagan put it in her powerful *Italian Colors* dissent, the Supreme Court has sent the message to those left with no meaningful legal recourse that “it’s too darn bad.”

The Founders envisioned the civil jury as Sir William Blackstone had, as a means of preventing “the encroachments of the more powerful and wealthy citizens.” Unfortunately, today’s most powerful and wealthy beings—corporations—view jury trials with annoyance and hostility. Juries have become a thorn in the side of these influential corporations, which are used to special treatment elsewhere in

government but, before a jury, must stand equal before the law. In this context, it should come as no surprise that corporations spread a mythology of greedy trial lawyers, runaway juries, abusive discovery and preposterous verdicts. It also should come as no surprise that corporations use their power to insist on contracts depriving their victims of fundamental jury rights.

It is against this backdrop that we in Congress must act. We must eliminate mandatory binding arbitration from consumer and employment contracts because all the statutory protections in the world will mean very little if the wrongdoers can shunt the injured from courts to arbitration. We must pass bills—like the Arbitration Fairness Act—that would prohibit the enforcement of pre-dispute arbitration agreements. We must keep pressing the fight in Congress, and must restore the jury to its proper role in our democracy.

PREPARED STATEMENT OF LESLIE C. OVERTON



# Department of Justice

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STATEMENT

OF

LESLIE C. OVERTON  
DEPUTY ASSISTANT ATTORNEY GENERAL  
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY  
UNITED STATES SENATE

HEARING ENTITLED

"THE FEDERAL ARBITRATION ACT AND  
ACCESS TO JUSTICE"

PRESENTED ON

DECEMBER 17, 2013

STATEMENT  
OF  
LESLIE C. OVERTON  
DEPUTY ASSISTANT ATTORNEY GENERAL  
ANTITRUST DIVISION  
BEFORE THE  
COMMITTEE ON THE JUDICIARY  
UNITED STATES SENATE  
HEARING ENTITLED  
“THE FEDERAL ARBITRATION ACT AND  
ACCESS TO JUSTICE”  
PRESENTED ON  
DECEMBER 17, 2013

Mr. Chairman, and distinguished members of the Committee, I appreciate this opportunity to appear before you today to share with the Committee the position that the United States put forward in its brief in the Supreme Court as *Amicus Curiae* supporting Respondents, in *American Express Company, et al. v. Italian Colors Restaurant, et al.*, No. 12-133 (January 2013). The United States filed its brief because of its concern that the effect of the mandatory arbitration agreement in the facts of that case would prevent respondents from being able to effectively vindicate their rights under the antitrust laws.

**Background**

The respondents in *Italian Colors*, the named plaintiffs in a consolidated set of putative class actions, were merchants who accept American Express cards. The merchants alleged that petitioners—American Express Company and a wholly owned subsidiary (American Express)—violated Section 1 of the Sherman Act, 15 U.S.C. § 1, by engaging in an unlawful tying arrangement. Specifically, the merchants alleged that American Express used its market power in corporate and personal charge cards to compel the merchants to accept American Express’ mass-market credit and debit cards at elevated merchant-fee rates.

The contractual relationship between American Express and the merchants was governed by the Card Acceptance Agreement (Card Agreement), American Express’ standard form contract for merchants. The Card Agreement required all disputes between the parties to be resolved by arbitration. The Card Agreement further provided that “[t]here shall be no right or authority for any Claims to be arbitrated on a class action basis,” and that “[c]laims ... may not be joined or

consolidated” with claims brought by other merchants. The Card Agreement did not permit the prevailing party to shift its costs to the other party, and it contained a confidentiality provision that prohibited the disclosure of information obtained in an arbitration proceeding.

The class action complaints were consolidated in federal district court, and American Express moved to compel arbitration under the Card Agreement’s mandatory arbitration clause. The district court held that the parties’ dispute fell within the scope of the Card Agreement’s arbitration clause, granted American Express’ motion to compel arbitration, and dismissed the suits. The district court rejected the merchants’ argument that the clause should not be enforced because the costs of individual arbitration would eclipse the value of any potential recovery.

The court of appeals reversed and remanded, noting that when “a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs.” *In re American Express Merchants’ Litigation*, 554 F.3d 300 (2<sup>nd</sup> Cir., Jan. 30, 2009), at 315 (citing *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000), at 92). The merchants, who bore the burden of demonstrating that they would face prohibitive costs in arbitration, presented expert evidence demonstrating that they would bear expert fees and expenses of at least several hundred thousand dollars, and possibly more than \$1 million. The estimated damages for the merchant with the largest volume of American Express transactions, however, amounted to only \$38,549 when trebled, as provided under the antitrust laws.

The court of appeals accordingly concluded that “the class action waiver in the Card Acceptance Agreement cannot be enforced in this case because to do so would grant [American Express] de facto immunity from antitrust liability by removing [the merchants’] only reasonably feasible means of recovery.” 554 F.3d at 320. The Supreme Court subsequently granted certiorari.

#### **The United States’ Brief**

The United States’ brief observed that under the Supreme Court’s precedents, agreements to arbitrate federal statutory claims are enforceable if, but only if, “the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum.” See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985). While the Federal Arbitration Act establishes a

generally applicable federal policy favoring the creation and enforcement of agreements to arbitrate, the “effective-vindication” rule reconciles this policy with the policies of a wide range of federal statutes that confer substantive rights and authorize private suits by aggrieved persons. The rule allows contracting parties to agree that their disputes will be resolved by an alternative adjudicator, while denying enforcement of an arbitration agreement in circumstances where its function would be, in practical effect, a prospective waiver of substantive rights.

The brief explained that the arbitration agreement at issue in *Italian Colors* effectively precluded the merchants from asserting their antitrust claims by making it prohibitively expensive for them to do so. Because the costs of proving the merchants’ claims would have greatly exceeded the potential recovery for any individual merchant, some mechanism for sharing or shifting costs would have been necessary to permit the merchants to effectively vindicate their claims in arbitration. But the arbitration agreement foreclosed all such methods, leaving the merchants with no practical means of establishing American Express’ alleged Sherman Act violations.

The United States’ brief argued that, because of restrictions contained in the arbitration agreement, the merchants had established that each merchant, proceeding individually, could seek redress for American Express’ alleged antitrust violations only by incurring expenses far greater than the maximum recovery an individual business could hope to obtain. No rational actor would attempt to bring a claim when a negative recovery is a certainty. Under the circumstances of that case, an order compelling arbitration therefore would preclude the merchants from effectively vindicating their federal claims.

The United States argued that under American Express’ approach, companies could use a combination of class-action and joinder prohibitions, confidentiality requirements, and other procedural restrictions to increase the likelihood that a plaintiff’s cost of arbitration would exceed its projected recovery. Companies could then require acceptance of unwieldy procedures as a condition of doing business, getting hired, or purchasing products. That would deprive a range of federal statutes of their intended deterrent and compensatory effect, without promoting the actual use of arbitration as an alternative means of dispute resolution.

This concludes my discussion of the United States’ brief. I would be happy to answer any questions you may have.

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**Alan S. Carlson**  
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**2220 Mountain Blvd.**  
**Oakland, CA 94611**

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**U.S. Senate Committee on the Judiciary**  
**Hearing:**  
**“The Federal Arbitration Act and Access to**  
**Justice: Will Recent Supreme Court**  
**Decisions Undermine the Rights of**  
**Consumers, Workers, and Small**  
**Businesses?”**  
**Tuesday, December 17, 2013**  
**2:00 p.m.**

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Good afternoon Chairman Franken, Ranking Member Grassley and members of the committee. I would like to thank the Committee for the opportunity to share my story here today. My name is Alan Carlson and I am the chef and owner of Italian Colors Restaurant, a small business located in Oakland, California.

I was born in suburban Detroit and have been working in the restaurant business in one way or another since I was 14 years old, when I started out washing dishes at a Greek diner. My passion for food grew into a career. In 1979, I graduated from the Culinary Institute of America in New York City. Afterwards, I traveled across America and worked with a number of chefs, absorbing new knowledge and skills from each opportunity. In the early 1980s, I settled in Oakland, California, and opened my first restaurant in 1986. Since then, I have started and run several restaurants in and around the San Francisco Bay area.

Nearly 20 years ago I opened Italian Colors with my wife, Dee Carlson-Cohen, and business partner, Steve Montgomery. Our goal was to create the quintessential neighborhood restaurant, geared toward community, quality food, and great customer service. I am incredibly proud to say that two decades later, we are still open, serving our community and employing more than 30 people.

However, like most local restaurants, our profit margins are razor thin. We survive through fostering client loyalty, keeping prices low, and cooking high quality food. Like so many other communities in the United States, we operate in a charge card and credit card-driven world and could not survive without accepting credit cards as payment.

To customers, one form of payment is as good as another, but for small businesses, that is far from the reality. In fact, American Express cards are pretty much the most expensive form of payment we must accept to survive.

A significant percentage of my restaurant's earnings comes from clients who use American Express cards. They are an extremely popular form of payment especially for diners who spend a lot of money at the restaurant because of all of the perks they offer. American Express imposes special rules and restrictions on restaurants and small businesses who must accept their cards as payment. For example, in order to accept *any* American Express card, my restaurant has to accept *all* types of American Express cards – even cards that carry rates and fees that are higher than all other forms of payment. In addition, American Express does not allow me to offer cash discounts or to encourage customers to pay with a form of payment that actually works better for my business. I cannot encourage my customers to pay in cash or debit cards by offering discounts or other incentives.

If I could offer discounts to my customers who use cash or their debit cards, or be able to say which cards make sense for me to accept, without being forced to accept all cards, I would be able to increase my earnings and decrease my costs – which means providing more services, having more employees.

Being forced to make a decision that is bad for my business isn't right. After talking about what I was facing with a long-time customer, friend, and attorney, Edward Zusman, he coordinated with anti-trust attorneys with whom he was acquainted and they decided to take up the cause. They believed that American Express was engaging in anti-competitive practices in violation of the antitrust laws. When I started with American Express in the early 90's my first agreement did not have an arbitration clause. To this day, I have not actually seen an arbitration agreement, but I have been told that in the late 90's they included an arbitration agreement as a term and condition of continued use of their cards. I did not know until the litigation commenced that that provision even existed.

Edward explained that forced arbitration means American Express cannot be held accountable in court, and that I will not be able to join with other small business owners to help defray the costs of enforcing our rights. Instead, if I want to hold American Express accountable, I would have to try to do it in an individual, private arbitration tribunal designed by American Express.

Needless to say, I was shocked. I honestly cannot recall *ever* even reading a forced arbitration clause, and certainly do not remember signing a contract that included one. But even if I knew the clause was in the fine print of the contract, American Express contracts are offered on a take-it-or-leave-it basis.

As we figured out how to move forward, we discovered that the cost of individual forced arbitration was so high that even if a small business won, it would lose. An expert economist explained in testimony that it would not be cost-effective for any small business owner in the same situation as me to pursue an individual arbitration claim against American Express. In fact, it would cost more to bring their claim than they could recover. This cost prohibitive system means that there is no way one small business can get justice alone.

Normally, every American has the right to join with others to fight to hold corporate giants accountable. But I don't, because of a forced arbitration clause buried in the fine print of terms and conditions imposed upon me years after I started taking American Express cards. If I cannot be part of a class action to enforce my rights against American Express, I have no way of enforcing those rights. I don't have the money to take on American Express by myself.

I tracked this case through the courts and I was very pleased with the results at the lower courts. Our case went all the way to the U.S. Supreme Court, where I thought surely justice would prevail. However, when the Supreme Court issued its decision in favor of American Express and forced arbitration, you can imagine my disappointment and shock. Essentially the Supreme Court was saying that it didn't matter that a small businessman couldn't pursue important rights against a big business.

Coming here today to testify before the Committee was difficult because I am in the process of opening a new restaurant. But the more I thought about it, the more I realized how

important it was for me to be here, to speak on behalf of small business owners like me who are struggling to stay in business and live the American dream.

This doesn't have to be the end of the story. It has become clear to me that certain congressional actions can and must be taken to help protect the small businesses on "Main Streets" across America. Small businesses and consumers should have the SAME access to the justice system as large corporations, like American Express. And corporate Goliaths should never be able to take away our ability to hold them responsible for their actions.

Sen. Franken has introduced a bill, the Arbitration Fairness Act, that would give back to small businesses like mine the right to go to court against big corporations instead of being locked into an arbitration system that is too expensive to use. I urge you to pass this bill to restore equal access to justice for small businesses and consumers.

In speaking to you, I hope I have been able to shed some light on just how critically important this issue is nationwide. Small businesses are the lifeblood of America and we play an essential role in creating good jobs. Small businesses, our customers, and really, our neighborhoods and communities are the ones who lose when Big Business gets to push us around. Please be assured that this is an issue that affects all small businesses.

Everyone in D.C. says that small businesses are important, and here is a real opportunity for Congress to actually do something to protect small businesses.

Please act swiftly to address these issues and know that I look forward to engaging in a meaningful conversation with the Committee members today. Thank you for your time and consideration.

PREPARED STATEMENT OF MYRIAM GILLES

# CARDOZO

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Myriam Gilles, Professor of Law  
Testimony to the Senate Judiciary Committee  
On the Arbitration Fairness Act of 2013 (AFA) [S. 878/H.R. 1844]  
Tuesday, December 17, 2013

“Too Dam Bad”

Chairman Leahy, Senator Franken, Committee Ranking Member Grassley, and other distinguished members of the Senate Judiciary Committee, thank you for inviting me today to participate in this important hearing. I hope my testimony will help to inform the discussion of the pernicious effects of mandatory, binding, predispute arbitration clauses on consumers, employees and small businesses; I also hope today’s hearing will spur this Committee to act on the proposed Arbitration Fairness Act, a vital amendment to the Federal Arbitration Act.

My name is Myriam Gilles, I am a law professor, writing and teaching primarily in the areas of tort law and class action litigation, and I have spent a lot of time over the past eight years researching, writing and lecturing about mandatory arbitration clauses in contracts with consumers, employees and small businesses. These clauses, which mandate one-on-one arbitration of all legal disputes and ban multiple claimants from pooling their claims, prevent individuals from vindicating their rights guaranteed by common law and by federal and state statute.

In 2005, I began studying the effects of mandatory, predispute arbitration clauses on consumers, employees and small businesses. That year, I wrote an article, which appeared in the *Michigan Law Review*, entitled *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*.<sup>1</sup> In it, I warned that corporate defendants were beginning to insert in their standard-form consumer contracts liability-avoiding arbitration provisions – clauses

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<sup>1</sup> 104 MICH. L. REV. 373 (2005).

requiring that disputes be asserted only in a one-on-one, non-aggregated proceeding. My research also showed that more aggressive clauses provided that consumers could not even be represented or counted as class members (in the event some other injured person managed to commence a class proceeding), and prohibited consumers from participating in the prosecution of any group action in any way. I predicted, back in 2005, that these arbitration clauses had “the capacity to derail putative class actions brought under consumer, antitrust, securities, employment and civil rights statutes, among other areas,” and that, absent broad legal invalidation, we would see these clauses in virtually all contracts that could even remotely form the predicate for a class action.<sup>2</sup> As a result, arbitration clauses would undermine corporate accountability and leave widespread wrongdoing unaddressed.

For a period between 2005 and 2011, my prophecies of doom-and-gloom looked like they might be proven incorrect. Just before my article went to press, the California Supreme Court decided a case, *Discover Bank v. Superior Court*, which declared that standard-form contractual prohibitions against class actions embedded in arbitration clauses were unconscionable as a matter of California state contract law and public policy.<sup>3</sup> The *Discover Bank* case ushered in a series of judicial decisions invalidating arbitration clauses on these grounds.<sup>4</sup> State and federal judges, Democrats and Republicans, in courts all around the country, recognized that remedy-

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<sup>2</sup> *Id.* at 412-3.

<sup>3</sup> 113 P.3d 1100 (Cal. 2005). The *Discover Bank* decision focused on the “important role of class action remedies in California law” as “the only effective way to halt and redress [consumer] exploitation,” and held that class action waivers in consumer adhesion contracts are unconscionable because they “may operate effectively as exculpatory clauses that are contrary to public policy.” *Id.* at 1106, 1108.

<sup>4</sup> *See, e.g.*, *Cooper v. QC Financial Services, Inc.*, 503 F Supp 2d 1266, 1290 (D. Ariz 2007) (Arizona law); *Caban v J.P. Morgan Chase & Co.*, 606 F Supp 2d 1361, 1372 (S.D. Fla 2009) (Delaware law); *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976, 985 (9th Cir. 2007) (California law); *Dale v Comcast Corp.*, 498 F.3d 1216, 1224 (11th Cir. 2007) (Georgia law); *Kinkel v Cingular Wireless LLC*, 857 N.E.2d 250, 274 (Ill. 2006); *Schnuerle v Insight Communications Company, LP*, 2010 WL 5129850, \*7 (Ky.); *Skirchak v Dynamics Research Corp.*, 508 F.3d 49, 59–60 (1st Cir. 2007) (Massachusetts law); *Ruhl v Lee’s Summit Honda*, 322 S.W.3d 136, 139–40 (Mo. 2010); *Fiser v Dell Computer Corporation*, 188 P.3d 1215, 1221 (N.M. 2008); *Muhammad v County Bank of Rehoboth Beach, Delaware*, 912 A.2d 88, 100–01 (N.J. 2006); *Tillman v Commercial Credit Loans, Inc.*, 655 S.E.2d 362, 373 (N.C. 2008); *Schwartz v Alltel Corporation*, 2006 WL 2243649, \*6–7 (Ohio App.); *Vasquez-Lopez v Beneficial Oregon, Inc.*, 152 P.3d 940, 953 (Or. Ct. App. 2007); *Thibodeau v Comcast Corporation*, 912 A.2d 874, 887 (Pa. Super Ct. 2006); *Herron v Century BMW*, 693 S.E.2d 394, 400 (S.C. 2010); *Scott v Cingular Wireless*, 161 P.3d 1000, 1009 (Wash. 2007); *Al-Saffin v Circuit City Stores, Inc.*, 394 F.3d 1254, 1261–62 (9th Cir. 2005) (Washington law); *Wisconsin Auto Title Loans, Inc v Jones*, 714 N.W.2d 155, 176 (2006) (Wisconsin law).

depriving arbitration clauses violated public policy by preventing people from vindicating the rights that legislatures and the common law give to them.<sup>5</sup>

Enter the Supreme Court of the United States, which has – in just a few decisions in recent terms – brought to life all my dire predictions.

The Supreme Court's 2011 decision in *AT&T Mobility v. Concepcion* (*Concepcion*)<sup>6</sup> and its most recent decision this year in *American Express v. Italian Colors* (*Amex*)<sup>7</sup> broadly upheld the use of mandatory arbitration clauses in contracts with consumers and small businesses, rendering them beyond legal challenge. A slim majority of the Court has repeatedly held that it simply does not matter whether claimants are unable to vindicate their rights in a one-on-one arbitration; all that matters under the Federal Arbitration Act ("FAA") is that the arbitration clause is enforced exactly as the company has written it up. In essence, the Court's recent rulings have interpreted the FAA, enacted in 1925, to mean that any remedy-stripping boilerplate term that is signed, clicked, or otherwise agreed to by consumers here in our 21<sup>st</sup> century economy must be fully enforced, never mind the policy implications.

For the Court's five-member majority, public policy serves no function in the legal determination of whether arbitration clauses are enforceable. It may well be, Justice Scalia recognized for the majority in *Concepcion*, that countless cases will "slip through the legal system" if boilerplate remedy-stripping arbitration clauses are enforced, but public policy doesn't matter.<sup>8</sup> And the reason policy doesn't matter, the Court held, is because the 1925 text of the FAA mandates that arbitration clauses are sacrosanct, and must be enforced exactly as they are written. As Justice Kagan wrote in her blistering dissent in *Amex*, "the nutshell version" of the majority view is simply this: "Too darn bad."<sup>9</sup> Congress enacted a remedial statute, but a one-on-one arbitration clause prevents you from vindicating your rights under that statute? "Too darn bad."

But here's the thing: "Too darn bad" may or may not be the right answer to an arcane legal question about the preemptive effects of the FAA – I'm not here to argue about preemption

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<sup>5</sup> See, e.g., Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of Concepcion*, 79 U. CHI. L. REV. 623, 633 (2012) (noting by, by 2011 when *Concepcion* was decided, fourteen states had ruled remedy-stripping arbitration clauses unenforceable on broad public policy grounds).

<sup>6</sup> 131 S.Ct. 1740 (2011).

<sup>7</sup> 133 S.Ct.2304 (2013).

<sup>8</sup> *Concepcion*, 131 S.Ct. at 1753.

<sup>9</sup> *American Express*, 133 S.Ct. at 2313.

principles – but “too darn bad” is a really lousy policy answer. And in fairness to Justice Scalia and the Court, they were not talking about policy. But we are talking about policy here today. As the preliminary results from the Consumer Financial Protection Bureau’s just-released Arbitration Study reveal, “nearly all arbitration clauses studied include provisions stating that arbitration may not proceed on a class basis.”<sup>10</sup> These clauses have become common place, and they are harming real people. So let’s look at what “too darn bad” means for real people in real cases:

- In recent years, thousands of people – young and old – have enrolled in various schools and programs that purport to offer career-enhancing training that will enable graduates to get better jobs. For-profit programs promising careers as medical assistants, paralegals, executive secretaries, dental hygienists, and assistant chefs are on the rise, as Americans worry about job security and seek ways to ensure continuing employment. But many of these programs systematically mislead prospective students in order to entice enrollment. They misrepresent the quality of the educational program, accreditation, career prospects for graduates, the availability of financial aid, and the actual cost of enrollment. And these institutions now regularly insert mandatory arbitration clauses in their enrollment contracts to ensure they cannot be subject to class actions by defrauded graduates. In case after case, courts have enforced these clauses, denying students the ability to vindicate their rights under state and federal law. In one case, students brought representative actions under California state law seeking injunctive relief against a for-profit school which had illegally targeted veterans and military personnel so that it could receive federal financial aid funds. A federal appellate court enforced the arbitration clauses in the enrollment contracts, finding the FAA preempted the state statute at issue, preventing these students from vindicating their rights.<sup>11</sup>
- Employers can now engage in widespread and difficult-to-detect wrongdoing, with little concern about liability. Even large employers, like Sears Roebuck & Co. and Macy’s,

<sup>10</sup> Consumer Financial Protection Bureau, Arbitration Study, Preliminary Results, Dec. 11, 2013, at p. 13, available at [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf). The CFPB reviewed 1241 credit card, checking and payday loan consumer disputes filed between 2010-2012 with the American Arbitration Association – the largest arbitral provider in the country. It found that nearly 90% of these clauses preclude class proceedings. *Id.* at 13, 37.

<sup>11</sup> See, e.g., *Ferguson v. Corinthian Colleges, Inc.*, 733 F.3d 928 (9<sup>th</sup> Cir. 2013); *Dean v. Draughons Jr. College, Inc.*, 917 F.Supp.2d 751 (M.D. Tenn. 2013); *Kilgore et al. v. KeyBank, National Association*, 2012 WL 718344 (9<sup>th</sup> Cir. 2012).

have added arbitration clauses to their employment contracts requiring all claims to be resolved in one-on-one arbitration. These arbitration clauses apply to disputes regarding the employment relationship, compensation, benefits, breaks and rest periods, termination, discrimination, or harassment; as well as claims arising under the Uniform Trade Secrets Act, Civil Rights Act of 1964, Americans with Disabilities Act, Age Discrimination in Employment Act, Family and Medical Leave Act, Fair Labor Standards Act, Employee Retirement and Income Security Act, Genetic Information Non-Disclosure Act, and all other state or federal employment statutes. In a recent typical case brought against Sears, Roebuck & Co. in San Diego, a district judge felt constrained to uphold the arbitration agreement, and dismissed the claims that store clerk Felipa Velazquez brought on behalf of herself and other employees who claimed the company failed to pay them minimum wage.<sup>12</sup>

- Many Americans use payday lenders for emergency loans and promise to repay the loan from their next paycheck, but some borrowers find it difficult to pay back the loan and the lender's fee.<sup>13</sup> In response, payday lenders have engaged in illegal and predatory practices: "some have made unauthorized debits from consumers' checking accounts or used aggressive methods to collect debts, such as posing as federal authorities, threatening borrowers with criminal prosecution, trying to garnish wages improperly, and harassing the borrower."<sup>14</sup> Today, nearly all payday lenders include mandatory arbitration clauses in their loan agreements to avoid liability exposure. In a recent case, a payday borrower brought an action against a lender, alleging it imposed a high rate of interest on loans in violation of state law. But her loan contract contained a one-on-one arbitration clause which barred class actions; in grudgingly enforcing the clause, the appellate court observed "post-*Concepcion*, courts may not apply state public policy

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<sup>12</sup> See *Velasquez v. Sears, Roebuck & Co.*, 2013 WL 4525581 (S.D. Cal. 2013). See also *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2<sup>nd</sup> Cir. 2013); *Morris v. Ernst & Young LLP*, 2013 WL 3460052 (N.D. Cal. 2013); *Andrade v. P.F. Chang's China Bistro, Inc.*, 2013 WL 5472589 (S.D. Cal. 2013); *Parisi v. Goldman, Sachs & Co.*, 710 F.3d 483 (2<sup>nd</sup> Cir. 2013).

<sup>13</sup> See CFPB Arbitration Study, *supra* note 10, at p. 64 (noting that "the FDIC also estimates that around 2 million households use payday loans annually"); *id.* at n. 152 (noting that "The Pew Charitable Trusts recently estimated that around 12 million individuals use payday loans every year"), citing Pew Charitable Trusts, WHO BORROWS, WHERE THEY BORROW, AND WHY: PAYDAY LENDING IN AMERICA (2012) 4.

<sup>14</sup> Prepared Remarks by Richard Cordray, Director of the Consumer Financial Protection Bureau Payday Loan Field Hearing, Birmingham, Ala. (Jan. 19, 2012), available at <http://tinyurl.com/7mu3hwb>.

concerns to invalidate an arbitration agreement even if the public policy at issue aims to prevent undesirable results to consumers.”<sup>15</sup>

- And certainly, ordinary small-value, run-of-the-mill consumer cases can no longer be brought in the face of arbitration clauses. For example, Time Warner of New York recently added a \$3.95 monthly charge for the modem it has long provided subscribers for free. There was no advance notice of the fee, no method of avoiding the fee (and continuing on as a Time Warner subscriber), and it did not matter that most subscribers are on a set price plan, which the company had promised not to raise for some number of years. But, importantly for Time Warner, the newest iteration of its subscriber agreement contains an arbitration clause, which a federal judge in Brooklyn recently enforced.<sup>16</sup> It is simply unimaginable that any Time Warner subscriber charged the \$3.95 monthly fee will bring an individual arbitration; each will pay the fee, or switch to another provider – which can just as easily impose hidden fees and costs without fear of liability or accountability by adding its own arbitration clause.

This body has already recognized the public policy implications of this debate: Congress has made attempts to protect military families by outlawing mandatory arbitration clauses in standard form agreements in payday loan and consumer credit contracts with military families, and has likewise attempted to limit the use of arbitration clauses in residential mortgage loans, as well as in automobile dealer franchise agreements.<sup>17</sup>

It is laudable that Congress has attempted to safeguard the ability of military families and auto dealer franchisees to vindicate their rights, and it is well past time to extend that ability to all consumers, employees, and small businesses – especially in the areas of antitrust and civil rights, as the proposed legislation would. The Supreme Court has squarely placed this issue in the lap of this Congress and this Committee: “Too darn bad” really means “Tell it to Congress.” The Court has made plain that it will “rigorously enforce” all the remedy-stripping terms that companies insert in their arbitration clauses – never mind the consequences – unless the FAA’s

<sup>15</sup> *Robinson v. Title Lenders, Inc.*, 364 S.W.3d 505 (Mo. 2012).

<sup>16</sup> *Damato v. Time Warner Cable, Inc.*, 2013 WL 3968765 (E.D.N.Y. 2013).

<sup>17</sup> See 10 USC § 987(e)(3), (f)(4) (voiding arbitration clauses in payday loan or any consumer credit contracts—with the exception of residential mortgages and car loans—with members of the military or their families); 15 USC § 1639c(e)(1) (barring arbitration clauses in residential mortgage loans); 15 USC § 1226(a)(2) (prohibiting automobile manufacturers from imposing predispute arbitration clauses in their franchise agreements with dealers).

mandate is “overridden by congressional command.”<sup>18</sup> Today, this Committee has the opportunity to accept that invitation and amend the FAA.

The proposed legislation before this Committee is in no sense whatsoever “anti-arbitration.” Arbitration can be an effective alternative to our court system. But make no mistake: the mandatory arbitration clauses that are the subject of this proposed legislation do not – and were never intended to – provide an alternative forum to *resolve* claims. Their one and only objective is simply to provide a way to suppress and bury claims. These clauses injure the institutional integrity of arbitration. The whole point is that consumers and employees seeking redress for broadly distributed small-value harms cannot and will not pursue one-on-one arbitrations.<sup>19</sup> Ever. Thus, mission accomplished for big corporations.

The timing could not be better for Congress to act, as mandatory arbitration clauses have proliferated beyond what anyone could have imagined just a few years ago. Click on the “Terms & Conditions” link in any standard form web transaction and you’ll surely see a mandatory arbitration clause. It may have started with telecom and credit card contracts, but now these clauses are de rigeur in contracts from insurance companies, airlines, landlords, securities brokerages, payday lenders, all banks, gyms, rental car companies, parking facilities, schools, kids’ camps, shippers – even HMOs and nursing homes.<sup>20</sup> Indeed, most nursing homes now use

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<sup>18</sup> *American Express*, 133 S.Ct. at 2309, citing *CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665, 668–669 (2012). See also Gilles, 104 MICH. L. REV. at 395 (“[T]he Supreme Court’s arbitration jurisprudence over the past thirty years have evinced an incredibly expansive view of the FAA, and while the full import of this national policy favoring arbitration has been criticized by man – including members of the Court itself – there is no reason to believe the Court will swing back to a more nuanced interpretation of the FAA.”).

<sup>19</sup> The CFPB’s Arbitration Study reveals that very few consumers ever arbitrate disputes. According to that agency, “around 80 million cardholders were subject to arbitration clauses as of the end of 2012,” “tens of millions of households are subject to arbitration on one or more checking accounts,” and “2 million households use payday loans annually.” Despite these vast numbers, from 2010-2012, only 1241 consumers filed arbitrations to resolve disputes with their credit card companies, banks, and lenders. CFPB Arbitration Study, *supra* note 10, at p. 63-64.

<sup>20</sup> Gilles & Friedman, 79 U. CHI. L. REV. at 631 (“[A]bsent broad legal invalidation, it is inevitable that the waiver will find its way from the agreements of ‘early adopter’ credit card, telecom, and e-commerce companies into virtually all contracts that could even remotely form the predicate of a class action someday. After all, the incremental burden of including magic words in dispute resolution boilerplate—or even on point-of-sale purchase receipts or box-stuffer notices—is surely minimal in relation to the benefit of removing oneself from potential exposure to aggregate litigation.”).

these clauses to make sure their residents are unable to bring individual actions or band together to hold them accountable for systemic harms.<sup>21</sup>

In addition, by taking private plaintiff enforcers out of the game, the Supreme Court's decisions also impose an unrealistic burden on our public agencies.<sup>22</sup> The Department of Justice and Federal Trade Commission submitted a powerful amicus brief in the *Amex* case arguing that private enforcement – particularly in the antitrust context but elsewhere as well – is absolutely indispensable to carrying out Congress's will as expressed in the Sherman Act.<sup>23</sup> And they recognized that private enforcement – in this day and age where large companies transact with thousands or millions of consumers and small businesses – means *collective* private enforcement, of the type expressly prohibited by these arbitration clauses. Without robust collective private enforcement, the top antitrust watchdogs told the Supreme Court, the detection and deterrence of antitrust violations will suffer gravely. Furthermore, the Attorneys General of 22 states made the same point in their own submission: banning collective private enforcement “erode[s] the states’ ability to protect their citizens and economies.”<sup>24</sup> Here, once again, the Court's response was “too damn bad.”

*Amex* is an interesting case in point: this was a case brought on behalf of small merchants, all of whom have contracts to accept Mastercard, Visa and American Express, among others. When those credit card companies engage in illegal acts, these merchants have to band together to prove that wrongdoing in expensive antitrust litigation. This is exactly what has happened in antitrust class actions brought by merchants against Mastercard and Visa – and over the past decade, there have been two class settlements resulting in more than \$10 billion in damages and important injunctive relief. American Express, on the other hand, was sued for the

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<sup>21</sup> See, e.g., Myriam Gilles, *Operation Arbitration: Privatizing Medical Malpractice Claims*, THEORETICAL INQUIRIES IN LAW, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2263429](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2263429).

<sup>22</sup> See, e.g., Gilles & Friedman, 79 U. CHI. L. REV. at 668 (public enforcers “lack the resources to take the laboring oar on many of the large-scale cases that have traditionally been the province of the class action plaintiffs’ bar”); see also Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. 698, 761 (2011) (“[S]tate attorneys general face resource constraints that limit the scope of possible enforcement actions.”).

<sup>23</sup> Brief for the United States as Amicus Curiae Supporting Respondents, available at [http://www.americanbar.org/content/dam/aba/publications/supreme\\_court\\_preview/briefs-v2/12-133\\_resp\\_amcu\\_usa.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs-v2/12-133_resp_amcu_usa.authcheckdam.pdf).

<sup>24</sup> Brief of the State of Ohio and 21 Other States as *Amici Curiae* in Support of Respondents, available at [http://www.americanbar.org/content/dam/aba/publications/supreme\\_court\\_preview/briefs-v2/12-133\\_resp\\_amcu\\_ohio\\_et\\_al.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs-v2/12-133_resp_amcu_ohio_et_al.authcheckdam.pdf).

same conduct. But because that company had inserted magic words in their boilerplate form contracts – requiring one-on-one arbitration – it has been allowed to avoid liability.

As mandatory arbitration clauses foreclose millions of citizens from vindicating their rights, and as the remedial statutes enacted by this body and the legislatures of the fifty states are thwarted, “too darn bad” just doesn’t cut it. I urge Congress and this body to act swiftly to remedy these wrongs and to pass the Arbitration Fairness Act.

PREPARED STATEMENT OF VILDAN A. TESKE

TESTIMONY  
OF

VILDAN A. TESKE  
PARTNER AT CROWDER, TESKE, KATZ & MICKO, PLLP

**“THE FEDERAL ARBITRATION ACT AND ACCESS TO JUSTICE:  
WILL RECENT SUPREME COURT DECISIONS UNDERMINE THE  
RIGHTS OF CONSUMERS, WORKERS, AND SMALL BUSINESSES?”**

HEARING BEFORE THE  
U.S SENATE JUDICIARY COMMITTEE

DECEMBER 17, 2013  
DIRKSEN SENATE BUILDING, WASHINGTON D.C.

Chairman Franken, Committee Ranking Member Grassley, and distinguished members of the Judiciary Committee, thank you for inviting me to testify about the recent Supreme Court decisions, mandatory pre-dispute arbitration clauses and class action ban provisions within those clauses.

**I. Introduction**

In today's testimony, I will share with you my perspective as an advocate for consumers and servicemembers from experiences over the length of my career. I will describe the types of cases consumers and servicemembers are no longer able to bring to our country's judicial system because of mandatory arbitration. I will explain how the prolific use of forced arbitration clauses and class action bans will ensure that illegal and abusive practices will go unchecked and largely undetected. Many cases simply will not be possible to bring due to the disproportionate expense of bringing a relatively small individual claim rather than banding with others in a class action. I will discuss the importance of protecting access to our public justice system and the right to a jury trial which will vanish for the many consumers and servicemembers whose claims will be pushed into the private, and most times secret, arbitration system against their will.

I want to be clear, at the outset, that I am referring to pre-dispute mandatory binding arbitration clauses, not voluntary arbitration where the parties agree to take their dispute to arbitration, after the dispute has arisen. I believe that the latter is an option parties should have. It is only forced arbitration clauses and the class action bans within them that are the subject of my testimony today.

**II. Pre-Dispute Forced Arbitration Clauses are Usually Buried in Fine Print and are Not Negotiated by Parties of Equal Bargaining Power.**

All of our clients, like the overwhelming majority of consumers, are not aware of the pre-dispute mandatory arbitration clauses and class action bans that are found in contracts for the goods and services they use every day. These clauses are usually buried in the fine print of lengthy contracts (whether in paper form, or electronic “terms and conditions” found in almost all internet transactions that require the consumer to click to accept before one can go any further). Many of these clauses are over multiple pages of indecipherable text that only attorneys have a shot at understanding.

These lengthy, fine print clauses are rarely read by consumers.<sup>1</sup> Even if they do attempt to read them, most consumers do not understand the legal ramifications of forced arbitration or a class action ban within an arbitration clause.

Even assuming the consumer understands the effect of these contract clauses, the opportunity to negotiate the terms is not available. Most consumer contracts are presented as a take it or leave it proposition. They are standard-form contracts of adhesion. The only choice the consumer has is to not purchase that good or service. However, when most, if not all, of the providers of those goods and services in a

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<sup>1</sup> If each and every consumer read every word of the contracts, or terms and conditions, with which they are presented every time they are contemplating entering into a transaction, commerce in our country would come to a grinding halt. Businesses count on, and design their processes around, consumers *not* reading the lengthy legalese-laden contracts. Imagine the car rental counter at a busy airport, with a long line of travelers standing behind you as you painstakingly go over each word in the contract, ask questions, and ask to negotiate the terms. Now imagine every single renter doing the same. A very unlikely scenario. In fact, many businesses now ask you to sign a small electronic screen at the counter that says you’ve read their agreement or terms and conditions, when they have not actually given you the document that contains the agreement.

particular industry put such clauses in their contracts, there is no choice in the true sense. When, for example, nearly every car rental company puts such clauses in their contracts, is there really a choice? How about if the only cable or internet provider in your area requires such clauses before it will install your cable or internet?

Arbitration was originally meant to be an option for parties of equal bargaining power to take their dispute outside the court system, if they each chose to do so. Forced arbitration, however, is a completely different animal.

### **III. Forced Arbitration Takes Away the Constitutionally Guaranteed Right to Trial by Jury in Our Public Court System.**

The Seventh Amendment of the U.S. Constitution guarantees a right to trial by jury in most situations when there is a dispute among two parties. The right to have a jury decide the facts of a case is one of the most important pillars of our justice system. The right to have one's day in court has long been ingrained in our system. Access to justice is critical to curbing unjust and illegal practices by those that would flout our laws. Like other constitutionally guaranteed rights, we must, as a society, take very seriously any attempts to eradicate these rights from our citizens, whether they are consumers, servicemembers, employees, investors, or seniors.

The constitutionally guaranteed right to have one's day in court, however, is being eroded by every contract that contains a forced arbitration clause. Unfortunately, consumers realize their right to seek redress in our public justice system before a judge or jury is destroyed only after a dispute arises and it is too late to do anything about it.

Our public court system provides a number of procedural and substantive due process protections, developed over several centuries of jurisprudence. Losing one's ability to have a jury decide the facts, or the ability to appeal a judge's decisions on the law, is an affront to our system of justice. Yet, these important rights are being taken away in forced arbitration clauses buried in fine print of contracts.

**IV. Class Action Bans Within Pre-Dispute Mandatory Arbitration Agreements Will Ensure that Many Claims Cannot Be Brought.**

Pre-dispute, forced arbitration clauses eviscerate the ability of consumers, servicemembers, seniors, investors, employees, small businesses, and others to effectively vindicate their rights under our country's longstanding federal and state laws.

The principal effect of an arbitration agreement requiring consumers and servicemembers to forfeit their right to bring their claims as a class action is not, as some would argue, to provide an alternative forum to court; it is, instead, to *suppress* consumers' and servicemembers' ability to prosecute their claims by joining others subjected to the same wrongdoing. Following the U.S Supreme Court's decisions in the *Concepcion* and *Italian Colors* cases<sup>2</sup>, groups of individuals, as well as small, "mom and pop" businesses, have lost the right to join together to use our country's court system to enforce federal and state laws.

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<sup>2</sup> *AT&T Mobility v. Concepcion*, 131 S.Ct. 1740 (2011) and *American Express v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013).

Important laws dealing with civil rights, employment discrimination, consumer protection, servicemember rights, and fair marketplace practices have become more and more difficult to enforce whenever there is a pre-dispute forced arbitration clause with a class action ban in an underlying contract. In effect, practically all challenges to such clauses on *any* ground are now foreclosed by these two U.S. Supreme Court decisions.

As a result of these rulings, the courthouse doors have been closed to consumers and servicemembers nationwide. Forced arbitration clauses are now included in almost all consumer and employment contracts. A recent study issued by the Consumer Financial Protection Bureau (“CFPB”) demonstrates that forced arbitration clauses are becoming standard business practice in contracts for financial products like payday loans, credit cards and checking accounts. The CFPB study found that 9 out of 10 arbitration clauses prevent consumers from banding together to bring collective claims.<sup>3</sup> This has an enormous impact on consumers—where the value of claims can be small individually, but large in the aggregate, and class actions are often the only way of revealing widespread corporate fraud. The myth of less expensive proceedings and faster results for the consumer is quickly dispelled by the evidence. There are cases, across industries, where forced arbitration has placed the consumer or servicemember at a distinct disadvantage, leaving them worse off, financially and emotionally, than if they had been afforded access to justice. This new dystopia must and should come to an end.

Americans deserve better.

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<sup>3</sup> Consumer Financial Protection Bureau, *Arbitration Study Preliminary Results*, p.13 (December 12, 2013) [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf)

In my practice, I have had the privilege of representing our brave military men and women in matters dealing with consumer financial issues. Congress provided important financial and civil protections for our servicemembers and their families through the Servicemembers Civil Relief Act (SCRA)<sup>4</sup>, formerly known as the Soldiers and Sailors Civil Relief Act. These protections have been on the books since before World War I, with periodic amendments to reflect modern life and new financial products and services. The stated purpose of the law is to “provide for, strengthen, and expedite the national defense through protection extended by this Act to servicemembers of the United States to enable such persons to devote their entire energy to the defense needs of the Nation.” 50 U.S.C. App. §502.

The law includes potent protections for active duty servicemembers against foreclosures on their homes, repossession of vehicles and other personal property, protection against default judgments, evictions, the right to a cap of 6% interest on any loan or obligation (including student loans, credit cards, mortgage loans, car loans, business loans, personal loans, etc.) entered into prior to active duty status, and also certain rights when terminating vehicle and premises leases, as well as cell phone contracts, when the servicemember is deployed or receives a Permanent Change of Station (PCS) outside the area.<sup>5</sup> As the Supreme Court stated, the law is meant to “protect those who have been obliged to drop their own affairs to take up the burdens of the nation.” *Boone v. Lightner*, 319 U.S. 561, 575 (1943).

<sup>4</sup> 50 U.S.C. App. § 501, *et seq.*

<sup>5</sup> The listed protections are the most common consumer financial provisions encountered under the SCRA. The Act provides a number of other protections that are not discussed here.

With the large number of deployments over the past decade, the financial crisis our country has experienced over the past six years, and reckless (if not intentional) business practices violating servicemember rights, SCRA claims have been more prevalent than in previous years. My firm has been contacted by a number of servicemembers from across the country that have been dealing with financial difficulties, or who have asked creditors for their SCRA rights but were denied them. In addition to advising the servicemembers pre-litigation, where appropriate, we have filed private enforcement actions against the creditors.

My colleagues and I were able to bring some of the cases as class actions on behalf of all servicemembers that were affected because our investigations revealed that there were likely numerous other servicemembers whose SCRA rights were violated by the same creditor, and the underlying contracts did not contain forced arbitration clauses with class action bans. Most of those contracts were entered into approximately 8-20 years ago, before many consumer financial companies began to, almost uniformly, include such provisions in their contracts. We were able to recover millions of dollars for thousands of servicemembers without each servicemember having to take the time and effort to bring an individual action on his or her own behalf.

The reality is that an overwhelming majority of those servicemembers would not, and could not, have brought these actions on their own without being part of a class action. Average damages were from several hundred to several thousand dollars- scarcely enough to make it economically feasible to bring individual actions. Many of the

hundreds of servicemembers we have spoken with did not know that they could bring an action to enforce their rights.<sup>6</sup> Those that knew their creditor was likely breaking the law did not have the time to pursue the claim or resources to hire an attorney to take the case on. Also, as with many consumer claims, expert testimony may be required, making an individual case prohibitively expensive to bring<sup>7</sup>. We have heard from many class members thanking the servicemember class representative and us for taking on the defendant in what was a David vs. Goliath scenario. Unfortunately, such cases on behalf of classes of servicemembers are now almost impossible to bring due to the Supreme Court's decisions in *Concepcion* and *Italian Colors*.

It is not sound public policy to require our military men and women to take time and energy away from their mission to handle such matters one by one, when their interests can be well served by one servicemember class representative and class counsel who are willing to shoulder the risk and commit substantial time and resources to the litigation. Imagine thousands of our armed forces members having to submit their claims to costly, time consuming, individual arbitrations, having to take time away from their service and/or from their families in order to vindicate their rights under our laws. Yet, this is exactly what has to happen when there is a class action ban in a servicemember's consumer contract. Or, more likely, the servicemember has to forgo enforcing his/her rights and the wrongdoer is not brought to justice. Forced arbitration clauses with class

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<sup>6</sup> Although all servicemembers receive information on the SCRA when they go through basic training, one cannot expect they will become experts in the legal nuances of the Act.

<sup>7</sup> It is not unusual for the services of an expert to run into the tens of thousands of dollars, and in some, more complex cases, for expert fees to total up to six figures or more.

action bans directly contradict the national interest when our military men and women cannot band together to bring their claims in one class action case.

The Department of Defense prepared a report for Congress in 2006 regarding predatory lending practices facing the military and found areas of concern that needed to be addressed, including forced arbitration clauses and class action bans in the consumer contracts servicemembers enter into.<sup>8</sup> The DoD, recognizing the harm such clauses impose, stated:

Service members should maintain full legal recourse against unscrupulous lenders. Loan contracts to Service members should not include mandatory arbitration clauses or onerous notice provisions, and should not require the Service member to waive his or her right of recourse, such as the right to participate in a plaintiff class. Waiver is not a matter of “choice” in take-it-or-leave-it contracts of adhesion.<sup>9</sup>

Throughout its report, the DoD emphasized that servicemembers need to have “judicial remedies through the courts for redress.”<sup>10</sup> Our nation’s two million servicemembers, like all other consumers, are now subjected to these forced arbitration clauses and class action bans in millions of contracts for a variety of goods and services.

Lower courts have been presented with these issues in the form of motions to compel arbitration and to dismiss class actions in SCRA cases over the last few years. Following the U.S. Supreme Court’s recent rulings, the courts have uniformly enforced the mandatory pre-dispute arbitration clauses and class action bans in consumer contracts

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<sup>8</sup> Department of Defense, Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents (Aug. 9, 2006), <http://1.usa.gov/rVdafq>.

<sup>9</sup> *Id.* at 7-8.

<sup>10</sup> *Id.* at 46.

entered into by servicemembers. One example is the decision in *Wolf v. Nissan Motor Acceptance Corp.*, 2011 WL 2490939 (D.N.J. June 22, 2011), where a servicemember that entered active duty service sought to enforce his right under the SCRA to terminate an auto lease agreement into which he had entered prior to his service. He sought the return of an advance payment of \$595.00 required by the creditor, as well as other amounts he prepaid. The auto finance company denied his request even though the SCRA clearly prohibits the company from keeping such advance, unearned payments. He brought a case on behalf of himself and all other servicemembers who had such fees retained by this national finance company. However, because the servicemember had signed a lease agreement that contained, in the fine print, a forced arbitration clause and class action ban, the defendant swiftly moved to force him into arbitration and to dismiss his class action case.

Citing the recent U.S. Supreme Court decisions, the district court sent the servicemember's case out of our public justice system and into private arbitration. The judge also ruled that, as a result of the class action ban in the arbitration agreement, the servicemember and his attorneys could not represent the interests of the other servicemembers who had been subjected to the same, illegal practice. This, of course, meant that the hundreds, if not thousands, of other servicemembers were left on their own to try to redress this wrong, even though the amount of the damages are relatively small and a class action would be the most efficient, and likely the only way, to get relief. Experience instructs us that the other servicemembers likely did not have the opportunity,

time, or the resources to bring their cases to enforce the protections that have long been guaranteed to them by federal law.

Another stark example is a case that we brought against a national mortgage lender for foreclosing on our servicemember client while he was on active duty and protected by the SCRA. The mortgage lender held a sheriff's sale and sold our client's house while he was being deployed to Iraq. The SCRA prohibits non-judicial foreclosures (also known as "foreclosure by advertisement" in some states) while a servicemember is on active duty or during other periods of SCRA coverage. In other words, the only way a lender can legally foreclose is to file a foreclosure action in court, and convince a judge that it should be able to move forward with the foreclosure even though the servicemember is on active duty. This is because the public policy behind the SCRA foreclosure protections is that our active duty servicemembers should not have to worry about their homes being foreclosed on while they are trying to focus their energies on serving our nation.

The lender in our case, however, did not go to court and get permission to foreclose. It simply published notice in the newspaper and attempted service of foreclosure papers on our client (he was already gone). In addition to the notice of foreclosure, it also filed an affidavit in the property records swearing that he was not currently in military service when, in fact, he was. Some months later, while he was in Iraq, he learned he lost his home in a foreclosure but, at that time, he did not know he was

protected by federal law from this unlawful foreclosure and, more importantly, had the right to go to court to remedy this wrong.

After hearing about some other SCRA foreclosure cases against various lenders in the national media, he contacted us. We investigated the facts of his case, as well as the practices of this particular mortgage lender. We found a report that had been issued as a result of an enforcement action, stating a review of a sample of foreclosures conducted by this particular lender found over 80 foreclosures that were subject to the protections of the SCRA. In discussing this with our client, he made the decision to file his case not only on his own behalf but also as a class representative for other servicemembers that had been wrongfully foreclosed on by this lender. Like many of our selfless servicemembers, this client didn't want this type of illegal conduct to happen to his military brothers and sisters while they were on active duty. And our country's laws have a simple way to accomplish that: a class action.

Much to our client's surprise,<sup>11</sup> the lender, rather than answering the complaint we filed in federal court, brought a motion to compel him to arbitrate his claim. It turned out that in the thick stack of closing documents he had been directed to sign when he purchased the house years before, there was a mandatory arbitration clause, which provided that the lender could force him to arbitrate any claims he may have relating to the mortgage loan, including a wrongful foreclosure. The arbitration clause also contained a class action ban. Thus, following the Supreme Court's rulings on arbitration,

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<sup>11</sup> Following the foreclosure, he no longer had copies of his closing documents.

the judge decided that our client was not able to represent other servicemembers that had been foreclosed on. He lost his right to a day in court and his constitutionally guaranteed right to present these facts to a jury. One cannot escape the irony that while he was serving his country and protecting our freedoms, he had lost his freedoms and rights under our constitution.

Although it was likely other servicemembers had been foreclosed on in the same way, rather than one class action, it would be up to each member of the military to know that they have rights under the SCRA, find their own lawyer, and take the time and energy to prosecute their own case in arbitration, with their limited resources, and presumably, after coming home from serving their country.

Another example is a case in California, against a national lender that repossessed active duty servicemembers' vehicles without court order, in violation of the SCRA. *Beard v. Santander Consumer USA, Inc.*, 2012 WL 1292576 (E.D. Cal. Apr. 16, 2012) report and recommendation adopted, 2012 WL 1576103 (E.D. Cal. May 3, 2012). In that case, when the servicemember was about to be deployed to Iraq and asked for some help with payments, the lender offered a forbearance of a few months and had him sign a modified lease agreement that contained a mandatory arbitration clause and class action ban. Later, as he was serving in Iraq, he fell behind in his payments. The lender repossessed the vehicle without obtaining a court order, in violation of the SCRA. After seeking help from the military legal assistance lawyers, and letters being sent on his behalf informing the creditor that it was in violation of the SCRA to no avail, Sgt. Beard

brought a class action against the lender to enforce his and others' SCRA rights. Predictably, that court also enforced the arbitration clause and Sgt. Beard lost his right to bring his and the other servicemembers' claims in court.

Unfortunately, with the proliferation of forced arbitration clauses and class action bans in consumer contracts, these scenarios will continue to play out for our servicemembers, as well as all other consumers. Due to class action bans in the underlying consumer contracts, my office has had to turn down cases that are not possible to bring when the individual damages amount at stake are relatively small. Not only are the protections of the SCRA being eviscerated, the scores of other consumer financial protections our laws provide for servicemembers, and non-servicemembers alike, will not be prosecuted fully, if at all.

#### **V. Conclusion**

At this juncture, Congressional action is the only way to ensure a fair marketplace for all consumers, employees, investors, seniors and other individuals. It is also needed to protect the rights of our military men and women under long-standing federal laws providing civil and financial relief to our active duty servicemembers and veterans. The only way to effectively remedy this grossly unfair situation is by passing federal legislation such as the Arbitration Fairness Act. As an advocate for consumers and servicemembers, I can definitively say that, without such legislation, our ability to enforce the laws of this country, that were meant to protect *all* Americans, will be greatly diminished, if not rendered impossible.

Thank you for the opportunity to testify today, and I look forward to answering your questions.

PREPARED STATEMENT OF ARCHIS A. PARASHARAMI

Statement of

Archis A. Parasharami  
Partner, Mayer Brown LLP

**“The Federal Arbitration Act and Access to Justice:  
Will Recent Supreme Court Decisions Undermine the  
Rights of Consumers, Workers, and Small Businesses?”**

**Hearing Before The Senate Committee on the Judiciary**

**December 17, 2013**

Chairman Leahy, Ranking Member Grassley, presiding Member Franken,  
and members of the Committee:

My name is Archis Parasharami, and I am a partner in the law firm Mayer  
Brown LLP, where I am also co-chair of the Consumer Litigation and Class Actions  
practice. Thank you for the opportunity to testify before the Committee today.

My legal practice involves defending businesses against class action lawsuits  
in courts around the country. In that context, I focus on strategy, critical motions,  
appeals, and—in a number of situations—resolving class actions through  
settlements. I also counsel businesses on the adoption of arbitration programs and  
assist them in defending the enforceability of their arbitration agreements. Among  
other things, I was one of the lawyers who represented AT&T in *AT&T Mobility  
LLC v. Concepcion*. In addition, I represent clients on policy issues relating to  
defending the enforceability of arbitration agreements. My practice thus gives me  
first-hand experience both with how arbitration agreements work and how class  
actions function in reality.

Based on that experience, I'd like to offer my views on why arbitration  
provides consumers and employees with a fair and accessible means of resolving the  
types of disputes they are most likely to have—and does so more effectively than  
our overburdened court system. Arbitration before a fair, neutral decisionmaker  
leads to outcomes for consumers and individuals that are comparable or superior to  
the alternative—litigation in court—and that are achieved faster and at lower  
expense. And the cost savings of arbitration over litigation benefit individuals and  
businesses alike.

For these and other reasons, the Arbitration Fairness Act (“AFA”), S. 878,  
should not be adopted. Despite its title, the proposed Act would effectively eliminate  
hundreds of millions of pre-dispute arbitration agreements. If enacted, the bill  
would eliminate the ability of consumers, workers, and businesses with modest-  
sized claims to access an inexpensive and easy-to-use dispute resolution system.

What is more, the bill would impose unjustified litigation costs on individuals and businesses alike at a time when consumers and businesses are already struggling, and when our overburdened court system cannot handle the massive influx of cases.

***For the ordinary consumer or employee, the elimination of arbitration will do far more harm than good.***

The plain fact is that fair arbitration—and current law requires that arbitration be fair (with courts enforcing that requirement vigorously)—significantly increases access to justice for consumers, employees, and others as compared to the incontrovertible reality of today’s courts, which unfortunately differs dramatically from the transaction cost-free, theoretical judicial system that some imagine.

My testimony focuses on several fundamental points:

- Arbitration enables consumers and employees with grievances to obtain redress for the vast majority of disputes they are likely to have—small, individualized claims for which litigation in court is impractical. This access to an inexpensive and simple system of dispute resolution is a very significant benefit that is often ignored in the debate over arbitration.
  - For consumers’ and employees’ typical claims, these individuals are unlikely to be able to hire an attorney to navigate the court system. And those claimants who do brave the courts find that a hearing on their claims is long delayed by overcrowded dockets in our underfunded courts.
- Empirical studies have repeatedly demonstrated that arbitration is at least as likely, and often more likely, than litigation in court to result in positive outcomes for consumers and employees.<sup>1</sup>
  - Arbitration is more user-friendly and inexpensive than litigating in court—especially when (as is increasingly common) parties’ arbitration agreements include provisions for shifting costs and attorney’s fees.
  - In addition, arbitration agreements offer fair and simplified procedures for individuals—something that is ensured by the protections of generally applicable state unconscionability law as well as the due process safeguards of the nation’s leading arbitration providers, most prominently including the American Arbitration Association.
- The arguments advanced by critics of arbitration do not stand up to scrutiny.

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<sup>1</sup> See discussion *infra* at pp. 8-10 and materials cited.

- The “option” of post-dispute arbitration is illusory. It would be economically irrational for a company to agree to maintain a dual-track dispute resolution system in which it subsidizes consumer arbitration on one track while being subjected to the costs of litigation in court on the other track. Permitting only post-dispute agreements would have the real-world effect of eliminating arbitration—and thus relegate consumers, employees, and others to burdensome and overcrowded courts.
- Class action proponents decry the fact that arbitration typically takes place on an individual basis. But their position rests on theoretical arguments about the supposed virtues of class actions. In reality, most class actions deliver (at best) benefits that are received by very few class members.
  - A new empirical assessment conducted by my law firm reviewed a robust sample of class actions filed in or removed to federal court in 2009, and found that the vast majority of them provide little or no benefit to class members.<sup>2</sup>
  - Furthermore, claimants can vindicate their rights effectively without class proceedings. The dissenting Justices in the Supreme Court’s decision in *American Express Co. v. Italian Colors Restaurant* specifically recognized that “non-class options abound” for effectively pursuing claims individually.
- If class procedures were required, companies would not be willing to absorb the additional costs of arbitration **and** the huge legal fees associated with defending class actions. Arbitration would not be available.
- Consumers and employees would be worse off from losing the ability to pursue individualized claims that cannot be realistically litigated in court. The only beneficiaries of such a requirement would be lawyers—plaintiff’s lawyers **and** defense lawyers—who are the only clear winners in class action litigation.
- The preliminary results of the CFPB’s study of arbitration are just that—preliminary—as the CFPB itself has repeatedly made clear. They do not come close to providing meaningful support for eliminating pre-dispute arbitration agreements.

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<sup>2</sup> See discussion *infra* at pp. 16-18 and Exhibit A.

**I. ARBITRATION BENEFITS CONSUMERS BY PROVIDING A FAIR MEANS OF RESOLVING DISPUTES THAT CONSUMERS, EMPLOYEES, AND OTHERS CANNOT PRACTICALLY PURSUE IN COURT.**

Arbitration enables consumers, employees, small businesses, and others to obtain redress for a large number of claims for which litigation is impractical. It benefits these individuals by providing a fair means of adjudicating claims that would go entirely unredressed if the Arbitration Fairness Act were enacted.

*Recourse to the judicial system is not a realistic option for most injured consumers and employees.* Most claims are individualized and too small to attract the legal representation needed to navigate the complex procedures that apply in court. In addition, the costs of litigating are too high for many claims, and the courts—even many small claims courts—impose requirements (such as appearing in person during the working day) that make litigating there burdensome and costly. These costs are multiplied by the myriad inefficiencies of the judicial system.

Wrongs suffered by consumers typically are small and individualized—excess charges on a bill, a defective piece of merchandise, and the like. These claims are too small to justify paying a lawyer to handle the matter; in any event, most consumers do not have the resources to do so. As Justice Breyer has recognized—in a decision joined by Justices Stevens, Souter, and Ginsburg—“the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)” would be left “without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery.”<sup>3</sup>

Employees face similar difficulties with bringing claims in court. In the employment context, for instance, it has been estimated that the potential recovery is too small in 72% of the cases currently resolved using pre-dispute arbitration<sup>4</sup> and in 95% of all potential claims<sup>5</sup> to justify litigation in court and the retention of counsel. Thus, as one scholar has put it, for most employees the choice is

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<sup>3</sup> *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995).

<sup>4</sup> Jyotin Hamid & Emily J. Mathieu, *The Arbitration Fairness Act: Performing Surgery with a Hatchet Instead of a Scalpel?*, 74 Alb. L. Rev. 769, 785 (2010/2011); accord Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 Wm. Mitchell L. Rev. 313, 318 (2003); Steven C. Bennett, *The Proposed Arbitration Fairness Act: Problems And Alternatives*, 67 Disp. Resol. J. 32, 37 (2012).

<sup>5</sup> Theodore J. St. Antoine, *Mandatory Arbitration: Why It's Better Than It Looks*, 41 U. Mich. J.L. Reform 783, 790 (2008).

“arbitration—or nothing.”<sup>6</sup> The same conclusion applies to consumers with small claims.

Claims that are modest in size do not—and could not—attract lawyers willing to work on a contingency-fee basis, because the fees earned would be far too low. Yet the complexities of judicial litigation make it difficult, if not impossible, for most individuals to represent themselves effectively in court. Small claims courts were designed to allow individuals to proceed without representation, but they offer no realistic alternative. Budget cuts have severely hobbled these courts, leading to interminable delay.

Some claims are large enough to support contingency fees that would attract the interest of plaintiffs’ lawyers. But litigation in court involves costs and delay that make litigation in court impracticable for all but the highest value claims.

The starting point for understanding our dysfunctional court system is the fact that they are plagued with funding problems. To take one example, after “California’s courts . . . lost about 65% of their general fund support from the state during the last five years,” delays have come to define the judiciary. As the *Los Angeles Times* reported, “[a]t least 53 courthouses have closed,” and “[c]ourts in 20 counties are closed for at least one day a month.” These and other “court closures have forced some San Bernardino [county] residents to drive up to 175 miles one way to attend to a legal matter.”<sup>7</sup> To take another example, budget cuts led to “shortened hours” in the New York City courts that have proven to be a “hardship” for litigants—especially the “economically distressed and working poor people” who face “less flexibility in getting to the court.”<sup>8</sup>

Although most civil claims are filed in state courts, federal district courts have experienced extraordinarily high caseloads and lengthy delays, as well. The Brennan Center for Justice reported “a 20 percent increase” in the average caseload for a federal district judge from 1992 to 2012.<sup>9</sup> Budget constraints have led to reductions in a wide range of court services. In the Eastern and Southern Districts

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<sup>6</sup> *Id.* at 792 (discussing analogous situation of employees with low-dollar claims).

<sup>7</sup> Maura Dolan, *Budget cuts force California courts to delay trials, ax services*, L.A. Times, Apr. 9, 2013, <http://articles.latimes.com/2013/apr/09/local/la-me-court-cutbacks-20130410>.

<sup>8</sup> *At a Standstill: Budget Cuts Have Brought New York’s Court System to a Crawl*, NYPress.com, Dec. 5, 2012, <http://nypress.com/at-a-standstill-budget-cuts-have-brought-new-yorks-court-system-to-a-crawl/>.

<sup>9</sup> Alicia Bannon, *Federal Judicial Vacancies: The Trial Courts* 5, Brennan Ctr. for Justice, 2013, <http://www.brennancenter.org/publication/federal-judicial-vacancies-trial-courts>.

of New York, for example, reductions have included staffing furloughs, “curtail[ing] [courts’] hours of operation,” and “slower processing of civil and bankruptcy cases.”<sup>10</sup>

These trends can have serious consequences for consumers, employees, and small businesses. As delays drag on, businesses can become insolvent and judgment-proof, making it impossible for individuals to obtain relief.<sup>11</sup> Budget cuts have also forced underfunded courts to supplement their revenue by increasing fees, raising the cost of accessing justice through courts.<sup>12</sup>

Simply put, the situation for litigants in the underfunded and understaffed courts is grim; and because the trend is toward more cutbacks, the situation will likely get worse.

## II. ARBITRATION PROVIDES A FAIR AND EFFECTIVE MEANS OF DISPUTE RESOLUTION FOR CONSUMERS AND EMPLOYEES FOR WHOM THE JUDICIAL SYSTEM IS NOT A REALISTIC OPTION.

Arbitration has a number of advantages over pursuing litigation in our overburdened court system.

To begin with, arbitration offers *flexible proceedings at lower cost*. Under the American Arbitration Association’s consumer procedures, for example, consumers cannot be asked to pay more than \$200 in total arbitration costs; businesses shoulder all remaining fees.<sup>13</sup> (That same \$200 cap applies to employees in employer-promulgated arbitration programs,<sup>14</sup> as compared with arbitration agreements in the individually negotiated employment contracts typical of the highest-paid employees.) And many businesses agree to pay all of the costs of

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<sup>10</sup> New York County Lawyers’ Association, *Report on the Continuing Effect of Judicial Budget Cuts on The U.S. District Courts for the Southern and Eastern Districts of New York* 11, Sept. 4, 2013, [http://www.nycla.org/siteFiles/Publications/Publications1637\\_0.pdf](http://www.nycla.org/siteFiles/Publications/Publications1637_0.pdf).

<sup>11</sup> See, e.g., Constitution Project, *The Cost of Justice: Budgetary Threats to America’s Courts* 8, 2006, <http://www.constitutionproject.org/wp-content/uploads/2012/10/36.pdf> (citing Washington Courts, Bd. for Judicial Admin., Court Funding Task Force, *Justice in Jeopardy: The Court Funding Crisis in Washington State* 36, 2004, [http://www.courts.wa.gov/programs\\_orgs/pos\\_bja/-wgFinal/wgFinal.pdf](http://www.courts.wa.gov/programs_orgs/pos_bja/-wgFinal/wgFinal.pdf)).

<sup>12</sup> See, e.g., Chief Justice Eric Magnuson, *The State of the Judiciary: 2009 – Building a 21<sup>st</sup> Century Judiciary*, Bench&Bar of Minn., Aug. 1, 2009, <http://mnbenchbar.com/2009/08/the-state-of-the-judiciary-building-a-21st-century-judiciary/>.

<sup>13</sup> Am. Arb. Ass’n (“AAA”), *Costs of Arbitration (Including AAA Administrative Fees)* 1, March 1, 2013, [https://www.adr.org/cs/ideplg?IdcService=GET\\_FILE&dDocName=-ADRSTAGE2009593&RevisionSelectionMethod=LatestReleased](https://www.adr.org/cs/ideplg?IdcService=GET_FILE&dDocName=-ADRSTAGE2009593&RevisionSelectionMethod=LatestReleased).

<sup>14</sup> AAA, *Employment Arbitration Rules and Mediation Procedures* 24, Nov. 1, 2009, [http://www.adr.org/aaa/faces/aoe/lee/lee\\_search/lee\\_rule/lee\\_rule\\_detail?doc=ADRSTG\\_004366](http://www.adr.org/aaa/faces/aoe/lee/lee_search/lee_rule/lee_rule_detail?doc=ADRSTG_004366).

arbitration for consumer and employee claims. By comparison, the cost of filing a civil suit in a federal district court has recently risen to \$400 or more.<sup>15</sup>

Arbitration does not require individuals to make personal appearances (although they typically can have in-person hearings if they wish). Instead, claims can be adjudicated on the papers of on the basis of a telephone conference, so claimants need not miss work or return another day due to court delays. And, in contrast to the delays typical of overburdened courts—such as the 25.7 months that pass before the average civil lawsuit in federal court reaches trial—consumer arbitrations administered by the AAA are typically resolved in four to six months.<sup>16</sup>

Although arbitration proceedings can be navigated without a lawyer, claimants with more complicated claims may obtain representation to assist them if necessary—but the cost is less due to the more informal nature of arbitration. Furthermore, parties can (and often do) agree to include fee-shifting provisions in their arbitration agreements that make it less expensive to resolve disputes in arbitration. That was the case with the arbitration provision that the Supreme Court approved in *AT&T Mobility v. Concepcion*. As the Court explained, the claim was “most unlikely to go unresolved” because “the arbitration provision provide[d] that AT&T [would] pay [the Concepcions] a minimum of \$7,500”—now \$10,000—“and twice their attorneys fees if they obtain[ed] an arbitration award greater than AT&T’s last settlement offer.”<sup>17</sup>

Most importantly, ***studies show that consumers and employees who use this efficient dispute-resolution system prevail in arbitration at least as frequently as—and often more frequently than—they do in court.*** As I will explain, a wealth of scholarship comparing outcomes of consumers’ and employees’ claims in arbitration and in litigation reveals that arbitration provides a realistic and fair opportunity for individuals to seek justice before a neutral decisionmaker.

- A recent study by scholars Christopher Drahozal and Samantha Zyontz of claims filed with the AAA found that consumers win relief 53.3% of the

<sup>15</sup> Judicial Conference of the United States, *District Courts Miscellaneous Fee Schedule* (approving a \$50 “administrative” filing fee on top of the previous \$350 filing fee), <http://www.uscourts.gov/FormsAndFees/Fees/DistrictCourtMiscellaneousFeeSchedule.aspx>.

<sup>16</sup> AAA, *Analysis of the AAA’s Consumer Arbitration Caseload* (2007), [http://www.adr.org/aaa/ShowPDF?doc=ADRSTG\\_004325](http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_004325); see also David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 *Stan. L. Rev.* 1557, 1572-73 (2005) (“few dispute the assertion that arbitration is faster than litigation”); *U.S. District Court—Judicial Caseload Profile* (2012), <http://www.uscourts.gov/Statistics/FederalCourtManagementStatistics.aspx>.

<sup>17</sup> *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 1753 (2011) (noting that “aggrieved customers who filed claims would be ‘essentially guarantee[d] to be made whole,” and that “the District Court concluded that the Concepcions were *better off* under their arbitration agreement with AT&T than they would have been as participants in a class action”) (quoting *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 856 n.9 (9th Cir. 2009)).

time.<sup>18</sup> By contrast, empirical studies that have sampled wide ranges of claims have similarly reported that plaintiffs win in state and federal court approximately 50% of the time.<sup>19</sup>

- Drahozal and Zyontz found that “the consumer claimant[s] won some relief against the business more than half of the time,” and were generally awarded between 42% and 73% of the amount they claimed, depending on the size of the claim and how average recoveries were calculated (mean or median). The authors found little evidence for a purported “repeat player” effect. Consumers prevailed more than half the time against repeat and non-repeat businesses alike; prevailing claimants were “awarded on average an almost identical percent of the amount claimed” (approximately 52%). The authors concluded that any discrepancy could be explained by businesses becoming better at screening cases ahead of time to “settle meritorious claims and arbitrate only weaker claims.”<sup>20</sup>
- A study of 186 claimants who pursued employment arbitration in the securities industry concluded that employees who arbitrate were more likely to win their disputes than employees who litigate in federal court. The study found that 46% of those who arbitrated won, as compared to only 34% in litigation; the median monetary award in arbitration was higher; only 3.8% of the litigated cases studied ever reached a jury trial; and the arbitrations were resolved 33% faster than in court.<sup>21</sup>
- One study of 200 AAA employment awards concluded that low-income employees brought 43.5% of arbitration claims, most of which were low-value enough that the employees would not have been able to find an attorney willing to bring litigation on their behalf. These employees were often able to

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<sup>18</sup> Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 896-904 (2010).

<sup>19</sup> See, e.g., Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991-92, plaintiffs won 51% of jury trials in state court and 56% of jury trials in federal court, while in 1979-1993 plaintiffs won 50% of jury trials).

<sup>20</sup> Drahozal & Zyontz, 25 Ohio St. J. on Disp. Resol. at 898, 912-13.

<sup>21</sup> Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where do Plaintiffs Better Vindicate Their Rights?*, 58 Disp. Resol. J. 56, 58 (Nov. 2003 - Jan. 2004).

pursue their arbitrations without an attorney, and won at the same rate as individuals with representation.<sup>22</sup>

- A later study of 261 AAA employment awards from the same period found that for higher-income employees, *win rates in like cases in arbitration and litigation were essentially equal*, as were median damages. The study attempted to compare “apples” to “apples” by considering separately cases that involved and those that did not involve discrimination claims. With respect to discrimination and non-discrimination claims alike, the study found no statistically significant difference in the success rates of higher-income employees in arbitration and in litigation. For lower-income employees, the study did not attempt to draw comparisons between results in arbitration and in litigation, because lower-income employees appeared to lack meaningful access to the courts—and therefore could not bring a sufficient volume of court cases to provide a baseline for comparison.<sup>23</sup>
- Another study of arbitration of employment-discrimination claims concluded that arbitration is “substantially fair to employees, including those employees at the lower end of the income scale,” with employees enjoying a win rate comparable to the win rate for employees proceeding in federal court.<sup>24</sup>
- In 2004, the National Workrights Institute compiled all available employment-arbitration studies, and concluded that employees were almost 20% more likely to win in arbitration than in litigated employment cases. It also concluded that in almost half of employment arbitrations, employees were seeking redress for claims too small to support cost-effective litigation. Median awards received by plaintiffs were the same as in court, although the distorting effect of occasional large jury awards resulted in higher average recoveries in litigation.<sup>25</sup>

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<sup>22</sup> Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 785-88 (2003) (summarizing results of past studies by Lisa Bingham that lacked empirical evidence proving the existence of an alleged “repeat player” and “repeat arbitrator” effect).

<sup>23</sup> See Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 Disp. Resol. J. 44, 45, 47-50 (Nov. 2003-Jan. 2004).

<sup>24</sup> See Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 Disp. Resol. J. 9, 13 (May/July 2003) (reporting employee win rate in arbitration of 43 percent); see also Eisenberg & Hill, 58 Disp. Resol. J. at 48 tbl. 1 (reporting employee win rate in federal district court during the same time period was 36.4 percent).

<sup>25</sup> National Workrights Institute, *Employment Arbitration: What Does the Data Show?* (2004), [https://web.archive.org/web/20090423052708/http://www.workrights.org/current/cd\\_arbitration.html](https://web.archive.org/web/20090423052708/http://www.workrights.org/current/cd_arbitration.html).

- Critics of arbitration sometimes point to a now-discredited report from the advocacy group Public Citizen,<sup>26</sup> as purported support for the assertion that arbitration is unfair. That report shows the folly of examining outcomes in arbitration without comparing them to analogous outcomes in court.
  - Public Citizen examined data about claims brought by creditors against consumer debtors, and concluded from a high win rate for creditors that arbitration is biased. In those cases, however, the consumer often does not appear and does not contest the claim, and is therefore liable either because he has defaulted or “because he owes the debt.”<sup>27</sup>
  - A more rigorous empirical study showed that “consumers fare better” in debt-collection arbitrations than in court: “creditors won some relief before the AAA in 77.8 percent of individual AAA debt collection arbitrations and either 64.1 percent or 85.2 percent of the AAA debt collection program arbitrations,” depending on how the research parameters were defined. By contrast, in contested court cases creditors won relief against consumers between 80% and 100% of the time, depending on the court.<sup>28</sup>

As one study published in the *Stanford Law Review* explained in surveying the empirical research, “[w]hat seems clear from the results of these studies is that the assertions of many **arbitration critics were either overstated or simply wrong**.”<sup>29</sup> There simply is no empirical support for the contention that arbitration leads to unfair or subpar outcomes when compared with litigation in our overcrowded court system. Rather, the overwhelming weight of the available evidence establishes reflects that arbitration allows consumers and employees to obtain redress faster, cheaper, and more effectively than they could in court.

In addition to delivering results for consumers, employees, and other individuals that are as good, if not better, than litigation in court, the arbitration process is substantially fair: ***The rules of arbitration organizations along with existing law protect consumers and employees against unfair procedures and biased arbitrators.***

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<sup>26</sup> Public Citizen, *The Arbitration Trap*, Sept. 2007, <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

<sup>27</sup> Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration*, 15 Disp. Resol. Mag. 30, 31 (Fall 2008).

<sup>28</sup> Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 Hastings Bus. L.J. 77, 91, 97, 111-16 (Winter 2011).

<sup>29</sup> Sherwyn et al., 57 Stan. L. Rev. at 1567 (emphasis added).

Critics of arbitration sometimes claim that consumers and employees are subjected to unfair arbitration procedures. But current law already contains clear and effective protections against unfair arbitration clauses, and state and federal courts consistently strike down those arbitration clauses that transgress those limits. Section 2 of the Federal Arbitration Act empowers courts to exercise their authority to review arbitration agreements for compliance with generally applicable state-law contract principles, including unconscionability.

When courts find arbitration provisions unfair to consumers or employees under generally applicable principles, they do not hesitate to invalidate the agreements. Thus, courts have repeatedly invalidated provisions of arbitration agreements that purported to impose:

- excessive costs and fees to the consumer or employee for accessing the arbitral forum;<sup>30</sup>
- limits on damages that can be awarded by an arbitrator when such damages would be available to an individual consumer or employee in court;<sup>31</sup>
- requirements that arbitration take place in inconvenient locations;<sup>32</sup>

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<sup>30</sup> The Supreme Court has held that a party to an arbitration agreement may challenge enforcement of the agreement if the claimant would be required to pay excessive filing fees or arbitrator fees in order to arbitrate a claim. See *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 90-92 (2000). Since *Randolph*, courts have aggressively protected consumers and employees who show that they would be forced to bear excessive costs to access the arbitral forum. See, e.g., *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 923-25 (9th Cir. 2013) (refusing to enforce an arbitration agreement that required the employee to pay an unrecoverable portion of the arbitrator's fees "regardless of the merits of the claim"); *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2310-11 (2013) (reaffirming that a challenge to an arbitration agreement might be successful if "filing and administrative fees attached to arbitration . . . are so high as to make access to the forum impracticable" for a plaintiff). Courts also have reached the same conclusion under state unconscionability law. See, e.g., *Brunke v. Ohio State Home Servs., Inc.*, 2008 WL 4615578 (Ohio Ct. App. Oct. 20, 2008); *Liebrand v. Brinker Rest. Corp.*, 2008 WL 2445544 (Cal. Ct. App. June 18, 2008); *Murphy v. Mid-West Nat'l Life Ins. Co. of Tenn.*, 78 P.3d 766 (Idaho 2003).

<sup>31</sup> See, e.g., *Venture Cotton Coop. v. Freeman*, 395 S.W.3d 272 (Tex. Ct. App. 2013) (limit on damages and attorney's fees under state consumer protection law); *Mortg. Elec. Registration Sys., Inc. v. Abner*, 260 S.W.3d 351, 352, 355 (Ky. Ct. App. 2008) (limited to "actual and direct" damages); see also *Carll v. Terminix Int'l Co.*, 793 A.2d 921 (Pa. Super. Ct. 2002) (limit on damages for personal injury); *Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003) (limit on punitive damages); *Woebse v. Health Care & Retirement Corp. of Am.*, 977 So. 2d 630 (Fla. Dist. Ct. App. 2008) (limit on punitive damages); cf. *Am. Express Co.*, 133 S. Ct. at 2310 (explaining that federal law would require invalidating "a provision in an arbitration agreement forbidding the assertion of certain [federal] statutory rights").

- biased procedures for selecting the arbitrator;<sup>33</sup>
- unreasonably shortened statutes of limitations;<sup>34</sup> and
- “loser pays” provisions under which a consumer or employee might have to pay the full costs of the arbitration,<sup>35</sup> or must pay the drafting party’s costs regardless of who wins.<sup>36</sup>

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<sup>32</sup> See, e.g., *Willis v. Nationwide Debt Settlement Grp.*, 878 F. Supp. 2d 1208 (D. Or. 2012) (travel from Oregon to California); *College Park Pentecostal Holiness Church v. Gen. Steel Corp.*, 847 F. Supp. 2d 807 (D. Md. 2012) (travel from Maryland to Colorado); *Hollins v. Debt Relief of Am.*, 479 F. Supp. 2d 1099 (D. Neb. 2007) (travel from Nebraska to Texas); *Philyaw v. Platinum Enters., Inc.*, 54 Va. Cir. 364 (Va. Cir. Ct. Spotsylvania Cnty. 2001) (travel from Virginia to Los Angeles); see also, e.g., *Dominguez v. Finish Line, Inc.*, 439 F. Supp. 2d 688 (W.D. Tex. 2006) (travel from Texas to Indiana); *Swain v. Auto Servs., Inc.*, 128 S.W.3d 103, 108 (Mo. Ct. App. 2003) (travel from Missouri to Arkansas); *Pinedo v. Premium Tobacco Stores, Inc.*, 102 Cal. Rptr. 2d 435 (Ct. App. 2000) (travel from Los Angeles to Oakland).

<sup>33</sup> See, e.g., *Chavarria*, 733 F.3d at 923-25 (holding that an arbitration agreement was unconscionable and unenforceable when it “would always produce an arbitrator proposed by [the company] in employee-initiated arbitration[s],” and barred selection of “institutional arbitration administrators”); see also, e.g., *Murray v. United Food & Commercial Workers Int’l Union*, 289 F.3d 297 (4th Cir. 2002) (striking down an arbitration agreement that gave the employer the sole right to create a list of arbitrators from whom the employee could then pick); *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999); *Newton v. American Debt Services, Inc.*, 854 F. Supp. 2d 712, 726 (N.D. Cal. 2012) (refusing to enforce a provision that would have granted a company sole discretion to choose an “independent and qualified” arbitrator for its consumer disputes because, under the circumstances, there was no guarantee that the arbitrator would be neutral); *Roberts v. Time Plus Payroll Servs., Inc.*, 2008 WL 376288 (E.D. Pa. Feb. 7, 2008) (refusing to enforce provision that would have given employer sole discretion to select arbitrator, and instead requiring parties to select arbitrator jointly); *Missouri ex rel. Vincent v. Schneider*, 194 S.W.3d 853 (Mo. 2006) (invalidating provision giving president of a local home-builder association sole discretion to pick arbitrator for disputes between local home-builders and home buyers).

<sup>34</sup> See, e.g., *Zaborowski v. MHN Gov’t Servs., Inc.*, 2013 WL 1363568 (N.D. Cal. Apr. 3, 2013); *Adler v. Fred Lind Manor*, 103 P.3d 773 (Wash. 2004) (180 days); see also *Gandee v. LDL Freedom Enters., Inc.*, 293 P.3d 1197 (Wash. 2013) (refusing to enforce arbitration agreement in debt-collection contract that required debtor to present claim within 30 days after dispute arose); *Alexander*, 341 F.3d at 256 (same, for an employee); *Stirlen*, 60 Cal. Rptr. 2d at 138 (rejecting provision that imposed shortened one-year statute of limitations).

<sup>35</sup> See *Gandee*, 293 P.3d at 1197; *Alexander*, 341 F.3d at 256; *Sosa v. Paulos*, 924 P.2d 357 (Utah 1996).

Of course, the vast majority of arbitration agreements do not exhibit these sorts of defects; and the clear trend has been for companies to make arbitration provisions ever more favorable to their customers and employees. But when courts find that overreaching occurs, they have not hesitated to strike down the offending provision.

In addition to the courts' oversight of arbitration provisions, the *leading arbitration forums provide additional fairness protections*. The AAA and JAMS—the nation's leading arbitration service providers—recognize that independence, due process, and reasonable costs to consumers are vital elements of a fair and accessible arbitration system. They therefore adhere to standards that establish basic requirements of fairness that provide strong protections for consumers and employees—and refuse to administer arbitrations unless the operative clause is consistent with those standards.

Furthermore, *companies increasingly are adopting consumer-friendly arbitration agreements*. In the wake of the Supreme Court's decision in *Concepcion*, an increasing number of arbitration agreements include consumer- and employee-friendly provisions modeled on the elements of the arbitration agreement upheld in that case. That should not be surprising. As the Solicitor General of the United States explained in its briefing before the Supreme Court in *American Express v. Italian Colors Restaurant*, “many companies have modified their agreements to include streamlined procedures and premiums designed to encourage customers to bring claims.”<sup>37</sup> The government recognized that consumer-friendly clauses ensure that instances where individuals cannot bring their claims “remain rare.” As the brief explained:

AT&T Mobility modified its arbitration agreement during the course of the litigation to include cost- and fee-shifting provisions and premiums designed to ensure that *customers could bring low-value claims on an individual basis*. These modifications left consumers *‘better off under their arbitration agreement’ than they would have been in class litigation*. And by obviating a potential objection to enforcement of the arbitration agreement, those modifications

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<sup>36</sup> See, e.g., *In re Checking Account Overdraft Litig.*, MDL No. 2036, 485 F. App'x 403 (11th Cir. 2012); see also *Samaniego v. Empire Today LLC*, 140 Cal. Rptr. 3d 492 (Cal. Ct. App. 2012) (attorneys' fees).

<sup>37</sup> Brief for the United States as Amicus Curiae Supporting Respondents at 28-29, *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) (No. 12-133), 2013 WL 367051 (emphasis added).

simultaneously served the company's interest in avoiding litigation.

Consistent with these observations, arbitration agreements include a variety of consumer-friendly provisions:

- Many require businesses to shoulder all of the costs of arbitration, including filing fees and the arbitrator's compensation.
- Some agreements, such as the one the Supreme Court considered in *Concepcion*, provide for "bounty payments" as an incentive for an individual to bring a claim in arbitration, and agree not only to pay any attorney's fees that would be authorized by the underlying law, but double the attorney's fees if the arbitrator awards more than the company's last pre-hearing settlement offer.
- In some very complex cases, it is possible that a consumer or employee might require an expert witness or even complex discovery in order to pursue a claim against a company. Many agreements contain provisions that allow for such costs to be shifted to the company if the claimant prevails—even when the underlying law does not provide for such cost-shifting, which thus would not be available in a lawsuit in court.
- Agreements often adopt informal procedures that make it easy for claimants to pursue their disputes. For example, these agreements enable consumers and employees to choose whether the dispute should be resolved on the basis of a written submission, a telephonic hearing, or in-person proceedings.

In addition to all these direct benefits, ***consumers and employees also benefit*** through the systematic reduction of litigation-related transaction costs, which leads to ***lower prices for products and services and higher wages***.

How does this work? Businesses face many costs in bringing products and services to market. On top of the ordinary costs of running a business, they must absorb costs of litigating business-related claims. The transaction costs of litigation are high; they include settlements, judgments resolving meritorious claims, and the costs of defending against *all* lawsuits. Because those transaction costs are lower in arbitration, businesses can reduce costs that otherwise inflate product and service prices and reduce the availability of margins that could pay for wage increases.

### **III. THE ARGUMENTS ADVANCED BY ARBITRATION'S CRITICS DO NOT STAND UP.**

Despite the advantages that arbitration offers over pursuing litigation, some argue that arbitration should be prohibited or restricted in various ways. But these critics' arguments do not withstand scrutiny.

To begin with, *the ‘option’ of entering into a post-dispute arbitration agreement is illusory*. Some critics recognize that a generalized attack on arbitration flies in the face of alternative dispute resolution’s widespread acceptance—and its role as an effective alternative to our overwhelmed and underfunded court system. They thus frame their attack as one on *pre-dispute* arbitration agreements—those that involve agreements to arbitrate future disputes that might arise—and contend, incorrectly, that “if arbitration is indeed ... desirable, it will be readily accepted by claimants in the postdispute setting.”<sup>38</sup> Following that logic, some critics of arbitration have promised that adoption of measures like the Arbitration Fairness Act will not bring an end to consumer and employment arbitration, and that consumers and employees will still be able to choose to arbitrate any disputes that they wish.

*Nothing could be further from the truth*. Once a particular dispute arises, studies show that the opposing parties will rarely if ever agree to arbitration.<sup>39</sup> That unwillingness has nothing to do with the relative benefits or burdens of arbitration or litigation in court, and instead has everything to do with the practical burdens of administering dual systems and the tactical choices of parties and lawyers—both on the plaintiffs’ and defense side—in the context of particular cases.

A company that sets up an arbitration program incurs significant administrative costs that it will not incur in litigation in court. The AAA’s Supplementary Procedures for consumer disputes, for example, require the company to pay at least \$1,500 in filing fees. And a company that promises to shift attorneys’ or even experts’ fees is likely to take on an uncertain but possibly substantial additional amount of costs. Companies willingly incur these costs because, on average, the overall costs of resolving disputes in arbitration are lower than the costs of resolving disputes in litigation in court.

But companies will offer arbitration only if their agreements cover most or all possible claims. If the company cannot ensure that most or all of its dispute resolution will take place in arbitration rather than litigation, it will simply

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<sup>38</sup> Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 Ohio St. J. on Disp. Resol. 559, 567 (2001) (describing detractors’ position and explaining why it is wrong).

<sup>39</sup> See, e.g., *id.* at 567 (“[I]n all but the rarest cases,” post-dispute arbitration agreements “will not be offered by one party [and] accepted by the other.”); Hamid & Mathieu, 74 Alb. L. Rev. at 785 (“Post-dispute agreements to arbitrate are extremely uncommon.”); David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 Berkeley J. Emp. & Lab. L. 1, 61-62 (2003) (finding that far less than 1% of employment disputes are resolved by post-dispute arbitration *even when a responsible state agency organizes an arbitration program and routinely makes that program available to parties*).

relegate all disputes to the court system, because that is the system that is not optional—leaving individual claimants far worse off.

There are other reasons that post-dispute arbitration agreements are illusory. Among other things, less rational factors—such as emotional investment in the parties' respective positions, hope that multi-tiered court proceedings will result in a victory, visceral dislike for an opponent, or an attorney's pursuit of ever-greater fees—can prevent parties from agreeing to resolve their disputes fairly, quickly and at low cost before a neutral decisionmaker: “parties are loathe to agree to anything post-dispute when relationships sour.”<sup>40</sup>

A very significant reduction in access to justice would accordingly result from permitting only a post-dispute choice between arbitration and litigation—it would as a practical matter eliminate arbitration of consumer and employee claims—leaving most individuals with no meaningful access to a dispute resolution system. Pre-dispute agreements to arbitrate, which preserve that access to a simple and affordable forum, accordingly represent the only real-world option for addressing this very significant gap resulting from the court system.<sup>41</sup>

Perhaps the most vehement attack on arbitration stems from the fact that virtually all arbitration agreements require that arbitration proceed on an individual basis and bar class procedures in arbitration and in court. The Supreme Court upheld the use of such agreements in *AT&T Mobility v. Concepcion* and *American Express Co. v. Italian Colors Restaurant*. The elimination of class actions, the argument goes, deprives consumers of a procedural mechanism that supposedly provides enormous benefits by allowing the vindication of small claims that (according to the argument) would be too expensive for plaintiffs to arbitrate individually. Therefore, the critics contend, arbitration should be prohibited or, at a minimum, waivers of class procedure should be banned.

In fact, ***the claims of class action proponents are undermined by the reality of class actions.*** Although the debate about class action has relied on competing anecdotes, my law firm conducted an empirical analysis of class actions that is attached as Exhibit A to this testimony. That study, which examined a sample set of 148 putative consumer and employee class action lawsuits filed in or removed to federal court in 2009, is attached to this testimony. The study revealed:

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<sup>40</sup> Amy J. Schmitz, *Building Bridges To Remedies For Consumers In International Econflicts*, 34 U. Ark. Little Rock L. Rev. 779, 785 (2012).

<sup>41</sup> Theodore J. St. Antoine, *Mandatory Employment Arbitration: Keeping It Fair, Keeping it Lawful*, 60 Case W. Res. L. Rev. 629, 636 (2010) (“All the statutory (or contractual) rights in the world mean nothing if they cannot be enforced. Both personal anecdote and more systematic studies indicate that access to the courts will not be easy for the usual lower-paid worker with an employment claim.”).

- In the entire data set, ***not one of the class actions ended in a final judgment on the merits for the plaintiffs***. And none of the class actions went to trial, either before a judge or a jury.
- The vast majority of cases produced ***no benefits to most members of the putative class***—even though in a number of those cases the lawyers who sought to represent the class often enriched themselves in the process (and the lawyers representing the defendants always did).
  - ***Approximately 14 percent of all class action cases remained pending four years after they were filed***, without resolution or even a determination of whether the case could go forward on a class-wide basis. In these cases, class members have not yet received any benefits—and likely will never receive any, based on the disposition of the other cases we studied.
  - ***Over one-third (35%) of the class actions that have been resolved were dismissed voluntarily by the plaintiff***. Many of these cases settled on an individual basis, meaning a payout to the individual named plaintiff and the lawyers who brought the suit—***even though the class members receive nothing***. Information about who receives what in such settlements typically isn't publicly available.
  - ***Just under one-third (31%) of the class actions that have been resolved were dismissed by a court on the merits***—again, meaning that class members received ***nothing***.
- ***One-third (33%) of resolved cases were settled on a class basis***.
  - This ***settlement rate is half the average for federal court litigation***, meaning that a class member is far less likely to have even a chance of obtaining relief than the average party suing individually.
  - ***For those cases that do settle, there is often little or no benefit for class members***.
  - What is more, ***few class members ever even see those paltry benefits—particularly in consumer class actions***. Unfortunately, because ***information regarding the distribution of class action settlements is rarely available***, the public almost never learns what percentage of a settlement is actually paid to class members. But of the six cases in our data set for which settlement distribution data was public, ***five delivered funds to only miniscule percentages of the class: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%***. Those results are consistent with other available information about settlement distribution in consumer class actions.

- Although some cases provide for automatic distribution of benefits to class members, automatic distribution almost never is used in consumer class actions—only *one of the 40* settled cases fell into this category.
- Some class actions are settled without even the potential for a monetary payment to class members, with the settlement agreement providing for *payment to a charity or injunctive relief that, in virtually every case, provides no real benefit to class members.*

*In short, class actions do not provide class members with anything close to the benefits claimed by their proponents, although they can (and do) enrich attorneys—both on the plaintiffs’ and defense side.*

The lesson that should be taken from this study: It would be irrational for any policymaker to rest a decision on the theoretical benefits of class actions, when the real-world evidence shows that class actions provide little or no benefit, particularly in the consumer and employment context.

Moreover, *claimants can effectively vindicate in individual arbitration any claims that might be asserted through class actions.* Many arbitration provisions require businesses to pay costs of filing claims, to pay incentive or bonus payments to encourage arbitration of small claims, or to shift the costs associated with proving claims. And a number of other means for obtaining economies of scale—such as sharing the costs of proof across a set of individual arbitrations—are not only authorized by most arbitration agreements, but provide a fully viable model of effective dispute resolution.

The contention that class procedures are essential to permit vindication of small claims was specifically rejected by *both the majority and the dissent* in the Supreme Court’s recent decision in *American Express Co. v. Italian Colors Restaurant*.<sup>42</sup> The dissenting opinion, joined by Justices who also dissented in the *Concepcion* case, specifically identified several different ways in which consumers could effectively vindicate even small claims in arbitration without the use of class action procedures:

In this case, . . . the [arbitration] agreement could have prohibited class arbitration without offending the effective-vindication rule *if* it had provided an alternative mechanism to share, shift or reduce the necessary costs. The agreement’s problem is that it bars not just class actions, but also all mechanisms . . . for joinder or consolidation of claims, informal coordination among

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<sup>42</sup> 133 S. Ct. 2304 (2013).

individual claimants, or amelioration of arbitral expenses.<sup>43</sup>

As the dissenters in *American Express* explained, any concerns about whether individuals can vindicate their small claims in arbitration without the class-device are eliminated when an arbitration provision “provide[s] an alternative mechanism to . . . shift . . . the necessary costs.” A significant number of companies have adopted bonus/cost-shifting approaches similar to the one approved by the Court in *Concepcion*.

The *American Express* dissenters further stated that the concern about cost could be addressed through “**informal coordination among individual claimants**” to share the same lawyer, expert, and other elements required to prove the claim. For example, an entrepreneurial plaintiffs’ lawyer can recruit large numbers of clients (via the internet, social media, or other similar means), file thousands of individual arbitration demands on behalf of those clients, and distribute common costs over all those claimants, making the costs for expert witnesses and fact development negligible on a per-claimant basis. ***This is not just theory: it is happening today.***

Indeed, given the low cost, efficiency, and fairness of arbitration, it is no surprise that some plaintiffs’ lawyers are already beginning to recognize that pursuing multiple individual arbitrations (or small-claims actions) is an economically viable business model—especially in view of the ability to reach multiple, similarly situated individuals using websites and social media. Indeed, this strategy for spreading fixed litigation costs is an increasingly common means of pursuing disputes in arbitration.

There are thus multiple alternatives to private class action lawsuits in court brought by entrepreneurial plaintiffs’ attorneys; these alternatives afford individual consumers and employees actual opportunities to pursue their disputes or otherwise vindicate their rights—in sharp contrast to the false promise of private class actions.

Furthermore, ***class actions are not needed to deter wrongdoing.*** Deterrence theory holds that a party will not engage in wrongdoing if the party believes that it will incur costs for acting wrongfully that it will not incur if it complies with the law. If those costs are incurred without regard to the wrongfulness of the underlying conduct, there is no such deterrent effect.<sup>44</sup>

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<sup>43</sup> *Id.* at 2318 (Kagan, J., dissenting). The majority disagreed with the dissent’s claim that the agreement at issue in that case barred informal coordination among individual claimants. *Id.* at 2311 n.4.

<sup>44</sup> For an analogous discussion of how a failure to distinguish adequately between the culpable and the innocent dilutes the deterrent effect of sanctions in the criminal-law

Plaintiffs' attorneys have little incentive to choose class action cases based on the merits of the underlying claims; rather, they seek to find a claim for which the complaint can withstand a motion to dismiss and that can satisfy the (legitimately) high hurdles for class certification. Once a class is certified, settlement virtually always follows, driven by the transaction costs that such actions impose. These burdens are unrelated to the merits of the lawsuit, and affect many businesses that do not engage in wrongful conduct. Because these burdens are a function of who plaintiffs' lawyers sue rather than who has engaged in actual wrongdoing, the threat of class actions cannot—and does not—generally deter wrongful conduct.

Businesses are far more likely to be deterred from wrongdoing by the reputational consequences of engaging in improper behavior, especially because reputational harm is often directly correlated to a business's success or failure. Especially in an age of social media, consumer complaints can quickly go viral on Facebook, Twitter, and change.org (to name a few examples). That phenomenon impacts companies immediately and directly leads to changes in practices that garner consumer opposition. Class actions, by contrast, rarely, if ever, have that effect.

Even though class-wide procedures are not necessary to vindicate small-value claims, *some critics of arbitration have urged that arbitration agreements should be required to permit either class-wide arbitration or the filing of class actions in court*. But like the argument in favor of permitting only “post-dispute arbitration agreements,” *such a rule would eliminate consumer and employee arbitration*.

As explained above, companies incur substantial costs in setting up an arbitration system because arbitration offers transaction cost savings over the alternative—litigation in court. But they would not be able to minimize those costs—which are regularly passed along to consumers and employees in the form of lower prices and higher wages—if also forced to incur the substantial transaction costs associated with litigating class actions in court, or undertaking classwide procedures in arbitration. Indeed, many companies have publicly stated that they would abandon arbitration entirely if the class-action waivers contained in their arbitration agreements are rendered unenforceable.

In sum, class-wide proceedings do not deliver on the promises that their proponents have made. Their absence does not justify jettisoning arbitration, which (unlike litigation) creates an opportunity for consumers and employees to pursue their real-world disputes—ones that are often too small and individualized to ever qualify for class treatment anyway.

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context, see A. Mitchell Polinsky & Steven Shavell, *The Theory of Public Enforcement of Law*, in 1 Handbook of Law and Economics 403, 427-29 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

**IV. THE CONSUMER FINANCIAL PROTECTION BUREAU'S  
"PRELIMINARY RESULTS" FROM ITS ONGOING STUDY OF  
ARBITRATION PROVIDES NO EMPIRICAL BASIS FOR  
REGULATING ARBITRATION AGREEMENTS.**

Under Section 1028 of the Dodd-Frank Act, the Consumer Financial Protection Bureau has been charged with conducting a study of the use of arbitration in connection with consumer financial products and services. On December 11, 2013 the CFPB issued a report containing some "preliminary results" relating to elements of its study. The Bureau expressly stated that:

- "Readers should not interpret this presentation as our assessment, preliminary or otherwise, of the relative importance of different areas to be covered in the statutory report to Congress. Rather, the subjects addressed here are those as to which we already have been able to obtain and analyze sufficient data in order to make some preliminary findings."
- "Because the Bureau's work on this study is ongoing, any of the findings presented here may be refined or modified when we issue our report to Congress."
- "This presentation focuses on the 'front-end' of formal disputes involving consumers—the nature of formal filings; "[i]n later work, we intend to address the 'back-end' of formal disputes: what happens, in how long, and at what cost."

The Bureau also identified a variety of areas that it had not yet addressed, such as "the disposition of cases across arbitration and litigation (including class litigation), both in terms of substantive outcome and in terms of procedural variable like speed to resolution"; "consumer benefits and transaction costs in consumer class actions involving consumer financial services" including "whether class actions exert improper pressure on defendants to settle meritless claims"; and "the possible impact of arbitration clauses on the price of consumer financial products."

The key takeaway from the CFPB's announcement last week is that—as the agency itself made clear—the information released is "preliminary." That is putting it mildly; the study itself identifies a number of areas requiring a substantial amount of empirical work. And that is important, because the results announced so far provide little information about the central questions that the Bureau must address: For the kinds of injuries that most consumers are likely to experience, what is the real-world accessibility, cost, fairness, and efficiency of arbitration as compared to suing in court – and, therefore, how will consumers be harmed if arbitration is prohibited or subjected to regulation that eliminate arbitration's availability?

For the reasons explained above, the existing empirical evidence points in

favor of arbitration rather than courts as the most accessible forum for consumer and employee dispute resolution.

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Thank you again for the opportunity to testify before the Committee today. I look forward to answering your questions.

# Exhibit A

## Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions

By Mayer Brown LLP

### Executive Summary

This empirical study of class action litigation—one of the few to examine class action resolutions in any rigorous way—provides strong evidence that class actions provide far less benefit to individual class members than proponents of class actions assert.

The debate thus far has consisted of competing anecdotes. Proponents of class action litigation contend that the class device effectively compensates large numbers of injured individuals. They point to cases in which class members supposedly have obtained benefits. Skeptics respond that individuals obtain little or no compensation and that class actions are most effective at generating large transaction costs—in the form of legal fees—that benefit both plaintiff and defense lawyers. They point to cases in which class members received little or nothing.

Rather than simply relying on anecdotes, this study undertakes an empirical analysis of a neutrally-selected sample set of putative consumer and employee class action lawsuits filed in or removed to federal court in 2009.<sup>1</sup>

Here's what we learned:

- In our entire data set, ***not one of the class actions ended in a final judgment on the merits for the plaintiffs.*** And none of the class actions went to trial, either before a judge or a jury.
- The vast majority of cases produced ***no benefits to most members of the putative class***—even though in a number of those cases the lawyers who sought to represent the class often enriched themselves in the process (and the lawyers representing the defendants always did).
  - ***Approximately 14 percent of all class action cases remained pending four years after they were filed,*** without resolution or even a determination of whether the case could go forward on a class-wide basis. In these cases, class members have not yet received any benefits—and likely will never receive any, based on the disposition of the other cases we studied.
  - ***Over one-third (35%) of the class actions that have been resolved were dismissed voluntarily by the plaintiff.*** Many of these cases settled on an individual basis, meaning a payout to the

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<sup>1</sup> For information about our methodology, see Appendix C.

individual named plaintiff and the lawyers who brought the suit—*even though the class members receive nothing*. Information about who receives what in such settlements typically isn't publicly available.

- *Just under one-third (31%) of the class actions that have been resolved were dismissed by a court on the merits*—again, meaning that class members received *nothing*.
- *One-third (33%) of resolved cases were settled on a class basis.*
  - This *settlement rate is half the average for federal court litigation*, meaning that a class member is far less likely to have even a chance of obtaining relief than the average party suing individually.
  - *For those cases that do settle, there is often little or no benefit for class members.*
  - What is more, *few class members ever even see those paltry benefits—particularly in consumer class actions*. Unfortunately, because *information regarding the distribution of class action settlements is rarely available*, the public almost never learns what percentage of a settlement is actually paid to class members. But of the six cases in our data set for which settlement distribution data was public, *five delivered funds to only minuscule percentages of the class: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%*. Those results are consistent with other available information about settlement distribution in consumer class actions.
  - Although some cases provide for automatic distribution of benefits to class members, automatic distribution almost never is used in consumer class actions—only *one of the 40* settled cases fell into this category.
  - Some class actions are settled without even the potential for a monetary payment to class members, with the settlement agreement providing for *payment to a charity or injunctive relief that, in virtually every case, provides no real benefit to class members*.

*The bottom line: The hard evidence shows that class actions do not provide class members with anything close to the benefits claimed by their proponents, although they can (and do) enrich attorneys.* Policymakers who are considering the efficacy of class actions cannot simply rest on a theoretical assessment of class actions' benefits or on favorable anecdotes to justify the value of class actions. Any decision-maker wishing to rest a policy determination on the

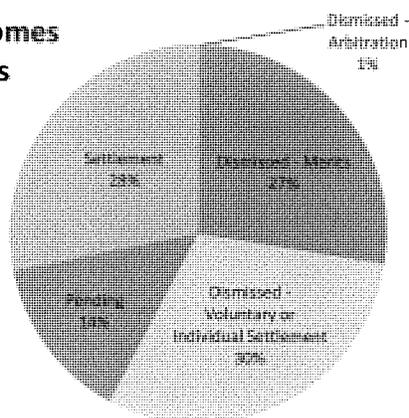
claimed benefits of class actions would have to engage in significant additional empirical research to conclude—contrary to what our study indicates—that class actions actually do provide significant benefits to consumers, employees, and other class members.

## Results

### Overall Outcomes

Of the 148 federal court class actions we studied that were initiated in 2009, 127 cases (or nearly 86 percent) had reached a final resolution by September 1, 2013, the date when the study closed.

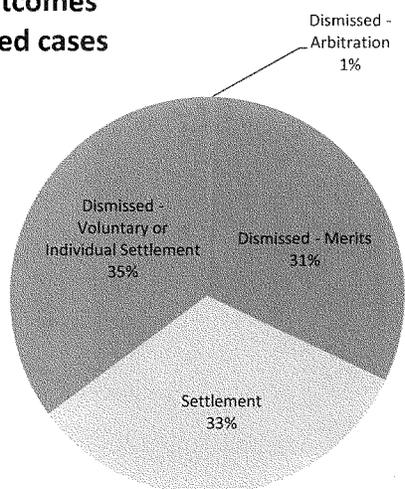
**Figure 1: Outcomes  
in 148 cases**



**Zero cases resulted in a judgment on the merits.** Of the 148 cases in our sample set, *not one had gone to trial*—either before a judge or jury. And, as of the closing date of our study, *not one resulted in a judgment for the plaintiffs on the merits.*

Unlike ordinary (non-class) disputed cases, some of which end with a judgment on the merits in favor of the plaintiffs or defendants, class actions end without any determination of the case's merits. The class action claims that make it past the pleadings stage and class-certification gateway virtually always settle—regardless of the merits of the claims.

**Figure 2: Outcomes  
in 127 resolved cases**



Indeed, Justice Ruth Bader Ginsburg has recognized that “[a] court’s decision to certify a class \* \* \* places pressure on the defendant to settle even unmeritorious claims.”<sup>2</sup> Then-Chief Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit explained that certification of a class action, even one lacking in merit, forces defendants “to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability.”<sup>3</sup> And Judge Diane Wood of the Seventh Circuit has explained that certification “is, in effect, the whole case.”<sup>4</sup> That may be why another study of class

<sup>2</sup> *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 445 n.3 (2010) (Ginsburg, J., dissenting).

<sup>3</sup> *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293, 1299 (7th Cir. 1995).

<sup>4</sup> Hon. Diane Wood, Circuit Judge, Remarks at the FTC Workshop: Protecting Consumer Interests in Class Actions (Sept. 13–14, 2004), in *Panel 2: Tools for Ensuring that Settlements are “Fair, Reasonable, and Adequate,”* 18 Geo. J. Legal Ethics 1197, 1213 (2005).

actions reported that “[e]very case in which a motion to certify was granted, unconditionally or for settlement purposes, resulted in a class settlement.”<sup>5</sup>

**Fourteen percent of the class actions filed remain unresolved.** Even though our study period encompassed more than 44 months since the filing of the last case in our sample (and 55 months from the filing of the first case), a significant number of cases—21 of the 148 in our sample, or 14%—remained pending with no resolution, let alone final judgment on the merits.<sup>6</sup>

And there is no reason to believe that these cases are more likely to yield a benefit for class members than the cases that have been resolved thus far. In 15 of these cases either no motion for class certification has been filed or the court has not yet ruled on the motion, and in another 2 the court denied certification. In a significant proportion of these pending cases, it seems likely that class certification will be denied or never ruled upon before the case is ultimately dismissed. After all, prior studies indicate that nearly 4 out of every 5 lawsuits pleaded as class actions are not certified.<sup>7</sup>

**Over one-third of the class actions that have been resolved were dismissed voluntarily by the named plaintiff and produced no relief at all for the class.** Forty-five cases were voluntarily dismissed by the named plaintiff who had sought to serve as a class representative or were otherwise resolved on an individual basis. That means either that the plaintiff (and his or her counsel) simply decided not to pursue the class action lawsuit, or that the case was settled on an individual basis, without any benefit to the rest of the class. These voluntary dismissals represent 30 percent of all cases studied, or 35 percent of cases that reached a resolution by the beginning of September 2013.<sup>8</sup>

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<sup>5</sup> Emery G. Lee III et al., *Impact of the Class Action Fairness Act on the Federal Courts: Preliminary Findings from Phase Two's Pre-CAFA Sample of Diversity Class Actions* at 11 (Federal Judicial Center 2008), <http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Preliminary%20Findings%20from%20Phase%20Two%20Class%20Action%20Fairness%20Study%20%282008%29.pdf> (discussing 30 such cases).

<sup>6</sup> These results are broadly consistent with other studies of class actions. *See, e.g., id.* at 6 (noting that 9% of cases remained pending after at least 3.5 years).

<sup>7</sup> *See* Thomas E. Willging & Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does it Make?*, 81 *Notre Dame L. Rev.* 591, 635-36, 638 (2006).

<sup>8</sup> In one of the cases we studied, the court compelled arbitration of the named plaintiff's claims—a determination that almost always precludes class treatment of the case.

In fourteen of the cases that were voluntarily dismissed—approximately one-third of all voluntary dismissals in the data set—the dismissal papers, other docket entries, or contemporaneous news reports made clear that the parties were settling the claim on an individual basis, although the terms of those settlements were not available. Many of the remaining voluntary dismissals also may have resulted from individual settlements.

These settlements often provide that the plaintiff—and his or her attorney—receive recoveries themselves, even though the rest of the class that they sought to represent receive *nothing*. When parties settle cases on an individual basis, those settlements often are confidential, and the settlement agreements therefore are not included on the court’s public docket.<sup>9</sup>

**Just under one-third of the class actions that have been resolved were dismissed on the merits.** In addition to the 45 cases dismissed voluntarily by plaintiffs, 41 cases were dismissed outright by federal courts, through a dismissal on the pleadings or a grant of summary judgment for the defendant. The courts in these cases concluded that the lawsuits were meritless before even considering whether the case should be treated as a class action. These represented 27 percent of all cases studied, and 31 percent of resolved cases.

In other words, *in over half of all putative class actions studied—and nearly two-thirds of all resolved cases studied—members of the putative class received zero relief.* These results are depicted in Figures 1 and 2, which appear below. And these results are broadly consistent with other empirical studies of class actions. If anything, for reasons explained in Appendix C, abusive, illegitimate class actions are probably under-represented in our sample, and the sample therefore probably significantly *overstates* the extent to which class

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<sup>9</sup> Unlike class settlements under Federal Rule of Civil Procedure 23, which must be publicly disclosed and approved by the court, individual settlements of lawsuits in federal court need not be disclosed publicly, nor is court approval required. Typically, parties that agree to settle claims on an individual basis in a lawsuit pending in federal court—whether or not those claims are part of a class action—enter into confidential settlement agreements, a condition of which is that the named plaintiff will voluntarily dismiss his or her individual claims with prejudice; remaining claims that were purported to have been brought on behalf of a class may be dismissed without prejudice with respect to other class members, who may or may not assert the claim in subsequent litigation.

members benefit from the class action. For comparison, another study found that ***84% of class actions ended without any benefit to the class.***<sup>10</sup>

**Fewer than thirty percent of the cases filed were settled.** All of the remaining class actions that have been concluded were settled on a class-wide basis: The parties reached settlements in 40 cases—28% of all cases studied, or 33% of all resolved cases.<sup>11</sup>

This subset of class actions is the only one in our study in which it is possible that absent class members could possibly receive any benefit at all. As we next discuss, however, the benefits claimed to be associated with such settlements are largely illusory.

### **Class Settlements**

**Class actions have a significantly lower settlement rate than other federal cases.** The settlement rate for our sample of cases—33% of resolved cases—is much lower than for federal court litigation as a whole. One study of federal litigation estimated that “the aggregate settlement rate across case categories” for two districts studied was “66.9 percent in 2001-2002.”<sup>12</sup> Even the least frequently settled case category in that study—constitutional litigation—had a higher settlement rate (39%) than the 33% for the class action cases we studied.<sup>13</sup>

Thus, ***class actions are significantly less likely to produce settlements, and therefore significantly less likely to produce any benefit to class members, than other forms of litigation.*** Settlement is the only resolution that produces even the possibility of a benefit to class members, because class actions are virtually never resolved through judgments on the merits, a fact that our study corroborates. And the settlement rate in our sample set is not an outlier: a study of

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<sup>10</sup> See, e.g., Lee et al., *supra* note 5, at 6 (noting that in cases not remanded, 55% of cases were voluntarily dismissed without class certification or class settlement, and another 29% were dismissed by the court).

<sup>11</sup> This category includes one case in which the parties have announced a class settlement and sought preliminary approval; five cases in which the court has granted preliminary approval (but has not yet finally approved it); one case that resulted in a settlement to fewer than all plaintiff class members; and two cases in which appeals are pending.

<sup>12</sup> Theodore Eisenberg and Charlotte Lanvers, *What is the Settlement Rate and Why Should We Care?*, 6 J. Empir. Leg. Stud. 111, 115 (2009).

<sup>13</sup> *Id.* at 133.

class actions brought in California state court in 2009 reported a similarly low settlement rate of 31.9%.<sup>14</sup>

Moreover, the fact that 40 of our sample cases were settled says nothing about the extent of the benefit, if any, that those settlements conferred on class members.

**Many class settlements—and virtually all settlements of consumer class actions—produce negligible benefits for class members.** It is a notoriously difficult exercise to assess empirically how class members benefit from class action settlements. These settlements fall generally into three basic categories:

- “Claims-made” settlements, under which class members are bound by a class settlement—and thereby release all of their claims—but only obtain recoveries if they affirmatively request to do so, usually through use of a claims form.<sup>15</sup> Funds not distributed to claimants are returned to the defendant or, in some cases, distributed to a charity via the *cy pres* process (which creates significant additional problems, as we discuss below). They are not given to class members. Most settlements fall into this category.
- Injunctive relief/cy pres settlements, in which the relief provided to settling class members involves only injunctive relief (which may provide little or no benefit to class members) or *cy pres* distributions (in which money is paid to charitable organizations rather than class members).
- “Automatic distribution” settlements, in which each class member’s settlement is distributed automatically to class members whose

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<sup>14</sup> Hilary Hehman, *Class Certification in California: Second Interim Report from the Study of California Class Action Litigation*, Judicial Council of California: Administrative Office of the Courts, at Tables D1-D2 (Feb. 2010), <http://www.courts.ca.gov/documents/classaction-certification.pdf> (observing that 410 of 1294 resolved cases were settled); see also Patricia Hatamyar Moore, *Confronting the Myth of “State Court Class Action Abuses” Through an Understanding of Heuristics and a Plea for More Statistics*, 82 UMKC L. Rev. 133, at 165 & n.192 (2013).

<sup>15</sup> See 4 *Newberg on Class Actions* § 12:35 (4th ed. 2013) (“[A] common formula in class actions for damages is to distribute the net settlement fund after payment of counsel fees and expenses, ratably among class claimants according to the amount of their recognized transactions during the relevant time period. A typical requirement is for recognized loss to be established by the filing of proofs of claim. . .”).

eligibility and alleged damages could be ascertained and calculated—such as retirement-plan participants in ERISA class actions.

***The parties typically have no meaningful choice among these methods of structuring a settlement.*** Automatic distribution settlements are feasible only if the parties have the names and current addresses of class members as well as the ability to calculate each class member’s alleged damages. But companies typically lack the information needed to settle cases using an automatic distribution mechanism—especially in consumer cases, where purchase records may be incomplete or unavailable, and/or class members’ claimed injuries may vary widely and unpredictably.

***Thus, consumer class actions are almost always resolved on a claims-made basis, and the actual amount of money delivered to class members in such cases almost always is a miniscule percentage of the stated value of the settlement.*** That is because, in practice, relatively few class members actually make claims in response to class settlements: many class members may not believe it is not worth their while to request the (usually very modest) awards to which they might be entitled under a settlement. And the claim-filing process is often burdensome, requiring production of years-old bills or other data to corroborate entitlement to recovery.

**The class members’ actual benefit from a settlement—if any—is almost never revealed.** Remarkably, the public almost never has access to settlement distribution data. One study found that settlement distribution data were available in “fewer than one in five class actions in [the] sample.”<sup>16</sup> Companies and their defense lawyers are hesitant to reveal how much a company has been required to pay out to class members, and plaintiffs’ counsel have strong incentives to conceal the information because requests for attorneys’ fees based on a settlement’s face value will appear overstated when compared to the actual value. Judges are often happy to have the case resolved, and therefore have little to no interest in requiring transparency in the settlement distribution process.

While third-party claims administrators often possess direct information about claims rates, they are routinely bound by contract to maintain the confidentiality of that information in the absence of party permission, a court order, or other legal authority.<sup>17</sup> This may be a function of the incentive shared by class

<sup>16</sup> Nicholas M. Pace & William B. Rubenstein, *How Transparent are Class Action Outcomes? Empirical Research on the Availability of Class Action Claims Data* at 3, RAND Institute for Civil Justice Working Paper (July 2008), [billrubenstein.com/Downloads/RAND%20Working%20Paper.pdf](http://billrubenstein.com/Downloads/RAND%20Working%20Paper.pdf).

<sup>17</sup> *Id.* at 31-32 (explaining that in a survey of class action participants, only 25% of “chief executive officers” at settlement administrators responded to the survey, and even those only “did so solely to inform [the researchers] that the information

counsel and defense counsel to avoid facilitating grounds for a class member to object that a settlement was unfair because it provided too little tangible benefit to the class.<sup>18</sup> Indeed, “[h]ow many people were actually members of this class, how many of these class members actually submitted a claim form, and how much they were actually paid appear to be closely held secrets between the class counsel and the defendant.”<sup>19</sup>

**In rare cases in which class-settlement distribution data was available, few class members received any benefit at all.** In our data set, *18 cases were resolved by claims-made settlements*—44% of the total. *We were able to obtain meaningful data regarding the distribution of settlement proceeds in only six of the 18 cases*, which is not surprising given the well-established and widespread lack of publically available information regarding the extent to which class members actually benefit from settlements. *Five of the six cases resulted in minuscule claims rates: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.*<sup>20</sup> These

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that they held was ‘proprietary’ to their clients, namely the attorneys that had hired them to oversee the class action claiming process”); cf. Deborah R. Hensler, et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 163-64 (2000) (noting difficulty in obtaining “information about the claiming process and distribution” from a “settlement administrator,” who “declined to share distribution figures, suggesting that we talk to the attorneys involved with the case,” and noting further that the plaintiffs’ and defense attorneys had agreed between themselves “not to discuss or divulge matters related to . . . the actual distribution to the class”).

<sup>18</sup> See Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 Fla. L. Rev. 71, 93 (2007) (explaining that when a “notice do[es] not estimate the size of the class, . . . class members are unable to calculate their own individual recoveries” and therefore lack “sufficient bases for objecting to the proposed settlement”); see also *Thorogood v. Sears, Roebuck & Co.*, 547 F.3d 742, 744-45 (7th Cir. 2008) (Posner, J.) (“The defendants in class actions are interested in minimizing the sum of the damages they pay the class and the fees they pay the class counsel, and so they are willing to trade small damages for high attorneys’ fees. . . . The result of these incentives is to forge a community of interest between class counsel, who control the plaintiff’s side of the case, and the defendants. . . . The judge . . . is charged with responsibility for preventing the class lawyers from selling out the class, but it is a responsibility difficult to discharge when the judge confronts a phalanx of colluding counsel.”) (citations omitted).

<sup>19</sup> Hensler, *supra* note 17, at 165.

<sup>20</sup> The lone outlier—a case with a 98.72% claims rate—involved the settlement of an ERISA case involving claims about the Bernie Madoff Ponzi scheme for which potentially enormous claims could be made. The math explains why an “astonishing

extremely small claim-filing rates are consistent with the few other reports of claim rates in class action settlements that have come to light.

As one federal court observed, “claims made’ settlements regularly yield response rates of 10 percent or less.”<sup>21</sup> In fact, the claims rate frequently is *much lower*—in the single digits. Appendix A contains a list of more than 20 additional cases for which information about distributions is available, all of which involved distributions to less than seven percent of the class and many of which involved distributions to less than one percent of the class.

There is thus ample evidence to infer that *the extremely small claims rates for cases in our sample is representative of what happens in class actions generally, and particularly in consumer class actions.*<sup>22</sup> And although documents filed in the remaining 12 of the 18 claims-made settlements lacked information about claims rates, there is every reason to believe that class members made claims at the small rates ordinarily observed in such cases. While some may argue that parties should use automatic distribution mechanisms instead

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98.72%” of the 470 members of the damages class filed claims in this \$1.2165 billion settlement. Final Order at 11, *In re Beacon Assoc. Litig.*, No. 09-cv-777 (S.D.N.Y. May 9, 2013), PACER No. 77-2. Because each class member’s individual claim was worth, on average, over \$2.5 million, it is unsurprising that over 460 of the class members decided to submit a claim. Needless to say, virtually no consumer or employment class actions settle for anything approaching such a large amount per class member.

<sup>21</sup> *Sylvester v. CIGNA Corp.*, 369 F. Supp. 2d 34, 52 (D. Me. 2005).

<sup>22</sup> Some earlier studies purported to assess the benefits received by class members, but they examined “only what defendants *agreed to pay*” in settlements, rather than “the amounts that defendants *actually paid* after the claims administration process concluded.” Brian Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. Empirical Legal Stud. 811, 826 (2010) (emphasis added); see also Theodore Eisenberg & Geoffrey Miller, *Attorney’s Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. Empirical Legal Stud. 248, 258-59 (2010) (using same approach).

Moreover, because Fitzpatrick studied only settlements (see 7 J. Empirical Legal Stud. at 812), his study failed to take into account that most putative class actions are dismissed or otherwise terminated without any benefits for class members. And Eisenberg and Miller ignored settlements that promised *only* nonpecuniary relief (such as coupons or injunctive relief) to class members. An earlier version of their study—which laid the methodological groundwork for the later expanded study in 2010 (see *id.* at 252)—appears to have counted cases involving such “soft relief” only when it was “included” along with pecuniary relief. Theodore Eisenberg & Geoffrey Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. Empirical Legal Stud. 27, 40 (2004).

of “claims-made” settlements to resolve class actions, the reality is that automatic distribution is difficult, if not impossible, to achieve in many (perhaps most) consumer class actions.

**Only one consumer class action settlement was resolved through automatic distribution.** Of the remaining 22 settled cases in our sample, 13 involved *settlements with automatic distribution of settlement proceeds*. Ten of these 13 involved claims by retirement plan participants in ERISA class actions, in which the class members’ eligibility and alleged damages could be easily ascertained and calculated based on their investment positions. The plans of distribution in these 10 cases generally involved lump-sum payments to the plan, which would then be allocated directly to plan members’ accounts.

The other three automatic-distribution settlements were reached in consumer and employment class actions. In each case—atypical of most class actions—the defendant was in a position to ascertain and calculate class members’ eligibility and alleged damages:

- In one, an employer settled claims that it conspired with health care providers and insurers to dictate medical treatment provided to about 13,764 employees injured on the job, whose identities were readily known to the defendant employer; employees who were treated by one health-care provider received a check for \$520, while injured employees treated by another provider received a check for \$50.<sup>23</sup>
- In a second settlement, a credit-card issuer settled claims that it improperly raised the minimum monthly payment and added new fees in connection with promotional loan offers. The defendant issued class members a flat-rate payment of \$25, plus (for certain customers) a share of the remaining settlement fund calculated by taking into account the ways the class member had used the promotional loan and had been charged fees.<sup>24</sup>
- Finally, as we explain in more detail below, a third settlement resolved privacy claims against a mobile-phone gaming app developer in

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<sup>23</sup> Plaintiffs’ Unopposed Motion for Order Preliminarily Approving Class Action Settlement at 8, *Gianzero v. Wal-Mart Stores, Inc.*, No. 09-cv-00656 (D. Colo. Nov. 21, 2011), PACER No. 464 (“*Gianzero* Preliminary Approval Motion”).

<sup>24</sup> Plaintiffs’ Motion for Preliminary Approval of Class Settlement at 5-7, *In re Chase Bank USA, N.A. “Check Loan” Contract Litigation*, No. 09-md-2032 (N.D. Cal. July 23, 2012), PACER No. 338.

exchange for 45 in-game “points” that were automatically distributed to users so they could advance through the game’s levels.<sup>25</sup>

Thus, only two consumer cases involved automatic distributions, and in one the distribution involved “game points.” *Only a single settled consumer class action—one of 127 class actions resolved—conveyed real benefits to anything more than a small percentage of the class.*

*Cy pres awards and injunctive relief serve primarily to inflate attorney’s fee awards—and benefit third parties with little or no ties to the putative class.* The final group of 9 settled cases largely involved *injunctive relief or cy pres distributions*. Because these cases involve no monetary compensation to class members, it is difficult for outsiders to assess the claimed benefit. Certainly, *in many cases “injunctive relief” has little or no real-world impact on class members, but is used to provide a basis for claiming a “benefit” to class members justifying an award of attorneys’ fees to class counsel* (as we detail below). The injunctive-relief-only settlements we reviewed included the following:

- Plaintiff subscribers of America Online (“AOL”) claimed that it embedded advertisements at the bottom of the subscribers’ email messages without their permission. After an early settlement was vacated on appeal for improper *cy pres* awards to unrelated charities, the parties again settled the claims, with AOL promising to tell subscribers how to opt out of email advertisements if it restarted the challenged practice.<sup>26</sup>
- In a class action involving claims that a social-networking app developer failed to protect properly the personally identifiable information of 32 million customers from a data security breach, the settlement provided that the defendant will undergo two audits of its information security policies with regard to maintenance of consumer records, to be made by an independent third party. The settlement explicitly reserves the rights of the plaintiff class to sue for monetary relief.<sup>27</sup>
- Plaintiffs brought false advertising claims against Unilever, contending that it had misrepresented the health or nutritional characteristics of “I Can’t Believe It’s Not Butter.” As part of the

<sup>25</sup> See notes 44–46 and accompanying text.

<sup>26</sup> Revised Class Action Settlement Agreement ¶¶ 20-22, *Bronster v. AOL, LLC*, No. 09-cv-3568 (C.D. Cal. July 31, 2013), PACER No. 66-10. The settlement also proposes a *cy pres* award to a more related charitable organization. *Id.* ¶ 23.

<sup>27</sup> Settlement Agreement and Release at 4, *Claridge v. RockYou, Inc.*, No. 09-cv-6032 (N.D. Cal. Dec. 15, 2011), PACER No. 55-1.

settlement, Unilever was to remove all partially hydrogenated vegetable oils from its soft spreads by December 31, 2011, and from its stick products by December 31, 2012, and keep those ingredients out of those products for 10 years. Although they did not receive monetary compensation, class members released all monetary and equitable claims other than claims for personal injury.<sup>28</sup>

- Finally, in a class action alleging the violation of consumer protection laws arising out of the marketing of Zicam supplements (sold as a way of combating the common cold), the parties provided for a number of non-pecuniary “benefits”—all in the form of labeling changes. These include: (1) indicating that the FDA has not approved the supplements; (2) disclosing that customers with zinc allergies or sensitivities should consult a doctor; (3) informing customers that the products are not intended to be effective for the flu or for allergies; and (4) removing language recommending that customers continue to use the products for 48 hours after cold symptoms subside. If the court approves the settlement and requested attorneys’ fees, the defendant will pay plaintiff’s counsel up to \$1.75 million in fees in one case, and another \$150,000 in a related MDL proceeding.<sup>29</sup>

Like injunctive relief settlements, *the cy pres doctrine is being used by plaintiffs’ lawyers to inflate artificially the purported size of the benefit to the class in order to justify higher awards of attorney’s fees to the plaintiffs’ lawyers*. In four of the cases we examined, the settlement provided that one or more charitable organizations would receive either all monetary relief, or any remaining monetary relief after claims made were paid out.

Courts often assess the propriety of an attorneys’ fee award in the settlement context by comparing the percentage of the settlement paid to class members or charities with the percentage of the settlement allocated to class counsel.<sup>30</sup> That

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<sup>28</sup> Notice of Joint Motion for Final Approval of Class Settlement and Memorandum of Points and Authorities in Support Thereof at 4, *Red v. Unilever United States, Inc.*, No. 10-cv-387 (N.D. Cal. June 6, 2011), PACER No. 153.

<sup>29</sup> Plaintiffs’ Memorandum in Support of Motion for Final Approval of Class Action Settlement at 4-5, *Hohman v. Matrixx Initiatives, Inc.*, No. 09-cv-3693 (N.D. Ill. May 26, 2011), PACER No. 81.

<sup>30</sup> See, e.g., *Strong v. BellSouth Telecommunications, Inc.*, 137 F.3d 844, 851 (5th Cir. 1998) (affirming the district court’s decision to compare the “actual distribution of class benefits” against the potential recovery, and adjusting the requested fees to account for the fact that a “drastically” small 2.7 percent of the fund was distributed); see also *Int’l Precious Metals Corp. v. Waters*, 530 U.S. 1223, 1223 (2000) (O’Connor, J., respecting the denial of certiorari) (noting that fee

approach has been endorsed by the Manual for Complex Litigation.<sup>31</sup> If no funds are allocated to the class, or a small portion of the amount ostensibly allocated to the class is actually distributed and the remainder of the funds returned to the defendants, the relative percentages could be disturbing to a court reviewing the fairness of the settlement. But if the amount not collected by class members is contributed to a charity that can be claimed to have some tenuous relationship to the class, then the percentage allocated to attorneys' fees may appear more acceptable.

The result, as one district court has warned, is that attorney fee awards "determined using the percentage of recovery" will be "exaggerated by *cy pres* distributions that do not truly benefit the plaintiff class."<sup>32</sup> As Professor Martin Redish has noted, the *cy pres* form confirms that "[t]he real parties in interest in . . . class actions are . . . the plaintiffs' lawyers, who are the ones primarily responsible for bringing th[e] proceeding."<sup>33</sup> One district court has noted that when a consumer class action results in a *cy pres* award that "provide[s] those with individual claims no redress," where there are other "incentives" for bringing individual suits, the class action fails the requirement that the class action be "superior to other available methods" of dispute resolution.<sup>34</sup>

**Lawyers (as opposed to class members) were the principal beneficiaries of the remaining settlements in our study.** For the "*cy pres*" settlements in our data set, and the "claims made" settlements for which there is no distribution data,

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awards disconnected from actual recovery "decouple class counsel's financial incentives from those of the class," and "encourage the filing of needless lawsuits where, because the value of each class member's individual claim is small compared to the transaction costs in obtaining recovery, the actual distribution to the class will inevitably be small").

<sup>31</sup> See Federal Judicial Center, *Manual for Complex Litigation (Fourth)* § 27.71 (2004).

<sup>32</sup> *SEC v. Bear Stearns & Co.*, 626 F. Supp. 2d 402, 415 (S.D.N.Y. 2009).

<sup>33</sup> Testimony of Martin H. Redish at 7, U.S. House of Representatives, Committee on the Judiciary, Subcommittee on the Constitution, *Hearing: Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), available at <http://judiciary.house.gov/hearings/Hearings%202012/Redish%2006012012.pdf>.

<sup>34</sup> *Hoffer v. Landmark Chevrolet Ltd.*, 245 F.R.D. 588, 601-04 (S.D. Tex. 2007) (Rosenthal, J.). In one of the cases in our sample, the same district judge cautioned that *cy pres* awards "violat[e] the ideal that litigation is meant to compensate individuals who were harmed," but ultimately approved the award because prior court precedents had authorized the use of *cy pres*. *In re Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig.*, 851 F. Supp. 2d 1040, 1076 (S.D. Tex. 2012) (Rosenthal, J.).

publicly available information provides further support for the conclusion that little in the way of benefit flows to class members. Examples from our data set include:

- ***Disproportionate allocation of settlement funds to attorneys' fees.*** Plaintiffs brought a class action alleging that the defendants improperly interfered with the medical care of injured employees in violation of Colorado law.<sup>35</sup> Under the settlement agreement, the defendants (who denied wrongdoing) were required to make an \$8 million fund available to compensate more than 13,500 class members. But class counsel received over \$4.5 million out of the \$8 million—more than 55 percent of the fund.<sup>36</sup>
- ***Named plaintiffs object to the settlement.*** In a class action against the National Football League, retired players alleged that the league was using their names and likenesses without compensation to promote the league. The NFL and some players settled the class-wide claims under federal competition law and state right of publicity laws. But the original named plaintiffs who spearheaded the litigation objected to the settlement, arguing that it provided ***no direct payout to the retired players***.<sup>37</sup> Rather, it created an independent organization that would fund charitable initiatives related to the health and welfare of NFL players—and would create a licensing organization that would help fund the independent organization. Meanwhile, “[p]laintiffs’ lawyers would receive a total of \$7.7 million under the proposed agreement.”<sup>38</sup>
- ***Low recovery for class members.*** Plaintiffs alleged in eight consolidated class actions that their employer, a bank, violated the federal Employee Retirement Income Security Act (ERISA) by offering its own stock as a retirement plan investment option while hiding the true extent of the bank’s losses in the mortgage crisis.<sup>39</sup> The class

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<sup>35</sup> *Gianzero* Preliminary Approval Motion at 4.

<sup>36</sup> *Id.* at 10.

<sup>37</sup> The Dryer Plaintiffs’ Opposition to Preliminary Approval of the Proposed Settlement Class, *Dryer v. Nat’l Football League*, No. 09-cv-2182 (D. Minn. Mar. 20, 2013), PACER No. 264.

<sup>38</sup> Alison Frankel, Retired NFL stars reject settlement of their own licensing class action, REUTERS (Mar. 25, 2013), available at <http://blogs.reuters.com/alison-frankel/2013/03/25/retired-nfl-stars-reject-settlement-of-their-own-licensing-class-action/>.

<sup>39</sup> Class Action Complaint at 2, 24-25, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Aug. 20, 2009), PACER No. 1.

settlement established a \$2.5 million common fund that was ostensibly designed to compensate the employees for their losses arising from the bank's alleged breach of fiduciary duty.<sup>40</sup> But commentators note that, when all of the allegations in the various complaints were taken into account, plaintiffs had alleged more than \$50 million in losses, meaning that class members would recover no more than five cents on the dollar.<sup>41</sup> And according to the plan of allocation, members of the settlement class who were calculated to have suffered damages less than \$25 would receive *nothing*<sup>42</sup>—meaning that their claims were released without even the opportunity to receive something in exchange. Meanwhile, the plaintiffs' attorneys received a fee award amounting to 26% of the common fund (\$645,595.78), plus \$104,404.22 in expenses.<sup>43</sup>

- ***Settlement requires further use of defendant's services.*** A plaintiff filed a class action alleging that certain mobile-phone gaming apps were improperly collecting and disseminating users' mobile phone numbers.<sup>44</sup> Under the terms of the settlement agreement, class members were not entitled to any monetary payment. Instead, they were slated to receive 45 in-game "points" (with an approximate cash value of \$3.75) per mobile device owned; the points could be used to advance through the gaming apps' levels.<sup>45</sup> These points could be redeemed or used only within the defendant's apps.<sup>46</sup> Unsurprisingly, the plaintiffs' counsel were not paid in points, but instead were awarded \$125,000 in attorneys' fees.

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<sup>40</sup> See, e.g., Final Judgment at 2-3, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Oct. 12, 2012), PACER No. 207 ("Colonial Bancgroup Final Judgment").

<sup>41</sup> Bill Donahue, *Colonial Bank Execs Pay \$2.5m to Dodge ERISA Claims*, Law360 (June 18, 2012), available at <http://www.law360.com/articles/350930>

<sup>42</sup> Plan of Allocation at 3, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Sept. 14, 2012), PACER No. 192-1.

<sup>43</sup> *Colonial Bancgroup* Final Judgment at 8.

<sup>44</sup> First Amended Complaint at 2, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. June 22, 2010), PACER No. 27.

<sup>45</sup> Motion for Final Approval of Class Action Settlement Agreement at 3, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. Nov. 11, 2010), PACER No. 32.

<sup>46</sup> Settlement Agreement at 8, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. June 22, 2010), PACER No. 26-1.

- **Attorneys seek fees far exceeding class recovery.** Class counsel in a case involving allegedly faulty laptops found their fee request chopped down from \$2.5 million to \$943,000.<sup>47</sup> The settlement resulted in a recovery of \$889,000 to claimants, plus \$500,000 in additional costs for administering the settlement—meaning that the attorneys were seeking just under *three times* the amount that would have gone directly to the class—and even after the fees were cut down, they still represented 106 percent of the class’s direct recovery.

These characteristics are not unique to the sample cases. To the contrary, results are consistent with a significant number of class action settlements that produce minimal benefits for the class members themselves. We summarize additional examples of such settlements—taken from outside our data set—in Appendix B.

Other studies of class settlements and attorneys’ fees confirm that these examples are not outliers: Such settlements commonly produce insignificant benefits to class members and outsize benefits to class counsel. A RAND study of insurance class actions found that attorneys’ fees amounted to **an average of 47% of total class-action payouts**, taking into account benefits actually claimed and distributed, rather than theoretical benefits measured by the estimated size of the class. “In a quarter of these cases, the effective fee and cost percentages were 75 percent or higher and, in 14 percent (five cases), the effective percentages were over 90 percent.”<sup>48</sup>

In other words, for practical purposes, counsel for plaintiffs (and for defendants) are frequently the only real beneficiaries of the class actions.

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<sup>47</sup> Attorney’s Fees Slashed in Faulty Laptop Class Action, *BNA Class Action Litigation Report*, 14 Class 1497 (Oct. 25, 2013), available at [http://news.bna.com/clsn/CLSNWB/split\\_display.adp?fedfid=37476946&vname=clasnotallissues&jd=a0e2t3w1f0&split=0](http://news.bna.com/clsn/CLSNWB/split_display.adp?fedfid=37476946&vname=clasnotallissues&jd=a0e2t3w1f0&split=0). This case was among the ones we studied, but the court’s decision awarding a reduced amount of attorneys’ fees was issued after the closing date of our study.

<sup>48</sup> Nicholas M. Pace et al., *Insurance Class Actions in the United States*, Rand Inst. for Civil Just., xxiv (2007), <http://www.rand.org/pubs/monographs/MG587-1.html>. Another RAND study similarly found that in three of ten class actions, class counsel received more than the class. See Deborah R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* (Executive Summary), Rand Inst. for Civil Just., 21 (1999), [http://www.rand.org/pubs/monograph\\_reports/MR969.html](http://www.rand.org/pubs/monograph_reports/MR969.html).

### **Conclusion**

This study confirms that class actions rarely benefit absent class members in whose interest class actions are supposedly initiated. The overwhelming majority of class actions are dismissed or dropped with *no recovery* for class members. And those recoveries that class settlements achieve are typically minimal—and obtained only after long delays. To be sure, not every class action is subject to these criticisms: a few class actions do achieve laudable results. But virtually none of those were consumer class actions. Certainly our analysis demonstrates—at a bare minimum—that the vast majority of class actions in our sample set cannot be viewed as efficient, effective, or beneficial to class members.

**Appendix A: Additional Examples of Settlements  
With Payments to a Very Small Percentage of Class Members**

- The Seventh Circuit vacated an order approving a class action settlement so that the district court could “evaluate whether the settlement is fair to class members,” where (among other problems with the settlement) only “a paltry three percent” of the quarter-million-wide proposed class “had filed proofs of claim.”<sup>49</sup> And the Third Circuit recently noted that “consumer claim filing rates rarely exceed seven percent, even with the most extensive notice campaigns.”<sup>50</sup>
- One affidavit analyzed 13 cases for which data had been disclosed (and in which the settlement was approved). The median claims rate was 4.70%. The highest claims rate in those cases was 5.98%, and the lowest non-zero claims rate was 0.67%. In two cases, the claims rate was 0%—reflecting that not a single class member obtained the agreed-on recovery.<sup>51</sup>
- A class action alleging antitrust claims in connection with compact disc “music club” marketing settled, with only 2% of the class making claims for vouchers (valued at \$4.28) for CDs.<sup>52</sup>
- Indeed, in many cases, the claims rate may be well under 1 percent.
  - Fair Credit Reporting Act case: court noted that “less than one percent of the class chose to participate in the settlement.”<sup>53</sup>
  - Case alleging that a software manufacturer sold its customers unnecessary diagnostic tools: court approved settlement despite the fact that only 0.17% of customers made claims for a \$10 payment, because “the settlement amount is commensurate with the strength of the class’ claims and their likelihood of success absent the settlement.”<sup>54</sup>

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<sup>49</sup> *Synfuel Techs., Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646, 648, 650 (7th Cir. 2006) (emphasis added).

<sup>50</sup> *Sullivan v. DB Investments, Inc.*, 667 F.3d 273, 329 n. 60 (3d Cir. 2011) (en banc) (emphasis added; quotation marks omitted).

<sup>51</sup> Declaration of Kevin Ranlett in Support of Defendants’ Amended Motion to Compel Arbitration at 8, *Coneff v. AT&T Corp.*, No. 2:06-cv-00944 (W.D. Wash. May 27, 2009), PACER No. 199. Mr. Ranlett is a Mayer Brown lawyer.

<sup>52</sup> *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 370 F. Supp. 2d 320, 321 (D. Me. 2005).

<sup>53</sup> *Yeagley v. Wells Fargo & Co.*, 2008 WL 171083, at \*2 (N.D. Cal. Jan. 18, 2008), *rev’d*, 365 F. App’x 886 (9th Cir. 2010).

<sup>54</sup> *LaGarde v. Support.com, Inc.*, 2013 WL 1283325, at \*6 (N.D. Cal. Mar. 26, 2013). The court approved a proposed modified settlement under which the class

- Case involving product liability claims related to alleged antenna problems with Apple's iPhone 4: court approved settlement noting that the "number of claims represents somewhere between 0.16% and 0.28% of the total class."<sup>55</sup>
- Class action alleging fraud in the procurement of credit-life insurance: Supreme Court of Alabama noted that "only 113 claims" had been made in a class of approximately 104,000—or a response rate of 0.1%.<sup>56</sup>
- Action alleging that restaurant chain had printed credit-card expiration dates on customers' receipts: "approximately 165 class members" out of 291,000—or fewer than 0.06% of the class—"had obtained a voucher" for one of four types of menu items worth no more than \$4.78.<sup>57</sup>
- Class action alleging that Sears had deceptively marketed automobile-wheel alignments: "only 337 valid claims were filed out of a possible class of 1,500,000"—a take rate of just over 0.02%.<sup>58</sup>
- Class action alleging that video game manufacturer had improperly included explicit sexual content in the game: **one fortieth of one percent** of the potential class (2,676 of 10 million) made claims.<sup>59</sup>
- Class action involving allegations that a Ford Explorer was prone to dangerous rollovers: only 75 out of "1 million" class members—or **less than one hundredth of one percent**—participated in the class settlement.<sup>60</sup>

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members "who made a claim" after having been "offered a \$10 cash payment \* \* \* will now receive a \$25 cash payment, rather than \$10." *Id.* at \*4.

<sup>55</sup> *In re Apple iPhone 4 Prods. Liab. Litig.*, 2012 WL 3283432, at \*1 (N.D. Cal. Aug. 10, 2012).

<sup>56</sup> *Union Fid. Life Ins. Co. v. McCurdy*, 781 So. 2d 186, 188 (Ala. 2000).

<sup>57</sup> *Palamara v. Kings Family Rests.*, 2008 WL 1818453, at \*2 (W.D. Pa. Apr. 22, 2008).

<sup>58</sup> *Moody v. Sears, Roebuck & Co.*, 2007 WL 2582193, at \*5 (N.C. Super. Ct. May 7, 2007), *rev'd*, 664 S.E.2d 569 (N.C. Ct. App. 2008).

<sup>59</sup> *In re Grand Theft Auto Video Game Consumer Litig.*, 251 F.R.D. 139 (S.D.N.Y. 2008).

<sup>60</sup> Cheryl Miller, "Ford Explorer Settlement Called a Flop," *The Recorder* (July 13, 2009), <http://www.law.com/jsp/article.jsp?id=1202432211252>.

**Appendix B: Additional Examples of Settlements  
Providing Negligible Benefits to Class Members**

- ***Class members receive extended membership in buying club.*** In a class action against DirectBuy—a club for which customers pay a membership fee to purchase goods at lower prices—the plaintiffs alleged that the defendant had misrepresented the nature of the discounts that were available through the club.<sup>61</sup> The settlement afforded class members nothing other than discounts for renewal or extension of their memberships in the very club that was alleged to have tricked them into joining in the first place. Meanwhile, the attorneys for the class “could receive between \$350,000 and \$1 million.”<sup>62</sup>
- ***\$21 million for the lawyers, pennies and coupons for the class members.*** One Missouri class settlement in a case against a brokerage house alleging breaches of fiduciary duties provided \$21 million to class counsel, but only \$20.42 to each of the brokerage’s former customers and three \$8.22 coupons to each current customer. And most of the coupons are unlikely to be redeemed.<sup>63</sup>
- ***Class members receive right to request \$5 refund, lawyers take (and fail to disclose sufficiently) \$1.3 million in fees.*** Under the settlement of a class action in which the plaintiffs alleged that Kellogg’s had misrepresented that Rice Krispies are fortified with antioxidants, class members could request \$5 refunds for up to three boxes of cereal purchased between June 1, 2009, and March 1, 2010.<sup>64</sup> Class counsel sought \$1.3 million in attorneys’ fees on a claim fund valued at \$2.5 million to be paid out to class members.<sup>65</sup>

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<sup>61</sup> Michelle Singletary, *Class-action Coupon Settlements are a No-Win for Consumers*, Wash. Post, Apr. 28, 2011 at A14.

<sup>62</sup> *Id.*

<sup>63</sup> See Stipulation of Settlement of Class Action, *Bachman v. A.G. Edwards, Inc.*, No. 22052-01266-03 (Mo. Cir. Ct. St. Louis Feb. 18, 2010), [http://www.agedwardsclassactionsettlement.com/bach\\_20100219094521.pdf](http://www.agedwardsclassactionsettlement.com/bach_20100219094521.pdf); see also Daniel Fisher, *Lawyer Appeals Judge’s Award of \$21 Million in Fees, \$8 Coupons for Clients*, FORBES.COM (Jan. 10, 2011), <http://blogs.forbes.com/danielfisher/2011/01/10/lawyer-appeals-judges-award-of-21-million-in-fees-8-coupons-for-clients> (“The judge didn’t even see fit to inquire into the lawyers’ valuation of the coupon portion of the settlement, despite strong evidence that less than 10% of coupons in such cases are ever redeemed”).

<sup>64</sup> Stipulation of Settlement at 2-8, *Weeks v. Kellogg*, No. 2:09-cv-8102 (C.D. Cal. Jan. 10, 2011), PACER No. 121.

<sup>65</sup> Memorandum of Law in Support of Plaintiffs’ Motion for Award of Attorneys’ Fees, Expenses, and Plaintiff Service Awards at 4, *Weeks v. Kellogg*, No. 2:09-cv-8102 (C.D. Cal. July 18, 2011), PACER No. 135-1.

- ***Class receives opportunity to attend future conferences.*** In a 2009 settlement in the District of Columbia, a court approved a settlement against a conference organizer that failed to deliver promised services to those who had paid to attend. The settlement provides class members with nothing other than coupons to attend future events put on by the same company alleged to have bilked them in the first place; class counsel will take \$1.4 million in fees.<sup>66</sup>
- ***Class members receive nothing, class counsel take \$2.3 million.*** In a \$9.5 million settlement of a class action against Facebook over the disclosure to other Facebook users of personal information about on-line purchases through Facebook’s “Beacon” program, the class members received no remedy whatever for the invasions of their privacy and were barred from making future claims for any remedy. Instead, approximately \$6.5 million went to create and fund a new organization that would give grants to support projects on internet privacy; a few thousand dollars went to each of the named plaintiffs as “incentive payments”; and class counsel received more than \$2.3 million.<sup>67</sup> Meanwhile, although Facebook agreed to end the Beacon program—which it had actually already ended months before—it remained free to reinstitute the program as long as it didn’t use the name “Beacon.”<sup>68</sup> As one federal appellate judge put it (in a dissent from a decision upholding the settlement):

The majority approves ratification of a class action settlement in which class members get no compensation at all. ***They do not get one cent.*** They do not get even an injunction against Facebook doing exactly the same thing to them again. ***Their purported lawyers get millions of dollars.*** Facebook gets a bar against any claims any of them might make for breach of their privacy rights. The most we could say . . . is that in exchange for giving up any claims they may have, the exposed Facebook users get the satisfaction of contributing to a charity to be funded by Facebook, partially controlled by Facebook, and advised by a legal team consisting of Facebook’s counsel and their own

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<sup>66</sup> See Memorandum Opinion at 3-5, 8, *Radosti v. Envision EMI, LLC*, No. 1:09-cv-887 (D.D.C. June 8, 2010), PACER No. 40; Order at 1-2, *Radosti v. Envision EMI, LLC*, No. 1:09-cv-887 (D.D.C. Jan. 19, 2011), PACER No. 45.

<sup>67</sup> *Lane v. Facebook, Inc.*, 696 F.3d 811 (9th Cir.), *reh’g en banc den.* 709 F.3d 791 (9th Cir. 2013), *cert. denied*, 134 S. Ct. 8 (2013).

<sup>68</sup> Petition for Certiorari at 11-13, *Marek v. Lane*, No. 13-136 (filed July 26, 2013), 2013 WL 3944136.

purported counsel whom they did not hire and have never met.<sup>69</sup>

The Supreme Court ultimately declined to review the Ninth Circuit's decision approving the settlement. As Chief Justice Roberts explained in a rare statement addressing the court's denial of certiorari, the objectors had challenged "the particular features of the specific *cy pres* settlement at issue," but in his view had not addressed "more fundamental concerns surrounding the use of such remedies" and the standards that should govern their use. Such concerns, he pointed out, would have to await a future case.<sup>70</sup>

- ***Court reduced attorneys' fees because of lack of benefit to class members.***

The Sixth Circuit upheld a district court's decision to reduce class counsel's requested fees from \$5.9 million to \$3.2 million in a settlement of a class action involving auto-insurance benefits.<sup>71</sup> In affirming the decision, the Sixth Circuit pointed out that the district court "did not believe that the class members received an especially good benefit [because] Class Counsel chose to pursue a relatively insignificant claim" as opposed to "other potential claims, . . . and [they] agreed to a settlement mechanism which yielded a low claims rate[.]"<sup>72</sup> Although the court noted that "the settlement makes available a common fund of \$27,651,288.83 less any attorney fee award, costs, and administrative expenses," for individual class member benefits up to a maximum of \$199.44, "only a small percent of eligible class members have made claims" totaling approximately \$4 million—or 14% of the total common fund available.<sup>73</sup> What is more, class counsel represented in their fee motion that they provided notice to 189,305 class members and received "well over 12,000" claims—in other words, a claims-made rate of just over six percent.<sup>74</sup>

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<sup>69</sup> *Lane*, 696 F.3d at 835 (Kleinfeld, J., dissenting) (emphasis added).

<sup>70</sup> *Marek*, 134 S. Ct. at 9 (Roberts, C.J., respecting the denial of certiorari).

<sup>71</sup> *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, 436 F. App'x 496 (6th Cir. Aug. 26, 2011).

<sup>72</sup> *Id.* at 500.

<sup>73</sup> Opinion and Order at 10-11, *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, No. 1:08-cv-605 (N.D. Ohio, Apr. 30, 2010), PACER No. 308.

<sup>74</sup> Class Counsel's Supplemental Memorandum in Support of Class Counsel's Motion for Award of Attorney's Fees and Reimbursement of Litigation Expenses at 3-4, 7, *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, No. 1:08-cv-605 (N.D. Ohio Mar. 19, 2010), PACER No. 296

## Appendix C: Study Design and Methodology

### *Identifying the Study Sample*

The first step in studying putative class actions was to select a suitable pool of cases. Identifying every putative class action filed during 2009 would be impracticable—not least without extensive resources and staff support.<sup>75</sup> We instead used two commercial publications—the *BNA Class Action Litigation Reporter* and the *Mealey's Litigation Class Action Reporter*—to identify cases for inclusion in the study. These publications cover a wide array of developments in class action litigation, and therefore provide a diverse sample of filed class action complaints. The publications have an incentive to report comparatively more significant class actions out of all class actions filed, without wasting readers' time and attention on minor or obviously meritless suits. If anything, the sample would be skewed in favor of more significant class actions filed by prominent plaintiffs' attorneys—which should be *more meritorious on average* than a sample generated randomly from all class actions filed.

We reviewed issues of BNA and Mealey's published between December 2008 and February 2010 in order to identify cases filed in 2009. The reason for that limitation was the importance of analyzing “modern” cases that were filed after the passage of the Class Action Fairness Act of 2005, but long enough ago to track how the cases have actually progressed and whether they have been resolved. From those publications, we identified a pool of putative class actions brought by private plaintiffs that were either filed in federal court or were removed to federal court from state court in 2009. To begin with, because data about state court cases is much more difficult to obtain, we excluded a number of cases, such as those brought in state court initially (where the BNA or Mealey's report did not mention that the case was removed). We also excluded one case that was removed to federal court and then remanded to state court. This left us with 188 cases.

Nineteen of these eventually became part of eleven other consolidated cases that were also part of our data set—whether under the multidistrict litigation

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<sup>75</sup> See, e.g., Deborah Hensler, et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* § 4.60 (RAND Institute for Civil Justice, Monograph MR-969/1-ICJ) (1999) (“Enormous methodological obstacles confront anyone conducting research on class action litigation. The first obstacle is a dearth of statistical information. No national register of lawsuits filed with class action claims exists. Until recently, data on the number of federal class actions were substantially incomplete, and data on the number and types of state class actions are still virtually nonexistent. Consequently, no one can reliably estimate how much class action litigation exists or how the number of lawsuits has changed over time. Incomplete reporting of cases also means that it is impossible to select a random sample of all class action lawsuits for quantitative analysis.”).

(“MDL”) procedure, 28 U.S.C. § 1407, or otherwise (for example, cases are often consolidated when they are pending in the same federal district court). When multiple putative class actions appearing in our data set were consolidated, we treated the consolidated case as a single action to avoid the risk of “overcounting” lawsuits.<sup>76</sup> And when a case in our data set was consolidated with other cases not in our data set, we considered activity reflected on the docket of the “lead” consolidated case that was attributable to the individual case as filed. If after consolidation the case was resolved together with the “lead” case—such that we could not trace outcomes for the individual case separate from the “lead” case—we considered activity attributable to the “lead” case. This approach dovetails with the practical mechanics of consolidation: After cases are consolidated into an MDL, for example, the judge to whom the MDL proceeding is assigned will resolve pretrial motions presented in all the consolidated cases. And more generally, to the extent that courts treat a number of separately filed cases together as a single unit for purposes of adjudication, we have followed the courts’ lead.<sup>77</sup> Excluding the cases that became part of other consolidated cases in our data set left us with 169 cases.

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<sup>76</sup> By way of example, four cases—*Sansom v. Heartland Payment Sys., Inc.* No. 09-cv-335 (D.N.J.); *Lone Summit Bank v. Heartland Payment Sys., Inc.* No. 09-cv-581 (D.N.J.); *Tricentury Bank v. Heartland Payment Sys., Inc.* No. 09-cv-697 (D.N.J.), and *Kaissi v. Heartland Payment Sys., Inc.* No. 09-cv-540 (D.N.J.)—eventually were consolidated into *In re: Heartland Payment Sys., Inc., Customer Data Security Breach Litigation*, No. 4:09-md-02046 (S.D. Tex.).

<sup>77</sup> The decision to treat these consolidated cases along with the lead case had little effect on our data. A comparison of statistics on outcomes reveals that, if anything, treating consolidated class actions as a single action rather than separately tended to overstate the benefits of class actions.

In our full 188-case sample set (including the consolidated cases), 99 cases (54%) were dismissed, whether on the merits by the court, by the plaintiff voluntarily, or as an inferred settlement on an individual basis; 31 cases (16%) remain pending; 55 cases (29%) were settled on a class-wide basis; and 3 cases (2%) were dismissed after the court granted a motion to compel arbitration. By comparison, in the 169-case sample set (excluding the consolidated cases), 99 cases (57%) were dismissed, whether on the merits by the court, by the plaintiff voluntarily, or as an inferred settlement on an individual basis; 23 cases (14%) remained pending; 47 cases (28%) were settled on a class-wide basis; and 1 (1%) was dismissed after the court granted a motion to compel arbitration.

Similarly, this methodology ensures that me-too actions—cases filed by other attorneys after a complaint in a different case, raising materially identical claims—that are routinely dismissed after consolidation without any award or settlement will instead be treated as sharing in any benefits to class members that were actually obtained.

Our next goal was to identify a set of class actions consisting of claims resembling those asserted by consumers—because that is the area under study by the CFPB. We therefore excluded three non-Rule-23 putative class actions brought by the Equal Employment Opportunity Commission.<sup>78</sup> We also excluded nine Fair Labor Standards Act cases.<sup>79</sup> Finally, we excluded nine securities cases, because the stakes and nature of those claims are very different from the claims asserted in consumer class actions, and because they are litigated in a different manner because of the procedural checks imposed by federal laws governing securities litigation.<sup>80</sup> Excluding these 21 EEOC, securities, and FLSA cases had next to no effect on the statistical results of our study.<sup>81</sup>

Accordingly, the statistics about the total number of class actions filed in 2009 are based on a set of 148 putative class actions.

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<sup>78</sup> The Supreme Court has held that the EEOC may pursue enforcement actions under Title VII § 706 without being certified as a class representative under Federal Rule of Civil Procedure 23. *See Gen. Tel. Co. of Nw., Inc. v. EEOC*, 446 U.S. 318 (1980). The Supreme Court’s reasoning would appear to apply equally outside the context of Title VII. Because the EEOC does not need to pursue a Rule 23 class, the dynamics of EEOC class-wide enforcement actions differ markedly from those in Rule 23 actions.

<sup>79</sup> Class actions under the FLSA are certified conditionally as “opt-in” classes. Section 216(b) of the FLSA permits a right of action against an employer by an employee on behalf of “other employees similarly situated,” who must have opted in by providing and filing with the court “consent in writing” to become a plaintiff. 29 U.S.C. § 216(b). These cases present different incentives for plaintiffs’ counsel than consumer class actions, because they typically involve statutory attorneys’ fees to prevailing plaintiffs and may involve large backpay and overtime pay awards.

<sup>80</sup> As one academic study explained, securities class actions “are managed under a set of class action rules distinct from those used for other Rule 23(b)(3) classes—and . . . the plaintiffs with the largest losses have a significant role in the litigation (including choosing class counsel and defining the terms of the settlement) and can hardly be thought of [as] an ‘absent’ class member.” Pace & Rubenstein, *supra* note 16, at 20; *see, e.g.*, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-76, 109 Stat. 737 (1995); Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

<sup>81</sup> Recall that our 169-case sample set, which included these cases, resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration. *See supra* note 77. After excluding them, our 148-case sample set resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration. *See* Figure 1.

*Constructing the Data Set*

We identified and coded a number of variables about each case. Using the federal courts' Public Access to Court Electronic Records ("PACER") system, we evaluated the filings on each case's docket. Where criteria for a case could be coded in more than one way, we scrutinized the underlying filings and rulings to determine whether the criteria better fit one or another category. For administrative purposes, we treated September 1, 2013, as the date on which our study period closed. We did not code filings and events that were entered onto the docket after that date.

Among the data collected for each case were: jurisdiction; date filed; plaintiffs' firm; assigned judge; cause of action (as reported by PACER); nature of suit (as reported by PACER); whether the case was a lead or related case (if it was in a consolidated action);<sup>82</sup> whether the court granted class certification; whether the case was voluntarily dismissed,<sup>83</sup> settled, settled but on appeal, dismissed, otherwise disposed of, or still pending; the current posture of the case;<sup>84</sup> and the date of the last action on the case.

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<sup>82</sup> If a case was a related case in a consolidated action, we collected information based on what happened in the lead case.

<sup>83</sup> If a case was voluntarily dismissed, we attempted to discern from filings (and from sources external to the docket) whether the dismissal should be attributed to a settlement on an individual basis—such as when the filings refer to a settlement, or when the named plaintiff sought to dismiss her own claims with prejudice but without prejudice to absent members of the putative class. On one hand, this is likely to understate the rate at which individual plaintiffs settle their claims individually, which in any event results in no recovery to other absent members of the putative class unless another lawsuit moves forward. On the other hand, we were often not able to discern whether the claims in a lawsuit dismissed voluntarily would continue to be litigated (or settled) by another named plaintiff under a different case caption. Thus our decision to select a readily accessible sample of class actions may understate the extent to which members of a putative class may have their claims dismissed on the merits, or alternatively settled, in a class action under a different docket.

<sup>84</sup> The data set includes two certified class actions in which motions for summary judgment are pending. The data set also includes an additional certified class action in which the court granted summary judgment to the plaintiffs on their claim for injunctive relief, and granted summary judgment to the defendants on all remaining claims. At the time our study closed, on September 1, 2013, the parties proposed text for an injunctive order that would resolve the parties' remaining claims on a class-wide basis.

For cases involving settlements, we also collected information about the date of dismissal or final settlement approval; the terms of the settlement agreement; any attorneys' fees, expenses, and incentive payments to lead plaintiffs; and the presence of any *cy pres* provision in the settlement agreement.

There are, of course, limitations to the data we collected. First, our conclusions are based on the cases that we reviewed. While there is good reason to believe that generalizations can be made to all class actions, the sample is undoubtedly smaller than the total number of class actions filed in 2009. Attempting to estimate that number reliably—let alone to examine those cases—would have exceeded the scope of our review. On the other hand, the sample includes cases from across the country and is drawn from sources that are likely to report on significant class actions—those that are of comparatively greater importance or quality than those actions that neither BNA nor Mealey's considered worth reporting. Because the BNA and Mealey's reporters do not present a random sample of all class actions filed in 2009, it would not be useful to calculate a margin of error or otherwise attempt to quantify the extent to which the sample differs randomly from the population of all class actions filed in 2009.

PREPARED STATEMENT OF PETER B. RUTLEDGE

**The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers and Small Businesses?**

**Hearing before the Senate Committee on the Judiciary**

Testimony of Professor Peter B. Rutledge  
University of Georgia School of Law  
December 17, 2013

Chairman Leahy, Ranking Member Grassley and Members of the Committee. Thank you for the opportunity to testify today. My name is Peter B. Rutledge, and I am the Associate Dean for Faculty Development at the University of Georgia School of Law, where I also hold the Herman E. Talmadge Chair of Law. I am author of the book *Arbitration and the Constitution*, co-author of the book *International Civil Litigation in United States Courts* and have written (or co-written) several articles and book chapters on the field of arbitration. I am pleased to offer my thoughts on the topic of today's hearing.

In an abundance of caution, I should stress the obvious point that the views expressed in my testimony (both written and oral) are entirely my own. They do not necessarily reflect the views of my employer, the University of Georgia, or my co-authors. I stress this because one of my regular collaborators, Professor Chris Drahozal, with whom I have written several articles on the topic of arbitration, also serves as a consultant to the Consumer Financial Protection Bureau ("CFPB"). While we share the views expressed in our written papers, I would not want anything I say (or write) in connection with this hearing erroneously to be imputed to him (or, indirectly, the CFPB).

At bottom, I wish to make three main points to the committee today:

First, I wish to thank you and your fellow lawmakers for shifting the terms of the debate over arbitration (and dispute resolution more generally) away from legislation by anecdote and more toward policymaking grounded in sound empirical evidence. Earlier iterations of this debate risked reacting to sensationalized stories, irrespective of whether those stories were

representative of the system or whether the proposed reform benefited the very entities whom interest groups were purporting to protect. Now, the debate is firmly anchored in empirical research and should remain so. Sound policy or regulation must not simply examine arbitration proceedings in isolation. Instead, it must both engage in a meaningful apples-to-apples comparison of arbitration with the alternatives (presumably civil litigation) and consider the role of arbitration as part of a broader quilt of dispute resolution options which may well enable consumers and others to achieve fast, equitable results before a full-blown dispute emerges.

Second, consistent with my first observation, Congress should approach with caution claims that some parade of horrors will ensue following the Supreme Court's recent decisions in the area of arbitration. Empirical research that others and I have undertaken does not validate those predictions. Instead, it reveals that the choice whether to utilize an arbitration clause reflects a complex set of factors and preferences that vary among industries and among firms within industries. The recent preliminary report completed by the Consumer Financial Protection Bureau appears to confirm these findings with respect to the consumer financial services industry.

Third, while the *Concepcion* and *Italian Colors* decisions present related (but distinct) questions about the relationship between alternative dispute resolution and aggregate proceedings, arbitration should not become caught in the crossfire of an underlying debate over class actions. The procedural flexibility often afforded by arbitration offers a number of practical options by

which to address aggregate proceedings. Public regulatory authorities can perform an aggregative role even when they are acting on behalf of individuals who are bound by an arbitral commitment. In all events, Congress should resist the temptation to see class actions as a panacea; some research casts doubt on the efficacy of this tool.

**I. The Debate Over Arbitration Has Laudably Shifted Toward An Emphasis On Empirical Research, And Investigation Should Continue Into Under-examined Questions.**

My first main point is to stress again the importance of sound empirical research to the policy question before you. When I began writing and testifying on this subject over six years ago, empirical research in this field was scarce.<sup>1</sup> We had some, albeit limited, knowledge about several important issues such as (1) the rate at which arbitration clauses were used, (2) the provisions of those clauses, and (3) outcomes in arbitration.<sup>2</sup>

Against this empirical void, the risks of legislating were grave – not only did Congress risk basing policy on unrepresentative (but sensational) anecdotes, it also risked unintended consequences – whether upending important doctrines

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<sup>1</sup> See S. Comm. on the Judiciary, Subcomm. on the Constitution, S. 1782, The Arbitration Fairness Act of 2007 (Dec. 12, 2007); H. Comm. on the Judiciary, Subcomm. on Commercial and Administrative Law, Arbitration Fairness Act of 2007 (Oct. 25, 2007).

<sup>2</sup> See Peter B. Rutledge, *Arbitration Reform: What We Know, What We Need to Know*, 10 *Cardozo J. Conflict Res.* 539 (2009); David Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 *Stanford L. Rev.* 1557 (2005).

in international arbitration or even undermining the interests of the very groups whom advocates of reform were purporting to advance.<sup>3</sup>

Since that time, the empirical record has improved – and so too has the degree of sensitivity to the importance of empirical argument in this debate. Scholars, think tanks and advocacy groups have sought to advance the empirical record and give Congress has a clearer picture against which it can consider whether, and to what extent, policy change is appropriate. In several respects, that research generally has vindicated arbitration – it has shown that arbitration yields results far faster than the civil litigation system; it also has shown that arbitration often achieves fair results for employees and consumers, at least as good as those in the civil litigation system; and it has shown that arbitration clauses typically do not contain the sorts of nefarious procedural provisions for which they were at one time roundly criticized.<sup>4</sup>

Against this backdrop of heightened attention to empirical research, Congress should be praised for its decision to insist upon study by the CFPB before deciding whether it should regulate arbitration clauses in the field of

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<sup>3</sup> In this regard, it is worth noting that the current draft Arbitration Fairness Act has abandoned several of the so-called “findings” that were contained in prior versions and criticized for a lack of empirical foundation. See S. 878 & H.R. 1844, Arbitration Fairness Act of 2013 (May 7, 2013); Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 *Cardozo J. Conflict Res.* 267 (2008).

<sup>4</sup> For a report that both summarized the state of the literature and make an important original contribution to it, see Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Agreements*, 25 *Ohio St. J. Disp. Res.* 843 (2010). In the rare instances where arbitration clauses do contain an objectionable provision (such as a damages waiver or a requirement that the individual arbitrate in an inconvenient location), courts have tools at their disposal to police those terms.

consumer financial services. Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 instructs the CFPB to study the use of arbitration clauses in this industry and requires that any subsequent regulation of those agreements to be consistent with the results of that study.<sup>5</sup> Last week's release of the CFPB's "preliminary" findings in this area represents another incremental step in flushing out the empirical record. (I will return to the details of those findings later in my testimony.)

While progress has been made, I should sound a note of caution about two challenges facing the ongoing empirical work in this area. First, it is not sufficient to analyze arbitration in isolation from the alternatives. Normative assessments of arbitration, whether praise or criticism, have meaning only when measured against some other baseline such as the civil litigation system. If arbitration is criticized upon some basis – such as the rate at which defendant prevails – that criticism may sound convincing unless, of course, the defendant prevails *at a higher rate* in the civil litigation system (this assumes, of course, that the raw win-rate represents the appropriate metric for assessing the desirability of a system of dispute resolution).<sup>6</sup> It is akin to castigating someone for his or her choice to drink juice (due to some perceived adverse health effect) if the only alternative were sugary soda.

Second, a bare focus on actual cases may mask less visible, yet no less important, benefits to a system of dispute resolution. As I have explained

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<sup>5</sup> 12 U.S.C. 5518(b).

<sup>6</sup> For a good example of scholarship debunking these sorts of exaggerated attacks on arbitration, see Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and Court*, 7 *Hastings Bus. L.J.* 77 (2011).

elsewhere, it is essential to consider arbitration as part of a quilt of dispute resolution forms.<sup>7</sup> Many consumer disagreements may never reach the point of full-blown dispute precisely *because* they are resolved at an early stage. Arbitration, given the predictability and certainty of the forum and procedures, may well enable such amicable resolution. Eliminate arbitration, and one ironically may end up ripping out the keystone upon which these settlements rest.

Both empirical challenges are formidable. The former requires researchers to be able to generate a meaningful metric for comparing like cases and a normative account for the result that a system “ought” to produce. The latter requires researchers to peer behind the curtain of various internal dispute resolution processes to understand how they operate and the factors on which they depend. Unless these steps occur, any regulation of arbitration would rest, at best, on a shaky foundation.

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<sup>7</sup> See *Renting Cars: On Cadillacs, Saturns and Consumer Arbitration*, in *Beyond Elite Law: Access to Civil Justice for Americans of Average Means*, Estreicher and Radice (eds.) (forthcoming); Peter B. Rutledge, *Arbitration Reform: What We Know and What We Need to Know*, 10 *Cardozo J. Conflict Res.* 579 (2009).

**II. Congress Should Be Skeptical About Claims That A Particular Supreme Court Decision Will Have A Sudden Impact On Contracting Practices In A Given Industry.**

The emphasis in the preceding section on the importance of solid empirical research – and the accompanying skepticism about accepting untested arguments or generalizing from anecdotes – leads naturally to my second point. That is, contrary to the expectations of some observers, the Supreme Court’s decision in *Concepcion*<sup>8</sup> has not led to some cataclysmic shift in contracting practices. My own research suggests this has been true in the franchising field, and the recent preliminary report from the CFPB shows similar results in the consumer financial services industry. While it is too early to judge the effect, if any, of the *Italian Colors*<sup>9</sup> decision on contracting practices, these findings again counsel caution before Congress unreflectively embraces the untested arguments of arbitration’s critics.

To put these findings into context, a bit of background is in order. Beginning several years ago, Professor Chris Drahozal and I undertook a series of studies examining various measurable features of arbitration.<sup>10</sup> Those studies drew on two primary sources of data: (1) franchise agreements regularly deposited with Minnesota regulatory authorities and (2) credit card agreements

<sup>8</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).

<sup>9</sup> *American Express Co. v. Italian Colors Restaurant*, 131 S. Ct. 2304 (2013).

<sup>10</sup> See Peter B. Rutledge & Christopher R. Drahozal, *Sticky Arbitration Clauses: The Use of Arbitration Clauses After Concepcion and Amex*, 67 *Vanderbilt L. Rev.* \_\_ (forthcoming 2014); *Contract and Choice*, 2013 *B.Y.U. L. Rev.* 1; Christopher R. Drahozal & Peter B. Rutledge, *The Use of Arbitration Clauses in Credit Card Agreements: An Empirical Study*, 9 *J. Empirical Legal Studies* 536 (2012); Christopher R. Drahozal & Peter B. Rutledge, *Contract and Procedure*, 94 *Marquette L. Rev.* 1104 (2011).

deposited with federal authorities (initially the Federal Reserve and, more recently, the CFPB). Among the major findings of these papers:

- The utilization of arbitration clauses among firms in particular industries (franchise and consumer financial services) was not as widespread as arbitration's critics purported to be the case;
- With the possible exception of class waivers, arbitration clauses generally did not contain the sorts of "unfair" procedural terms that they often were criticized by containing;
- In the credit card industry, the use of arbitration clauses appeared to be correlated with variables such as the corporate form of the issuing institution (for-profit banks were likelier to use them than credit unions) as well as the size, riskiness and composition of the lender's portfolio.

That led to the most recent paper, *Sticky Arbitration Clauses?*, a draft of which I have attached to my written testimony.<sup>11</sup> That paper, forthcoming in the *Vanderbilt Law Review*, examined contracting practices in the franchise industry to assess the effect (if any) of *Concepcion* on the use of (and terms of) arbitration clauses. We considered two data sets – a sample of franchise agreements that

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<sup>11</sup> Peter B. Rutledge & Christopher R. Drahozal, *Sticky Arbitration Clauses? The Use of Arbitration Clauses After Concepcion and Amex*, \_\_ *Vanderbilt L. Rev.* \_\_ (forthcoming 2014).

we tracked since 1999 and a second set that we tracked since 2011 (immediately before *Concepcion* was decided).

At bottom, we discovered that *Concepcion* had little to no effect on the overall use of such clauses. To be specific, in the data set tracing to 1999, the use of arbitration clauses following *Concepcion* increased only from 40.3% to 44.8%. In the sample dating from 2011, the use of arbitration clauses increased from 62.6% to 63.6%. Interestingly, in the latter set, some franchisors actually switched *away* from arbitration after *Concepcion* (while others switched to it). While the *use* of arbitration clauses remained largely unchanged since *Concepcion*, we did note some movement *among those franchisors who used such clauses* – namely, the use of class waivers in arbitration clauses has risen over time: from 51.6% in 1999 to 77.8% in 2011 (immediately before *Concepcion*) to 86.7% in 2013.

Tellingly, the general “stickiness” of dispute resolution clauses did not appear to be coincidence. At the time the dispute resolution provisions of these agreements remained unchanged, other provisions of the franchise contracts *were* changing. Nearly 80% of the franchisors in our sample changed at least one provision of the franchise agreement during the years we studied, and almost half of the franchisors not using arbitration clauses were making major changes to their franchise agreements. Franchisors were not simply leaving provisions of their contracts unaltered but were actively revising them in material ways – but not, by and large, the dispute resolution provisions.

This led us to several important conclusions – (1) that the predicted parade of horrors in the wake of *Concepcion* had not come to pass; (2) that courts and lawmakers should be skeptical in the wake of arguments confidently predicting that some Supreme Court decision will necessarily result in some abrupt change in contracting behavior, and (3) that some theory was needed to explain the apparent stickiness of arbitration clauses, including in the adhesive setting.

While our current paper focused principally on practices in the franchise industry, last week’s CFPB report of preliminary results told a similar story in several sectors of the consumer financial services industry.<sup>12</sup> I trust your staff will examine the report in detail, but I would draw your attention to the finding on page 19 that “most institutions do not use arbitration clauses, and credit unions typically do not, but larger institutions are more likely to use arbitration clauses than small institutions.”<sup>13</sup> These findings lend further support to the conclusions we drew in *Sticky Arbitration Clauses*. (By contrast, the use of arbitration clauses among general purpose reloadable prepaid cards appeared to be higher).

This naturally leads to the *Italian Colors* case. *Italian Colors* is obviously a quite recent decision, so we are still unable to test whether that decision, unlike *Concepcion*, will have some sort of effect on dispute resolution practices, whether in the franchise industry or the financial services industry. At a

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<sup>12</sup> Consumer Financial Protection Bureau, Arbitration Study: Preliminary Results (Dec. 12, 2013) (“*CFPB Report*”).

<sup>13</sup> CFPB Report at 19.

minimum, the results of our prior research, confirmed by the CFPB's preliminary results, suggest that Congress should be cautious before unreflectively accepting predictions that the decision will result in some sudden shift in contracting practices.

In our paper, we do note one possibility raised by *Italian Colors*: pure "class" waivers – that is waivers of the right to proceed in a collective manner without an accompanying arbitration clause. While such clauses are not widely reported, our franchise data did reveal some instances. Future research might test whether contracts lacking arbitration clauses begin to employ class waivers or, instead, also remain sticky.

### **III. Congress Should Approach With Caution Criticisms About Arbitration's Effect on Aggregate Dispute Resolution.**

To this point, my testimony has focused on the state of the empirical record and the apparent lack of validity to the predictions that the Supreme Court's decision in *Concepcion* would result in some cascading change in contracting practices. In this final section, I address the questions raised by *Concepcion* and *Italian Colors* for companies that do, in fact, employ arbitration clauses. That is, whether the effect of those clauses, coupled with a collective litigation waiver, effectively insulates the defendant from liability by eliminating the necessary incentives to bring suit.

Up front, it is important to note the different phenomena at work in the two settings. *Concepcion*, a consumer-to-business case, involves a situation

where the stakes of proceeding on an individualized basis are allegedly too small for any individual consumer to have an incentive to bring the claim. *Italian Colors*, a business-to-business case, does not involve allegations about insufficient individual stakes; instead, the claim here is that the costs of marshaling the necessary proof of a claim are so exorbitant that an individual litigant allegedly cannot bear them.

Taking the *Concepcion*-type situation first. A variety of mechanisms can address the apparent lack of incentive to proceed on an individualized basis. Procedural flexibility is a hallmark of arbitration, and it can be designed in a manner to minimize cost to the consumer: the dispute can occur in an on-line or documents-only setting with the company bearing the costs of the dispute; companies can include cost-shifting or fee-shifting provisions in their contracts (including provisions that only shift fees to the prevailing consumer while requiring the company, in all events, to bear its own fees); they can unilaterally offer to pay the attorney's fees of the consumer; a few companies (like AT&T) go one step further and embed reward provisions in their arbitration clauses in the event the consumer recovers more in arbitration than the company offers in settlement. These sorts of procedural innovations, as well as the Consumer Due Process Protocol utilized by the American Arbitration Association, all can address the alleged lack of incentive to proceed on an individualized basis. Indeed, consistent with this general solicitude for arbitration as a flexible device for handling consumer claims, the United States has been working with the Organization of American States to develop methods for addressing cross-border

consumer disputes and has included, as part of its proposal, model rules for arbitration of cross-border business-to-consumer claims.<sup>14</sup>

Even assuming these mechanisms were insufficient, other mechanisms can address the aggregation question. Most importantly, public enforcement authorities charged with the civil enforcement of certain statutory remedies, like attorneys general or state regulatory bodies, retain the authority to sue on behalf of a group of affected individuals, even when those individuals may be parties to arbitration agreements. As the Supreme Court has made clear, those public regulatory entities are not bound by the arbitration commitment, even when they are suing on behalf of individuals who are bound by it.<sup>15</sup>

*Italian Colors* presents a different phenomenon. Here, the underlying agreement arises between business entities; moreover, the stakes of the claim are sufficiently high that there is no argument about a lack of incentive to bring suit. Instead, the alleged cost of proving the underlying antitrust claims is sufficiently expensive that it might discourage the individual litigant from proceeding unless he or she can share those costs with other claimants. Here too, the procedural flexibility afforded by arbitration could supply creative solutions. The arbitrator might appoint his or her own expert to resolve the question and allocate the costs across the claimant and respondent. The arbitrator could order the respondent to pay the claimant's expert fees in the event the expert prevailed.

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<sup>14</sup> See Michael J. Dennis, *Developing A Practical Agenda for Consumer Protection in the Americas*, available at <http://www.oas.org/dil/esp/14%20-%20dennis.DM.309-328.pdf>.

<sup>15</sup> See *EEOC v. Waffle House*, 534 U.S. 279 (2002).

Beyond arbitration, the market itself might provide such solutions. Multiple claimants could bring single proceedings against a single respondent and then enter into cost-sharing arrangements. Law firms might develop expertise in the field and then either leverage that know-how across cases or spread the costs of developing that know-how across cases. As with the situation presented by *Concepcion*, public enforcement and regulatory authorities, which are not bound by the arbitration agreement, can step in and serve that aggregative function where the public interest requires it.

Against these options, it is often claimed that the true solution lies in invalidation of the class waiver and restoration of the class action as a means of overcoming these aggregation difficulties. Indeed, as I have participated and witnessed these debates over arbitration for several years, one of the unfortunate aspects has been the conflation of a debate about arbitration with a debate about class actions. The risk in framing the debate this way is that it subjects arbitration to unfair broadside criticisms. If groups want to have a debate about class actions, then they should have one, but the arbitration system cannot – and should not – become caught in the crossfire.

Nonetheless, I recognize one reason the two topics have been coupled is the appearance, as described in our research, of arbitration clauses with class waivers. So to the extent class actions are seen as the superior aggregation option, it certainly is important to ask whether this device holds forth the promise touted by arbitration's critics.

There is an extensive literature on class actions, and I do not intend to rehash it here.<sup>16</sup> Rather, I do wish to draw your attention to some research casting doubt on the efficacy of that mechanism. As you know, class actions almost never result in a verdict. Instead, if the class is certified, some settlement which results in a significant fee to the class attorneys and some potential compensation to class members. Yet, according to one recent study, the frequency with which class members actually obtain that relief (known as the claims form completion rate) is astonishingly low.<sup>17</sup> Other research finds similarly low completion rates whenever the consumer must complete a form to receive a share of the settlement, even when the consumer's share is nontrivial.<sup>18</sup> Findings of this sort have prompted my colleague, Professor Jaime Dodge, to express skepticism over the efficacy of privately managed class actions: "Many class actions are only providing compensation to a small fraction of harmed individuals, while preclusion operates to bar these individuals' claims."<sup>19</sup>

My claim is measured. My purpose is not to offer some unequivocal criticism (or praise) for class actions. Rather, my goal is simply to sound a note

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<sup>16</sup> See, e.g., Richard A. Nagareda *et al.*, *The Law of Class Actions and Other Aggregate Litigation* (2d ed. 2013); Richard A. Nagareda, *Mass Torts in a World of Settlement* (University of Chicago Press 2007).

<sup>17</sup> Rust Consulting, *Anticipating Claims Filing Rates in Class Actions* (2013).

<sup>18</sup> See Nicholas M. Pace & William B. Rubinstein, *How Transparent Are Class Action Outcomes? Empirical Research on the Availability of Class Action Claims Data* (Rand 2008); Nicholas M. Pace *et al.*, *Insurance Class Actions in the United States* (Rand 2007); Deborah Hensler *et al.*, *Class Action Dilemmas: Pursuing Public Goals for Private Gain* (Rand 2000).

<sup>19</sup> Jaime Dodge, *Disaggregative Mechanisms: The New Frontier of Mass-Claims Resolution Without Class Actions*, \_\_ Emory L.J. \_\_ (forthcoming 2014).

of caution: do not be seduced by claims that class actions, or any other mechanism, offers a wholly unproblematic mechanism for addressing the aggregation issues identified by cases like *Concepcion* and *Italian Colors*. Rather, examine the relative efficacy of class actions (or any other mechanism) and consider the available empirical literature. Put another way, to pick up on a theme expressed earlier in my testimony, as you scrutinize arbitration for its effectiveness as a dispute resolution device, it is essential that class actions be subjected to the same level of scrutiny.

**CONCLUSION**

In sum, Mr. Chairman, thank you for the opportunity to offer these views. At bottom, it is my view that the “parade of horrors” often predicted in connection with Supreme Court decisions on arbitration, particularly *Concepcion*, has not come to pass. While it is simply too early to predict the effects of the *Italian Colors* case, the historical disconnect between the rhetorical criticism and the empirical reality of arbitration counsels caution. Rather, as I have noted elsewhere, the available empirical record on arbitration suggests that the system generally produces sound results.

To be sure, arbitration is not immune from criticism, the empirical record is incomplete, and the subject should continue to be subject to rigorous empirical examination and, where appropriate, refinement. The same can and should be said for our system of civil litigation. Indeed, if sound policy is to emerge from these debates, it is critical that our system of civil litigation, particularly the class action mechanism, be subject to the same level of exacting scrutiny.

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**ADDENDUM TO THE TESTIMONY OF  
PROFESSOR PETER B. RUTLEDGE**

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**“Sticky” Arbitration Clauses?:  
 The Use of Arbitration Clauses after *Concepcion* and *Amex***

Peter B. Rutledge\*  
 Christopher R. Drahozal\*\*

We present the results of the first empirical study of the extent to which businesses have switched to arbitration after *AT&T Mobility LLC v. Concepcion*. After the Supreme Court’s decision in *Concepcion*, commentators predicted that every business soon would use an arbitration clause, coupled with a class arbitration waiver, in their standard form contracts to avoid the risk of class actions. We examine two samples of franchise agreements: one sample in which we track changes in arbitration clauses since 1999, and a broader sample focusing on changes since 2011, immediately before *Concepcion* was decided. Our central finding is consistent across both samples of franchise agreements: the use of arbitration clauses in franchise agreements has increased since *Concepcion*, but not dramatically, and most franchisors have not switched to arbitration. While our results necessarily are limited to franchise agreements and may not be generalizable to consumer and employment contracts, they nonetheless provide valuable evidence on how businesses are responding to *Concepcion*.

Given our finding that only a handful of franchisors have switched to arbitration clauses since *Concepcion*, the next question is “why not”? We reexamine the assumptions underlying the predictions of a switch to arbitration — that there is no reason for a business not to use an arbitral class waiver and that businesses readily and costlessly can and will modify their form contracts — and find reason to question both. By using an arbitration clause, businesses do more than simply contract out of class actions: they contract for a bundle of dispute resolution services, including, for example, a very limited right to appeal. For businesses that perceive themselves as unlikely to be sued in a class action, these “bundling costs” may discourage them from using an arbitration clause. In addition, even standard form contracts might be sticky — i.e., resistant to change

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even if change might be in the business's best interest. We find empirical support for both possible explanations for why many franchisors have not begun using arbitration clauses after *Concepcion*.

Finally, we consider the potential implications of the Court's subsequent decision in *American Express Cos. v. Italian Colors Restaurant* for the future use of arbitration clauses. To the extent bundling costs deter the use of arbitral class waivers, we still would not expect all or most businesses to switch to arbitration even after *Amex*. Likewise, to the extent contract stickiness explains the limited switch to arbitration, *Amex* will have limited effect. In fact, *Amex* might actually make class action waivers that are not part of an arbitration clause more attractive than before. Although on its facts *Amex* addresses the enforceability of arbitral class waivers, much of the Court's reasoning applies as well to non-arbitral class waivers, which avoid the bundling costs of an arbitral class waiver. Of course, even after *Amex* much legal uncertainty remains about the enforceability of non-arbitral class waivers. But on this broad interpretation, *Amex* on the margin increases the attractiveness of non-arbitral class waivers and might result in some uptick in their use (an increase that was occurring even before *Amex*, at least in franchise agreements).

## **I. Introduction**

The Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*<sup>1</sup> has been described as a "crushing blow to consumers,"<sup>2</sup> a "disaster for consumer protection,"<sup>3</sup> and "one of the most important and favorable cases for businesses in a very long time."<sup>4</sup> In *Concepcion*, the Court held that the Federal Arbitration Act preempts state court decisions invalidating class arbitration waivers as unconscionable.<sup>5</sup> After *Concepcion*, commentators predicted that every business soon would use an arbitration clause, coupled with a class arbitration waiver, in their standard

<sup>1</sup> 131 S. Ct. 1740 (2011).

<sup>2</sup> Bob Sullivan, *After High Court Ruling, Firms Divide and Conquer in Consumer Cases*, NBC News (Sept. 21, 2011), available at [http://redtape.nbcnews.com/\\_news/2011/09/21/7863184-after-high-court-ruling-firms-divide-and-conquer-in-consumer-cases?lite](http://redtape.nbcnews.com/_news/2011/09/21/7863184-after-high-court-ruling-firms-divide-and-conquer-in-consumer-cases?lite) (quoting Ed Mierzewski, U.S. Public Interest Research Group).

<sup>3</sup> Bruce D. Greenberg, *A Poor Judicial Product and a Disaster for Consumer Protection: A Lengthy Analysis of AT&T v. Concepcion* (May 5, 2011), available at <http://appellate-law-nj.com/a-poor-judicial-product-and-a-disaster-for-consumer-protection-a-lengthy-analysis-of-att-v-concepcion/>; see also Ian Millhiser, *The Supreme Court's One Thousandth Cut Against Consumers* (Nov 9, 2010), available at <http://thinkprogress.org/justice/2010/11/09/176967/att-concepcion/> ("if *Concepcion* turns out badly it will be a disaster for millions of American consumers and a green light for corporate America to scam us all a few dollars at a time").

<sup>4</sup> Adam Liptak, *Supreme Court Allows Contracts That Prohibit Class-Action Arbitration* (Apr. 27, 2011), available at <http://www.nytimes.com/2011/04/28/business/28bizcourt.html> (quoting Brian Fitzpatrick, Vanderbilt University Law School) ("The decision basically lets companies escape class actions, so long as they do so by means of arbitration agreements," Brian T. Fitzpatrick, a law professor at Vanderbilt University, said. "This is a game-changer for businesses.")

<sup>5</sup> 131 S. Ct. at 1753.

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form contracts to avoid the risk of class actions.<sup>6</sup> A “tsunami”<sup>7</sup> of these arbitral class waivers was coming, such that “[a]fter *Concepcion*, it is only a matter of time before nearly every credit card provider, cell phone company, mail-order business or even every potential employer requires anyone who wants to do business with them to first give up their right to file a class action.”<sup>8</sup>

More recently, a similar chorus of criticisms followed the Supreme Court’s decision in *American Express Co. v. Italian Colors Restaurant (Amex)*.<sup>9</sup> In *Amex*, the Court rejected the argument that an arbitral class waiver was unenforceable because it precluded the plaintiffs from vindicating their federal statutory rights, even though the lack of class relief arguably made it uneconomical for plaintiffs to prove their federal antitrust claim.<sup>10</sup> This decision ended most if not all remaining uncertainty over the enforceability of arbitral class waivers.<sup>11</sup> Reiterating the refrains about *Concepcion*, commentators quickly decried *Amex* as an “unmitigated disaster” and the “worst Supreme Court arbitration decision ever,”<sup>12</sup> and predicted “a new rash of companies issuing arbitration clauses that preclude class actions.”<sup>13</sup>

<sup>6</sup> See, e.g., Brian T. Fitzpatrick, *Supreme Court Case Could End Class-Action Suits*, S.F. CHRON. (Nov. 7, 2010), available at <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2010/11/06/INA41G6131.DTL> (“Once given the green light, it is hard to imagine any company would not want its shareholders, consumers and employees to agree to such provisions [arbitration agreements with class waivers].”); Nathan Koppel, *Will Federal Consumer Bureau Ride to the Rescue of Class Actions?*, WSJ LAW BLOG (Apr. 29, 2011), available at <http://blogs.wsj.com/law/2011/04/29/will-federal-consumer-bureau-ride-to-the-rescue-of-class-actions/> (“Class-action bans are already pretty common in certain industries, such as consumer credit and cell phones, and they are about to become much more common, lawyers say.”); Steven Berk, *EBay Offering Rare Chance to Opt-Out of Forced Arbitration* (Oct. 1, 2012), <http://www.thecorporateobserver.com/2012/10/01/ebay-offering-rare-chance-to-opt-out-of-forced-arbitration-nov-9th-deadline/> (“At this point, nearly every company that provides consumer goods or services, from Amazon to Verizon, now requires users to agree to an arbitration clause. Companies are wasting no time in taking advantage of the opportunity to smother those pesky class action suits before they even have a chance to breathe.”); Jean Sternlight, *Eliminating Class Actions — A Tsunami in the Wake of AT&T Mobility v. Concepcion Threatens Access to Justice*, SCOTUSBLOG (Sep. 19, 2011, 9:19 AM), <http://www.scotusblog.com/2011/09/eliminating-class-actions-%e2%80%93-a-tsunami-in-the-wake-of-at-t-mobility-v-concepcion-threatens-access-to-justice/> (“In the future we can expect that far more companies will impose arbitral class action waivers as a means to insulate themselves from class actions.”).

<sup>7</sup> Myriam E. Gilles & Gary B. Friedman, *After Class: Aggregate Litigation in the Wake of AT&T Mobility v. Concepcion*, 79 U. CHI. L. REV. 623, 629 (2012).

<sup>8</sup> Ian Millhiser, *Supreme Court Nukes Consumers’ Rights In Most Pro-Corporate Decision Since Citizens United*, THINKPROGRESS: JUSTICE (Apr. 27, 2011), available at <http://thinkprogress.org/justice/2011/04/27/176997/scotus-nukes-consumers/>.

<sup>9</sup> 133 S. Ct. 2304 (2013).

<sup>10</sup> *Id.* at 2309-10.

<sup>11</sup> *But see infra* note \_\_\_\_.

<sup>12</sup> Paul Bland, *Worst Supreme Court Arbitration Decision Ever* (June 20, 2013), <http://publicjustice.net/blog/worst-supreme-court-arbitration-decision-ever/>; Jean Sternlight, *American Express Co. v. Italian Colors Restaurant Guts Enforcement of Federal Laws*, ADR Prof Blog (June 20, 2013), <http://www.indisputably.org/?p=4750> (same).

<sup>13</sup> Sternlight, *supra* note \_\_\_\_; Matt Brownell, *Forced Arbitration: Killing the Right to Sue Big Companies, One TOS Agreement at a Time* (Mar 7, 2013),

<http://www.dailyfinance.com/on/forced-arbitration-killing-class-action-lawsuits-tos-agreements/> (“If the court does indeed rule in favor of American Express, look for even more businesses to find ways to shield themselves from lawsuits.”); *In Court Rulings, Roberts Takes Long-Term Approach*, Fresh Air with Terry Gross (July 2, 2013) (interview with Adam Liptak), available at <http://m.npr.org/news/Politics/197713270> (“[A]ny smart business today

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Such empirical predictions are based on two, seemingly self-evident, assumptions. First, after *Concepcion* and *Amex* every business will benefit from using an arbitral class waiver to avoid class actions. Businesses want to avoid class actions, and, on this view, there is no downside to using an arbitral class waiver to accomplish that end. The writings of Myriam Gilles exemplify this first assumption:

I regard it as inevitable that firms will ultimately act in their economic best interests, and those interests dictate that virtually all companies will opt out of exposure to class liability. Why wouldn't they? Once the [class] waivers gain broader acceptance and recognition, it will become malpractice for corporate counsel not to include such clauses in consumer and other class-action-prone contracts.<sup>14</sup>

Second, unlike negotiated contracts between sophisticated parties, which may be “sticky” and resistant to change, consumer contracts can more easily be changed unilaterally by the business party. Gilles makes this assumption explicit as well: “most companies can quickly amend their clauses in response to or anticipation of litigation outcomes, revealing a nimble and adaptive corporate feedback loop.”<sup>15</sup>

It has now been more than two years since the decision in *Concepcion*, long enough to evaluate at least preliminarily how contracting practices have changed in response to the decision. In this paper, we present the results of the first empirical study of the extent to which businesses have switched to arbitration after *Concepcion*. As the basis for our study, we examine two samples of franchise agreements: one sample in which we track changes in arbitration clauses since 1999, and a broader sample focusing on changes since 2011, immediately before *Concepcion* was decided. Commentators have strongly urged franchisors, like consumer businesses and employers, to switch to arbitration clauses after *Concepcion*.<sup>16</sup>

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puts in a clause that says you must arbitrate, and you can't join up with other people to do so, you can't do it in arbitration, you can't do it in court, you're on your own.”)

<sup>14</sup> Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 377 (2005); see also Myriam Gilles, *Gutting the Vindication-of-Rights Challenge to Arbitration Agreements*, 81 GEO. WASH. U.L. REV. \_\_ (forthcoming 2013) (ms. at 1) (predicting that “one day soon, some unfortunate transactional lawyer will be the first to be held liable for failing to insert an arbitration clause banning all aggregate claiming in a standard form agreement”); Gilles & Friedman, *supra* note \_\_, at 629 (same).

<sup>15</sup> Myriam Gilles, *Killing Them with Kindness: Examining “Consumer-Friendly” Arbitration Clauses After AT&T Mobility v. Concepcion*, 88 NOTRE DAME L. REV. 825, 846 (2012); see also Jean R. Sternlight, *Tsunami: AT&T Mobility v. Concepcion Impedes Access to Justice*, 90 ORE. L. REV. 703, 718 (2012) (“For companies that fear being sued in class actions it will be quite easy to insert class action waivers into small-print documents or online provisions that they send or make available to their customers or employees.”); Brownell, *supra* note \_\_ (“It’s easy for tech companies, websites and wireless carriers to insert arbitration clauses into their contracts, because people are used to skipping the terms of service agreements and fine print that accompany these services.”).

<sup>16</sup> Anthony J. Calamunci, *Concepcion v. AT&T: Its Impact on Franchise Law* (June 15, 2001), <http://www.lexology.com/library/detail.aspx?g=bc0de932-81a5-4356-a25d-41d69083f3eb> (“*Concepcion*, when applied to franchise agreements, grants franchisors the authority to draft much stronger language even when the agreement is offered as a “take-it or leave-it” . . . Franchisors should contact counsel and sharpen their pencils. If there was ever a time to test the boundaries of the fine print, the time is now!”); Martin Fern, *Franchise Law*

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Indeed, franchise agreements were among the very first types of contracts as to which lawyers first publicized the use of an arbitration clause as a “class action shield” back in the 1990s.<sup>17</sup> Moreover, franchise agreements exemplify a rare type of standard form contract that is publicly available in a systematic way and for which a reasonably lengthy history of contracting practices is available. While our results necessarily are limited to franchise agreements and may not be generalizable to consumer and employment contracts, they nonetheless provide valuable evidence on how businesses are responding to *Concepcion*.<sup>18</sup>

Our central finding is consistent across both samples of franchise agreements: *the predicted tsunami of arbitral class waivers has not occurred*. The use of arbitration clauses in franchise agreements has increased since *Concepcion*, but not dramatically, and most franchisors have not switched to arbitration. The reason is not that all franchisors were already using arbitration before *Concepcion*.<sup>19</sup> Indeed, less than half or two-thirds of franchisors (depending on the sample) used arbitration clauses in their standard form contracts immediately prior to *Concepcion*.<sup>20</sup> There was plenty of room for franchisors to switch to arbitration, but they have not done so in any substantial way.

Given our finding that only a handful of franchisors have switched to arbitration clauses since *Concepcion*, the next question is “why not”? We examine the assumptions underlying the predictions of a tsunami of arbitration clauses — that there is no reason for a business not to use an arbitral class waiver and that businesses readily and costlessly can and will modify their form contracts — and find reason to question both. By using an arbitration clause, businesses do more

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*Update: Protecting a Franchisor Against the Risk of System-Wide Class Actions* (June 13, 2011),

<http://franchiselaw.foxrothschild.com/tags/class-actions/>

(“[T]he AT&T decision ends this debate [over the pros and cons of arbitration], at least for franchisors and companies that provide contractual services to consumers, since it is now clear that a franchisor may both mandate arbitration of franchisor-franchisee disputes and preclude classwide arbitrations. This can effectively eliminate the risk of a class action by franchisees against a franchisor. The AT&T decision now makes a well-drafted arbitration clause an essential feature of every franchise agreement.”); Judy Rost et al., *Comparative International Perspectives of Arbitration in the Franchising Context*, 31 *FRANCHISE L.J.* 124, 126 (2012) (“In the United States, one compelling reason for franchisors to include an arbitration provision is as a potential means to avoid class actions.”); Kemp Sawers & Paul Russell, *Franchise Report: Avoiding Class Arbitrations* (May 11, 2011) [http://www.bakerbots.com/file\\_upload/2011May11FranchiseReportAvoidingClassArbitrations.htm](http://www.bakerbots.com/file_upload/2011May11FranchiseReportAvoidingClassArbitrations.htm) (“The prudent franchisor should not assume that the absence of express language authorizing class arbitration immunizes the franchisor from class treatment. Instead, the safe course of action for franchisors is to include a class arbitration waiver in franchise agreements.”).

<sup>17</sup> Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 *FRANCHISE L.J.* 141, 141 (1997).

<sup>18</sup> Anecdotal evidence suggests that some industries have shifted more strongly toward arbitration since *Concepcion*. Thus, Microsoft, Sony, and other software and online companies have announced since *Concepcion* that they were adopting arbitration clauses in their end user license agreements. We seek to reconcile these anecdotal reports with our empirical findings later in the paper. See *infra* text accompanying notes \_\_\_\_.

<sup>19</sup> By comparison, the limited empirical evidence on the use of arbitration clauses by mobile wireless services providers suggests that almost all facilities-based operators already use arbitration clauses, in which case of course one would not expect a major move toward arbitration by such businesses. See Erin O’Hara O’Connor & Christopher R. Drahozal, *Carve-Outs and Contractual Procedure* (June 14, 2013) (ms. at 35).

<sup>20</sup> See *supra* text accompanying notes \_\_\_\_; see also Christopher R. Drahozal, “Unfair” Arbitration Clauses, 2001 *U. ILL. L. REV.* 695, 727; Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight from Arbitration?*, 37 *HOFSTRA L. REV.* 71, 95 (2008).

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than simply contract out of class actions: they contract for a bundle of dispute resolution services, including, for example, a very limited right to appeal. For businesses that perceive themselves as unlikely to be sued in a class action (and hence to receive little benefit from an arbitral class waiver), the other services bundled with the waiver of class actions (what we call “bundling costs”) may discourage them from using an arbitration clause. In addition, even standard form contracts might be sticky — i.e., resistant to change even if change might be in the business’s best interest. We find empirical support for both possible explanations for why many businesses have not switched to arbitration clauses after *Concepcion*.<sup>21</sup>

We then consider the potential implications of *Amex* for the future use of arbitration clauses. Of course, if all businesses switched to arbitration because of *Concepcion*, *Amex* likely would have little additional effect. But given our finding that such a switch has not occurred, the question then is how is *Amex* likely to affect contracting behavior? To the extent businesses have not switched to arbitration clauses because of any residual uncertainty over the enforceability of arbitral class waivers, *Amex* largely removes that uncertainty. The expected result would be an increased use of arbitration clauses. But to the extent businesses have not switched to arbitration clauses for reasons other than legal uncertainty, *Amex* will not make arbitration more attractive. Other characteristics of arbitration (such as the limited right to appeal) might explain franchisors’ decisions not to switch. To the extent such bundling costs deter the use of arbitral class waivers, we still would not expect all or most businesses to switch to arbitration. Likewise, to the extent contract stickiness explains the limited switch to arbitration, *Amex* will have limited effect.

That said, *Amex* might actually make an alternative to arbitral class waivers — what we call non-arbitral class waivers — more attractive than before. By non-arbitral class waivers, we mean waivers of class actions that are not part of an arbitration clause.<sup>22</sup> The parties remain in court but by contract seek to waive class actions directly. Such clauses are not as common as arbitral class waivers, but they do exist.<sup>23</sup> Although on its facts *Amex* addresses the enforceability of arbitral class waivers, much of the Court’s reasoning applies as well to non-arbitral class waivers. Indeed, in our view *Amex* might be better understood not as a case about arbitration clauses, but, as a case about class actions. If read broadly, it could be construed as making class actions waiveable even without the use of an arbitration clause. The advantage of non-arbitral class waivers for businesses is that they avoid the bundling costs of an arbitral class waiver: the business can avoid class actions but otherwise have disputes resolved in court (maintaining full appeal rights, for example). Of course, even after *Amex* much legal uncertainty remains about the enforceability of non-arbitral class waivers, and we certainly do not predict a “tsunami” of non-arbitral class waivers. But on this broad interpretation, *Amex* on the margin increases the attractiveness of non-arbitral class waivers and might result in some uptick in their use (an increase that was occurring even before *Amex*, at least in franchise agreements).

These findings carry several implications. First, and most obviously, they call into question some of the empirical predictions following *Concepcion* and *Amex*. So far, at least, it is

<sup>21</sup> For other possible reasons, see *infra* text accompanying notes \_\_-\_\_.

<sup>22</sup> We elaborate on the importance of this technical distinction in Part II.

<sup>23</sup> See *infra* text accompanying notes \_\_-\_\_.

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simply not true that all or even most businesses are switching to arbitration clauses after *Concepcion*. To be clear, however, whether businesses have broadly switched to arbitration clauses with class waivers is not the same question as whether courts have applied *Concepcion* to dismiss claims seeking class relief in court, or even whether *Concepcion* (and *Amex*) might result in the end of consumer and other contract-based class actions. We offer no views here on how courts have applied *Concepcion*, and readily acknowledge (as our prior research has found empirically<sup>24</sup>) that the businesses most likely to be subject to class actions (or at least perceive themselves to be) are the ones most likely to use arbitral class waivers.

Second, the paper cautions against unquestioning acceptance of the common “parade-of-horribles” arguments marshaled in courtrooms around the nation, including the Supreme Court of the United States. At a high level of abstraction, this argument typically takes the following form: if the court decides the case in a certain manner, an avalanche of undesirable behavior will surely follow. In the specific context of contract cases, the argument unfolds in this manner: if the court enforces certain contractual terms in a firm’s contract, similarly situated firms will flock to the approved language, often to the detriment of some other constituency, such as a consumer or an employee. In whatever context, arguments of this sort ultimately entail predictions about human (or firm) behavior. At the time they are advanced, those predictions *should* have some empirical foundation. Yet often they do not. Moreover, after the court decides the case, those predictions *should* be tested empirically. Yet often they are not. Not only does this state of affairs sully the quality of legal argument, it entails the risk that a court may base a decision on an invalid empirical premise.

Third, the paper adds to our understanding of the nature of arbitration as a means of resolving disputes. An arbitration clause is an agreement to a bundle of dispute resolution services — a party-appointed judge, less discovery, a limited right to appeal, and the like. Litigation provides its own bundle of services. While parties can modify the bundles by contract, there are limits. For some parties, all aspects of the arbitral bundle may be preferable to all aspects of the litigation bundle. For others, some characteristics of the arbitral bundle may be advantageous while others are not, but the advantages outweigh the disadvantages. But for still others, the disadvantages may outweigh the advantages of arbitration — even if one of those advantages is avoiding class actions. Stated otherwise, one cannot assume that parties will choose arbitration on the basis of only one characteristic without considering the entire bundle.

Fourth, this paper provides insights into the nature of contract change and innovation. Specifically, it draws on prior scholars’ work about why, under certain circumstances, contract terms might be “sticky” — that is, why parties might be reluctant to modify their contracting behavior even when it might be beneficial for them to do so. We examine several explanations for why contracting parties do not necessarily adopt terms that would be to their benefit, and consider how those explanations apply, if at all, when the contracts involve parties occupying unequal bargaining positions. There certainly is reason to expect some degree of stickiness in franchise agreements, and we find some evidence of stickiness in the contracts we studied. But

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<sup>24</sup> Christopher R. Drahozal & Peter B. Rutledge, *The Use of Arbitration Clauses in Credit Card Agreements: An Empirical Study*, 9 J. EMPIRICAL LEGAL STUD. 536, 540 (2012).

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the evidence does not exclude the possibility of other explanations for the lack of a shift to arbitration by franchisors, such as the bundling theory suggested above. This paper also gives reason to question whether a Supreme Court decision upholding a particular contract provision necessarily is a sufficient “shock” to overcome contract stickiness.

Finally, fifth, we offer a first look at how the Supreme Court’s recent decision in *Amex* might affect contracting behavior. Although on its facts *Amex* involves the enforceability of an arbitral class waiver, the Court’s reasoning might extend as well to non-arbitral class waivers, at least as to certain federal statutory claims. There are, however, important differences between the two forms of class waivers (arbitral vs non-arbitral) that might affect firm behavior. Unlike arbitral class waivers, non-arbitral class waivers likely remain subject to state unconscionability challenges (since *Concepcion* is based on preemption of such challenges by the Federal Arbitration Act and therefore is limited to arbitral class waivers). But for businesses that want to avoid the bundling costs of arbitration (e.g., retain the right to appeal in court), non-arbitral class waivers would become more attractive after *Amex*. Thus, for a firm that favored the most airtight class waiver, an arbitral class waiver might make sense; for a firm that favored a greater opportunity to appeal an adverse decision, a non-arbitral class waiver might make sense.

Part II of the paper provides background on the use of arbitration clauses as class action waivers and on the *Concepcion* and *Amex* decisions. Part III discusses the economics of arbitration and standard form contracts, considering both arbitration as a bundle of dispute resolution services and the “stickiness” of contract terms. Part IV describes our data and methodology and presents our empirical analysis. Part V examines possible implications of *Amex* for the use of arbitral and non-arbitral class waivers. Finally, Part VI summarizes our conclusions and sets out the implications of our empirical findings.

## **II. Background: *Concepcion*, *Amex*, and the Use of Arbitration Clauses**

We begin with terminology and some history. Although many of the cases and much of the commentary speak generically of “class action waivers,” here we use more precise labels. Technically, provisions addressing class relief in arbitration clauses are class *arbitration* waivers, not class action waivers.<sup>25</sup> The arbitration clause itself has the effect of avoiding class relief in court because the parties have agreed to arbitrate any dispute instead.<sup>26</sup> The additional waiver language precludes the arbitration from proceeding on a class basis, hence the “class arbitration waiver” label.

<sup>25</sup> Although sometimes an arbitration agreement will include a non-arbitral class waiver in the event the arbitration clause is invalidated. See David A. Hoffman, *Whither Bespoke Procedure?*, 2014 U. ILL. L. REV. \_\_\_ (manuscript at 29-30).

<sup>26</sup> See, e.g., *Ex Parte Green Tree Fin’l Corp.*, 723 So. 2d 6, 10 & n.3 (Ala. 1998); *Zawikowski v. Beneficial Nat’l Bank*, 1999 U.S. Dist. LEXIS 514 (N.D. Ill. Jan. 7, 1999); *Collins v. International Dairy Queen, Inc.*, 169 F.R.D. 690, 694 (M.D. Ga. 1997); *Hunt v. Up North Plastics*, 980 F. Supp. 1046, 1048 (D. Minn. 1997).

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In this paper, we refer to the combined effect of an arbitration clause and a class arbitration waiver as an “arbitral class waiver.”<sup>27</sup> By comparison, we use the term “non-arbitral class waiver” to refer to contract provisions that seek to waive the availability of a class action in court without using an arbitration clause. Such provisions are much less common but do exist, particularly in the franchise setting.<sup>28</sup> Finally, we refer to both types of provisions collectively as class action waivers.<sup>29</sup>

Because the history of arbitral class waivers has been detailed at length elsewhere,<sup>30</sup> we provide only a brief overview here. We reiterate the highlights of the events leading up to *Concepcion* in sub-part A, and then discuss *Concepcion* itself in sub-part B. Finally, in sub-part C we consider the *Amex* case and its importance for the enforceability of class waivers.

### A. Arbitration Clauses and Class Actions

Lawyers for franchisors were among the very first to recognize (in print, anyway) that an arbitration clause could reduce the risks of class actions faced by their clients.<sup>31</sup> When a party agrees to have its dispute resolved in arbitration, it necessarily cannot be party to a court action involving that same dispute; it has agreed to proceed in arbitration instead.<sup>32</sup> Thus, in a 1997 article in the *Franchise Law Journal*, franchise lawyer Jack Dunham, after explaining that franchisors faced a heightened risk of class actions, concluded that “franchisors with an arbitration clause in their franchise agreements have an effective tool for managing these new class action risks” — in other words, a “class action shield.”<sup>33</sup>

<sup>27</sup> For prior uses of the phrase, see, e.g., Maureen A. Weston, *The Death of Class Arbitration After Concepcion?*, 60 KAN. L. REV. 767, 786 (2012); see also Sternlight, *supra* note \_\_ (“arbitral class action waiver”).

<sup>28</sup> See *infra* text accompanying notes \_\_-\_\_.

<sup>29</sup> Gilles uses the term “collective action waiver” to the same effect. Gilles, *supra* note \_\_, at 375-76; see also Christopher R. Drahozal & Quentin R. Wittrock, *Franchising, Arbitration, and the Future of the Class Action*, 3 ENTREPRENEURIAL BUS. L.J. 276, 270-80 (2009).

<sup>30</sup> See, e.g., Jill I. Gross, *AT&T Mobility and the Future of Small Claims Arbitration*, 42 SW. L. REV. 47, 51-56 (2012); Sternlight, *supra* note \_\_, at 705-07; Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1 (2000).

<sup>31</sup> For other early publications making the same point, see Michael R. Pennington, *Every Health Insurer's Litigation Nightmare: A Case Study of How One Class Action Affected the Business of One Health Insurer*, BRIEF, Summer 1999, at 46, 52 (“In a further effort to limit litigation exposure in general, and exposure to class actions in particular, many insurance companies in Alabama are presently working to sustain the use of arbitration clauses in insurance policies.”); J.T. Westermeir, *How Arbitration Clauses Can Help Avoid Class Action Damages: Strategies for Managing Risks of Litigation*, COMPUTER L. STRATEGIST, Sept. 1997, at 1; Alan S. Kaplinsky & Mark J. Levin, *Excuse Me, But Who's the Predator? Banks Can Use Arbitration Clauses as a Defense*, BUS. L. TODAY, May/June 1998, at 24. (“Arbitration is a powerful deterrent to class action lawsuits against lenders because the great weight of authority holds that arbitrations cannot be conducted on a class basis unless the parties have agreed to do so.”). Kaplinsky describes himself as the “pioneer of class action waivers.” See Mickey Meece, *Arbitration Is Here to Stay and One Lawyer Says That Is Good for Consumers*, Forbes.com (Jan. 11, 2012), available at <http://www.forbes.com/sites/mickeymeece/2012/01/11/arbitration-is-here-to-stay-and-one-lawyer-says-that-is-good-for-consumers/>.

<sup>32</sup> See *supra* text accompanying note \_\_.

<sup>33</sup> Dunham, *supra* note \_\_, at 141.

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At the time, many courts refused to order arbitration to proceed on a class basis so that the arbitration clause itself “shielded” franchisors from class actions.<sup>34</sup> Even so, some franchisors (and other businesses) began coupling their arbitration clauses with provisions precluding arbitration from proceeding on a class basis.<sup>35</sup> Such “class arbitration waivers” became more important after the Supreme Court’s 2003 decision in *Green Tree Financial Corp. v. Bazzle*.<sup>36</sup> The issue in *Bazzle* was whether the Federal Arbitration Act preempted the South Carolina Supreme Court’s decision compelling arbitration to proceed on a class basis.<sup>37</sup> The U.S. Supreme Court was sharply divided, with the plurality concluding that the issue of whether an arbitration clause permitted class arbitration was for the arbitrator to decide.<sup>38</sup> (Justice Stevens concurred in the judgment vacating the South Carolina court’s decision so that there would at least be a judgment of the Court.<sup>39</sup>).

In response to *Bazzle*, the American Arbitration Association promulgated rules for administering class arbitrations,<sup>40</sup> and indicated that it would administer a class arbitration as long as the parties had agreed to arbitrate under any set of AAA rules and the arbitration agreement was “silent” on class arbitration, consolidation, or joinder.<sup>41</sup> Following the *Bazzle* plurality, the AAA class arbitration rules specified that the arbitrator was to decide in a “clause construction award” “whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class.”<sup>42</sup> The arbitration proceedings would then be stayed to permit any party to seek court review of the clause construction award. Assuming the arbitrator construed the agreement as permitting class arbitration, subsequent steps in the process track Federal Rule of Procedure 23 on class actions — i.e., the arbitrator would decide whether to certify a class (the “class determination award”),<sup>43</sup> and if the arbitrator does so (and the case does

<sup>34</sup> *E.g.*, *Iowa Grain Co. v. Brown*, 171 F.3d 504, 510 (7th Cir. 1999); *Champ v. Siegel Trading Co.*, 55 F.3d 269, 274-77 (7th Cir. 1995). *But see* *Keating v. Superior Court*, 31 Cal. 3d 584 (1982), *rev’d on other grounds sub nom.*, *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Bazzle v. Green Tree Fin’l Corp.*, 569 S.E.2d 349 (S.C. 2002), *vacated*, 539 U.S. 444 (2003).

<sup>35</sup> *See* Drahozal, *supra* note \_\_, at 731-32.

<sup>36</sup> 539 U.S. 444 (2003). It is not just parties or commentators that make empirical predictions. *See* Transcript of Oral Argument at 55, *Green Tree Fin. Corp.*, 539 U.S. 444 (No. 02-634), *available at* [www.supremecourt.gov/oral\\_arguments/argument\\_transcripts/02-634.pdf](http://www.supremecourt.gov/oral_arguments/argument_transcripts/02-634.pdf) (“Does this case have any real future significance, because isn’t it fairly clear that all the arbitration agreements in the future will prohibit class actions?”).

<sup>37</sup> 539 U.S. at 447 (Breyer, J.). A companion case involved a decision by the arbitrator that arbitration could proceed on a class basis. *Id.* at 453-54 (Breyer, J.).

<sup>38</sup> *Id.* at 452-53 (Breyer, J.).

<sup>39</sup> *Id.* at 454-55 (Stevens, J., concurring in the judgment and dissenting in part).

<sup>40</sup> Am. Arb. Ass’n, Supplementary Rules for Class Arbitrations (Oct. 8, 2003), [http://www.adr.org/aaa/ShowPDF?jsessionid=Q38zRMZQvJFBzn295h3vWxwZDyxRNYqnmT2dlynW2SmlyPCLGRpL!644581746?url=/cs/groups/commercial/documents/document/dgdf/mda0/~edis/adrstg\\_004129.pdf](http://www.adr.org/aaa/ShowPDF?jsessionid=Q38zRMZQvJFBzn295h3vWxwZDyxRNYqnmT2dlynW2SmlyPCLGRpL!644581746?url=/cs/groups/commercial/documents/document/dgdf/mda0/~edis/adrstg_004129.pdf) [hereinafter AAA Class Arbitration Rules]. JAMS also has promulgated class arbitration rules. *See* JAMS Class Action Procedures (May 1, 2009), <http://www.jamsadr.com/rules-class-action-procedures/>.

<sup>41</sup> AAA Policy on Class Arbitrations (July 14, 2005), [http://www.adr.org/aaa/ShowPDF?doc=ADRSTG\\_003840](http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_003840) (“[T]he American Arbitration Association will administer demands for class arbitration pursuant to its Supplementary Rules for Class Arbitrations if (1) the underlying agreement specifies that disputes arising out of the parties’ agreement shall be resolved by arbitration in accordance with any of the Association’s rules, and (2) the agreement is silent with respect to class claims, consolidation or joinder of claims.”).

<sup>42</sup> AAA Class Arbitration Rules, *supra* note \_\_, Rule 3.

<sup>43</sup> *Id.* Rules 4-5.

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not settle), proceed to adjudicate the merits.<sup>44</sup> Since promulgating its rules, the AAA has administered over 350 class arbitration proceedings.<sup>45</sup>

In only a handful of clause construction awards (7 of 135, or 5%) in AAA class arbitrations did the arbitrators decide that the arbitration clause did not permit class arbitration.<sup>46</sup> In the vast majority, the arbitrators construed the clause as permitting class arbitration (95 of 135, or 70%) or the parties stipulated that it did so (33 of 135, or 24%).<sup>47</sup> Seeking to avoid the prospect of class proceedings in arbitration, businesses increasingly included class arbitration waivers in their arbitration clauses.<sup>48</sup> Consumers, employees, and franchisees in turn challenged the enforceability of those class arbitration waivers, most commonly (although not exclusively) on the ground that the class arbitration waiver was unconscionable.<sup>49</sup> Businesses responded by arguing that the FAA preempted such unconscionability decisions, and the issue made it to the United States Supreme Court in *AT&T Mobility LLC v. Concepcion*.<sup>50</sup>

**B. *AT&T Mobility LLC v. Concepcion* and FAA Preemption**

The *Concepcions* were cell phone customers of AT&T Mobility (AT&T), who were charged sales tax on what AT&T advertised as a “free” phone.<sup>51</sup> The AT&T cell phone agreement included an arbitration clause with a class arbitration waiver, but also provided that AT&T was to pay all the customer’s arbitration costs for non-frivolous claims; AT&T could not seek to recover its attorney’s fees from the customer; and if the customer recovered more in arbitration than AT&T’s final written settlement offer, the customer would receive a minimum of \$7500 (a so-called “bonus payment”) plus double attorneys’ fees.<sup>52</sup>

When the *Concepcions* filed a class action on behalf of all similarly situated cell phone customers, AT&T filed a petition to compel arbitration. The trial court and the Ninth Circuit held that, under California law, the class arbitration waiver was unconscionable and not

<sup>44</sup> *Id.* Rule 7.

<sup>45</sup> Gregory A. Litt & Tina Praprotnik, *After Stolt-Nielsen, Circuits Split, but AAA Filings Continue*, MEALEY’S INT’L ARB. REP., July 2012, at 1.

<sup>46</sup> Brief of American Arbitration Association as Amicus Curiae in Support of Neither Party at 22, *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 130 S. Ct. 1758 (2010) (No. 08-1198).

<sup>47</sup> *Id.*

<sup>48</sup> See *infra* text accompanying notes \_\_\_-\_\_\_.

<sup>49</sup> See *infra* text accompanying notes \_\_\_-\_\_\_. In addition, arbitration clauses also were challenged on the ground that they precluded the claimant from vindicating his or her statutory rights. See *infra* text accompanying notes \_\_\_-\_\_\_.

<sup>50</sup> Some of the groundwork for the Court’s decision in *Concepcion* was laid by *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 130 S. Ct. 1758 (2010), in which the Court vacated a class arbitration award on the ground that the arbitrators exceeded their powers. See 9 U.S.C. § 10(a)(4).

<sup>51</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1744 (2011).

<sup>52</sup> *Id.*

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severable from the rest of the arbitration clause.<sup>53</sup> The lower courts also concluded that the FAA did not preempt California’s application of its unconscionability doctrine.<sup>54</sup>

The Supreme Court reversed, holding that the application of state unconscionability doctrine to invalidate an arbitral class waiver was preempted. The Court began by explaining that while the savings clause of FAA Section 2 permitted the use of general state contract defenses to invalidate arbitration clauses, such use was not unlimited. Citing dicta from two prior decisions, the Court reiterated that “a court may not ‘rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what ... the state legislature cannot.’”<sup>55</sup> The Court continued:

An obvious illustration of this point would be a case finding unconscionable or unenforceable as against public policy consumer arbitration agreements that fail to provide for judicially monitored discovery....

Other examples are easy to imagine. The same argument might apply to a rule classifying as unconscionable arbitration agreements that fail to abide by the Federal Rules of Evidence, or that disallow an ultimate disposition by a jury (perhaps termed “a panel of twelve lay arbitrators” to help avoid preemption).<sup>56</sup>

Application of state unconscionability doctrine so as effectively to require class arbitration, the Court concluded, likewise “[i]nterfered with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.”<sup>57</sup>

The decision in *Concepcion* has been extremely controversial and widely criticized.<sup>58</sup> Although a handful of courts have sought to limit the decision to its facts — i.e., to arbitration clauses with a “bonus provision” and other sorts of pro-consumer provisions that the AT&T clause had<sup>59</sup> — most have not done so.<sup>60</sup> On the first anniversary of the *Concepcion* decision, in

<sup>53</sup> *Laster v. T-Mobile USA, Inc.*, 2008 U.S. Dist. LEXIS 103712 (S.D. Cal. Aug. 11, 2008), *aff’d sub. nom.*, *Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), *rev’d sub. nom.*, *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).

<sup>54</sup> *E.g.*, *Laster*, 584 F.3d at 857-59.

<sup>55</sup> 131 S. Ct. at 1746 (citing *Doctor’s Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996); *Perry v. Thomas*, 482 U.S. 483, 492-493, n. 9 (1987)).

<sup>56</sup> *Id.* at 1747.

<sup>57</sup> *Id.* at 1748. According to the Court, class arbitration is “inconsistent with the FAA” because (1) “the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration — its informality — and makes the process slower, more costly, and more likely to generate procedural morass than final judgment”; (2) “class arbitration requires procedural formality”; and (3) “class arbitration greatly increases risks to defendants.” *Id.* at 1751-53.

<sup>58</sup> See *supra* text accompanying notes \_\_\_-\_\_\_.

<sup>59</sup> See, e.g., *Feecey v. Dell, Inc.*, 28 Mass. L. Rptr. 652, at \*8 (Super. Ct. 2011) (distinguishing *Concepcion* on ground that unlike the AT&T Mobility clause in *Concepcion*, “[t]he Dell Arbitration Clause provides no incentives and simply requires arbitration of all disputes, even those that could not possibly justify the expense in light of the amount in controversy”), *rev’d*, 993 N.E.2d 329, 331 (Mass. 2013).

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April 2012, Public Citizen “reported that 76 court decisions had applied *Concepcion* to stay or dismiss a putative class action.”<sup>61</sup> Courts have applied *Concepcion* to uphold arbitral class waivers in a variety of contracting contexts, including franchise agreements.<sup>62</sup>

After *Concepcion*, plaintiffs continued to challenge the enforceability of arbitral class waivers on the ground that the lack of class relief precluded the plaintiffs from vindicating their rights under a particular federal statute (so-called “effective vindication” challenges). Building on dicta in a number of Supreme Court arbitration cases, plaintiffs challenged arbitration agreements on the ground that the arbitration clause amounted to an impermissible prospective waiver of a statutory right and hence was unenforceable.<sup>63</sup> In simple terms, the argument is that if parties cannot waive a statutory right directly,<sup>64</sup> they should not be able to do so indirectly — by using an unfair arbitration clause. A common basis for an effective vindication challenge is that the upfront costs of arbitration are too high.<sup>65</sup> But the challenge has been made against other provisions of arbitration clauses as well, and after *Concepcion* it became the primary basis for challenging arbitral class waivers.

**C. American Express Co. v. Italian Colors Restaurant and the Effective Vindication of Federal Statutory Rights**

The effective vindication theory — as applied to class waivers — reached the Supreme Court in *American Express Co. v. Italian Colors Restaurant*.<sup>66</sup> The plaintiffs in *Amex* were merchants that accepted American Express charge cards. They brought a class action alleging that the sales and pricing practices of American Express violated the federal antitrust laws. The agreement between American Express and the merchants included an arbitration clause with a class arbitration waiver, and American Express sought to compel individual arbitration of the merchants’ claims. The merchants opposed individual arbitration on the ground that proof of their antitrust claim was so expensive that the claim could only be brought economically as a

<sup>60</sup> See, e.g., *Bellows v. Midland Credit Mgmt., Inc.*, 2011 U.S. Dist. LEXIS 48237, at \*11 (S.D. Cal. May 4, 2011); *Day v. Persels & Assocs., LLC*, 2011 U.S. Dist. LEXIS 49231, at \*15-\*16 (M.D. Fla. May 9, 2011); *Zarandi v. Alliance Data Sys. Corp.*, 2011 U.S. Dist. LEXIS 54602, at \*4-\*5 (C.D. Cal. May 9, 2011).

<sup>61</sup> Public Citizen & National Association of Consumer Advocates, *Justice Denied One Year Later: The Harms to Consumers from the Supreme Court’s Concepcion Decision Are Plainly Evident 4* (April 2012) (“identify[ing] 76 potential class action cases where judges cited *Concepcion* and held that class action bans within arbitration clauses were enforceable”).

<sup>62</sup> See, e.g., *Muriithi v. Shuttle Express*, 712 F.3d 173 (4th Cir. 2013); *Green v. SuperShuttle Int’l, Inc.*, 653 F.3d 766 (8th Cir. 2011); *Villano et al v. TD Bank*, 2012 U.S. Dist. LEXIS 123013, at \*8 (D.N.J. Aug. 29, 2012); *Kairy v. SuperShuttle Int’l, Inc.*, 2012 U.S. Dist. LEXIS 134945 (Sept. 20, 2012).

<sup>63</sup> E.g., *Green Tree Financial Corp.-Ala. v. Randolph*, 531 U.S. 79, 90 (2000) (“It may well be that the existence of large arbitration costs could preclude a litigant ... from effectively vindicating her federal statutory rights”); see also *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 637 (1985) (“And so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function.”).

<sup>64</sup> By a “direct” waiver of a statutory right, we mean a contract provision that says something like “the parties agree to waive any claim under the federal antitrust laws.”

<sup>65</sup> E.g., *Green Tree*, 531 U.S. at 90.

<sup>66</sup> 133 S. Ct. 2304 (2013).

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class action. Enforcing the arbitral class waiver would prevent them from effectively vindicating their statutory rights under the antitrust laws.

The district court granted the motion to compel arbitration, but the Second Circuit reversed, holding that the class arbitration waiver was unenforceable.<sup>67</sup> After reconsidering its decision in light of both *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, and *AT&T Mobility LLC v. Concepcion*, the Second Circuit reaffirmed its decision.<sup>68</sup> The Supreme Court granted certiorari and reversed.<sup>69</sup>

The Court's reasoning was twofold. First, the Court recited that the FAA requires enforcement of arbitration clauses, and found "[n]o contrary congressional command [that] requires us to reject the waiver of class arbitration here."<sup>70</sup> Nothing in the antitrust laws (which, the Court pointed out, were enacted before adoption of the Federal Rules of Civil Procedure) precludes the waiver of class actions. "Nor does congressional approval of Rule 23," the Court stated, "establish an entitlement to class proceedings for the vindication of statutory rights."<sup>71</sup>

Second, as for the argument that the arbitral class waiver prevented the plaintiffs from vindicating their federal statutory rights, the Court noted that it had only recognized the argument in dicta. But even assuming such a challenge was available, the Court found it unavailing:

[T]he exception finds its origin in the desire to prevent "prospective waiver of a party's right to pursue statutory remedies." That would certainly cover a provision in an arbitration agreement forbidding the assertion of certain statutory rights. And it would perhaps cover filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable. The class-action waiver merely limits arbitration to the two contracting parties. It no more eliminates those parties' right to pursue their statutory remedy than did federal law before its adoption of the class action for legal relief in 1938. Or, to put it differently, the individual suit that was considered adequate to assure "effective vindication" of a federal right before adoption of class-action procedures did not suddenly become "ineffective vindication" upon their adoption.<sup>72</sup>

By rejecting the effective vindication challenge here, *Amex* resolved much of the remaining legal uncertainty over the enforceability of arbitral class waivers, at least pending future statutory or

<sup>67</sup> *In re American Express Merchants' Litigation*, 554 F. 3d 300, 315-16 (2d Cir. 2009).

<sup>68</sup> *Italian Colors Rest. v. Am. Express Travel Related Servs. Co.* (*In re Am. Express Merchs. Litig.*), 667 F.3d 204 (2d Cir. 2012); *In re American Express Merchants' Litigation*, 634 F. 3d 187, 200 (CA2 2011).

<sup>69</sup> 133 S. Ct. at 2312.

<sup>70</sup> *Id.* at 2309.

<sup>71</sup> *Id.* at 2309-10.

<sup>72</sup> *Id.*

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regulatory developments.<sup>73</sup> We discuss possible implications of the decision for non-arbitral class waivers below.<sup>74</sup>

### III. Literature Review: Bundled Dispute Resolution and Sticky Contracts

Predictions that most or all businesses will begin using arbitration clauses after *Concepcion* and *Amex* depend on two key assumptions: that there is no reason for businesses not to use arbitration clauses; and that businesses can and do readily change their standard form contracts in response to favorable court decisions.<sup>75</sup> In this part, we evaluate those assumptions by examining the literature on arbitration as a bundle of dispute resolution services and on the stickiness of contract terms.

#### A. The Decision Whether to Use an Arbitral Class Waiver: Arbitration as a Bundle of Dispute Resolution Services

The first assumption that underlies predictions of widespread switching to arbitration clauses after *Concepcion* is that there is no reason for businesses not to switch. Businesses want to avoid class actions, and they can do so — it is assumed — at essentially no cost by using an arbitral class waiver. In other words, the assumption is that the only meaningful consequence of using an arbitral class waiver is getting rid of class actions.

But an arbitration clause does more than simply reduce the risk of class actions; it removes the case altogether from a judicial forum. By using an arbitration clause, parties agree to use a bundle of dispute resolution services, a bundle that includes avoiding class actions but has other features as well.<sup>76</sup> These features include, for example, decision makers selected by the parties, procedures paid for by the parties, and, importantly, a very limited appeals process that, generally, cannot be altered by contract.<sup>77</sup> For franchisors, the lack of an appeals process is a

<sup>73</sup> Congress might enact legislation restricting the enforceability of arbitral class waivers, although the prospects of any statutory change are slight. In addition, the Consumer Financial Protection Bureau has authority to regulate arbitration clauses in consumer financial services contracts under Section 1028(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, after it completes its statutorily mandated study. See 12 U.S.C. § 5518(b).

<sup>74</sup> See *infra* Part IV(A).

<sup>75</sup> See *supra* text accompanying notes \_\_\_\_.

<sup>76</sup> See, e.g., Drahozal & Wittrock, *supra* note \_\_\_, at 300 (explaining that “arbitration clauses bundle a variety of characteristics — including but not limited to acting as a class action waiver — into a single means of dispute resolution. Not all drafting parties will agree to arbitration, even if they might prefer individual arbitrations to class actions.”).

<sup>77</sup> O’Hara O’Connor & Drahozal, *supra* note \_\_\_, at \_\_\_\_ (ms. at 2). In *Hall Street Associates v. Mattel, Inc.*, 552 U.S. 576 (2008), the Supreme Court held that parties could not, by agreement, expand the grounds under Section 10 of the FAA for judicial review of arbitral awards. The Court left open the possibility that such agreements might be enforceable in state court under state arbitration laws, and a few states such as California and Texas have enforced these sorts of agreements. See, e.g., *NAFTA Traders, Inc. v. Quinn*, 339 S.W.3d 84 (Tex. 2011); *Cable Connection Inc. v. DirectTV, Inc.*, 190 P.3d 586 (Cal. 2008).

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very serious cost of using an arbitration clause — and an arbitral class waiver.<sup>78</sup> As franchise lawyer Martin Fern explains:

There has long been a debate among lawyers regarding the pros and cons of arbitration in general and in the franchise context in particular. The principal advantages of arbitration include informality, lower costs, greater efficiency and speed, and the ability to choose expert arbitrators to resolve specialized disputes. The principal disadvantage of arbitration is the absence of the availability of multi-layered appeal which can normally be filed to rectify erroneous court decisions, but not arbitration awards. In other words, in arbitration, the principal tradeoff against the many advantages is the inability of the losing party to correct erroneous decisions by the arbitrator.<sup>79</sup>

Franchisors can mitigate some of the costs of an arbitral class waiver by using carve-outs, excluding claims for which arbitration is particularly ill-suited from arbitration such that the claims will be resolved instead in court.<sup>80</sup> But using carve-outs has its own costs.<sup>81</sup>

By comparison, a non-arbitral class waiver avoids the bundling costs of an arbitral class waiver. A party that prefers to have disputes resolved in court can do so but can avoid class actions as well if it uses a clause that affects only the availability of class actions.<sup>82</sup> The parties still can use public court judges, take advantage of the government subsidy to courts, and appeal on much broader grounds than if their contract contained an arbitral class waiver. While non-arbitral class waivers are much less common than arbitral class waivers, they do exist.<sup>83</sup> But using a non-arbitral class waiver poses greater risks of court invalidation. After *Concepcion*, arbitral class waivers have a substantial degree of protection by the Federal Arbitration Act; non-arbitral class waivers have no such federal law backing. As a result, a number of courts — although certainly not all — have refused to enforce non-arbitral class waivers.<sup>84</sup> We discuss the

<sup>78</sup> Arguably, such costs are another cost of *Concepcion*, although alternatively one might characterize them as costs of court decisions refusing to enforce non-arbitral class waivers — which result in parties having to choose instead the less efficient arbitral class waiver. See O'Hara O'Connor & Drahozal, *supra* note \_\_, at \_\_ (ms. at 44 n.160).

<sup>79</sup> Fern, *supra* note \_\_.

<sup>80</sup> O'Hara O'Connor & Drahozal, *supra* note \_\_, at \_\_ (ms. at 19-36).

<sup>81</sup> *Id.* (ms. at 12-14).

<sup>82</sup> Assuming, of course, that a court will enforce the non-arbitral class waiver. See *infra* text accompanying notes \_\_.

<sup>83</sup> See *infra* text accompanying notes \_\_.

<sup>84</sup> Compare *Martrano v. Quizno's Franchise Co., L.L.C.*, 2009 U.S. Dist. LEXIS 52025, at \*87 (W.D. Pa. June 15, 2009) (invalidating non-arbitral class waiver); and *Elhilu v. Quizno's Franchise Co., LLC*, No. 06-CV-07855, 2008 U.S. Dist. LEXIS 109435, at \*15 (C.D. Cal. April 3, 2008) (same) with *Bonanno v. Quizno's Franchise Co., LLC*, 2009 U.S. Dist. LEXIS 37702, at \*69 (D. Colo. Apr. 20, 2009) (enforcing non-arbitral class waiver); see *In re Yahoo! Litig.*, 251 F.R.D. 459, 469-70 (C.D. Cal. 2008) (refusing to hold non-arbitral class waiver enforceable as a matter of law in commercial case and denying motion for summary judgment pending "more developed evidentiary record"). Cf. *America Online, Inc. v. Superior Court*, 108 Cal. Rptr. 2d 699, 712 (Cal Ct. App. 2001) (refusing to enforce forum selection clause when forum selected does not permit class actions); *Dix v. ICT Group, Inc.*, 161 P.3d 1016, 1024 (Wash. 2007) (same); *America Online, Inc. v. Pasioka*, 870 So.2d 170, 171-72 (Fla. Ct. App. 2004) (same); and *Doe I v. AOL LLC*, 552 F.3d 1077, 1085 (9th Cir. 2009) (per curiam). But cf. *Koch v. America Online, Inc.*, 139 F. Supp. 2d 690, 695 (D. Md. 2000) (concluding that unavailability of class actions in chosen forum is not reason to refuse to enforce forum selection clause); *Gilman v. Wheat, First Sec., Inc.*, 692 A.2d 454, 464-65 (Md.

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possibility in Part V that *Amex* might make non-arbitral class waivers more enforceable. If so, non-arbitral class waivers would become more attractive, at least for those businesses that have other reasons for not using arbitration clauses.

We are not suggesting that all franchisors will avoid arbitration because of the limited right to appeal (or other bundling costs of arbitration). But the limited availability of appeals from arbitration awards certainly is a consideration on the margin. Nor is the limited right to appeal the only reason why a business might not use arbitration. Other possible reasons include less effective interim measures, the lack of summary adjudication, inefficiencies in collection cases, and added uncertainty in the application of otherwise certain legal remedies.<sup>85</sup> Instead, our point is simply that there are costs to using an arbitral class waiver that result from the bundled nature of arbitration, and that these costs provide a reason for some businesses not to use an arbitral class waiver even after *Concepcion* and *Amex*.<sup>86</sup>

At the same time, not all businesses are equally susceptible to class actions. As one illustration, the Searle study found that while all of the credit card issuers and cell phone companies in a sample of AAA consumer arbitrations included class arbitration waivers in their arbitration clauses, none of the real estate brokerage firms did.<sup>87</sup> Presumably real estate brokerages are less subject to class actions than mass contracting firms like credit card issuers and cell phone companies, and so had less incentive to include a class arbitration waiver.

The same is true even among businesses that use mass contracts. Our prior research on the use of arbitration clauses in credit card agreements (prior to *Concepcion*) predicted that while “on the margin, issuers likely will respond to *Concepcion* ... by increasing their use of arbitration clauses,” “the significance of other factors in explaining the use of arbitration clauses” suggests that “predictions that all issuers will begin using arbitration clauses are unsupported.”<sup>88</sup> The other factors found to be related to the use of arbitration clauses in credit card agreements included the riskiness of the issuer’s credit card portfolio, the size of the issuer, whether the

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Ct. App. 1997) (same); *America Online, Inc. v. Booker*, 781 So. 2d 423, 425 (Fla. Ct. App. 2001) (per curiam) (same); *Forrest v. Verizon Communications, Inc.*, 805 A.2d 1007, 1012 (D.C. Ct. App. 2002).

<sup>85</sup> See Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (and Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433, 453-57 (2010). This latter point is exacerbated by, but not coextensive with, the limited right to appeal.

<sup>86</sup> Reputational constraints provide another possible reason businesses might not use arbitration clauses with class arbitration waivers, even after *Concepcion* and *Amex*. See Gregory C. Cook, *Why American Express v. Italian Colors Does Not Matter and Coordinated Pursuit of Aggregate Claims May Be a Viable Option After Concepcion*, 2 U. MICH. J.L. REFORM 104A (Apr. 14, 2013) (“It is also a mistake to assert that corporate America will uniformly modify contracts to include arbitration. Making changes to an existing contract is not simple or costless. Corporate defendants make such changes cautiously and the marketplace can be a discipline on contract changes. In other words, corporations may decide not to include an arbitration clause for marketing reasons or may decide not to amend their contracts because amendment may have a marketing impact.”); Brownell, *supra* note \_\_ (“If the court does indeed rule in favor of American Express, look for even more businesses to find ways to shield themselves from lawsuits. ‘Companies would only be restrained either by their own good conscience, or by their fear that consumers would get mad,’ says [Jean] Sternlight.”).

<sup>87</sup> Christopher R. Drahozal & Samantha Zyontz, *Private Regulation of Consumer Arbitration*, 79 TENN. L. REV. 289, 349-50 (2012) (publishing results from Searle Civil Justice Institute, Preliminary Report, Mar. 2009).

<sup>88</sup> Drahozal & Rutledge, *supra* note \_\_, at 540.

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issuer specialized in credit card loans, and whether the issuer was mutually owned (i.e., was a credit union).<sup>89</sup>

When potential bundling costs of arbitral class waivers are taken together with the relatively low risk of class actions some businesses face, it is plausible that some businesses might rationally decide not to use an arbitral class waiver in their standard form contracts. At the very least, it provides a theoretical explanation for the possibility that not all businesses will switch to arbitration after *Concepcion*, and thus presents an empirically testable proposition.

#### **B. Making Changes to Standard Form Contracts: Are Arbitration Clauses Sticky?**

The second assumption that underlies predictions of widespread switching to arbitration after *Concepcion* is that businesses can and do quickly and readily amend their form contracts in response to court decisions. Here we consider the possibility that this assumption might not hold — i.e., that contract terms might instead be “sticky.”

The notion of sticky contract terms is hardly new. Numerous scholars have examined why parties may be reluctant to alter contract terms, even when the law might (or clearly does) allow alterations that would benefit the parties. This sub-part reviews that literature and examines how it bears on the particular contracting practice examined here — namely standard form contracts presented to the other party on a take-it-or-leave-it basis. We find that several of the traditional explanations for the stickiness of contract terms likely do not apply in this particular context and, therefore, try to isolate the likeliest explanations. From there, we generate hypotheses in order to ascertain whether (and why) franchisors do not always adapt their contract terms to the extent permitted or encouraged by Supreme Court decisions.

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<sup>89</sup> *Id.* at 559.

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### 1. Possible Explanations for Contract Stickiness

We do not write on a blank slate. Contracts scholars have offered various explanations for the possible stickiness of contract terms, and some have provided helpful syntheses of existing explanations.<sup>90</sup> The literature reveals at least eleven different explanations, though not all of them have particularly compelling explanatory force for the types of contracts that we investigate here.

**Endowment effects** — The theory of “endowment effects” postulates that individuals “often place a higher value on retaining the goods that they already possess (their endowments).”<sup>91</sup> For example, if a market would price my rowing club T-shirt at the same level as a kitchen sponge, I nonetheless might subjectively perceive a greater cost in the loss of my T-shirt than whatever gain I might accrue from receiving a sponge. Though a series of psychological experiments, Russell Korobkin extended this theory to contract change and negotiation.<sup>92</sup> According to Korobkin’s theory of endowment effects, contracting parties accord higher (perhaps irrationally high) value to existing contract terms.<sup>93</sup> So if one party aims to change those terms, perhaps in response to an intervening Supreme Court decision, the other party will extract a (perhaps irrationally) high price in order to assent to the change.

**Interpretive risk** — Closely related to the theory of endowment effects is the idea of interpretive risk. Contracts scholarship tends to conceptualize transactional lawyering as a process of identifying and addressing risk through the design of appropriate contract terms.<sup>94</sup> Interpretive risk is premised on the idea that changes from preferred language in an industry norm will be met with resistance by the counter-party to the transaction.<sup>95</sup> Like endowment effects, the notion of interpretive risk rests on the view that the counter-party prefers familiar contract language to unfamiliar language. Unlike endowment effects, the preference flows not from some irrational attachment to the familiar; instead, it flows from the relative lower uncertainty that attaches to using a term that has an accepted meaning within the industry.

<sup>90</sup> For especially helpful syntheses, see G. MITU GULATI & ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* 32-44 (2012); Omri Ben-Shahar & John A.E. Pottow, *On the Stickiness of Default Rules*, 33 FLA. ST. U. L. REV. 651, 655-60 (2006). For other scholarship on the topic, not cited below, see W. Mark C. Weidemaier, *The Arbitration Clause in Context: How Contract Terms Do (and Do not) Define the Process*, 40 CREIGHTON L. REV. 655 (2007); Stephen J. Choi & G. Mitu Gulati, *Contract as Statute*, 104 MICH. L. REV. 1129 (2006); Gus De Franco et al., *Sticky Covenants* (March 1, 2013) (Chicago Booth Research Paper No. 13-61), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2288723](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2288723). See also the articles published by the *NYU Law Review* from a *Conference on Contractual Innovation*, 88 NYU L. REV. 1-285 (2013).

<sup>91</sup> GULATI & SCOTT, *supra* note \_\_, at 41.

<sup>92</sup> Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998); Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583 (1998).

<sup>93</sup> Russell Korobkin, *Behavioral Economics, Contract Formation and Contract Law*, in *BEHAVIORAL LAW AND ECONOMICS* (Cass Sunstein, ed. 2000).

<sup>94</sup> Weidemaier, *supra* note \_\_, at \_\_.

<sup>95</sup> Lisa Bernstein, *Social Norms and Default Rule Analysis*, 3 S. CAL. INTERDISC. L.J. 59 (1993).

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***Overhang*** — Overhang bears a close relationship to the idea of interpretive risk. It reflects a belief that changes in contract terms will affect the interpretation of *prior* contracts before the change was adopted. It is perhaps best explained by reference to an example. Suppose that a contract term “x” is generally understood to mean that risk passes to the buyer once the goods are loaded onto the ship. Suppose further that a court interprets “x” in fact to mean that the risk passes to the buyer only after the goods reach their port of destination. In reaction to this judicial decision, the seller considers changing its contracts to replace term “x” with term “y.” Term “y” somehow makes clearer that risk passes to the buyer at the earlier point in the shipment. If the buyer proposed the inclusion of term “y,” the very fact of this proposal might imply that preexisting contracts (all of which use term “x”) were understood by the seller, as drafted, to reflect the judicial interpretation.<sup>96</sup> Ideas of overhang, thus, are especially salient in industries that involve high volumes of contracting whereby subtle changes in *new* contracts could have significant impact on the interpretation of a large number of *pre-existing* contracts.<sup>97</sup> In situations of overhang, as opposed to interpretive risk, the concerns over interpretation stem from the party contemplating the change (as opposed to the expected reaction of the party to whom the change is proposed).

***Herd effects*** — Closely related to the idea of interpretive risk and overhang is the concept of herd effects. This notion stems from the insights of psychological research suggesting that certain individuals tend to be risk-averse.<sup>98</sup> Translated into the context of contracting practices, the idea of herd effects suggests that lawyers, particularly in-house counsel, engage in risk-averse behavior by repeating what their predecessors have done.<sup>99</sup> In doing so, lawyers reduce the likelihood that they will be blamed for proposed changes that prove contrary to the firm’s (or client’s) interests. Innovation is discouraged because it isolates the entrepreneurial lawyer from the herd and, thereby, makes him peculiarly vulnerable to blame. Consequently, contract terms remain sticky — not because of the costs to the firm (as would be suggested by a theory like overhang or endowment effects) but instead due to agency problems stemming from the lawyer’s selfish incentives.

***Contract Routines*** — Herd effects are not the only explanation for stickiness rooted in agency problems. Another explanation, identified by Gulati and Scott, is the notion of contract routines.<sup>100</sup> This idea begins from the premise that agents (such as lawyers) are working within a complex set of contractual structures. No single agent may fully understand the relationship between a particular contract provision and the larger contractual (or commercial) structure. Consequently, they are reluctant to make any changes to a particular term for fear of unwittingly upsetting other contractual provisions that may (unbeknownst to the lawyer) have some actual (or potential) relationship to the term that is proposed to be altered. Like the notion of herding,

<sup>96</sup> See Michelle Boardman, *Contra Preferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105 (2006).

<sup>97</sup> See, e.g., Daniel Kahneman, Daniel & Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 ECONOMETRICA 263 (1979).

<sup>98</sup> GULATI & SCOTT, *supra* note \_\_, at 37; Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH U. L. Q. 347 (1996).

<sup>99</sup> GULATI & SCOTT, *supra* note \_\_\_\_, at 39 & n. 23.

<sup>100</sup> *Id.* at 38-39.

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the idea of contract routines roots the explanation in the incentives of the firm's agent. Unlike the theory of herding, the agency problem lies not in blame-avoidance but, instead, in a simple reaction to uncertainty over a complex model and a desire to avoid unintended costs to the firm.

***Uncertainty*** — In addition to their theory of contract routines, Gulati and Scott also suggest that the stickiness of contract terms may be attributable to simple uncertainty.<sup>101</sup> Boilerplate contracts may have been drafted with a particular allocation of risk in mind. As time passes, the intentions of the original drafters are forgotten (as the drafters themselves move on). So the successors at the firm inherit the clauses without the understanding behind them. They are reluctant to change the clauses not for fear of blame (as the herding instinct would suggest) but simply because they do not know the consequences of the change. Therefore, they “leave well enough alone” and do not question the continued use of a clause in a contract. The theory closely resembles that of “contract routines” except, here, the account trains on the passage of time and the consequent loss of personnel who can explain the particular risk allocation behind a boilerplate term.

***Free riders*** — a final agency-based explanation for the stickiness of contract terms is the idea of free riders. Free riding traces to Mancur Olson's idea of collective action problems.<sup>102</sup> Firms would prefer not to undertake the cost and investment of innovation if another firm will undertake that cost first. If a competing firm does so, then the first firm can take advantage of whatever benefits accrue from the innovation without having to bear the cost itself. In the context of contracting practices, the theory of free riders would explain stickiness on the ground that firms are unwilling to assume the costs themselves of innovation in contract terms. Instead, they wait for another firm to do so. They then wait and see how that other firm's innovation holds up in court. If it is interpreted in a manner favorable to the firm, then other firms will employ the new formulation.

***Negative Signaling*** — A series of scholars, including Jason Johnston and Omri Ben-Shahar, explain the stickiness of contract terms in terms of negative signaling.<sup>103</sup> This theory postulates that contracting parties are reluctant to propose changes to contract terms because such proposals might convey information to their contract partner. The very conveyance of information might then work to the detriment of a proposing party. Writing in this school of thought, the economist Kathryn Spier gives the example of a professional athlete negotiating a contract with her team.<sup>104</sup> Suppose that she requests a special “injury” clause — that deviates from the industry standard by providing her more compensation in the event of an injury. Even if such “insurance” might well be in her economic interest, the very fact of the request might signal to the sports team that she is aware of an exceptional risk of an injury in light of her

<sup>101</sup> *Id.* at 42-43.

<sup>102</sup> MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1965).

<sup>103</sup> Ben-Shahar & Pottow, *supra* note \_\_, at 651; Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Default Rules*, 100 YALE L.J. 615 (1990).

<sup>104</sup> Kathryn Spier, *Incomplete Contracts and Signalling*, 23 RAND J. ECON. 432 (1992). For an analogous example in the context of Silicon Valley start-ups, see Joseph Bankman, *The Structure of Silicon Valley Start-Ups*, 41 U.C.L.A. L. REV. 1737, 1738 (1994). For a skeptical view of the negative-signaling account, at least in the context of employment contracts, see J. Hoult Verkerke, *An Empirical Perspective on Indefinite Employment Contracts: Resolving the Just Cause Debate*, 1995 WIS. L. REV. 837.

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physical condition. This could result in a counter-proposal to reduce the athlete's overall compensation in light of the risk. While Spier's example provides an instance of a negative signaling effect about the "asset," other negative signals might come in the form of revelations about a party's private preferences. For example, if a party to a partnership agreement request an earlier payout than the industry norm provides, this might signal something to the other partners about the proposing partner's economic interests, private information that they might use to extract some concession from her elsewhere in the negotiations. Due to any of these negative signals, parties might prefer not to deviate from industry norms.

**Satisficing** — Ideas of interpretive risk and negative signals converge into the theory of satisficing. Satisficing, like herd behavior, traces to psychological research of economists like Herbert Simon.<sup>105</sup> The theory of satisficing begins with the supposition that any individual party has an outcome (or set of outcomes) that would be optimal from the party's individual perspective. In the context of transactional behavior, like contracting, achieving that optimal outcome may especially (perhaps prohibitively) costly.<sup>106</sup> This may be due to the costs entailed in dickering over every term necessary to achieve the optimal outcome for a party. Rather than incur those costs, parties "satisfice" by reaching agreement over *enough* terms that they are willing to leave the remaining terms unaddressed in the contract (meaning they will be addressed by the parties or, ultimately, a court should questions arise as to the unaddressed topics). Like the theories of interpretive risk and negative signals, the idea of satisficing explains the stickiness of contract terms by reference to the costs of change; here, however, the costs are due to the transaction costs entailed in negotiating out the remaining provisions of the contract.

**Learning Externalities** — Pioneered by Marcel Kahan and Michael Klausner, the theory of learning externalities (sometimes referred to as "learning effects" or "learning benefits") suggests that the explanation for the stickiness of contract terms lies in the costs associated with change.<sup>107</sup> To use a non-contract example, a company incurs costs when it has used a PC-platform for many years then shifts to a Mac-based one in its IT department. These learning effects arise from past use of a particular norm within a firm. In the context of contracting practices, the consistent use of the same contract terms "locks in" certain benefits to a party. These may derive from efficiency in drafting, reduced uncertainty in the ambiguity over the judicial interpretation of the term (a variation on the theories of interpretive risk and overhang) and the reduced need to incur the costs of lawyers.<sup>108</sup> Changing contract terms around which these "lock-in effects" have formed surrenders those savings to a firm and forces it to incur new "switching costs" as it develops similar synergies from the new term.<sup>109</sup> When the foregone costs of the "lock-in effect" outweigh whatever savings or advantages might come from the introduction of the new term, the theory of learning externalities suggests that the contract term will remain sticky.

<sup>105</sup> Herbert A. Simon, *Rational Choice and the Structure of the Environment*, 63 PSYCH. REV. 129, 136 (1956).

<sup>106</sup> See generally Patrick Bolton & Antoine Faure-Grimaud, *Satisficing Contracts*, 77 REV. ECON. STUD. 937 (2010).

<sup>107</sup> Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting*, 83 VA. L. REV. 713 (1997).

<sup>108</sup> See Ben-Shahar & Pottow, *supra* note \_\_, at 659-60.

<sup>109</sup> Florencia Marotta-Wurgler & Robert Taylor, *Set in Stone? Change and Innovation in Consumer Standard Form Contracts*, 88 N.Y.U. L. REV. 240, 246 (2013).

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**Network externalities** — In addition to their theory of learning externalities, Kahan and Klausner also hypothesize that some stickiness in contract terms may be due to network externalities. Network externalities capture savings that accrue due to the use of a common term within an industry or network. To take a non-contractual example, the use of compatible telephones (or other communications equipment) yields benefits to individual firms within an industry.<sup>110</sup> In contrast to learning effects, network effects derive from the contemporaneous use of a norm within an industry. In the contractual setting, the use of a familiar term may reduce the costs of legal representation (since companies need not invest in educating a lawyer about a term with which he already is familiar).<sup>111</sup> It also can result in industry-wide standardization, thereby reducing contracting costs for repeat players within the industry. Unlike learning externalities (which result from costs borne due to changes within the firm), network externalities result from costs borne due to departure from accepted terms within the “network” or industry.

Finally, these existing accounts must be tested against a null hypothesis — also identified by Scott and Gulati — namely that stickiness is a myth.<sup>112</sup> In other words, contract terms are not sticky. Rather, firms do in fact innovate and respond to changes in the legal landscape. Under this account, change may not occur instantaneously. Instead, in what is sometimes described as the “shock model,” contract terms evolve as a result of shocks.<sup>113</sup> Those shocks may come in the form of a judicial interpretation of a contract term or some other innovation. The second phase of that contract innovation would consist of firms experimenting with new terms after “a series of exogenous shocks.”<sup>114</sup> David Hoffman explains: “What would such shocks look like? A Supreme Court decision making terms salient — and explicitly approving their enforceability — would be exemplary. Decisions like *AT&T v. Concepcion* (validating class-arbitration waivers) ... could have spurred attorneys to consider clauses that they previously would have left unused.”<sup>115</sup> In response to those shocks, contract terms will change over a period of time during which the shock works its way through a firm’s information network.

This section has reviewed the prevailing accounts for why contracts are sticky and introduced the null hypothesis — namely that they are, in fact, not sticky but respond, albeit sometimes slowly, to systemic shocks. In the next section, we map these accounts onto the particular types of contracts in our study.

<sup>110</sup> Ben-Shahar & Pottow, *supra* note \_\_\_, at 660.

<sup>111</sup> Sometimes, contracting agents can ameliorate these effects. For example, underwriters and law firms can undertake the front-end investment to change a particular norm within the industry. Not only do these agents absorb these costs (which can then be spread across industry players), but they can serve to bridge the disparate interests of firms within the industry and roll out a new industry standard which firms then replicate.

<sup>112</sup> SCOTT & GULATI, *supra* note \_\_\_, at 43.

<sup>113</sup> Stephen Choi, Mitu Gulati, & Eric Posner, *The Dynamics of Contract Evolution*, 88 N.Y.U. L. REV. 1 (2013); Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929 (2004).

<sup>114</sup> Hoffman, *supra* note \_\_\_, at \_\_\_ (ms. at 41) (citing Choi et al., *supra* note \_\_). In the first phase, “the standard form dominates” and established contract drafters will resist any change. Only after the exogenous shocks of the second phase does “innovation become standardized” in a third phase. *Id.*

<sup>115</sup> *Id.* at \_\_\_ (ms. at 43-44). Hoffman notes, however, that “proceduralists should expect that even if the Supreme Court were to validate particular new forms of bespoke procedure, ... many contracts would still remain silent about what should happen if the parties go to court.” *Id.* at \_\_\_ (ms. at 44).

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## 2. Stickiness and Adhesion Contracts

As noted above, we are interested in examining whether the terms of arbitration agreements prove sticky even after a decision of the United States Supreme Court approves the term (or otherwise interprets the term in a manner favorable to one party). We undertake this examination by focusing on a subset of contracts — franchise agreements, a type of standard form contract presented by the franchisor to the franchisee on a take-it-or-leave-it basis.

We reiterate these parameters of our inquiry here because they shed light on the extent to which certain of the above-described theories might (or might not) have explanatory value. Consider first the aspect of our inquiry placing emphasis on the pronouncements of the United States Supreme Court. This feature affects several of the explanations described in the preceding section. The free rider explanation offers a good example. By definition, if a matter has reached the Supreme Court (or litigation for that matter), at least one firm has chosen to innovate its contract terms. Thus, at least some of the incentive for other firms to retain “sticky” terms has diminished — they can now free-ride on the investment of the innovating firm.

Even after one firm innovates, however, follow-on firms might remain reluctant to change their contract language. The innovating firm not only bears the cost of altering its contract language, it also bears the litigation risk that the contract language might be interpreted by a court in a manner contrary to the interests of an innovating firm. For example, in the case of innovation coming in the form of an arbitral class waiver, a court might find that the FAA does not preempt a state law rule invalidating the class waiver.

But once the Supreme Court rules, the free rider account suggests that firms should adapt. At this point, much — though admittedly not all — of the residual litigation risk has dissipated.<sup>116</sup> Consequently, follow-on firms should be more inclined to adopt the innovating firm’s new contract language. On the other hand, if contract terms *remained* sticky even after the intervening Supreme Court decision, this would cast doubt on the validity of the free-rider theory (at least as an explanatory tool for the class of cases we are studying). Thus, our focus on a Supreme Court decision carries force for a variety of explanations that explain stickiness in terms of agency problems or risk avoidance. These include not only the free-rider theory but also theories like uncertainty, contract routines, and herd effects.

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<sup>116</sup> We acknowledge that there will be residual litigation risk over the scope of the Supreme Court’s holding. This residual risk might have a factual or legal basis. Consider, for example, the AT&T arbitration clause at issue in *Concepcion*. A follow-on firm might adopt some but not all of the incentives contained in the AT&T clause; in that case, it bears a residual risk that a lower court, even after *Concepcion*, would conclude that this lack of incentives distinguishes the instant clause from the AT&T Clause. Alternatively, a follow-on firm in another state might mimic completely the AT&T clause. In that case, it still bears a residual risk that a lower court could construe the applicable unconscionability doctrine in a manner differently from California’s *Discover Bank* rule (the rule at issue in *Concepcion* holding that the presence of the class waiver in the arbitration clause rendered the clause *per se* unconscionable). It might thereby conclude that the state’s unconscionability doctrine did not sweep as broadly as the *Discover Bank* rule and, therefore, was not preempted by the FAA. See *infra* text accompanying notes \_\_\_-\_\_\_.

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Focus now on the nature of the contract we are studying — contracts between franchisors and franchisees. Because these contracts typically are adhesive — that is, they are offered to the franchisee on a take-it-or-leave-it basis — individualized dickering over the terms does not occur.<sup>117</sup> This suggests that theories like endowment effects, satisficing, and negative signaling do not have much explanatory value in this context. A new franchisee does not really have an “endowment” in the terms of an existing franchise agreement.<sup>118</sup> Moreover, drafters of the contract are unlikely to encounter “satisficing” problems because a single party controls the terms of the agreement and, therefore, ordinarily does not encounter substantial transaction costs by contracting with specificity.<sup>119</sup> Indeed, franchise agreements would seem to be easier to change than negotiated corporate contracts. Precisely because it is an adhesion contract, the franchisor drafts the form contract and (subject to market and regulatory constraints) has unilateral control over the terms. Finally, drafters are unlikely to encounter negative signaling problems, either because their counterparty cannot dicker over the terms or, in some cases, because the counterparty does not read the terms at all.

That said, franchise agreements are distinguishable from and may be stickier than consumer contracts.<sup>120</sup> First, franchise agreements have higher stakes than virtually all consumer contracts.<sup>121</sup> The higher stakes may induce franchisees to read franchise agreements more carefully and invest more in understanding the terms to which they are agreeing.<sup>122</sup>

<sup>117</sup> Clayton Gillette, *Standard Form Contracts*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1374990](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1374990).

<sup>118</sup> It might, of course, be the case that endowment effects work in the opposite direction. That is, the franchisor (or, more abstractly, the party in the superior bargaining position) attaches significance to the chosen form of dispute resolution even where, as a matter of rational choice theory, another option would be in the franchisor’s interest.

<sup>119</sup> That said, even for adhesive contracts, changes in terms are not necessarily costless. For example, franchisee organizations have some bargaining power vis-à-vis franchisors, which might increase the stickiness of the contract. Moreover, changes may be subject to regulatory oversight. Even if the franchisor does not need to dicker with the franchisee, it may incur costs placating a regulator. See *infra* text accompanying notes \_\_-\_\_.

<sup>120</sup> Prior scholarship has demonstrated that credit card agreements can be modified through the simple act of conveying the modification by means of a bill stuffer or electronic communication followed by some period for the consumer to opt-out (or, alternatively, accept the proposed modification by conduct through the use of the card). See David Horton, *The Shadow Terms of Contract Procedure and Unilateral Amendments*, 57 U.C.L.A. L. Rev. 605 (2010). Insofar as this is true — again we do not independently test the validity of the proposition in this paper — this premise too casts doubt on several theories. In particular, overhang theory lacks much explanatory value under this condition of easy modification. Under conditions where contracts are easily modified, the bank can simultaneously alter the terms for future transactions as well as the terms governing the repayment of debts for prior transactions. (Again, while overhang risk can be reduced, it cannot be eliminated entirely. Consider a company that is in litigation over the meaning of term “A.” If, during the litigation, it proposes to modify that term, the proposed modification still carries overhang risk in the pending litigation.)

<sup>121</sup> See Adam B. Badawi, *Relational Governance and Contract Damages: Evidence from Franchising*, 7 J. EMPIRICAL LEGAL STUD. 743, 753 table 3 (2010) (reporting average start up cost in sample of franchise agreements of \$571,000, with range across types of franchise from low of \$55,150 for home care franchises to high of \$5,459,643 for lodging franchises).

<sup>122</sup> By comparison, some scholarship, including empirical research, suggests that consumers often do not read their contracts. See Yannis Bakos et al. *Does Anyone Read the Fine Print?*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1443256](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1443256). For a literature survey, see Gillette, *supra* note \_\_ at 5-7. Assuming this is valid (we do not attempt to make an original contribution on that question), this phenomenon suggests that several other explanations described in the previous section lack much explanatory value here. For example, there would not be much of a concern about negative signaling because the consumer would not perceive

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Second, franchise agreements tend to have longer terms than consumer contracts.<sup>123</sup> The ability to turn over only a fraction of the total stock of contracts in any given year necessarily affects the franchisor's incentives to modify its contracts. Not only does it take time for the parties (or the franchisor) to realize fully the benefits of the new contract terms, but during the interim it faces the prospect of nonuniform contract terms, posing a greater risk of overhang, for example.<sup>124</sup> Third, franchise agreements are more heavily regulated than many consumer contracts. State franchise laws provide for disclosure requirements, substantive regulation, and agency oversight, which may increase the stickiness of the terms of franchise agreements.<sup>125</sup> (This last feature of franchise agreements may impose a form of network externality, albeit one created by public regulation rather than a privately developed industry norm.)

In sum, the salience of the accounts for contract stickiness depends critically on the sort of contract under study. For the type of contract we are studying (adhesive contracts) and the phenomenon we are studying (the effect of intervening Supreme Court decisions), theories that presuppose parties of equal bargaining power (or at least parties in a position to react to changes in contract language) largely drop out. These includes theories like endowment effects, satisficing and negative signaling. By contrast, other theories, which depend on firm-specific behavior, like free riders, herd effects, learning externalities, contract routines and uncertainty remain more relevant. And of course all of these theories are tested against the null hypothesis — namely that contract terms, including in this context, are not “sticky” but respond (eventually) to shocks.

For our purposes here, we are interested less in what particular explanation for stickiness does or does not apply than that at least some explanation for stickiness might hold, which certainly is the case. We leave distinguishing among these (and other) possible explanations for contract stickiness for future research.

### C. Hypotheses

With these parameters of our study and phenomena of the specific form of contracting laid plain, we can begin to generate hypotheses regarding the predicted response to *Concepcion*.

The first set of hypotheses focuses on the predictions that *Concepcion* will result in all or at least most businesses using arbitration clauses in their standard form contracts. Those

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the “signal” communicated by a change in the contract language. For similar reasons, interpretive risk, endowment effects and satisficing again lose some explanatory value. In short, the “unread” nature of many consumer contracts — again assuming the validity of this proposition — casts doubt on the explanatory value of theories that assume parties have symmetrical information and actually perceive the signal sent by a proposed modification. See Scott & Triantis, *supra* note \_\_, at \_\_. Franchise agreements seem likely to differ from consumer contracts in that the stakes are much higher and franchisees are more sophisticated contracting parties than consumers.

<sup>123</sup> See Badawi, *supra* note \_\_, at 753 table 3 (reporting average term in sample of franchise agreements of 12.3 years).

<sup>124</sup> See *supra* text accompanying notes \_\_-\_\_.

<sup>125</sup> Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting the Debate over Franchise Relationship Laws*, 76 ALB. L. REV. 193 (2013).

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predictions are subject to question both because using an arbitration clause does more than contract out of class actions and because contracts may be sticky. Accordingly, the first set of hypotheses tests the basic assumptions about firm behavior that animate criticisms of decisions like *Concepcion*:

**Hypothesis 1: Many or most firms that did not use arbitration clauses prior to *Concepcion* will not switch to arbitration after the decision.**

**Hypothesis 1A: The firms most likely to switch to arbitration clauses are ones that previously switched away from arbitration or otherwise are on the margin between arbitration and litigation.**

If the data support these hypotheses, the next question is why have firms not switched to arbitration. The second set of hypotheses considers the two possible explanations we have suggested:

**Hypothesis 2: Using arbitral class waivers is not costless because arbitration is a bundle of dispute resolution services not just a class action waiver. To the extent this is true, firms will not switch to arbitration after *Concepcion*, especially firms that face little risk of class actions or place a high value on court procedures such as the right to appeal.**

**Hypothesis 3: The use of a dispute resolution clause (or lack of one) is sticky. The accounts of stickiness suggest that if a firm previously does not use an arbitration clause, then they would not be affected by a Supreme Court decision even if the Supreme Court decision might encourage the use of such a clause.**

**Hypothesis 3A: A modified version of this hypothesis, building on Choi and Gulati's theory of "shock effect," suggests that the use of arbitration resolution clauses should increase over time. As Supreme Court decisions like *Concepcion* filter through a firm's network, the firm will eventually invest the resources necessary to make a change.<sup>126</sup>**

#### IV. Methodology and Findings

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<sup>126</sup> Possible questions for future research include, to the extent stickiness appears to be playing a role, which theoretical explanations for contract stickiness seem to be at play. For franchise agreements, our discussion of the literature suggests limited explanatory value of several theories in the franchise contracting context (including negative signaling, interpretive risk, endowment effects, network externalities and satisficing). This leaves learning externalities, overhang, herding, free riders, contract routines and uncertainty. These varying theories give rise to possible hypotheses, such as the following: If free rider theory or herding explained stickiness, we would expect to see more change after the Supreme Court blessed a clause than beforehand; if learning externalities explained stickiness, then we would expect to see more change among larger firms than smaller ones; and if contract routines or uncertainty explained the stickiness of terms within arbitration clauses, then we would expect to see more change among agreements that had simpler (i.e., shorter) clauses.

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In this part, we present the results of our empirical study of changes in the use of arbitration clauses since *AT&T Mobility LLC v. Concepcion*. Examining two samples of franchise agreements, we find evidence of at most a slight shift to arbitration following *Concepcion*, and certainly not the “tsunami” predicted by some commentators. We begin by describing our data and methodology. We then present our basic findings, and seek to reconcile those basic findings with other reports about the use of arbitration clauses after *Concepcion*. We conclude with evidence on whether the limited move to arbitration can best be explained by the stickiness of franchise agreements or by the nature of arbitration as a dispute resolution process.

### A. Data and Methodology

A number of states — including Minnesota, which is the source for the franchise agreements studied here — require franchisors to file Franchise Disclosure Documents (FDDs) annually before they can sell franchises in the state.<sup>127</sup> The standard form franchise agreement (typically redlined to indicate any changes from the previous year<sup>128</sup>) is attached to the FDD.

We used two samples of franchise agreements in this study. The first sample consists of franchisors that were among the top franchise opportunities listed in *Entrepreneur Magazine’s Franchise 500* in 1999 (the “panel sample”).<sup>129</sup> The sample originally consisted of 75 franchisors; due to business attrition our current sample now is 67 franchisors.<sup>130</sup> For these franchisors, we collected the dispute resolution clauses from their franchise agreements in 1999, 2007, 2011, 2012, and 2013,<sup>131</sup> which enables us to track changes in the dispute resolution clauses over time — including before and after *Concepcion*.

<sup>127</sup> Minnesota Department of Commerce, *Franchise Registration Information*, [http://mn.gov/commerce/images/Franchise\\_Registration\\_Info.pdf](http://mn.gov/commerce/images/Franchise_Registration_Info.pdf) (last visited June 20, 2013). For discussion of the representativeness and other uses of the *Franchise 500* as a source of data for research on franchises, as we do here for the cross-section sample, see Drahozal, *supra* note \_\_\_, at 723-24; O’Hara O’Connor & Drahozal, *supra* note \_\_\_, at \_\_\_ (ms. at 32-35).

The proportion of arbitration clauses in our cross-section sample might be affected by our sampling of agreements filed with the Minnesota Department of Commerce. If, for example, we had instead selected a random sample of franchisors that filed in California, where courts have been less willing to enforce arbitration clauses, we might find a smaller proportion of franchise agreements with arbitration clauses before *Concepcion*. But that bias should decrease if not largely disappear after *Concepcion* and *Amex*. Moreover, as noted above, while California also makes Franchise Disclosure Documents available online, exemptions from the California franchise registration statute exclude most established franchisors from the filing requirement, thus biasing the sample in a different way. By comparison, our panel sample was selected from a national list of franchisors and should not be subject to significant geographic biases.

<sup>128</sup> North American Securities Administrators Association, Inc., 2008 Franchise Registration and Disclosure Guidelines ¶ 11(c)(1) (July 1, 2008), available at <http://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf>.

<sup>129</sup> The 2013 *Franchise 500* is available at *Entrepreneur 2013 Franchise 500*, <http://www.entrepreneur.com/franchise500/index.html> (last visited June 18, 2013).

<sup>130</sup> The franchisors no longer in the sample include ones that went out of business, merged into other franchisors, or apparently stopped doing business in Minnesota.

<sup>131</sup> For a description of the data collection for the 1999 agreements, see Drahozal, *supra* note \_\_\_, at 722-26; for a description of the data collection for the 2007 agreements, see Drahozal & Wittrock, *supra* note \_\_\_, at 90-94.

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In addition, we collected a random sample of 214 franchise agreements from all franchisors that filed an FDD with the Minnesota Department of Commerce both before and after *Concepcion* (the “cross-section sample”).<sup>132</sup> The cross-section sample does not overlap with the panel sample; none of the franchisors in the panel sample is in the cross-section sample. For the cross-section sample, we collected the dispute resolution clause as it was immediately before the decision in *Concepcion* — i.e., prior to April 27, 2011 — and the dispute resolution clause in franchise agreements filed after *Concepcion*.<sup>133</sup> This dataset gives us a broader view of how franchisors are responding to *Concepcion*, but without the historical context.

As indicated, for both samples, the dispute resolution clauses were collected from the franchise agreements as filed with the Minnesota Department of Commerce.<sup>134</sup> Prior to 2010, franchise agreements were only available on paper from the Minnesota Department of Commerce. For 2011 through 2013, we collected the FDDs online from the Minnesota Department of Commerce web site, and then extracted information about the franchise agreement from the FDD.<sup>135</sup> The FDD also serves as the source for data on the numbers of franchised units of the franchise.<sup>136</sup> We give little emphasis to the number of franchised units in our analysis, however, because of various uncertainties in that data.<sup>137</sup> Because the franchise agreement in the FDD typically is red-lined to show changes from the prior year, we are able to examine the extent to which franchisors make changes their franchise agreements, as discussed below.<sup>138</sup>

As noted above, using franchise agreements as a source of data has advantages over other form contracts. The agreements are publicly available and have been for a number of years, so that a reasonable degree of historical information is available.<sup>139</sup> However, we recognize the

<sup>132</sup> We began with a sample 239 franchises, and then excluded 25 franchisors that did not make filings in Minnesota in 2013. Of the excluded franchisors, one switched to arbitration between 2011 (i.e., before *Concepcion*) and 2012 (i.e., after *Concepcion*) and one switched away from arbitration.

<sup>133</sup> For simplicity in data collection, we treated franchise agreements filed with the Minnesota Department of Commerce on or before April 30, 2011, as filed before *Concepcion*. But we also verified that the dispute resolution clauses in those agreements had not changed since the previous version, usually sometime in 2010.

<sup>134</sup> On a handful of occasions, when the agreement was not available from the Minnesota Department of Commerce, we obtained a copy of the franchise agreement from a database maintained by the California Department of Corporations. See California Department of Corporations, *California Electronic Access to Securities & Franchise Information*, <http://www.corp.ca.gov/CalEASI/caleasi.asp> (last visited June 18, 2013). While including more years’ worth of agreements, the California database has limited coverage of franchisors because established franchisors are generally exempted from filing in California.

<sup>135</sup> Minnesota Department of Commerce, *Welcome to CARDS — Commerce Actions and Regulatory Documents Search*, <https://www.cards.commerce.state.mn.us/CARDS/> (last visited August 1, 2013).

<sup>136</sup> Item 20 of the FDD reports this information. For 1999, the data were derived primarily from the *Franchise 500*, and occasionally we used the *Franchise 500* as the source for more recent years to maintain consistency or to fill gaps.

<sup>137</sup> First, it is not clear that the number of franchises is an appropriate proxy for size of the franchise chain, because number of units does not necessarily correlate with total sales. Second, some franchisors may report in the FDD only the number of units of the type of franchise they are selling at the particular time, not the total number of units of any type in the chain. Third, franchisors report the number of units as of the end of their fiscal year, which varies by franchisor.

<sup>138</sup> See *infra* text accompanying notes \_\_\_-\_\_\_.

<sup>139</sup> See *supra* text accompanying notes \_\_\_-\_\_\_.

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limitations of using franchise agreements as well, which we discuss at length below.<sup>140</sup> Because of those limitations, our findings here may not be generalizable to other settings in which standard form contracts are used, such as consumer and employment contracts. In sub-part D below, we attempt to reconcile our findings here with other reports of changes in the use of arbitration clauses following *Concepcion*.<sup>141</sup>

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<sup>140</sup> See *infra* text accompanying notes \_\_-\_\_.

<sup>141</sup> See *infra* text accompanying notes \_\_-\_\_.

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### B. Changes in the Use of Arbitration Clauses After *Concepcion*: Empirical Findings

In this sub-part, we report our empirical findings on changes in the use of arbitration clauses in franchise agreements following *AT&T Mobility LLC v. Concepcion*. We find:

- In the panel sample, the use of arbitration clauses increased from 40.3% of franchisors immediately before *Concepcion* to 44.8% by 2013 (**Hypothesis 1**). Of the four franchisors that have switched to arbitration since *Concepcion*, three had used arbitration clauses at some point prior to the decision and switched back afterwards, while the fourth used arbitration to resolve some disputes before *Concepcion* and expanded its use to all disputes afterwards (**Hypothesis 1A**).
- In the cross-section sample, the net use of arbitration clauses increased only slightly after *Concepcion*, with 62.6% of franchisors using arbitration clauses before *Concepcion* and 63.6% after the decision. Five franchisors actually switched to arbitration after *Concepcion*, but four others switched away from arbitration, resulting in a net increase of one (**Hypothesis 3**).
- In the panel sample, the use of class arbitration waivers by franchisors using arbitration clauses has increased substantially since 1999, with most of the increase coming before 2011. In 1999, 51.6% of franchisors with arbitration clauses also used class arbitration waivers. By 2011, immediately before *Concepcion*, that percentage had increased to 77.8%, with an additional increase to 86.7% by 2013 (**Hypothesis 3A**).

#### 1. Changes in the Use of Arbitration Clauses in Franchise Agreements

Contrary to the predictions that all businesses would soon use arbitration clauses in their standard form contracts after *Concepcion*, we find only a slight change in the use of arbitration clauses in both of our samples of franchise agreements.

In the panel sample, as shown in Table 1, the percentage of franchisors using arbitration clauses increased slightly, from 40.3% in 2011 immediately before *Concepcion* to 41.8% in 2012 and 44.8% in 2013.<sup>142</sup> As a percentage of total franchises, the amount of the shift was similar (from 50.4% of franchises in 2011 to 52.5% of franchises in 2012 and 53.7% of franchises in

<sup>142</sup> Because *Concepcion* was decided in April 2011, we measure each year after the decision as beginning in April. So when we refer to 2012, we mean the year from April 2011 to April 2012, 2013 is the year from April 2012 to April 2013, and so on. At the time this article went to press, only very partial data for the year April 2013 to April 2014 were available because most franchisors file their Franchise Disclosure Documents at the end of March. As a result, we do not include data for 2013-2014 in the tables. We do note in the text, however, that one additional franchisor switched to arbitration between April 2013 and when the article went to press. If we calculated the percentage of franchisors using arbitration clauses by assuming that all franchisors that had not yet filed their FDDs would keep their dispute resolution clause unchanged, the percentage of franchisors using arbitration clauses would have increased to 46.3% (31/67) for 2013-2014.

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2013).<sup>143</sup> One franchisor switched to arbitration in mid-2012, two more in late 2012 and mid-2013, and a fourth later in 2013. Interestingly, in all four cases the franchisor had had prior experience with arbitration. In 1999, GNC included an arbitration clause in its franchise agreement, but by 2007 had switched to a forum selection clause. It then switched back to arbitration after *Concepcion*, and, indeed, many provisions in its current arbitration clause were identical to those in the 1999 agreement. The pattern for the Rent-A-Wreck franchise agreement is similar — switching from an arbitration clause in 2007 to a forum selection clause in 2011, and then back to arbitration in late 2012. Although not identical, the Rent-A-Wreck arbitration clause in 2012 bears many similarities to the one from 2007. Hungry Howie’s switched to arbitration in 2013 for all disputes; prior to 2013, it used arbitration for some disputes and not others. And Kahala Corp. (the franchisor for Blimpie sub shops) switched back to arbitration in 2013 after having switched away from arbitration in 2008.<sup>144</sup> Stated otherwise, these franchisors were all on the margin between arbitration and litigation — they either had switched away from arbitration or used it for some disputes, and so were among the most likely to switch to arbitration following *Concepcion*.

Table I. Change in the Use of Arbitration Clauses in Franchise Agreements After *Concepcion*: Panel Sample

	2010-2011		2011-2012		2012-2013	
	Pre- <i>Concepcion</i>		Post- <i>Concepcion</i>		Post- <i>Concepcion</i>	
	Number of Clauses	% of Franchises	Number of Clauses	% of Franchises	Number of Clauses	% of Franchises
Arbitration Clause	27 (40.3%)	47.4%	28 (41.8%)	49.4%	30 (44.8%)	50.6%
No Arbitration Clause	40 (59.7%)	52.6%	39 (58.2%)	50.6%	37 (55.2%)	49.4%

The panel sample also permits us to examine changes in the use of arbitration clauses over a longer period of time — beginning in 1999. Figure 1 summarizes the results.<sup>145</sup> It reveals a slight, long-term decline in the use of arbitration clauses by franchisors from 1999 through 2011, which apparently reverses after the decision in *Concepcion*.<sup>146</sup> Our findings thus might understate the effect of *Concepcion* on the use of arbitration clauses because without *Concepcion*

<sup>143</sup> Data for 2013-2014 are largely unavailable as yet, as discussed above, so we do not include those data here. See *supra* note \_\_. And data for one franchisor are missing for 2010-11.

<sup>144</sup> See Drahozal & Wittrock, *supra* note \_\_, at 97 n.124.

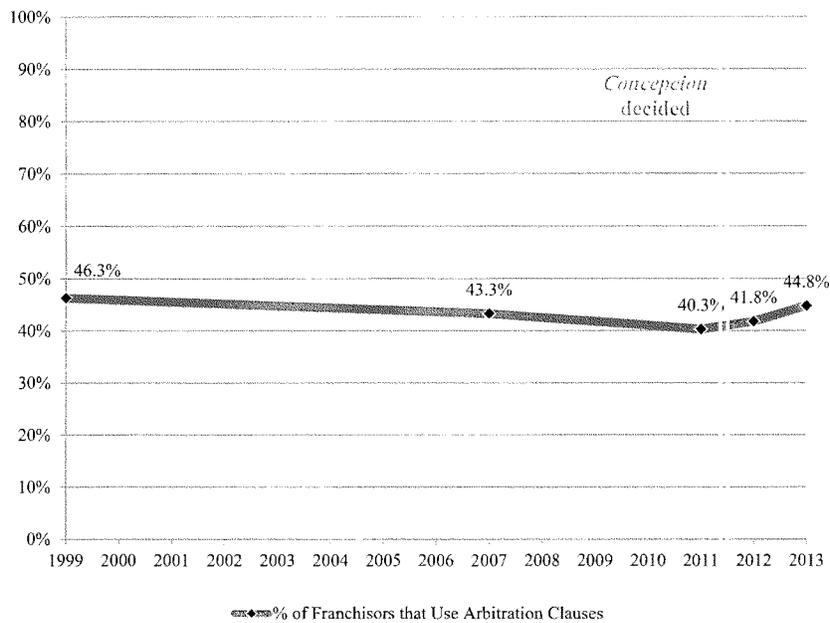
<sup>145</sup> As discussed *supra* note \_\_, one additional franchisor switched to arbitration at the end of the third quarter of 2013. We do not report overall percentages for the year 2013-2014 in Figure 1 because most of the data for that period was not available at the time this article went to press. Given the one switch to arbitration, however, and assuming the franchise agreements for which data are missing remain unchanged, the percentage of franchise agreements using arbitration clauses is now up to 46.3% — i.e., back to its level in 1999.

<sup>146</sup> The percentages differ slightly from those reported for 2007 by Drahozal & Wittrock, *supra* note \_\_, for two reasons: first, because our sample has declined to 68 franchisors from the 71 in that study; and, second, because we were able to add one franchisor (which switched away from arbitration) for that year which previously was unavailable.

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the downward trend might have continued. Or stated otherwise, *Concepcion* not only might have induced some franchisors to switch to arbitration, it also might have induced some franchisors to continue using arbitration who otherwise might have switched away from arbitration. As far as the prediction we are testing here, however, that distinction is immaterial.

Figure 1. Use of Arbitration Clauses in Franchise Agreements, 1999-2013



In the cross-section sample, the overall percentage of franchisors using arbitration clauses was higher than in the panel sample as shown in Table 2,<sup>147</sup> but that percentage changed only slightly between 2011 and 2013. In 2011, before *Concepcion*, 134 of 214 franchise agreements, or 62.6%, included arbitration clauses. In 2013, after *Concepcion*, 136 of 214 franchise agreements, or 63.6%, included arbitration clauses. The very slight shift in the aggregate masks some reshuffling among franchisors: five franchisors in fact switched to arbitration by 2013, but those changes were largely offset by three franchisors that switched away from arbitration during the same period.

<sup>147</sup> These findings are consistent with William L. Killion, *An Informal Study of Arbitration Clauses Reveals Surprising Results*, FRANCHISE L.J., Fall 2002, at 79, 79 (finding higher rate of arbitration clauses by franchisors ranked lower in *Franchise 500*).

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Table 2. Change in the Use of Arbitration Clauses in Franchise Agreements After *Concepcion*: Cross-Section Sample

	2010-2011 Pre- <i>Concepcion</i>	2011-2012 Post- <i>Concepcion</i>	2012-2013 Post- <i>Concepcion</i>
	Number of Clauses	Number of Clauses	Number of Clauses
Arbitration Clause	134 (62.6%)	133 (62.1%)	136 (63.6%)
No Arbitration Clause	80 (37.4%)	81 (37.9%)	78 (36.4%)

Finally, Figure 2 shows the percentage of franchisors using arbitration clauses that also use class arbitration waivers.<sup>148</sup> In 1999, barely half (51.6%) of franchisors using arbitration clauses also used class arbitration waivers. By 2011, the percentage had increased to 77.8%, and then to 86.7% in 2013. The use of class arbitration waivers (in franchise agreements, at least) has increased significantly in the past fifteen years.<sup>149</sup>

But even so, not all franchise agreements with arbitration clauses include class arbitration waivers. This result is surprising because the costs of adding a class arbitration waiver to an arbitration clause would seem much lower than the costs of adding an arbitral class waiver to a franchise agreement. Although the benefits of avoiding class actions would be the same as we described before, the bundling costs identified previously do not apply to the decision whether to include a class arbitration waiver in an existing arbitration clause.

We can identify at least three explanations for this less than ubiquitous use of class arbitration waivers.<sup>150</sup> First, it may be evidence of contract stickiness (**Hypothesis 3**). Franchisors simply may not have revised their franchise agreements to include class arbitration waivers, even though it would seem beneficial for them to do so. Second, franchisors may fear a residual risk, even after *Concepcion*, that using a class arbitration waiver might result in the invalidation of the arbitration clause. Given the Supreme Court's recent decision reversing the Second Circuit in *American Express Co. v. Italian Colors Restaurant*, any such risk has declined

<sup>148</sup> In other words, the denominator for the calculations in Figure 2 differs from the denominator in Figures 1 and 3. Both Figures 1 and 3 present the percentage of franchisors, including those that use arbitration clauses and those that do not. Table 2 presents the percentage of only those franchisors that use arbitration clauses.

<sup>149</sup> Gilles also reports "a clear increase in the popularity of [class arbitration waivers] over the past decade." Gilles, *supra* note \_\_, at 853. She reaches this conclusion by comparing the use of class arbitration waivers in a non-random sample of recent arbitration clauses to the use of class arbitration waivers reported by studies examining consumer contracts across a range of industries. *Id.* at 853 n.104. Although the conclusion she reaches is consistent with our findings here, her methodology is problematic because she is not comparing the same types of contracts. For example, the Searle study (one of the studies to which she compares her data) found that all or almost all credit card and cell phone contracts in the sample included class arbitration waivers but that no real estate brokerage contracts did. Drahozal & Zyontz, *supra* note \_\_, at 349-50. Gilles does not examine any real estate brokerage contracts, and so her results might simply be due to her comparing different types of contracts rather than any change over time.

<sup>150</sup> By comparison, 93.6% of credit card issuers using arbitration clauses covering 99.9% of credit card loans outstanding used class arbitration waivers as of December 31, 2010. Peter B. Rutledge & Christopher R. Drahozal, *Contract and Choice*, 2013 B.Y.U. L. REV. 1, 39.

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substantially.<sup>151</sup> But during the time period studied, there remained some risk that a court would invalidate an arbitration clause with a class arbitration waiver on an effective vindication theory.<sup>152</sup> Third, given the Supreme Court's decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*,<sup>153</sup> franchisors might believe that using a class arbitration waiver is not necessary. In *Stolt-Nielsen*, the Court held that a clause that was "silent" on class arbitration could not be construed as authorizing class arbitration.<sup>154</sup> That said, arbitral tribunals continued construing clauses without class arbitration waivers as authorizing class arbitration even after *Stolt-Nielsen*,<sup>155</sup> and franchise lawyers continued to recommend that franchisors use class arbitration waivers.<sup>156</sup> Accordingly, we find this third possible explanation unlikely.

The explanations explored in the foregoing paragraph all treat franchisors as interchangeable. Another set of explanations might differentiate among franchisors, whether with respect to their resources or their interests.<sup>157</sup> For example, large franchisors (measured by sales or number of franchised units) might display a greater tendency to favor arbitration clauses (coupled with class waivers) to the extent they perceive themselves to be a litigation target; by contrast, small franchisors might perceive a lower risk of litigation given that their pockets are not as deep. Along the same lines, larger franchisors might be more likely to have in-house legal counsel attuned to the most significant changes in the legal landscape (and thus more capable of responding quickly to "shocks" that result in changes in contract drafting); by contrast, smaller franchisors may lack the same personnel ranks and, consequently, be less likely to respond to these sorts of shocks. Future research might examine such firm-specific explanations.

<sup>151</sup> 133 S. Ct. 2304 (2013).

<sup>152</sup> See *supra* text accompanying notes \_\_ - \_\_.

<sup>153</sup> 130 S. Ct. 1758 (2010); see also *Oxford Health Plans v. Sutter*, 133 S. Ct. 2064 (2013).

<sup>154</sup> *Stolt-Nielsen*, 130 S. Ct. at 1776 & n.10.

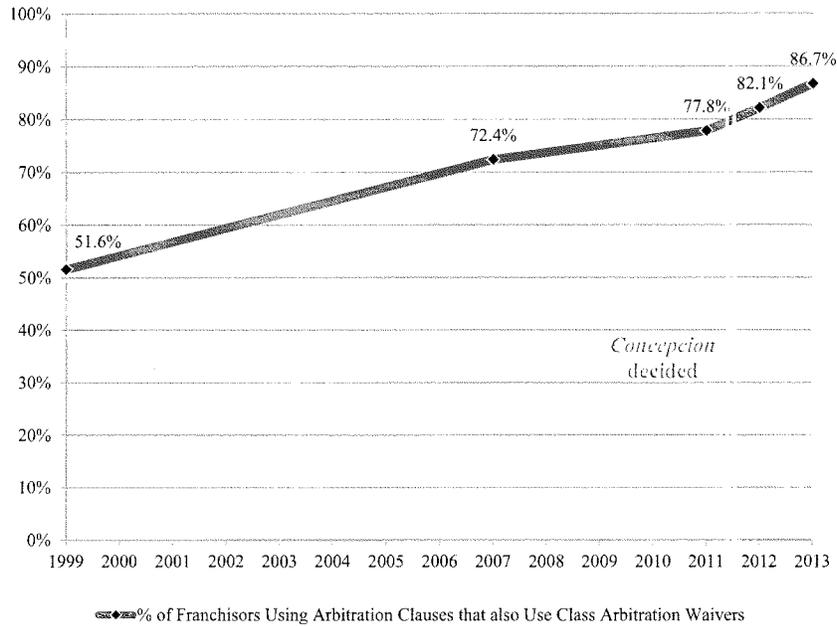
<sup>155</sup> Christopher R. Drahozal & Peter B. Rutledge, *Contract and Procedure*, 94 *MARQ. L. REV.* 1103, 1157-58 (2011).

<sup>156</sup> Sawers & Russell, *supra* note \_\_ ("The prudent franchisor should not assume that the absence of express language authorizing class arbitration immunizes the franchisor from class treatment. Instead, the safe course of action for franchisors is to include a class arbitration waiver in franchise agreements.").

<sup>157</sup> Research on the use of arbitration clauses in credit card agreements suggests such firm-specific explanations, see Drahozal & Rutledge, *supra* note \_\_, as does prior research on the use of arbitration clauses in franchise agreements, see Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Agreements*, 32 *J. LEGAL STUD.* 549, 580-81 (2003).

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Figure 2. Use of Class Arbitration Waivers in Franchise Agreements with Arbitration Clauses, 1999-2013



## 2. Caveats

We recognize and reiterate the limitations of our research. Initially, we have only two years of data since *Concepcion*. While that time period would seem to be long enough to detect changes to contracts if businesses could in fact quickly and costlessly change their contracts, to the extent contracts are sticky it may take longer for businesses to implement those changes. That may be particularly true for franchise agreements, given their relatively long terms.<sup>158</sup> At a minimum, the relatively short time frame makes it difficult to distinguish between bundling and stickiness explanations for the limited switching to arbitration we have observed in franchise agreements.

Second, it might be that franchisors anticipated the outcome in *Concepcion* and so had already changed their contracts before the case was decided. If so, we would not observe a

<sup>158</sup> See *supra* text accompanying notes \_\_ - \_\_.

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change in the use of arbitration clauses after the decision because the changes would already have occurred before the decision. But our panel sample finds no evidence of an increase in the use of arbitration clauses leading up to *Concepcion*; to the contrary, the use of arbitration clauses continued its slight, long-term decline up until 2010, and only began to increase after the decision in *Concepcion*.<sup>159</sup> Moreover, even if franchisors anticipated the outcome in *Concepcion*, it remains the case that fewer than half of the franchise agreements studied use arbitration clauses, despite the predictions that all would do so after *Concepcion*.

Finally, and more fundamentally, although often grouped together with consumer and employment contracts in policy discussions,<sup>160</sup> franchise agreements differ in a number of respects from those types of standard form contracts. As discussed above, franchise agreements have higher stakes, longer terms, and are subject to more regulation than the typical consumer or employment contract.<sup>161</sup> As a result, one must be cautious not to extrapolate too broadly from our findings here to other standard form contracts.

That said, at a minimum our results provide evidence that not all businesses have so far switched to arbitration after *Concepcion*, even businesses that commentators have argued should do so.

### C. Reconciling Our Findings with Other Reports

As noted above, our findings necessarily are limited to franchise agreements, which differ in important ways from other form contracts, in particular consumer and employment contracts.<sup>162</sup> In this section we reconcile our findings with anecdotal press reports of companies that have adopted arbitration clauses since *Concepcion*. The businesses typically reported as adopting arbitration clause after *Concepcion* are computer software companies and online businesses, as shown in Table 3.<sup>163</sup>

These businesses are notable because they are in industries that, prior to *Concepcion*, only rarely used arbitration clauses. Florencia Marotta-Wurgler found that almost no software

<sup>159</sup> See *supra* text accompanying notes \_\_\_-\_\_\_.

<sup>160</sup> George Padis, *Note: Arbitration Under Siege: Reforming Consumer and Employment Arbitration and Class Actions*, 91 TEX. L. REV. 665, 669 n.20 (2013) (“Often, franchise agreements are lumped together with employment agreements and consumer contracts as problematic areas of adhesive bargaining, because franchisees are often small businesses dealing with large corporations, and thus lack the bargaining strength to negotiate arbitration clauses in advance.”).

<sup>161</sup> See *supra* text accompanying notes \_\_\_-\_\_\_.

<sup>162</sup> See *supra* text accompanying notes \_\_\_-\_\_\_.

<sup>163</sup> The one exception is Umpqua Bank, which revised its deposit account agreement to include an arbitration clause after *Concepcion*. See *infra* text accompanying note \_\_\_. Professor Gilles reports that Regions Bank switched to arbitration after *Concepcion*. Gilles, *supra* note \_\_\_, at 853 n.105. By comparison, the *Wall Street Journal* reports that Regions Bank “strengthened the existing mandatory-arbitration provision contained in its deposit accounts” after *Concepcion*. Robin Sidel, *No Day in Court for Bank Clients*, WALL ST. J., Aug. 2, 2011 (emphasis added), available at <http://online.wsj.com/article/SB10001424053111904292504576482603037174400.html>.

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license agreements used arbitration clauses or class arbitration waivers in her 2007 study,<sup>164</sup> a situation that had not changed much prior to *Concepcion*.<sup>165</sup> Moreover, at least some of the firms (both Sony and Netflix) had been subject to high-profile class action lawsuits shortly before they switched to arbitration.<sup>166</sup> Finally, the anecdotal reports only highlight the switch to arbitration of several, large players in the market. Without more systematic data, there is no way to know whether arbitration clauses are used by most or all firms in the market, or whether these markets resemble the credit card market, in which small banks and credit unions often do not use arbitration clauses.<sup>167</sup>

Company	Product	Date Switch Reported
Sony <sup>168</sup>	Video games	September 2011
Umpqua Bank <sup>169</sup>	Deposit account	January 2012
Netflix <sup>170</sup>	Video rental and streaming	March 2012
Microsoft <sup>171</sup>	Video games and software	May 2012
Valve <sup>172</sup>	Computer games	July 2012
eBay <sup>173</sup>	Online auction	September 2012
PayPal <sup>174</sup>	Electronic payment service	October 2012
Instagram <sup>175</sup>	Online photo sharing service	December 2012

<sup>164</sup> Florencia Marotta-Wurgler, "Unfair" *Dispute Resolution Clauses: Much Ado About Nothing?*, in *BOILERPLATE: FOUNDATIONS OF MARKET CONTRACTS* 45 (Omri Ben-Shahar ed., 2007).

<sup>165</sup> Marotta-Wurgler & Taylor, *supra* note \_\_, at 280.

<sup>166</sup> Michael Liedtke, *Netflix Class Action Settlement: Service Pays \$9 Million After Allegations Of Privacy Violations* (Feb. 10, 2012), [http://www.huffingtonpost.com/2012/02/11/netflix-class-action-settlement\\_n\\_1270230.html](http://www.huffingtonpost.com/2012/02/11/netflix-class-action-settlement_n_1270230.html); Winda Benedetti, *Sony Sued, Could Bleed Billions Following PlayStation Network Hack*, NBCNEWS.COM (Apr. 27, 2011), <http://www.nbcnews.com/technology/sony-sued-could-bleed-billions-following-playstation-network-hack-123539>.

<sup>167</sup> Drahozal & Rutledge, *supra* note \_\_, at 559-61.

<sup>168</sup> Mark Milian, *Sony: Supreme Court Ruling Spurred Changes to PlayStation Terms* (Sept. 21, 2011), <http://www.cnn.com/2011/09/21/tech/gaming-gadgets/sony-psn-terms/>.

<sup>169</sup> Brent Hunsberger, *Umpqua Bank Joins Wells Fargo and Chase in Requiring Customers to Arbitrate Disputes, Barring Class Actions*, THE OREGONIAN (Jan. 23, 2012), [http://www.oregonlive.com/business/index.ssf/2012/01/umpqua\\_bank\\_joins\\_wells\\_fargo\\_1.html](http://www.oregonlive.com/business/index.ssf/2012/01/umpqua_bank_joins_wells_fargo_1.html).

<sup>170</sup> Jordan Crook, *Netflix Doesn't Want You to Sue Them, According to New Terms of Service*, (Mar. 20, 2012), <http://techerunch.com/2012/03/20/netflix-doesnt-want-you-to-sue-them-according-to-new-terms-of-service/>.

<sup>171</sup> Tim Fielden, *Microsoft on the Issues: Consumer Product and Service Agreement Updates* (May 25, 2012), [http://blogs.technet.com/b/microsoft\\_on\\_the\\_issues/archive/2012/05/25/consumer-product-and-service-agreement-updates.aspx](http://blogs.technet.com/b/microsoft_on_the_issues/archive/2012/05/25/consumer-product-and-service-agreement-updates.aspx).

<sup>172</sup> Chris Morran, *Video Game Publisher/Seller Valve Now Forcing Customers Into Mandatory Binding Arbitration* (Aug. 1, 2012), <http://consumerist.com/2012/08/01/video-game-publisherseller-valve-now-forcing-customers-into-mandatory-binding-arbitration/>.

<sup>173</sup> Brian Wolfman, *New E-Bay Arbitration Agreements with Its Customers Include Class-Action Ban (but with an Opt-Out)* (Sept. 17, 2012), <http://pubcity.typepad.com/clpblog/2012/09/e-bay-user-arbitration-agreements-include-class-action-ban-but-with-opt-out.html>; Steven Berk, *Ebay Offering Rare Chance to Opt-Out of Forced Arbitration: Nov. 9th Deadline* (Oct. 1, 2012), <http://www.thecorporateobserver.com/2012/10/01/ebay-offering-rare-chance-to-opt-out-of-forced-arbitration-nov-9th-deadline/>.

<sup>174</sup> Greg Blankinship, *PayPal Adds Class Action Arbitration Waiver to Its Contract* (Oct. 10, 2012), <http://classactionblog.mpnbs.com/2012/10/10/paypal-adds-class-action-arbitration-waiver-to-its-contract/>.

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StubHub<sup>176</sup>

Online ticket market

February 2013

All told, the markets for online services and computer software may reflect a different contracting dynamic than the franchise market. Those markets were marked by an initial low usage of arbitration clauses, with a number of large firms switching to arbitration after *Concepcion* and the filing of several high profile class actions. By contrast, the franchise market had a much higher usage of arbitration clauses prior to *Concepcion*, and a slight but not dramatic move to arbitration after that case. More research into the online services and computer software markets would be useful to help provide a better understanding of why firms in those markets behaved differently than those in the franchise market, both before and after *Concepcion*.

#### D. Are Arbitration Clauses Sticky?

Given our findings above — that, so far, at least in franchise agreements, the predicted switch to arbitration has not yet occurred — the next question is: why not? In our theoretical discussion, we identify two possible reasons. The first is that franchisors in fact have business reasons not to use arbitral class waivers — that by agreeing to arbitrate, the parties agree to a bundle of dispute resolution services, at least some of which may be undesirable from the franchisor's perspective (**Hypothesis 2**).<sup>177</sup> The second is that form contracts may be sticky — i.e., for various reasons, drafters might not change contract terms even when as a business matter it might make sense to do so (**Hypothesis 3**).

As discussed above, there is reason to believe that franchise agreements may be somewhat sticky, albeit perhaps less sticky than negotiated contracts.<sup>178</sup> Our prior research has found evidence of stickiness in credit card agreements that continued to list the National Arbitration Forum (NAF) as the sole provider of arbitration services several years after the NAF had ceased administering consumer arbitrations.<sup>179</sup> As a result, the agreements risked court appointment of arbitrators at best and invalidation of the arbitration clause at worst.<sup>180</sup> Florencia Marotta-Wurgler and Robert Taylor reported that “[a]most forty percent of the contracts [they] examined [end-user license agreements prepared by mass market consumer software companies] saw at least one standard term change over the period between 2003 and 2001; some changed more than ten terms.”<sup>181</sup> They explain that “[w]hile this number could be perceived as low,

<sup>175</sup> Chris Morran, *Here's How to Opt Out of Instagram's New Arbitration Clause* (Dec. 21, 2012), <http://consumerist.com/2012/12/21/heres-how-to-opt-out-of-instagrams-new-arbitration-clause/>.

<sup>176</sup> Chris Morran, *Now You Can No Longer File Class-Action Suits Against StubHub; Here's How to Opt Out* (Feb. 22, 2013), <http://consumerist.com/2013/02/22/now-you-can-no-longer-file-class-action-suits-against-stubhub-heres-how-to-opt-out/>.

<sup>177</sup> Or, perhaps, for reputational reasons they might decide not to use arbitration clauses. See *supra* note \_\_.

<sup>178</sup> See *supra* text accompanying notes \_\_-\_\_.

<sup>179</sup> Rutledge & Drahozal, *supra* note \_\_, at 30.

<sup>180</sup> *Id.*

<sup>181</sup> Marotta-Wurgler & Taylor, *supra* note \_\_, at 274-75.

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especially in an industry as dynamic as software, the results challenge conventional views that a large fraction of consumer fine print is set in stone.”<sup>182</sup>

We develop a simple measure of change in franchise agreements using the redlined versions of the agreements included in the Franchise Disclosure Document.<sup>183</sup> For each franchise agreement for 2011-12 and 2012-13, we counted the number of provisions of the franchise agreement that were changed substantively. For example, an expansion of the parties subject to an arbitration clause (such as by expressly including affiliates) would count as a substantive change. Renumbering a provision because of the insertion of a new provision earlier in the agreement would not. We included changes to all types of provisions of the franchise agreement, and counted the number of provisions with substantive changes rather than the number of substantive changes. If a single provision was changed in multiple ways, we counted it only as a single change. This measure of contract change necessarily is very approximate and is most useful at the extremes. Nonetheless, it provides at least a rough measure of the extent to which franchisors changed their franchise agreements during the years studied.

Based on the data described above, we categorized each franchisor as to the number of changes in any particular year and the number of years in which changes were made, as shown in Table 4. A franchise agreement with ten or more provisions with substantive changes in any given year was classified as having major changes. If the agreement had major changes in only one year the changes were characterized as periodic; if in both years they were characterized as regular. A franchise agreement with at least one but fewer than ten provisions with substantive changes in any given year was characterized as having minor changes. Again, if the agreement had major changes in only one year the changes were characterized as periodic; if in both years they were characterized as regular. A franchise agreement with no substantive changes in either year was categorized as unchanged.

Table 4. Categorizations for Changes to Franchise Agreements, 2011-12 & 2012-13

Category	Definition
Major — regular	Ten or more changed provisions in both years
Major — periodic	Ten or more changed provisions in one year
Minor — regular	Some but fewer than ten changed provisions in both years
Minor — periodic	Some but fewer than ten changed provisions in one year
Unchanged	No changes in either year

Table 5 summarizes our categorizations of the changes in the franchise agreements in the panel sample, by the type of dispute resolution clause used in the franchise agreement in 2012.<sup>184</sup> Note first that 53 of the 67 franchisors (79.1%) changed at least one provision during the two

<sup>182</sup> *Id.* at 275.

<sup>183</sup> See *supra* text accompanying notes \_\_ - \_\_. When a franchise agreement did not reflect any changes in red-lining, we compared the agreement to the previous year’s agreement to determine whether in fact it was unchanged from the prior year or whether the version of the franchise agreement we were using was not red-lined.

<sup>184</sup> Two of the agreements switched to arbitration in 2013.

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years we examined, and 7 of the 67 franchisors (10.4%) changed ten or more provisions in both years. These are higher percentages than Marotta-Wurgler and Taylor found for the UELAs they studied, but we use a more generous definition of change than their study so our results are not directly comparable.<sup>185</sup>

Category	Arbitration clause (2013)	No arbitration clause (2013)
Major — regular	4	3
Major — periodic	12	15
Minor — regular	7	6
Minor — periodic	1	5
Unchanged	6	8
Total	30	37

No clear patterns emerge by type of dispute resolution clause (or at least none for which we can claim any statistical significance because of the small sample size). The percentage of franchise agreements without an arbitration clause that were unchanged during the period studied was almost identical to the percentage with an arbitration clause that were unchanged. At the other extreme, a higher percentage of franchisors using arbitration clauses were classified as making regular, major changes to the franchise agreement. For those franchisors making major changes, either periodic or regular, it seems less likely that contract stickiness explains the failure to switch to arbitration. Indeed, almost half (18 of 37) of the franchisors that do not use arbitration clauses were classified as making major changes to the franchise agreement. Again, we cannot draw definitive conclusions, but **our data is at least suggestive that something more than contract stickiness is the explanation for why some franchisors have not switched to arbitration after *Concepcion*.**

An alternative possibility is that dispute resolution provisions are stickier than other contract provisions, so that the data above understate the degree of stickiness. We also separately counted the number of franchisors that made substantive changes to the dispute resolution clause itself, such as by switching to (or from) arbitration or otherwise changing the characteristics of the dispute resolution clause. In 2012, eleven of sixty-seven (or 16.4%) of franchisors changed their dispute resolution clauses. In 2011, six of sixty-seven franchisors (or 9.0%) changed their dispute resolution clauses. Six of the eleven used arbitration clauses in 2012, while five of the six in 2011 did so. Not surprisingly, a smaller percentage of franchisors changed the dispute resolution clauses in their franchise agreements than changed some other provision in the franchise agreement. It also is not surprising that franchisors that used arbitration clauses were more likely to change their dispute resolution clause because arbitration clauses tend to be longer and more complex than forum selection clauses. That said, just over thirty-five percent (6 of 17, or 42.1%) of the franchisors that changed their dispute resolution

<sup>185</sup> See *supra* text accompanying notes \_\_ - \_\_.

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clause used forum selection clauses in their franchise agreements, suggesting that forum selection clauses are not necessarily stickier than arbitration clauses.

Overall, we cannot reject the hypothesis that the stickiness of franchise agreements is a partial explanation for the fact that many franchisors have not switched to arbitration since *Concepcion*. Half of the franchisors that do not currently use arbitration clauses made either no changes (8 of 37, or 21.6%) or only minor changes (11 of 37, or 29.7%) to their franchise agreements in 2011-12 and 2012-13. It may be that those franchise agreements are sticky. But a sizable proportion of franchisors that do not currently use arbitration clauses made major changes to their franchise agreements in one (15 of 37, or 40.5%) or both (3 of 37, or 8.1%) of those years. For those franchisors, it seems unlikely that contract stickiness alone explains the fact that they have not switched to arbitration.

#### V. *Amex* and Non-Arbitral Class Waivers

Commentators have predicted that the Supreme Court's decision in *American Express Co. v. Italian Colors Restaurant* will result in a new "rash" of businesses switching to arbitration clauses to avoid class actions.<sup>186</sup> Of course, if all businesses already had adopted arbitration clauses after *Concepcion*, as some predicted then, *Amex* would have no additional effect on contracting behavior. Given our finding that such a switch has not occurred, the likely effect of *Amex* remains open.

It is too soon to present empirical evidence on the extent to which businesses switched to arbitration after *Amex*. Instead, we offer some thoughts on the legal implications of the decision and how those implications might affect future contracting behavior.

##### A. Legal Implications of *Amex* for Class Waivers

In *Amex*, the Supreme Court held an arbitral class waiver enforceable even though the lack of class relief arguably made it uneconomical to pursue a federal antitrust claim.<sup>187</sup> By foreclosing what appears to be the last major court challenge to arbitral class waivers after *Concepcion*, the Court in *Amex* reduced if not eliminated any residual legal uncertainty about their enforceability.

In addition, the dissent in *Amex*, perhaps inadvertently, rejected a variation on the effective vindication challenge. Some courts, typically state courts, had extended the theory to rights arising out of state statutes, rather than limiting it to federal statutory rights. For example, in *Feeney v. Dell, Inc.*, the Massachusetts Supreme Court refused to limit the effective vindication doctrine to federal statutory rights, instead holding that it applied to state statutory

<sup>186</sup> See *supra* text accompanying notes \_\_-\_\_.

<sup>187</sup> *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2309-11 (2013).

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rights as well.<sup>188</sup> Justice Kagan’s dissent in *Amex*, however, made clear that such analysis is erroneous:

When a state rule allegedly conflicts with the FAA, we apply standard preemption principles, asking whether the state law frustrates the FAA’s purposes and objectives. If the state rule does so — as the Court found in *AT&T Mobility* — the Supremacy Clause requires its invalidation. We have no earthly interest (quite the contrary) in vindicating that law. Our effective-vindication rule comes into play only when the FAA is alleged to conflict with another *federal* law, like the Sherman Act here. In that all-federal context, one law does not automatically bow to the other, and the effective vindication rule serves as a way to reconcile any tension between them.<sup>189</sup>

Given that even the *Amex* dissenters would have limited the effective vindication doctrine to federal statutory rights, cases like *Feeney* would seem to be no longer good law.<sup>190</sup>

Finally, while on its facts *Amex* addresses an arbitral class waiver, the decision might also increase the likelihood that courts will enforce non-arbitral class waivers.<sup>191</sup> Stated otherwise, although the decision has been criticized as the “worst Supreme Court arbitration decision ever,”<sup>192</sup> arguably it is a class action decision more than an arbitration decision.

Most of the reasoning of the Court in *Amex* applies to non-arbitral class waivers as well as arbitral class waivers. Thus, as the Court points out, the effective vindication doctrine essentially is an application of the bar on prospective waivers of statutory rights.<sup>193</sup> If parties cannot directly waive a statutory right, they also cannot do so indirectly by using an unfair arbitration clause.<sup>194</sup> The Court then goes on to hold that an arbitral class waiver does not amount to a prospective waiver of a statutory right because “the class-action waiver merely limits arbitration to the two contracting parties. It no more eliminates those parties’ right to pursue their statutory remedy than did federal law before its adoption of the class action for legal

<sup>188</sup> *Feeney v. Dell Inc.*, 989 N.E.2d 439, 455-56 (Mass. 2013), *rev’d on rehearing*, 993 N.E.2d 329, 331 (Mass. 2013); *see also* *Booker v. Robert Half Int’l, Inc.*, 413 F.3d 77, 81 (D.C. Cir. 2005); *Kristian v. Comcast Corp.*, 446 F.3d 25, 29 (1st Cir. 2006); *Gibson v. Nye Frontier Ford, Inc.*, 205 P.3d 1091, 1101 (Ala. 2009). *But see* *Coneff v. AT&T Corp.*, 673 F.3d 1155, 1158 n.2 (9th Cir. 2012) (“Plaintiffs assert primarily state statutory rights, but *Mitsubishi*, *Gilmer*, *Green Tree* and similar decisions are limited to federal statutory rights.”)

<sup>189</sup> *Amex*, 133 S. Ct. at 2320 (Kagan, J., dissenting).

<sup>190</sup> Of course, *Feeney* would be inconsistent with the majority’s decision in *Amex* even if it had involved federal statutory rights because the basis for the effective vindication challenge was a class arbitration waiver. The Massachusetts court later acknowledged that its decision was incorrect under *Amex*. *Feeney v. Dell*, 993 N.E.2d 329, 331 (Mass. 2013).

<sup>191</sup> As noted above, courts currently are split on the enforceability of non-arbitral class waivers. *See supra* text accompanying notes \_\_-\_\_.

<sup>192</sup> Bland, *supra* note \_\_; Sternlight, *supra* note \_\_.

<sup>193</sup> 133 S. Ct. at 2310.

<sup>194</sup> As the Court explains in *Amex*: “That would certainly cover a provision in an arbitration agreement forbidding the assertion of certain statutory rights. And it would perhaps cover filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable.” *Id.* at 2310-11..

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relief in 1938.”<sup>195</sup> Nothing in that analysis depends in any way on the fact that the class waiver used an arbitration clause. Rather, central to the Court’s analysis seems to be that at the time Congress enacted the antitrust laws class actions under the Federal Rules of Civil Procedure had not yet been adopted, an argument that would apply as well to non-arbitral class waivers.<sup>196</sup>

Clearly any effect of *Amex* on the enforceability of non-arbitral class waivers would only be dicta because *Amex* on its facts involved an arbitral class waiver. Moreover, the Court relies on the FAA and its own prior arbitration cases at various points in the opinion. Thus, the Court later explained that the “the FAA does, contrary to the dissent’s assertion, favor the absence of litigation when that is the consequence of a class-action waiver, since its ‘principal purpose’ is the enforcement of arbitration agreements according to their terms.”<sup>197</sup> And the framework the Court applies to reconciling the FAA and the antitrust laws is its usual framework for analyzing whether a federal statute makes a particular statutory claim nonarbitrable.<sup>198</sup> That said, there is at least an argument that the decision in *Amex* enhances the enforceability of both arbitral and non-arbitral class waivers.

**B. Arbitral and Non-Arbitral Class Waivers in Franchise Agreements: Predictions and an Empirical Baseline**

As stated above, it is too early to evaluate empirically the effect of *Amex* on the use of arbitral class waivers and non-arbitral class waivers. Instead, we offer some predictions about how businesses are likely to respond to that case.

First, to the extent businesses refrained from switching to arbitration after *Concepcion* because of residual legal uncertainty about application of the effective vindication doctrine, those businesses might switch to arbitration after *Amex*. But to the extent businesses avoided arbitration because of its limited right of appeal or other bundling costs, one would not expect all or even most businesses to begin using arbitration even after *Amex*.<sup>199</sup> Likewise, *Amex* will have little effect on the stickiness of franchise agreements, although over time the use of arbitration might nonetheless increase as firms slowly adopt contractual innovations.

<sup>195</sup> *Id.* at 2311. “Or, to put it differently, the individual suit that was considered adequate to assure ‘effective vindication’ of a federal right before adoption of class-action procedures did not suddenly become ‘ineffective vindication’ upon their adoption.” *Id.*

<sup>196</sup> On this view, an open question after *Amex* is how to deal with a statutory right arising out of a federal statute enacted after the creation of class action procedures under the Federal Rules — particularly the adoption of the current version of Federal Rule of Civil Procedure 23 in 1966. For arbitral class waivers, the Court’s analysis suggests that it would use its general framework for non-arbitrability. *See id.* at 2309-10. But that framework presumably would not apply, at least not directly, to non-arbitral class waivers.

<sup>197</sup> *Id.* at 2312 n.5.

<sup>198</sup> *Id.* at 2309-10.

<sup>199</sup> Our hypothesis about arbitration and bundling costs dovetails with some of the arguments of Ted Eisenberg and Geoff Miller about the paucity of arbitration agreements in certain business-to-business contract. *See* Theodore Eisenberg & Geoffrey P. Miller, *The Flight From Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 364 (2007). Here, however, the bundling costs influence the behavior of a single party (the franchisor) as opposed to two equally sophisticated business parties (the subject of Eisenberg and Miller’s research).

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Second, as suggested above, *Amex* might enhance the enforceability of non-arbitral class waivers as well as arbitral class waivers. But because a non-arbitral class waiver does not use an arbitration clause, the Federal Arbitration Act would not apply, so there would be no federal law basis for preempting state law regulation. As a result, even if *Amex* is construed broadly as applying to non-arbitral class waivers, states should still be able to invalidate non-arbitral class waivers as unconscionable (or otherwise regulate those provisions, by statute, regulation, or court decision).<sup>200</sup> Thus, one might expect to see varied state approaches to the regulation of non-arbitral class waivers, much as one saw with respect to arbitral class waivers prior to *Concepcion*.<sup>201</sup>

Conversely, unlike arbitral class waivers, non-arbitral class waivers should have no bundling costs. The only change to the litigation process the parties are making is to waive class actions; they are not changing other characteristics of litigation (unlike an arbitral class waiver, which also contracts for a limited appeals process, for example). As such, businesses that want to waive class actions but also maintain their usual appeal rights would prefer non-arbitral class waivers to arbitral class waivers (all else equal).

Whether the legal uncertainty or the absence of bundling costs predominates is an empirical question, and it is difficult to make any definitive predictions. As Figure 3 indicates, prior to *Amex* the enforceability considerations appear to have predominated. More than twice as many franchisors in the panel sample (38.9% versus 16.4% in 2013<sup>202</sup>) used arbitral class waivers as non-arbitral class waivers. The ratio is similar for the cross-section sample, although the use of both arbitral (51.4%) and non-arbitral (18.7%) class waivers is higher in that sample. Given the overwhelming predominance of arbitral class waivers over non-arbitral class waivers in other standard form contracts (such as credit card and cell phone agreements<sup>203</sup>), our findings here suggest that bundling costs are higher in franchising than in those settings.

<sup>200</sup> In addition, there might be arguments against the enforceability of non-arbitral class waivers in addition to state law unconscionability. See, e.g., *Martrano v. Quizno's Franchise Co.*, L.L.C., 2009 U.S. Dist. LEXIS 52025, at \*87 (W.D. Pa. June 15, 2009) (invalidating non-arbitral class waiver as inconsistent with the Federal Rules of Civil Procedure).

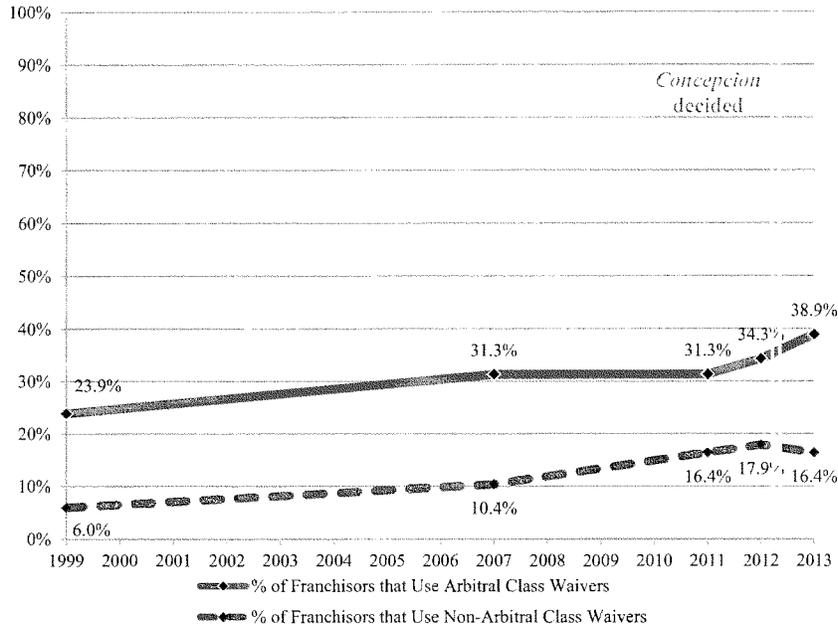
<sup>201</sup> Cf. Alan S. Kaplinsky, Scorecard on Where Federal and State Appellate Courts and Statutes Stand on Enforcing Class Action Waivers in Pre-Dispute Consumer Arbitration Agreements 42-43 (Dec. 27, 2010), [http://www.ballardspahr.com/~media/Files/Alerts/2010-12-27\\_Scorecard\\_on\\_Appellate\\_Courts\\_on\\_Enforcing\\_Class\\_Action\\_Waivers\\_Pre-Dispute\\_Consumer\\_Arbitration.aspx](http://www.ballardspahr.com/~media/Files/Alerts/2010-12-27_Scorecard_on_Appellate_Courts_on_Enforcing_Class_Action_Waivers_Pre-Dispute_Consumer_Arbitration.aspx) (summarizing “final tally” of different courts on enforceability of arbitral class waivers prior to *Concepcion*).

<sup>202</sup> The increase in arbitral class waivers and the decline in non-arbitral class waivers in 2013 offset each other to some extent because of one franchisor that previously used a non-arbitral class waiver switching to an arbitral class waiver.

<sup>203</sup> David Hoffman finds only a small number of non-arbitral class waivers in credit card agreements, all of which appeared in contracts with arbitration clauses. See Hoffman, *supra* note \_\_, at \_\_ (ms. at 29-30). Arbitration clauses and class arbitration waivers clearly are dominant in cell phone contracts. See O’Hara O’Connor & Drahozal, *supra* note \_\_, at \_\_ (ms. at 35).

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Figure 3. Use of Arbitral Class Waivers and Non-Arbitral Class Waivers in Franchise Agreements, 1999-2013



*Amex* may enhance the enforceability of non-arbitral class waivers while leaving their bundling benefits unchanged, so that on the margin non-arbitral class waivers will become more attractive. Since 1999, the use of non-arbitral class waivers in the panel sample has increased at a faster rate than the use of non-arbitral class waivers, and, in both samples, the overall use of non-arbitral class waivers is higher than one might expect, given the limited attention to such waivers by courts and academics. Whether the enhanced enforceability as a result of *Amex* will be enough to result in a greater use of non-arbitral class waivers is as yet unknown.

**VI. Implications and Conclusions**

After *AT&T Mobility LLC v. Concepcion*, commentators predicted that all or most businesses would soon switch to arbitration clauses. This paper tests that prediction and finds it

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unsupported. Based on our samples of franchise agreements, we find only a small switch to arbitration, not the widespread switch predicted. In the panel sample, the use of arbitration clauses increased from 40.3% of franchisors immediately before *Concepcion* to 44.8% in 2013. The four franchisors that have switched to arbitration after *Concepcion* all were on the margin between arbitration and litigation: three had used arbitration clauses at some point prior to *Concepcion* and switched back, while the fourth used arbitration to resolve some disputes and expanded its use. In the cross-section sample, the net use of arbitration clauses was virtually unchanged after *Concepcion*, with 62.6% of franchisors using arbitration clauses before and 63.6% after the decision. Five franchisors switched to arbitration after *Concepcion*, while three others switched away from arbitration, leaving a net increase of one franchisor. We also find that the use of class arbitration waivers by franchisors using arbitration clauses has increased substantially over time, with most of the increase coming before 2011 (from 51.6% of franchisors in 1999 to 77.8% in 2011, with a further increase to 86.7% in 2013).

These findings have a number of implications. First, and most obviously, they call into question some of the empirical predictions following *Concepcion* (and *American Express Co. v. Italian Colors Restaurant*). So far, at least, it is not the case that all or even most businesses are switching to arbitration clauses after *Concepcion*. As we have noted before, however, one would expect those businesses most susceptible to class actions to be the most likely to switch. Second, the paper cautions against unquestioning acceptance of the common “parade-of-horribles” arguments often made in litigation. Third, the paper adds to our understanding of the nature of arbitration as a means of resolving disputes. An arbitration clause does more than waive class actions. It brings with it other characteristics of the arbitration bundle of dispute services, which gives businesses a reason not to use arbitration even after *Concepcion* and *Amex*. Fourth, the paper provides insights into the nature of contract change and innovation. We find a significant degree of change in franchise agreements among franchisors in the panel sample, suggesting that contract stickiness is not the sole reason for the limited switching to arbitration clauses after *Concepcion*. Moreover, our findings as to franchise agreements suggest that Supreme Court decisions may not always be the sort of systemic shock likely to result in contract change.

Finally, we offer a first look at how the Supreme Court’s recent decision in *Amex* might affect contracting behavior. Although on its facts *Amex* involves the enforceability of an arbitral class waiver, that the decision could be read as applying to non-arbitral class waivers as well as arbitral class waivers, at least as to certain federal statutory claims. Businesses that want to avoid the bundling costs of arbitration, such as the limited right to appeal, would prefer to use non-arbitral class waivers. *Amex* might enhance the enforceability of non-arbitral class waivers (although they likely remain subject to state unconscionability challenges), and thus to some degree increase their use.

## QUESTIONS SUBMITTED BY SENATOR FRANKEN FOR MYRIAM GILLES

**Senate Judiciary Committee Hearing**  
**“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**

**Questions for the Record Submitted by Senator Al Franken for Myriam Gilles**

**Question 1:** In recent years, we’ve seen changes that make it harder and harder for ordinary people to enforce their rights: *Iqbal* and *Twombly* made it harder to get into court in the first place; *Dukes* and *Symczyk* and *Concepcion* made it a lot harder for workers to band together as a class. How does the *Italian Colors* decision fit within the broader context of diminishing access to justice?

**Question 2:** In his opinion in the *Italian Colors* case, Justice Scalia wrote, in effect, that enforcing arbitration agreements is more important than giving workers, consumers, and small businesses an opportunity to vindicate their federal rights. It is difficult to imagine that the drafters of the Federal Arbitration Act ever would have envisioned the law being interpreted that way. Can you provide some historical perspective about the FAA’s intended purpose and scope and explain how we’ve strayed from that?

**Question 3:** The Arbitration Fairness Act would prohibit mandatory, pre-dispute arbitration agreements in certain cases. If corporations knew that people had a choice to go to court after a dispute arose, would the corporations change their arbitration agreements? If so, how?

**Question 4:** Some people have argued that corporations will refuse to submit post-dispute claims to arbitration unless mandatory, pre-dispute arbitration clauses are enforceable. In other words, people have argued that the Arbitration Fairness Act would remove corporations’ incentive to submit any claims to arbitration. How would you respond to this argument?

**Question 5:** What is your initial assessment of the Consumer Financial Protection Board’s preliminary study on the use of mandatory pre-dispute arbitration agreements in the consumer financial services industry?

**Question 6:** Mr. Parasharami attached to his written testimony a document titled, “Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions” by Mayer Brown LLP. What is your assessment of that document?

**Question 7:** Professor Rutledge attached to his written testimony a document titled, “Sticky Arbitration Clauses: The Use of Arbitration Clauses after *Concepcion* and *Amex*”. What is your assessment of that document?

QUESTIONS SUBMITTED BY SENATOR FRANKEN FOR VILDAN TESKE

**Senate Judiciary Committee Hearing**  
**“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**

**Questions for the Record Submitted by Senator Al Franken for Vildan Teske**

**Question 1:** I’ve heard some employment advocates point to the Lilly Ledbetter case as another good illustration of why the Arbitration Fairness Act is necessary. Can you discuss that?

**Question 2:** Some people have argued that limiting class actions – as *Concepcion* did – is a good thing because class actions benefit plaintiffs’ lawyers and nobody else. Can you respond to that argument and talk about the value of class actions?

**Question 3:** You testified that mandatory, pre-dispute arbitration clauses and class actions allow corporations to get away with illegal and abusive practices perpetrated against service members. Please explain the impact that these practices have on service members’ finances, readiness, rankings, and careers?

QUESTIONS SUBMITTED BY SENATOR FRANKEN FOR ARCHIS PARASHARAMI

**Senate Judiciary Committee Hearing**  
**“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**

**Questions for the Record Submitted by Senator Al Franken for Archis Parasharami**

**Question 1:** Before *Italian Colors* was decided, you wrote that corporations should consider removing certain provisions from their arbitration agreements. These included costs that are excessive in the context of small claims, waivers of substantive rights available under applicable laws, and requirements that people travel to distant places to arbitrate. Today, do you advise corporations to remove these features from the arbitration agreements they have with their consumers and workers?

**Question 2:** During the hearing, Ms. Teske testified about a service member who tried to file a class action lawsuit under the Servicemembers Civil Relief Act (SCRA) after a bank illegally foreclosed on his home while he was serving in Iraq. Ms. Teske put forth evidence indicating that other service members' SCRA rights also had been violated because of the bank's policies and practices. However, because the service member's mortgage documents included a mandatory, pre-dispute arbitration clause and a class action waiver, the service member's case was dismissed, and he was unable to bring either a class action or a class arbitration. As a result, it is likely that other service members are unaware of their SCRA rights or that those rights may have been violated. Does this seem like a just result to you?

QUESTIONS SUBMITTED BY SENATOR GRASSLEY FOR ARCHIS PARASHARAMI

**“The Federal Arbitration Act and Access to  
Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers,  
and Small Businesses?”  
Questions for the Record Submitted by Ranking Member Charles E. Grassley  
December 20, 2013**

**Questions for Archis Parasharami**

1. The Supreme Court has stated that class action waivers in an arbitration agreement will be enforced. However, there are alternatives to class actions such as cost sharing or cost shifting. These tools may allow individual claimants to pursue what would otherwise be cost-prohibitive small claims. Please explain how small, but costly, claims will proceed? Also, please describe the alternatives to class actions and how they are used.
2. Do you consider a class action proceeding as the best or most efficient way for individuals to have their claims adjudicated, whether or not in an arbitration proceeding?
3. Professor Gilles stated that your law firm’s study of class actions involved “cherry-picked” data. Please respond.
4. Last week, the Consumer Financial Protection Bureau announced its preliminary findings from the arbitration study Congress mandated in the Dodd-Frank Act. According to one report, there’s concern the Consumer Financial Protection Bureau is preparing to write tough new rules restricting the use of arbitration clauses in consumer banking contracts. Please provide more information about the Consumer Financial Protection Bureau’s study and what it means going forward.
5. Please provide any additional thoughts that you might have on the issues raised by the hearing, including but not limited to expanding on your testimony, responding to the testimony of the other witnesses and/or anything else that came up at the hearing, which you did not have a chance to respond to.

QUESTIONS SUBMITTED BY SENATOR GRASSLEY FOR PETER RUTLEDGE

**“The Federal Arbitration Act and Access to  
Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers,  
and Small Businesses?”  
Questions for the Record Submitted by Ranking Member Charles E. Grassley  
December 20, 2013**

**Questions for Professor Peter B. Rutledge**

1. You published a law review article in 2004 in which you described potential incentives relating to arbitrator partiality. Please explain what you meant in your law review article, and what your scholarship and research reveal about the likelihood that arbitrators might be biased in favor of or against consumers and employees?
2. Your testimony cited the CFPB’s recently-issued preliminary determination that 17 percent of credit card issuers make use of arbitration agreements. Please explain the relevance of this statistic.
3. If a consumer or employee believes that an arbitrator has been biased or otherwise partial to the opposing party, and the consumer or employee subsequently loses an arbitration, what, if any, remedies would that individual have?
4. In the wake of these recent Supreme Court cases, what safeguards are in place to ensure that individuals can have their claims adjudicated?
5. Please provide any additional thoughts that you might have on the issues raised by the hearing, including but not limited to expanding on your testimony, responding to the testimony of the other witnesses and/or anything else that came up at the hearing, which you did not have a chance to respond to.

QUESTIONS SUBMITTED BY SENATOR HATCH FOR MYRIAM GILLES

**“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**

**Questions from Senator Orrin Hatch for Professor Gilles**

Professor Gilles, I’m wondering whether the case against arbitration is really so complete that we should prohibit arbitration clauses altogether.

For example, have you considered whether arbitration might facilitate dispute resolution for borrowers pursuing their own cases or borrowers in remote areas?

Or have you studied the improvements that have been made in how arbitrations are conducted?

QUESTIONS SUBMITTED BY SENATOR HATCH FOR PETER RUTLEDGE

"The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

Questions from Senator Orrin Hatch for Professor Rutledge

1.

The proper way to evaluate arbitration, it seems to me, is in comparison to litigation.

Those are the two options for parties trying to obtain binding dispute resolution.

Frankly, I think this explains in part why trial lawyers so often oppose arbitration.

They want to litigate instead.

But empirical research shows a few things that seem important in this regard.

First, arbitration is faster and cheaper than litigation.

Second, arbitration claimants are at least as likely, if not more so, to prevail than plaintiffs who sue in court.

Professor Rutledge, is that your understanding of the research and, if so, are these significant findings that should inform how Congress proceeds with legislation in this area?

2.

Along those same lines, do you know of any research about whether it is easier for consumers who pursue their own claims to navigate the arbitration process as opposed to the judicial process?

3.

Last week, the Consumer Financial Protection Bureau announced preliminary findings from the study Congress required in the Dodd-Frank Act.

It notes that consumers involved in arbitration are “disproportionately” located in certain areas.

I confess I don’t know what the right proportion is supposed to be, so it’s hard to know what is disproportionate.

But did this report offer any data regarding whether the same discrepancy also exists in the context of litigation rather than arbitration?

In fact, doesn’t the CFPB acknowledge that it cannot tell whether a similar disparity exists?

4.

As I said before, litigation is the alternative to arbitration.

The bill before us would not only prohibit arbitration, but actually terminate arbitration agreements that parties have already entered into.

Before taking a step like that, shouldn’t we consider the delays that already exist in both state and federal court?

RESPONSES OF MYRIAM GILLES TO QUESTIONS SUBMITTED BY SENATORS FRANKEN  
AND HATCH

# CARDOZO

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**Myriam Gilles, Professor of Law**  
**January 13, 2014**

**Senate Judiciary Committee Hearing**  
**“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions  
Undermine the Rights of Consumers, Workers, and Small Businesses?”**

## **Responses to Questions for the Record Submitted by Senator Al Franken**

**Question 1:** In recent years, we’ve seen changes that make it harder and harder for ordinary people to enforce their rights: *Iqbal* and *Twombly* made it harder to get into court in the first place; *Dukes* and *Symczyk* and *Concepcion* made it a lot harder for workers to band together as a class. How does the *Italian Colors* decision fit within the broader context of diminishing access to justice?

The Supreme Court’s decision in *American Express v. Italian Colors*<sup>1</sup> rejected the vindication of rights challenge to a forced arbitration clause, and in doing so, denied plaintiffs the ability to enforce congressionally-created rights. Prior to *Italian Colors*, it had been universally recognized that arbitration clauses were enforceable only so long as they allowed claimants to vindicate their federal statutory rights. This “vindication of rights” doctrine, which originated in the Supreme Court’s 1985 decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, underscored a fundamental and uncontroversial idea – that an arbitration clause which operates as “a prospective waiver of a party’s right to pursue statutory remedies” is unenforceable “as against public policy.”<sup>2</sup>

Since *Mitsubishi*, the Supreme Court has repeatedly recognized the vindication-of-rights doctrine. Indeed, in 2000, a pragmatic Court declared in *Green Tree Financial v. Randolph*, that

<sup>1</sup> 133 S.Ct. 2304 (2013).

<sup>2</sup> 473 U.S. 614, 637 (1985).

where the high costs of arbitrating a claim “preclude[s] a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum,” the forced arbitration clause may be unenforceable. The *Randolph* Court established a simple case-by-case framework for determining when prohibitive costs might stand as an obstacle to rights-claiming, placing upon the “party seek[ing] to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive” the “burden of showing the likelihood of incurring such costs.”<sup>3</sup>

In the years since *Mitsubishi* and *Randolph*, the Supreme Court has repeatedly reaffirmed the vindication-of-rights doctrine as an essential safety valve to preserve federal rights.<sup>4</sup> Further, the federal lower courts have been uniform in setting a high bar for proving that prohibitively-high costs threatened to impede a plaintiff’s ability to effectively assert her legal rights.<sup>5</sup> Indeed, despite many efforts, few plaintiffs have ever cleared this fact-based, evidentiary hurdle.<sup>6</sup>

The *Italian Colors* plaintiffs sought to prove that high arbitral costs prevented them from vindicating their rights under the federal antitrust laws. First, these plaintiffs offered as evidence the American Express arbitration clause, which was forced upon every small merchant as a non-negotiable provision of the Card Acceptance Agreement. This arbitration clause explicitly prohibited any merchant from bringing or participating in class actions in court or in an arbitral forum, barred any joinder of claims, prohibited the sharing of “any information relating to” any claim, and prevented claimants from seeking relief “on behalf of . . . other [merchants].”<sup>7</sup>

<sup>3</sup> 531 U.S. 79, 90-1 (2000). In *Randolph*, the Court found that the consumer had not carried her burden to prove the costs of arbitration were prohibitive: “[T]he record does not show that [the consumer in this case] will bear such costs if she goes to arbitration. . . . The ‘risk’ that [the consumer] will be saddled with prohibitive costs is too speculative to justify the invalidation of an arbitration agreement.” *Id.*

<sup>4</sup> See, e.g., *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 481 (1989) (proof that federal statutory rights would be nullified by an arbitral forum is required, as mere “suspicion of arbitration as a method of weakening the protections afforded in the substantive law” is insufficient); *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247 (2009) (recognizing that arbitration agreements may not prevent claimants “from effectively vindicating their ‘federal statutory rights in the arbitral forum’”).

<sup>5</sup> See, e.g., *Booker v. Robert Half Int’l, Inc.*, 413 F.3d 77, 81 (D.C. Cir. 2005) (Roberts, J.) (finding that a party may “resist[] arbitration on the ground that the terms of an arbitration agreement interfere with the effective vindication of statutory rights,” but that party “bears the burden of showing the likelihood of such interference,” which “cannot be carried by ‘mere speculation’”).

<sup>6</sup> See, e.g., *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (concluding that an arbitration agreement which placed significant limitations on treble damages, attorney’s fees and costs, and aggregate procedures otherwise available under federal law “would prevent the vindication of statutory rights” and thus could not be enforced in an antitrust action against cable company under state and federal law); *Dale v. Comcast Corp.*, 498 F.3d 1216, 1223–24 (11th Cir. 2007) (holding arbitration agreements unenforceable in a putative class action under federal Cable Communications Policy Act).

<sup>7</sup> See *In re American Express Merchants’ Litigation*, 554 F.3d 300, 307-8 (2009) (*Amex I*) (“There shall be no right or authority for any Claims to be arbitrated on a class action basis or on any basis involving

Second, plaintiffs introduced undisputed evidence showing that an economic antitrust study necessary to prove that American Express had violated the Sherman Act would cost somewhere between “several hundred thousand dollars [to] \$1 million.”<sup>8</sup> Meanwhile, the median plaintiff could only hope to recover \$5,252 in trebled damages. Applying a common-sense cost-benefit analysis, plaintiffs showed that “it would not be worthwhile for an individual plaintiff ... to pursue individual arbitration or litigation where the out-of-pocket costs, just for the expert economic study and services,” would dwarf any individual claimant’s recovery.<sup>9</sup>

In three separate decisions, the Second Circuit ruled that the *Italian Colors* plaintiffs had met the heavy burden established in *Randolph* with evidence they “would incur prohibitive costs if compelled to arbitrate” because the non-recoverable, per-claimant costs of bringing their claims in arbitration (as opposed to aggregate proceedings in court) would exceed their expected individual recoveries many times over.<sup>10</sup>

But in the stroke of a pen, the Supreme Court’s decision in *American Express v. Italian Colors* undid decades of important law, essentially rejecting cost-based vindication of rights challenges to forced arbitration clauses. No longer does it matter whether an arbitration clause is designed to suppress rather than effectuate claims, or whether an arbitration procedure would strip plaintiffs of the ability to vindicate their statutory rights. Instead, the Supreme Court’s decision permits corporate defendants to draft arbitration clauses that effectively provide de facto immunity from all sorts of federal statutes.

And, lest anyone take comfort in the possibility that other legal challenges to forced arbitration clauses are possible – recall that the Court’s 2011 decision in *AT&T Mobility v.*

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Claims brought in a purported representative capacity on behalf of the general public, other establishments which accept the Card ( Service Establishments ), or other persons or entities similarly situated. Furthermore, Claims brought by or against a Service Establishment may not be joined or consolidated in the arbitration with Claims brought by or against any other Service Establishment(s), unless otherwise agreed to in writing by all parties.”)

<sup>8</sup> *Id.*, 554 F.3d at 316 (describing affidavit of Dr. Gary French).

<sup>9</sup> *Id.*, 554 F.3d at 317.

<sup>10</sup> *Id.* at 316 (stressing the significant outlay of expert fees -- estimated at over \$1 million -- and the fact that such fees are not recoupable by successful litigants under the cost-shifting provisions applicable in either court or arbitration). See also *In re Am. Express Merchs.’ Litig. (Amex II)*, 634 F.3d 187 (2nd Cir. 2011) (“the record evidence before us establishes, as a matter of law, that the cost of plaintiffs’ individually arbitrating their dispute with Amex would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws”); *In re Am. Express Merchs.’ Litig. (Amex III)*, 667 F.3d 204 (2d Cir. 2012) (observing that *Concepcion* did not mention or cite *Randolph*, nor did that case address whether an arbitration clause is enforceable “even if the plaintiffs are able to demonstrate that the practical effect of enforcement would be to preclude their ability to vindicate their federal statutory rights”).

*Concepcion*<sup>11</sup> essentially rejected any challenge based on how unfair these clauses can be. Taken together, *Concepcion* and *Amex* leave plaintiffs today with no viable means to challenge arbitration clauses, and allow businesses and employers to prevent those with less economic power from ever having access to court to hold them accountable. Claims alleging violations of all sorts of federal statutes will no longer be brought – neither in court nor in arbitration – because no rational individual would ever expend the tremendous amount of money and time required to prove such a claim, given the individual stakes. Violations of the Sherman Act, the Civil Rights Act of 1964,<sup>12</sup> the Consumer Credit Protection Act, and other vital federal statutes will never see the light of day. Under *Amex* and *Concepcion*, corporate entities are now free to craft agreements whose practical effect is to confer prospective immunity from liability under a wide range of federal statutes, undermining the remedial and deterrent effects of numerous federal statutes. And none of this furthers the policies of the FAA: while the FAA reflects a decidedly pro-arbitration policy, what it favors is the *resolution* of claims in arbitration, not the complete *elimination* of claims resulting from the terms of a forced arbitration agreement.

It is vital that Congress enact the proposed S. 878, “The Arbitration Fairness Act,” and restore the vindication of rights doctrine to ensure that federal judicial enforcement of forced arbitration agreements will not result in the wholesale foreclosure of federal statutory rights.

**Question 2:** In his opinion in the *Italian Colors* case, Justice Scalia wrote, in effect, that enforcing arbitration agreements is more important than giving workers, consumers, and small businesses an opportunity to vindicate their federal rights. It is difficult to imagine that the drafters of the Federal Arbitration Act ever would have envisioned the law being interpreted that way. Can you provide some historical perspective about the FAA’s intended purpose and scope and explain how we’ve strayed from that?

As nearly every legal historian researching and writing on the subject has concluded, the meaning and intent of the 1925 Federal Arbitration Act has been radically distorted by the

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<sup>11</sup> 131 S.Ct. 1740 (2011).

<sup>12</sup> This includes claims filed under Title VII, the Age Discrimination Act, the Rehabilitation Act, the Americans with Disabilities Act, the Fair Labor Standards Act, and the Family and Medical Leave Act. See, e.g., Civil Rights Procedures Protection Act of 1996, H.R. 3748, 104th Cong., 2d Sess. (1996); Civil Rights Procedures Protection Act of 1997, S. 63, 105th Cong., 1st Sess. (1997); Civil Rights Procedures Protection Act of 1999, S. 121, 106th Cong., 1st Sess. (1999); Civil Rights Procedures Protection Act of 2001, H.R. 1489, 107th Cong., 1st Sess. (2001).

current Supreme Court – such that its drafters and those who voted for the bill would be stunned by its current interpretation and operation.<sup>13</sup>

The Federal Arbitration Act was enacted in 1925 to promote arbitration among equally sophisticated parties in commercial and maritime contracts, and to counteract the ‘ancient judicial hostility’ to arbitration through its injunction that an arbitration provision “written in any maritime transaction or contract evidencing a transaction involving commerce” was enforceable, subject to “such grounds as exist at law or equity for the revocation of any contract.”<sup>14</sup> The legislative history reveals that the Act’s drafters were focused exclusively on opponents of “roughly equivalent bargaining power,” and the primary purpose of the statute was to encourage arbitration for purposes of preserving business relationships.<sup>15</sup> Time and again, legislators voiced their view that the FAA would promote voluntary arbitration between business entities seeking fast and inexpensive resolution of disputes.<sup>16</sup>

At the time of enactment and for many decades after, the universal understanding was that the FAA did not apply to ordinary consumer contracts, nor to employment agreements.<sup>17</sup> Indeed, when legislators worried the FAA might be applied to standard-form adhesion contracts with consumers,<sup>18</sup> they were assured that “the primary end of [the Act] is a contract between merchants, one with another, buying and selling goods.”<sup>19</sup> Further, supporters of the bill believed that arbitration should be purely voluntary, and that the FAA was “not intended to

<sup>13</sup> See, e.g., Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 Fl. S. U. L. REV. 99 (2006) (examining “how a simple procedural statute enacted to require enforcement of arbitration agreements in federal court has become unrecognizable as the law Congress enacted in 1925”); Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 381 (criticizing the Supreme Court’s “bogus legislative history” of the FAA).

<sup>14</sup> Federal Arbitration Act, 9 U.S.C. § 2.

<sup>15</sup> See Moses, *supra* note 13, at 102 (quoting Charles Bernheimer’s testimony at the Joint Hearings of the Senate and House Subcommittees that arbitration “preserves business friendships...it raises business standards, it maintains business honor”) (internal citations omitted).

<sup>16</sup> *Id.* at 111-112 (explaining that the legislative history clearly reveals that supporters of the FAA believed the Act would enable “merchants to resolve their disputes more cheaply and easily,” and that it was a “bill of limited scope, intended to apply in disputes between merchants of approximately equal economic strength to questions arising out of their daily relations”).

<sup>17</sup> *Id.* at 105-106 (“[T]he supporters of the legislation did not believe that it would apply to any workers at all.”); *id.* (“The hearings make clear that the focus of the Act was merchant-to-merchant arbitrations, never merchant-to-consumer arbitrations.”).

<sup>18</sup> *Id.* at 107 (quoting Senator Sterling, who asked at the Joint Hearings on the Act whether, “if you let people sign away their rights, the powerful people will come in and take away the rights of the weaker ones”).

<sup>19</sup> *Id.* at 107 (quoting W.H.H. Piatt’s testimony at Joint Hearings; Piatt was chairman of the Committee of Commerce Trade and Commercial Law of the American Bar Association).

permit a party with greater economic strength to compel a weaker party to arbitrate.”<sup>20</sup> And finally, the 1925 Congress understood that the lack of transparency in arbitration made it ill-suited for the adjudication of public-regarding disputes.<sup>21</sup> Questions regarding complex statutory interpretation and constitutional law were deemed beyond the jurisdiction of arbitrators, and best left to public courts of law.

This was the original understanding of the purpose FAA – to encourage and promote arbitration of disputes between relatively equal and sophisticated business interests. But by the mid-1980’s, “new majorities” of the Supreme Court reread the FAA to “permit arbitration for various legal claims and between parties of different bargaining capacities.”<sup>22</sup> Over time, with the backing of conservative, corporate interests, the FAA took on a life of its own. In 1984, the Supreme Court decided in *Southland Corp. v. Keating* that the FAA applied to state courts, essentially displacing state authority and ignoring clear legislative intent that the statute apply only to federal proceedings.<sup>23</sup> In 1991, the Court in *Gilmer v. Interstate/Johnson Lane Corp.* held that an employee alleging violations of the federal antidiscrimination laws could be forced to arbitrate his claims, again disregarding that the FAA was never intended to apply to contracts of adhesion nor to employment agreements.<sup>24</sup> And, in a series of cases, the Supreme Court has asserted that federally-created statutory rights – rights under the securities acts, antitrust statutes, and antidiscrimination laws – can be subject to forced arbitration.<sup>25</sup> This, despite unambiguous legislative history (and common sense) indicating that the 1925 Congress never intended to undermine its own power or the force of its laws by handing over enforcement of federal statutes to private arbitrators.

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<sup>20</sup> *Id.* at 108.

<sup>21</sup> *Id.* at 111 (quoting Julius Cohen, proponent of the Act, that arbitration was “not the proper method for deciding points of law of major importance involving constitutional questions or policy in the application of statutes” because these kinds of questions were not within the particular experience of arbitrators and thus were “better left to the determination of skilled judges with a background of legal experience and established systems of law”).

<sup>22</sup> Judith Resnik, Comment, *Fairness in Numbers: A Comment on AT&T v. Concepcion, Wal-mart v. Dukes, and Turner v. Rogers*, 125 HARV. L. REV. 78, 115 (2011).

<sup>23</sup> 465 U.S. 1 (1984); see also Kenneth F. Dunham, *Southland Corp. v. Keating Revisited: Twenty Five Years in Which Direction?*, 4 CHARLESTON L. REV. 331, 369 (2010) (asserting that, under *Southland*, “[s]tates are ordered by federal courts to enforce a federal act in state courts even though that act may be contrary to the public policy of the state”).

<sup>24</sup> 500 U.S. 20 (1991). See also *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 109, 119-24 (2001).

<sup>25</sup> See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 624-30 (1985); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 242 (1987); *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 480-84 (1989); *Gilmer*, 500 U.S. 20, 24-35 (1991).

In sum, the Supreme Court, often in 5-4 decisions, has slowly and steadily enlarged the FAA's scope in the face of serious public policy challenges, and often based on not much more than the Court's own assessment of arbitration as preferable to adjudication. Ignoring obvious problems with forced arbitration of public-regarding disputes – including the pragmatic concern that arbitration decisions are generally non-appealable, are secret and unpublished, and do not become a binding precedent – a slim majority of the Court has stretched the FAA beyond its original and intended goals.

At this point, given that Justices have now repeatedly asserted that they will continue to “rigorously enforce” the mandates of the FAA unless and until Congress acts, it is time to bring the FAA back into line with the original intent of the legislation – to enforce arbitration amongst and between sophisticated business entities that specifically negotiate and contract for private, sequestered forms of adjudication to protect their trade secrets or other business interests. The proposed S. 878, “The Arbitration Fairness Act,” would do just this – and it is not a radical overhaul of the statute. What is radical is the Supreme Court's reinterpretation of the 1925 Act to cover all sorts of contracts and disputes that were never intended by the original drafters.

**Question 3:** The Arbitration Fairness Act would prohibit mandatory, pre-dispute arbitration agreements in certain cases. If corporations knew that people had a choice to go to court after a dispute arose, would the corporations change their arbitration agreements? If so, how?

Enacting S. 878, “The Arbitration Fairness Act,” would prevent companies from using mandatory pre-dispute arbitration clauses to insulate themselves from liability. As I and many others have long argued, it is obvious that this liability-avoiding effect is the reason why companies use mandatory arbitration in their contracts with consumers and employees.<sup>26</sup> If this function were no longer available – if corporations knew that people had a choice to go to court

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<sup>26</sup> See, e.g., Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373(2005); Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 883 (2008) (finding that less than 10% of companies which imposed arbitration on consumers also used arbitration in negotiated, non-consumer, non-employment contracts and concluding that the “absence of arbitration provisions in the great majority of negotiated business contracts suggests that companies value, even prefer, litigation as the means for resolving disputes with peers . . . [and] casts doubt on the corporations' asserted beliefs in the superior fairness and efficiency of arbitration clauses”)

after a dispute arose one would expect companies to make their arbitration processes more consumer-friendly to encourage continued use of the arbitral fora.

What will these consumer-friendly clauses look like? It is not clear. For a brief time, between the Supreme Court's decisions in *AT&T Mobility v. Concepcion* in 2011 and *American Express v. Italian Colors* in 2013, corporations had strong incentives to draft arbitration clauses to include consumer-friendly provisions – such as offering to pay arbitration filing fees, providing for attorney and expert fee-shifting where the consumer won in arbitration, and promising premium payments to claimants who achieve a better outcome in arbitration than the company's last-best offer.<sup>27</sup> But these companies were using nominally “consumer friendly” clauses to convince courts that they did not run afoul of the vindication-of-rights doctrine, rather than as part of an effort to induce an employee or consumer to actually choose arbitration.<sup>28</sup>

Separate and apart from any incentives for companies to draft more consumer-friendly arbitration clauses, the proposed AFA would surely deter corporate defendants from engaging in wrongdoing that could result in class action liability. If companies knew they could be held accountable in court for widely-dispersed, small-dollar harms – as they have been for many decades before the advent of the Supreme Court's arbitration jurisprudence – they would presumably engage in less wrongdoing. Deterrence is, and has always been, the best justification for the class action device.<sup>29</sup> Companies tempted to skirt fair credit reporting requirements, or

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<sup>27</sup> See, e.g., Myriam Gilles, *Killing Them With Kindness: Examining “Consumer-Friendly” Arbitration Clauses After AT&T Mobility v. Concepcion*, 88 NOTRE DAME L. REV. 825 (2012) (reviewing recent amendments to arbitration clauses by 37 consumer-oriented companies and finding significantly “friendlier” offers to arbitrate).

<sup>28</sup> All that ended, of course, when Justice Scalia and his brethren in *Amex* rejected the plaintiffs' vindication of rights challenge. The *Amex* decision eliminated any corporate incentive to include more consumer-friendly terms in arbitration clauses. Instead, *Amex* provides companies (especially those with market power) with clear incentives to draft unfair and unfriendly clauses, which will ensure that federal statutory claims are never actually arbitrated. The irony is lost on no one: *Amex* defeats the purpose of the antitrust laws by allowing the defendant to use the very market power these laws were aimed at to require its customers to waive the protection of those laws.

<sup>29</sup> See, e.g., Harry Kalven, Jr., & Maurice Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684, 686 (1941) (warning against restricting the availability of class actions lest we “impair the deterrent effect of the sanctions which underlie much contemporary law”); RICHARD POSNER, *ECONOMIC ANALYSIS OF THE LAW* 349-50 (1972) (observing of class actions that “the most important point, from an economic perspective, is that the violator be confronted with the costs of his violation -- this achieves the allocative purpose of the suit--not that he pays them to his victims”); Kenneth W. Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest*, 4 J. LEGAL STUD. 47, 73 (1975) (concluding that the class action serves the deterrence purpose when “the individual claims are too small to make actual compensation of the class members financially feasible”); Arthur R. Miller, *Of Frankenstein Monsters and Shining Knights: Myth, Reality, and the “Class Action Problem.”* 92 HARV.

impose hidden and illegal fees, or engage in anticompetitive conduct are far more “concerned with ruinous liability at the hands of the class action bar than they are with the corrective measures and fines that might be meted out following” federal or state regulatory agency investigation.<sup>30</sup>

The Supreme Court’s decisions in *Concepcion* and *Amex* reject the “private attorney general” role undertaken by class action lawyers over the past fifty years, radically restricting the ability of private actors to vindicate public rights via the class action mechanism.<sup>31</sup> These decisions leave, in their wake, an enforcement gap that will be difficult for budget-strapped public agencies to fill.<sup>32</sup> Consumers, employees and others are left without recourse for violations of federal statutory law, while corporate actors are made invulnerable to the legislative will. The only viable solution is to return to a system where corporate actors are properly deterred from violating federal law by restoring private actors as frontline enforcers in actions redressing broad-scale consumer fraud and deceptive practices, antitrust violations, and civil rights violations.

**Question 4:** Some people have argued that corporations will refuse to submit post-dispute claims to arbitration unless mandatory, pre-dispute arbitration clauses are enforceable. In other words, people have argued that the Arbitration Fairness Act would remove corporations’ incentive to submit any claims to arbitration. How would you respond to this argument?

Nothing in the proposed legislation would bar a company and a consumer (or employee) from agreeing to arbitrate their disputes, once those disputes arise. The legislation only bars, or renders unenforceable, “pre-dispute” clauses – *i.e.*, mandatory arbitration clauses that companies insert in boilerplate agreement forms with their consumers and employees.

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L. REV. 664, 666 (1979) (asserting that empirical evidence suggests that the 1966 amendments to Rule 23 resulted in some deterrence).

<sup>30</sup> Myriam Gilles & Gary Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PENN. L. REV. 103, 106 (2007).

<sup>31</sup> See generally William B. Rubenstein, *On What A “Private Attorney General” Is -- And Why It Matters*, 57 VAND. L. REV. 2129 (2004).

<sup>32</sup> See, e.g., Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of AT&T Mobility v. Concepcion*, 79 U. CHI. L. REV. 623 (2012).

It may well be that some companies will have little interest in agreeing to arbitrate consumer and employment claims after they arise.<sup>33</sup> At that point, arbitration will no longer serve a liability-avoiding purpose; it will simply provide an alternative forum for the resolution of claims. Companies will then rationally make a cost-benefit determination of whether their interests are best served resolving disputes in these alternative fora; and for some, arbitration will continue to provide important benefits and savings.<sup>34</sup> Certainly, for claims that require collective action to be viable, we can expect plaintiffs to prefer the court system – at least until the arbitral bodies develop reliable processes for dealing with mass or class claims.<sup>35</sup>

**Question 5:** What is your initial assessment of the Consumer Financial Protection Board’s preliminary study on the use of mandatory pre-dispute arbitration agreements in the consumer financial services industry?

The preliminary results of the two-year CFPB study, released on December 12, 2013, provide positive, empirical proof of two important points relating to forced arbitration clauses.

<sup>33</sup> See, e.g., Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 883 (2008) (finding that less than 10% of companies which imposed arbitration on consumers also used arbitration in negotiated, non-consumer, non-employment contracts and concluding that the “absence of arbitration provisions in the great majority of negotiated business contracts suggests that companies value, even prefer, litigation as the means for resolving disputes with peers . . . [and] casts doubt on the corporations’ asserted beliefs in the superior fairness and efficiency of arbitration clauses”).

<sup>34</sup> See, e.g., Alexander J.S. Colvin, *Employment Arbitration: Empirical Findings and Research Needs*, DISP. RESOL. L.J. Aug.–Oct. 2009 (in a study comparing thousands of employment disputes handled in arbitration and in court, author finds (1) employees win substantially less often in arbitration than they do in court; and (2) when employees do win cases in arbitration, their awards are smaller than they would typically be in court; concludes that arbitration tends to favor large corporations over individuals).

<sup>35</sup> See Myriam Gilles & Tony Sebok, *Crowd-classing Individual Arbitrations in a Post-Class Action Era*, \_\_ DEPAUL. L. REV. \_\_ (forthcoming 2014) (finding that “the rules governing the dominant arbitral bodies do not provide for consolidation of related cases before a single arbitrator, nor is there any intra-arbitration *res judicata* effect awarded to prior victories”) (internal citations omitted); *id.* (“[N]either AAA nor JAMS currently have any discernible rules on how to obtain a single arbitrator for a set of related arbitrations, how to schedule related arbitrations in a compressed timeframe, or how to use a single expert report across multiple arbitrations. There are no ‘best practices’ governing damages calculations or the alignment of awards across arbitrations. Nor do the major arbitral associations currently offer volume discounts on arbitral costs or neutrals’ fees for those seeking to arbitrate a mass of related claims.”).<sup>36</sup> CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY PRELIMINARY RESULTS (Dec. 12, 2013) at p. 12, available at [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf). The study finds that over 50% of outstanding credit card debt is subject to forced arbitration clauses – and that, once a 3-year moratorium on imposing such clauses comes to an end in 2014, 94% of credit card debt will be subject to these clauses. *Id.* Further, 44% of checking account contracts and 81% of prepaid cards contain forced arbitration clauses. *Id.*

First, the study makes clear that these clauses have become standard in the contracts of the biggest credit card companies, banks, and payday lenders.<sup>36</sup> Moreover, nearly all the forced arbitration clauses the agency studied contain class action bans.<sup>37</sup> This key finding confirms prior studies, which have similarly found that forced arbitration clauses containing class action bans are becoming ubiquitous in all sorts of consumer contracts,<sup>38</sup> including contracts with nursing homes, assisted living facilities, and long-term-care providers<sup>39</sup>; as well as in employment contracts.<sup>40</sup>

Second, the CFPB study confirms what many observers and academics have long suspected: that arbitration clauses work to suppress rather than effectuate dispute resolution. The CFPB study found that between 2010 and 2012, more than 13 million consumers made claims or received payments in roughly four hundred class actions brought against credit card companies, payday lenders, and other specified types of financial service providers. During that same time frame, the study found that only 900 consumers initiated claims directly against such defendants in arbitrations under their contracts. 13 million versus 900.

This is incontrovertible evidence that forced arbitration clauses do not result in the fair and efficient resolution of claims, but rather, in burying claims and denying rights guaranteed under federal statutes.

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<sup>36</sup> CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY PRELIMINARY RESULTS (Dec. 12, 2013) at p. 12, available at [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf). The study finds that over 50% of outstanding credit card debt is subject to forced arbitration clauses – and that, once a 3-year moratorium on imposing such clauses comes to an end in 2014, 94% of credit card debt will be subject to these clauses. *Id.* Further, 44% of checking account contracts and 81% of prepaid cards contain forced arbitration clauses. *Id.*

<sup>37</sup> *Id.* at p. 13 (“Around 90% of the contracts with arbitration clauses -- covering close to 100% of credit card loans outstanding, insured deposits, or prepaid card loads subject to arbitration -- include such no-class arbitration provisions.”).

<sup>38</sup> See, e.g., Linda J. Demaine & Deborah R. Hensler, “Volunteering” to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer’s Experience, 67 LAW & CONTEMP. PROBS. 55, 64 (2004) (finding 69.2% of consumer contracts studied contained forced arbitration clauses); Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J. L. REFORM 871, 883-884 (2008) (76.9% of consumer contracts studied contained forced arbitration clauses and “every consumer contract with an arbitration clause also included a waiver of classwide arbitration.”).

<sup>39</sup> See, e.g., Lisa Tripp, *Arbitration Agreements Used by Nursing Homes: An Empirical Study and Critique of AT&T Mobility v. Concepcion* (draft on file with the author) (finding that 43% of North Carolina nursing homes use arbitration clauses in their admissions contracts).

<sup>40</sup> See, e.g., Alexander J.S. Colvin, *Employment Arbitration: Empirical Findings and Research Needs*, DISP. RESOL. L.J. Aug.–Oct. 2009.

**Question 6:** Mr. Parasharami attached to his written testimony a document titled, “Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions” by Mayer Brown LLP. What is your assessment of that document?

This memo, drafted by lawyers at the defense firm, Mayer Brown LLP, purports to examine class actions filed or removed to federal court in 2009, and concludes that none of these proceedings produced any real value to class members. The memo finds that only plaintiffs’ attorneys were benefited by class and aggregate litigation. This is a shop-worn narrative repeatedly invoked by acolytes of the Chamber of Commerce: the basic idea is to focus attention on the large fees awarded to class action lawyers, rather than the many hundreds of millions extracted from citizens by corporate malfeasance.

This memo was produced by lawyers whose clients include AT&T Mobility, American Express, and other Fortune 500 companies – all of which have a strong interest in retaining the immunity from class action liability secured in the Supreme Court’s recent arbitration decisions. One potential threat to this de facto immunity from federal antitrust, antidiscrimination and consumer protection laws is the Consumer Financial Protection Bureau, which has the authority under the Dodd-Frank Consumer Protection Act to enact regulations that would restrict or even prohibit the use of forced arbitration clauses.<sup>41</sup> Not surprisingly, the Mayer Brown memo was released on the same day that the CFPB issued the preliminary results of its two-year study of arbitration clauses in consumer financial contracts. This shrewd timing ensured the Mayer Brown memo would receive some media coverage (whereas, ordinarily, this type of document barely gets read by lawyers within the firm, much less those on the outside). In all likelihood, the timing was also intended to detract from the rigorous, careful, and conclusive study done by the agency, and to start coalescing opposition against its possible regulatory efforts in this area.

In addition, there are a number of glaring methodological concerns with a result-driven memo of this sort. For example, the memo’s authors chose to examine 148 class actions, but acknowledge that this number does not represent all the class actions filed or removed in 2009,

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<sup>41</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) § 1028, Pub. L. No. 111-203, 124 Stat. 1376, 2003–04 (2010), codified in relevant part at 12 USC § 5518.

nor what percentage it does represent.<sup>42</sup> Without context, it is impossible to know whether these cases are a representative sample, or were simply chosen because they advance the corporations' claims that class action serve no purpose. Further, in analyzing awards to class members, the memo focuses on only 6 of the aforementioned 148 class actions – and again, without explanation or qualification. One could go on and on pointing out errors and omissions, but suffice to say that this document is not a “study,” but rather, a white paper drafted by and for corporate interests which is solely intended to distract attention away from the real policy debate over S. 878 and the perils of forced arbitration.

**Question 7:** Professor Rutledge attached to his written testimony a document titled, “Sticky Arbitration Clauses: The Use of Arbitration Clauses after *Concepcion* and *Amex*”. What is your assessment of that document?

Professors Rutledge and Drahozal have written an article, *Sticky Arbitration Clauses*, which purports to examine changes to franchise agreements immediately before and after the Supreme Court's decision in *Concepcion* to determine whether there has been an increase in the use of arbitration clauses. The authors conclude that, in this quite limited arena of contracts between relatively sophisticated business entities, “the predicted tsunami of arbitral class waivers” has not yet occurred.”<sup>43</sup> But the franchisor-franchisee relationship is so different from typical business-to-consumer or business-to-employee relationships that this study seems entirely irrelevant to the policy debate surrounding forced arbitration. Indeed, the authors may be right in their assessments as to why some franchisors may not wish to add arbitration clauses with class action bans to contracts with equally sophisticated franchisees with whom they hope to maintain lasting business relations. But this analysis tells us little about consumer and employment contracts, where businesses have few reasons to refrain from adopting liability-reducing arbitration provisions.<sup>44</sup>

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<sup>42</sup> *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* at \_\_\_ (“the sample is undoubtedly smaller than the total number of class actions filed in 2009. Attempting to estimate that number reliably -- let alone to examine those cases -- would have exceeded the scope of our review... it would not be useful to calculate a margin of error or otherwise attempt to quantify the extent to which the sample differs randomly from the population of all class actions filed in 2009”).

<sup>43</sup> Peter Rutledge & Christopher Drahozal, *Sticky Arbitration Clauses: The Use of Arbitration Clauses After Concepcion and Amex*, \_\_\_ VAND. L. REV. \_\_\_ (2013)

<sup>44</sup> See, e.g., Eisenberg, et al., *supra* note \_\_\_ (finding that less than 10% of companies which imposed arbitration on consumers also used arbitration in negotiated, non-consumer, non-employment contracts and concluding that the “absence of arbitration provisions in the great majority of negotiated business

In addition, somewhere between 50-66% of franchisors were already using arbitration clauses long before *Concepcion* was decided. Therefore, while the authors conclude that few franchisors have *added* arbitration provisions to their contracts since 2011, this merely obscures the reality that many franchisors have relied on these liability-avoiding provisions for many years before *Concepcion* was decided.

More fundamentally, I disagree with an underlying premise of the article – that standard-form contracts can be “sticky,” or resistant to change that is in the defendant corporation’s best interests. This sort of claim has been refuted by many scholars in various contexts, but is especially weak in the context of arbitration and class action bans. For example, back in 2008, Professor Aaron-Andrew Bruhl demonstrated that, “given the recent successes of unconscionability challenges, the most aggressive arbitration clauses are now being scaled back.”<sup>45</sup> In other words, at the height of unconscionability’s success in beating back arbitration clauses, companies responded by redrafting their provisions to make them less vulnerable to that challenge.

Moreover, in the four-year period between *Buckeye Check Cashing, Inc. v. Cardegna*<sup>46</sup> and *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*,<sup>47</sup> some arbitrators were interpreting contracts that were silent on collective dispute resolution to nonetheless provide for class arbitration. As a result, “[b]usinesses moved quickly to block the possibility of collective redress in any forum, judicial or arbitral” by adding severability and no-class-arbitration language to their contracts.<sup>48</sup> In my view, standard-form contractual provisions are not at all “sticky” or

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contracts suggests that companies value, even prefer, litigation as the means for resolving disputes with peers . . . [and] casts doubt on the corporations’ asserted beliefs in the superior fairness and efficiency of arbitration clauses”).

<sup>45</sup> Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420, 1457, n. 141 (2008). Bruhl continues: “Some business advocates provide such an account, admitting that some early arbitration provisions were unduly burdensome but contending that the clauses have now improved to become more attractive to consumers.” *Id.* (citing Brief of AT&T Mobility LLC as Amicus Curiae in Support of Neither Party, *T-Mobile USA, Inc. v. Laster*, 128 S. Ct. 2500 (2008) (“[C]onsumer arbitration provisions have been evolving. At first, many provisions plainly favored the business that drafted them. Invoking state unconscionability principles, several courts struck down these clauses . . .”).

<sup>46</sup> 546 U.S. 440, 449 (2006).

<sup>47</sup> 130 S. Ct. 1758 (2010).

<sup>48</sup> See Ann Marie Tracey & Shelley McGill, *Seeking a Rational Lawyer for Consumer Claims After the Supreme Court Disconnects Consumers in AT&T Mobility LLC v. Concepcion*, 45 LOY. L. A. L. REV. 435, 440 & 448 (2012) (“It will take only seconds for businesses to amend unilaterally their online contracts of adhesion and remove class actions from existence, assuming they have not already done so.”).

resistant to change where that change is in the best interests of the defendant-contract drafter. Whether the current number of contracts containing arbitration clauses is 50% or 99% seems of little significance when it is clear that, at some point soon, *all* businesses which believe it is in their best interests to avoid potential class action liabilities will incorporate arbitration provisions barring class and aggregate litigation in court or in the arbitral fora.

# CARDOZO

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**Myriam Gilles, Professor of Law**  
**January 13, 2014**

**Senate Judiciary Committee Hearing**  
**“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**

**Responses to Questions for the Record Submitted by Senator Orrin Hatch**

**Question: Professor Gilles, I’m wondering whether the case against arbitration is really so complete that we should prohibit arbitration clauses altogether. For example, have you considered whether arbitration might facilitate dispute resolution for borrowers pursuing their own cases or borrowers in remote areas? Or have you studied the improvements that have been made in how arbitrations are conducted?**

The purpose of S.878, “The Arbitration Fairness Act,” is not to prohibit arbitration clauses altogether. Rather, the proposed legislation would only prohibit “pre-dispute” clauses – *i.e.*, mandatory arbitration clauses that companies insert in boilerplate forms with their consumers and employees. Further, the proposed legislation does not undermine the institution of arbitration. Indeed, the AFA specifically provides for arbitration in situations where both parties agree to this form of alternative dispute resolution.

But to be clear: the Supreme Court’s decisions in cases such as *AT&T Mobility v. Concepcion* and *American Express v. Italian Colors* are not about the efficacy or desirability of

arbitration. These decisions deny claimants the right to challenge a forced arbitration clause banning class actions. And in doing so, *Concepcion* and *Amex* ensure that no consumer, employee or small business will be able to vindicate their federal statutory rights -- not in court or in the arbitral fora -- and that businesses will be effectively immune from liability under these statutes. These decisions are about claim suppression, not claim facilitation.

As such, it matters little whether arbitration may, on occasion and in specific instances, facilitate dispute resolution for borrowers in remote places, or whether arbitration procedures have improved in recent years. The relevant questions, to my mind, are (1) whether forced arbitration suppresses claims overall; (2) whether this claim suppression results in under-enforcement of federal statutory law; and finally, (3) whether the ultimate result is de facto immunity from federal law for the corporations which have used their market power to impose these arbitration clauses upon consumers, employees and small businesses. I think the answer to all three questions is clearly yes.

RESPONSES OF VILDAN TESKE TO QUESTIONS SUBMITTED BY SENATOR FRANKEN

**Senate Judiciary Committee Hearing  
“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions  
Undermine the Rights of Consumers, Workers, and Small Businesses?”**

**Questions for the Record Submitted by Senator Al Franken for Vildan Teske**

**Question 1:** I’ve heard some employment advocates point to the Lilly Ledbetter case as another good illustration of why the Arbitration Fairness Act is necessary. Can you discuss that?

**ANSWER**

The Lilly Ledbetter case is a good example of why consumers, workers, and servicemembers need access to our country’s open public justice system rather than being forced into secretive arbitration proceedings. Because her case was litigated in our public court system, we now have the Lilly Ledbetter Fair Pay Act of 2009.

Ms. Ledbetter filed a Title VII case against her employer, Goodyear, for pay discrimination based on gender. The legal issues in her case went up to the U.S. Supreme Court. The Supreme Court decided against her, holding that her case was filed too late, even though Ms. Ledbetter continued to receive discriminatory pay. The Supreme Court ruled that workers cannot challenge ongoing pay discrimination if the employer’s original discriminatory pay decision occurred more than 180 days earlier, even when the employee continues to receive paychecks that have been discriminatorily reduced. This decision severely limited the ability of victims of pay discrimination to sue and recover damages under Title VII of the Civil Rights Act of 1964. It also undermined the Congressional goal of eliminating pay discrimination in the workplace. Recognizing the unfairness of having the 180 days begin at the time the discriminatory pay decision was made by the employer (which could be many years before the employee learns that she is being discriminated against and that others are being paid more for the same work, as was in Ms. Ledbetter’s case), Congress took action. It passed the Lilly

Ledbetter Fair Pay Act which made clear that the statute of limitations clock is reset with each paycheck that is the result of discriminatory pay decision.

Had Ms. Ledbetter's employment contract contained a forced arbitration clause, the outcome would have been very different. Her case would have been forced into private arbitration and the public would not have known about the discrimination and the legal issues involved in her case. Nor would Congress have become aware of the unfairness of applying the statute of limitations in the way it was in her case. Employers that chose to discriminate in pay could have continued to do so because the employee's ability to challenge the practice would be foreclosed by an unfair application of the statute of limitations. We might have had many Lilly Ledbetters, i.e. victims of discrimination based on gender, race, age, disability, or religion, but the public, and Congress, would not have known about it. Our country would not have had the public discourse regarding this very important issue and we would not have had the resulting legislation. Simply put, forced arbitration keeps illegal practices from coming to light.

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**Question 2:** Some people have argued that limiting class actions – as *Concepcion* did – is a good thing because class actions benefit plaintiffs' lawyers and nobody else. Can you respond to that argument and talk about the value of class actions?

**ANSWER**

When individuals are forced into arbitration and their rights to bring class actions is cut off, the corporate wrongdoer benefits. Class actions are often the only way that American servicemembers, consumers, small business owners and workers can hold corporations accountable for wrongdoing. When facing powerful and well-funded corporate defendants engaged in reckless and corrupt behavior, class actions level the playing field by allowing injured Americans to bring their claims by banding together. This is especially important when

it is economically infeasible to bring a case as an individual action. Class actions give persons who are injured in the same manner by the same defendant the ability to hold the wrongdoers accountable.

Class actions are an efficient mechanism to deal with what would otherwise be a large number of small and repetitive cases with the same facts and the same law. Through class certification, courts can consolidate similar cases, conserving judicial resources.

Our court system has in place a number of tools to ensure class actions are litigated in a manner fair to both plaintiff class members and to the defendant(s). Federal Rule of Civil Procedure 23 (and its state law counterparts) governs the procedures to be followed in class actions and provides important safeguards whenever a case is litigated as a class action. Not only is there a high bar for which cases are certified as a class action, but there is also a stringent body of law requiring any class action settlement be reasonable and fair to the class members. All class settlements must be approved by the court after meticulous review of the settlement agreement's terms and, most importantly, the benefits to the class members. Furthermore, most class cases are litigated on a contingency fee system. The attorneys representing the plaintiff class members only get paid if they provide a benefit to the class members and only after the court has carefully reviewed and approved any fees.

If any class member feels a settlement is unfair, or the attorney fees being sought are unmerited, they can object to the settlement and ask the judge not to approve it. After the judge approves the settlement (and any counsel fees), any interested party can appeal that order. In other words, our public system of civil justice along with the body of class action law that has developed over the last five decades, provides the tools to ensure the class action process is fair and just.

Indeed, class actions have a proud history and have played a central role in some of the most pivotal moments in our nation's social justice trajectory. Perhaps the crowning achievement of class actions lies with *Brown v. Board of Education*, the U.S. Supreme Court's seminal case outlawing racial segregation. Class action litigation has, likewise, borne positive results in the form of safer consumer products, such as automobiles, children's toys and pharmaceuticals; safer workplaces; ending discrimination in the workplace based on race, gender, religion, disability and age. The argument that only plaintiffs' lawyers benefit from class actions defies logic given the reality that, in the last half century, the everyday lives of Americans have vastly improved thanks to class action litigation.

Class actions have also uncovered a number of consumer financial frauds that would have continued if left unchallenged - like charging illegal interest fees, adding on bogus fees and charges to accounts, and siphoning illegal, albeit relatively small, amounts of money from millions of consumers. Also, unlike in a forced private arbitration, a class action allows a plaintiff to ask for injunctive relief to stop a defendant from continuing its illegal practices or policies so that other consumers, servicemembers, workers, and small businesses will not have their rights violated in the future. In my own practice, my colleagues and I have been able to recover millions of dollars for consumers and servicemembers in class actions that exposed and stopped illegal and fraudulent practices. It is almost certain that, had we not taken on those cases, the many class members we represented would not have obtained any redress absent the class action procedure. Had those cases been forced into private, individual arbitrations, only a very small percentage of those that had been victimized by the illegal practice would have been able to receive any relief.

In conclusion, as a result of *Concepcion*, forced arbitration clauses that ban collective or class actions have an enormously negative impact on servicemembers, consumers, small business owners and workers whose claims can be small individually, but large in the aggregate and for whom it is not economically possible to file a claim on an individual basis in any forum, arbitration or court. The result is that corporations that choose to break the law are immune and are never held accountable in any forum.

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**Question 3:** You testified that mandatory, pre-dispute arbitration clauses and class actions allow corporations to get away with illegal and abusive practices perpetrated against service members. Please explain the impact that these practices have on service members' finances, readiness, rankings, and careers.

**ANSWER**

Mandatory, pre-dispute arbitration clauses and class action bans in consumer contracts give corporate wrongdoers a get out of jail free card when they break the laws that protect our country's servicemembers. Illegal conduct is much less likely to be challenged when such clauses are in servicemembers' consumer contracts. A servicemember should have the ability to bring a court action to represent not only himself, but also all the other servicemembers that were subjected to the same illegal conduct by the same defendant.

Illegal and abusive practices such as predatory and deceptive lending, wrongful foreclosures, illegal repossessions of servicemember vehicles, illegal fees and interest rates on servicemember loans, among other violations of the law, impact our servicemembers in a variety of negative ways. A servicemember that experiences financial difficulties, exacerbated further by illegal actions taken by creditors, faces the possibility of disciplinary action by his or her unit. Such disciplinary action can include letters of reprimand, non-judicial punishment, loss of

promotions, and in the extreme case, separation from the military.<sup>1</sup> One of the main concerns for my servicemember clients that have faced financial difficulty and adverse action by their creditors is the potential for losing their security clearance. Loss of security clearance may result in a demotion or the loss of the opportunity to advance in their career.

Furthermore, financial problems caused or exacerbated by a creditor's illegal actions against a servicemember jeopardize troop readiness when a servicemember is under stress and is unable to devote all of his or her energy to the defense needs of the nation.<sup>2</sup> Our military members should not have to be worrying about whether their house is going to be foreclosed, or whether their family vehicle is going to be repossessed while they are deployed.

Our servicemembers deserve to know that creditors will not be allowed to break the laws meant to protect our military, and then hide behind forced arbitration clauses and class action bans. Servicemembers must have access to our public court system and have the ability to band together in a class action when their rights are violated.

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<sup>1</sup> *See e.g.* Department of Defense, Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents (Aug. 9, 2006), pp. 42-43, <http://1.usa.gov/rVdafq>.

<sup>2</sup> *Id.* at p. 53.

RESPONSES OF ARCHIS PARASHARAMI TO QUESTIONS SUBMITTED BY SENATORS  
FRANKEN AND GRASSLEY

**Senate Judiciary Committee Hearing**  
**“The Federal Arbitration Act and Access to Justice:**  
**Will Recent Supreme Court Decisions Undermine the**  
**Rights of Consumers, Workers, and Small Businesses?”**

**Questions for the Record Submitted by**  
**Senator Al Franken for Archis Parasharami**

**Question 1: Before *Italian Colors* was decided, you wrote that corporations should consider removing certain provisions from their arbitration agreements. These included costs that are excessive in the context of small claims, waivers of substantive rights available under applicable laws, and requirements that people travel to distant places to arbitrate. Today, do you advise corporations to remove these features from the arbitration agreements they have with their consumers and workers?**

Both before and after the Supreme Court’s decision in *American Express v. Italian Colors Restaurant*, I have written that companies should consider adopting arbitration provisions that are favorable to consumers and employees. As I wrote in a subsequent version of the article referred to in the question—one published in August 2013, some months after the *Italian Colors* decision:

“Some unconscionability challenges attack features of the arbitration agreement that arguably tilt the process in favor of the company, such as requirements that consumers or employees pay arbitration costs that are excessive in the context of small claims, waive substantive rights available to remedy an individual’s claims under applicable law or travel to distant places to arbitrate. Many of these features are common in business-to-business agreements. To forestall unconscionability challenges, companies should consider removing these artifacts of older business agreements from their consumer or employee arbitration agreements. In addition, drafters may consider adding some or all of the following hallmarks of pro-consumer arbitration provisions”:

- “Low-cost or cost-free arbitration: Make arbitration affordable for customers and employees. Consider offering to pay the full costs of arbitration for modest-size claims.
- “Mutuality: To the greatest extent possible, both parties should be obligated to arbitrate claims, and any exceptions to arbitration should be fully mutual.
- “Do not impose limits on legal remedies: Courts remain skeptical of efforts to bar statutory or punitive damages and recovery of statutory attorneys’ fees or to shorten statutes of limitations.

- “Offer a convenient location for the non-business party: Courts are reluctant to enforce arbitration agreements that require a consumer or employee to cross the country to arbitrate.
- “Confidentiality: Although confidentiality is often thought of as a benefit of arbitration, some courts have expressed concerns with arbitration agreements that require a consumer or employee to keep the results of arbitration secret.
- “Neutral arbitrator-selection process: When specifying an organization as the forum for arbitration of disputes, make sure that the organization and its process for selecting arbitrators are reputable and unbiased.”

I further stated in the article that “given the Supreme Court’s ruling in [*AT&T Mobility LLC v. Concepcion*], companies that adopt arbitration provisions similar to AT&T’s clause will likely benefit from what one judge has described as a ‘safe harbor.’”

Although I cannot comment on confidential legal advice I provide to specific clients, I can state that, in general, I offer views similar to those expressed above when counseling clients about how to adopt or revise consumer and employment arbitration agreements.

**Question 2: During the hearing, Ms. Teske testified about a service member who tried to file a class action lawsuit under the Servicemembers Civil Relief Act (SCRA) after a bank illegally foreclosed on his home while he was serving in Iraq. Ms. Teske put forth evidence indicating that other service members’ SCRA rights also had been violated because of the bank’s policies and practices. However, because the service member’s mortgage documents included a mandatory, pre-dispute arbitration clause and a class action waiver, the service member’s case was dismissed, and he was unable to bring either a class action or a class arbitration. As a result, it is likely that other service members are unaware of their SCRA rights or that those rights may have been violated. Does this seem like a just result to you?**

Please let me begin by reiterating what I indicated at the hearing: I support our service members and am truly grateful for their service to this Nation. In addition, I oppose any violations of the substantive legal rights of our service members.

It is not possible to assess the case described in the question without more information. Unfortunately, Ms. Teske’s testimony fails to identify the case in question. I understand from Ms. Teske’s testimony that, after the arbitration provision was enforced, the service member she represented was able to obtain a

settlement of his claims on an individual basis. I would need more information about the settlement to offer any views on whether the service member achieved a just result.

The question also appears to ask whether it was appropriate that the service member was able to achieve an individual settlement only, instead of pursuing claims on behalf of other service members who were potential members of a class. Again, without knowing more about the case, it is not possible to determine whether, in the absence of an arbitration agreement, a class action would have delivered meaningful benefits to class members. As I discussed in my testimony, my law firm conducted a study of class actions that showed that the vast majority of consumer class actions that are filed do not result in significant benefits to members of the proposed class. In the absence of any information, it is hard to tell whether Ms. Teske's class action fits with the majority of class actions that do not afford most class members significant benefits or instead would have stood as an exception to the rule.

In looking more broadly than the case mentioned by Ms. Teske and considering dispute resolution for service members overall, it is my view that arbitration can provide service members with an inexpensive and simple means of accessing justice. Because arbitration offers procedural flexibility, service members can pursue arbitration through conference call or by documentary submissions; arbitration rules also often permit, after the initial submission, subsequent submissions by email. Service members therefore would not have to take time off work to pursue their disputes. And, under most modern arbitration agreements, businesses pay most or all of the costs of arbitration—therefore subsidizing dispute resolution to a much greater extent than litigation in court.

Moreover, the government can—and I believe, has a special responsibility to—help service members whose legal rights may have been violated. It can do so in at least two ways.

First, the CFPB has supervision and examination powers that can help monitor potential violations of service members' rights, as well as enforcement authority with respect to consumer protection laws.<sup>1</sup> The CFPB has created an Office of Servicemember Affairs. That office, according to a letter on the CFPB's web site by Holly Petraeus, "will ask CFPB bank and non-bank examiners to keep an eye out for military-specific issues. When we find out about people breaking consumer financial protection laws to harm servicemembers, we'll help CFPB

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<sup>1</sup> See 12 U.S.C. § 5514(a)(1) (providing for supervisory authority over certain nonbank covered persons); *id.* § 5514(c) (enforcement authority); *see also* Defining Larger Participants of the Consumer Reporting Market, 77 Fed. Reg. 42,874 (July 20, 2012) (codified at 12 CFR Part 1090) (addressing scope of supervision authority over nonbank covered persons under § 5514).

enforcement teams take action against them. And we plan to make it easy for military personnel and their families to contact the CFPB with questions or complaints about consumer financial products and services.”<sup>2</sup> Thus, especially if there were a systemic problem that adversely affected our service members, the CFPB possesses the authority and ability to assist them.

Second, the Judge Advocate General’s Corps for the branches of the armed services provide legal assistance to service members and retirees; this legal assistance extends to providing advice about real property disputes and the Servicemembers’ Civil Relief Act.<sup>3</sup>

In these ways, the government can help protect the legal rights of our service members without the burdens associated with class action litigation.

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<sup>2</sup> <http://www.consumerfinance.gov/petraeus-letter/>.

<sup>3</sup> For example, the Regional Legal Service Office, Naval District Washington, provides legal assistance to individuals in “Maryland, Northern Virginia, and the District of Columbia.” Its website states that it allows “service members and their dependents, reservists on active duty for 30 days or more, and retirees, as resources permit” to obtain assistance in a number of areas, including “Real Property,” “SCRA,” and “Consumer/Financial Affairs” issues. *See* [http://www.jag.navy.mil/legal\\_services/rlso/rlso\\_naval\\_district\\_washington.htm](http://www.jag.navy.mil/legal_services/rlso/rlso_naval_district_washington.htm).

**“The Federal Arbitration Act and Access to Justice:  
Will Recent Supreme Court Decisions Undermine the  
Rights of Consumers, Workers, and Small Businesses?”**

**Questions for the Record Submitted by  
Ranking Member Charles E. Grassley  
December 20, 2013**

**Questions for Archis Parasharami**

- 1. The Supreme Court has stated that class action waivers in an arbitration agreement will be enforced. However, there are alternatives to class actions such as cost sharing or cost shifting. These tools may allow individual claimants to pursue what would otherwise be cost-prohibitive small claims. Please explain how small, but costly, claims will proceed? Also, please describe the alternatives to class actions and how they are used.**

As I described in my written testimony (at pages 18-19), there are a variety of ways to pursue claims in individual arbitration that are relatively small in size but may be costly to prove.

Significantly, even the dissenting Justices in *American Express Co. v. Italian Colors Restaurant*<sup>1</sup> recognized that that class procedures are not necessary to vindicate small individual claims because “non-class options abound” for pursuing claims under federal law in individual arbitration.

For example, many arbitration provisions provide for some combination of (i) incentive or bonus payments designed to encourage the pursuit of small claims, and (ii) the shifting of expert witness costs and attorneys’ fees to defendants when the consumer or employee prevails on his or her claim. The AT&T provision at issue in *AT&T Mobility LLC v. Concepcion*<sup>2</sup> contains such features. If a consumer obtains an arbitral award that is greater than AT&T’s last settlement offer, he or she will receive a minimum recovery of \$10,000 plus twice the amount of attorneys’ fees that his or her counsel incurred for bringing the arbitration. In addition, under such circumstances, the company is required to reimburse such a customer for reasonable expert witness fees.

As the dissenting Justices in *American Express* acknowledged, when an arbitration provision “provide[s] [such] an alternative mechanism to . . . shift . . . the necessary costs” of proving a claim, that eliminates any concern about the ability of individual

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<sup>1</sup> 133 S. Ct. 2304 (2013).

<sup>2</sup> 131 S. Ct. 1740 (2011).

plaintiffs to vindicate their rights in arbitration.<sup>3</sup> A number of companies have adopted approaches that are similar to AT&T's arbitration provision.

The *American Express* dissenting Justices further recognized that “informal coordination among individual claimants” would allow those claimants to share the same lawyer, experts, and costs of proof, thereby reducing the costs to each claimant.<sup>4</sup> For example, an entrepreneurial plaintiffs’ lawyer can recruit large numbers of clients (via the internet, social media, or other similar means), file thousands of individual arbitration demands on behalf of those clients, and distribute common costs over all those claimants, making the costs for expert witnesses and fact development negligible on a per-claimant basis.

The litigants before the Supreme Court also recognized that cost-sharing can support the vindication of small claims in individual arbitration.

As mentioned at the first panel at the Hearing, the brief of the United States in *American Express* stated that companies can “adopt[] arbitration procedures that can feasibly be invoked even for small-value claims.” The brief also stated that “many companies have modified their agreements to include streamlined procedures and premiums designed to encourage customers to bring claims.”<sup>5</sup>

In addition, counsel for Italian Colors Restaurant explained in its brief to the Supreme Court that although “[t]he cost-sharing available in class-action litigation provides one mechanism to address the high expert costs” necessary to prove their claim, “it is far from the only mechanism.” Indeed, they explained, “[b]ilateral arbitration *remains feasible* if costs can be shared or shifted,” as under the “arbitration clause at issue in *Concepcion*.”<sup>6</sup>

With these principles in mind, some plaintiffs’ lawyers are already beginning to institute multiple individual arbitrations or small claims actions—especially in view of the ability to reach multiple, similarly situated individuals using websites and social media. Indeed, this strategy for spreading litigation costs is an increasingly common means of pursuing disputes in arbitration:

- One of the lead counsel for the plaintiffs in *American Express* indicated at a Practising Law Institute program that if the Supreme Court compelled arbitration the plaintiffs could, and would, pursue their claims through

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<sup>3</sup> 133 S. Ct. at 2318 (Kagan, J., dissenting).

<sup>4</sup> *Id.*

<sup>5</sup> Brief for the United States as Amicus Curiae Supporting Respondents at 24, 28, *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) (No. 12-133), 2013 WL 367051.

<sup>6</sup> Brief for Respondents at 17-18, 37, *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) (No. 12-133), 2013 WL 267025 (emphasis added).

individual arbitrations by using this cost-spreading approach.<sup>7</sup> While that counsel ultimately entered into a settlement, *Law360* later reported that, as part of the settlement, any claimant who pursued individual arbitrations would have “access to the entire litigation record from the nearly decade-long antitrust battle, as long as the merchant signs a confidentiality agreement.” As counsel for the plaintiffs explained: “We fought really hard for that, to make the arbitration process as viable as it can be.” He continued by acknowledging that “merchants representing 70 to 80 percent of AmEx’s charge volume” would be able to “avail themselves” of the arbitration process.<sup>8</sup>

- The Internet and social media have made it easier than ever for aggrieved consumers to find each other. One lawyer “set up a website to recruit plaintiffs” to bring multiple small-claims cases alleging marketing of credit information.<sup>9</sup> Similarly, a former lawyer who sued an automaker in small-claims court after opting out of a class action set up a website along with profiles on Twitter and Facebook and a video on YouTube to publicize her case. She was as a result “contacted by hundreds of other car owners seeking guidance in how to file small claims suits if they opted out of” the class action.<sup>10</sup>
- After the decision in *American Express*, a member of a leading plaintiffs’ firm recognized this new approach: “I think you’ll continue to see firms like mine move into arbitration. If what large corporations want is to have thousands or tens of thousands of individual arbitrations as opposed to class actions ... then that’s the direction we’ll go in. It’s a bit of ‘be careful what you ask for.’”<sup>11</sup>
- At oral argument in *American Express*, Chief Justice John Roberts suggested that plaintiffs could use the resources of a common interest group, such as a small-merchant trade organization, to “get together and say we want to

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<sup>7</sup> See Gary B. Friedman, “Arbitration,” *Consumer Financial Services Institute 2013*, Practising Law Institute (Apr. 23, 2013), online at [http://www.pli.edu/Content/OnDemand/Consumer\\_Financial\\_Services\\_Institute\\_2013/\\_/N-4nZ1z12p2h?fromsearch=false&ID=158662](http://www.pli.edu/Content/OnDemand/Consumer_Financial_Services_Institute_2013/_/N-4nZ1z12p2h?fromsearch=false&ID=158662).

<sup>8</sup> Melissa Lipman, *AmEx To Spend Up To \$79M In Surcharge Suit Settlement*, *Law360.com* (Dec. 19, 2013), online at <http://www.law360.com/classaction/articles/497520>.

<sup>9</sup> Sara Foley & Jessica Savage, *Court Filings Boost Revenue*, *Corpus Christi Caller Times* (Nov. 27, 2010), online at <http://www.caller.com/news/2010/nov/27/court-filings-boost-revenue/>

<sup>10</sup> Linda Deutsch, *Honda Loses Small-Claims Suit Over Hybrid MPG*, *Associated Press* (Feb. 1, 2012), online at <http://www.msnbc.msn.com/id/46228337/ns/business-autos/t/honda-loses-small-claims-suit-over-hybrid-mpg/>

<sup>11</sup> Melissa Lipman, *Plaintiff’s Lawyers Still Hopeful After AmEx Ruling*, *LAW360* (June 21, 2013), online at <http://www.law360.com/articles/452294/plaintiffs-lawyers-still-hopeful-after-amex-ruling> (quoting Jonathan Selbin).

prepare an antitrust expert report” that could be used in each of the subsequent arbitrations.<sup>12</sup>

- In other contexts, the pooling approach has helped plaintiffs lower their individual costs. As one study noted, “[a]n example of how such coordination can work is the large number of individual actions filed in litigation by common counsel for alleged violations of the Fair Debt Collection Practices Act, often against the same defendant.”<sup>13</sup> In no small part because the fixed costs of proving a claim against the same defendant may be spread across many plaintiffs—and because attorneys’ fees are provided by statute<sup>14</sup>—one newspaper reported that “[h]igh-volume consumer law firms are churning out [FDCPA] lawsuits as efficiently as the collectors they battle.”<sup>15</sup>

In short, consumers, employees, and other potential plaintiffs have a wide array of tools for spreading litigation costs across a number of individual arbitrations. Social media and other technological innovations make it easier than ever for people who have common grievances to find each other and utilize common resources.

**2. Do you consider a class action proceeding as the best or most efficient way for individuals to have their claims adjudicated, whether or not in an arbitration proceeding?**

Class action proceedings are rarely the best or most efficient way for claims to be adjudicated—whether in arbitration or not.

To begin with, the overwhelming majority of disputes that consumers and employees may have would never qualify for class treatment because they are fact-specific and individualized—for example, if a consumer claims that a product he or she purchased does not work, or that particular charges appearing on a bill were not actually incurred.

Even in the minority of situations where a claim might qualify for class treatment, class actions are not efficient ways to deliver meaningful benefits to class members. Indeed, class actions are often troubling because they impose substantial costs without providing much in the way of benefits to most class members. My firm

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<sup>12</sup> Tr. of Oral Argument at 21, *American Express Co. v. Italian Colors Restaurant*, No. 12-133 (Feb. 27, 2013), online at [http://www.supremecourt.gov/oral\\_arguments/argument\\_transcripts/12-133.pdf](http://www.supremecourt.gov/oral_arguments/argument_transcripts/12-133.pdf).

<sup>13</sup> Gregory C. Cook, *Why American Express v. Italian Colors Does Not Matter and Coordinated Pursuit of Aggregate Claims May Be a Viable Option After Concepcion*, MICH. J. L. REFORM ONLINE (Apr. 14, 2013), online at <http://www.mjlr.org/2013/04/why-american-express-v-italian-colors-does-not-matter-and-coordinated-pursuit-of-aggregate-claims-may-be-a-viable-option-after-concepcion/#fnref-2132-14> (footnote omitted).

<sup>14</sup> *Id.* (citing 15 U.S.C. § 1692k).

<sup>15</sup> Chris Serres, *Debtors in Court – Suing Collectors*, MINN. STAR-TRIB. (Mar. 17, 2011), online at <http://www.startribune.com/investigators/99676349.html?refer=y>.

conducted a study of class action litigation that was attached as Exhibit A to my written testimony. As explained in that study, only about a third of cases settled on a class-wide basis; moreover, the settlements for which claims and/or distribution data were available showed that the lawsuits delivered funds to under 10% of the class—and sometimes under 1%. That is not surprising: many settlements require class members to submit a claim form—often with onerous documentation requirements—leading class members not to try to seek relief in the first place.

Arbitration on an individual basis affords consumers, employees, and small businesses with a mechanism that can be much more effective at delivering fair, easy, and quick access to a neutral decisionmaker at low cost. As the empirical research discussed in my written testimony reveals, arbitration is faster and cheaper than litigation, and is more likely to result in positive outcomes for consumers and employees.

**3. Professor Gilles stated that your law firm’s study of class actions involved “cherry-picked” data. Please respond.**

Professor Gilles’ unsupported assertion is false. The methodology for my firm’s study is simple, straightforward, and transparent. Appendix C to the study provides details of that methodology, which I also explain here.

It was not possible to study all class actions; no other study has even come close. To make the study design manageable, we focused on cases filed in or removed to federal court because the dockets and case filings for federal courts are available online. By contrast, filings in state courts often are not searchable, let alone available, online.

We decided to study cases filed in or removed to federal court in a single year for three reasons. First, limiting the sample set to cases brought in a single year would ensure that the number of cases was manageable. Second, by selecting the year 2009, we were able to ensure that the Class Action Fairness Act of 2005 applied, which meant that most of the significant class actions that were alleged to be worth at least \$5 million would proceed in federal court (and thus have the case files available online). Third, our experience suggested that most of the cases would have proceeded to a resolution over a four- to five-year period. Indeed, we found that 86% of the cases we studied were completed by 2013.

We also recognized that it would be impracticable to identify every putative class action filed in federal courts during 2009. There is no listing of class actions filed each year. And the federal courts’ Public Access to Court Electronic Records (PACER) system does not offer an option for filtering cases, on a nationwide basis, to determine which lawsuits involve class allegations.

We therefore sought a neutral way of identifying class actions that were filed. We decided to review cases that were mentioned in two commercial publications: the *BNA Class Action Litigation Reporter* and the *Mealey’s Litigation Class Action*

*Reporter*. Those publications cover a wide array of developments in class action litigation, and therefore provide a diverse sample of filed class action complaints. The publications have an incentive to report comparatively more significant class actions out of all class actions filed, without wasting readers' time and attention on minor or obviously meritless suits. If anything, that means the sample set of cases we reviewed would be skewed in favor of more significant class actions filed by prominent plaintiffs' attorneys – which, experience and logic would suggest, should be *more meritorious on average* than a sample generated randomly from all class actions filed.

Finally, we excluded three categories of cases that are not analogous to the types of disputes that would be covered by the proposed Arbitration Fairness Act—i.e., claims by consumers, employees, and small businesses. These exclusions had next to no effect on the results of our study.<sup>16</sup>

- We excluded class actions brought by the EEOC, which do not proceed under Federal Rule of Civil Procedure 23.<sup>17</sup>
- We also excluded Fair Labor Standards Act “collective actions,” for which—in contrast with opt-out class actions typical of consumer and employee claims—similarly situated employees must provide consent in writing in order affirmatively to opt-in to the representative plaintiffs suit.<sup>18</sup>
- Finally, we also excluded securities class actions, which one academic study has described as being “managed under a set of class action rules distinct from” typical consumer and employee class actions, and under which “the plaintiffs with the largest losses have a significant role in the litigation.”<sup>19</sup>

It is critically important for policymakers to base decisions on empirical data rather than anecdotes. For a long time, the debate about class actions has suffered from a lack of empirical information. Our study takes an important step forward in filling that gap, by reviewing a neutrally selected sample of cases. We are proud of and stand by the work done on our firm's study. At the same time, we welcome others to

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<sup>16</sup> Our 169-case sample set, which included these cases, resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration. After excluding them, our 148-case sample set resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration.

<sup>17</sup> See, e.g., *Gen. Tel. Co. of Nw., Inc. v. EEOC*, 446 U.S. 318 (1980).

<sup>18</sup> See 29 U.S.C. § 216(b).

<sup>19</sup> Nicholas M. Pace & William B. Rubenstein, *How Transparent are Class Action Outcomes? Empirical Research on the Availability of Class Action Claims Data* at 20, RAND Institute for Civil Justice Working Paper (July 2008), online at [billrubenstein.com/Downloads/RAND%20Working%20Paper.pdf](http://billrubenstein.com/Downloads/RAND%20Working%20Paper.pdf); see, also e.g., Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-76, 109 Stat. 737 (1995); Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

take further steps in researching class actions to continue the work of replacing anecdotes with data.

4. **Last week, the Consumer Financial Protection Bureau announced its preliminary findings from the arbitration study Congress mandated in the Dodd-Frank Act. According to one report, there's concern the Consumer Financial Protection Bureau is preparing to write tough new rules restricting the use of arbitration clauses in consumer banking contracts. Please provide more information about the Consumer Financial Protection Bureau's study and what it means going forward.**

When the Bureau issued what it described as its “study results to date,” its report included a number of important disclaimers that show why its “preliminary results” provide little information that is relevant to the central question that the Bureau must address: For the kinds of injuries that most consumers can suffer, what is the real-world accessibility, cost, fairness and efficiency of arbitration as compared to suing in court? And how will consumers be harmed if arbitration is prohibited or subjected to regulation that eliminates arbitration’s availability. The Bureau stated:

- “Readers should not interpret this presentation as our assessment, preliminary or otherwise, of the relative importance of different areas to be covered in the statutory report to Congress. Rather, the subjects addressed here are those as to which we already have been able to obtain and analyze sufficient data in order to make some preliminary findings.”
- “Because the Bureau’s work on this study is ongoing, any of the findings presented here may be refined or modified when we issue our report to Congress.”
- “This presentation focuses on the ‘front-end’ of formal disputes involving customers”—the nature of formal filings; “[i]n later work, we intend to address the ‘back-end’ of formal disputes: what happens, in how long, and at what cost.”

The Bureau also identified a variety of areas not yet addressed, such as “the disposition of cases across arbitration and litigation (including class litigation), both in terms of substantive outcome and in terms of procedural variable like speed to resolution”; “consumer benefits and transaction costs in consumer class actions involving consumer financial services” including “whether class actions exert improper pressure on defendants to settle meritless claims”; and “the possible impact of arbitration clauses on the price of consumer financial products.”

Especially with all of those issues—and more—left unresolved, the preliminary study does not even begin to answer the central questions that the Bureau must address.

To begin with, the number of formal claims filed by consumers in arbitration and in court—the principal focus of the Bureau’s attention—says nothing about the relative accessibility and fairness of the two methods of dispute resolution. The Bureau compares the number of complaints filed in arbitration to a larger total number of potential customers, and seems to view the disparity as possible evidence that arbitration is not useful to consumers. Any such conclusion would be misguided for several reasons:

- *First*, consumers’ claims often are resolved before the filing of a formal arbitration proceeding. Individuals who file arbitration demands—just like those who file small claims court cases or lawsuits in court—are almost always a very small group of consumers whose concerns were not resolved through the less-formal customer service mechanisms that precede the filing of an arbitration demand. The vast majority of customer concerns are resolved through informal channels, such as customer service processes, negotiation, or mediation, before a concern ripens into a dispute and a formal arbitration demand is filed.

Moreover, because businesses subsidize most or all of the costs of arbitration—under AAA consumer rules, for example, a business must cover at least \$1500 in filing fees—it is economically rational for every business to settle disputes of less than \$2,000-5,000 before an arbitration is commenced. But that same incentive is lacking in court, where the cost burden falls on the consumer.

What is more, many arbitration agreements create even greater incentives to settle claims before arbitration begins, such as through arbitration provisions that—like the provision at issue in *AT&T Mobility v. Concepcion*—contain potential bonus payments to customers who do better in arbitration than a company’s last settlement offer. It is thus a straightforward matter of economics that, if a consumer has a dispute with a company of less than the bonus figure—and the claim is not frivolous or abusive—the company has every reason to settle by offering a payment (often for the full amount of the claim plus an amount for attorneys’ fees) that satisfies the customer.

Thus, as the Supreme Court explained in *Concepcion*, the consumers’ claim in that case was “most unlikely to go unresolved” because the arbitration provision at issue provided that the company would pay the *Concepcions* a minimum of \$7,500 and twice their attorneys fees if they obtained an award “greater than AT&T’s last settlement offer.”<sup>20</sup> And this self-imposed incentive to settle occurs not just at the stages of a formally commenced arbitration or the pre-arbitration negotiation period. Instead, large numbers of AT&T customers have their concerns resolved at a much earlier point by calling or

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<sup>20</sup> 131 S. Ct. at 1753.

e-mailing AT&T's customer care department, which is remarkably effective: the record in *Concepcion* indicated that AT&T representatives awarded more than \$1.3 billion in compensation to customers during a single twelve-month period in response to customer concerns and complaints.

Significantly, the Bureau's own preliminary results recognize that virtually all of the arbitration provisions studied require the company involved to pay all or nearly all of the arbitration costs and that many of the provisions include bonus provisions. Those agreements provide a very weighty incentive for pre-arbitration settlement of any non-frivolous consumer claim of \$5,000 or less.

- *Second*, a concerted campaign to invalidate arbitration agreements was underway for the entire period studied by the Bureau. Plaintiffs' lawyers vigorously resisted arbitration (with success in certain "magnet" jurisdictions for class actions) before *Concepcion*. And after the Supreme Court held in *Concepcion* that class waivers in arbitration agreements are enforceable, the plaintiffs' bar has continued to search for ways to avoid their clients' agreements to resolve their disputes in arbitration. The unfortunate effect of these widespread efforts is that lawyers who represent consumers and their allies in consumer advocacy organizations have failed to encourage consumers to pursue their disputes in simplified, often cost-free arbitration.
- *Third*, the number of individuals who opt out of class action settlements shows nothing about the relative utility of arbitration and judicial litigation. The Bureau identified eight class actions in which the class members could choose to reject the benefits of the proposed settlement and instead file an individual arbitration claim. The failure of class members to do that, the Bureau seems to say, provides some evidence of the relative utility of arbitration and class actions. Put simply, any such contention makes no sense.

A large number of consumers in these cases did nothing: they neither opted out, nor filed the forms required (in all but two of the cases) to obtain a share of the settlement. The most logical conclusion is that these consumers viewed the claim as spurious and/or the litigation process as a waste of their time.

The fact that some consumers took advantage of a settlement offer says nothing about their view of the judicial litigation process—they may simply have concluded that it was worth obtaining what was offered—and absolutely nothing about their view of arbitration as an alternative.

Finally, that some consumers opted out but did not pursue arbitration claims similarly offers no illumination about their views of arbitration as compared to litigation. Class members opt out of class actions for multiple reasons, as practitioners know well. True, some opt-outs may wish to pursue their own

claim separately, either by arbitration or small claims court. But other opt-outs may believe that the case is meritless and so they do not want to be part of the settlement class, and still others may object to class actions or to litigation in general. If (as is common) the class member who opted out has no quarrel with the company, then there is no reason that he or she would have chosen to initiate an arbitration. By suggesting otherwise, the Bureau appears to be assuming that (a) the claims at issue in the class action have merit; and (b) that the class members who opted out feel the same way. That thinking defies common sense and real-world experience.

- *Fourth*, the Bureau’s definition of “small-value” claims presents a misleading picture of arbitration. The Bureau defines small-value claims as those involving \$1,000 or less and then concludes that few consumers arbitrate small claims. But that definition is odd, given that—based on information compiled in Appendix E of the CFPB’s own document—most state small-claims courts permit the assertion of claims of up to \$10,000. Hopefully, the Bureau did not adopt this overly narrow definition in order to be able to assert, erroneously, that consumers do not use arbitration for small claims. In addition, of course, this analysis ignores entirely the fact, discussed above, that the terms of a growing number of arbitration agreements provide a very substantial incentive for the pre-arbitration settlement of such claims.
- *Fifth*, the Bureau has not yet addressed the critical question of how the resolution of consumers’ claims in arbitration compares to the outcomes obtained in court. As the Bureau acknowledges, it has not yet compared the results that consumers obtain in arbitration and in court. But, as I explained in my written testimony, existing empirical research shows that consumers do at least as well – if not better – in arbitration than in court.

Furthermore, the Bureau’s brief discussion of class actions provides no basis for any conclusion regarding their value to consumers – as the Bureau itself acknowledges.

The Bureau observes that most arbitration agreements preclude class actions and class arbitrations. That is not surprising because, as the Supreme Court explained in great detail in *Concepcion*, class actions are incompatible with arbitration, which traditionally has taken place on an individual (one-on-one) basis. The assumption underlying the Bureau’s observation appears to be that consumers would be better off without these features of arbitration agreements. But that assumption is based on a theoretical opinion of how class actions function; as it turns out, the theory is diametrically opposed to how class actions work in practice.

Any legitimate study of dispute resolution—and certainly any regulation based on such a study—cannot rest on theoretical assumptions about the value of the class action device; instead, the study should examine the reality of how that procedure works. Thus, the question for the Bureau is whether the value of class actions outweighs the value that arbitration provides individual consumers by increasing

their ability to pursue their claims and obtain meaningful recoveries—not just through the formal arbitration process but also through informal resolutions that result from the greater incentives to settle that are generated by arbitration agreements.

The study my law firm conducted shows that in even in the minority of class actions that are settled on a classwide basis provide little, if any, tangible benefit to class members. In the cases where claims information was available, few class members—often fewer than 10 percent, and sometimes less than 1 percent—even bothered to submit claims.

While it is true that some class actions result in settlements where the parties agree to an “automatic distribution” of benefits to class members, such distributions are the exception rather than the rule. The Bureau’s unrepresentative sample pointed to two automatic distributions out of eight possible settlements. While my law firm’s broader study identified thirteen automatic distributions out of forty settlements studied, only one of the thirteen was a consumer case; ten involved claims by retirement plan participants in ERISA class actions where damages and eligibility could be ascertained easily from the plan’s records. Thus, contrary to the implication in the Bureau’s study, such settlements are exceptionally rare in the consumer context.

And the Bureau itself has acknowledged that it intends to study—among other areas that it has not yet addressed—“the disposition of cases across arbitration and litigation (including class litigation), both in terms of substantive outcomes and in terms of procedural variables like speed to resolution.” It must do so by looking at a sample set that is greater than (a statistically insignificant) eight cases, and one that is selected on the basis of neutral factors rather than selected because class members obtained relief.

Finally, the Bureau’s analysis provides strong evidence of the fairness of the arbitration process. The CFPB’s review reveals:

- By far the leading choice of arbitration provider is the non-profit American Arbitration Association, which has long been recognized as the gold standard among arbitration administrators.
- Under most of the arbitration provisions studied, the business has agreed to pay all (or nearly all) of the costs of arbitration.
- All but one of the arbitration provisions studied ensured that the arbitration provider’s rules would govern the selection of arbitrators using neutral criteria, and therefore did not create even an arguable risk of biased arbitrators.
- The Bureau states that arbitration clauses are “more complex than the rest of the contract.” But there are many reasons for that.

*First*, arbitration provisions define procedures that will govern dispute resolution, and (by necessity) must be comprehensive because they apply in every dispute.

*Second*, even simplified legal procedures are likely to be more complicated than the “business” terms of consumer financial contracts. If companies were required to attach to their contracts the rules for dispute resolution in court, such as the Federal Rules of Civil Procedure, there is no doubt that those rules would be at least as hard to read—perhaps even harder—than the typical arbitration provision. (Indeed, the Federal Rules of Civil Procedure were so hard to read that they were substantially revised in 2007 solely to make them more comprehensible.)

*Third*, arbitration agreements have become longer and more complex over time in response to a wide variety of novel challenges raised by lawyers seeking to avoid those agreements. And courts that are hostile to arbitration have accepted some of those challenges, forcing the drafters of arbitration agreements to respond by adding further explanations (and, unfortunately, more length).

In short, the Bureau’s “preliminary results” reveal that it has much more work to do. Congress has required that any regulation that the Bureau might propose must be consistent with the results of the study and justified by the public interest; the Bureau also “shall” consider “the potential benefits and costs to consumers and [businesses], including the potential reduction of access by consumers to consumer financial products or services resulting from” any such rule.<sup>21</sup> The study released on December 11 provides little information calculated toward answering those important questions, and even less information about how the Bureau plans in the next round of its study to address how arbitration and class actions work in reality, rather than in theory.

- 5. Please provide any additional thoughts that you might have on the issues raised by the hearing, including but not limited to expanding on your testimony, responding to the testimony of the other witnesses and/or anything else that came up at the hearing, which you did not have a chance to respond to.**

A number of issues were raised at the hearing that warrant a response.

*First*, Professor Gilles suggested at the hearing that the arbitration agreement in *American Express* precluded the parties from sharing the costs of proving their claims. She apparently relied on a contention in the *American Express* dissent that a confidentiality provision in the agreement prohibited “informal coordination

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<sup>21</sup> 12 U.S.C. §§ 1028(b) & 1022(b)(2)(A)(i).

among individual claimants.”<sup>22</sup> In fact, American Express contested that interpretation of the confidentiality provision at oral argument, and in any event a majority of the Supreme Court disagreed with the dissent’s factual claim that the agreement at issue barred informal coordination among individual claimants.<sup>23</sup>

*Second*, it was suggested during the hearing that an individual employee or consumer who believes that he or she faced a biased arbitrator has no recourse *in court* to challenge that arbitrator’s award. In fact, the Federal Arbitration Act allows such a consumer or employee to go to court to invalidate the arbitral award on the ground that the arbitrator was biased. Section 10 of the FAA states that “where there was evident partiality or corruption in the arbitrators”—*i.e.*, any arbitrator was biased—a party to the arbitral award may apply for “an order vacating the award.” Moreover, even before arbitration commences, an individual may go to court to challenge the enforceability of the agreement if it lacks procedures for selecting a bias-free arbitrator. As I explained in my written testimony (at page 12), most consumer and employment arbitration agreements adopt fair and neutral mechanisms for selecting an arbitrator. But if an arbitration agreement fails to do so, courts have not hesitated to strike such agreements down. The U.S. Court of Appeals for the Ninth Circuit, for example, recently struck down an arbitration provision that “would always produce an arbitrator proposed by [the company] in employee-initiated arbitration[s],” and barred selection of “institutional arbitration administrators.”<sup>24</sup>

*Third*, Professor Gilles stated that companies who adopt arbitration programs will “not have to be held accountable for any violations of the law.” In addition, Professor Gilles stated that arbitrations are “private, sequestered, [and] individual,” and that individual claimants thus have “no power to change” the defendant company’s behavior on a broader scale. But these statements are based on assumptions that class actions are necessary deterrents to corporate wrongdoing—assumptions based on how class actions are supposed to work in theory that simply do not reflect the reality of class actions. As I discussed in my written testimony (at pp. 19-20), class actions do not deter corporate wrongdoing. That is because companies view class actions as a cost of doing business, rather than as a penalty for wrongdoing. The burdens of class action settlements fall on businesses against which plaintiffs’ attorneys can present claims that survive a motion to dismiss and the standards for class certification—not against businesses that have engaged in wrongdoing.

New technology has provided individual claimants suffering from actual wrongdoing with new, extremely effective tools to hold corporations accountable. As

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<sup>22</sup> 133 S. Ct. at 2318 (Kagan, J., dissenting).

<sup>23</sup> *Id.* at 2311 n.4 (majority); *see also* Transcript of Oral Argument at 22-23, *American Express Inc. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (No. 12-133), online at [http://www.supremecourt.gov/oral\\_arguments/argument\\_transcripts/12-133.pdf](http://www.supremecourt.gov/oral_arguments/argument_transcripts/12-133.pdf).

<sup>24</sup> *Chavarría v. Ralphs Grocery Inc.*, 733 F.3d 916, 923-25 (9th Cir. 2013).

explained above (at p. 3), individuals with common grievances are increasingly using social media to target companies that they believe have aggrieved them.

*Finally*, although it has been suggested that the Arbitration Fairness Act would not prohibit consumer and employment arbitration altogether, in reality that would be the Act's effect if enacted. Companies that are told they must participate in the default system of litigation in court will not be willing to construct a second system of consumer or employee-friendly arbitration in which they subsidize the costs. As a result, they would abandon arbitration, leaving the vast majority of consumers and employees—whose claims tend to be small-value and not subject to certification in a class action—without any meaningful remedy. Those consumers and employees would undoubtedly be worse off, left to fend for themselves in our overburdened and underfunded courts.

RESPONSES OF PETER RUTLEDGE TO QUESTIONS SUBMITTED BY SENATORS GRASSLEY  
AND HATCH



The University of Georgia<sup>®</sup>

School of Law

Peter B. Rutledge  
*Herman E. Talmadge Chair of Law*

January 13, 2014  
**By email**

Senator Patrick Leahy  
United States Senate  
Committee on the Judiciary  
Washington, D.C. 20501-6275

Dear Senator Leahy:

Thank you for your letter of December 30 enclosing written questions from  
Committee members.

As requested, I submit electronically my answers to the written questions by the  
deadline specified.

With thanks to you, the members of the Committee and the staff for the opportunity  
to testify at the hearing, I remain

Sincerely yours,

Peter B. Rutledge  
Associate Dean for Faculty Development  
Herman E. Talmadge Chair of Law

**RESPONSES TO QUESTIONS FROM SENATOR GRASSLEY**

1. In a 2004 article, I advanced the doctrinal argument that arbitrators should not be accorded the same absolute immunity from suit as judges but, instead, should be subject to contractual immunity as often appears in arbitral rules. Peter B. Rutledge, *Toward a Contractual Approach to Arbitral Immunity*, 39 Ga. L. Rev. 151 (2004). In the theoretical section of that article, I wrote that “an arbitrator may be perceived as ‘industry friendly’ in securities law disputes or ‘contractor friendly’ in construction disputes.” *Id.* at 165. That sentence has been quoted to suggest my belief in the empirical proposition that arbitrators are not neutral. I would encourage you and your colleagues to read the article in full, where I also said:

Arbitrators who are repeat players in the market for their services have an incentive to develop a reputation for independence. This reputation for independence enhances the likelihood of future appointments, particularly in the case of single-arbitrator disputes, appointments as chairman in three-arbitrators disputes, or other scenarios where the parties lack control over the appointment.

Moreover, alternative mechanisms such as neutrality requirements already help to ensure an arbitrator’s independence. These neutrality requirements come in a variety of forms. For example, some judicial decisions have specifically held that lack of neutrality supplies a basis for setting aside an arbitral award. Likewise, most institutional rules, at least in international arbitrations, require arbitrators to be neutral. In fulfillment of this obligation, the arbitrator must disclose any past business connections that would suggest an inability to be impartial. *Id.* at 170-71 (footnotes omitted).

In a footnote to this block-quoted passage, I also wrote that “just as competition in the marketplace may provide some arbitrators independence, it may provide other arbitrators incentives to be beholden to particular parties or industries likely to nominate them.” *Id.* at 170 n. 76. That sentence likewise sometimes has been read out of context to suggest my belief in the empirical proposition that arbitrators are not neutral. Again, I would encourage you and your colleagues to read the footnote in full. The *very* next sentence makes plain that I am talking about particular, historical phenomenon in domestic arbitration – that is,

so-called “party-appointed, non-neutral arbitrators.” These were individuals appointed by the parties in certain arbitrations explicitly to advocate on behalf of the parties. These were not bound by obligations of impartiality and independence. Today, most domestic arbitration rules – with strict requirements for impartiality and independent – do not countenance the use of such party-appointed non-neutrals.

2. The 17% figure mentioned in the CFPB preliminary report and discussed in my oral testimony confirms earlier research conducted by Professor Drahozal and myself on the frequency with which firms in the credit card industry employ arbitration agreements. See Christopher R. Drahozal & Peter B. Rutledge, *Arbitration Clauses in Credit Card Agreements: An Empirical Study*, 9 J. Empirical Legal Studies 536 (2012).

This 17% utilization rate is relevant in two respects. First, it casts doubt on the frequently heard charge that “all firms” (generally or in a particular industry) will use arbitration clauses in the wake of a Supreme Court decision like *Concepcion* or *Italian Colors*. The empirical data in the CFPB preliminary report and in our own research rebut that claim. Second, the statistic has potentially important regulatory implications. To the extent the Congress (or the CFPB) believes regulation of arbitration agreements was necessary to preserve some modicum of “choice” for consumers, that choice already exists (at least in certain sectors of the financial services industry). Consequently, outright bans on the use of arbitration agreements would be ill-designed for the dynamics of the market. Rather, regulators might instead consider rules designed to inform consumers of their choice.

3. Thank you for this question, which I see as an opportunity to elaborate on my answers to the last round of questions from Senator Franken. The answer is quite simple – if a consumer or employee believes that an arbitrator has been biased or partial to the opposing party – and the consumer or employee loses the arbitration – current law gives her an efficacious remedy – namely petitioning to vacate the award under Section 10 of the Federal Arbitration Act. That statute authorizes United States Courts to vacate awards where the award has been “procured by corruption, fraud, or undue means,” 9 USC 10(a)(1), or where “there was evident partiality or corruption in the arbitrators, or either of them,” 9 USC 10 (a)(2).
4. In the wake of the recent Supreme Court cases at issue in the hearing (*Concepcion* and *Italian Colors*), several safeguards help to ensure that individuals can have their claims adjudicated. Of course, they may proceed individually in the arbitration. Under many rules, including the AAA’s Consumer Due Process Protocol, they can proceed individually in small claims court. For certain statutes, public administrative bodies (like

the EEOC) can bring judicial actions on behalf of the individuals or classes of people. The arbitration agreement remains subject to generally applicable contract defenses like unconscionability. If the underlying argument is that the arbitration costs are too financially burdensome, the Supreme Court's decisions in *Green Tree Finance v. Randolph*, 531 U.S. 79 (2000) and *Italian Colors* suggest that the consumer can challenge the proceeding for that reason.

5. Thank you for the opportunity to offer additional thoughts, to expand on my testimony and to respond to the testimony of others:
- First, in light of Professor Gilles' comments on my testimony (Draft Transcript at 78; Final Transcript at \_\_), allow me to make the following point: Contrary to the predictions of some scholars (including Professor Gilles) companies have not unilaterally flocked to arbitration and class waivers as a result of the Supreme Court's decisions in cases like *Concepcion*. Rather, at least as to the industries that have been studied, there is a diversity of approaches by firms, and the reasons for that diversity need to be understood. Having said that, I acknowledge (and have acknowledged) that it is also important to consider not simply firm behavior but the market as a whole (where, prior to a settlement, much of the credit card debt in the United States was subject to arbitration agreements). But, given the diversity of firm practices, the proper regulatory response, if one is warranted, may be to facilitate consumer choice rather than an outright ban on the practice.
  - Second, in light of Professor Gilles' characterization of my testimony (Draft Transcript at 90-91; Final Transcript at \_\_), allow me to make the following point: I do not see the support for Professor Gilles' statement that "basically nine out of ten companies are using these forced arbitration clauses." The CFPB preliminary report and Professor Drahozal's and my research do not support the proposition regarding "nine out of ten companies" using these clauses, and I am unsure what's the empirical basis for Professor Gilles' statement. See, e.g., CFPB Preliminary Report at 21, 26. The CFPB found, as did Professor Drahozal and myself, that among companies employing arbitration clauses in the industries under study, there has been an uptick in the use of class waivers, so I must respectfully disagree with Professor Gilles' characterization (Draft Transcript at 91; Final Transcript at \_\_) that my testimony was somehow not "accurate."

My bottom line is (and has been) this: please let the debate here be driven by sound empirical research and please avoid legislating on the basis of statements that are not backed by facts.

**RESPONSES TO QUESTIONS FROM SENATOR HATCH**

1. Senator, my understanding of the research largely gels with yours, and I would encourage you, your colleagues and your staff to review one of the seminal reports in this area that discusses several of these points. See Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. Disp. Res. 843 (2010). First, as I indicated in my testimony and have indicated elsewhere, there is little doubt that arbitration resolves cases more expeditiously than the civil litigation system. Second, while the point is slightly more debatable, arbitration also tends to be cheaper. Periodically, you hear the argument that arbitration is more expensive because, compared to court, parties have to pay fees, including the arbitrator's fees. But there are two problems with this argument. The first is that the consumer's or employee's share of those fees is often regulated as it is, for example, in the Consumer Due Process Protocol of the American Arbitration Association. Second, a bare focus on fees overlooks other "process costs" that might actually make litigation more costly. For example, if a dispute lasts longer or involves more contested motions (as civil litigation often does), then logically attorneys' fees will be correspondingly higher.

Third, as to outcomes, most studies show that consumers or employees are at least as likely, if not more likely, to prevail than plaintiffs who sue in court. In the interest of completeness, I should note, as I have noted elsewhere, that some studies cut in the other direction. Some early research of employment arbitration by William Howard found a slightly lower win rate. See William Howard, *Arbitrating Claims of Employment Discrimination, What Really Happens?, What Really Should Happen?*, DISP. RESOL. J., Oct.-Dec. 1995, at 44. But the difference in win rate was not statistically significant, a conclusion confirmed by subsequent papers. See, e.g., Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Pre-dispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 564-65 (2001); David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1569 (2005). Some more recent research by Alexander Colvin also suggested lower win rates. See, e.g., Alexander J.S. Colvin, *Employment Arbitration: Empirical Findings and Research Needs*, Disp. Res. J 6 (Aug.-Oct. 2009). But, as Professor Colvin acknowledges, the record is unclear as to what factors explain these results. *Id.* at 11. It may be due to the employee, or it may be due to other factors like an efficacious internal grievance procedure that, as part of the "quilt" of dispute resolution methods described in my testimony, may help resolve many cases at a pre-arbitral stage. Answering such empirical questions is a critical prerequisite to any regulation.

2. Some studies, including a report by the Federal Trade Commission, have sought to compare individuals' abilities to navigate the small claims system (as compared to arbitration). Otherwise, though, I unfortunately cannot recall research comparing the ease with which consumers can navigate the litigation and arbitration systems more generally.
3. Based on my reading of the CFPB's preliminary report, I do not believe that the CFPB offered any data regarding whether similar discrepancies exist with respect to litigation. As you are aware, certain judicial districts occasionally have developed reputation as hotbeds for litigation because of the plaintiff-friendly character of their procedures, their laws or their verdicts. My understanding is that one goal of the CFPB's research is to try to develop some metric whereby to undertake meaningful apples-to-apples comparisons of the litigation and arbitration systems so that the systems are not analyzed in isolation but can truly be benchmarked against each other.
4. Yes, I believe it is critical for Congress (and the CFPB) to consider the effect of retroactively invalidating pre-existing arbitration agreements. As I said several years ago in comments at a meeting before the American Bar Association, where will these disputes go? If they are funneled into the civil litigation system (where delays, as noted above, are already endemic), it is difficult to see how that makes consumers or employees better off. This further illustrates the concern that I mentioned to Senator Lee at the hearing that some of the legislative proposals do not necessarily benefit to the very groups whom they purport to help.

## MISCELLANEOUS SUBMISSIONS FOR THE RECORD



The American Antitrust Institute

December 24, 2013

The Honorable Al Franken  
 309 Hart Senate Office Building  
 2nd & C Streets, NE  
 Washington, DC 20510

Re: Statement of the American Antitrust Institute, *The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?: Hearing on S. 878 Before the Senate Committee on the Judiciary, 113th Cong. (2013)*

Dear Senator Franken:

The American Antitrust Institute (“AAI”)<sup>1</sup> commends you and your co-sponsors for introducing the Arbitration Fairness Act of 2013, S. 878, 113th Cong. (2013) (“AFA”), and Chairman Leahy, Ranking Member Grassley, and other members of the Senate Judiciary Committee for convening this hearing. AAI supports S. 878 because it would restore consumers’ ability to effectively vindicate their Sherman and Clayton Act rights. Section 3 of the AFA would amend the Federal Arbitration Act (“FAA”) to invalidate certain agreements that mandate individual arbitration of antitrust disputes. This Section would remedy the negative consequences of recent Supreme Court decisions that prevent effective private enforcement of the antitrust laws by eliminating class actions in a large and important category of consumer cases. Specifically, Section 3 of the AFA would prevent class action waivers inserted into arbitration agreements from acting as de facto exculpatory clauses that eliminate the only procedural mechanisms able to convert certain consumer antitrust claims into financially rational pursuits.

The class action device is essential to consumer antitrust enforcement because it is essential to private enforcement. Because of limitations on government antitrust enforcement,<sup>2</sup> private antitrust enforcement sometimes is the only available means of redressing antitrust violations.<sup>3</sup> Moreover, even when government and private enforcement work in tandem, private enforcement remains the primary means of compensating victims and the principal deterrent against future anticompetitive behavior. Empirical research supported by AAI has shown that (1) conservatively, private enforcement has led to the recovery of at least \$33.8 billion in damages over the previous two decades, see Joshua P. Davis & Robert H. Lande, *Towards an Empirical and Theoretical Assessment of*

<sup>1</sup> The AAI is an independent and non-profit education, research, and advocacy organization devoted to advancing the role of competition in the economy, protecting consumers, and sustaining the vitality of the antitrust laws. For more information, see [www.antitrustinstitute.org](http://www.antitrustinstitute.org).

<sup>2</sup> See Robert H. Lande & Joshua P. Davis, *Benefits from Private Antitrust Enforcement: An Analysis of Forty Cases*, 42 U.S.F.L. Rev. 879, 906 (2008) (citing budgetary constraints, institutional incentives to pursue certain types of cases, lack of awareness about industry conditions, institutional suspicion of competitor complaints, higher turnover among government attorneys, and political realities).

<sup>3</sup> See *id.*; Spencer Weber Waller, *Symposium: Private Law, Punishment, and Disgorgement: The Incoherence of Punishment in Antitrust*, 78 Chi.-Kent. L. Rev. 207, 211 (2003).

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The Honorable Al Franken  
 December 24, 2013  
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*Private Antitrust Enforcement*, 36 Seattle U. L. Rev. 1269, 1272 (2013), and (2) the deterrent effect of private enforcement likely outweighs the deterrent effect of even criminal enforcement by the Department of Justice, see Robert H. Lande & Joshua P. Davis, *Comparative Deterrence from Private Enforcement and Criminal Enforcement of the U.S. Antitrust Laws*, 2011 B.Y.U. L. Rev. 315, 347 (2011).

Without a procedural mechanism for aggregating claims, antitrust violations often will go uncompensated, under-deterred, or altogether un-remedied. Worse, private victims can be forced to forego their rights and remedies unknowingly and involuntarily when class action waivers are surreptitiously inserted into mandatory arbitration clauses in standard form “adhesion” contracts. In the Internet era, where pages-long terms and conditions demand instant acceptance in the click of a mouse, such waivers will only grow increasingly pervasive.<sup>4</sup> As Professor Gilles suggested in her testimony, a corporate attorney arguably would commit malpractice if she failed to advise a client to employ such a waiver in a consumer contract.

Without legislative action, the proliferation of class action waivers in mandatory arbitration clauses likely will destroy a wide swath of private antitrust rights. Antitrust violations very often involve high-volume, low-dollar frauds and price fixing in which perpetrators “deliberately cheat large numbers of consumers out of individually small sums of money.”<sup>5</sup> Consequently, individual victims’ claims often are small in absolute value or small in relation to the significant expenses of developing and prosecuting an antitrust case. Because such claims pose a negative value proposition for an individual claimant, they cannot feasibly be pursued in any forum absent class procedures, which allow for aggregation of claims and pooling of resources. While it may be literally true, as the divided Supreme Court recently declared, that the “antitrust laws do not guarantee an affordable procedural path,”<sup>6</sup> an affordable procedural path to aggregation is essential to an effective antitrust law regime and thus to the maintenance of a competitive free market economy.

The new status quo engendered by the Supreme Court’s recent arbitration decisions, including *Italian Colors*, *Concepcion*, and *Stolt-Nielsen*,<sup>7</sup> is not only problematic as antitrust policy, but as contract policy and arbitration policy. Courts enforce standard form “adhesion” contracts by employing the legal fiction that a consumer has assented to something she almost certainly has not even read, much less understood for its legal implications. Courts employ this fiction on the premise that procedural and substantive unconscionability doctrine will encourage businesses to incorporate only efficiency enhancing terms and not exploitative terms in their standard form contracts.<sup>8</sup> Yet contract terms that exculpate a party for harm caused intentionally, as compared to negligently, are widely recognized as unconscionable.<sup>9</sup> If standard form contract terms that

<sup>4</sup> As the Consumer Financial Protection Bureau has recognized, class action waivers in mandatory arbitration clauses are already nearly ubiquitous in the consumer financial services industry. See Consumer Financial Protection Bureau, Arbitration Study Preliminary Results (Dec. 12, 2013), available at [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf). Moreover, as more and more small business make purchases online, they too will experience this problem.

<sup>5</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1761 (2011) (Breyer, J., dissenting) (internal quotation and alteration omitted).

<sup>6</sup> *American Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2309 (2013).

<sup>7</sup> 130 S. Ct. 1758 (2010).

<sup>8</sup> See Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. Rev. 429 (2002).

<sup>9</sup> See, e.g., *American Express*, 133 S. Ct. at 2313-2314 (2013) (Kagan, J., dissenting) (“courts will not enforce a prospective waiver of the right to gain redress for an antitrust injury, whether in an arbitration agreement or any other contract”) (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U. S. 614, 637 (1985)); cf. Restatement (Second) of Contracts § 195(1)b (“A term exempting a party from tort liability for harm caused intentionally . . . is unenforceable on grounds of public policy.”).

The Honorable Al Franken  
December 24, 2013  
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exculpate defendants for intentional antitrust violations are enforceable simply because they are embedded in arbitration clauses, then unconscionable contracts are not only permitted but encouraged, a result that is both illogical and undesirable.<sup>10</sup>

With respect to sound arbitration policy, the Court has described the goal of the FAA as “encouragement of efficient and speedy dispute resolution.”<sup>11</sup> Yet, perversely, when an arbitration agreement is permitted to act as a de facto exculpatory clause, claims are not resolved *at all*. Rather, they are nullified, sometimes with plaintiffs left to incur unjustified losses and defendants left to enjoy ill-gotten gains. The Court’s interpretation actually precludes rather than promotes dispute resolution in any form, however efficient or speedy.

For all of these reasons, AAI urges the Committee and other members of Congress to pass S. 878.

Thank you for receiving AAI’s input on this subject. We would be pleased to provide additional perspectives and any other assistance that may be requested.

Sincerely,



Albert A. Foer  
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American Antitrust Institute  
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Randy M. Stutz  
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American Antitrust Institute  
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cc:

Members of the Senate Judiciary Committee

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<sup>10</sup> See David Horton, *Unconscionability Wars*, 106 *Northwestern Univ. L. Rev.* 387, 408 (2012).

<sup>11</sup> *Concepcion*, 131 S. Ct. at 1749 (emphasis added).



December 19, 2013

The Honorable Patrick Leahy  
Chairman  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Chuck Grassley  
Ranking Member  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Tim Johnson  
Chairman  
Committee on Banking, Housing  
& Urban Affairs  
534 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Mike Crapo  
Ranking Member  
Committee on Banking, Housing Affairs  
& Urban Affairs  
534 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairman Leahy, Chairman Johnson, Ranking Member Grassley and Ranking Member Crapo:

Amalgamated Bank ("Amalgamated"), as Trustee of the LongView® Funds, is a long-term investor in approximately three thousand publicly-listed companies in the United States. We manage approximately \$13 billion in assets for institutional investors, which are largely comprised of employee benefit funds. We join the voices of other institutional investors in writing to the committees of jurisdiction to ask the committees to:

- 1) Support the Securities and Exchange Commission ("SEC") in its exercise of Congressionally-granted authority under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to prohibit the use of mandatory pre-dispute arbitration provisions in broker-dealer and investment advisor agreements; and,
- 2) Act to formalize the SEC's longstanding policy that mandatory pre-dispute arbitration proposals included in the bylaws of publicly traded corporations are harmful to capital markets, contrary to public policy, and could be subject to enforcement action.

As the "LongView®" name implies, we take a long-term view of shareholder value. The beneficiaries of the funds invested with us, almost exclusively current or former working people, rely on stable and sustainable performance across the marketplace for many decades to come to meet obligations and pay out retirement, health and welfare benefits. To promote long-term performance, we actively advocate rigorous standards for corporate governance at our portfolio companies. But to protect against corporate malfeasance, we also seek strong investor protections that can both deter corporate wrongdoing and ensure that investors will have recourse, if necessary. We believe that both aims are compromised when companies attempt to preempt investors' rights to participate in a class.

While we believe arbitration may play a productive role in certain kinds of dispute resolution, we are concerned by recent attempts by some corporate issuers to unilaterally and preemptively adopt governance provisions requiring all investors to *only* pursue arbitration in event of disputes, generally accompanied by class action waivers. Arbitration may at times be a viable option, but it should not be the only one. We are concerned that remedies provided by Congress and the courts to companies and investors that have been an instrumental means of investor protection are being jettisoned by board fiat. The type of arbitration being imposed in its place is not the result of mutual agreement after arm's-length

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*America's Labor Bank*

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December 19, 2013  
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negotiation between equals, but the result of a policy decision unilaterally imposed on investors by corporate boards – and, to date, universally without shareholder approval. Removing the option – and right – to participate in a litigated class action, in our view, undermines a careful system of checks and balances in our capital markets.

As a prime example, we note that the LongView® Funds were the first to take action against egregious accounting malfeasance and investor fraud at Enron, becoming a named plaintiff in the ensuing investor class action. In the wake of shareholder losses of over \$74 billion, the LongView® Funds and other plaintiffs were able to recover \$7.2 billion for all investors in the class. We believe that the case itself was vital not only to obtain some recovery of losses for investors impacted by the fraud, but also to send a strong message to deter malfeasance in the marketplace. Without the option to pursue possible legal action and participate in a class action, we are concerned that deterrence of market fraud will be weakened. Arbitration should be an option, but it should not be the *only* option. We believe that capital markets operate best with a system of checks and balances and believe there is a role for judicial enforcement. The beneficiaries of the funds invested with Amalgamated Bank's LongView® Funds are often pensioners who have worked decades to build their retirement security. When one-off incidents of market fraud prompt companies like Enron to implode, the malfeasance not only creates an immediate economic loss, but also sends shockwaves that undermine all investors' confidence in the market. Providing an appropriate and well-balanced system of potential recourse is crucial for our capital markets to continue to excel.

We therefore join with other investors in asking the Committees on the Judiciary and on Banking, Housing, & Urban Affairs, jointly tasked with protecting American investors from unscrupulous or illegal financial practices, to encourage the SEC to continue its efforts to protect investor rights and restore the balance between those rights and the responsibilities of publicly traded companies and their corporate managers.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Noel Beasley', written over a circular stamp or seal.

Noel Beasley  
Chairman

December 17, 2013

The Honorable Al Franken  
U.S. Senate  
Washington, DC 20510

Dear Senator Franken:

**Re: Statement for the Senate Judiciary Committee Hearing Record: “The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**

We are members of a law school clinic, Civil Justice Through the Courts, at New York Law School. This is a public policy clinic, the mission of which is to raise awareness about attacks on access to the civil justice system. After studying the issue of forced arbitration, we write today to express our support for the Arbitration Fairness Act of 2013 (AFA), S.878, and to respectfully submit these comments for the hearing record of the December 17 hearing, “The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”

The AFA is critical to the protection of the American consumer, employee, and small business. The right of injured or violated people to vindicate their rights in court is a fundamental precept of American democracy. However, recent Supreme Court cases have allowed corporations to strip away this basic right by taking away consumers, employees, and small businesses’ access to civil trials and forcing them into mandatory, individual, binding arbitration.

A recent Alliance for Justice Report notes a 2007 study that “found that consumers win only five percent of cases brought before an arbitrator.”<sup>1</sup> There are many reasons that the process is so one-sided.

To start, the company or corporation typically chooses the arbitrator. Thus the private arbitration company has a financial incentive to side with the corporation – repeat business. Alliance for Justice explains, “[b]ecause major corporations create millions of dollars in business, a firm and its arbitrators have an incentive to keep corporation clients happy or risk losing business. Stark evidence of this ‘repeat player bias’ was revealed by a study finding that [the National Arbitration Forum’s] top arbitrators ruled for businesses against consumers 93.8% of the time.”<sup>2</sup>

Further, as *US News and World Reports* points out, arbitration clauses are “inherently unfair, because the companies choose the arbitrators, who know they’re unlikely to be re-hired if they make a habit of giving consumers an obviously fair shake. A recent Pew study<sup>3</sup> found that even

<sup>1</sup> Alliance for Justice, “Arbitration Activism: How the Corporate Court Helps Business Evade Our Civil Justice System,” December 16, 2013 <http://www.afj.org/wp-content/uploads/2013/12/Arbitration-Activism-Report-12162013.pdf>

<sup>2</sup> *Id.* citing Public Citizen, “The Arbitration Trap,” at 15-16. September 2007, [www.citizen.org/documents/ArbitrationTrap.pdf](http://www.citizen.org/documents/ArbitrationTrap.pdf)

<sup>3</sup> The Pew Charitable Trusts, “Banking on Arbitration: Big Banks, Consumers, and Checking Account Dispute Resolution,” November 2012, [http://www.pewstates.org/uploadedFiles/PCS\\_Assets/2012/Pew\\_arbitration\\_report.pdf](http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_arbitration_report.pdf)

when the process leads to financial compensation, the average amount is only about half what a court would bestow.<sup>4</sup>

Court rules of evidence do not apply to arbitration hearings and arbitrators are not required to follow the law – they do not even need legal training. As Public Citizen and the National Association of Consumer Advocates explain, “corporations can write the rules that govern arbitration proceedings involving them – such as rules concerning fees, discovery rights, or hearing venues – giving them the ability to tilt the playing field.”<sup>5</sup>

Additionally, arbitration proceedings are secret and decisions are binding. And companies can “contend with complaints one at a time, leaving victims unable to join forces or even to unearth evidence of a pattern of bad conduct.”<sup>6</sup>

Arbitration can be very expensive and class action bans prevent consumers from sharing the costs with other wronged parties. Often this prevents consumers from bringing their claims at all.

Over the past several years, more and more Americans have seen their rights taken away as the result of the Supreme Court’s interpretation of the Federal Arbitration Act (FAA), passed in 1925, “intended to target commercial arbitration agreements between two companies of generally comparable bargaining power.”<sup>7</sup> The Supreme Court expanded the meaning of the FAA far beyond its original scope and, as a result, forced arbitration clauses are appearing, not just in consumer contracts, but also in employment contracts, nursing home admission forms, online agreements, and more.

The AFA is designed to limit the use of mandatory arbitration – preventing corporations from insulating themselves from liability by forcing consumers to sign away their Constitutional rights. It is intended to “restore[] the original intent of the FAA.” Moreover, the AFA “restores the rights of workers and consumers to seek justice in our courts. It ensures transparency in civil litigation. And it protects the integrity of the Civil Rights Act, the Equal Pay Act, the Americans with Disabilities Act, and the Age Discrimination in Employment Act, among others.”<sup>8</sup>

#### **Recent Supreme Court Decisions That Have Made Arbitration Fairness Act is Necessary**

Three recent Supreme Court decisions in particular have altered the way cases are brought in this country. Those three cases are *Stolt-Nielson S.A. v. AnimalFeeds Int’l Corp.*, 130 S. Ct. 1758 (2010); *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011); *American Express Co. v.*

<sup>4</sup> Jim Lardner, “A Corporate ‘Get Out of Jail Free’ Card,” *US News and World Reports*, September 6, 2013, <http://www.usnews.com/opinion/blogs/economic-intelligence/2013/09/06/forced-arbitration-is-a-corporate-get-out-of-jail-free-card>

<sup>5</sup> Public Citizen and the National Association of Consumer Advocates, “Justice Denied One Year Later: The Harms to Consumers from the Supreme Court’s *Concepcion* Decision are Plainly Evident,” April 2012, <http://www.naca.net/sites/default/files/Justice%20Denied%20Concepcion%20Anniversary%20Report.pdf>

<sup>6</sup> Jim Lardner, “A Corporate ‘Get Out of Jail Free’ Card,” *US News and World Reports*, September 6, 2013, <http://www.usnews.com/opinion/blogs/economic-intelligence/2013/09/06/forced-arbitration-is-a-corporate-get-out-of-jail-free-card>

<sup>7</sup> Senator Al Franken, “The Arbitration Fairness Act of 2013,” May 7, 2013, <http://www.franken.senate.gov/files/documents/130507ArbitrationFairness.pdf>

<sup>8</sup> *Id.*

*Italian Colors Restaurant*, 133 S. Ct. 2304 (2013). While each presents a unique situation, all concern the way in which litigation is directed towards and often squashed under the rules of arbitration.

#### *Stolt-Nielson* Decision

*Stolt-Nielson* concerned international animal feed companies who discovered the shipping companies they had contracted with were engaged in an illegal price-fixing conspiracy. Respondent AnimalFeeds brought suit alleging price fixing under the Sherman Anti-trust Act. The suit was grouped with other similarly situated customers of the shipping companies. The contract was silent on the issue of class arbitration, however, and the issue had to be resolved before the case could continue. The issue was decided before a panel of arbitrators, who found that based on the evidence, there was no “intent to preclude class arbitration”<sup>9</sup>, and therefore class arbitration would be allowed. The decision was appealed to the District Court for the Southern District of New York, which vacated the award on the basis the arbitrators failed to conduct a choice-of-law analysis.<sup>10</sup> AnimalFeeds appealed to the Court of Appeals in New York, which again reversed, holding that “because Petitioners had cited no authority... against class arbitration, the arbitrators’ decision was not in manifest disregard of federal maritime law.”<sup>11</sup> The Supreme Court granted certiorari.

The Court took pains to point out that under the Federal Arbitration Act (FAA), arbitration “is a matter of consent, not coercion.”<sup>12</sup> It was undisputed that the contract between the parties required disputes be settled in arbitration, but said nothing about class proceedings.

AnimalFeeds relies on a recently decided Supreme Court decision, *Bazze v. Green Tree Financial Corp.*, 123 S. Ct. 2402. “In *Bazze*, a plurality of the court had ruled that the issue of class arbitration, where not specifically provided for in the contract, should be decided by the arbitrator, not the court.”<sup>13</sup>

Many companies after *Bazze* attempted to evade its perceived impact by including in contractual arbitration clauses provisions affirmatively prohibiting class action arbitrations. A number of courts, in increasing frequency, however, have stricken such provisions as void against public policy on a variety of grounds.<sup>14</sup>

The Court felt that lower courts had misinterpreted its holding in *Bazze*, and used its majority to eliminate the refuge consumers had sought from class action waivers. The Court began by first

<sup>9</sup> *Stolt-Nielsen S.A.*, 130 S. Ct. at 1766.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 1773, quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 109 S. Ct. 1248, (1989).

<sup>13</sup> Susan Jordan, “Stolt-Nielsen’s Effect on Consolidation of Arbitration,” *Law360*, July 07, 2010, [http://www.lockelord.com/files/News/9424c623-87bd-4514-97a6-9da91766731d/Presentation/NewsAttachment/a4608d66-324a-467c-82dd-9db2056704c4/2010-07\\_Stolt-NielsensEffect\\_Jordan.pdf](http://www.lockelord.com/files/News/9424c623-87bd-4514-97a6-9da91766731d/Presentation/NewsAttachment/a4608d66-324a-467c-82dd-9db2056704c4/2010-07_Stolt-NielsensEffect_Jordan.pdf).

<sup>14</sup> D. Matthew Allen & Rebecca N. Shwayri, “The Supreme Court’s Class Action “Do Over” in *Stolt Nielsen*,” *Bloomberg Law Reports*, <http://www.carltonfields.com/files/Publication/580f5c76-060c-4caf-a39f-c1ade757be5f/Presentation/PublicationAttachment/0ce7a1ad-bc6b-46e4-96ca-c90feb017e23/The%20Supreme%20Court%27s%20Class%20Action%20Arbitration%20-%20Do%20Over.pdf>.

noting that “only the plurality decided that question”<sup>15</sup>, and with little explanation determined that “*Bazze* did not establish the rule to be applied in deciding whether class arbitration is permitted.”<sup>16</sup>

The Supreme Court ultimately reached the conclusion that “a party may not be compelled under FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so.”<sup>17</sup> Because the contract between the companies was silent on the issue of class actions, it couldn’t be inferred that either party had consented to class arbitration proceedings.<sup>18</sup> In other words, where an arbitration agreement exists, for class proceedings to proceed, agreement on the issue must be explicit.

#### *AT&T Mobility* Decision

A year after *Stolt-Nielsen*, the Court was again called upon to decide whether a class arbitration action should be permitted. Following the *Stolt-Nielsen* decision, companies made sure arbitration agreements expressly prohibited class arbitrations. Such was the case when the Concepcions purchased cellular service through AT&T. The phones that came with the service plan were advertised as free, but the Concepcions “were charged \$30.22 in sales tax based on the phones’ retail value.”<sup>19</sup>

The Concepcions brought suit against AT&T in the United States District Court for the Southern District of California, and were consolidated into a class action, alleging false advertising and fraud.<sup>20</sup> AT&T moved compel individual arbitration, on the grounds the contract the Concepcions signed expressly required arbitration and prohibited class proceedings. The District Court held that based on a rule from the California Supreme Court case *Discover Bank v. Superior Court*, 113 P. 3d 1100 (2005), “the arbitration provision was unconscionable”<sup>21</sup>. The so called *Discover Bank* rule works to nullify class-action waivers in consumer contracts of adhesion where “the party with the superior bargaining power has carried out a scheme of deliberately cheat large numbers of consumers out of individually small sums of money.”<sup>22</sup> That decision was affirmed by the Ninth Circuit, and the case ultimately made its way to the Supreme Court of the United States.

In an opinion written by Justice Scalia, the Court found that the *Discover Bank* rule conflicts with the Federal Arbitration Act (FAA), and was therefore preempted. Section 2 of the FAA says that an arbitration agreement “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”<sup>23</sup> The majority does not shy away from this language; it is the first sentence of the majority opinion. The Court says that

<sup>15</sup> *Stolt-Nielsen S.A.*, 130 S. Ct. at 1772.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 1775.

<sup>18</sup> *Id.* at 1776.

<sup>19</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1744 (2011).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* at 1745.

<sup>22</sup> *Id.* at 1745.

<sup>23</sup> *Id.* at 1744.

the grounds in which an arbitration agreement can be invalidated are “generally applicable contract defenses”<sup>24</sup>, such as fraud or duress.

Like in *Stolt-Nielsen*, the majority focused on the differences between bilateral and class arbitration. “The switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment.”<sup>25</sup>

Finally the majority acknowledges the concern of the dissent; “that class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system.”<sup>26</sup> This concern is really foundational to the issues raised by predispute arbitration agreements, when a company effectively insulates itself from liability from wrongdoing by making the process of vindicating a right so arduous that it cannot feasibly be done. Again, this important public policy issue was dealt with coldly by the majority; “States cannot require a process that is inconsistent with the FAA, even if it is desirable for unrelated reasons.”<sup>27</sup>

The dissent reads the language of Section 2 of the FAA plainly, stating the very wording of Section 2 allows for the operation of the California *Discover Bank* rule.<sup>28</sup> The dissent believes the majority is simply wrong in believing that the FAA and the Discover Bank rule are inconsistent with one another; that by “increasing the complexity of arbitration proceedings”<sup>29</sup>, the *Discover Bank* rule discourages “parties from entering into arbitration agreements.”<sup>30</sup> The dissent first points out that contrary to the majority’s argument, “class arbitration proceedings...take less time than the average class action in court.”<sup>31</sup> And if efficiency is such a concern, surely a single class proceeding would be “more efficient than thousands of separate proceedings for identical claims.”<sup>32</sup>

#### *Italian Colors* Decision

With the *AT&T Mobility* decision having been decided two years prior, the decision in *American Express Co. v. Italian Colors Restaurant* followed the same rationale but went even further. In short, a group of restaurants brought suit against American Express alleging that American Express (“Amex”) used its superior market position in the credit card market “to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards.”<sup>33</sup>

The restaurant presented evidence that proving the antitrust claims would require an expert analysis, costing “several hundred thousand dollars, and might exceed \$1 million, while the maximum recovery for an individual plaintiff would be \$12,850, or \$38,549 when trebled.”<sup>34</sup>

<sup>24</sup> *Id.* at 1748.

<sup>25</sup> *Id.* at 1751.

<sup>26</sup> *Id.* at 1753.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 1756.

<sup>29</sup> *Id.* at 1758.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 1759.

<sup>32</sup> *Id.*

<sup>33</sup> *American Express Co.*, 133 S. Ct. at 2308.

<sup>34</sup> *Id.*

Like *AT&T Mobility*, there was an explicit agreement against class arbitration in the contracts between American Express and the restaurants. But in this scenario, not only was arbitration an unlikely solution to the issue, but arbitration would have been completely insufficient to find a remedy. Essentially, this was a scenario where, if the court were to find that no class arbitration could proceed, Amex had insulated itself from antitrust violations and realized potentially millions of dollars from their wrongdoing. This concern, however, did not sway a majority of the Supreme Court.

The restaurants attempted to distinguish themselves from the *Stolt-Nielsen* holding by not expressly pursuing a remedy in class arbitration. “As the merchants explain, all they have ever sought is the effective vindication of their statutory rights. It doesn’t matter whether that takes the form of class litigation, class arbitration, bilateral arbitration with cost-shifting, or something else.”<sup>35</sup> This “effective vindication” argument resonated with the Second Circuit, which held “because respondents had established that ‘they would incur prohibitive costs if compelled to arbitrate under the class action waiver,’ the waiver was unenforceable and the arbitration could not proceed.”<sup>36</sup>

But the Supreme Court was not persuaded by the “effective vindication” argument, holding “the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the right to pursue that remedy.”<sup>37</sup>

#### The Impact of These Supreme Court Cases

Many corporations have taken it upon themselves to revise their contracts to include mandatory arbitration agreements. Public Citizen illustrated the scope of the problem by compiling a list of corporations that force consumers into mandatory binding arbitration and “immuniz[e] themselves from accountability for wrongdoing.”<sup>38</sup>

Their list, which is only a sample of the corporations that have started including these clauses in their contracts with consumers includes telecommunications corporations: DirecTV, Verizon, AT&T, Comcast, Sprint Nextel Wireless, T-Mobile, Clearwire, Time Warner Cable, and Tracfone.<sup>39</sup>

It also lists consumer banks and credit corporations, including Wells Fargo, US Bank, Regions Banks, BB&T, Discover, PNC Bank, Chase, TD Bank, Charles Schwab Bank, and American Express.<sup>40</sup>

Corporations that provide students with loan money, including Sallie Mae, Citibank, Sovereign Bank and Discover<sup>41</sup>, are including these mandatory arbitration clauses in their contracts with

<sup>35</sup>David Garcia, “Argument Preview: Under what circumstances are arbitration agreements with class action waivers enforceable?,” *SCOTUS Blog*, February 22, 2013, <http://www.scotusblog.com/2013/02/argument-preview-under-what-circumstances-are-arbitration-agreements-with-class-action-waivers-enforceable/>.

<sup>36</sup>*American Express Co.*, 133 S. Ct. at 2308, citing *In re American Express Merchants’ Litigation*, 554 F. 3d 300, 315-316 (CA2 2009).

<sup>37</sup>*Id.* at 2311.

<sup>38</sup>Public Citizen, “Forced Arbitration Rogues Gallery,” <http://www.citizen.org/rigged-justice-rogues-gallery>.

<sup>39</sup>*Id.*

<sup>40</sup>*Id.*

<sup>41</sup>*Id.*

students, which is inherently unfair given the fact that the average student in need of a school loan is not financially equipped to bring an individual suit against the corporation in an arbitration forum.

Consumer electronics corporations, such as Sony, Dell, Gateway Computers, Electronic Arts, Xbox Live, and Toshiba,<sup>42</sup> have included these mandatory arbitration agreements in their typical consumer contract to the detriment of all.

Nursing homes, such as Carrington Place Care Center (Candansk, LLC), Covenant Health (Covenant Dove, Inc.), Driftwood Rehabilitation and Nursing Center, Kindred Nursing Center, Manor Care of Florida, OP Winter Haven, Inc., Palm Garden of Sun City Center (SA-PG Sun City Center, LLC), and Tara at Thunderbolt Nursing and Rehabilitation Center (Triad Health Management of Georgia, III, LLC)<sup>43</sup> have all taken advantage of ill, elderly, and disabled consumers who require medical treatment, but lack the negotiation abilities required to avoid agreeing to the pre-dispute mandatory arbitration clauses with class action waivers.

Home builders, such as D.R. Horton, Pulte Homes, Centex, Lennar, KB Home, Hovnanian Enterprises, NVR, The Ryland Group, and Beazer Homes,<sup>44</sup> are all corporations that have selfishly taken advantage of American families who hire the corporation to help them begin their new life.

Starbucks, Pep Boys, Gold's Gym, Ticketmaster, Crocs, In-N-Out Burger, Red Mango, Patagonia, and Discover<sup>45</sup> are corporations that have included pre-dispute mandatory arbitration clauses in their contracts relating to the purchase of gift cards, immunizing themselves from liability, as no rational consumer would individually sue Starbucks over the cost of three cups of coffee.

Pre-dispute mandatory arbitration clauses have also made their way online, with websites such as Amazon.com, Barnes and Noble, Netflix, Hulu, Groupon, Match.com, Ebay, Microsoft, Paypal, Change.org, Spotify, and Stubhub<sup>46</sup> putting online consumers at risk of being unable to vindicate their rights over unfair trade practices relating to their purchase.

Another place people are now finding forced arbitration agreements is in their cruise ship tickets. After the Carnival Cruise Lines ship Triumph disaster in February 2013, where passengers "suffered in sweltering heat, walked through sewage and faced unspeakable conditions,"<sup>47</sup> many assumed they could sue the cruise line. However, as Nan Aron, President of Alliance for Justice noted, "[i]t appears that Carnival is far better prepared to prevent lawsuits than it was to contain the damage aboard the Triumph. In the fine print found in every ticket, there is a clause that bars most lawsuits, passengers must go into forced arbitration."

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<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> Nan Aron, "Arbitration Fairness Act would protect American consumers," *The Reporter*, May 12, 2013, [http://www.thereporter.com/ci\\_23226704/arbitration-fairness-act-would-protect-american-consumers](http://www.thereporter.com/ci_23226704/arbitration-fairness-act-would-protect-american-consumers)

This list makes clear why forced arbitration is not voluntary. Average consumers buying a cell phone or opening a bank account, students taking out loans, and the elderly and disabled entering nursing homes, lack the ability to fight forced arbitration clauses in the contracts they are signing. Often they don't even know they are there – and even if they do, they don't have a choice but to sign.

### Case Examples

Before *Concepcion*, contracts that included forced arbitration agreements with class action waivers could have been invalidated under state contract law. But after *Concepcion*, these agreements are being upheld. Any case that may have been able to get around *Concepcion* is now in danger because of *American Express*. Examples of cases where forced arbitration clauses have prevented victims from bringing claims in court are illustrated below:

- Matthew Wolf, “captain in the Judge Advocate General Corps of the Army Reserves,” had to break the lease for his Nissan Infiniti when he was called to join forces in Afghanistan, but fortunately, the Servicemembers Civil Relief Act would have protected him from losing the \$400 he had paid in advance towards his monthly payments.<sup>48</sup> But he was deprived of the \$400, so in 2010, his attorney brought a claim on behalf of Wolf and other similarly situated service members.<sup>49</sup> Unfortunately for them, the *Concepcion* decision brought their lawsuit to a screeching halt, because the contract between Wolf and Nissan included a pre-dispute mandatory arbitration clause with a class action waiver.<sup>50</sup> On a larger scale, the ramifications of this decision are more severe than a \$400 loss: if this claim was tried as a class action, it would have alerted other unaware service members, who were called into active duty, that they were also entitled to reimbursement of the monthly payments that they paid in advance. In fact, Wolf never would have known that he was entitled to this reimbursement if a friend who was also a service member hadn't told him so.<sup>51</sup> There could be thousands of other similarly situated service men, unaware that they are entitled to this right.<sup>52</sup>
- The Alliance for Justice listed several examples of cases thrown out after *Concepcion*. One was the case of Lourdes Cruz. Cruz fell victim to AT&T Wireless's superior contracting power when she was faced with charges of \$2.99/month for “roadside assistance service” that she was not even aware she had agreed to. She attempted to bring a class-action suit “under Florida's unfair trade practices law,” but due to the Supreme Court's decision in *Concepcion*, she had to individually arbitrate her claim instead.<sup>53</sup> Like Wolf, the court essentially told Cruz that, in order to recover the sum of the monthly charges, she would first have to spend more than that sum individually arbitrating her

<sup>48</sup> David Segal, “A Rising Tide Against Class-Action Suits,” *New York Times*, May 5, 2012, [http://www.nytimes.com/2012/05/06/your-money/class-actions-face-hurdle-in-2011-supreme-court-ruling.html?\\_r=1](http://www.nytimes.com/2012/05/06/your-money/class-actions-face-hurdle-in-2011-supreme-court-ruling.html?_r=1).

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> Alliance for Justice, “One Year Later: The Consequences of AT&T Mobility v. Concepcion,” *Justice Watch*, April 27, 2012, <http://afjjusticewatch.blogspot.com/2012/04/one-year-later-consequences-of-at.html>.

claim. This situation allows corporations to take advantage of unsuspecting consumers and gives the corporations peace of mind because it is not in the consumers' best interests financially to sue the corporation for their wrongful acts.

- Arbitration clauses have been upheld even when it's clear the person signing the agreement has no idea what they're agreeing to. In *Spring Lake NC, LLC v Holloway*<sup>54</sup> involves the infliction of a mandatory arbitration agreement upon "a 92 year old with a fourth-grade education," who was in a state of increasing confusion and lacking normal memory functionality.<sup>55</sup> The trial court found that this person "could not possibly have understood what she was signing," but the mandatory arbitration clause was enforced regardless.<sup>56</sup>
- Another example of the impact of mandatory arbitration clauses on the elderly involves William Kurth, an eighty-four year old World War II veteran, who passed away due to the negligent staff at Mount Carmel Medical and Rehabilitation Center ("Center"), which is a Kindred Healthcare Inc. owned facility.<sup>57</sup> Within about an hour of arriving at the Center to admit her husband, Mrs. Kurth was fed the plain-English version of more than fifty pages of documents, which included a pre-dispute mandatory arbitration clause at the end.<sup>58</sup> This mandatory arbitration clause was described to Mrs. Kurth as "necessary in order to admit Mr. Kurth into the nursing home."<sup>59</sup> Admitting Mr. Kurth was the only practical option because of Mrs. Kurth's inability to take care of him on her own, so she truly had no choice. Mr. Kurth was immobile after he had hip surgery; the staff at the Center was expected to ensure that he did not develop pressure ulcers due to the lack of mobility. However, Mr. Kurth's care did not change to accommodate his need for increased care, and he "developed 10-11 stage 4 pressure ulcers, [which were] so severe that they left bone and organs exposed."<sup>60</sup> Around the same time that Mr. Kurth developed these ulcers, Kindred switched from having a "wound care team," consisting of multiple nurses, to just one nurse, whose duty was to monitor and treat the wounds of all 155 residents.<sup>61</sup> Unfortunately for Mr. Kurth, the wound care nurse did not treat a single one of his pressure ulcers.<sup>62</sup> These incidents, when taken together, directly caused Mr. Kurth's untimely demise. After two half-hearted offers by Kindred to pay for Mr. Kurth's funeral costs, Mr. Kurth's family attempted to sue Kindred; the pre-dispute mandatory arbitration clause stopped their lawsuit before it began.<sup>63</sup> This case took place before *Concepcion*.

<sup>54</sup> *Spring Lake NC, LLC v Holloway*, 110 So.3d 916 (Fla. Dist. Ct. App. 2013)

<sup>55</sup> Public Justice, "Comments of Public Justice to the Consumer Financial Protection Bureau," August 7, 2013, <http://publicjustice.net/sites/default/files/downloads/Public-Justice-Response-to-CFPB-re-Consumer-Survey.pdf>.

<sup>56</sup> *Id.*

<sup>57</sup> American Association for Justice, "The Real Life Consequences of Forced Arbitration," <http://www.justice.org/cps/rde/justice/hs.xsl/2961.htm>.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

- A recent US News article<sup>64</sup> cites a case involving New York citizen, and disabled resident, Bernadita Duran. Duran was a victim of a “last-dollar” scam and lost “\$4000 to a ‘debt settlement’ company, which pocketed the whole amount in fees without settling any of her debts.”<sup>65</sup> Because of an arbitration clause, she learned she would be forced to “take her complaint outside the public court system to a private arbitration firm of the company’s choosing.”<sup>66</sup> In addition to her monetary loss, Ms. Duran was expected to travel to Arizona, where the debt company and its chosen arbitrator were. And, “if she considered that an unfair burden, well, Duran was free to raise the point- with the Arizona arbitrator, once she got there.”<sup>67</sup>
- The Second Circuit recently upheld an arbitration clause in an employment contract in *Parisi v Goldman Sachs & Co.*<sup>68</sup> In this case, upon becoming a managing director at Goldman Sachs in 2003, Lisa Parisi “signed a Managing Director Agreement, which contained an arbitration clause. The scope of the clause included any claim arising out of ‘employment related matters.’”<sup>69</sup> After she was fired in 2008, Parisi sued Goldman Sachs, alleging Title VII gender discrimination, along with two other former employees, “as part of a putative class, alleging a continued pattern of gender discrimination.”<sup>70</sup> Goldman Sachs filed a motion to compel arbitration. The lower courts denied the motion to compel, but on appeal, the Second Circuit “found that Congress has expressly allowed for arbitration of Title VII claims.” Doing so, the court recognized “two circumstances in which motions to compel arbitration must be denied because they would prevent plaintiffs from vindicating a statutory right. First, arbitration agreements have been invalidated when they have interfered with the recovery of statutory damages. Second, when dealing with some antitrust actions under the Sherman Act, arbitration clauses containing class waivers have been held unenforceable because individual arbitration would be cost prohibitive to the point of precluding plaintiffs from bringing such claims.”<sup>71</sup>

Parisi attempted to argue that the Court should allow her claim to continue because Title VII’s “pattern-or-practice” clause was only available only to class plaintiffs, and the arbitration clause prevented her from following through on her “substantive right” on the claim. Unfortunately, but not surprisingly, the Court “disagreed with Parisi, saying that ‘pattern-or-practice’ is not an independent cause of action, but merely a method of proving the disparate treatment element of a Title VII claim...[and] the Court therefore

<sup>64</sup> Jim Lardner, “A Corporate ‘Get Out of Jail Free’ Card,” *US News and World Reports*, September 6, 2013, <http://www.usnews.com/opinion/blogs/economic-intelligence/2013/09/06/forced-arbitration-is-a-corporate-get-out-of-jail-free-card>

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Parisi v. Goldman Sachs & Co.*, No. 11-5229-cv (2d Cir. March 21, 2013).

<sup>69</sup> Jeremy Gray, “Parisi v. Goldman Sachs & Co.: Second Circuit Upholds Arbitration Clause Barring Title VII ‘Pattern or Practice,’” *LawUpdates.com*, May 22, 2013, [http://www.lawupdates.com/commentary/parisi\\_v.\\_goldman\\_sachs\\_co.\\_second\\_circuit\\_upholds\\_arbitration\\_clau/](http://www.lawupdates.com/commentary/parisi_v._goldman_sachs_co._second_circuit_upholds_arbitration_clau/)

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

held that 'such a right does not exist.'<sup>72</sup>

Jeremy Gray, a partner in an employment law firm who wrote about this case for *Lawupdates.com* explains, the "Second Circuit's holding in *Parisi* has demonstrated the strength of the FAA and the courts' subsequent unwillingness to invalidate arbitration agreements, even when they forbid discrimination class actions."<sup>73</sup>

The United States has always been a leader in the right to be guaranteed a fair day in court. Cases like those above are affecting those who most desperately need our judicial system. They clearly illustrate why the Arbitration Fairness Act is so desperately needed.

#### **What the AFA Will Do**

Whether or not the AFA remedies the problems that exist because of forced arbitration depends on what exactly the AFA purports to do. The text of the bill itself is short, but the summary does a good job of describing what the bill hopes to accomplish. "Arbitration Fairness Act of 2013 - Declares that no predispute arbitration agreement shall be valid or enforceable if it requires arbitration of an employment, consumer, antitrust, or civil rights dispute."<sup>74</sup> Thus it would give consumers the freedom to choose whether or not to submit themselves to the arbitration process.

There are occasions where people may prefer arbitration; the system of arbitration is faster and easier in some cases. The important point is that this bill would give the injured party a choice.

Thank you for hearing our views on this important legislation. If you have any questions, please contact Zakary Woodruff, Zakary.Woodruff@law.nyls.edu, Jessica Braunstein, Jessica.Braunstein@law.nyls.edu, or Parul Nanavati, Parul.Nanavati@law.nyls.edu.

Respectfully submitted,

Law Student Clinic Members  
Civil Justice Through the Courts  
New York Law School  
185 West Broadway  
New York, NY 10013

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<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> S. 878, 113<sup>th</sup> Cong. (2013-2014), <http://beta.congress.gov/bill/113th/senate-bill/878?q={%22search%22:%22arbitration%20fairness%20act%22}}>.

December 16, 2013

The Honorable Patrick J. Leahy, Chairman  
The Honorable Charles Grassley, Ranking Member  
U.S. Senate Committee on the Judiciary  
224 Dirksen Senate Office Building  
Washington, DC 20510

Re: Support for the Arbitration Fairness Act of 2013, S. 878

Dear Chairman Leahy and Ranking Member Grassley:

We, the undersigned organizations, strongly support the Arbitration Fairness Act of 2013 (or "AFA"), S. 878, introduced in the Senate by Senator Al Franken (D-MN). This important legislation would end the growing predatory practice of forcing non-union employees, consumers, and small businesses to sign away their Constitutional rights to legal protections and access to federal and state courts. Predispute binding mandatory (or forced) arbitration clauses are proliferating in employment contracts (including minimum wage-workers, whistleblowers, servicemembers, and executives), and in everyday consumer contracts for products and services such as credit cards, child care, cell phones, car loans, home construction, student loans, rent-to-own products, payday loans, health insurance policies, and nursing homes.

Specifically, the AFA would make forced arbitration unenforceable in civil rights, employment, antitrust, and consumer disputes. It would also restore the congressional intent behind the Federal Arbitration Act (FAA), which was enacted in 1925 to facilitate arbitration of disputes between commercial entities of similar sophistication and bargaining power.

A series of decisions by the U.S. Supreme Court have broadly interpreted the FAA to allow corporations to insert arbitration clauses in one-sided, non-negotiable contracts. The Court further expanded the FAA's meaning to effectively overcome other federal laws, including those that exhibit a clear congressional intent to preserve consumers' rights, and make it significantly more difficult to challenge even the most abusive forced arbitration clauses.

**Consumer and employment contracts with arbitration clauses are often non-negotiable, and erode traditional legal safeguards.**

Corporations that place forced arbitration clauses in their standard contracts with consumers and non-union employees shield themselves from accountability for wrongdoing. The contracts typically specify who the arbitrator will be, under what rules the arbitration will take place, the state the arbitration will occur in, and the payment terms for the arbitration. Arbitration clauses are often contained in non-negotiable contracts and a person has no choice but to acquiesce or forgo the goods, services, and/or employment altogether.

None of the safeguards of our civil justice system are guaranteed for persons attempting to enforce their employment, consumer, antitrust, and civil rights in forced arbitration. There is no impartial judge or jury, but rather arbitrators who rely on major corporations for repeat business. With nearly no oversight or accountability, businesses or their chosen arbitration firms set the rules for the secret proceedings, often limiting the procedural protections and remedies otherwise

available to individuals in a court of law. In addition, the often exorbitant arbitration fees are prohibitive for most individuals.

Forced arbitration also weakens the value of federal and state laws intended to protect consumers and employees by removing their ability to enforce those laws in court.

Laws at risk include provisions of the Civil Rights Acts of 1964 and 1991, the Age Discrimination in Employment Act, the Americans with Disabilities Act, the Family and Medical Leave Act, the Fair Labor Standards Act, the Equal Pay Act, the Uniformed Services Employment and Reemployment Rights Act (USERRA), the National Labor Relations Act, the Sherman Antitrust Act, the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Servicemembers Civil Relief Act, the National Defense Authorization Act for Fiscal Year 2013 (amending the Military Lending Act), the Lilly Ledbetter Fair Pay Act of 2009, the Telephone Consumer Protection Act, the Fair Debt Collection Practices Act, the Credit Repair Organizations Act, the Electronic Fund Transfer Act, the False Claims Act, the Fair Credit Reporting Act, the Right to Financial Privacy Act, the Real Estate Settlement Procedures Act, the Truth in Lending Act, and the civil provisions of the Racketeer Influenced and Corrupt Organizations Act.

In April 2011, the U.S. Supreme Court dealt a blow to consumers and employees, ruling that companies can ban class actions in the fine print of contracts. In *AT&T Mobility, LLC v. Concepcion*, the Court held that corporations may use arbitration clauses to ban consumers and employees from exercising their right to join together through class actions to hold powerful corporations accountable. As a result, thousands of valid legal claims by consumers and employees that expose clear abuses and corporate misconduct have been suppressed and prevented from being brought in court. In addition, many class actions have been dismissed and sent to arbitration on an individual basis even when judges state that the cases may be best suited to proceed as class actions.

The Supreme Court further expanded corporations' ability to evade the enforcement of critical federal laws with its decision in *American Express v. Italian Colors Restaurant* (June 2013). In this case, small businesses sought a class action to pursue their claims that Amex had violated federal antitrust laws. The Court held that the class action ban and forced arbitration clause in the contracts were enforceable—even in cases where the cost of individual arbitration would, as a practical matter, prevent the vindication of rights under federal law. The arbitration clause in the Amex contract with the merchants prevented the sharing of costs that a class action would allow. Consequently, these contract terms enable companies to insulate themselves from liability even where they have in fact violated the law.

**The AFA would allow consumers and employees to choose arbitration after the dispute arises.**

The impact of recent Supreme Court precedent should add urgency for Congress to pass the AFA to enable individuals and small businesses to decide how to resolve disputes, after the dispute arises.

The AFA does not seek to eliminate arbitration and other forms of alternative dispute resolution agreed to voluntarily after a dispute arises. Nor would it affect collective bargaining agreements that require arbitration between unions and employers. The AFA would restore transparency and access to our civil justice system and preserve important civil rights, employment, antitrust, and consumer protections.

Congress has passed laws to ban forced arbitration for disputes involving auto dealers, poultry and livestock producers, certain employees of federal contractors, and servicemembers for some credit and loan products. The time has come for Congress to outlaw forced arbitration for all America's consumers and workers.

We urge you and the other members of Congress to pass S. 878.

Sincerely,

9to5  
AARP  
AFL-CIO  
Alliance for Justice  
American Association of Justice  
American Association of University Women  
American Civil Liberties Union (ACLU)  
American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO  
Americans for Financial Reform  
Bazelon Center for Mental Health Law  
Center for Justice & Democracy  
Center for Responsible Lending  
Citizen Works  
Committee to Support the Antitrust Laws  
Consumer Action  
Consumer Federation of America  
Consumer Watchdog  
Consumers for Auto Reliability and Safety  
Consumers Union  
ConsumersCount.Org  
D.C. Consumer Rights Coalition  
Home Owners for Better Building  
Homeowners Against Deficient Dwellings  
Legal Aid Justice Center  
Maryland Consumer Rights Coalition  
MFY Legal Services, Inc.  
NAACP  
National Association of Consumer Advocates  
National Consumer Voice for Quality Long-Term Care  
National Consumer Law Center  
National Consumers League  
National Employment Law Project

National Employment Lawyers Association (NELA)  
National Partnership for Women & Families  
National Women's Law Center  
NC Justice Center  
People For the American Way  
Public Citizen  
Reserve Officers Association (ROA)  
The Leadership Conference on Civil and Human Rights  
U.S. Public Interest Research Group  
West Virginia Citizen Action Group



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December 16, 2013

Honorable Al Franken  
 309 Hart Senate Office Building  
 Washington, DC 20510

Dear Senator Franken:

Thank you for your commitment to addressing a long series of rulings by the Supreme Court that have unduly expanded the reach of the Federal Arbitration Act (FAA), and for your work in organizing this important hearing, entitled "The Federal Arbitration Act and Access to Justice." I am writing on behalf of Constitutional Accountability Center (CAC), a public interest law firm, think tank, and action center dedicated to fulfilling the progressive promise of the Constitution's text and history, to offer our thoughts on these recent rulings and to place these rulings within the larger context of the Court's business docket.

Having reviewed the history behind the FAA, CAC shares your conviction that in a series of mostly 5-to-4 rulings, the Supreme Court majority has badly misinterpreted the meaning of the law and the intent of Congress. While CAC has not yet endorsed any specific legislative fixes for these misguided rulings, we believe that it is critical that you and the Senate Judiciary Committee are holding hearings and working on a response to these rulings. In that vein, we are troubled by the statistics produced by Professor Richard Hasen that indicate that Congress has been far less active than in the past at passing legislation that effectively reverses Supreme Court rulings that misinterpret statutes.<sup>1</sup> With a conservative Supreme Court that is actively chipping away at some of the most important progressive statutes enacted by Congress since the New Deal, a responsive Congress is more important now than ever.

I am also writing to share the findings from recent research that we have conducted on the U.S. Chamber of Commerce's success before the Roberts Court. We believe that these findings provide useful background information on the important role that the Chamber has played in shaping the Court's recent business decisions, including those addressing arbitration.

Since 2010, CAC has completed a series of empirical studies on the success rate of the U.S. Chamber of Commerce as an *amicus* participant before the Supreme Court.<sup>2</sup> These studies document a

<sup>1</sup> Richard L. Hasen, *End of the Dialogue? Political Polarization, the Supreme Court, and Congress*, 86 S. CAL. L. REV. 205 (2013). Professor Hasen documents that recent Congresses have been much less active in overriding the Court's statutorily-incorrect decisions than have prior Congresses – with the number of overrides plummeting from 12 during each two-year congressional term from 1975-1990, to 5.8 per term from 1991-2000, and to a mere 2.8 per term from 2001-2012.

<sup>2</sup> See *A Big Term for Big Business*, <http://theusconstitution.org/text-history/2094/big-term-big-business>; *Not-So-Risky Business: The Chamber of Commerce's Quiet Success Before the Roberts Court – An Early Report for 2012-2013*, <http://theusconstitution.org/think-tank/issue-brief/not-so-risky-business-chamber-commerce%E2%80%99s>.

sharp increase in the Chamber's success rate before the Court since Chief Justice Roberts and Justice Alito were confirmed. They also show a serious ideological divide in cases with Chamber participation, with the Court's five conservatives – Chief Justice Roberts and Justices Alito, Kennedy, Scalia, and Thomas – virtually certain to rule in favor of the Chamber's position in closely decided cases.

Just last Term, the Chamber participated in nearly a quarter of the Court's cases, compiling an impressive record of 14 wins and 3 losses – an 82% winning percentage. All told, since Justice Alito succeeded Justice O'Connor on the Court in 2006, the Chamber has won 71% of its cases overall (76 out of 107), compared with only 43% in the late Burger Court (15 of 35 from 1981-1986) and 56% in the stable Rehnquist Court (45 of 80 from 1994-2005).

Even more striking is the Chamber's success in 5-to-4 or 5-to-3 rulings – cases in which just one defection from the majority could have swung the case against the Chamber. With its undefeated record in these closely decided cases last Term, the Chamber has won 82% of these cases overall (27 of 33) since Justice Alito joined the Court, and the Court's conservatives have sided with the Chamber's position 85% of the time in these controversial cases. This represents a massive pro-business shift, even when compared to the last eleven years of the conservative Rehnquist Court (from 1994 to 2005), which sided with the Chamber's position in 64% of its close cases (9 of 14) and whose conservatives sided with the Chamber's position 68% of the time.

One area of particular success for the Chamber has been the Roberts Court's decisions regarding arbitration. In recent years, the Chamber and its Institute for Legal Reform have helped lead the charge in Congress against the proposed Arbitration Fairness Act. Our research demonstrates that the Chamber has also played a leading role in shaping the Roberts Court's arbitration rulings. Indeed, the Chamber has filed *amicus* briefs in every major arbitration case decided by the Roberts Court, including *American Express v. Italian Colors Restaurant*, *AT&T Mobility LLC v. Concepcion*, and *Rent-A-Center v. Jackson*.

The Chamber has also been on the winning side in the vast majority of these cases. Since Justice Alito joined the Court, the Chamber has compiled a record of 8 wins and 2 losses in its arbitration cases – an 80% winning percentage. Interestingly, 6 of these cases were decided by 5-to-4 or 5-to-3 majorities, with the Chamber winning 5 of them and the Court's conservatives siding with the Chamber's position 90% of the time.

Through its participation and success before the Roberts Court, the Chamber has continued to push the Court to expand the reach of the FAA, often by manipulating the text of this near-century-old law and disregarding its legislative history. Nearly two decades ago, Justice O'Connor correctly described the Court's arbitration jurisprudence as "an edifice of its own creation."<sup>3</sup> Today, as a product

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[quiet-success-roberts-court-%E2%80%93-early](#); *Big Wins for Big Business: Themes and Statistics in the Supreme Court's 2010-2011 Business Cases*, <http://theusconstitution.org/think-tank/issue-brief/big-wins-big-business-themes-and-statistics-supreme-courts-2010-2011-business>; *Open for Business: Tracking the Chamber of Commerce's Supreme Court Success Rate from the Burger Court Through the Rehnquist Court and Into the Roberts Court*, <http://theusconstitution.org/think-tank/issue-brief/open-business-tracking-chamber-commerces-supreme-court-success-rate-burger>; *A Tale of Two Courts: Comparing Corporate Rulings by the Roberts and Burger Courts*, <http://theusconstitution.org/think-tank/issue-brief/tale-two-courts-comparing-corporate-rulings-roberts-and-burger-courts>; *The Roberts Court and Corporations: The Numbers Tell the Story*, <http://theusconstitution.org/think-tank/issue-brief/roberts-court-and-corporations-numbers-tell-story>.

<sup>3</sup> *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 283 (1995) (O'Connor, J., concurring).

Page 3

of subsequent arbitration rulings – many of them issued by the Roberts Court at the Chamber’s urging – mandatory binding arbitration provisions now pop up, or more often lie hidden in fine print, in just about every conceivable agreement that Americans are obliged to sign, whether to take a job, obtain telephone service, enroll a parent in an assisted living facility, visit a hospital emergency room, purchase a product, or open a bank account; the list goes on and on.

These agreements frequently tilt the arbitration proceedings in a pro-business direction – for instance, by allowing the companies to choose the arbitrator in a given dispute. Other times – as was the case last Term in *American Express* – these agreements include class arbitration waivers, which require ordinary Americans and small businesses to arbitrate their claims individually rather than as a group. From there, each injured party often faces a disturbing choice, described well by Justice Kagan in her *American Express* dissent: “Spend way, way, way more money than your claim is worth,” or drop you claim altogether and “relinquish” your legal rights.<sup>4</sup> In turn, Justice Kagan added, the Court has created a “mechanism” that allows businesses “to block the vindication of meritorious . . . claims and insulate wrongdoers from liability.”<sup>5</sup>

These are very serious claims that warrant this Committee’s full attention. Thank you very much for considering Constitutional Accountability Center’s views as part of this process.

Respectfully,



Douglas T. Kendall  
President

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<sup>4</sup> *American Exp. Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2316 (2013) (Kagan, J., dissenting).

<sup>5</sup> *Id.* at 2320.

**Submission by the Committee to Support the Antitrust Laws****To the Senate Judiciary Committee****For the Record of the Hearing Entitled****“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**

December 17, 2013

The Committee to Support the Antitrust Laws (COSAL) was established in 1986 to promote and support the enactment, preservation and enforcement of a strong body of antitrust laws in the United States. COSAL members are law firms based throughout the country that represent individuals and businesses that have been harmed by violations of the antitrust laws. COSAL urges the Senate to enact the Arbitration Fairness Act, which would prohibit the enforcement of binding, mandatory pre-dispute arbitration clauses in certain cases, including antitrust class actions.

The antitrust laws are vital to the health of our economy because price-fixing and other anticompetitive behavior directly harm small businesses and consumers. For example, in recent years, a number of large-scale empirical studies have examined the impact of cartel activity on prices and determined that cartel overcharges substantially raise prices. Antitrust scholars John M. Connor and Robert H. Lande recently conducted an analysis of over 1500 estimates of cartel overcharges.<sup>1</sup> The median average cartel overcharge for all types of cartels and time periods was 23.3 percent.

According to recent testimony before this Committee by William J. Baer, Assistant Attorney General at the Antitrust Division of the Department of Justice and Ronald T. Hosko, Assistant Director of the Criminal Investigative Division of the FBI, antitrust crimes “cause direct and unambiguous antitrust harm” to consumers and businesses.<sup>2</sup> Their testimony stated:

During Fiscal Year 2013 the Antitrust Division filed 50 criminal cases, and obtained \$1.02 billion in criminal fines. The criminal antitrust fines imposed in these cases reflect the harm that cartels inflict on consumers; under the Sentencing Guidelines they take into account the total value of sales affected by the defendant’s participation in the cartel. In

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<sup>1</sup> John M. Connor & Robert H. Lande, *Cartels as Rational Business Strategy: Crime Pays*, 34 *Cardozo L. Rev.* 427, 456-57 (2012).

<sup>2</sup> Statement of William J. Baer and Ronald T. Hosko before the Antitrust, Competition Policy and Consumer Rights Subcommittee of the Committee on the Judiciary, United States Senate, November 14, 2013.

those 12 months we charged 21 corporations and 34 individuals and courts imposed 28 prison terms with an average sentence of just over two years per defendant.<sup>3</sup>

Private enforcement provides virtually the only way to compensate businesses and consumers that are victims of antitrust violations, such as the ones prosecuted by the Justice Department. The importance of private enforcement is underscored by the very language of the United States' antitrust statutes. Congress created a financial incentive to encourage plaintiffs to act as private attorneys general to bring enforcement actions by allowing them to recover treble damages and attorneys' fees under the Sherman and Clayton acts.<sup>4</sup> Courts have also long considered private enforcement of the antitrust laws, including through class actions,<sup>5</sup> an important complement to public enforcement.<sup>6</sup> The Antitrust Division's Workload Statistics underscore this symbiotic relationship, noting "frequently restitution is not sought in criminal antitrust cases, as damages are obtained through treble damage actions filed by the victims."<sup>7</sup>

Where a cartel has injured businesses or individuals, class actions can be an efficient and effective means of ensuring adequate compensation. This is especially true where the violation resulted in harm to many victims with negative value claims – individual claims involving damages that are much smaller than it would cost to litigate the claim. In the most recent of a string of decisions imposing greater barriers on plaintiffs pursuing class action claims, the Supreme Court blocked the ability of some plaintiffs with low or negative value antitrust claims to bring suit in *American Express Co. v. Italian Colors Restaurant* ("*Italian Colors*"). Here, the Court held that a contractual waiver of class arbitration is enforceable even where a plaintiff's costs to individually arbitrate its claim exceed the potential recovery.<sup>8</sup>

In *Italian Colors*, a class of merchants subject to American Express's Card Acceptance Agreement, which contains provisions mandating arbitration, but precluding class-wide

<sup>3</sup> *Id.*

<sup>4</sup> See section 4 of the Clayton Act, 15 U.S.C. § 15 ("[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue . . . and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.")

<sup>5</sup> In particular, the class action mechanism has facilitated the prosecution of meritorious antitrust claims where otherwise there might not have been private enforcement. See, e.g., HERBERT B. NEWBERG & ALBA CONTE, NEWBERG ON CLASS ACTIONS § 18.08, at 18-3 (3d ed. 1992) ("It may be that a class action lawsuit is the most fair and efficient means of enforcing the law where antitrust violations have been continuous, widespread, and detrimental to as yet unidentified consumers. Sometimes a class-action lawsuit is the only way in which consumers would know of their rights at all, let alone have a forum for their vindication.") (quoting *Coleman v. Cannon Oil Co.*, 141 F.R.D. 516, 520 (M.D. Ala. 192).

<sup>6</sup> See, e.g., *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 13031 (1969) ("[T]he purpose of giving private parties treble-damage and injunctive remedies was not merely to provide private relief, but was to serve as well the high purpose of enforcing the antitrust laws."); *Perma Life Mufflers, Inc. v. Int'l Parts Corp.*, 392 U.S. 134, 139 (1968), ("[T]he purpose of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws."), overruled on other grounds by *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *Minn. Mining & Mfg. Co. v. N.J. Wood Finishing Co.*, 381 U.S. 311, 318 (1965) ("Congress has expressed its belief that private antitrust litigation is one of the surest weapons for effective enforcement of the antitrust laws.")

<sup>7</sup> U.S. Dep't of Justice, Antitrust Division Workload Statistics FY 2003-2012, 11 n.15,

<http://www.justice.gov/atr/public/workload-statistics.html>.

<sup>8</sup> No. 12-133, 133 S. Ct. 2304 (June 20, 2013).

arbitration, brought antitrust claims against American Express. The plaintiff merchants argued that the provision preventing class arbitration was unenforceable because it rendered arbitration prohibitively expensive; it would cost more for individual merchants to arbitrate their claims than they could recover if they succeeded in arbitration. Plaintiffs' expert economist, Dr. Gary L. French, found that total expert fees, even in an individual action, would cost between several hundred thousand dollars to over one million dollars while the average class member (a median volume merchant) might expect damages of \$12,850, or \$38,549 when trebled.<sup>9</sup>

On *certiorari*, the Supreme Court reversed the Second Circuit's holding that enforcement of the class arbitration waiver would bar "effective vindication" of statutory rights under the federal antitrust laws. The Supreme Court found that even if a class arbitration waiver renders arbitration prohibitively expensive, the arbitration provision must be enforced.<sup>10</sup>

It is not only the cost of experts that makes individual arbitration prohibitively expensive in cases on behalf of small businesses against large corporations that have violated the antitrust laws. Arbitration of a case brought by a small business against another business would generally be governed by the rules of *commercial* arbitration. Under the American Arbitration Association's (AAA) system, for example, standard administrative filing fees for commercial matters are over \$1,000.<sup>11</sup> The majority of these fees has to be paid up front, when a party first files its claim. There are also "deficient filing fees" assessed on "[p]arties that file demands for arbitration that are incomplete or otherwise do not meet the filing requirements" and "[t]he AAA may assess additional fees where procedures or services outside the Rules sections are required." Also, if the case requires three or more arbitrators, the minimum filing fees total over \$4,000.

If arbitrating with AAA, each plaintiff would likely have to pay \$500 to \$800 per hour for the services of the arbitrator. See *In re A2P SMS Antitrust Litig.*, Master File 12-cv-2656 (AJN), Declaration of George A. Bermann Regarding Arbitration Issues, ¶28 (Dec. 10, 2012). An antitrust arbitration can last up to 640 hours, if three arbitrators are used and up to 204 hours, if one arbitrator is used. *Id.* at ¶39.

A piece in the New York Bar Journal made the following statement, in regard to commercial arbitration:

When a commercial agreement containing an arbitration clause is negotiated, often it is by non-litigators unfamiliar with the arbitration process. Parties who agree to arbitrate before a panel of arbitrators of the AAA, JAMS Resolution Centers (JAMS), The American Health Lawyers Association (AHLA), the

<sup>9</sup> *In re Am. Express Merchants' Litig.*, 554 F.3d 300, 317 (2d Cir. 2009)

<sup>10</sup> *Id.* at 2309.

<sup>11</sup> See [http://www.adr.org/aaa>ShowPDF?doc=ADRSLG\\_004102](http://www.adr.org/aaa>ShowPDF?doc=ADRSLG_004102)

International Chamber of Commerce (ICC) or a myriad of others, are unlikely to contemplate that the out-of-pocket outlay can, within a short period of time, easily reach six figures and be subject to reallocation to impose payment of the entire fee on the losing party.

Ronald J. Offenkrantz, *Arbitrating Commercial Issues, Do You Really Know the Out-of-Pocket Cost?*, 18 N.Y.St.B.J. 30, 31 (2009) (emphasis added).

Like the administrative fees, a portion of the arbitrator fees also have to be paid in advance and must be replenished if they run low. A party's inability to pay its share of fees can result in it being prejudiced in the arbitration. Unlike in most litigation, costs, as well as fees, are often imposed on the losing party in an arbitration. Such relief for a winning defendant could expose some antitrust plaintiffs, especially small businesses, to bankruptcy or "bet the company" risks.

In addition, in an antitrust case with a large number of plaintiffs, a number of factors aside from high costs preclude the victims from being able to assert their rights through individual arbitrations. There are myriad reasons why *seriatim* or even concurrent arbitrations are utterly impractical for handling antitrust cases with numerous plaintiffs. To start with, the average antitrust case lasts about six years, even without trial.<sup>12</sup> Once the first plaintiff begins arbitration, all the others may have to wait six years before they can benefit from the outcome of that arbitration and take advantage of any preclusive effects it may have. However, even waiting for the completion of one arbitration will not aid future plaintiffs in pursuing a subsequent arbitration, as arbitration settlements and rulings can be confidential. Even if the arbitrators' rulings were able to be used by subsequent plaintiffs and constituted grounds for collateral estoppel, the other victims would still have to initiate their own arbitrations, and pay their own filing and arbitrator fees, as well as potential expert fees, before they could take advantage of any collateral estoppel. Furthermore, the first arbitration will likely not toll the statute of limitations for subsequent plaintiffs, as a class action litigation would do for putative class members. Under the four-year statute of limitations dictated by the Clayton Act, many may lose their claims, while awaiting the outcome of the first arbitration or simply due to not finding out that they have been injured.

If numerous cases go forward at once, then numerous sets of plaintiffs' lawyers and experts have to separately, repetitively and wastefully perform work that could be done by one team in a class action. And, as set forth above, arbitrators, unlike judges, do not work for free. They must be paid for equally by each single plaintiff.

<sup>12</sup> Daniel Crane, *Optimizing Private Antitrust Enforcement*, 63 VAND. L. REV. 675, 692 (2010) ("[T]he average private antitrust lawsuit today takes over six years to disposition" and "[t]he Georgetown study of private antitrust litigation conducted in the early 1980s found that antitrust cases take, on average, about three times longer than other federal cases from initiation of the lawsuit to disposition.")

Furthermore, arbitral forums do not allow an individual plaintiff to obtain, or order the defendant to produce, the names and addresses of class members, notify them of settlements or outcomes, create claim forums, distribute money under a formula or conduct any of the other procedures available in class antitrust damage litigation for the compensation of the parties injured by illegal anticompetitive conduct.

District court class action litigation allows one recovery at one time for all victims wishing to join the action or accept its consequences, efficiently distributed by one administrator. This achieves judicial economy and deterrence based on the full effect of the violation. In contrast, if there is an antitrust violation with a hundred similarly-affected victims and single plaintiff arbitration is imposed due to take-it-or-leave-it form agreements, the victims who do not arbitrate individually would be left, at best, with questionable alternatives, and most likely with no recovery at all. And victims who do not even know that they have a claim against a defendant will never be notified of the claim as they would be in a class action. Thus, the named plaintiffs in any given class action may be the only plaintiffs who benefit from arbitration. Nor can a defendant engaging in arbitration obtain global peace from one settlement, but must instead engage in separate proceedings with each plaintiff whose claim it wishes to resolve.

Prohibiting class actions in situations in which numerous plaintiffs have been injured by a widespread antitrust violation will preclude achievement of the antitrust laws' goals of compensation and deterrence. Antitrust violations are criminal acts. In many cases, defendant companies in private antitrust class action suits have pleaded guilty to federal crimes. Often, executives in those companies spend years in prison as a result of their criminal acts. Under the Supreme Court's decision in *Italian Colors*, firms that commit criminal antitrust violations against millions of victims can insulate themselves from most damage liability by selling their goods only on the condition that any antitrust damage case against them must be conducted in bilateral, one-by-one arbitration.

Compensation of all victims of such widespread conspiracies is necessary to achieve the deterrence objective of the antitrust laws. As Profs. Connor and Lande wrote:

[t]he dominant law-and-economics model of crime posits that rational choices drive corporate decisions (including the decisions of the individuals involved) to commit crimes--a "cost/benefit analysis" of the decision. Consequently, there exists a bundle of sanctions that the legal system can (at least in theory) calculate that optimally will deter the crime.<sup>13</sup>

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<sup>13</sup> Connor and Lande, *supra*, at p. 438.

Such sanctions include government fines and private damages, among other fines. "The standard optimal deterrence formula shows that the total amount of cartel sanctions should equal the cartel's "net harm to others" divided by the probability of detection and proof of the violation."<sup>14</sup> Being precluded from having to pay full compensation to its victims will encourage a cartelist to strike again.

If price-fixers who overcharged hundreds of buyers are sued in a federal class action, and succeed in getting the federal case dismissed in favor of bilateral arbitrations, the game is over. The price-fixers win, pay almost nothing, and the victims lose, as does the antitrust enforcement system. This is a death knell for the victims and a triumph for the antitrust violators, guaranteeing that their scheme will be profitable, and making certain that the antitrust statutes will be prevented from serving their compensation and deterrence functions. In order to prevent such unfair and harmful results for consumers, small businesses, and the marketplace, COSAL urges you to enact the Arbitration Fairness Act.

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<sup>14</sup> *Id.* At 455



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October 30, 2013

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Chair  
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100 F Street, N.E.  
Washington, D.C. 20549

Re: Arbitration Provisions Threaten Market Integrity And Are Contrary To  
The Federal Securities Laws

Dear Chair White:

We are a group of 29 professors from 19 different law schools<sup>1</sup> across the country, each with a specialized focus on and expertise in issues of corporate law or the federal securities laws. Although we hold different views on many aspects of the law in these areas, we are in agreement that the judiciary serves an essential role in the development and enforcement of corporate and securities laws and the protection of investors, and that the judiciary's involvement in the resolution of shareholder disputes is necessary to preserve the integrity of this nation's public financial markets.

We write to bring to the Commission's attention a rapidly developing trend whereby publicly traded businesses, without the approval of their shareholders, are attempting, through broadly written provisions, to limit or eliminate access to state and federal courts for adjudication of a broad range of claims that shareholders may have. We therefore urge the Commission to closely review the potentially harmful impact these practices may have on the historic and important role that private rights of action play in protecting investors, and ultimately to make clear that efforts by corporate boards to eliminate the ability of investors and shareholders to enforce their rights in a public judicial forum is contrary to the federal securities laws.

#### **Background**

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<sup>1</sup> Each signer does so individually and his or her institutional identification is provided solely for informational purposes and does not reflect the position of an institution.

Recent years have seen substantial increases in state law shareholder litigation relating to corporate transactions, especially mergers and other types of acquisitions.<sup>2</sup> Additionally, more of these cases have been filed outside of Delaware, where almost half of all public corporations in the United States are incorporated, and thus the traditional forum for the resolution of shareholder disputes.<sup>3</sup> In an effort to rein in multi-forum litigation, an increasing number of corporations have adopted bylaws designating an exclusive forum for the resolution of shareholder disputes. As of September 2011, over 300 publicly-traded corporations had adopted such bylaws. (Such provisions, however, are not the focus of this request.)

At the same time, the U.S. Supreme Court has interpreted the scope of the Federal Arbitration Act (“FAA”) to allow greater enforcement of arbitration agreements. Notably, in *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011), the Supreme Court held that the FAA requires courts to enforce class-action waivers in arbitration agreements contained in consumer contracts. And more recently in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013), the Court held that the FAA requires courts to enforce arbitration provisions that bar class actions with respect to federal claims, as well as state claims.

These two developments have begun to conflate, with publicly-traded businesses purporting to designate arbitration as the exclusive forum for the resolution of *all forms* of shareholder disputes through, *inter alia*, bylaw amendments and registration statements. For example, as the Commission is aware, the Carlyle Group recently attempted in anticipation of its IPO to amend its partnership agreement and registration statement to require the arbitration of all shareholder disputes on an individual basis in anticipation of its IPO; after the Commission objected, the Carlyle Group removed the provision. And, in *Corvex Management L.P. v. Commonwealth REIT*, No. 24-C-13-001111, Baltimore City, Part 23 (May 8, 2013), the trustees of a REIT similarly adopted an extraordinarily-broad arbitration bylaw that purported to require that *all* shareholder disputes be arbitrated. A circuit court for the City of Baltimore enforced the bylaw to require arbitration of a claim that the company’s board of directors had breached their fiduciary duties responding to a proxy contest from an activist shareholder. In so doing, the court relied in part on its interpretation of the requirements of the FAA.

As discussed below, the FAA has never been interpreted to require the enforcement of bylaws or similar provisions unilaterally adopted to remove judicial oversight of investor disputes. Although often analogized to “contracts,” corporate bylaws – particularly in public

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<sup>2</sup> In 2007, shareholders filed litigation relating to about forty percent of public company mergers. By the first half of 2011, ninety percent of the deals exceeding \$100 million were challenged; the number rises to ninety-six percent for deals above \$500 million. See Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 *Bus. Law.* 325, 335 (2013).

<sup>3</sup> Delaware has seen its dominance in the forum of choice for resolving suits against Delaware corporations plummet since 2001, so that the percentage of merger challenges filed exclusively in Delaware reached its lowest point of 30 percent in 2006. There has been no similar change with respect to challenges filed against non-Delaware corporations, which are traditionally brought in the corporation’s home state.

corporations that form the basis of the nation's financial markets – are vastly dissimilar to the kind of contractual agreements that have been enforced by courts, including the Supreme Court, under the FAA. We believe that in the absence of a clear Congressional mandate to permit the forced arbitration of shareholder disputes, the Commission should continue to exercise its well-founded and long-held opposition to such provisions as being contrary to the anti-waiver provisions of the securities laws.

**Judicial Review Of Investor and Shareholder Disputes Involving  
Publicly-Traded Businesses Protects The Integrity of the Nation's Financial Markets**

We believe that it is essential to maintaining the integrity of our nation's financial markets that investors and shareholders have access to the courts to resolve claims under the federal securities laws. The federal securities laws provide a range of enforceable rights that protect shareholders and thereby significantly enhance investor confidence in U.S. securities markets. An important component in the investors' faith in the U.S. capital markets is the independence and transparency that has historically accompanied their vindication of the rights and protections accorded them through the courts. For example, private litigation of federal securities claims has significantly advanced the development of the federal securities laws, generating a set of standards regarding corporate disclosure duties that guides corporate action and management behavior. Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder in particular, serve a public purpose by providing a means for private investors to police securities fraud and maintain the integrity of the markets. Similarly, private enforcement of the Exchange Act's proxy rules greatly enhances shareholder participation in the governance of public corporations. These are public rights that are being vindicated and their vindication should happen in a public forum.

Arbitration simply is not an equivalent medium for meaningful oversight of the rights of investors and shareholders. Arbitration proceedings are not public, and arbitration decisions do not require written opinions. In arbitration, there is no requirement that principles of *stare decisis* guide decisions, and arbitrators may or may not have the expertise and experience of a judge. Moreover, arbitrators do not face the same level of review or public accountability as do judges generally. And appeals and other important procedures and safeguards that are available in court are not available in arbitration. In short, forcing investor and shareholder disputes into arbitration would fundamentally alter investor confidence in the corporate form, by eliminating any real ability of shareholders – the owners of publicly traded corporations – to rely on the existence and enforceability of the disclosure obligations to which corporations and their managers are subject.

**Forcing Arbitration Of Shareholder Disputes Is Contrary To The Federal Securities Laws**

In the absence of any statutory presumption in favor of arbitration, the Commission should continue to regard mandatory arbitration provisions as contrary to the public policy concerns that animate the federal securities laws, and as inconsistent with the "anti-waiver" provisions of Section 29(a) of the Exchange Act ("Section 29(a)") and Section 14 of the Securities Act ("Section 14").

For decades, the Commission has taken the view that public policy concerns weigh heavily against the inclusion of arbitration clauses in the corporate documents of public companies. In 1990, then SEC Assistant General Counsel Thomas L. Riesenbergr explained that "it would be contrary to the public interest to require investors who want to participate in the nation's equity markets to waive access to a judicial forum for vindication of federal or state law rights, where such waiver is made through a corporate charter rather than an individual investor's decision."<sup>4</sup> And more recently, Commissioner Luis A. Aguilar observed that "[i]t is unrealistic to expect that the Commission will have the resources to police all securities frauds on its own, and as a result, it is essential that investors be given private rights of action to complement and complete the Commission's efforts."<sup>5</sup>

Concerns that such provisions run afoul of the letter of the securities laws are equally well founded. Congress has recognized investors' right to private enforcement of the securities laws in the Private Securities Litigation Reform Act of 1995 (the "PSLRA") 15 U.S.C. §§ 77z-1 *et seq.* and 78u-4 *et seq.*, which sets forth detailed guidance regarding the role of lead plaintiffs in private class actions to enforce the securities laws. This explicit statutory instruction highlights the key function of federal securities class actions in maintaining the transparency and integrity of the U.S. capital markets. *See* Joint Explanatory Statement of the Committee of Conference on H.R. 1058 at 31, reprinted in 2 U.S.C.C.A.N. 730 (104th Cong., 1st Sess. 1995).

We believe that by substantially weakening investors' access to the courts, mandatory arbitration clauses run afoul of Sections 14 and 29(a), which provide that "any condition, stipulation, or provision waiving compliance with either Act is void.

The nature of the threat mandatory arbitration provisions pose to investor access to the courts is underlined by the Supreme Court's decision in *Shearson-Am. Exp. Inc. v. McMahon*, 482 U.S. 220, 228 (1987). In *McMahon*, the Court concluded that only "where the SEC has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights," would enforcement of an agreement to arbitrate not constitute a waiver of compliance with any provision of the Exchange Act under Section 29(a). *Id.* at 238. With respect to mandatory arbitration provisions in corporate bylaws the Commission does not have oversight of the type referred to in *McMahon*. The current mandatory arbitration provisions in broker-customer agreements therefore arise from a very different arrangement than that approved by the Supreme Court. The extreme feature of mandatory arbitration clauses is not only the absence of Commission oversight but more importantly the absence of any one-on-one interchange from which consent can be said to arise that arbitration will be the exclusive means for resolving any future dispute. Accordingly, mandatory arbitration provisions violate Section 29(a).

For the above reasons, the undersigned professors respectfully request the Commission evaluate the validity of corporate provisions restricting shareholder access to the courts.

<sup>4</sup> *See* Thomas L. Riesenbergr, *Arbitration and Corporate Governance: A Reply to Carl Schneider*, Insights, Aug. 1990, at 2.

<sup>5</sup> Luis A. Aguilar, Commissioner, U.S. Securities and Exchange Commission, *Statement by Commissioner: Defrauded Investors Deserve Their Day in Court* (Apr. 11, 2012), available at <http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171490204#.UjhoQuDDIQs>

CC: Commissioner Luis A. Aguilar  
Commissioner Daniel M. Gallagher  
Commissioner Kara M. Stein  
Commissioner Michael S. Piwowar

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OFFICE OF THE STATE COMPTROLLER

December 16, 2013

Honorable Patrick Leahy, Chairman  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
Washington, DC 20510

Honorable Chuck Grassley, Ranking Member  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
Washington, DC 20510

Re: The Federal Arbitration Act and Access to Justice: Will  
Recent Supreme Court Decisions Undermine the Rights of  
Consumers, Workers, and Small Businesses?"  
Hearing: December 17, 2013

Dear Chairman Leahy and Ranking Member Grassley:

As Comptroller of New York State, I am the administrative head of the New York State and Local Employees Retirement System (System) and the Trustee of the New York State Common Retirement Fund (Fund). I have a fiduciary duty to invest and safeguard the System's assets, held by the Fund and currently valued at approximately \$160 billion, for the exclusive benefit of the System's more than one million members, beneficiaries, and retirees. It is in this capacity that I respectfully request consideration of my comments below in conjunction with the Senate Judiciary Committee's December 17, 2013 hearing entitled "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?" While I appreciate that the focus of the hearing does not specifically encompass the investment community, the issues to be examined are equally important to this community and have equal bearing thereto.

To help me fulfill my fiduciary duty, I have instituted a robust corporate governance program by which I strive to identify and engage with those of the Fund's portfolio companies whose governance and/or business models may expose our investments to undue risk. The Fund has achieved significant results through such engagement; nonetheless, the Fund's portfolio includes companies whose wrongful behavior results in investment losses, leaving me with no recourse other than litigation. In determining whether to pursue litigation, I am mindful of the consequent expense and time commitment – both for the Fund and for our portfolio company.

The Honorable Patrick Leahy and Chuck Grassley  
December 16, 2013  
Page 2

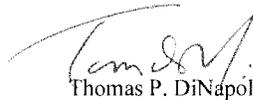
Thus, it is only in the most egregious circumstances that I will proceed with litigation. And it is in those same circumstances that access to our judicial system in order to adjudicate such disputes is most critical. Courts at both the federal and state level have long provided guidance to corporations and investors alike on their respective responsibilities and rights.

As Congress intended when it enacted the Private Securities Litigation Reform Act in 1995 (PSLRA), the Fund, as a large institutional investor, has served as lead or co-lead plaintiff in nine class actions and, to date, has recovered in excess of \$11.5 billion on behalf of investors who incurred losses due to the fraudulent or negligent behavior of corporate actors. Class actions provide, in many instances, the only economically feasible means by which most investors can obtain redress. I believe that exercising this private right of action in our public judicial system in accordance with the PSLRA not only provides for an equitable adjudication of disputes, but also helps maintain the integrity of our capital markets and can act as a deterrent to corporate wrongdoing.

I am concerned that the recent Supreme Court decisions being examined by the Senate Judiciary Committee, as well as rulings by other courts upholding a variety of forced arbitration and class waiver provisions, will restrict or eliminate investors' access to our judicial system. Specifically, such decisions may encourage a trend toward corporate actions to enact or amend bylaws – even by unilateral amendment – in order to include mandatory arbitration and/or class waiver provisions. Such provisions would effectively deny or greatly diminish the ability of investors to seek meaningful recourse for losses incurred as a result of corporate wrongdoing. I do not believe that substituting forced arbitration in the place of access to the judicial system will afford investors the opportunity for reasonable adjudication of disputes, particularly in those instances in which investors are unable to share costs to pursue arbitration. Further, such requirements would directly undermine the PSLRA and enforcement of the federal securities laws generally.

Mandatory arbitration, especially when coupled with class waiver provisions, would all but eliminate meaningful remedies for such investors. I respectfully request that this Committee's focus on the impact of recent court decisions on consumers, workers and small businesses be broadened to consider the related impact on investors.

Very truly yours,



Thomas P. DiNapoli  
New York State Comptroller

Cc: Honorable Al Franken  
Honorable Charles E. Schumer  
Honorable Kirsten Gillibrand  
Honorable Tim Johnson  
Honorable Mike Crapo

**United States Senate**

**Committee on the Judiciary**

113<sup>th</sup> Congress -- First Session

**STATEMENT OF THE  
PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION  
IN CONNECTION WITH THE COMMITTEE'S REVIEW OF  
THE FEDERAL ARBITRATION ACT AND ACCESS TO JUSTICE:  
WILL RECENT SUPREME COURT DECISIONS UNDERMINE THE  
RIGHTS OF CONSUMERS, WORKERS, AND SMALL BUSINESS?**

My name is Jason Doss. I am a Georgia-based attorney that has been representing public investors in cases against securities broker-dealers for eleven (11) years.

I am president of The Public Investors Arbitration Bar Association (PIABA). PIABA is a non-profit, international bar association, whose members are dedicated to the representation of investors in disputes with members of the securities industry. Formed in 1990, the mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process, making securities and commodities arbitration as just and fair as possible; and creating a level playing field for the public investor in securities and commodities arbitration. Since its founding, PIABA and its individual members have been on "the front lines" of every significant issue relating to the securities arbitration process and the development of law, regulations and rules impacting the process. By virtue of its longstanding commitment to and involvement in the securities arbitration process, PIABA is uniquely qualified to render insight from the perspective of

investors who, in most cases, are contractually bound to resolve their disputes through arbitration.

PIABA supports ending the use of mandatory pre-dispute arbitration clauses in consumer contracts with the securities industry. Consumers should be given the choice as to whether they want to resolve their disputes with their financial professional in arbitration. It should not be forced upon them by the use of pre-dispute arbitration provisions.

In the context of the securities industry, the Financial Industry Regulatory Authority (FINRA) operates the arbitration forum that resolves virtually all investment disputes between investment professionals and their customers. FINRA also maintains the qualification, employment and disclosure histories of 5100 broker/dealers and approximately 660,000 of their registered representatives in the electronic CRD system.<sup>1</sup> Some of the information contained in the CRD system is publicly available. For example, some former customer complaints about a financial advisor can be accessed by the public. As such, the CRD system serves a very important investor protection purpose.

Through its arbitration forum, FINRA provides its financial professionals and their firms a process to request having customer complaints permanently removed (i.e. expunged) from their public regulatory record maintained in the CRD system.<sup>2</sup> FINRA arbitrators decide whether to recommend whether to grant these expungement requests.

PIABA recently conducted a study of FINRA expungement requests and identified many problems with FINRA's expungement process that harm the investing public, which provides

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<sup>1</sup> See FINRA Dispute Resolution Expungement training materials at p. 5. The FINRA Dispute Resolution Expungement training materials are available at <http://www.finra.org/ArbitrationAndMediation/Arbitrators/Training/WrittenMaterials/index.htm>.

<sup>2</sup> Broker/dealers that are members of FINRA may also seek expungement of customer complaint information.

another reason that investors should be able to choose whether they want to resolve their investment disputes in FINRA arbitration. For example, for the time period May 18, 2009 through December 31, 2011, expungement relief was granted by arbitrators in 96.9% of the cases resolved by settlements or stipulated awards even though in many cases the financial firms and/or financial professional paid significant sums of money to settle the disputes. A copy of *Expungement Study of the Public Investors Arbitration Bar Association (PIABA Expungement Study)*, authored by our Immediate Past-President, Scott C. Ilgenfritz, and released in October 2013 is attached hereto as Exhibit A.

**CONCLUSION**

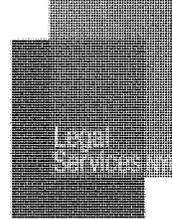
We appreciate the opportunity to share with the Committee the *PIABA Expungement Study*. It illustrates one of the many problems facing the consumer public as a result of forced Arbitration. It continues to be PIABA's position that consumers should not be required to arbitrate disputes with their trusted financial professionals.

We thank you for the opportunity to be heard on this important issue.

Jason Doss, President

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December 12, 2013

Senator Al Franken, Chairman  
Subcommittee on Privacy, Technology and the Law  
Senate Judiciary Committee

Re: December 17, 2013 Hearing, 2:30 PM  
The Arbitration Fairness Act of 2013

Statement from Bernardita Duran,  
Client of LS-NYC



Dear Senator Franken,

Thank you for asking me to tell my story about arbitration. I am different from many of the witnesses you will speak with at your hearing. I don't have much money and did not go far in school. I live with my three children in a two bedroom apartment in Queens New York. The four of us live-off the wages of my older children, my Social Security check, and food stamps.

Despite my lack of money and education, I probably have something in common with your other witnesses: I don't read the fine print in sales contracts.

In 2007, I found myself in a bad situation. I owed a lot of money to seven credit card companies. Every day, I struggled with paying the monthly minimums and still paying my rent and feeding my children.

Then I heard about a company in Long Island that helped people get out of debt. I called and was referred to a law firm in Arizona called J Hass. To this day, I cannot explain exactly what J Hass was supposed to do other than fix my debts. They called it

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Raun J. Rasmussen, Executive Director  
Joseph Steven Genova, Board Chair



“debt settlement.” All I had to do was stop paying my monthly minimum credit card payments and instead send those payments to J Hass. In three years, everything would be fine. So in October 2007, I signed J Hass’ three page contract and a form that allowed J Hass to automatically take \$492 a month from my bank account.

Everything went bad quickly. By January 2008, two of the seven credit card companies were calling. When I asked the callers whether my attorney, J Hass, had contacted them, they said they had never heard of him.

In February 2008, HSBC sued me. J Hass’ employees said this was good, exactly what was supposed to happen, not to worry, and to keep sending the money. Since it was a law firm, I trusted J Hass.

But by July 2008, the collection calls were getting me upset. So I contacted a free lawyer. She told me I was being scammed and that I should stop paying J Hass. She explained that there were hundreds of bogus companies like J Hass that promised to get people out of debt but instead took their money. My lawyer asked J Hass for my money back and complained to the Arizona Bar. But only \$185 of over \$3,000 I had paid was returned.

I was really upset. Sending \$492 each month to J Hass had been difficult. I had paid J Hass before my phone company and had to ask welfare for a one-shot payment to keep my phone on. I had borrowed money from my adult daughter. I had told my son he could not enroll in a basketball league because “fixing Mom’s bill problem” was more important.

Having nowhere to turn, I went to court. J Hass had broken a law that said it could not take a cent from me until it made good on its promises. Rather than defend itself (which would have been hard) J Hass pointed to a sentence in the contract that said the judge could not decide my case. Rather, only an arbitrator in Arizona could. And the kicker, I had to present my case in person in Arizona. Of course I had never read that part of the contract, and even if I had, I would have signed the contract anyway. After all, I am a trusting person and I wanted to get out of debt. I also did not understand what the words in the arbitration clause meant.

What these few words meant was that I had to buy a plane ticket to Arizona and pay for a hotel and meals. This meant gambling more than a month’s worth of rent (\$1,200) in hopes of getting \$3,000 back – a gamble I could not take.

With just a few words that no one would read, J Hass had put a mote of lava between me and justice. It did not matter that J Hass had stolen my money. It did not matter that the law it broke was designed to stop fraud. It did not matter that J Hass knew

that very few of its customers could travel to Arizona to get their money back. It did not matter that J Hass had been sued by state regulators in New Hampshire and Arizona, and had been caught lying to regulators in Connecticut. And, it did not matter that 182 customers had complained about J Hass to the Better Business Bureau.

Although I told a federal judge in 2012 that I could not afford to travel to Arizona, the judge said “too bad, you agreed to arbitrate in Arizona.” She said if I thought New York was the right place to arbitrate, I should ask the Arizona Arbitrator, not her, to move the case to New York.<sup>1</sup> This still meant I had to travel to Arizona to speak to the arbitrator as my personal appearance was required there. In 2013, the appellate judges agreed.<sup>2</sup>

In September 2013, I followed the judges’ orders and asked J Hass to arbitrate in Arizona. But my letter to J Hass was returned. By this time, J Hass had disappeared with my money and lots of other people’s money too.

I think that if the judge in New York considered what J Hass did to me, rather what the arbitration clause said, I would have easily gotten my money back. More importantly, J Hass and the hundreds of other businesses that make money off false-promises would have second thoughts about running such businesses if consumers could sue them in court.

Congress should pass the Arbitration Fairness Act to stop unethical businesses from using arbitration as a get-out-of-jail-free card. If the law is not passed, consumers will only be protected from unfair business practices by busy law enforcement officials. That makes no sense. While I don’t read the fine print in contracts, I do know that courts were built to provide justice to anyone, not just those without arbitration clauses in there contracts.

Sincerely,  
-s-  
Bernardita Duran

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<sup>1</sup> *Duran v. J. Hass Group, L.L.C.*, 2012 WL 3233818 (E.D.N.Y., 2012).

<sup>2</sup> *Duran v. J. Hass Group, L.L.C.*, 2013 WL 4732497 (2d Cir. 2013).

Statement from Johnson M. Tyler.  
Attorney for Ms. Duran  
South Brooklyn Legal Services

Thank you for inviting LS-NYC and our client Ms. Duran to comment on Congress's need to pass the Arbitration Fairness Act of 2013. The Arbitration Fairness Act is needed because pre-dispute arbitration clauses hide the wrong-doings of businesses. Moreover, unless the AFA is passed, the private-right-of-action found in many consumer laws (which enable a regular citizen to sue a bad business) will become meaningless. That will leave only overworked public officials to stop fraudulent, deceptive or unfair business practices that affect consumers. Such a burden is too large for our shrinking governments, and not one that Congress wants.

Legal Services NYC (LS-NYC) is the nation's largest provider of free civil legal services to the poor. For nearly 40 years, LS-NYC has provided critical legal help to low-income residents of New York City. The nineteen neighborhood offices of LS-NYC operate in diverse communities throughout the city, representing over 25,000 clients each year across the five boroughs.

LS-NYC has a long history of litigating consumer cases against debt collectors, debt buyers, debt relief organizations, trade schools, mortgage servicers, and banks. Consumer litigation in a public forum casts light on wrongdoers. Our consumer suits also serve as models others can imitate. In some instances, a consumer suit alerts law makers of new legislation that is needed. Occasionally, it triggers a criminal prosecution.

Much of LS-NYC's consumer litigation has **not** involved contracts containing arbitration clauses. Ms. Duran's case (described in her testimony above) did have such a clause which produced unfair and wrong results.

LS-NYC writes separately to emphasize how the near ubiquitous arbitration clause immunizes not just an individual wrongdoer (such as J Hass) from private law suit, but also an entire industry. Debt settlement's durability is largely due to the arbitration clause.

#### **No Privates Suits against J Hass**

When Ms. Duran came to LS-NYC, her case seemed strong. First, mountains of evidence demonstrated that Debt Settlement did not work and was fraudulent. This included a Senate Hearing entitled, *Debt Settlement: Fraudulent, Abusive, and Deceptive*

*Practices Pose Risk to Consumers*,<sup>3</sup> a Federal Trade Commission report<sup>4</sup>, and a memo from 21 Attorneys General who had filed 128 actions against various debt settlement companies.<sup>5</sup>

Second, J Hass's record was consistent with the industry. The internet contained scores of angry posts from J Hass customers residing in 18 different states.<sup>6</sup> The Arizona Better Business Board had received 182 complaints.<sup>7</sup> State regulators in New Hampshire and Connecticut had sued J Hass for defrauding close to 300 of their citizens.<sup>8</sup>

Third, winning a case against J Hass seemed straightforward. Its website boasted that J Hass would improve a client's credit score.<sup>9</sup> This violated the Credit Repair Organization Act (CROA) that prohibited any fee collection before a credit score was improved. On top of that, the Ninth Circuit had just ruled that that a CROA claim could not be arbitrated.<sup>10</sup>

But when LS-NYC tried to find examples of customer suits against J Hass, we could not find any.<sup>11</sup> This was puzzling. There were many unhappy customers. And the CROA provided attorney's fees if you won.

Why no suits? No doubt, some of J Hass' victims did not seek legal help because they were embarrassed about being in debt (or scammed). Others lacked resources to find or pay for a lawyer. But enough disgruntled customers complained in Connecticut,

<sup>3</sup> Senate Hearing 111-1034, Field Hearing before the Comm. on Commerce, Science, and Transportation, (2010).

<sup>4</sup> Federal Trade Commission, Press Release: *Debt Services Operations Settle FTC Charges* (Mar. 30, 2005).

<sup>5</sup> Nat'l Ass'n of Attorneys General, *Comments in Support of Proposed Rulemaking to Amend the Federal Trade Comm'n's Telemarketing Sales Rule*, 5 (Oct. 23, 2009).

<sup>6</sup> The J Hass customers were from: Arizona, California, Connecticut, Delaware, Florida, Illinois, Indiana, Iowa, Michigan, Missouri, New Hampshire, New Mexico Nevada, Pennsylvania, Oklahoma, Utah, Texas, Wisconsin and Washington.

<sup>7</sup> On file with LS-NYC.

<sup>8</sup> The New Hampshire Banking Department Consent Order, dated February 12, 2010, required Defendant J. Hass Group to pay \$31,986.97 in restitution to twelve (12) New Hampshire consumers, as well as \$2,600.00 in fines and back fees. On November 5, 2010, the Connecticut Department of Banking issued a temporary cease and desist order against the J. Hass Group for illegally contracting with 274 persons in Connecticut.

<sup>9</sup> On file with LS-NYC.

<sup>10</sup> *Greenwood v. CompuCredit Corp.*, 615 F.3d 1204 (9th Cir. 2010).

<sup>11</sup> One class of suits excluded from this research is "claw back" suits by bankruptcy trustees. LS-NYC found eight such suits against J Hass. The debtors had tried and failed to get out debt with J Hass within two years of filing for bankruptcy. The bankruptcy code allows the trustee to sue J Hass for those moneys. J Hass' arbitration clause provides no shield as claw back suits are "core proceedings" in bankruptcy that cannot be arbitrated. 28 U.S.C. §157(b)(2)(A), (F) & (H).

New Hampshire, Wisconsin, Florida and Arizona that regulators and attorneys general in those states started investigations of J Hass or filed suit.

The (now) obvious answer is that many J Hass victims probably did talk with lawyers but the lawyers recognized Hass' arbitration clause for what it is: "a mote filled with lava" between their clients and a reasonable reward.

### Few Privates Suits against other Debt Settlers

When last counted in 2010, there were over 2,000 debt settlement companies in the United States.<sup>12</sup> By 2010, the Federal Trade Commission counted 214 suits against debt settlers by public officials (the FTC, state attorneys general or state regulators).<sup>13</sup> In contrast, LS-NYC could find only 2 actions against a single debt settlers who was not using an arbitration clause (its 2001 contract may have pre-dated the arbitration revolution.)<sup>14</sup> Another seven private actions against debt settlers failed to go to the merits, but instead were removed to arbitrators.<sup>15</sup> Only three cases with arbitration clauses managed to remain in federal court,<sup>16</sup> although the reasoning in those decisions is of no value after a recent Supreme Court ruling.<sup>17</sup> In short, LS-NYC could only find only one private litigant suit involving a debt settler not using an arbitration clause, and that was an old case.

This is an amazing statistic. Here a federal law says debt settlers cannot take up front fees. There are thousands of debt settlement companies violating that law. The law is designed to be self enforcing (and thus not cost the taxpayers anything) because it provides a private right of action and attorneys fees. The scam has received substantial public attention. Yet only tax-paid attorneys are going after debt settlers because of the arbitration clause.

<sup>12</sup> Federal Trade Commission, 16 C.F.R. 310; Telemarketing Sales Rule, 75 Fed. Reg. 48458, 48503 (Aug. 10, 2010).

<sup>13</sup> Id. at 48509 – 48515.

<sup>14</sup> *Plattner v. Edge Solutions, Inc.*, 2004 WL 1575557 (N.D.Ill. Apr.1, 2004); *Cortese v. Edge Solutions, Inc.*, 2007 WL 2782750 (E.D.N.Y. 2007).

<sup>15</sup> *Carlsen v. Freedom Debt Relief, LLC*, 2010 WL 1286616 (E.D.Wash. 2010); *Del Rio v. Creditanswers*, 2010 WL 3418430 (S.D.Cal. 2010); *Finely v. CSA-Credit Solutions of America, Inc.*, 2008 WL 5280551 (E.D.Okla. 2008); *Picard v. Credit Solutions, Inc.*, 564 F.3d 1249 (11th Cir. 2009); *Rex v. CSA-Credit Solutions of America, Inc.*, 507 F.Supp.2d 788 (W.D.Mich.,2007); *Schreiner v. Credit Advisors, Inc.* 2007 WL 2904098 (D.Neb. 2007); *Vegter v. Forecast Financial Corp.*, 2007 WL 4178947 (W.D.Mich. 2007).

<sup>16</sup> *Alexander v. U.S. Credit Management, Inc.*, 384 F.Supp.2d 1003 (N.D.Tex.,2005); *Greenwood v. CompuCredit Corp.*, 615 F.3d 1204 (9th Cir. 2010); *Hollins v. Debt Relief of America*, 479 F.Supp.2d 1099 (D.Neb.,2007).

<sup>17</sup> *CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665 (2012).

**Maybe all the private suits against debt settlers are brought in secret arbitration proceedings?**

This seems unlikely given the extent that the FTC and General Accounting Office have studied the debt settlement industry. However, if it is true, this “secret docket” exclusively benefits an industry that the Senate and others describe as “fraudulent, abusive, and deceptive.”

**Epilogue**

Without a right to sue in court, what is a debt settlement victim to do if a public official can not get his or her money back? In 2010, 61 year old Brian Yard bared his soul to the Philadelphia Weekly after J Hass took \$6,000 in fees while increasing his debt by \$14,000.<sup>18</sup> It’s unclear whether that front page article triggered any give-back. Two years later, Patricia Aker of Scottsdale Arizona reported her \$8,000 loss to *3 On Your Side*.<sup>19</sup> The reporter drove to J Hass’ office to confront the owner, but found the office empty of furniture and people. The reporter was told later that J Hass had been sold to an undisclosed foreign company.

**Conclusion**

Congress passes powerful consumer laws. Hundreds of lawsuits are brought against shady businesses by government officials. And still, desperate men and woman must seek justice from the local media rather than judges whose hands are tied by arbitration clauses. It’s time to pass the Arbitration Fairness Act.

*For Further Information, Please Contact Johnson M. Tyler at 718-237-5548 or  
JTYLER@SBL.S.ORG*

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<sup>18</sup> Powell, *A Fate Worse Than Debt*, Philadelphia Weekly, (June 29, 2010).

<sup>19</sup> *3 On Your Side, Scottsdale Debt Settlement Company Draws Criticism*, AZFamily.com (Sept. 27, 2012). Article on file with LS-NYC.

## *Home Owners for Better Building*

P.O. Box 791438, San Antonio TX 78279

Email: [president@hobb.org](mailto:president@hobb.org) \* Website: [www.hobb.org](http://www.hobb.org)

December 23, 2013

Senator Franken  
Washington, DC  
U.S. Senate Committee on the Judiciary  
224 Dirksen Senate Office Building  
Washington, DC 20510

Re: Support for the Arbitration Fairness Act of 2013, S. 878

The Honorable Al Franken:

This letter is written testimony submitted to The Senate Judiciary Committee reference the hearing of December 17, 2013, to comment on the need to pass the *Arbitration Fairness Act of 2013, Senate Bill 878 to Prevent Big Corporations from Taking Away Consumers' Right to Justice*.

Most exciting is the news by Leslie Overton, deputy assistant director for civil enforcement with the Department of Justice (DoJ), Antitrust Division; confirming that the department recognizes that the high cost of pre-dispute arbitration impinges upon the federal antitrust rights of consumers.

Unfair pre-dispute arbitration opinions today are strikingly similar to those outlined by Home Owners for Better Building when we testified long ago at the *1998 Texas Senate Interim Committee on State Affairs*. See Attached 1998 Report on Pre-dispute Binding Arbitration.

To those who support the idea that pre-dispute mandatory arbitration is good for consumers is analogous to the biblical account of Adam and Eve in the Garden of Eden featuring the cunning serpent and the apple tree.

For buyers betrayed by false promises and the take-it-or-leave-it builder forced arbitration contracts, the results have been emotionally and financially devastating. To the homebuilding industry forced arbitration has been a highly profitable marketing campaign of deceit.

Home Owners for Better Building, as a 501 (C)3 has been dedicated to educating the public for the last decade and a half on how the homebuilding industry has exploited pre-dispute mandatory arbitration clauses. A practice that is the direct result of a 1996 joint venture between American Arbitration Association (AAA) and the National Association of Home Builders (NAHB) which exclusively promulgated the industry contract to its members containing the lucrative forced pre-dispute arbitration clause.

The word "pre-dispute" expresses the ill-will of the industry and its intent to carelessly construct houses. Pre-dispute arbitration provides the perfect means for industry to avoid warranty accountability for repair of defective homes; as arbitrators have become beholden to the industry for repeat business and their livelihood. Equally advantageous to industry is the shield of secrecy surrounding privately held arbitration without public record results. Absent public records business monopolies operate under the radar of the DoJ as infringement upon federal antitrust rights of consumers grow exponentially.

**Methods used are simple:**

Whether small or major defects, confident builders simply ignore warranty responsibility eventually forcing homeowners into a protracted legal dispute of unaffordable binding arbitration; causing hundreds of thousands owners to give up in financial defeat.

No job is too small for powerful corporate attorneys who cleverly outfox the underdog consumer. Despite the fact that "American Arbitration Association (AAA) rules" specifically allow homeowners the opportunity and the right to have their construction defect claims up to \$10,000.00 affordably adjudicated in small claims court, sharp industry attorney successfully argue that the US Supreme Court has spoken.

Unfortunately for many years small claims court Judges routinely disregard AAA rules and order homeowners into the unrealistic financial burdens of AAA arbitration; putting to rest any affordable venue for homebuyers to hold defiant builders accountable.

On a much larger scale is the aftermath of the "housing crisis" that is the result of new homebuilders greedy rush to participate in the massive mortgage fraud that fed the building boom. Yet to be fully appreciated is the depth of financial damage caused by builders who threw up communities overnight with little or no attention to home or community sustainability, quality, or legitimacy of new homebuilder warranties.

Staggering major construction evidence can be seen in the attached photos (attached) of new 2-year-old homes that plague communities with 70% experiencing major construction defects. As it was with the mortgage fraud crisis, builders are inspired with power and confident in knowing they can disregard standards and successfully cheating their customers out of perhaps billions of dollars.

Lastly, probably more advantageous to the homebuilding industry is the secrecy surrounding construction defect arbitration; eliminating any public record of lawsuits that might alert the buying public and tarnish the reputation of builders.

Sparked by public outcry Texas Congressmen Charles Gonzales and Ciro Rodriguez in 2000 filed the American Home Buyer Protection Act to prohibit pre-dispute clauses in new home contracts. After years of public hearings across the country testimony has provide a long record for needed consumer protection reforms. Most promising is the Senate Judiciary Committee Hearing that conveys persuasive evidence for the need to pass consumer protection relief provided in the Senator Al Franken Arbitration Fairness Act of 2013 (S. 878) and US Representative Hank Johnson's Arbitration Fairness Act (H.R. 1844) bills.

It is illogical that a toaster comes with more protection than a new home, the largest and most expensive consumer purchase most people will ever make.

It is with gratitude that I would like to thank you and the committee members for the opportunity to participate in the legislative process. Our organization stands ready and willing to share vital consumer information that supports the need for passage of Senate Bill 878.

Respectfully,

Janet Ahmad  
National President  
(210) 494-6404

## *Home Owners for Better Building*

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### **Texas Senate Interim Committee On State Affairs**

In 1998 the Texas Senate Interim Committee on State Affairs held public hearings. Consumers testified of their heart breaking stories. Bubba Claridge, a native Texan, had difficulty holding back the tears as he testified on behalf of his ailing mother Gladys Claridge.

Home Owners for Better Building presented the following report on Binding Arbitration to the committee.

### **ARBITRATION DEADLY FOR THE CONSUMER**

FOR THE CONSUMER, ARBITRATION IS NOT A JUST ALTERNATIVE TO A TRIAL BY JURY FOR THE FOLLOWING REASONS:

1. **AAA INDUSTRY FRIENDLY, NOT CONSUMER ORIENTED**
  - Builder prepared contract solicits business for American Arbitration Association.
  - Consumer believes the American Arbitration Association is unbiased.
  - Consumer is not informed of connections between the Builder and the American Arbitration Association prior to signing a contract to purchase a home.
2. **COST - VERY EXPENSIVE**
3. **TIME RESTRAINTS**
  - Hearing is held 30 days after choosing Arbitrator (faster than JP courts), representing a clear Builder advantage.
4. **NO DISCOVERY OR CONTINUANCE**
  - Rules of Law not applied to arbitration process
  - Rules of procedure do not apply under AAA
  - No additional time granted for discovery
  - No procedure requiring other side to produce requested discovery
  - Hearsay accepted over sworn testimony
  - No procedure to appeal Arbitrator's decision
5. **METHOD FOR CHOOSING ARBITRATOR**
  - Qualifications and fees of arbitrators designed to be confusing to consumer
6. **NO APPEAL TO JUDGE**
  - No opportunity to appeal matters of law, discovery, or time restraints of Fast Track, etc.

**DISTINCT ADVANTAGES FOR BUILDER**

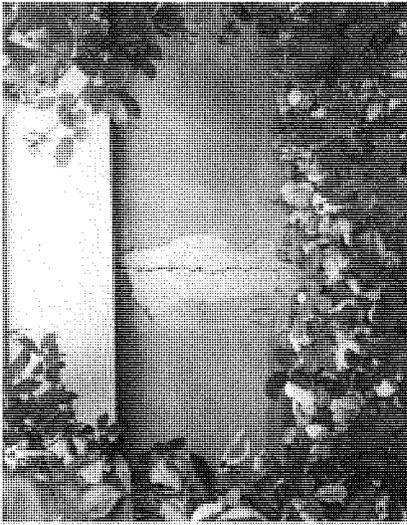
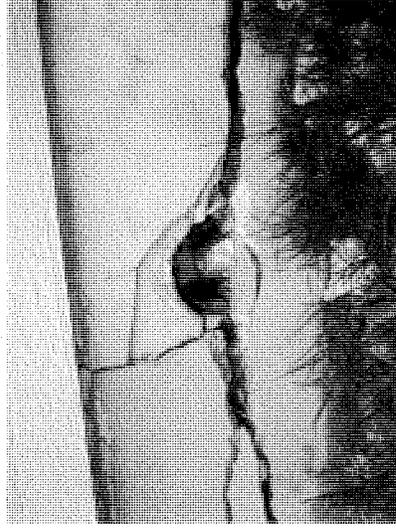
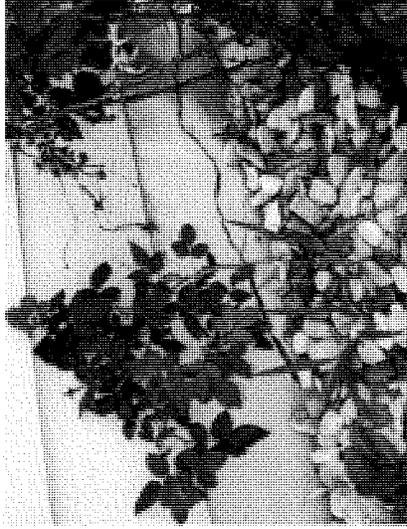
- Builder's expertise and what she or he does for a living. All of which is related to protection of profits through limiting Builder responsibilities and warranties to Buyer and through arbitration of all disputes, which is only paperwork to the Builder.
- Relationship with and close ties to AAA
- Experienced legal council (most likely on retainer)
- Expert witnesses readily available to Builder
- Buyer must educate her or himself about arbitration, warranties, relevant legal issues, etc., and take time from work to search for an attorney, an arbitrator, expert witnesses, discovery, etc., all WITHIN 30 DAYS!
- Years of industry experience writing contracts designed to limit (if not eliminate) Buyer's rights and protections

**HOME BUYER (CONSUMER) DISADVANTAGES**

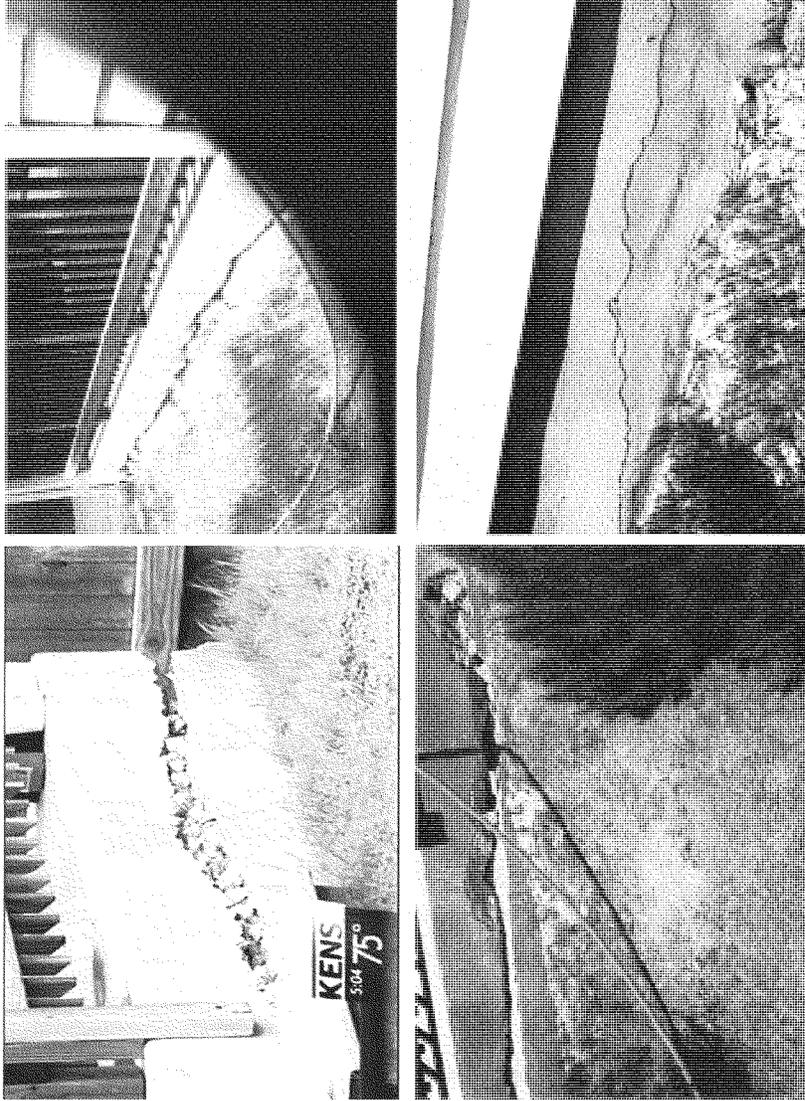
- Builder's contract uses unclear, ambiguous language along with narrowly worded, specific language to Builder's advantage
- Consumer believes Realtors protect Buyers interests
- No arbitration training in curriculum or continuing education
- Realtor unable to point out contract problem areas related to arbitration
- Extreme difficulty finding an attorney
- Bar Association referral lists no one with construction industry arbitration experience
- Most attorneys tell Buyer arbitration is quicker and cheaper. This usually indicates attorney has not handled Builder/Homeowner cases.
- Attorneys only available on hourly basis, not on contingency basis
- Difficulty finding expert witnesses; while builder has his subcontractors as expert witnesses
- Buyer/Consumer has other full time obligations
- Under old contracts without binding arbitration, Builder did not sue Buyer because the builder did not honor the warranty
- AAA keeps the construction industry informed of all changes to rules of arbitration; Buyers must educate themselves - painful, expensive education
- Home owner arbitration expenses are greater than cost of repairs
- Home buyer does not realize and is not informed they are giving up Constitutional Rights when they sign a contract with the Builder

**THE THREAT OF ARBITRATION IS BUILDERS' LETHAL WEAPON!**

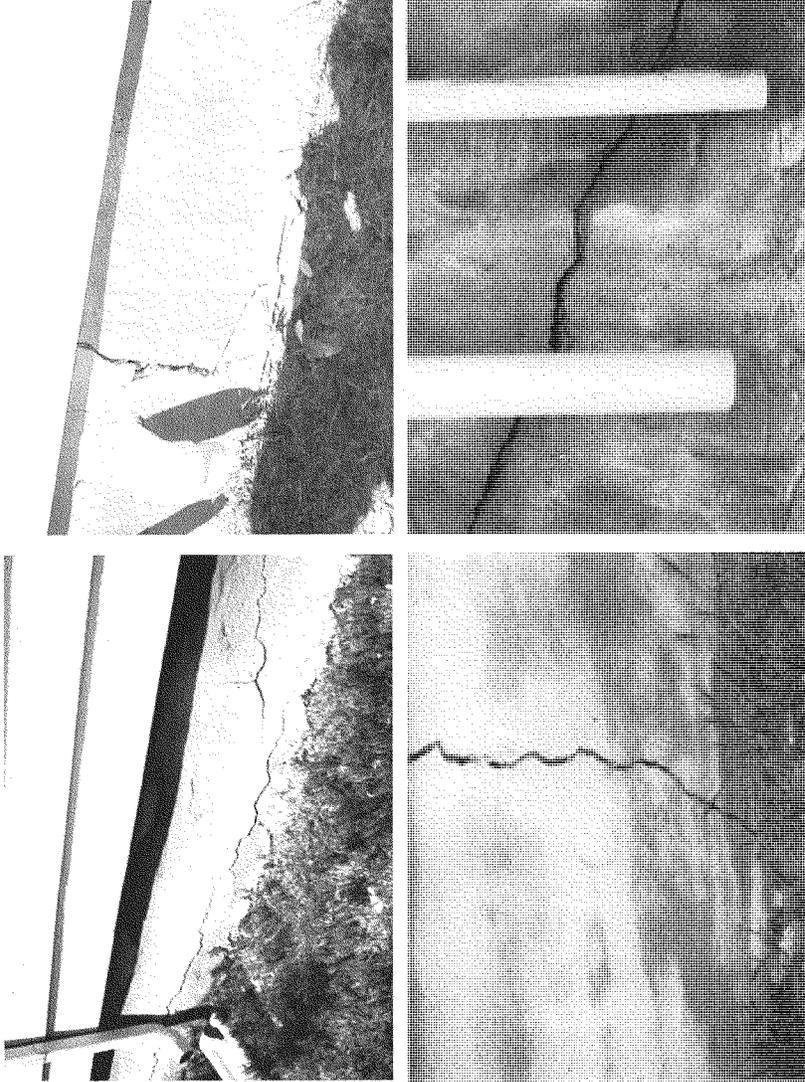
Home Foundations - 2 Years Old



Home Foundations — 2 Years Old



Home Foundations — 2 Years Old



**Statement of Matthew Kilgore, Rohnert Park, Calif.**

**U.S. Senate  
Committee on the Judiciary**

**“The Federal Arbitration Act and Access to Justice:  
Will Recent Supreme Court Decisions Undermine the  
Rights of Consumers, Workers, and Small  
Businesses?”**

**(In support of passage of the Arbitration Fairness Act,  
S. 878)**

**December 17, 2013**

Thank you for this opportunity to share my experiences with you for the record on forced arbitration and class-action bans. I am a private student-loan borrower who was defrauded by a for-profit college and denied access to court by the bank that made student loans to me and other students at the school.

I thought I was achieving my dream of becoming a helicopter pilot when I enrolled at Silver State Helicopters in Oakland, California. But actually, like the other thousands of students of this school, I was probably the victim of a scam. I first learned of Silver State through an advertisement on the radio for an upcoming seminar in Oakland, California. I learned that the school held similar seminars all over the country, so I decided to attend.

At the seminar, Silver State offered to provide pilot training and certification. My fellow students and I were told that we would earn our pilot's license and an instrument rating in less than two years. As students, we would be able to attend classes and amass actual flight time with instructors. I knew my family would be proud of me when I accomplished this goal.

The school representatives indicated at the seminar that students could obtain loans through KeyBank, National Association, apparently a primary lender for the school, to pay the tuition. Like so many others, I took out a \$55,000 loan with KeyBank, to pay the trade school's tuition. On Sunday, February 3, 2008, a short few months after I began my courses, I received a phone call from a flight instructor who told me not to attend class the next day. The school had shut down and filed for bankruptcy.

Earlier this year, a bankruptcy judge who oversaw the bankruptcy proceedings for the school described it as an "airborne Ponzi scheme." The school appeared to have been caught in a credit crunch, and collapsed when it could no longer get funded through private student loans.

When the school abruptly closed, Silver State students, including myself, had no diplomas, certificates, or accreditation, nor any marketable skills, for that matter. We were certainly not qualified to be helicopter pilots. Instead we were left with tens of thousands of dollars in student-loan debt.

With the help of my lawyer, I filed a lawsuit on behalf of myself and other Silver State students against Keybank. As we stated in court, Keybank knew that "the private student loan industry—and particularly aviation schools—was a slowly unfolding disaster," yet it continued on with its business, loaning money to students and handing over the funds to the school. Additionally, my lawyers discovered that Keybank conspired with Silver State to

intentionally omit the so-called “FTC Holder Rule” from both the loan documents and my contract with Silver State.<sup>1</sup>

We sought to enforce our rights under California law and the FTC Holder Rule to prevent the bank from collecting our loans or reporting non-payment of the loans to credit reporting agencies. Although the district court judge that heard the case determined that we stated a proper claim against Keybank for conspiring with Silver State to violate the Holder Rule, we were unable to pursue the case in court because of the pre-dispute forced arbitration clause and class-action waiver. Keybank’s loan terms had a provision that said borrowers would be forced to resolve legal disputes with it in private arbitration and on an individual basis. The terms also banned our participation in class actions.

Keybank argued to the court that the arbitration terms and class-action ban should apply. It asked the court to deny the class action and force us students to arbitrate our claims individually. However, the district court judge denied Keybank’s motion to compel arbitration and supported our right to go to court.

But then I learned about a Supreme Court decision, *AT&T Mobility v. Concepcion*, that was decided while our case was ongoing. This decision said that companies like Keybank could require arbitration and forbid class actions in their terms of service. As a result, Keybank appealed the district court’s decision and because of *Concepcion*, the appeals court said that my fellow students and I would have to settle our disputes individually in private arbitration. We could not go to court to seek redress.

Another striking outcome of my experience with arbitration clauses is that Keybank borrowers like myself are at the losing end of a two-tiered justice system. A second student loan lender, Student Loan Express, Inc. (SLX) also marketed loans to Silver State students. But unlike Keybank borrowers, students who borrowed from SLX received some justice after the school shut down because SLX did not have an arbitration clause in its loan terms. Therefore, they could seek redress.

I later learned that SLX student borrowers, in a class settlement, would receive up to 75 percent debt forgiveness, lowered interest rates and other redress. Although we suffered the exact same injuries and pursued the exact same paths to justice, the arbitration clause denied Keybank borrowers access to the court, while SLX borrowers received substantial relief for their harm and could move on with their lives.

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<sup>1</sup> The FTC Holder Rule, 16 C.F.R. § 433, is an important consumer protection disclosure regulation in the FTC Act which, had it been included in either Keybank’s loan documents or in my contract with Silver State, would have enabled the Silver State students to defend themselves against Keybank based on its fraudulent scheme with the school.

Since 2008, my loans have accrued interest and have nearly doubled to \$103,000. My wife and children continue to feel the strain of this growing financial burden. The loan debt will take funds that I would have saved for my children. Despite the enormous dollar amount to me personally, I have thus far been unable to attract a lawyer to take my case to arbitration because I cannot afford to pay one on an hourly basis and as a practical matter, nobody is willing to do it on a contingency basis because the amount is too small when my claim is considered alone.

I think most companies are honest, but many of us know that there are others that will seek to take advantage of us. My fellow students and I were caught in an elaborate and deceptive corporate scheme. But I was surprised, outraged and then saddened, like most other Americans would be, that I could not go to the court to seek justice when I was wronged.

Thank you for considering my story.

Matthew Kilgore  
Rohnert Park, California

The Leadership Conference  
on Civil and Human Rights

1629 K Street, NW 202.466.3311 voice  
10th Floor 202.466.3435 fax  
Washington, DC www.civilrights.org  
20006



**STATEMENT OF WADE HENDERSON, PRESIDENT AND CEO  
THE LEADERSHIP CONFERENCE ON CIVIL AND HUMAN RIGHTS**

**HEARING BEFORE THE  
SENATE COMMITTEE ON THE JUDICIARY  
ON**

**“THE FEDERAL ARBITRATION ACT AND ACCESS TO JUSTICE: WILL RECENT  
SUPREME COURT DECISIONS UNDERMINE THE RIGHTS OF CONSUMERS, WORKERS,  
AND SMALL BUSINESSES?”**

**December 17, 2013**

Chairman Leahy, Ranking Member Grassley, and Members of the Committee: thank you for holding today’s hearing on the urgent need to outlaw forced arbitration for all America’s consumers and workers. On behalf of The Leadership Conference on Civil and Human Rights, I am pleased to provide this written statement for inclusion in the record.

The Leadership Conference on Civil and Human Rights is a coalition charged by its diverse membership to promote and protect the civil and human rights of all persons in the United States. Founded in 1950 by A. Philip Randolph, Arnold Aronson, and Roy Wilkins, The Leadership Conference works in support of policies that further the goal of equality under law through legislative advocacy and public education. The Leadership Conference’s more than 200 national organizations represent persons of color, women, children, organized labor, persons with disabilities, older adults, gays and lesbians, and major religious groups. The Leadership Conference is committed to building an America that is as good as its ideals – an America that affords everyone access to quality education, housing, health care, collective bargaining rights in the workplace, economic opportunity, and financial security.

I applaud the Committee for holding this hearing on a matter of great significance to the civil and human rights community. For The Leadership Conference, access to the judicial system is a fundamental right that must be preserved. It is essential to our fair and unfettered democracy. Indeed, it is the language of our democracy.

**Forced Arbitration Hurts Consumers and Employees**

Arbitration can be a fair and effective method of dispute resolution when parties voluntarily agree to arbitrate. Instead, pre-dispute binding mandatory arbitration clauses are increasingly proliferating in: employment contracts; every day consumer contracts for products and services including credit cards, payday loans, health insurance policies, student loans, cell phones, and car loans; and civil rights disputes. Binding mandatory arbitration clauses are buried in the fine print of contracts and employee handbooks, which burden consumers and deprive them of equal justice under the law.

First, this practice is one-sided because corporations write the forced arbitration clauses in a way that often steers the entire process to the company’s advantage, including specifying the arbitrator and

payment terms. Since the clauses are written in the contracts, an individual cannot adjust the process and must abandon or accept the product, service, or job as presented. Second, binding mandatory arbitration does not have legal protections nor is it subject to public review to ensure that the arbitrator's decision was legitimate, avoiding transparency and accountability. Third, the practice removes the fundamental right of equal justice under the law. Forced arbitration makes the dozens of anti-discrimination laws meaningless because they are unenforceable in court, allowing employers the freedom to ignore civil rights laws intended to protect people from employment discrimination on the basis of age, sex, religion, race, and disability. Finally, a dispute under binding mandatory arbitration imposes high costs, including attorney and arbitrator fees, which most individuals cannot afford, while for companies it is the "price of doing business." Thus, the burden to individuals harms their ability to seek justice.

Recent Supreme Court decisions have stripped away statutory rights from consumers and employees. *AT&T Mobility LLC v. Concepcion*, a 2011 consumer rights case, undermined the use of class actions in the pursuit of justice against corporate civil and employment rights infractions. *Concepcion* allowed forced arbitrations and the inclusion of class action bans within arbitration clauses. The decision contradicts at least 20 states that have struck down bans on class action lawsuits, by freeing companies from accountability when they infringe upon civil rights and employment laws.

More recently, in *American Express v. Italian Colors Restaurant et al*, the Court considered a challenge to anticompetitive practices of American Express that violated federal antitrust laws. Despite these violations, the Court ruled that forced arbitration and class action bans are protected even when an individual can prove that the cost of arbitration would be too high to pursue.

Class action lawsuits have long been an important means for individuals to seek remedy for civil rights, consumer, and employee infractions. Many individuals cannot afford to settle disputes through arbitration. This problem is exacerbated when individuals cannot come together to spread the costs of a lawsuit. Corporate bans of class actions allow businesses to evade well-established civil rights and employment laws, rendering them ineffective. The deprivation of rights afforded by the Court's decisions in *Concepcion* and *American Express* could be remedied with the Arbitration Fairness Act.

#### **The Arbitration Fairness Act Would Restore Choice to the Judicial Process**

The Arbitration Fairness Act (AFA), S. 878, reestablishes the congressional intent of the Federal Arbitration Act by requiring that agreements to arbitrate employment, consumer, antitrust or civil rights disputes be made after the dispute has arisen. The combined impact of *Concepcion* and *American Express* adds urgency for Congress to pass the AFA to enable individuals and small businesses to decide how to resolve disputes. The AFA would not prohibit arbitration, but would simply ensure that it is a voluntary decision made by both parties once a dispute occurs, making pre-dispute binding mandatory arbitration clauses unenforceable in civil rights, employment, antitrust, and consumer disputes. This legislation would allow pre-dispute mandatory arbitration to continue in business-to-business agreements. The legislation would apply to collective bargaining agreements that require arbitration between unions and employers. Its sole aim is to end the unscrupulous business practice of forcing consumers and employees into biased, costly arbitrations by binding them long before any disputes arise, and ensuring an individual's constitutional rights of access to the judicial system are not waived under coercion.

The ability to access the judicial system is a fundamental civil right. The Arbitration Fairness Act will create a more fair system in which consumers and employees can safely resolve disputes without corporate coercion into arbitration. We urge Congress to pass the Arbitration Fairness Act to protect the legal and civil rights of all Americans.

Thank you for your leadership on this important issue.



Via Hand Delivery

December 12, 2013

The Honorable Patrick J. Leahy  
437 Russell Senate Office Building  
United States Senate  
Washington, DC 20510

The Honorable Charles Grassley  
135 Hart Senate Office Building  
United States Senate  
Washington, DC 2051

*Re: Senate Judiciary Committee Hearing on the Federal Arbitration Act*

Dear Chairman Leahy and Ranking Member Grassley:

I am writing on behalf of the Council of Institutional Investors ("CII") to bring to your attention the attached letter that we issued yesterday to the staff of the Securities and Exchange Commission relating to CII's membership approved policy discouraging the use of forced arbitration clauses in company governing documents.<sup>1</sup>

CII is a non-profit association of pension funds, other employee benefit funds, endowments and foundations with combined assets that exceed \$3 trillion. Many CII members are long-term shareowners responsible for safeguarding the retirement savings of millions of American workers and retirees.<sup>2</sup>

We understand that your Committee has scheduled a hearing for December 17<sup>th</sup> entitled, "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?" As we believe that issues raised in the attached letter are likely to be relevant to the subject matter of your hearing, we would respectfully request that our letter be submitted as part of the official hearing record.

Thank you for consideration of this request. If you have any questions regarding our letter or this request, please contact me at 202-261-7088 or [Jordan@cii.org](mailto:Jordan@cii.org), or our general counsel Jeff Mahoney at 202-261-7081 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,

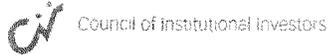
Jordan Lofaro

cc: The Honorable Al Franken

**Attachment**

<sup>1</sup> CII corporate governance policy 1.9: "Companies should not attempt to restrict the venue for shareowner claims by adopting charter or bylaw provisions that seek to establish an exclusive forum. Nor should companies attempt to bar shareowners from the courts through the introduction of forced arbitration clauses," [http://www.cii.org/corp\\_gov\\_policies](http://www.cii.org/corp_gov_policies).

<sup>2</sup> For more information about our membership, please visit <http://www.cii.org/members>.



December 11, 2013

Keith F. Higgins  
 Director  
 Division of Corporation Finance  
 U.S. Securities and Exchange Commission  
 100 F Street, NE  
 Washington, DC 20549-1090

John Ramsey  
 Acting Director  
 Division of Trading and Markets  
 U.S. Securities and Exchange Commission  
 100 F Street, NE  
 Washington, DC 20549-1090

Re: *Forced Arbitration Clauses In Corporate Bylaws*

Dear Messrs. Higgins and Ramsey:

I am writing on behalf of the Council of Institutional Investors ("CII") to bring to your attention a recent potential trend in corporate governance that may not only impair shareowners' rights, but also threaten to undermine the integrity of our public markets generally.

CII is a non-profit association of pension funds, other employee benefit funds, endowments and foundations with combined assets that exceed \$3 trillion. Many CII members are long-term shareowners responsible for safeguarding the retirement savings of millions of American workers and retirees.<sup>1</sup>

A pair of relatively recent decisions by the United States Supreme Court — *AT&T Mobility v. Concepcion*<sup>2</sup> and *American Express v. Italian Colors Restaurant*<sup>3</sup>—appear to generally support the view that the Federal Arbitration Act ("FAA") requires courts to enforce arbitration provisions that bar class actions with respect to federal and state claims. We are concerned that those decisions could potentially be used in an effort to enable public corporations to avoid liability simply by including a forced arbitration clause in a corporate bylaw.

It is our understanding that some corporations may have already begun to explore forced arbitration provisions in their chartered bylaws as a potential vehicle to limit shareowner rights. Bylaws are considered to establish the "contractual" terms that govern a company's operations, and some might argue that such provisions are sanctioned by the forced arbitration frameworks created by the above referenced Supreme Court precedents.

As you are well aware, bylaw provisions can be adopted unilaterally by corporate boards without shareowner approval. As a result, forced arbitration provisions in corporate bylaws represent a potential threat to principles of sound corporate governance that balance the rights of shareowners against the responsibility of corporate managers to run the business.

<sup>1</sup> For more information about the Council of Institutional Investors ("CII") and our members, please visit our website at <http://www.cii.org/members>.

<sup>2</sup> *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (Apr. 27, 2011), <http://www.supremecourt.gov/opinions/110pdf/09-893.pdf>.

<sup>3</sup> *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (June 20, 2013), [http://www.supremecourt.gov/opinions/12pdf/12-133\\_19m1.pdf](http://www.supremecourt.gov/opinions/12pdf/12-133_19m1.pdf).

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For example, in the recent case of *Corvex Management LP v. Commonwealth REIT*,<sup>4</sup> shareowners brought an action on behalf of a real estate investment trust ("REIT") arguing that the company's board breached their fiduciary duties by taking unlawful actions designed to prevent or delay a shareowner vote on a takeover bid.<sup>5</sup> The REIT's bylaws, however, contains a broad mandatory arbitration provision that bans class actions, including shareowner derivative suits.<sup>6</sup> Citing Supreme Court precedent, including *AT&T Mobility v. Concepcion*,<sup>7</sup> a Maryland Circuit Court dismissed the litigation, holding that the shareowners' claims had to be submitted to arbitration even though the REIT's board unilaterally adopted the bylaw without shareowner approval.<sup>8</sup>

Perhaps unwittingly, the Delaware Court of Chancery may have set the stage for this further reduction of judicial oversight of corporations. In his 2013 decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,<sup>9</sup> Chancellor Strine upheld the enforceability of bylaws, unilaterally adopted by two corporate boards, requiring all litigation relating to the internal affairs of the corporations to be conducted in Delaware.<sup>10</sup>

Chancellor Strine's decision in *Boilermakers Local 154 Retirement Fund* may have significant consequences. If, for example, Delaware law allows corporate boards, through the adoption of bylaws, to dictate unilaterally the forum for resolution of all shareowner disputes, directors of Delaware corporations might attempt to dictate arbitration as the mandatory forum for any shareowner disputes, even if Delaware courts are available to hear the case.<sup>11</sup>

More specifically, if it is established that corporate boards are empowered under state law to designate a forum for the resolution of shareowner disputes, those corporate directors could potentially attempt to rely on federal law—in particular the FAA as interpreted by the Supreme Court—to designate forced arbitration as the only available forum. As one commentator earlier noted this year: "It would be frighteningly ironic if Chancellor Strine's ruling on corporate by-laws, which seems intended to drive shareowner litigation to Delaware, ended up driving corporations to arbitration instead of

<sup>4</sup> *Corvex Management LP v. Commonwealth REIT*, 24-C-13-001111, slip op. (Cir. Ct. Baltimore City, May 8, 2013), [http://www.sec.gov/Archives/edgar/data/803649/000110465913039281/a13-11995\\_1ex99d2.htm](http://www.sec.gov/Archives/edgar/data/803649/000110465913039281/a13-11995_1ex99d2.htm).

<sup>5</sup> *Id.* at 2-3.

<sup>6</sup> *Id.* at 4.

<sup>7</sup> *Id.* at 7.

<sup>8</sup> *Id.* at 27.

<sup>9</sup> *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 2013 WL 3191981 (Del. Ch. June 25, 2013), [http://scholar.google.com/scholar\\_case?case=953851692202390762&q=Boilermakers+Local+154+Ret.+Fund+v.+Chevron+Corp&hl=en&as\\_sdt=6,47&as\\_vis=1](http://scholar.google.com/scholar_case?case=953851692202390762&q=Boilermakers+Local+154+Ret.+Fund+v.+Chevron+Corp&hl=en&as_sdt=6,47&as_vis=1).

<sup>10</sup> *Id.* Of note, as of September 30, 2012, three hundred publicly traded companies had adopted some form of provision in their bylaws or governing documents purporting to designate an exclusive forum for the resolution of any claim a shareholder may have against, or on behalf of, the corporation. See Joseph A. Grundfest & Kristen A. Saveille, *The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 *Bus. Law.* 325, 330 (2013).

<sup>11</sup> *Cf. Elf Atochem North America, Inc. v. Jaffari*, 727 A.2d 286, 295 (Del. 1999) (enforcing provision in the charter of a Limited Liability Company to require arbitration derivative claims in California), [http://de.findacase.com/research/wfrmDocViewer.aspx/xq/fac.19990406\\_42099.DE.htm/qx](http://de.findacase.com/research/wfrmDocViewer.aspx/xq/fac.19990406_42099.DE.htm/qx); *Douzinis v. American Bureau of Shipping, Inc.*, 888 A.2d 1146, 1149 (Del. Ch. 2006) (enforcing provision in the operating agreement for a Delaware LLC requiring arbitration under Texas law), [http://scholar.google.com/scholar\\_case?case=4285329806925466829&q=Douzinis+v.+American+Bureau+of+Shipping,+Inc.&hl=en&as\\_sdt=6,47&as\\_vis=1](http://scholar.google.com/scholar_case?case=4285329806925466829&q=Douzinis+v.+American+Bureau+of+Shipping,+Inc.&hl=en&as_sdt=6,47&as_vis=1).

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litigation in any forum."<sup>12</sup> We note that such a result would be in direct conflict with CII's membership-approved corporate governance best practices which state:

Companies should not attempt to restrict the venue for shareowner claims by adopting charter or bylaw provisions that seek to establish an exclusive forum. Nor should companies attempt to bar shareowners from the courts through the introduction of forced arbitration clauses.<sup>13</sup>

Consistent with our membership approved policy, we would respectfully request that, in the absence of a clear Congressional mandate to permit the forced arbitration of shareowner disputes, the Securities and Exchange Commission continue to remain vigilant in exercising its well-founded and long-held opposition to such provisions as being contrary to the anti-waiver provisions of the federal securities laws.<sup>14</sup>

Thank you for consideration of this important matter. If you have any questions regarding this letter, please feel free to contact me directly at 202-261-7081 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,



Jeff Mahoney  
General Counsel

Cc: John H. Stout, Chair, Corporate Governance Committee, Business Law Section,  
American Bar Association (via email)

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<sup>12</sup> Alison Frankel, *Wake up Shareholders! Your Right to Sue Corporations May Be in Danger*, Reuters, June 25, 2013, at 2; <http://blogs.reuters.com/alison-frankel/2013/06/25/wake-up-shareholders-your-right-to-sue-corporations-may-be-in-danger/>.

<sup>13</sup> CII, *Policies on Corporate Governance § 1.9 Judicial Forum* (updated Sept. 27, 2013), [http://www.cii.org/corp\\_gov\\_policies#ntro](http://www.cii.org/corp_gov_policies#ntro).

<sup>14</sup> See Thomas L. Riesenber, *Commentary, Arbitration and Corporate Governance: A Reply to Carly Schneider*, *Insights*, Vol. 4, No. 8, Aug. 1990, at 2 ("it would be contrary to the public interest to require investors who want to participate in the nation's equity markets to waive access to a judicial forum for vindication of federal or state law rights, where such waiver is made through a corporate charter rather than an individual investor's decision").

December 17, 2013

The Honorable Patrick Leahy  
Chairman  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Chuck Grassley  
Ranking Member  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Tim Johnson  
Chairman  
Committee on Banking, Housing  
& Urban Affairs  
534 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Mike Crapo  
Ranking Member  
Committee on Banking, Housing Affairs  
& Urban Affairs  
534 Dirksen Senate Office Building  
Washington, DC 20510

Chairman Leahy, Chairman Johnson, Ranking Member Grassley and Ranking Member Crapo:

The below signatories to this letter collectively manage approximately \$900 billion in capital invested globally and have significant investments in the United States. As investors whose participation in the public markets is vital to the growth of the global economy, we believe that companies should not be permitted to force shareholders into any system under which their rights are limited or their ability to participate in a class is extinguished. Forced arbitration systems—especially those which include class action bans—are not a viable substitute to judicial enforcement of fiduciary obligations owed to investors when the arbitration is an involuntary, costly, and biased dispute resolution system.

We ask that the Committees of Jurisdiction act to preserve the ability of investors to access the judicial system for the enforcement and protection of their legal rights by:

- 1) Supporting the Securities and Exchange Commission (“SEC”) in its exercise of Congressionally-granted authority under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to prohibit the use of mandatory pre-dispute arbitration provisions in broker-dealer and investment advisor agreements; and,
- 2) Acting to formalize the SEC’s longstanding policy that mandatory pre-dispute provisions requiring arbitration of investor disputes in the bylaws and governing documents of publicly traded corporations are harmful to capital markets, contrary to public policy, and could be subject to enforcement action.

Relying on the government to enforce the rights of individuals is no suitable alternative to private enforcement. Requiring the government to bear the expense of prosecuting every investor dispute would place an enormous additional burden on already strained budgets. In private litigation relating to the financial scandals at Enron, WorldCom, Tyco, Bank of America and Global

Crossing, private enforcement returned over \$19.4 billion to investors.<sup>1</sup> The SEC's enforcement actions against these same companies relating to the same wrongdoing netted penalties and fees of \$1.750 billion.<sup>2</sup> Indeed, in the last three years on litigation relating to the financial crisis, the SEC has recovered \$2.73 billion in penalties, disgorgement and other monetary relief.<sup>3</sup> In comparison, private litigation against just four financial institutions arising from their conduct that led to the near collapse of the U.S. economy resulted in judgments or settlements of over \$16 billion.<sup>4</sup>

Unfortunately, and perhaps precisely because private litigation provides the most efficient (and in some cases the only) way for investors to enforce their rights, publicly traded corporations have taken steps to eliminate judicial oversight of their fiduciary obligations to investors and their compliance with the federal securities laws. These steps have included inserting pre-dispute, forced arbitration clauses in investment-advisor contracts and corporate by-laws to force all shareholder disputes into arbitrations controlled by the very same corporations against whom the claims are being brought. These forced arbitration clauses also typically require shareholders to waive their rights to participate in any collective or class action.

When forced arbitration clauses and class action waivers appear in corporate bylaws or investor-advisor agreements, they can have the practical effect of preventing shareholders from pursuing any legal remedy whatsoever. When, as is often the case for smaller investors, the cost and expense of pursuing an individual claim far exceeds any possible recovery, a "waiver" of the right to participate in any collective action effectively immunizes wrongdoing corporations and their directors and officers from these smaller claims. These "waivers" are specifically designed to prevent class actions under Rule 10b-5 of the Securities Exchange Act of 1934, and would prevent class actions like the shareholder action brought against Enron Corporation from ever being brought. These forced arbitration clauses and class action waivers represent a real and present threat to principles of sound corporate governance, balancing the rights of shareowners against the responsibilities of corporate managers to run their businesses.

Institutional investors are the foundation of a successful and thriving securities market. The victims of corporate wrongdoing aren't the ultra-wealthy—they are hard-working employees who rely on income from their pension funds. Without sufficient protections and a meaningful way to hold financial institutions accountable when they violate financial or fiduciary obligations to their

<sup>1</sup> Source: *In re: Tyco International, Ltd., Securities Litigation*, U.S. District Court, District of New Hampshire, 02-266 (\$3.2 billion settlement); *In re: Enron Corporation Securities Litigation*, U.S. District Court, Southern District of Texas, 01-3624 (\$7.2 billion settlement); *In re: Worldcom, Inc. Securities Litigation*, U.S. District Court, Southern District of New York, 02-3288 (\$6.1 billion); *In re: Bank of America Corp. Securities, Derivative, and Employee Retirement Income Security Act (ERISA) Litigation*, U.S. District Court, Southern District of New York, 09-2058 (\$2.4 billion settlement); *In re: Global Crossing Ltd. Securities Litigation*, U.S. District Court, Southern District of New York, 02-910 (\$447.8 million settlement).

<sup>2</sup> Source: Tyco SEC Settlement Fair Fund: <http://www.tycosecsettlement.com/> (\$55.8 million settlement); Enron SEC Settlement Fair Fund: <http://enronvictimtrust.com/> (\$570 million); Worldcom SEC Settlement Press Release: <http://www.sec.gov/news/press/2003-81.htm> (\$750 million); Bank of America SEC Fair Fund: <http://bankofamericafairfund.com/> (\$375 million); Global Crossing SEC Settlement Press Release: <http://www.sec.gov/litigation/litreleases/lr19179.htm> (\$300,000).

<sup>3</sup> Source: SEC Enforcement Actions, Addressing Misconduct That Led To or Arose From the Financial Crisis, Key Statistics (through September 1, 2013), available at <http://www.sec.gov/spotlight/enf-actions-fc.shtml>

<sup>4</sup> Source: Sam Carr, SNL Financial, Largest US banks have built a \$60B settlement tab, so far (March 5, 2013), available at <http://www.snl.com/InteractiveX/Article.aspx?cdid=A-17047074-12337>

shareholders, investor confidence diminishes and market participation suffers, hurting investors, the institutions they invest in, and the American and global economy.

We ask the Committees on the Judiciary and on Banking, Housing, & Urban Affairs, jointly tasked with protecting American investors from unscrupulous or illegal financial practices, to encourage the SEC to continue its efforts to protect investor rights and restore the balance between those rights and the responsibilities of publicly traded companies and their corporate managers.

*Sincerely,*

AFA Forsakring  
*Anders Algotsson*  
Head of Equities



AP7  
*Richard Gröthheim*  
Chief Executive Officer



AP1  
*Anders Rahmn*  
Administrative Director  
*Jan Matej*  
Head of Legal Department



AMF Pension  
*Anders Oscarsson*  
Head of Equity



AP4  
*Agneta Wilhelmson Kåremar*  
Chief Operating Officer  
*Ulrika Malmberg Livijn*  
General Counsel



AMF Fonder  
*Gunilla Nyström*  
Chief Executive Officer



APG Asset Management  
*Guus M. Warringa LL.M (Cantab)*  
 Board Member, Chief Counsel



PFA Pension  
*Jesper Langmack*  
 Head of Equities



Industriens Pension  
*Jan Østergaard*  
 Chief Investment Officer



PGGM Investments  
*Marcel Jeucken*  
 Managing Director Responsible Investment  
*Femke van't Groenewout*  
 Senior Advisor Responsible Investment



MN Services  
*Anatoli van der Krans*  
 Senior Advisor Responsible Investment &  
 Governance



Sampension  
*Mads Smith Hansen*  
 Chief Financial Officer



**WRITTEN STATEMENT OF**  
**MIKE ROTHMAN**  
**COMMISSIONER OF THE MINNESOTA DEPARTMENT OF COMMERCE**  
**ON BEHALF OF THE**  
**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION (NASAA)**  
**BEFORE THE**  
**SENATE JUDICIARY COMMITTEE**  
**“The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”**  
**DECEMBER 17, 2013**  
**WASHINGTON, DC**

Chairman Leahy, Ranking Member Grassley, Senator Franken and Members of this Committee, thank you for the opportunity to submit this statement for inclusion in the record of the hearing by the Senate Judiciary Committee on December 17, 2013 entitled “The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?”

On behalf of the North American Securities Administrators Association, Inc. (NASAA), I appreciate the opportunity to share my views on arbitration as it impacts the public and specifically, investors. As the Commissioner of the Minnesota Department of Commerce, I am the securities regulator for the state of Minnesota and a member of NASAA. I am also a member of NASAA’s Board of Directors and serve on its Federal Legislation Committee, which is responsible for developing NASAA’s biannual Legislative Agenda and works with NASAA’s leadership to set the organization’s federal policy priorities. One of NASAA’s top legislative priorities for the 113<sup>th</sup> Congress is to promote efforts aimed at providing aggrieved investors meaningful remedies and a choice of forum in which to pursue those remedies. On June 14, 2013, I spoke to the Upper Midwest Securities Conference in Minneapolis. In my speech, I discussed the need for Congress to encourage the U.S. Securities and Exchange Commission

(SEC) to use its authority granted under the Dodd-Frank Act to take action and curb the use of mandatory pre-dispute arbitration agreements.

From the outset, I want to applaud Senator Franken for introducing the Arbitration Fairness Act of 2013 (S. 878) and for recognizing the importance of including services related to securities and other investments in the definition of “consumer dispute” under the bill. Your bill will help retail investors in Minnesota, and across the country, seek effective recourse through the judicial system to resolve securities disputes. I also wish to recognize Senator Amy Klobuchar, as a member of this Committee, for her leadership and work on behalf of all Minnesotans.

#### **About NASAA**

NASAA was organized in 1919 and is the oldest international organization devoted to investor protection. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. Ten securities administrators are appointed by Secretaries of State, five come under the jurisdiction of their states’ Attorneys General, some are appointed by their Governors and Cabinet officials, and others work for independent commissions or boards.

NASAA is the voice of these securities agencies that are responsible for both grass-roots investor protection and efficient capital formation. Securities regulation is a complementary regime of both state and federal laws. The securities administrators in your states are responsible for enforcing state securities laws by pursuing cases of suspected investment fraud, conducting investigations of unlawful conduct, licensing firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, and providing investor education programs and materials to your constituents.

State securities regulators have protected Main Street investors for the past 100 years, longer than any other securities regulator. State securities regulators continue to focus on protecting retail investors more so than any other regulator. Our primary goal and mission is to

act for the protection of these investors, especially those who lack the expertise, experience, and resources to protect their own interests. States are also the undisputed leaders in criminal prosecutions of securities violators. In 2012 alone, state securities regulators conducted nearly 6,000 investigations, leading to nearly 2,500 enforcement actions, including 339 criminal actions. Moreover, in 2012, 4,300 licenses of brokers and investment advisers were withdrawn, denied, revoked, suspended, or conditioned due to state action, up 27 percent from the previous year.

### Federal Arbitration Act – Legislative History

The Federal Arbitration Act (FAA) was enacted in 1925 to honor agreements to arbitrate between mutually consenting parties. The “principal purpose” of the FAA was to “require courts to enforce privately negotiated agreements to arbitration, like other contracts, in accordance with their terms.”<sup>1</sup> Form contracts or “contracts of adhesion,” where one party offers terms on a non-negotiated “take-it-or-leave-it” basis, are contrary to the intended purpose of the FAA. In fact, the legislative history makes clear that Congress intended the FAA to target commercial parties of generally comparable bargaining power, rather than consumers or, by extension, investors.

Legislative history reveals that Congress intended the Federal Arbitration Act to cover disputes between merchants of approximately equal strength, Arbitration of Interstate Commercial Disputes: Hearing of S. 1005 and H.R. 646 Before the J. Comm. of Subcomms. on the Judiciary, 68th Cong. 10 (1924), but not involving disputes with workers, Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration: Hearing on S. 4213 and S. 4214 Before a Subcomm. of the S. Comm. on the Judiciary, 67th Cong. 9, 14 (1923), or disputes where the arbitration agreement could be considered an adhesion contract, Arbitration of Interstate Commercial Disputes: Hearing of S. 1005 and H.R. 646 Before the J. Comm. of Subcomms. on the Judiciary, 68th Cong. 15 (1924).<sup>2</sup> As Representative Graham noted in the House floor debate in 1924, “[t]his bill simply provides for one thing, and that is to give an opportunity to enforce an agreement in commercial contracts and admiralty contracts—an agreement to arbitrate, when voluntarily placed in the document by the parties to it.” 68

<sup>1</sup> *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ. U.*, 489 U.S. 468, 478 (1989).

<sup>2</sup> House Committee on the Judiciary, Report on Activities During 111th Congress, H.R. Rep. No. 111-712, at n. 128.

Cong. Rec. 1931 (1924).<sup>3</sup>

Unfortunately, the reach of the FAA has been expanded by the Supreme Court over the last twenty years to apply in contracts between parties of unequal bargaining power. The House Committee on the Judiciary's Report on Activities during the 111<sup>th</sup> Congress discussed this expansion and some of the benefits associated with traditional litigation.

Although arbitration was initially conceived as a privately-run, voluntary process for resolving disputes, mainly between businesses, written and oral testimony from Congressional hearings during the 110th Congress indicated that the use of arbitration had expanded in the last twenty years. Many businesses are now requiring arbitration of disputes in their consumer, employment, and franchise relationships. Ironically, during the passage of the Federal Arbitration Act, Congress did not intend to allow binding arbitration agreements on individuals if the contracts were between parties of unequal bargaining power. The secret nature of arbitration, the ability of the drafter to dictate the terms of the arbitration process, and the apparent loss of civil protections when compared to a court proceeding have created controversy among consumer and employee advocates and small business owners.

Because arbitration avoids the public court system in favor of a private industry of arbitration groups, individuals lose some of the benefits and rights associated with traditional litigation. These benefits and rights include lower initial financial hurdles, pretrial discovery, formal civil procedure rules, proximity to the resolution forum, access to counsel, class action options, and fairness. Arbitration clauses may even negate the protection of some federal statutes.<sup>4</sup>

State securities regulators are deeply concerned about the implications of the recent Supreme Court decisions expanding the scope of arbitration, including the Court's recent decision in *American Express Co. v. Italian Colors Rest.*, which held that a group of merchants were bound by individual arbitration agreements with American Express even if a class action was the only way to make their claim – alleging a violation of federal antitrust law – economically viable.<sup>5</sup> As the scope of this hearing suggests, these decisions may further undermine the rights of consumers, workers and small businesses.

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<sup>3</sup> *Id.* at n. 126.

<sup>4</sup> *Id.* at 55-56.

<sup>5</sup> *American Express Co. v. Italian Colors Rest.*, Slip Op. No. 12-133 (S. Ct. June 20, 2013) (“AMEX III”).

### Mandatory Pre-dispute Arbitration Clauses in Investor Contracts

NASAA has had a longstanding concern about the use and proliferation of mandatory pre-dispute arbitration provisions (i.e., before a dispute or loss is known) that appear in the overwhelming majority of customer agreements used by broker-dealers. This concern has deepened in recent months, in part due to the decision, discussed further below, by one major brokerage firm to expand the scope of its arbitration clause to include a waiver of class action rights, thus further eroding investors' rights to fair recourse.

Prior to 1987, an investor's claim against his or her stock broker for alleged wrongdoing could generally be pursued as a lawsuit against the broker or the brokerage firm. But that year, the Supreme Court upheld the enforceability of agreements to arbitrate investors' claims arising under the Securities Exchange Act of 1934,<sup>6</sup> and subsequently, mandatory pre-dispute arbitration clauses have become a fixture in contracts between investors and brokerage firms. In addition to requiring arbitration, these agreements direct that such arbitration must be conducted in only one forum: the arbitration forum administered by the Financial Industry Regulatory Authority, or FINRA.<sup>7</sup> Increasingly, investment advisers are also requiring that their clients agree to binding pre-dispute arbitration.<sup>8</sup> In fact, a survey conducted by the Massachusetts Securities Division of its registered investment advisers revealed that 87% of those advisers now use a standard form of investment advisory agreement, and of those almost half include a pre-dispute arbitration agreement.<sup>9</sup>

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<sup>6</sup> *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

<sup>7</sup> The Financial Industry Regulatory Authority, or FINRA, is a private non-profit self-regulatory organization for broker-dealers organized as a national securities association pursuant to Section 15A of the Securities Exchange Act. 15 U.S.C. § 78o-3.

<sup>8</sup> In December 2012, FINRA issued "Guidance on Disputes between Investors and Investment Advisers who are not FINRA-Regulated firms." This guidance discusses the conditions required for an investor and registered investment adviser to submit a case to the FINRA arbitration forum, which has traditionally been open only to broker dealers and their customers. This Guidance requires that both parties sign an agreement to arbitrate *after* their dispute arises, and then a second agreement to have FINRA arbitrators hear the dispute.

<sup>9</sup> Massachusetts Securities Division, Report on Massachusetts Investment Advisers' Use of Mandatory Pre-Dispute Arbitration Clauses in Investment Advisory Contracts by Massachusetts Securities Division Staff (Feb. 11, 2013), available at <http://www.sec.state.ma.us/sectarbitration/Report%20on%20MA%20IAs%27%20Use%20of%20MPDACs.pdf>.

NASAA believes that investors must have a choice of forum when it comes to resolving disputes with their investment professionals. Investor confidence in fair and equitable recourse is critical to the stability of the securities markets and long-term investments by retail investors. NASAA has argued that participation by “mom and pop” investors in our capital markets, and, by extension, job growth, is directly tied to their level of trust in having a reasonable avenue to seek recovery if they are victimized by securities fraud or other unethical conduct. Unfortunately, investor confidence in the U.S. markets remains low as reflected by a recent Bankrate survey.<sup>10</sup>

As noted above, NASAA was particularly alarmed when, in late 2011, Charles Schwab & Co. sent over 6.8 million existing account holders monthly account statements accompanied by immediately effective amendments to their account agreements. These amendments included a class action waiver (i.e., denial of the right to participate in class action litigation or on a representative basis). The waiver was also included in new account agreements. Schwab’s decision to make these changes came after the Supreme Court’s decision in *AT&T Mobility v. Concepcion*, holding class action waivers in consumer contracts enforceable.<sup>11</sup> Interestingly, just a few years prior to issuing this amendment, investors that purchased one of Schwab’s mutual funds brought class actions against Schwab, including its broker-dealer affiliate, alleging violations of federal and state securities laws.<sup>12</sup> The court approved a \$235 million settlement, with an average estimated payment to individual investors of \$881, which the court noted offered “substantial recoveries” that “will provide real benefits” to those investors.<sup>13</sup> Had those investors been prohibited from participating in a class action, their potential recovery, even if greater than \$881, would have been too small to warrant pursuing an individual arbitration.<sup>14</sup>

In the instance of Schwab seeking to expand its arbitration clauses to include class

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<sup>10</sup> When asked to pick the best way to invest money that would not be needed for the next ten years, investors picked cash, real estate, and even precious metals over the stock market. The findings of the Bankrate survey are available at <http://www.bankrate.com/finance/consumer-index/financial-security-charts-0713.aspx>.

<sup>11</sup> *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011).

<sup>12</sup> *In re Charles Schwab Sec. Litig.*, No. C08-01510 WHA, 2011 WL 1481424 (N.D. Cal. Apr. 19, 2011).

<sup>13</sup> *Id.*

<sup>14</sup> See Black, Barbara and Gross, Jill, Investor Protection Meets the Federal Arbitration Act (Sept. 5, 2012), 1 Stan. J. Complex Litig. 1 (2012).

action waivers, FINRA instituted a disciplinary action against Schwab for the violation of its own member rules which preserve judicial class actions as an alternative to arbitration.<sup>15</sup> However, to the detriment of investors, in February 2013 a FINRA Hearing Panel determined that those rules and, by extension, the agreement between Schwab and FINRA to abide by those rules, could not be enforced under *Concepcion*.<sup>16</sup> FINRA has appealed the Hearing Panel ruling and a decision by FINRA's National Adjudicatory Council is forthcoming. However, if Schwab is successful in the appeal,<sup>17</sup> it is likely that every broker-dealer and investment adviser will follow suit and include class action waiver language in their customer agreements.<sup>18</sup> Even publicly-traded companies may attempt to insulate themselves from shareholder liability by including mandatory arbitration and class action waiver language in their governing documents.<sup>19</sup>

A decision in favor of Schwab would pose an imminent threat to investors' ability to

<sup>15</sup> *Department of Enforcement v. Charles Schwab & Co.*, FINRA Disciplinary Proceeding No. 2011029760201 (Feb. 1, 2012), available at <http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p210893.pdf>; see also Letter from Sen. Franken and 36 Members of Congress to SEC Chair Mary Jo White (Apr. 26, 2013), available at <http://www.nasaa.org/wp-content/uploads/2013/08/Bicameral-Letter-to-SEC-re-Mandatory-Arbitration-April-26-2013.pdf> ("While the Supreme Court in *Concepcion* did find that the FAA preempts state actions that would restrict the use of arbitration, the facts in the Schwab case are notably distinguishable—not least because FINRA is a membership organization seeking to enforce its own rules."); see also *infra* n.19 (arguing that the Hearing Panel erred "because FINRA is statutorily required to enforce its rules and its membership agreement with Schwab" and "[t]he only agreement at issue in this enforcement action is the agreement between FINRA and Schwab and that agreement is unquestionably valid and permissible under the [FAA]").

<sup>16</sup> See *Dept. of Enforcement v. Charles Schwab & Co.*, FINRA Disciplinary Proceeding No. 2011029760201 (CRD No. 5393) (Feb. 1, 2012), available at <http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p210893.pdf>.

<sup>17</sup> On May 15, 2013 Schwab released a statement on its website that it was suspending class action waivers in its account agreements. Notably, however, it qualified this measure as temporary "until the issue is resolved by the appropriate regulatory and/or court decisions." The Schwab statement is no longer available on its website.

<sup>18</sup> As Secretary Galvin has stated "This ruling is akin to giving every rogue broker-dealer the green light to steal from their customers in small dollars amounts." Letter from Secretary William Francis Galvin of the Commonwealth of Massachusetts to SEC Chairman Elisse B. Walter (Feb. 26, 2013), available at <http://www.sec.state.ma.us/sct/sctschwabarb/Schwab-letter.pdf>.

<sup>19</sup> See *supra* n. 13, at pgs. 7-9 (discussing the 2012 attempt by Carlyle Group LP to amend its initial public offering registration statement to require arbitration of investor disputes and recent attempts by shareholders to include in proxy statements of four publicly traded companies bylaw amendments that would require arbitration, and prohibition on class actions, of all shareholder claims including securities law violations); see also Letter from Sens. Al Franken, Richard Blumenthal and Robert Menendez to SEC Chair Mary Shapiro (Feb. 3, 2012) (urging the SEC to maintain its policy of opposing the inclusion of provisions requiring mandatory arbitration of shareholder disputes in the corporate documents of public companies in response to Carlyle Group, LP's attempt to amend its registration papers to prohibit litigation and instead require individual arbitration).

seek redress, particularly for small dollar claims.<sup>20</sup> In other words, the practical effect of the Hearing Panel's decision could be the elimination of the ability of investors to bring or participate in class actions, which is the only viable means for most small investors to recoup their losses. As the Seventh Circuit Court of Appeals has correctly observed "[t]he realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for \$30."<sup>21</sup> The high cost of attorneys' fees and expenses alone makes adequate representation in a FINRA arbitration, particularly against a large and sophisticated brokerage firm, insurmountable for a single investor.

Restoring protections for Americans with limited means to invest is even more critical in light of changes enacted as part of the Jumpstart Our Business Startups Act (JOBS Act), which became law on April 5, 2012. The JOBS Act established a mechanism for small investors to engage in crowdfunding and loosened restrictions on advertising and solicitation of private securities. NASAA anticipates that these provisions of the JOBS Act will lead to an increase in very small investments. If these investors are forced to waive their right to participate in class actions, they will be left with no economically viable remedy when they are defrauded, thereby undercutting the goal of the JOBS Act to spur investment in smaller offerings.

#### **Securities Arbitration and the Dodd-Frank Act**

Congress recognized the potential harm to investors from mandatory pre-dispute arbitration clauses when it enacted, on July 21, 2010, Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This section provided the SEC with the authority to prohibit or impose limitations on the use of mandatory pre-dispute arbitration clauses in broker-dealer and investment adviser customer contracts.

Section 921 was included in response to Congressional concern that mandatory pre-

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<sup>20</sup> See Amicus Curiae Brief of NASAA at 14, *Dept. of Enforcement v. Charles Schwab & Co.*, FINRA Disciplinary Proceeding No. 2011029760201 (Feb. 1, 2012).

<sup>21</sup> *Carnegie v. Household Int'l. Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).

dispute arbitration agreements were unfair to investors.<sup>22</sup> During deliberation, lawmakers observed the following with regard to mandatory pre-dispute arbitration clauses in broker-dealer contracts:

For too long, securities industry practices have deprived investors of a choice when seeking dispute settlements, too. In particular, pre-dispute mandatory arbitration clauses inserted into contracts have limited the ability of defrauded investors to seek redress. Brokerage firms contend that arbitration is fair and efficient as a dispute resolution mechanism.

Critics of mandatory arbitration clauses, however, maintain that the brokerage firms hold powerful advantages over investors. Brokerages often hide mandatory arbitration clauses in dense contract language. Moreover, arbitration settlements generally remain secret, preventing other investors from learning about the performance of a particular brokerage firm.

If arbitration truly offers investors the opportunity to efficiently and fairly settle disputes, then investors will choose that option. But investors should also have the choice to pursue remedies in court, should they view that option as superior to arbitration. For these reasons, H.R. 3817 [the precursor to Section 921] provides the SEC with the authority to limit, prohibit or place conditions on mandatory arbitration clauses in securities contracts.<sup>23</sup>

Section 921 of the Dodd-Frank Act gives the SEC explicit rulemaking authority to prohibit or limit the use of mandatory pre-dispute arbitration agreements if it finds that doing so is in the public interest and for the protection of investors. Although Congress gave the SEC an important tool to act in this area, in the three years since the Dodd-Frank Act was passed, the SEC has not exercised its authority to conduct rulemaking or even examine the impact of mandatory pre-dispute arbitration clauses on investors and the public.<sup>24</sup> It is uncertain whether

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<sup>22</sup> Congress considered the following concerns about the arbitration process: “high upfront costs; limited access to documents and other key information; limited knowledge upon which to base the choice of arbitrator; the absence of a requirement that arbitrators follow the law or issue written decisions; and extremely limited grounds for appeal.” AARP letter to Senators Dodd and Shelby, November 19, 2009. *See also* Senate Committee on Banking, Housing, and Urban Affairs on S. 3217, S. Rep. No. 111-176, at 110.

<sup>23</sup> House Committee on Financial Services on H.R. 3817, H.R. Rep. No. 111-687, Part 1, at 50.

<sup>24</sup> Notably, even the SEC has previously advised brokerage firms that “form” contracts requiring mandatory pre-dispute arbitration are against public policy. “Requiring the signing of an arbitration agreement without adequate disclosure as to its meaning and effect violates standards of fair dealing with customers and constitutes conduct that

the SEC will take action in the near future under its Section 921 rulemaking authority,<sup>25</sup> even given the exigent circumstances presented by Schwab.

NASAA has urged the SEC to take such action, and has argued that as the agency chosen by Congress to oversee FINRA arbitration, the SEC's exercise of its specific authority under Section 921 of the Dodd-Frank Act supersedes the FAA's general provisions.<sup>26</sup> *We are deeply thankful to Senator Franken for spearheading a letter to the SEC along with 36 other Members of Congress urging the SEC to exercise its Section 921 authority in light of the actions taken by Schwab to limit investors' class action rights.*<sup>27</sup>

#### Conclusion

The Federal Arbitration Act was never intended to enforce contracts of adhesion, where one party offers terms on a non-negotiated, take-it-or-leave-it basis. Unfortunately, these contracts of adhesion containing mandatory pre-dispute arbitration clauses in their fine print are commonplace in the brokerage and investment adviser industry. Schwab's actions to expand these clauses and prohibit class action participation are an example of the pernicious effect of forced arbitration and brokerage "form" contracts. It is also an alarming example of the continued erosion of investor protections. Indeed, without a class action vehicle, many small dollar claims and potentially harmful activity will go undiscovered by the harmed investor, thus resulting in windfalls to violators.

The Arbitration Fairness Act of 2013 reaches beyond the securities regime and eliminates mandatory, pre-dispute arbitration clauses in a wide range of consumer contracts. It restores investors' access to the courts, and allows them to determine, *after a dispute arises*, if arbitration

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is inconsistent with just and equitable principles of trade." Notice to Broker-Dealers Concerning Clauses in Customer Agreements which Provide for Arbitration of Future Disputes," 1979 WL 174165 (S.E.C. Release No. 34-15984), p. 4.

<sup>25</sup> See SEC published agency rule list – Fall 2013, available at ([http://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION\\_GET\\_AGENCY\\_RULE\\_LIST&currentPubId=201310&showStage=longterm&agencyCd=3235&Image58.x=11&Image58.y=9&Image58=Submit](http://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPubId=201310&showStage=longterm&agencyCd=3235&Image58.x=11&Image58.y=9&Image58=Submit)).

<sup>26</sup> See Letter from NASAA to SEC Chair Mary Jo White (May 3, 2013), available at <http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-to-SEC-on-Arbitration-and-Class-Action-Waivers.pdf>.

<sup>27</sup> Letter from Sen. Franken and 36 Members of Congress to SEC Chair Mary Jo White (Apr. 26, 2013), available at <http://www.nasaa.org/wp-content/uploads/2013/08/Bicameral-Letter-to-SEC-re-Mandatory-Arbitration-April-26-2013.pdf>.

is the appropriate and desired forum. This legislation is consistent with the intent and spirit of Section 921 of the Dodd-Frank Act, and it removes the ability of any brokerage firm to unilaterally restrict an investor's ability to seek judicial relief. This legislation goes a long way to restore investor participation and confidence in the markets.

Thank you, Chairman Leahy, Ranking Member Grassley, Senator Franken, and Members of this Committee, for the opportunity to submit this written statement.



California Public Employees' Retirement System  
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Via Email

December 12, 2013

The Honorable Patrick Leahy  
 Chairman  
 Committee on the Judiciary  
 226 Dirksen Senate Office Building  
 Washington, DC 20510

The Honorable Tim Johnson  
 Chairman  
 Committee on Banking, Housing & Urban Affairs  
 534 Dirksen Senate Office Building  
 Washington, DC 20510

The Honorable Chuck Grassley  
 Ranking Member  
 Committee on the Judiciary  
 226 Dirksen Senate Office Building  
 Washington, DC 20510

The Honorable Mike Crapo  
 Ranking Member  
 Committee on Banking, Housing & Urban Affairs  
 534 Dirksen Senate Office Building  
 Washington, DC 20510

Chairman Leahy, Chairman Johnson, Ranking Member Grassley and Ranking Member Crapo:

On behalf of the California Public Employees' Retirement System (CalPERS), I am writing to express our strong concerns about efforts to force shareholders into any system which limits their rights or ability to seek legal remedies against issuers involved in corporate malfeasance.

As the largest public pension fund in the United States, with approximately \$277 billion in global assets providing retirement security to more than 1.6 million public workers, retirees, their families, and beneficiaries, CalPERS is reliant upon effective and comprehensive market regulation designed to protect investors. However, government intervention should not be the exclusive remedy for shareowners to hold corporations accountable.

Relying on the government alone to enforce individual rights of action is inefficient and impractical. For example, private litigation in the Enron, WorldCom, Tyco, Bank of America and Global Crossing cases garnered investors \$19.4 billion, according to settlement documents. By comparison, a review of Fair Funds records at the Securities and Exchange Commission (SEC or Commission) shows that Commission enforcement actions in these matters resulted in penalties and fees of only \$1.8 billion. More recently, private securities actions against four of the large financial institutions partially responsible for the last financial crisis returned over \$16 billion to investors, whereas SEC enforcement actions resulted in recoupment of approximately \$2.7 billion.

In response to these investor successes in holding corporations accountable, publicly traded companies are seeking to circumvent private rights of action by including mandatory, binding arbitration clauses in investment advisor agreements, corporate bylaws or other contracts. Such provisions force all shareholder disputes into arbitrations controlled by the very same corporations against whom the claims are being brought and these forced arbitration clauses typically require shareholders to waive their rights to participate in any collective or class action.

In sum, forced arbitration schemes, particularly schemes that bar class action, cannot supplant judicial enforcement of fiduciary duties owed to shareowners.

Accordingly, we ask that you act to preserve the ability of investors to access the judicial system for the enforcement and protection of their legal rights by:

- 1) Supporting the SEC in its exercise of Congressionally-granted authority under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to prohibit the use of mandatory pre-dispute arbitration provisions in broker-dealer and investment advisor agreements; and,
- 2) Acting to formalize the SEC's longstanding policy that mandatory pre-dispute provisions requiring arbitration of investor disputes in the bylaws and governing documents of publicly traded corporations are harmful to capital markets, contrary to public policy, and could be subject to enforcement action.

Thank you for your consideration. If you have any questions, please do not hesitate to contact me at (916) 795-9672 ([anne\\_simpson@calpers.ca.gov](mailto:anne_simpson@calpers.ca.gov)) or Don Marlais of Lussier, Gregor, Vienna & Associates - our federal representatives - at (703) 888-4522 ([dmarlais@lqva.net](mailto:dmarlais@lqva.net)).

Sincerely,



ANNE SIMPSON  
Senior Portfolio Manager  
Investments  
Director of Global Governance

Cc: The Honorable Barbara Boxer  
The Honorable Dianne Feinstein



**TESTIMONY TO THE UNITED STATES SENATE JUDICIARY COMMITTEE**

**FORCED ARBITRATION UNDERMINES ENFORCEMENT OF FEDERAL LAWS BY  
SUPPRESSING CONSUMERS' AND EMPLOYEES' ABILITY TO BRING CLAIMS**

December 17, 2013

By Jean R. Sternlight<sup>1</sup>

Michael and Sonja Saltman Professor of Law &  
Director Saltman Center for Conflict Resolution  
University of Nevada, Las Vegas Boyd School of Law

**Introduction**

I thank the Committee for scheduling this hearing and for inviting me to present my testimony. I believe that the proposed Arbitration Fairness Act of 2013-14, S. 878, addresses a critically important topic and that it ought to be passed in order to protect United States consumers and employees as well as the sanctity of our laws. There is no point having substantive laws to protect us unless these laws can be enforced, and yet companies are currently using mandatory arbitration to prevent their consumers and employees from enforcing their substantive rights. In particular, companies are using mandatory arbitration clauses both to deter individuals from bringing claims and also to eliminate individuals' opportunity to participate in class actions.

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<sup>1</sup> Jean R. Sternlight is the Michael & Sonja Saltman Professor of Law and also Director of the Saltman Center for Conflict Resolution, Boyd School of Law, University of Nevada, Las Vegas.

### Personal Background

By way of background, I have studied the topic of what I have called “mandatory arbitration” for almost twenty years. Indeed, I wrote one of the first law review articles on the subject: *Panacea or Corporate Tool?: Debunking the Supreme Court’s Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637 (1996). I have since written approximately twenty articles on the subject that have appeared in publications such as the STANFORD LAW REVIEW, the UNIVERSITY OF PENNSYLVANIA LAW REVIEW, and the WILLIAM AND MARY LAW REVIEW. I have also written four books on dispute resolution and been cited or quoted by numerous courts and newspapers. Currently I am employed by the University of Nevada-Las Vegas where I am the Director of the Saltman Center for Conflict Resolution and also the Michael and Sonja Saltman Professor of Law.<sup>2</sup>

As you might imagine, given my titles and interests, I am a big fan of alternative dispute resolution, including arbitration. I believe that disputants are often better served by resolving their disputes through negotiation, mediation or arbitration than through litigation. Nonetheless, I am staunchly opposed to the practice variously known as “mandatory,” “forced,” or “compelled” arbitration whereby businesses use form contracts to require their employees or consumers to resolve future disputes through arbitration rather than through litigation.<sup>3</sup> Rather, I favor giving businesses and individuals the chance to *knowingly and voluntarily* choose to resolve disputes in the venues they both prefer.

### Supreme Court Rulings on Arbitration

The legal landscape governing mandatory arbitration has changed substantially since I began writing on the topic almost twenty years ago. In particular, the U.S. Supreme Court has issued numerous decisions granting companies essentially free rein to require their consumers and employees to resolve disputes through arbitration, rather than through litigation. The Court has for example made clear that companies can use arbitration to eliminate plaintiffs’ opportunity to join together in class actions even where the elimination of class actions leaves plaintiffs without an economically realistic opportunity to present their claim.<sup>4</sup> The Court has also largely eliminated states’ opportunity to protect

<sup>2</sup> Of course the opinions I express here are only my own.

<sup>3</sup> While some may suggest that consumers and others can simply refuse to do business or take a job when arbitration is required the practical reality is that they often do not see the clause, understand it, or understand its importance. Moreover, in some fields even educated consumers would have virtually no choice but to agree to arbitration if they want the product or service in question, as the term may be so prevalent in some kinds of contracts.

<sup>4</sup> In *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011), the Court held that the Federal Arbitration Act preempted lower courts’ use of California precedent to hold an arbitral class action prohibition unconscionable. Subsequently, in *American Express v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013), the Court held that an arbitral class action prohibition was valid even though it would prevent plaintiffs from vindicating their rights under federal antitrust law.

their citizens from unfair arbitration by interpreting preemption doctrines broadly so as to void most state statutes governing arbitration.<sup>5</sup> Additionally the Court has held that arbitrators rather than courts should interpret many aspects of arbitration clauses, including determining whether the arbitration clause is invalid due to unconscionability, so long as the clause gives that power to the arbitrators.<sup>6</sup> In short, under current law companies are largely allowed to structure arbitration as they wish, subject only to limited regulation by the arbitrators themselves or by arbitration providers. Yet, arbitrators and arbitration providers have little incentive to rein in the practice that provides them with economic remuneration.

### **Policy Arguments Regarding Mandatory Arbitration**

While the legal landscape has changed substantially over the past twenty years, the policy arguments regarding whether mandatory arbitration is good or bad for employees and consumers remain substantially the same. Advocates of the practice urge that arbitration is quicker and cheaper than litigation and that companies who compel arbitration are therefore providing employees and consumers with a better venue than court in which to present their legal claims. Such advocates typically assert that any unfair clauses will generally be weeded out by courts or by arbitration providers. By contrast, critics typically assert that mandatory arbitration is often unfair to the “little guys” -- consumers and employees -- and that forcing disputes into private arbitration also deprives the public of access to the dispute resolution process or resulting precedent.

### **Very Few Consumers and Employees Bring Claims in Arbitration**

Those who focus on the fairness of arbitration *hearings* miss the main impact of mandatory arbitration clauses, which is that they typically deter or sometimes prevent consumers or employees from obtaining access to justice in *any* forum. That is, *almost no consumers or employees actually bring claims in arbitration*. Thus, rather than providing greater access to justice the main function of arbitration clauses is to protect companies from claims brought in any venue. Worrying about whether arbitration hearings are or are not fair largely misses the main point, which is that arbitration hearings are exceedingly rare.

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<sup>5</sup> For example, in *Doctor's Associates Inc. v. Casarotto*, 517 U.S. 681 (1996), the Court held that the FAA preempted Wyoming law requiring arbitration clauses to appear in a particular location and font in contracts. More recently, in *Preston v. Ferrer*, 552 U.S. 346 (2008), the Court held that the parties' arbitration clause superceded a California statute requiring that certain kinds of contractual disputes in the entertainment industry be resolved by a particular state agency.

<sup>6</sup> *Rent-a-Center West, Inc. v. Jackson*, 561 U.S. 63 (2010) (holding that courts shall enforce arbitration clause written to provide that arbitrator, rather than court, decides whether arbitration clause is unenforceable due to unfairness).

While hard evidence regarding the practice of mandatory arbitration has been scant,<sup>7</sup> the little publicly available data shows that miniscule numbers of consumers or employees end up filing claims in arbitration. The preliminary report of the Consumer Financial Protection Board, which has begun to study consumer arbitration pursuant to Congressional mandate, confirms the point that very few consumers are filing arbitration claims.<sup>8</sup> These small numbers are particularly striking given that so many consumers and employees are required to file claims in arbitration rather than litigation. Professor Alexander Colvin has estimated that more than 20% of employees are covered by mandatory arbitration clauses.<sup>9</sup> We all know that arbitration clauses are even more common in the consumer setting, as we see them in transactions involving banking, credit cards, insurance, schools, gym memberships, telephones, computers, and many many other goods and services.<sup>10</sup>

How few claims are actually filed in arbitration? On the consumer side in one informal report the American Arbitration Association, the largest and best-known arbitration provider in the country, stated that it handled roughly 1,000 claims by consumers per year.<sup>11</sup> The recent Consumer Financial Protection Bureau report is consistent, finding that from 2010 through 2012 consumers filed an average of just 300 arbitrations per year with AAA regarding credit cards, checking accounts, payday loans, or prepaid cards.<sup>12</sup> JAMS, the other major arbitration provider in the United States, states that it handles at most a few hundred consumer claims annually.<sup>13</sup> Data revealed in several lawsuits similarly shows that when companies set up arbitration programs almost no customers bring claims.<sup>14</sup> With respect to employees, the numbers are similar. Researcher Alexander Colvin, a professor at Cornell's International Labor Relations School, looked at the information the American Arbitration Association was required to produce by California law.

<sup>7</sup> Arbitration providers such as the American Arbitration Association or JAMS or the National Arbitration Forum typically cite both the importance of confidentiality as well as business justifications in refusing to open their files to researchers much less the general public. When providers do make their files available to researchers one can never be sure whether either the researchers or the providers are slanting the data or results to favor a particular perspective.

<sup>8</sup> CONSUMER FINANCIAL PROTECTION BOARD, ARBITRATION STUDY PRELIMINARY RESULTS 13 (December 12, 2013), available at [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf).

<sup>9</sup> Alexander Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury* 11 EMP. RTS. & EMP. POL'Y J., 405, 410 (2004).

<sup>10</sup> A 2001 study showed that thirty-five percent of the consumer contracts in an average California consumer's life required arbitration Linda J. Demaine & Deborah R. Hensler, "Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience, 67 LAW & CONTEMP. PROBS. 55, 62 (2004). Another more recent study of twenty-one companies with substantial name recognition or market share in the areas of telecommunications, credit, or financial services found that over seventy-five percent of the companies imposed mandatory arbitration on their consumers, and that every consumer arbitration contract included a waiver of class actions. Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J. LAW REFORM 871, 880-83 (2008).

<sup>11</sup> Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SOUTHWESTERN L. REV. 87, 99 (2012).

<sup>12</sup> CFPB ARBITRATION STUDY, *supra* n. 8.

<sup>13</sup> Sternlight, *supra* n. 11.

<sup>14</sup> *Id.* at 99-100.

Examining national data from 2003 through 2007 Colvin found that just 3,945 employees filed arbitration claims with AAA, or less than 1,000 employees per year.<sup>15</sup> While I recognize that AAA and JAMS are not the only arbitration providers, these statistics certainly suggest that neither consumers nor employees are filing lots of arbitration claims. Although the advocates of mandatory arbitration claim that the process is good because it provides inexpensive and quick access to the justice system, no one has produced data substantiating this claim with respect to either consumers or employees.

One thing we can say for sure is that the absence of consumer and employee claims in arbitration does not reflect that consumers and employees have no claims. In 2011, 1.8 million consumers filed claims with the Federal Trade Commission.<sup>16</sup> And, millions of consumers contest charges through their credit card companies.<sup>17</sup> We also know that plenty of employees do have claims they wish to file against their employers. In 2012, for example, just under 100,000 employees filed discrimination claims against their employers with the Equal Employment Opportunity Commission.<sup>18</sup> Of course many other employees filed discrimination claims with state agencies or might have liked to file tort or contract or other claims against their employers.

#### **Courts Offer More Access to Justice than does Mandatory Arbitration**

Some may suggest that even if arbitration is not perfectly accessible at least it is better than litigation, which is often slow and expensive. However, the evidence does not support this position. While it is certainly true that individual lawsuits are often difficult and expensive, court, despite all its drawbacks, offers consumers and employees far greater access to justice than does arbitration, particularly when one considers class actions. Federal court statistics show that 17,977 labor claims and 35,965 civil rights claims were filed in 2012.<sup>19</sup> Presumably not all of these were claims brought by employees against employers, but these numbers, from federal court alone, do provide quite a contrast to the scant number of employment claims filed in arbitration. Another study similarly found that 265,356 employment discrimination cases were filed in federal court alone between 1979 and 2000.<sup>20</sup> If state court statistics were added these numbers would be far greater. With respect to lawsuits brought by consumers, the Consumer Financial Protection Board found that consumers had filed more than 3,000 cases in federal court from 2010-2012

<sup>15</sup> Alexander J.S. Colvin, *An Empirical Study of Employment Arbitration: Case Outcomes and Processes*, 8 J. EMPIRICAL L. STUDIES 1, 4 (2011).

<sup>16</sup> *Id.* at 102.

<sup>17</sup> *Id.*

<sup>18</sup> <http://www1.eeoc.gov/eeoc/statistics/enforcement/charges.cfm>.

<sup>19</sup> Federal Court Management Statistics June 2013, available at <http://www.uscourts.gov/viewer.aspx?doc=/uscourts/Statistics/FederalCourtManagementStatistics/2013/district-fcms-profiles-june-2013.pdf&page=1>.

<sup>20</sup> Kevin M. Clermont & Stewart J. Schwab, *How Employment Discrimination Plaintiffs Fare in Federal Court*, 1 J. EMPIRICAL STUDS. 429, 457 (2004).

regarding credit card issues alone.<sup>21</sup> If one adds to this cases involving defective products, illegal fees, fraudulent charges and all the other matters consumers may complain of, and if one also adds consumer litigation in all the fifty state courts, of course the number would be far higher.

Class actions are also a tremendous resource for consumers and employees who would not be able to file individual claims, for example because they were not aware they were injured, because they did not realize the harm violated a law, because they could not afford to litigate their claim on an individual basis, or because they feared retaliation. The annual class action report compiled by law firm Seyfarth Shaw states that in 2011 employees filed 8,414 ERISA class actions, 6,779 Fair Labor Standards Act class actions, and 14,771 employment discrimination class actions.<sup>22</sup> Similarly, the Consumer Financial Protection Board found that more than 400 consumer class actions were brought in federal court alone between 2010 and 2012, just with regard to credit card issues.<sup>23</sup> A single class action may provide hundreds or thousands or even millions of claimants access to relief, and may also deter companies from committing future violations. For example, two California lawsuits brought against Career Education Corporation for making fraudulent representations as to post-school employment prospects led to a \$40 million dollar settlement whereby the company agreed to reimburse 8,500 students up to \$20,000 apiece.<sup>24</sup> On the employment side, while the Supreme Court's decision in *Walmart v. Dukes*, 131 S. Ct. 2541 (2011), disallowed a proposed employment class action that would have covered more than a million employees,<sup>25</sup> even the far smaller and more targeted classes now being pursued post-*Walmart* could each often include thousands and thousands of members.<sup>26</sup> Yet, companies are increasingly turning to mandatory arbitration precisely as a means to eliminate consumers' and employees' access to class actions. Thus, it appears that mandatory arbitration is limiting rather than broadening access to justice.

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<sup>21</sup> Prepared Remarks of Director Richard Cordray at the Field Hearing on Arbitration (December 12, 2013), available at <http://www.consumerfinance.gov/newsroom/prepared-remarks-of-director-richard-cordray-at-the-field-hearing-on-arbitration/>.

<sup>22</sup> Seyfarth Shaw, ANNUAL WORKPLACE CLASS ACTION LITIGATION REPORT (2012 edition) at 3, available at [http://www.seyfarth.com/dir\\_docs/publications/2012%20CAR%20short%20final%20\(secured\).pdf](http://www.seyfarth.com/dir_docs/publications/2012%20CAR%20short%20final%20(secured).pdf).

<sup>23</sup> Prepared Remarks of Director Richard Cordray, *supra* n. 21.

<sup>24</sup> Public Citizen & Nat'l Assoc. of Consumer Advocates, *Justice Denied – One Year Later: The Harms to Consumers from the Supreme Court's Concepcion Decision Are Plainly Evident* (2012) at 10, available at <http://www.citizen.org/documents/concepcion-anniversary-justice-denied-report.pdf>. For reports on other similar class actions see Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SOUTHWESTERN L. REV. 87, 102-103 (2012).

<sup>25</sup> 131 S. Ct. at 2547.

<sup>26</sup> See, e.g., *Easterling v. Connecticut Dept. of Correction*, 278 F.R.D. 41 (D. Conn. 2011) (refusing to decertify class, even post-*Wal-Mart*, that challenged the use of a 1.5 mile run as an employment test in the hiring of corrections officers); *Ellis v. Costco Wholesale Corp.*, 285 F.R.D. 492 (N.D. Cal. 2012) (certifying nationwide class of female Costco employees, post *Wal-Mart*, where class identified several companywide policies they claimed reduced their chances of promotion).

### **Why and How Mandatory Arbitration Suppresses Claims**

Why do so few employees and consumers file claims in arbitration? It turns out that the mandatory form of arbitration is often not particularly appealing either to the attorneys who sometimes represent employees and consumers or to consumers and employees trying to proceed without representation. Here are just a few of the reasons why mandatory arbitration suppresses claims:

(1) Attorneys generally (but not always) prefer to file their claims in litigation than in arbitration. Weighing out the costs and benefits of each process attorneys may prefer litigation because they don't have to pay high filing or administrative fees or arbitral salaries, because they believe they will have a higher likelihood of prevailing, because they believe their client's recovery will be greater, because they will not be automatically foreclosed from proceeding in a class action, or because they seek a process in which the decision maker is required to follow the law and issue a written decision that will be publicly available.

(2) Because many plaintiffs' attorneys see mandatory arbitration as inferior to litigation they will be more reluctant to accept contingent fee cases when consumers and employees are arguably covered by arbitration clauses. In this way the imposition of arbitration "disarms" employees and consumers, making it more difficult for them to secure legal representation.

(3) Arbitration does not turn out to be a good vehicle for most unrepresented consumers and employees, as they may not be competent to file or present the claim effectively on their own behalf, and may not be able to afford filing fees and costs imposed in many arbitrations. Many consumer and employment claims are sufficiently complicated as a matter of law or fact that the typical consumer or employee cannot hope to prevail without assistance.

(4) Employees or consumers who are not aware they have been injured, or that the injury violates a law, will not file claims on their own behalf. Examples include consumers harmed by a toxic substance, a discriminatory practice, or a dangerous vehicle, or employees harmed by a discriminatory practice or the failure to pay overtime that is required by law.

While more research is needed to show which of these or perhaps other concerns discourage consumers and employees from filing individual claims in arbitration, we can be sure that arbitration is not providing the fast, cheap, fair access to justice that has been claimed.

**Congress Must Act To Ensure Our Laws Are Enforceable**

When companies use mandatory arbitration to deprive consumers and employees of access to justice they not only harm those consumers and employees but also prevent enforcement of the laws passed by Congress and state legislatures. In this country we largely rely on private lawsuits to secure enforcement of our laws. When companies can use arbitration to elude such lawsuits by suppressing claims they effectively render our laws toothless. I favor passage of the Arbitration Fairness Act of 2013-14, S. 878, because I believe it is the best means of protecting consumers and employees from unfair arbitration and ensuring that the laws legislatures have passed continue to be enforced.

**Written Testimony of Professor Imre Stephen Szalai,  
Loyola University New Orleans College of Law**

**Before the United States Senate Committee on the Judiciary**

**For the Hearing Entitled "The Federal Arbitration Act and Access to Justice:  
Will Recent Supreme Court Decisions Undermine the Rights of  
Consumers, Workers, and Small Businesses?"**

**December 17, 2013**

Thank you for allowing me this opportunity to present testimony regarding the Federal Arbitration Act. As explained in more detail below, recent Supreme Court decisions threaten to undermine the rights of millions of Americans, and I respectfully urge that the Committee on the Judiciary favorably report Senate Bill 878, the Arbitration Fairness Act of 2013, to the full Senate and work toward its enactment.

In order to make this written testimony as useful as possible to the Committee and its staff, I have organized my testimony into the following five sections:

1. My Professional Background and Interest in Arbitration Law
2. The Federal Arbitration Act Was Never Intended to Apply to Employment Disputes or Small Consumer Disputes
3. The Supreme Court's Decisions in *Concepcion* and *American Express* Are Changing the Scope of Judicial Review of Individual Arbitration Agreements
4. The Reformers Who Pushed for the Federal Arbitration Act Understood the Statute as a Work-In-Progress That Would Require Future Amendments
5. The Arbitration Fairness Act of 2013 Contains a Subtle Flaw That Must Be Corrected Before Its Enactment

**1. My Professional Background and Interest in Arbitration Law**

I am a law professor who is very passionate about the study of arbitration law, and I have written extensively in this area. I am a graduate of Yale University, and I received my law degree from Columbia Law School, where I was named a Harlan Fiske Stone Scholar. In private practice, I litigated many issues regarding the Federal Arbitration Act (FAA). As a law professor, my scholarship concerning arbitration has appeared in top journals regarding alternative dispute resolution, including the Harvard Negotiation Law Review and the Journal of Dispute Resolution. I maintain a blog about arbitration law

developments, [www.outsourcingjustice.com](http://www.outsourcingjustice.com), and I recently finished writing a book setting forth a comprehensive legal history regarding the enactment of the FAA. My book, *OUTSOURCING JUSTICE: THE RISE OF MODERN ARBITRATION LAWS IN AMERICA*, is based on ten years of researching previously-untapped archival materials and other overlooked sources from the drafters of the FAA. My book presents a thorough, almost week-by-week account of the passage of the FAA in 1925, and my book explores why America's arbitration laws radically changed during the 1920s. By examining this history, my book demonstrates how the Supreme Court has grossly misconstrued the FAA and unjustifiably created an expansive, informal, second-class system of justice touching almost every aspect of American society and impacting the lives of millions.

## 2. The Federal Arbitration Act Was Never Intended to Apply to Employment Disputes or Small Consumer Disputes

The earliest drafts of the bills that would become the FAA did not contain the labor and employment exemption now found in section one of the FAA.<sup>1</sup> There was no need for the exemption because the FAA was drafted and intended for use in simple contract disputes between merchants of relatively co-equal status,<sup>2</sup> and because at the time of the FAA's enactment, most employment and labor disputes were beyond the scope of Congressional regulation through the Commerce Clause.<sup>3</sup> A labor and employment exemption was eventually added to the bills in an abundance of caution. Although most labor and employment issues were generally beyond the scope of the Commerce Clause at the time of the FAA's enactment, a small subset of workers was viewed as engaged in interstate commerce at the time. For example, transportation workers who crossed state lines, such as railroad employees, were considered to be involved in interstate commerce and were, therefore, subject to Congressional regulation.<sup>4</sup>

In January 1923, the bills that would eventually become the FAA were before the Judiciary Committees of the House and Senate, and a hearing was scheduled to occur at

<sup>1</sup> 9 U.S.C. §1 (2012) (the FAA shall not apply to "workers engaged in foreign or interstate commerce"); IMRE STEPHEN SZALAI, *OUTSOURCING JUSTICE: THE RISE OF MODERN ARBITRATION LAWS IN AMERICA* 132-35, 142-45 (2013); *see also* 45 ANNU. REP. A.B.A. 315-18 (1922).

<sup>2</sup> *See generally* SZALAI, *supra* note 1. The prototypical dispute covered by the FAA was a simple contract dispute regarding the quality of goods sold between two merchants located in different states. For example, during a hearing in 1924, a witness testified that the FAA would help support arbitration of a dispute between a seller of a carload of potatoes from Wyoming and a dealer from New Jersey. *Bills to Make Valid and Enforceable Written Provisions or Agreements for Arbitration of Disputes Arising Out of Contracts, Maritime Transactions, or Commerce Among the States or Territories or With Foreign Nations, Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, 68th Cong., 1st Sess. 7 (1924). *See also id.* at 30-31 (arbitration legislation would help reduce "business litigation" and encourage "business men" to settle their "business differences"); *id.* at 41 ("If business men desire to submit their disputes to speedy and expert decision, why should they not be enabled to do so?").

<sup>3</sup> *See, e.g.,* *Hammer v. Dagenhart*, 247 U.S. 251 (1918) (striking down as unconstitutional a federal child labor law because the Commerce Clause did not cover employees working within a state to produce items that would be shipped out of state), *overruled by* *U.S. v. Darby*, 312 U.S. 100 (1941).

<sup>4</sup> *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 136 (2001) (Souter, J., dissenting) (citing *The Employers' Liability Cases*, 207 U.S. 463 (1908) (regulation of the employment relations of railroad employees engaged in the operation of interstate commerce is permissible under the Commerce Clause, but regulation of a railroad company's clerical force is not)).

the end of the month before a subcommittee of the Senate Judiciary Committee.<sup>5</sup> A few days before the hearing, Senator Thomas Sterling of South Dakota, a member of the Senate Judiciary Committee, received a letter raising concerns about the early drafts of the bills from an important constituent, a prominent South Dakota lawyer whose firm had significant clients with employees involved in interstate transportation, such as large railroad companies and parcel transportation businesses.<sup>6</sup> As explained in more detail in my book, this letter, along with concerns raised by labor groups, gave rise to the language now found in section one of the FAA, which exempts workers “engaged in foreign or interstate commerce” from the coverage of the statute.<sup>7</sup> The main drafter of the FAA, an attorney named Julius H. Cohen, wrote a letter explaining that this exemption, which he drafted in response to the concerns raised by Senator Sterling and his constituent, would have the effect of “leav[ing] out labor disputes” from the coverage of the statute, and he did not view this exemption as materially changing his original draft of bill, which did not contain the exemption.<sup>8</sup> In other words, this labor and employment exemption was added in an abundance of caution to exclude the only possible category of workers subject to the Commerce Clause power at the time. This exemption simply reinforced the original intent behind the statute, which was to cover routine commercial disputes between merchants, not labor or employment disputes of any kind.<sup>9</sup>

Regarding consumer transactions, as explained in more detail in my book, interstate transactions occurred between consumers and large mail-order companies at the time of the FAA’s enactment, and disputes regarding such transactions were sometimes resolved through arbitration during the early 1900s.<sup>10</sup> Considering the broad language of the FAA and the existence of such disputes during the early 1900s, one may argue that the FAA could cover arbitration agreements in connection with consumer transactions

<sup>5</sup> SZALAI, *supra* note 1, at 135.

<sup>6</sup> *Id.* at 133 (citing Letter from Senator Thomas Sterling to Charles L. Bernheimer, Jan. 25, 1923, New York Chamber of Commerce and Industry Records Archival Collection, Series V, Rare Book & Manuscript Library, Columbia University in the City of New York, Box 114, Folder 19).

<sup>7</sup> 9 U.S.C. §1 (2012). For a more detailed discussion of the archival materials demonstrating that the FAA was never intended to apply in the labor and employment context, see SZALAI, *supra* note 1, at 131-33, 134-35, 136, 142-43, 144-45, 147, 148, 149, 150, 151, 152-54, 159, 191-92, 192-98. Many of these materials discussed in my book were not previously known when the Supreme Court issued its flawed decision in 2001 in *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (holding that the FAA covers employment disputes).

<sup>8</sup> SZALAI, *supra* note 1, at 135 (citing Letter from Julius H. Cohen to Charles L. Bernheimer, Jan. 29, 1923, New York Chamber of Commerce and Industry Records Archival Collection, Series V, Rare Book & Manuscript Library, Columbia University in the City of New York, Box 114, Folder 19).

<sup>9</sup> The addition of the exemption language found in section one of the FAA is loosely analogous to the ratification of the Bill of Rights. Some believed the Bill of Rights was unnecessary because the federal government would only have limited, narrowly defined powers, and as a result of such limited powers, the federal government could never threaten the fundamental liberties of American citizens. However, the Bill of Rights was added to the Constitution to alleviate concerns and explicitly confirm that the federal government would never overreach its limited powers and threaten fundamental freedoms. Similarly, the earliest drafts of the FAA did not contain a labor or employment exemption because the FAA was never intended to cover labor and employment disputes to begin with. However, the exemption was eventually added to section one of the FAA to alleviate the concerns of labor interests and to make it absolutely clear that the FAA would never apply in the labor and employment context.

<sup>10</sup> SZALAI, *supra* note 1, at 194-95.

involving interstate commerce. However, this argument is doubtful for at least two reasons.

First, during the January 1923 hearing, Senator Thomas J. Walsh of Montana raised concerns about enforcing arbitration clauses presented by a party with stronger bargaining power on a “take-it-or-leave-it” basis, such as a standard, non-negotiable contract drafted by an insurance company.<sup>11</sup> Senator Walsh explained that such contracts are “not really voluntary contracts.”<sup>12</sup> William Piatt, an American Bar Association lawyer who was testifying in favor of the FAA and whose committee helped develop the FAA, agreed with the Senator and explained that the FAA was not intended to apply to such take-it-or-leave-it contracts.<sup>13</sup> Instead, the purpose of the FAA was to facilitate the resolution of commercial disputes between merchants who knowingly and voluntarily agreed to arbitrate.<sup>14</sup> This testimony suggests that it is problematic to apply the FAA to contracts presented on a non-negotiable, take-it-or-leave-it basis. The FAA instead was designed to cover situations where parties knowingly, voluntarily, and with full understanding entered into an agreement to arbitrate.

Second, the jurisdictional scope of the FAA in 1925 helps demonstrate that the FAA was not intended to cover consumer disputes. At the time the FAA was enacted, in order for a federal court to have jurisdiction over a dispute, the dispute generally had to involve at least \$3,000.<sup>15</sup> When adjusted for inflation, this amount of \$3,000 in 1925 would be more than \$40,000 in 2013.<sup>16</sup> Disputes involving small dollar amounts were not intended to be heard by the federal judiciary. An initial draft of the bills that would become the FAA attempted to remove the \$3,000 minimum requirement, so that the FAA would cover disputes involving small dollar amounts.<sup>17</sup> However, Congress rejected this early draft of the FAA.<sup>18</sup> Consequently, when the FAA was enacted, it only applied to disputes where at least \$3,000 was in controversy, an amount that far exceeded the value of small, routine consumer transactions.

In sum, the FAA was never intended to cover disputes involving employees or routine consumer contracts; the statute was not designed to protect the needs of employees or consumers because they were beyond the scope of the statute. Yet, today, because of expansive and flawed interpretations by the Supreme Court, it is the norm for courts to apply the FAA in these contexts.

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<sup>11</sup> *Id.* at 143 (citing *A Bill Relating to Sales and Contracts to Sell in Interstate and Foreign Commerce; and a Bill to Make Valid and Enforceable Written Provisions or Agreements for Arbitration of Disputes Arising out of Contracts, Maritime Transactions, or Commerce Among the States or Territories or With Foreign Nations*, Hearings on S. 4213 and S. 4214 before a Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess. 10 (1923)).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> Both diversity and federal question jurisdiction required the amount in controversy to exceed \$3,000. Act of Mar. 3, 1911, ch. 231, § 24, 36 Stat. 1087, 1091.

<sup>16</sup> See US Inflation Calculator, <http://www.usinflationcalculator.com>.

<sup>17</sup> SZALAI, *supra* note 1, at 123, 134, 181, 182.

<sup>18</sup> *Id.*

### 3. The Supreme Court's Decisions in *Concepcion* and *American Express* Are Changing the Scope of Judicial Review of Individual Arbitration Agreements

The Supreme Court has recently issued two important decisions involving the enforceability of class waivers in arbitration agreements, *AT&T Mobility LLC v. Concepcion* (“*Concepcion*”)<sup>19</sup> and *American Express Co. v. Italian Colors Restaurant* (“*Amex*”).<sup>20</sup> In the wake of these Supreme Court decisions, several courts have ended class actions by compelling the named plaintiff to submit his or her claim to individual arbitration.<sup>21</sup> Armed with these decisions, companies and employers can in effect use arbitration agreements to immunize themselves from class action liability.

It is easy to focus on the class action implications of these Supreme Court decisions. *Concepcion* and *Amex* can have a significant impact on the availability of class actions, and the decreasing availability of class actions is highly problematic. However, the reach of these decisions goes far beyond the class action context. These Supreme Court rulings can also undermine the fairness of *individual* arbitration proceedings.

Before these decisions were issued, courts would sometimes strike down and carve out unfair, one-sided arbitration procedures before compelling arbitration of disputes, and in some situations, courts would invalidate an entire arbitration agreement because of unfair procedures. Such a judicial fairness review of an arbitration agreement helped ensure a fair arbitration proceeding would occur, and through this review, courts played an important role in helping to police arbitration procedures. For example, in *Armendariz v. Foundation Health Psychcare Services, Inc.*, the California Supreme Court addressed the arbitrability of antidiscrimination claims.<sup>22</sup> The California Supreme Court held that such claims are arbitrable provided that the arbitration would permit the plaintiff to vindicate his or her rights.<sup>23</sup> In order to help police the fairness of an arbitration agreement, the California Supreme Court in *Armendariz* explained that the plaintiff could vindicate his or her rights only if the arbitration agreement satisfied certain minimum fairness factors (the “*Armendariz* fairness factors”), such as whether the agreement provides for more than minimal discovery, and whether the agreement provides for relief that would be available in court.<sup>24</sup> There are several examples of pre-*Concepcion* court decisions invalidating arbitration agreements with one-sided or unfair arbitration procedures because the agreement failed to satisfy the *Armendariz* fairness factor analysis and/or a general unconscionability analysis.<sup>25</sup>

<sup>19</sup> 131 S.Ct. 1740 (2011).

<sup>20</sup> 133 S.Ct. 2304 (2013).

<sup>21</sup> See, e.g., *Arroyo v. Riverside Auto Holdings, Inc.*, No. E056256, 2013 WL 4997488 (Cal. Ct. App. Sept. 13, 2013) (plaintiff who filed a class action regarding wage and hour claims must submit his individual claims to arbitration); *Ryan v. JPMorgan Chase & Co.*, 924 F.Supp.2d 559 (S.D.N.Y. 2013) (relying on *Concepcion* and *Amex* to enforce class waiver and compel employee to submit her individual claims to arbitration).

<sup>22</sup> 6 P.3d 669 (Cal. 2000).

<sup>23</sup> *Id.* at 674, 680-82.

<sup>24</sup> *Id.* at 682.

<sup>25</sup> See, e.g., *Abraham v. ESIS, Inc.*, No. C-07-04014-JCS, 2008 WL 220104, \*5-6 (N.D. Cal. Jan. 25, 2008) (relying on *Armendariz* to invalidate an arbitration agreement's requirement that the employee pay a fee to an employer in order to initiate arbitration); *Hulett v. Capitol Auto Group, Inc.*, No. 07-6151-AA,

Unfortunately, in the wake of *Concepcion* and *Amex*, some courts are now changing the scope of judicial review of individual arbitration agreements. For example, some courts are relying on *Amex*'s limiting of the effective vindication doctrine and *Concepcion*'s broad preemption language to find that the FAA preempts consideration of the *Armendariz* fairness factors, and these factors previously provided a valuable tool to help police the fairness of individual arbitration agreements.<sup>26</sup> Moreover, some courts are construing *Concepcion* as changing the nature of an unconscionability review. In *Lucas v. Hertz Corp.*, a federal court addressed an unconscionability challenge to an arbitration agreement for not permitting discovery.<sup>27</sup> The court described how pre-*Concepcion* courts used to invalidate such provisions:

Prior to the Supreme Court's ruling in *Concepcion*, numerous courts, at both the state and federal level, found arbitration agreements substantively unconscionable where the rules of the arbitral forum allowed for only minimal discovery or where the affect of the discovery rules operated solely to one side's benefit.<sup>28</sup>

The *Lucas* court then stated that under *Concepcion*'s broad preemption analysis, "limitations on arbitral discovery no longer support a finding of substantive unconscionability."<sup>29</sup> Under this court's application of *Concepcion*, an unconscionability analysis that relies on the "uniqueness of an arbitration agreement" is inappropriate and preempted.<sup>30</sup> Under such readings of *Concepcion* and *Amex*, it is becoming more difficult for courts to police the fairness of the arbitration process.

This is a developing area of law, and courts are continuing to define the contours of *Concepcion*'s preemption analysis and the effective vindication doctrine following *Amex*. However, some courts have begun to construe *Concepcion* and *Amex* as changing the scope of judicial review of individual arbitration agreements, and corporations and employers can use these decisions to limit the ability of consumers and employees to challenge unfair arbitration procedures.

To make matters worse, in *Rent-A-Center, West, Inc. v. Jackson*, the Supreme Court expanded the separability doctrine so that an arbitration agreement can delegate to an arbitrator a dispute about the enforceability of an arbitration agreement, and such delegation clauses are generally enforceable unless a party specifically challenges the delegation clause.<sup>31</sup> As a result of the Supreme Court's decision in *Rent-A-Center*,

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2007 WL 3232283 (D. Ore. Oct. 29, 2007) (finding discovery limits in arbitration clause to be substantively unconscionable); *Ostroff v. Alterra Healthcare Corp.*, 433 F. Supp. 2d 538 (E.D. Pa. 2006) (same).

<sup>26</sup> *Ruhe v. Masimo Corp.*, No. SACV-11-00734-CJC(JCGx), 2011 WL 4442790, \*2 (C.D. Cal. Sept. 16, 2011) (*Armendariz* fairness factors "appear to be preempted by the FAA under the Supreme Court's reasoning in *Concepcion*"); *Baeza v. Superior Court*, 135 Cal.Rptr.3d 557, 568 (Cal. Ct. App. Dec. 14, 2011) (describing *Armendariz* as "abrogated in part" by *Concepcion*); *Mercado v. Doctors Medical Center of Modesto, Inc.*, No. F064478, 2013 WL 3892990, \*7 (Cal. Ct. App. July 26, 2013). (*Concepcion* and *Amex* "cast doubt on the continued validity of *Armendariz*").

<sup>27</sup> 875 F. Supp. 2d. 991 (N.D. Cal. 2012).

<sup>28</sup> *Id.* at 1007 (citations omitted).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> 130 S.Ct. 2772 (2010); see also *In re Checking Account Overdraft Litigation*, No. 09-MD-02036-JLK (S.D. Fla. Aug. 27, 2013) (order enforcing delegation clause and sending to arbitration all arguments regarding arbitration clause's enforceability).

coupled together with *Concepcion* and *Amex*, courts can enforce arbitration agreements in an increasingly rubberstamp-like manner. Slamming the courthouse door shut in this manner undermines public confidence and faith in our judicial system.

This changing and shrinking scope of judicial review of arbitration agreements is problematic for employees and consumers. With less judicial oversight of arbitration agreements, employees and consumers may find it difficult to invalidate one-sided arbitration provisions, and they may be forced to arbitrate with extremely limited procedural rights. Arbitration proceedings with increasingly limited procedural rights can, in turn, undermine the enforcement of critical statutory rights embodied in wage and hour, civil rights, and consumer protection legislation.

#### 4. The Reformers Who Pushed for the Federal Arbitration Act Understood the Statute as a Work-In-Progress That Would Require Future Amendments

As explained in my book, the reformers who lobbied for the FAA viewed the statute as a work-in-progress.<sup>32</sup> In May 1925, immediately after the FAA was enacted, Charles Bernheimer, who was known as the Father of Commercial Arbitration in the United States and who was the main driving force behind the passage of the FAA, wrote that “[w]hen the Federal Arbitration Act is put into operation *there is scarcely any doubt that it will develop the necessity for amendments.*”<sup>33</sup> Then-Secretary of Commerce Herbert Hoover explained in 1923 that “[i]f the bill proves to have some defects and we know most legislative measures do,” Congress could fix the problems with the FAA at a later time, after its enactment, “in light of further experience.”<sup>34</sup> Unfortunately, the FAA has never been significantly amended since its enactment in 1925.

We have now had almost one hundred years of “further experience” with the FAA as a work-in-progress, and amendments are long overdue. Courts and stronger parties are abusing the FAA in ways that were never intended by its drafters. As explained in my book, the drafters of the FAA during the 1920s had a sincerely-held, good faith belief in the use of arbitration to resolve disputes. However, arbitration agreements are often used today with the intent of stripping important rights from consumers and employees. Today, corporate entities often bury complex arbitration clauses in consumer and employment contracts in the nominal name of “efficiency,” but their main purpose in including a complex arbitration clause is often to make it more challenging for consumers and employees to assert claims.<sup>35</sup> It is becoming harder for American citizens to access justice and enter the courthouse door envisioned by our Federal and State Constitutions.

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<sup>32</sup> SZALAI, *supra* note 1, at 200-01.

<sup>33</sup> *Id.* at 201 (citation omitted and emphasis added).

<sup>34</sup> *Id.* (citation omitted).

<sup>35</sup> *See, e.g., Ting v. AT&T*, 319 F.3d 1126, 1133-34 (9th Cir. 2003) (finding that AT&T engaged in marketing studies to determine the best way to conceal an arbitration clause from consumers in order to prevent consumers from objecting or backing out of a transaction covered by an arbitration clause).

## 5. The Arbitration Fairness Act of 2013 Contains a Subtle Flaw That Must Be Corrected Before Its Enactment

I am very much in favor of the Arbitration Fairness Act of 2013 because I believe it can help protect some of America's most vulnerable citizens and rescue them from a second-class system of justice with very limited rights. As explained above, recent Supreme Court decisions are threatening to undermine judicial oversight of arbitration. Furthermore, all the policies supporting important civil rights, wage and hour, and consumer protection legislation similarly provide support for the Arbitration Fairness Act. If it is more challenging to enforce critical substantive rights because of the limited procedures available in arbitration, those substantive rights are weakened. Although I am in favor of the Arbitration Fairness Act, I am concerned that the current version of the bill, S. 878, will lead to wasteful litigation regarding its applicability in state courts.

From its enactment in 1925 to 1984, the FAA was generally considered a purely procedural statute applicable solely in Federal courts, not state courts.<sup>36</sup> In 1984, the Supreme Court radically transformed the FAA in a flawed decision called *Southland Corp. v. Keating*, where the Supreme Court misinterpreted the FAA and held that the statute applied in state courts.<sup>37</sup> The *Southland* decision involves one of the greatest constitutional errors the Supreme Court has ever made.<sup>38</sup> If the Arbitration Fairness Act of 2013 is intended to restore the FAA to its original meaning, which would include limiting the FAA solely to Federal courts, a good argument can be made that the Arbitration Fairness Act's restrictions would only bind the Federal courts. Under this narrow reading of the Arbitration Fairness Act, state courts would then be free to continue enforcing consumer and employment arbitration agreements. If the Arbitration Fairness Act is enacted in its current form, I am virtually certain that corporations and employers will push for this narrow interpretation of the Arbitration Fairness Act as solely restricting Federal courts. Some state courts, wishing to eliminate cases from their docket by enforcing all arbitration agreements, may go along with this narrow interpretation. Conflicting decisions, with years of wasted litigation and appeals, will likely develop regarding the applicability of the Arbitration Fairness Act in state courts. In order to prevent this problem from occurring, I suggest that the key prohibition in the bill be slightly modified to state something along the following lines:

No predispute arbitration agreement in connection with a transaction involving interstate commerce shall be valid or enforced **by a State or Federal court** if it requires arbitration of an employment dispute, consumer dispute, antitrust dispute, or civil rights dispute.

<sup>36</sup> See generally IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION (1992).

<sup>37</sup> 465 U.S. 1 (1984).

<sup>38</sup> David S. Schwartz, Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act, 67 Law & Contemp. Probs. 5, 54 (2004) ("In *Southland*, the Court made an error of constitutional proportions that is in significant respects comparable to the error of *Swift v. Tyson*, which the Court famously corrected in *Erie*.").

### Conclusion

While I was in private practice, I must admit that I routinely relied on the FAA to enforce arbitration agreements and compel consumers to arbitrate their disputes with my corporate clients. At the time, I did not deeply consider the impact of these court orders. Frankly, a court order dismissing a class action and compelling a consumer to submit a claim to arbitration was one less complex case for me to work on. However, my view of arbitration agreements began to change when my first child, my daughter Ella, was born.

My wife went into labor a few weeks earlier than expected, and when we arrived at the hospital, my wife was whisked away to the delivery room while I was given a thick stack of papers to sign at the registration desk. Buried in the stack of papers was an arbitration agreement, by which I promised never to sue in court the hospital, doctors, nurses, or insurance companies in connection with the delivery of my daughter. Because of my legal background, I was fully aware of what my signature on the arbitration agreement would mean, and I was shocked and remember thinking how did such agreements become so widespread in American society. Realizing that I was about to become a father and I needed to protect my child, I did not want to sign the arbitration agreement. If someone committed medical malpractice and hurt my daughter or wife, I wanted to have all the procedural rights available in court, as well as a jury from the community, instead of a highly secretive arbitration hearing with virtually no rights. However, the hospital staff was demanding signatures on every page. Thankfully, my wife gave birth to our beautiful, healthy baby daughter, and no disputes arose regarding her delivery. Sadly, other parents have not been so fortunate, and there are reported decisions dismissing lawsuits in connection with the delivery of a baby because of an arbitration agreement.

At that moment in the hospital when I was asked to sign the arbitration agreement, I was furious that I was being forced to give up my rights. I believe most people would feel the same way in these circumstances if they understood the implications of signing an arbitration agreement. I realized at that moment how could I be in favor of imposing on others what I would not be willing to impose on my own family.

In order to protect millions of American consumers and employees, and in order to promote faith in our judicial system as the best in the world, which it is, and open to all, which it is currently not because of the cancerous proliferation of arbitration agreements, I respectfully urge that the Committee on the Judiciary favorably report Senate Bill 878, the Arbitration Fairness Act of 2013, to the full Senate and work toward its enactment.

December 17, 2013

The Honorable Patrick Leahy  
Chairman  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Chuck Grassley  
Ranking Member  
Committee on the Judiciary  
226 Dirksen Senate Office Building  
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The Honorable Tim Johnson  
Chairman  
Committee on Banking, Housing  
& Urban Affairs  
534 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Mike Crapo  
Ranking Member  
Committee on Banking, Housing Affairs  
& Urban Affairs  
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Chairman Leahy, Chairman Johnson, Ranking Member Grassley and Ranking Member Crapo:

We represent investors that collectively manage assets exceeding \$1 trillion USD in capital invested globally and in our nation's public markets. As investors whose participation in our public markets is vital to our economy's growth, we believe that companies should not be permitted to force shareholders into any system under which their rights are limited or their ability to participate in a class is extinguished. Forced arbitration systems—especially those which include class action bans—are not a viable substitute to judicial enforcement of fiduciary obligations owed to investors when the arbitration is an involuntary, costly, and biased dispute resolution system.

We, the undersigned, ask that the Committees of Jurisdiction act to preserve the ability of investors to access the judicial system for the enforcement and protection of their legal rights by:

- 1) Supporting the Securities and Exchange Commission ("SEC") in its exercise of Congressionally-granted authority under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to prohibit the use of mandatory pre-dispute arbitration provisions in broker-dealer and investment advisor agreements; and,
- 2) Acting to formalize the SEC's longstanding policy that mandatory pre-dispute provisions requiring arbitration of investor disputes in the bylaws and governing documents of publicly traded corporations are harmful to capital markets, contrary to public policy, and could be subject to enforcement action.

Relying on the government to enforce the rights of individuals is no suitable alternative to private enforcement. Not only would requiring the government to bear the expense of prosecuting every investor dispute place an enormous additional burden on already strained budgets, but history has demonstrated that the government is ill-equipped to provide adequate recompense to individual investors injured by corporate fraud. In private litigation relating to the financial scandals at

Enron, WorldCom, Tyco, Bank of America and Global Crossing, private enforcement returned over \$19.4 billion to investors.<sup>1</sup> The SEC's enforcement actions against these same companies relating to the same wrongdoing netted penalties and fees of \$1.750 billion.<sup>2</sup> Indeed, in the last three years on litigation relating to the financial crisis, the SEC has recovered \$2.73 billion in penalties, disgorgement and other monetary relief.<sup>3</sup> In comparison, private litigation against just four financial institutions arising from their conduct that led to the near collapse of our economy resulted in judgments or settlements of over \$16 billion.<sup>4</sup>

Unfortunately, and perhaps precisely because private litigation provides the most efficient (and in some cases the only) way for investors to enforce their rights, publicly traded corporations have taken steps to eliminate judicial oversight of their fiduciary obligations to investors and their compliance with the federal securities laws. These steps have included inserting pre-dispute, forced arbitration clauses in investment-advisor contracts and corporate by-laws to force all shareholder disputes into arbitrations controlled by the very same corporations against whom the claims are being brought. These forced arbitration clauses also typically require shareholders to waive their rights to participate in any collective or class action.

When forced arbitration clauses and class action waivers appear in corporate bylaws or investor-advisor agreements, they can have the practical effect of preventing shareholders from pursuing any legal remedy whatsoever. When, as is often the case for smaller investors, the cost and expense of pursuing an individual claim far exceeds any possible recovery, a "waiver" of the right to participate in any collective action effectively immunizes wrongdoing corporations and their directors and officers from these smaller claims. These "waivers" are specifically designed to prevent class actions under Rule 10b-5 of the Securities Exchange Act of 1934, and would prevent class actions like the shareholder action brought against Enron Corporation from ever being brought. These forced arbitration clauses and class action waivers represent a real and present threat to principles of sound corporate governance, balancing the rights of shareowners against the responsibilities of corporate managers to run their businesses.

American investors are the foundation of a successful and thriving securities market. The victims of corporate wrongdoing aren't the ultra-wealthy—they are hard-working employees contributing towards their 401(k) accounts and relying on income from their pension funds, responsible

<sup>1</sup> Source: *In re: Tyco International, Ltd., Securities Litigation*, U.S. District Court, District of New Hampshire, 02-266 (\$3.2 billion settlement); *In re: Enron Corporation Securities Litigation*, U.S. District Court, Southern District of Texas, 01-3624 (\$7.2 billion settlement); *In re: Worldcom, Inc. Securities Litigation*, U.S. District Court, Southern District of New York, 02-3288 (\$6.1 billion); *In re: Bank of America Corp. Securities, Derivative, and Employee Retirement Income Security Act (ERISA) Litigation*, U.S. District Court, Southern District of New York, 09-2058 (\$2.4 billion settlement); *In re: Global Crossing Ltd. Securities Litigation*, U.S. District Court, Southern District of New York, 02-910 (\$447.8 million settlement).

<sup>2</sup> Source: Tyco SEC Settlement Fair Fund: <http://www.tycosecsettlement.com/> (\$55.8 million settlement); Enron SEC Settlement Fair Fund: <http://enronvictimtrust.com/> (\$570 million); Worldcom SEC Settlement Press Release: <http://www.sec.gov/news/press/2003-81.htm> (\$750 million); Bank of America SEC Fair Fund: <http://bankofamericafairfund.com/> (\$375 million); Global Crossing SEC Settlement Press Release: <http://www.sec.gov/litigation/litreleases/lr19179.htm> (\$300,000).

<sup>3</sup> Source: SEC Enforcement Actions, Addressing Misconduct That Led To or Arose From the Financial Crisis, Key Statistics (through September 1, 2013), available at <http://www.sec.gov/spotlight/enf-actions-fc.shtml>

<sup>4</sup> Source: Sam Carr, SNL Financial, Largest US banks have built a \$60B settlement tab, so far (March 5, 2013), available at <http://www.snl.com/InteractiveX/Article.aspx?cdid=A-17047074-12337>

American families saving for retirement, and parents investing in their children's education and future. Without sufficient protections and a meaningful way to hold financial institutions accountable when they violate financial or fiduciary obligations to their shareholders, investor confidence diminishes and market participation suffers, hurting investors, the institutions they invest in, and the American economy.

We ask the Committees on the Judiciary and on Banking, Housing, & Urban Affairs, jointly tasked with protecting American investors from unscrupulous or illegal financial practices, to encourage the SEC to continue its efforts to protect investor rights and restore the balance between those rights and the responsibilities of publicly traded companies and their corporate managers.

*Sincerely,*

American Federation of Musicians and Employers' Pension Fund (AFM-EPP)

Ann Arbor City Employees Retirement System

Arizona Public Safety Personnel Retirement System

Arkansas Teachers Retirement System

Board of Trustees of the Employees' Retirement System of the City of St. Louis

Carpenters' Pension Trust Fund of Northern California

City of Dearborn Heights General Government Fund

City of Dearborn Heights Policeman's & Fireman's Retirement System

City of Providence Employees' Retirement System

City of Roseville Employees' Retirement System

City of Southfield Fire & Police Retirement System

City of St. Clair Shores Police & Fire Retirement System

City of Sterling Heights General Employees' Retirement System

City of Sterling Heights Police & Fire Retirement System

City of Sunrise Firefighters' Retirement Fund

City of Westland Police and Fire Retirement System

North Carolina Retirement Systems

Northern CA Pipefitters

Ohio Police and Fire Pension Fund

Oklahoma Law Enforcement Retirement System

Oklahoma Firefighters Pension and Retirement System

Oklahoma Police Pension and Retirement System

Oklahoma Municipal Retirement Fund

Operating Engineers Local 66 (Pittsburgh)

Oregon State Treasurer

Plymouth County Retirement System

Pompano Beach Police & Firefighters Retirement System

San Diego City Employees' Retirement System (SDCERS)

SEIU Pension Plans and Master Trust

Teamsters Union No. 142 Pension, Welfare, Annuity and Training & Apprenticeship  
Trust Funds (Gary, Indiana)

The Police Retirement System of St. Louis

Utah Permanent School and Institutional Trust Funds

Utah State Treasurer

Virginia Retirement System

Washington State Investment Board

Washington State Treasurer

Cleveland Bakers & Teamsters Pension Fund  
Clinton Township Police & Fire Retirement System  
Colorado Public Employees' Retirement Association  
Connecticut Retirement Plans & Trust Funds  
Connecticut State Treasurer  
Daytona Beach Police & Fire Pension System  
Erie County Employees' Retirement System  
IBEW Local 110, International Brotherhood of Electrical Workers (St. Paul, Minnesota)  
Idaho Diversified Bond Fund  
Idaho Diversified Bond Fund Idle  
Idaho Millennium Permanent Endowment Fund  
Idaho State Treasurer  
Ironworkers Local 405 (Philadelphia, PA)  
Jacksonville Fire & Police  
Key West Police & Fire Pension Plan  
Laborers, District Council of Ohio  
Los Angeles County Employees Retirement Association (LACERA)  
Louisiana Municipal Police Employees Retirement Fund  
Luzerne County Retirement System  
Maine Public Employees' Retirement System (MainePERS)  
Monroe County Employees Retirement System  
Montgomery County, PA  
Municipal Police Employees' Retirement System

