Testimony
Of
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"Arbitration: Is It Fair When Forced?"

Good afternoon. Thank you for the opportunity to testify before the United States Senate Judiciary Committee on the topic of mandatory arbitration of consumer disputes.

I. Arbitration of Consumer Disputes.

The Federal Arbitration Act--passed in 1925--was originally designed to facilitate merchants of relatively equal bargaining power to agree to arbitration after a dispute arose and to mutually select an arbitrator to resolve the dispute. In recent years, however, companies expanded arbitration to a wide range of consumer contracts where the consumer has little bargaining power.

The right to have disputes resolved through an impartial judge or jury is deeply imbedded in our democracy and our values. In recent years, however, American consumers--in one contract or another--have given up the right to have their day in court through language contained in the "fine print" of consumer agreements. Large corporations often include--in the fine print of their consumer contracts--pre-dispute arbitration clauses, in which the consumer may be required to waive--in advance--his or her right to have a dispute resolved in court. Instead, the consumer may be required to resolve the dispute through arbitration. This language is generally binding on the consumer even if he or she does not notice the arbitration clause.

II. National Arbitration Forum Lawsuit and Consent Judgment.

In 2009, the Minnesota Attorney General's Office filed a lawsuit against the National Arbitration Forum--the then-largest arbitration company in the country for consumer credit disputes--alleging that it misrepresented its independence and hid from consumers and the public its extensive ties to the collection industry.

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

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

The lawsuit also alleged that the Forum had financial ties to the collection industry. Beginning in 2006 and through 2007, Accretive--a family of New York private equity funds--engineered two transactions. In the first transaction, Accretive formed several equity funds under the name "Agora" (meaning "Forum" in Greek), which invested $42 million in the Forum and obtained governance rights in it. In the second transaction, three of the country's then-largest debt collection law firms--Mann Bracken of Georgia, Wolpoff & Abramson of Maryland, and Eskanos & Adler of California--merged into one large national law firm called Mann Bracken. Accretive then acquired the majority interest in a debt collection agency called Axiant,

which acquired the collections operations of Mann Bracken. Through these transactions, Accretive took control of one of the country's largest debt collection enterprises and became affiliated with the Forum, the country's largest consumer collection arbitration company. The lawsuit alleged that, in 2006, the Forum processed just over 214,000 consumer collection arbitration claims, of which 125,000, or nearly 60 percent, were filed by these firms.

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

The company signed a Consent Judgment to resolve the lawsuit. Under the Consent Judgment, the company is barred from the business of arbitrating credit card and other consumer disputes and must stop accepting new consumer arbitrations or in any manner participating in the processing or administering of new consumer arbitrations, such as arbitrations involving consumer debt, including credit cards, consumer loans, telecommunications, utilities, health care, and consumer leases.

III. Problems with Mandatory Arbitration in Consumer Contracts.

Our investigation of the Forum and interviews of consumers highlighted underlying problems with the arbitration of consumer disputes arising out of mandatory arbitration clauses in fine-print consumer contracts:

First, there is unequal bargaining power between consumers and large corporations, which often present consumers with "take it or leave it" fine print contracts. In almost every interview we conducted of consumers during our investigation of the Forum, we found that the consumer was not aware of the arbitration provision, in most cases never saw the provision, and was given virtually no opportunity to negotiate or reject the provision. Yet, through these provisions, consumers gave up their right to have their day in court.

Second, it was apparent from interviews with consumers, arbitrators, and employees of the Forum that arbitrators have a powerful incentive to favor the dominant party in an arbitration; namely, the corporation. There is a term commonly used in the arbitration industry called "repeat player bias," describing the phenomena where an arbitrator is more likely to favor the party that is likely to send future cases. Corporations, and not consumers, generally select which arbitration companies they will appoint to process disputes, and arbitration companies compete for this business. If a particular corporation selects a particular arbitration company to resolve disputes, that arbitration company makes money. If a particular arbitration company is not "friendly" enough to the corporation, the corporation can select another arbitration company to resolve its claims. Similarly, the arbitration company wields great power in selecting which arbitrators will be in its network. In the case of the Forum, arbitrators and employees told us that arbitrators who issued an award against the corporation, or who failed to award attorneys' fees against the consumer, were sometimes "deselected" and not appointed to future proceedings. This bias does not exist in a court, where the judge is not reliant on a dominant player for his or her future income.

Third, during our investigation of the Forum, we were told by consumers that because they were unaware of the arbitration provision, they often did not recognize the significance of

the arbitration notice serviced on them. In other words, since they did not know that they agreed to arbitration, and were unfamiliar with the arbitration process or the arbitration administrator, consumers told us they did not know they were obligated to respond to the arbitration notice. As noted above, the Forum's own documents describe it this way: "[t]he customer does not know what to expect from Arbitration and is more willing to pay," and consumers "ask you to explain what Arbitration is then basically hand you the money."

Fourth, the due process protections found in court may be lacking in arbitration. For instance, consumers subject to a mandatory arbitration clause generally have no right to appeal in most cases to a judge if there is an adverse arbitration ruling. Similarly, the arbitrator's decision may not be supported by a written order, so the consumer may not understand the basis for the decision and therefore may question the integrity of the process.

IV. Conclusion.

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

Thank you for inviting me to this hearing.