

**TESTIMONY TO THE UNITED STATES SENATE JUDICIARY COMMITTEE**

**ARBITRATION: IS IT FAIR WHEN FORCED?**

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## INTRODUCTION AND SUMMARY

Thank you for inviting me to participate in this important hearing. My testimony will make the following points:

- A large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their rights to a trial by jury and to bring cases in the U.S. public civil justice system, and instead submit all of their legal claims to binding mandatory arbitration.<sup>2</sup>
- Recent decisions by the U.S. Supreme Court, as well as lower courts, have made it significantly more difficult for consumers and employees to challenge even the most abusive mandatory arbitration clauses. These decisions, including the recent case of *AT&T Mobility LLC v. Concepcion*, have curtailed efforts by states to protect consumers and employees against unfair contract terms.
- In many cases, mandatory arbitration clauses have the effect of immunizing corporations from any liability or accountability even when they have blatantly violated consumer protection or civil rights laws. As a result, corporations are able to break consumer protection laws by doing things such as misleading consumers about the costs of loans or engage in similar bait-and-switch practices, and the legal system does nothing to deter these behaviors or compensate cheated consumers. This is not “just” an issue of fairness to consumers, it also undermines the marketplace when there is no enforcement of the rules of the road:

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

honest companies are at a disadvantage against corporations willing to cheat consumers.

- Most consumers and employees have little or no meaningful choice about submitting to arbitration. Few people read or understand the fine print that strips them of their rights; and because arbitration clauses are found in nearly all consumer contracts, most consumers have no choice but to accept them.

### **BACKGROUND ABOUT PUBLIC JUSTICE**

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

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

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

## **I. MOST CONSUMER AND EMPLOYEE CONTRACTS REQUIRE BINDING ARBITRATION.**

In just the last generation, there has been a largely unnoticed but very important revolution in the way many corporations do business. Fifteen to twenty years ago, only a handful of corporations required consumers or non-unionized employees to submit their claims to binding arbitration. Now, these mandatory arbitration clauses are in hundreds of millions of form contracts. Here are just a few examples:

- It is very hard to get most loans, credit cards, checking accounts or other financial services products without submitting to an arbitration clause.<sup>1</sup>
- The vast majority of cell phone and residential phone companies require their customers to accept binding arbitration clauses on a take-it-or-leave-it basis. It would be hard for a customer to get a cell phone without giving up basic legal rights to redress if they are cheated by the carrier.
- Millions of persons are required by their employers to submit all claims – wage and hour claims, civil rights claims, everything – to binding arbitration. Employers such as Anheuser-Busch, Cheesecake Factor, Circuit City, Ford Motor Co., Hooters, Hughes Electronics, Kentucky Fried Chicken, Lenscrafters, Marriott International, Pfizer, Rockwell, Ralph's Grocery/Albertsons, Waffle House and General Electric (among

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<sup>1</sup> There is one important exception. Several years ago, Congress made it a misdemeanor for a lender to put an arbitration clause into many loan agreements with members of the military or their dependent family members. 10 U.S.C. § 987 (e)(2)-(4); (f)(1). There is a serious policy question as to how mandatory arbitration could be so unfair when it is imposed upon a member of the military that it is a crime, yet it is supposed fair and proper to impose it on other citizens.

thousands of others) all require their employees to agree to mandatory arbitration clauses as a condition of getting or keeping a job.<sup>2</sup> See Alexander J.S. Colvin, *Employment Arbitration: Empirical Findings and Research Needs*, *Dispute Resolution J.* (Aug./Oct. 2009) (studies show as many as 46.8% of non-union businesses use employment arbitration).

- The vast majority of car dealers in the U.S. have inserted binding arbitration clauses into their car sales contracts. (Only a few car dealers in the entire nation had such clauses a decade ago.)<sup>3</sup>
- It is hard to buy a computer without submitting to a binding arbitration clause. Dell, Gateway, and other major companies insist upon them. Most products or services one would purchase over the internet are only available if one clicks on a box “agreeing” to many thousands of words of fine print (which very few people read), and nearly all of those “terms and conditions” provisions now include an arbitration clause that bans class actions.

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<sup>2</sup> As one example of how courts often do not protect employees from mandatory arbitration, see *Garrett v. Circuit City Stores*, 449 F.3d 672 (5th Cir. 2006). In that case, a company allegedly did not preserve the job of a military reservist who was sent to Iraq. When he sued under the Uniformed Services Employment and Reemployment Rights Act (USERRA), 38 U.S.C. § 4302(b), the Court held that he had lost his right to bring this claim in court and had to bring his claim to a private arbitrator. There is no little irony that someone who has risked his life protecting our freedoms would be forced to lose a number of his own constitutional freedoms as a result of a fine print contract. In upholding the arbitration agreement, the court expressly ignored language in the House Committee Report that stated that arbitration of a USERRA claim would not be required or binding. *Id.* at 679.

<sup>3</sup> By contrast, back in 2002, automobile dealerships lobbied strenuously for and won a federal statute that bars car manufacturers from insisting that car dealers arbitrate disputes. 15 U.S.C. § 1226(a)(2). The Congress has only protected car dealers, however, and not car buying consumers.

- Mandatory arbitration is growing rapidly as a requirement for patients to receive necessary medical services. Many HMOs have arbitration clauses; more doctors have such clauses; the vast majority of nursing homes have arbitration clauses in the fine print of their contracts; I have seen such a clause in a contract providing for an organ transplant.
- Mandatory arbitration clauses are in contracts for a wide range of other consumer goods and services – home sales contracts, insurance companies, rental car companies, mortuaries, pest control companies, securities broker services, pet boarding companies, etc., all regularly require customers to sign them as a condition of service.

## **II. CONSUMERS HAVE LITTLE CHOICE BUT TO AGREE TO MANDATORY ARBITRATION CLAUSES.**

Literally millions of Americans have unknowingly received mandatory arbitration clauses in a manner that ensures that the clauses would not be read or understood by all but a very few of their recipients. I have seen hundreds of arbitration clauses, including clauses used by some of the largest and richest corporations in the United States, that are (a) cast in dense and cryptic legalese incomprehensible to lay persons (and even many lawyers); (b) set forth in minuscule print, often on the back side of a document; and (c) buried in the center of a mailing that contained a variety of other pieces, most of which were solicitations and advertisements unlikely to be read by most recipients.

Many on-line contracts bury the arbitration clauses hundreds of lines deep in the fine print; the corporations know that most normal people will just click “agree” rather than scroll down so far. Even when consumers are asked to sign or initial below or at the arbitration clause, it is often in the context of a transaction where the consumer is asked to quickly flip through a

large body of “standard” documents or contract provisions, which rarely include an explanation of the arbitration clause.<sup>1</sup>

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

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<sup>1</sup> In one case in which we were counsel, the first sentence of a payday lender’s arbitration clause was 256 words long!

procedural consequences of consenting to arbitration” and that “[v]ery few are aware of what they are waiving.”).

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

- In one case, where a consumer bought a computer over the phone, the arbitration clause was sent to consumers inside the box with a computer. For a consumer to reject the clause, she would have to pack up and send back the computer in the box (at her own expense) within 30 days. While anyone familiar with human nature and consumer behavior can predict that few consumers would take such a step, courts have upheld such clauses. *E.g., Hill v. Gateway 2000 Inc.*, 105 F.3d 1147 (7<sup>th</sup> Cir. 1997).
- Alabama’s highest court upheld an arbitration agreement that was not even in the contract that the consumers signed. Public Justice represented a husband and wife who purchased title insurance when they bought a farm. When they later found out that there were serious defects in the title, the title insurance company attempted to force them to arbitrate their claim despite the fact that the original contract they signed had not contained the arbitration clause. Instead of including the arbitration agreement in the contract, the insurance company had sent it to the consumers in the mail weeks later, arriving after the parties were already enmeshed in their legal dispute. Yet the court held it was enforceable. *McDougle v. Silvernell*, 738 So. 2d 806 (1999).
- And in an unusual case where one of our clients did know her employer gave her an arbitration clause and refused to sign it, the U.S. Court of Appeals for the Eleventh Circuit held that she was still bound by it because she failed to quit her job as a nurse at



Baptist Medical Center-Princeton in Alabama, after having worked there as a nurse for almost 30 years. *Luke v. Baptist Medical Center-Princeton*, No. 03-14342 (11<sup>th</sup> Cir. March 11, 2004).

- In another case, a court compelled arbitration against the estate of a woman who died in a nursing home. Although the woman was legally blind and could not understand the contents of the papers she signed, the court said that no one can defend against the enforcement of a contract just because they signed it without reading it. *Estate of Etting v. Regent's Park at Aventura, Inc.*, 891 So.2d 558 (Fla. Dist. Ct. App. 2004).

Data support the predictable conclusion that many consumers do not read or understand the long, fine-print mailings sent to them by credit card companies. A recent study conducted by Credit.com found that 66% of credit cardholders did not know what, if any, changes had been made to their credit card agreements. Eileen A.J. Connelly, *Credit Card Holders Frequently Don't Pay Attention to Changes Made to Accounts, Survey Finds*, Star Trib. (Minneapolis), March 1, 2009. In at least one case, evidence showed that a bank knew only four percent of cardholders would read its bill stuffers. See Sen. Russell D. Feingold, *Mandatory Arbitration: What Process Is Due?*, 39 Harv. J. on Legis. 281, 296 (2002) (citing case); see also Shmuel I. Becher, *Asymmetric Information in Consumer Contracts: The Challenge That Is Yet to Be Met*, 45 Am. Bus. L.J. 723, 730-31 (2008) (“empirical evidence shows that most consumers do not read [standard form contracts]”); Amy J. Schmitz, *Consideration of “Contracting Culture” in Enforcing Arbitration Provisions*, 81 St. John’s L. Rev. 123, 160 (2007) (“consumers rarely read or understand” arbitration agreements); Debra Pogrud Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, NYU J. Law

& Business (2009), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1340166](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1340166) (discussing studies showing that consumers are unlikely to read standard-form contracts).

Similarly, studies conducted by the Government Accountability Office (“GAO”) and Federal Reserve Board found that many credit card terms and disclosures are too complex for consumers to understand. See GAO, Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 6 (2006), available at <http://www.gao.gov/new.items/d06929.pdf>; Macro Int’l, Inc., Design and Testing of Effective Truth in Lending Disclosures (2007), available at <http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf>.<sup>5</sup> The GAO and Federal Reserve Board studies focused on contract terms that have a direct effect on cost, but presumably consumers spend even less time trying to understand terms, like mandatory arbitration clauses, that affect cost indirectly.

Many contracts are so dense and incomprehensible that the purported “opt out” provisions now included in some agreements are an entirely illusory improvement. Companies know that very few consumers read standard-form contracts, understand them, understand the differences between arbitration and litigation, are able to assess those differences, and have time to reject the default arbitration option by exercising any opt-out right (in the unlikely event that a consumer has actually read and understand the arbitration clause). See, e.g., *Ting v. AT&T*, 182 F.Supp.2d 902, 933 (N.D. Cal. 2002) (citing the defendant’s own research showing that many consumers would not read its dispute-resolution agreement), *aff’d in relevant part and reversed in part on other grounds*, 319 F.3d 1126 (9th Cir. 2003); see also Richard H. Thaler & Cass R. Sunstein, *Nudge: Improving Decisions about Health, Wealth and Happiness* 34-36 (2008) (discussing biases that affect consumer behavior and will make opt-outs unlikely). As the most

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<sup>5</sup> See also GAO at 37-38 (discussing finding that credit card agreements are written at too high a reading level for many consumers to understand); Bar-Gill & Warren at 27-28 (discussing the GAO and Federal Reserve Board studies)

companies certainly know, they are the real potential beneficiaries of opt-out language; consumers will hardly ever opt out, but companies can – and do – point to their “opt out” provisions in an attempt to defend arbitration against unfairness challenges in court.

**III. RECENT DECISIONS BY THE U.S. SUPREME COURT, AS WELL AS LOWER COURTS, HAVE MADE IT SIGNIFICANTLY MORE DIFFICULT FOR CONSUMERS AND EMPLOYEES TO RESIST MANDATORY ARBITRATION, EVEN IN THE MOST EGREGIOUS CASES.**

On April 27, 2011, the U.S. Supreme Court decided *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). *Concepcion* held, 5-4, that the Federal Arbitration Act (“FAA”) preempts a state rule of contract law – in this case, California’s “*Discover Bank* rule,” which, according to the Court, would invalidate a class action ban in an arbitration clause—and force the parties into non-consensual class arbitration—whenever (a) the term is imposed in a consumer contract of adhesion; (b) the plaintiffs’ claims involve predictably individually small damages; and (c) the defendant has allegedly engaged in a scheme to cheat consumers.<sup>3</sup> The Court held that the FAA, which was passed in 1925 (long before class actions even existed), wiped away key rules of contract law that would apply to all other types of contracts, to the extent that those rules would apply to arbitration clauses. Justice Scalia’s opinion acknowledged that under California law, a contract term banning class actions would not be enforceable in a case involving very small individual claims if the term was in a “regular” contract that did not contain an arbitration clause. Under Justice Scalia’s approach, however, if a corporation sticks an arbitration clause into its contract and then puts the otherwise illegal class action ban term into the arbitration clause, *now* federal law overrides the normal rule of state contract law.

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<sup>3</sup> The preempted rule was adopted by the California Supreme Court in *Discover Bank v. Superior Court (Boehr)*, 113 P.3d 1100 (Cal. 2005).

The *Concepcion* case was somewhat shocking, in many ways, to most legal observers. About 15 state Supreme Courts (and many more state courts of appeals) had considered the enforceability of class action bans in arbitration clauses, and every single one had considered this to be an issue governed by state law. A larger number of federal appellate decisions had addressed the issue, and all but one decision (and that one decision was later overturned by that circuit when it was sitting *en banc*, meaning all the members of that Court sitting together voted down the ruling of the original three judge panel) had found this to be an issue of state law, and scores of U.S. federal district courts had agreed. The Supreme Court's decision in *Concepcion*, by the usual 5-4, overturned (or at least arguably overturned) literally scores of lower court decisions, by inventing an new rule of federal law.

It was immediately clear to everyone who follows these issues that the U.S. Supreme Court's decision in *Concepcion* would immunize many corporations from class actions, by wiping away the common sense-based *Discover Bank* rule. In that case, the California Supreme Court had held that a contract term banning class actions would effectively eliminate the rights of the vast majority of consumers in a case that involved claims of less than \$50 per person. It is common sense, and prior to *Concepcion* had been acknowledged by dozens of courts, that consumers with such small claims would never find representation and would never receive relief if they had to proceed on a class action basis. Under the *Discover Bank* rule, consumers did not have to prove that class action bans were unenforceable in very small dollar cases, because courts could simply presume that through their common sense.

Unfortunately, it is possible that *Concepcion* will be read even more broadly than is strictly necessary, and if so will wipe away the vast majority of consumer and employment class

actions (or at least all class actions in cases where the corporation has an arbitration clause).<sup>4</sup>

*Concepcion* held that federal law allows companies to use contractual arbitration clauses to ban their customers or employees from joining together in a class action. As in *Citizens United*, the Court expanded the rights of big business; but this time instead of giving them control over elections, it gave them a way to opt out of the civil justice system.

Arguably, *Concepcion* appeared to have one saving grace: it did not say anything about overturning the rule (set out in a long line of other Supreme Court cases) that arbitration clauses are only enforceable if the parties can “effectively vindicate their statutory rights” in arbitration. See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985) (explaining that statutory claims are arbitrable “so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum”). Consumer and civil rights lawyers have been arguing that *Concepcion* should be “harmonized” with those earlier cases by creating an exception to the rule that class action bans are generally enforceable. Our argument has been that if a group of consumers or employees *proved* through hard evidence that they could not get justice without a class action (in other words, that they could not “effectively vindicate their statutory rights” if the arbitration clause was upheld), then courts should hold that the class action ban in the company’s arbitration clause would be unenforceable.

Unfortunately, however, some lower courts are interpreting *Concepcion* as holding that contract terms banning class actions have to be enforced even when a court finds that the evidence in a case has proven that the ban on class actions guts consumer protection or civil rights laws. According to several federal district judges and a panel of judges on the 11th Circuit

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<sup>4</sup> Indeed, in the wake of the decision, a prominent corporate defense firm trumpeted how their clients “can use this ruling to essentially eliminate one of the biggest litigation threats facing their businesses – the wage-and-hour class action.” [http://www.venable.com/files/Publication/50a0a297-3965-47ef-b87e-8e9308810f57/Preview/PublicationAttachment/e1dd5045-7f75-4f76-a702-9b4db2ef3320/The\\_End\\_of\\_Wage-and-Hour\\_Class\\_Actions.pdf](http://www.venable.com/files/Publication/50a0a297-3965-47ef-b87e-8e9308810f57/Preview/PublicationAttachment/e1dd5045-7f75-4f76-a702-9b4db2ef3320/The_End_of_Wage-and-Hour_Class_Actions.pdf)

Court of Appeals, for example, *Concepcion* apparently means that bans on class actions are always enforceable – even if that means consumers are left with no means of vindicating their rights. According to these courts, no consumer or employee would ever be able to challenge the presence of a class action ban in an arbitration agreement, even if it meant that they could never obtain relief for being wronged. See, e.g., *Cruz v. Cingular Wireless, LLC*, 2011 WL 3505016 (11th Cir. 2011) (discussed below); *Kaltwasser v. AT&T Mobility LLC*, 2011 WL 4381748 (N.D. Ca. 2011).

The potential impact of this rule, if it takes hold, will be devastating for consumers and employees. Assume a restaurant chain starts paying all its female employees half of what it pays male workers in the same positions, in violation of state labor laws. If the restaurant has a term in its contract prohibiting employees from going to court and instead requiring one-on-one arbitration, none of the women can join together to take on the company. Only the tiny handful willing to risk their jobs by bringing a claim in arbitration by themselves stand a chance. And even if they win, the company can keep paying all the other women half their pay. Under this reasoning, this get-out-of-jail-free card for businesses is what Congress supposedly intended when it passed the Federal Arbitration Act in the 1920's.

These decisions are already having real world impact. We have represented plaintiffs in numerous cases who would not have been able to vindicate their right if they were required to pursue arbitration on an individual basis. In a case in New Jersey, *Homa v. American Express*, our client, Mr. Homa experienced first-hand how the current legal framework can allow companies to cheat millions of customers and get away with it through their use of an arbitration agreement. Mr. Homa agreed to purchase a credit card based on the company's offer of a specific set of conditions and terms. In fact, however, he discovered that the terms that were

advertised were far better than what a cardholder could ever receive and that the credit card company was misleading people about the true cost of its loans (by exaggerating the size of the rebates the cardholders were supposed to receive).

Mr. Homa, who is far better at numbers than the average consumer, figured out the scam – that his rebate was much lower than he had been promised -- and tried to get his money back. The company rebuffed him at every turn, telling him he had miscalculated the rates and that he was not entitled to his money. He finally went to a lawyer, who told him that, while he had a valid claim, the damages in his case were so small that it did not make financial sense to pursue his claim on an individual basis. After realizing that the company had likely cheated many consumers in this bait and switch scheme, Mr. Homa sought to hold the company liable for its unfair and deceptive lending practice by filing a class action complaint in federal court.

Because the amount of individual damages was so small and the nature of the claims was so complex, no one could actually obtain a remedy on an individual basis. The company nevertheless sought to force Mr. Homa into arbitration on an individual basis, but this effort was firmly rejected by the Third Circuit -- until the U.S. Supreme Court decided *Concepcion*. After *Concepcion*, despite an unchallenged evidentiary record in the case that proved that no one could effectively vindicate their statutory rights under American Express's arbitration clause, the district court held that it doesn't matter whether consumers could vindicate their rights or not, because companies supposedly have a federal right to gut these statutory rights.

Other similar examples abound. In *Cruz v. Cingular Wireless*, the Eleventh Circuit held that even if AT&T Mobility's clause was proven as a matter of fact to bar all but an "infinitesimal" number of plaintiffs from vindicating their statutory rights, that it must be enforced in light of *Concepcion*. The court held that if Florida law would be to the contrary, that

this would not matter because the Federal Arbitration Act “unquestionably” would preempt this law. The allegations in that case involved a company’s violation of Florida’s Unfair Trade Practices Act by imposing an individually trivial monthly charge for a purportedly “optional” Roadside Assistance service that the plaintiffs had never requested or enrolled in. The evidence in that case established that, because the amount of money that each individual customer was cheated out of was a mere \$2.99 a month, no one would ever pursue arbitration on an individual basis. The court essentially agreed, but said it did not matter. In short, under the Eleventh Circuit’s reading of *Concepcion*, federal law pre-empts and overrides state laws that would protect any more than an “infinitesimal” number of consumers from having their rights violated under consumer protection statutes.

And, in a case in Ohio, a state court recently held that consumers could not avoid an unfair arbitration agreement, despite the fact that the company, a chain of 19 car dealerships, had explicitly violated the law and deceived customers by routinely selling former rental cars as used cars without disclosing their rental history. *See Wallace v. Ganley Auto Group*, 2011 WL 2434093 (Ohio Ct. App. 2011). Because consumers tend to refuse to pay as much for rental cars as they would pay for non-rental cars, the Ohio Attorney General requires used car dealers to disclose whether a used car was formerly a rental car or not, through two little boxes on the sales contract. This car dealer repeatedly checked “no” to this question for cars that were, in fact, rental cars. The court enforced the company’s arbitration clause even though the evidence in the case established that no consumer would ever have been able to find an attorney to represent them individually. This again did not matter to the court, which said that courts and states are unable to apply or formulate rules that would invalidate arbitration agreements even if it could be shown that no one could vindicate their rights under the arbitration agreement. As a result of this



Court's reading of *Concepcion*, a used car dealer has been given free reign to lie to its customers about something that would matter to many of them, and there is no meaningful way for them to get any relief.

If more courts start heading this direction, businesses will be able to bar people from taking the ONLY kind of legal action that could deter them from breaking certain types of consumer protection laws. And most Americans probably have no idea that their rights are so at risk.

Class action suits allow consumers to pool their individual resources, which is crucial when going up against well-funded corporations. As Congress stated, "Class action lawsuits are an important and valuable part of the legal system when they permit the fair and efficient resolution of legitimate claims of numerous parties by allowing the claims to be aggregated into a single action against a defendant that has allegedly caused harm." Class Action Fairness Act of 2005, 28 U.S.C. §1711 (2005). Stopping individuals from bringing class action suits effectively immunizes corporations from any legal accountability for certain categories of illegal acts they might commit, even when it is very clear that they have broken the law.

In many cases, class action bans insulate credit card companies from accountability because consumers cannot feasibly pursue certain claims on an individual basis, particularly cases in which individual claims are too small and complex to attract a private attorney. As an earlier Supreme Court explained, "small recoveries do not provide the incentive for any individual to bring a sole action." *Amchem Products, Inc v. Windsor*, 521 U.S. 591, 617 (1997). Class actions solve this problem and serve an important function by aggregating the potential recoveries "into something worth someone's (usually an attorney's) labor." *Id.*

Class actions also serve an important role in cases involving complex wrongdoing such as the rebate scam that would not be apparent to consumers from the face of their credit card statements. In cases like Mr. Homa's, individual consumers must rely on others who know more about the underlying facts – often one particularly motivated consumer who is able to discover them with the help of an attorney.<sup>24</sup> Public Justice is involved now in a case against American Express, in which the plaintiff alleges that although American Express promised 3% cash back to consumers who spent more than \$6,000, no consumer could ever actually receive a 3% return on total expenditures because of the way American Express calculated its cash back rewards. Most credit cardholders would probably never discover this practice on their own, which means they will only be able to recover (and to deter American Express's alleged wrongdoing) through the mechanism of a class action.

In *Ting v. AT&T*, for example, the company stipulated that class action bans are sometimes exculpatory. 182 F. Supp. 2d 902, 918-19 (N.D. Cal. 2002), *aff'd in part, rev'd in part on other grounds*, 319 F.3d 1126 (9th Cir. 2003). After a full trial, the court issued a 74-page decision striking down AT&T's class action ban as unconscionable under California law. *Id.* at 930-31. Prior to AT&T's promulgation of its contract, consumers had brought several successful class actions against phone carriers. *Id.* at 917-18. In one case, AT&T paid 100% of the class members' damages; in another, a class recovered \$88 million from a different carrier. *Id.* at 918. AT&T conceded that none of the lawyers in those cases would have brought them on an individual basis. *Id.* at 918-19. Relying on this and a wealth of other evidence, the district

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<sup>24</sup> See, e.g., *Gentry v. Super. Ct.*, 42 Cal. 4th at 461 (“[S]ome individual employees may not sue because they are unaware that their legal rights have been violated.”); *Muhammad v. County Bank of Rehoboth Beach, Del.*, 912 A.2d 88, 100 (N.J. 2006) (“[O]ften consumers do not know that a potential defendant's conduct is illegal. When they are being charged an excessive interest rate or a penalty for check bouncing, for example, few know or even sense that their rights are being violated.”) (citation omitted).

court found that AT&T's class action ban "functions as an effective deterrent to litigating many types of claims . . . and, ultimately, would serve to shield AT&T from liability even in cases where it has violated the law." *Id.* at 918.

Public Justice is co-counsel in a series of five cases involving payday lenders in North Carolina. North Carolina has a usury rate of 36% per year. Many payday lenders charge interest rates of over 500% per year. In 1997, the North Carolina legislature permitted payday lenders to charge over 400% interest for a limited time on a test basis, but that statute expired in 2001 and was not re-enacted despite fierce lobbying. State officials notified the payday lenders at that time that further operations would be illegal, but payday lenders continued to charge their customers interest rates more than ten times the legal rate. The predatory nature of payday lending has been established by numerous studies, as approximately 95% of payday borrowers are not able to pay off the loans on time and end up rolling them over, often many times. It is not uncommon for individuals to borrow \$500 and end up paying thousands of dollars in interest, but still owe the \$500 at the end of that period. In any case, while the North Carolina Commissioner on Banks and the state's Attorney General shut down payday lending after several more years, the payday lenders had not paid back any of the illegal overcharges to their consumers until our consumer class actions were filed. To date, we have resolved three of those class actions for more than \$44 million, with checks having been mailed to more than 300,000 North Carolina consumers. (By contrast, I've been told by an official with the American Arbitration Association that the total number of *all* of the consumer arbitrations filed with it for 2010 by any consumer against any corporation in the United States was about 1,300 cases.)

Arbitration clauses that ban class action proceedings prevent many consumers who have been harmed by corporate wrongdoing from seeking relief. These class action bans also shield

corporations from liability for their illegal activities. This not only hurts the consumers who have already been harmed and cannot get their money back, but also hurts future consumers because often corporations abandon illegal practices the moment that a class action is filed. Allowing corporations to use arbitration clauses to ban class action proceedings encourages deceptive and predatory behavior by corporations, and injures consumers.

**V. COMPANIES DO NOT FORCE THEIR CONSUMERS AND EMPLOYEES INTO ARBITRATION BECAUSE IT IS CONSUMER OR EMPLOYEE FRIENDLY; RATHER, THEY DO IT BECAUSE THEY KNOW THAT IT WILL REDUCE THEIR COSTS AND LIABILITY FOR VIOLATING THE LAW.**

A common refrain by many companies when asked about their unyielding effort to force their consumers and employees into arbitration is that they are doing this because it is better for consumers and employees. For example, in front of the Supreme Court, AT&T Mobility claimed that its clause provides “a realistic and effective dispute-resolution mechanism for consumers,” and that, notwithstanding its ban on class actions, it “remains liable to all of its customers for all wrongdoing.” See AT&T Br. in *Concepcion*, at p.44. This claim, however, is consistently contradicted by the actual data demonstrating how few consumers and employees actually pursue arbitration. After it won the *Concepcion* case, in contrast, in the *Cruz* case, AT&T argued that the court had to enforce its clause if it doing so would guarantee no recovery for all but an “infinitesimal” number of consumers.

Corporate advocates have spent a lot of money trying to generate data to compare the outcomes in a very small number of consumer cases that have been arbitrated against selected control groups of cases that went to court, with the goal of proving that arbitration is fair. (Corporate advocates talk a lot less about arbitration in the employment setting, because there is a LOT more data there, and – as will be established shortly – the data proves that employees win less often in arbitration than in court and when they do win, they win smaller sums than they

would have been likely to win in court.) While a lot of the empirical data pulled together by tort-reformers about consumer cases is partisan and dubious, one empirical fact is hard to question: arbitration clauses serve to SUPPRESS consumer claims. Put another way, uncontested statistical data obtained in several cases has demonstrated that the vast majority of dissatisfied customers do not bring arbitrations against companies. For example, by the end of 2007, AT&T had become the largest wireless provider in the nation, with over 70 million customers. *See Coneff v. AT&T Corp.*, 620 F. Supp. 2d 1248, 1252 (W.D. Wa. 2009). But between January 1, 2003, and December 31, 2007, only 170 customers in the entire country filed arbitration actions against AT&T.<sup>5</sup> And only 256 claims were filed in small claims court against AT&T in 2007 nationwide.

In comparison, Consumers Union reported that the year AT&T and Cingular merged, the companies had the worst records of customer complaints filed with the FCC.<sup>6</sup> Meanwhile, Consumer Watchdog, a non-profit consumer advocacy organization, received thousands of complaints from consumers.<sup>7</sup> A class action was brought as a result of those complaints.<sup>8</sup>

Within 24 hours of the press announcement that the class action had been filed, 1,800 AT&T customers contacted Consumer Watchdog with the same claims. As of March 2007, 4,700 complaints were received.<sup>9</sup> “No other legal action brought by [Consumer Watchdog] has . . . resulted in such a tremendous number of complaints following the announcement of a suit.”<sup>10</sup>

This example is not an outlier. In the *Homa* case discussed above, involving American Express, evidence demonstrated that, despite the fact that American Express has millions of

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<sup>5</sup> Decl. of Bruce Simon in Supp. of Pls.’ Opp’n to Am. Mot. to Compel Arbitration 2-3, *Coneff*.

<sup>6</sup> Decl. of Kevin Coluccio in Supp. of Pls.’ Opp’n to Am. Mot. to Compel Arbitration, Ex. S, *Coneff*.

<sup>7</sup> Decl. of Douglas Heller in Supp. of Pls.’ Opp’n to Am. Mot. to Compel Arbitration 2, *Coneff*.

<sup>8</sup> *Id.* at 2.

<sup>9</sup> *Id.* at 2-3.

<sup>10</sup> *Id.* at 2.

customers, since 2006 only *twenty-three* arbitrations on any issue have been reported by either of the two largest arbitration providers in the country.<sup>11</sup> And in a case from California, discovery revealed that, other than the named plaintiff, only *one* of the putative class members had ever challenged Circuit City's overtime policy. Decl. of Ellen Lake in Supp. of Pls.' Opp. to Mot. to Compel Arbitration ¶ 7, *Gentry v. Circuit City Stores, Inc.*, No. BC280631, 2008 WL 8009240 (Cal. Super. Ct. Aug. 28, 2008). Moreover, between 1998 and 2008, only *two* California Circuit City employees had brought *any* claims in arbitration. *Id.* at ¶ 8.

In the North Carolina payday lending cases described above, there had not been ANY individual arbitrations filed against any of the payday lenders. None.

Moreover, at least one industry – nursing homes – has been straightforward in explaining that profits have driven the rise in mandatory arbitration. The industry openly admits that the reason it places arbitration clauses in the fine print of its contracts is because they save the industry money. Arbitration agreements allow the industry to escape financial responsibility for wrongdoing and increase profits because the agreements allow the nursing homes to choose their own arbitrators. Not surprisingly, those arbitrators have been shown to be beholden to the nursing home industry. They rule for the nursing home more often than the public courts would. They give smaller awards to injured residents than the public courts would. In 2008, Congressman Lamar Smith testified that “arbitration in the nursing home and assisted living sector arose out of the need to find some way to control escalating costs in the 1990s.”<sup>12</sup> These efforts have proven successful, as the average nursing home claim amount in the United States shrank from \$261,000 in 1998 to an estimated \$116,000 in 2008. Arbitrated cases pay about 35% less to wronged consumers than non-arbitrated cases and cost nursing home companies

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<sup>11</sup> Decl. of Matthew Wessler in Supp. of Pls.' Opp'n to Mot. to Compel Arbitration, *Homa*.

<sup>12</sup> Congressional testimony of Lamar Smith on H.R. 6126, July 30, 2008.

about 41% less in legal fees.<sup>13</sup> Given these numbers, it's easy to see why the use of mandatory arbitration can be viewed as a good return on investment, even if this return is conditioned on hurting the very consumers and employees who support the business in the first place.

#### **IV. ARBITRATION IS OFTEN CLOAKED IN SECRECY, WHICH DISADVANTAGES CONSUMERS AND FAVORS CORPORATE REPEAT PLAYERS.**

Another reason why companies want to force all their consumers and employees into arbitration is that the results of any arbitration will be secret. Arbitration is all-too-often completely secretive, with strict confidentiality rules sometimes limiting what can be publicly revealed either about the underlying facts of a dispute or about the arbitrators' rulings. Reporters are generally not allowed to be present in arbitrations, and proceedings are closed to the public. These characteristics are not inherent to arbitration, but too often become part of the process.

In addition, some arbitration clauses and the rules of some arbitration providers require that all parties to a dispute keep all facts about both the dispute and the arbitrator's resolution of the dispute "confidential." Furthermore, "[a]rbitrators have no obligation to the court to give their reasons for an award," *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 976 n.8 (1960), and it is common for arbitrators to provide no written explanation for their decisions. *See* Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 Sup. Ct. Rev. 331, 397-98 (1996). Even when arbitrators do produce written decisions, "arbitrators' decisions are not intended to have precedential effect even in arbitration (unless given that effect by contract), let alone in the courts." *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998). Professor Richard Reuben, a proponent of alternative dispute resolution, has cautioned that arbitration can sacrifice important public values of transparency and

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<sup>13</sup> Nursing home residents often sign away rights to sue, Jessica Fargen, Boston Herald, March 8, 2010

accountability. Richard C. Reuben, *Democracy and Dispute Resolution: The Problem of Arbitration*, 67 *Law & contemp. Probs.* 279, 298-302 (Winter/Spring 2004).

This secrecy tends to reduce the ability of consumer attorneys to effectively represent their clients. See Jean Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 *Wash. U. L.Q.* 637, 683-84 (1996) (“[A] consumer’s attorney often relies on public information gained from other lawsuits to build her own claims of negligent or intentional misconduct. Repeat-player companies can gain similar information through private channels. Thus, by requiring private arbitration the company may again deprive the consumer of certain relief she might have obtained through litigation.” (citations omitted)); cf. Marcus Nieto & Margaret Hosel, *Arbitration in California Managed Health Care Systems* 22 (2000) (“[P]laintiffs in California health care claims generally do not have information about arbitrators’ decision records before selecting a neutral arbitrator. In contrast, health care plans do have information about the win-lose decisions of arbitrators. This information gap may favor health care plans.”).

#### **V. ARBITRATION COMPANIES HAVE POWERFUL INCENTIVES TO FAVOR THE CORPORATIONS THAT SELECT THEM THROUGH THEIR STANDARD FORM CONTRACTS.**

I have had numerous conversations with lawyers for corporations and advocates for individuals generally, and have participated in multiple mediations and settlement negotiations, and our experience is that the nearly universal perception among both plaintiff-side and defense-side lawyers is that arbitrators are more likely to have a pro-corporate defense attitude than are judges or juries. Exhaustive empirical evidence in the employment setting has proven this. Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury*, 11 *Employee Rights & Employment Policy J.* 405 (2007) (“the more recent data on cases deriving from employer-promulgated agreements . . . suggest that employee win



rates and damage awards are lower than indicated by the earlier studies and lower than those in litigation”).

There is also evidence that companies believe arbitration is “fair” only when it can be used against consumers. For example, many of the same corporations that applaud arbitration when it is imposed against consumers are reluctant to agree to arbitration when it might be imposed against them. *See* Bar-Gill & Warren at 78 n.254 (noting that “arbitration clauses . . . are much more common in consumer contracts than in business-to-business contracts”) (citing additional sources); Public Citizen, *Auto Dealers and Consumers Agree: Mandatory Arbitration Is Unfair* (listing various statements made by auto dealer representatives critical of arbitration and in support of bill to ban mandatory pre-dispute arbitration between dealers and car manufacturers), available at <http://www.citizen.org/congress/civjus/arbitration/articles.cfm?ID=650>.

A stark example of the double standard here can be found in the *Concepcion* case. Justice Scalia writes that it would be very unfair to require a corporation to go into arbitration where the arbitration would go forward on a class action basis. He says corporations should be able to insist upon individual arbitration. One of his reasons is that there is no meaningful judicial review of arbitrators’ decisions, so if an arbitrator awarded a group of cheated consumers a lot of money, the corporation wouldn’t be able to appeal that decision. By contrast, when the Supreme Court was considering whether to force civil rights claims in employment cases into arbitration, the employees argued, in effect, “you can’t force something as important as civil rights claims into mandatory arbitration, because there is no real judicial review.” The Supreme Court rejected this argument, saying that limited judicial review was a basic feature of arbitration, and that it was fine to force employment claims into arbitration. Under Justice

Scalia’s construct, mandatory arbitration is fine for things such as employment civil rights claims, but not fair for things that would matter to a corporation, such as a class action.

## **VI. ARBITRATORS ARE IMMUNE FROM ANY MEANINGFUL JUDICIAL REVIEW.**

The general rule is that judicial review of arbitrators’ decisions “is very narrow; one of the narrowest standards of judicial review in all of American jurisprudence.” *Lattimer-Stevens Co. v. United Steelworkers of Am. Dis.* 27, 913 F.2d 1166, 1169 (6th Cir. 1990).<sup>20</sup> Consider the following examples:

- The U.S. Court of Appeals for the Seventh Circuit remarked in a decision that courts should not review arbitrators’ interpretations of contracts even if they are “wacky,” so long as the arbitrator attempted to “interpret the contract at all.” *See Wise v. Wachovia Securities, Inc.*, 450 F.3d 265, 269 (7th Cir. 2006).
- The U.S. Court of Appeals for the Third Circuit considered an arbitrator’s decision that “inexplicably” cited and relied upon language that was not included in a key document. The court held that “such a mistake, while glaring, does not fatally taint the balance of the arbitrator’s decision in this case. . . .” *Brentwood Medical Associates v. United Mine Workers of America*, 396 F.3d 237 (3d Cir. 2005).
- In a case involving baseball player Steve Garvey, the U.S. Supreme Court held that “courts are not authorized to review the arbitrator’s decision on the merits” even if the

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<sup>20</sup> See also *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) (“the court will set aside [an arbitrator’s] decision only in very unusual circumstances.”); *Baravati v. Josephthal, Lyon & Ross*, 28 F.3d 704, 706 (7th Cir. 1994) (“[j]udicial review of arbitration awards is tightly limited.”); *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998) (“judges follow the law . . . , while arbitrators, who often . . . are not lawyers and cannot be compelled to follow the law and their errors cannot be corrected on appeal (there are no appeals in arbitration), although there are some limitations on the power of arbitrators to flout the law.”); *Di Russa v. Dean Witter Reynolds Inc.*, 121 F.3d 818, 821 (2d Cir. 1997) (to modify or vacate an arbitration award, a court must find both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case).

arbitrator's fact finding was "silly." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2002).

- The California Supreme Court has held that even when an arbitrator's decision would "cause substantial injustice," it was not subject to judicial review. *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992).

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

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

ultimately harm the public good or, because those decisions are secret, impede an innovation to a recurring problem, much to the detriment of Texas citizens.”).

### **CONCLUSION**

In all too many cases, the promise of fair and inexpensive arbitration is not kept for American consumers and employees, and companies use mandatory arbitration clauses as a tool to avoid accountability.