

Testimony of

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On behalf of

The U.S. Chamber of Commerce and the U.S. Chamber  
Institute for Legal Reform

Before the

U.S. SENATE COMMITTEE ON THE JUDICIARY

Hearing on

“Arbitration: Is It Fair When Forced?”

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Submitted by:

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Chairman Franken, Ranking Member Cornyn, and Members of this distinguished Committee, thank you for your most gracious invitation for me to testify today about pre-dispute arbitration agreements.

By way of background, for over 40 years, I have worked in and with our litigation system. I was privileged to do plaintiffs’ work for over a decade and defense work for over 25 years. I have been a law professor and am co-author of the most widely used torts casebook in the United States, *Prosser, Wade & Schwartz’s Torts, Cases and Materials*. Its 12<sup>th</sup> edition was published last year. I have also served as dean of the University of Cincinnati College of Law and have been an active member of the American Law Institute, serving as an Advisor for the *Restatement of Torts, Third* project. Currently, I am a partner at the law firm of Shook Hardy & Bacon, LLP and chair the firm’s Public Policy Group.

Today, I have the honor of testifying on behalf of the U.S. Chamber Institute for Legal Reform and the U.S. Chamber of Commerce. The U.S. Chamber Institute for Legal Reform (ILR) is an affiliate of the U.S. Chamber of Commerce dedicated to making our nation’s legal system simpler, fairer and faster for everyone. Founded by the Chamber in 1998 to address the country’s litigation explosion, ILR is the only national legal reform advocate to approach reform comprehensively, by working to improve not only the law, but also the legal climate. The U.S. Chamber of Commerce is the world’s largest business federation, representing the interests of

more than three million businesses and organizations of every size, sector and region. As has been true each time I have testified before this distinguished Committee, my views are my own.

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The wisest minister I have ever known, Albert Sikkelee, once said in a sermon, “something not placed in context is pretext.” While Reverend Sikkelee was speaking of selective uses of portions of the *Bible*, his words ring true with respect to the topic we are discussing today, namely, pre-dispute arbitration agreements. To evaluate them properly, they must be placed in context of our total litigation system.

#### Consumer Contracts Are Voluntary Contracts

Mr. Chairman, I realize that some call these agreements “mandatory” or “forced.” I also appreciate that this is your sincere view. But, as learned Professor Stephen Ware of the University of Kansas School of Law and other scholars have observed, no one forces an individual to sign a contract.<sup>1</sup> In this country, we have choices. It is true that in some industries pre-dispute arbitration agreements are widespread, but still one does not have to sign them. If an individual wants to purchase a particular product or service from a particular provider or seller, for example a Sprint cell phone, they can choose whether the benefits outweigh having to arbitrate their claim should a problem arise.

In our competitive world, if contractual arbitration were an anathema to millions of consumers, and there was consumer outrage about them, an enterprising business seeking a competitive advantage would simply offer a product or service without such a provision. Presumably, that entity would have to charge a premium to cover the substantial litigation costs,

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<sup>1</sup> See Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements – with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM ARB. 251, 262 n.21 (2006) (citing those who make this argument).

but if submitting to arbitration was such a vital concern in consumer decision-making, a market for non-arbitration agreements would likely develop. Alternatively, if consumers were unaware of arbitration provisions in any contract they signed, yet neglected to read carefully, greater awareness of this issue over the past decade or more – during which the use of the agreements has grown – would also give rise to such a market. Banning or otherwise limiting the use of pre-dispute arbitration clauses would ignore these market dynamics, and likely force consumers to pay more for products or services. It would also promote unsound public policy by reducing incentives for consumers to carefully read and understand the contracts they enter if they can later escape arbitration provisions.

#### Eliminating Pre-Dispute Arbitration Agreements Would Benefit Lawyers, Not Consumers

If pre-dispute arbitration agreements were abolished in whole or in part, the clear, unmistakable beneficiaries would be lawyers. From my experience, I can say that if there were true mandatory arbitration agreements in all aspects of life, my law firm, other defense litigation law firms, and many plaintiffs' law firms might have to consider another business or profession. The legal profession thrives on litigation, and in the absence of pre-dispute arbitration agreements, the only choice by which we have to resolve disputes would be litigation; an avenue that is both time consuming and expensive for all parties.

The costs associated with hiring a plaintiffs' lawyer on a contingency fee basis plus expenses can run upwards of fifty percent of the ultimate recovery, sometimes even more. In this regard, it is not surprising that the American Association for Justice (formerly the Association of Trial Lawyers of America) reports significant lobbying in an effort to outlaw pre-dispute arbitration agreements. But plaintiffs' lawyers are not alone in making money when people litigate disputes. Defense firms charge by the hour and these transaction costs can be

extraordinarily high as well. There are also significant court costs adding to these already high priced litigations, not to mention expenditures of scarce judicial resources. Taken together, these high transaction costs benefit attorneys, but can leave many consumers with comparatively little after years of litigation. As Judge Learned Hand once observed, “short of disease, a lawsuit is a person’s worst nightmare.” Arbitration, in comparison, often significantly reduces these transaction costs.

If pre-dispute arbitration agreements were abolished, in whole or part, some believe that it would open the portals for an attractive path of righting wrongs, namely class actions. But class actions are not ideal. Most importantly, the vast majority of consumer claims are individualized, for example, a dispute about an overcharge on one person’s bill or a product that is a lemon. Class actions are of no help in these circumstances.

Even in the rare situation when a dispute is amenable to class action treatment, the device has many shortcomings and can adversely affect people who feel they have been victimized. Often, consumers will have to submit complex claims forms to obtain recovery. But few individuals understand how to fill them out, and even fewer bother to do so. Sometimes, and there are numerous examples where this is the case, consumers become victims of the lawyer-tilted class action system and actually receive no direct benefit from consumer class actions.

In a recent Ninth Circuit case, class action lawyers representing customers who owned “Bluetooth” headsets claimed that manufacturers committed fraud when they failed to give prominent warnings indicating that listening to the headsets continually at loud volumes might cause hearing damage.<sup>2</sup> The potential litigation costs prompted the defendant to settle the class action. What did the settlement involve? Over \$100,000 was to be given to a hearing loss

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<sup>2</sup> See *In Re Bluetooth Prod. Liab. Litig.*, No. 09–56683, 2011 WL 3632604 (9th Cir. Aug. 19, 2011) (holding trial court abused its discretion in approving settlement and fee agreement).

charity. The plaintiffs' lawyers in the case were to receive \$850,000 in fees. The people who claimed the hearing loss – a physical injury – were set to receive virtually nothing from the settlement.

A group called The Center for Class Action Fairness intervened in the case and successfully argued before the Ninth Circuit that the lower court should review its approval of this valueless class action settlement. The case was remanded, providing a modest potential victory for the plaintiffs, but after years of litigation the customers still have recovered nothing. This is just one recent example. There are numerous other examples of multi-million dollar class actions where consumers get little or nothing and attorneys are well paid.<sup>3</sup>

The “Bluetooth” case and others illustrate that there are serious concerns with how class actions function in this country. Does that mean that every consumer class action is totally unsound? No. But the notion that they are a panacea, or even that they are more often beneficial than not, is belied by the evidence. I simply mention the case because it shows the fallacy of judging any dispute resolution system by one or two poster person cases where a victim can tell a potentially compelling story.

#### Contractual Pre-Dispute Arbitration Provides Important Benefits from Consumers' Perspective

In comparison to the litigation system, pre-dispute arbitration agreements can, and routinely do, benefit consumers who bring a claim in terms of affordability, timeliness, accessibility, and clarity and flexibility with respect to the process.

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<sup>3</sup> See, e.g., Steven B. Hantler & Robert E. Norton, *Coupon Settlements: The Emperor's Clothes of Class Actions*, 18 GEO. J. LEGAL ETHICS 1343, 1344 (2005).

Data, as set forth in articles by my fellow witness, Christopher Drahozal,<sup>4</sup> and studies by Professor Stephen Ware<sup>5</sup> and Professor Peter Rutledge,<sup>6</sup> show that contractual pre-dispute arbitration is usually both more affordable and efficient for consumers than full-scale litigation. These studies reflect my own experience. For over four decades, I have seen that making claims in courts can be very costly. Years can go by before there is any result. Even with regard to the most modest disputes made in small claims courts, claimants can experience substantial delays, particularly in light of shrinking court budgets in many states.<sup>7</sup> Arbitration offers lower transaction costs through simplified procedures and less attorney involvement, and improved timeliness by not having to wait to have a claim adjudicated in an ever increasingly overcrowded court system.

Contractual pre-dispute arbitration also provides greater accessibility for many consumers or employees to have their claims adjudicated. In many instances, the litigation system may not be accessible to these individuals. Plaintiffs' lawyers properly operate in a for-profit industry; they will typically only take cases where they believe they have a substantial likelihood of success and where the economic value of the case will justify their time investment. Prominent plaintiffs' lawyer, Kenneth Connor, was most honest when he said "from an economic feasibility standpoint [I] cannot handle the case that is not likely to deal back a

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<sup>4</sup> See Christopher R. Drahozal, *An Empirical Study of AAA Consumer Arbitrations*, 25 OHIO ST. J. ON DISP. RESOL. 843 (2010).

<sup>5</sup> See Stephen J. Ware, Testimony before the House of Representatives Judiciary Subcommittee on Commercial and Administrative Law (September 15, 2009), *available at* 2009 WL 2942430.

<sup>6</sup> See Peter B. Rutledge, *Who can be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 CARDOZO J. CONFL. RESOL. 267 (2008).

<sup>7</sup> See, e.g., *Budget Cuts Have Widespread Impact on NY State Courts Report*, Reuters, Aug. 16, 2011, *available at* [http://newsandinsight.thomsonreuters.com/Legal/News/2011/08\\_-\\_August/Budget\\_cuts\\_have\\_widespread\\_impact\\_on\\_NY\\_state\\_courts-report/](http://newsandinsight.thomsonreuters.com/Legal/News/2011/08_-_August/Budget_cuts_have_widespread_impact_on_NY_state_courts-report/).

return.”<sup>8</sup> Some studies show that most lawyers will not take a case unless the plaintiff’s claim is worth at least \$60,000.<sup>9</sup> Most consumer claims are of relatively modest value and, therefore, unlikely to motivate a plaintiff’s lawyer to get involved. Similarly, a recent study concluded that only about 5% of employees who contend they were discriminated against can access the litigation system given its economic realities; for them, “it looks like arbitration – or nothing.”<sup>10</sup>

Contractual pre-dispute arbitration, when contrasted with the litigation system, is also more simple, clear, and flexible from the point of view of the consumer. In arbitration, consumers can often submit and respond to claims using their own words. They are not bound by the formalities of the legal proceedings that take some individuals three years or more of law school to learn. In addition, consumers in arbitration can appear in person, or if they prefer by telephone, or by simply submitting documents. Some arbitration providers are even moving towards online claims resolution. Litigation, in contrast, generally requires the claimant to take time away from work, family, or other activities, causing great inconvenience.

#### Arbitration Produces Equally Valid and Just Results Compared with the Litigation System

A core argument of opponents of contractual pre-dispute arbitration is that it unfairly “stacks the deck” against the consumer or an employee. It has been argued that because pre-dispute arbitration clauses sometimes permit businesses to select the organization that will administer the arbitration, a powerful incentive is created for that organization’s arbitrator to

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<sup>8</sup> Hearing on H.R. 6126, the “Fairness in Nursing Home Arbitration Act of 2008” before House of Representatives Judiciary Subcommittee on Commerce and Administrative Law, 110th Congress (2008) (statement of Kenneth Connor).

<sup>9</sup> See, e.g., Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 DISP. RESOL. J. May-Jul. 2003, at 8, 10-11.

<sup>10</sup> See Theodore St. Antoine, *Mandatory Arbitration: Why It’s Better Than It Looks*, 41 U. MICH. J.L. REFORM 783, 792 (2008).



unjustly favor the defendant in order to secure future business. This argument is unsound for several reasons.

First, while an arbitration agreement may designate a service provider, both parties will typically have a role in selecting the individual arbitrator who will conduct the dispute. Moreover, arbitration service providers such as the American Arbitration Association (AAA) have conflict-of-interest rules that provide for the disqualification of any arbitrator who may have an interest in the outcome of the dispute.<sup>11</sup>

Second, it is important to remember, and not gloss over the fact, that arbitrators such as those in the AAA and other organizations are professionals. They are independent legal experts who abide by a comprehensive set of rules and procedures, and take an oath to render objective decisions, not unlike a judge or other court officer. Many arbitrators are, in fact, former judges. Accordingly, it is not surprising that no broad-based objective study supports the accusation that the average arbitrator is unable or unwilling to separate whatever alleged financial interests could exist and reach an unbiased, objective decision.

Third, as the writings of Professors Ware, Drahozal and Rutledge show, consumers often receive the same or better result in arbitration as in courts. One possible reason for this is that many arbitrators specialize in particular fields. In some instances, they may possess greater subject matter knowledge than a judge in a court of general jurisdiction.

Witnesses in this hearing will likely differ on this key point and cite reports that suggest consumers perform worse in arbitration. It is important to put such studies in context. There is an inherent selection difference between the types of cases that proceed to arbitration and those that proceed in the court system; they are apples and oranges. Common sense tells us that given

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<sup>11</sup> See, e.g., American Arbitration Association, *Commercial Arbitration Rules and Mediation Procedures R-17*, available at <http://www.adr.org/sp.asp?id=22440#R17>.

the higher costs of the court system, claimants are more likely to take on the burdens of litigation when they believe their claim is particularly strong or where the amount sought is so high that it leaves no room for settlement; these considerations function to weed out plaintiffs with weaker claims. Arbitrators, in comparison, generally decide the sound claims along with the weak and meritless ones. Thus, it would not be surprising to find that businesses prevail more often in arbitration. That said, the weight of the empirical studies still show that individuals fare just as well in arbitration as in court.

Finally, from a business point of view, the premise that a business would wish to place its customers into a forum where there is no fair chance to have cases properly heard is deeply flawed. Stated plainly, businesses want repeat customers. They often make accommodations for consumers when under no obligation to do so. For example, if one takes a product back to a store, that business will often take the product back even though they may not be fully, or actually, responsible for a product's damage or defect. And for the same reason, the alternative dispute resolution systems that businesses offer to their customers are aimed at ensuring that customers are satisfied that they receive a fair shake. Whereas the burdens and shortcomings of the litigation system make it more likely that businesses will lose customers due to acrimony, arbitration is more likely to lead to a prompt settlement that satisfies both sides and makes it more likely that a customer will continue to do business with the company.

#### Other Misconceptions About Contractual Pre-Dispute Arbitration

Another commonly employed argument against pre-dispute arbitration provisions is that they disadvantage consumers and employees because these groups have no bargaining power or have unequal bargaining power. This argument adds that these arbitration clauses are often buried in the "fine print" or are in contracts written in "legalese," leaving many consumers or

employees unaware that these provisions even exist. But, here is the key point mentioned in the beginning of my testimony. Consumers and employees voluntarily enter these contracts. It may seem extraterrestrial, but I have lived in a world where people did not have cell phones or the gadgetry we see in our daily lives. Folks did survive. If consumers balked at these agreements and refused to buy products or services unless they could litigate disputes, it is my belief that at least one or more companies would offer a non-arbitration alternative; in fact in many industries where arbitration is used, some non-arbitration alternatives exist. The argument that consumers lack bargaining power is a fallacy; consumers gain more bargaining power everyday through increased competition and more avenues, such as on the Internet, to rate products and services.

This same rationale also rebuts another commonly asserted argument that contractual pre-dispute arbitration creates incentives for businesses to engage in predatory practices. First, as previously explained, customers do as well, if not better, in arbitration than they do in court. Second, existing law prevents businesses from drafting arbitration agreements that tilt the playing field in their direction. Both state and federal courts routinely exercise authority under Section 2 of the Federal Arbitration Act to invalidate arbitration provisions that are unfair to consumers or employees. Examples include provisions imposing on consumers high or inappropriate costs, burdensome travel, or punitive damage limits. Third, businesses face multiple layers of government oversight. Businesses that sell to consumers are generally regulated by at least the Federal Trade Commission and one other federal agency, as well as all 50 state attorneys general and a myriad of state agencies and commissions. These agencies and offices routinely pursue allegations of wrongdoing, especially the use of unfair and deceptive practices. Hence, there already exists multiple “checks” on the scope and limits of arbitration agreements.

A final misconception about contractual pre-dispute arbitration is that by eliminating such agreements a robust market for post-dispute arbitration of claims would develop that would better serve consumers. A basic understanding of litigation dynamics demonstrates why this would not be the case. In the absence of contractual pre-dispute arbitration, plaintiffs would presumably be permitted to contract with defendants to have their dispute arbitrated. Under this scenario, claimants with very modest (low dollar amount) claims would likely prefer arbitration because it is less expensive than the court system; however, most defendants would likely prefer to litigate in the court system because the higher transaction costs serve to both weed out the more speculative claims and provide the defendant with greater settlement leverage. The result? The parties would be unlikely to agree to arbitration. The same outcome would also occur when the roles are reversed and the plaintiff has a relatively high dollar amount claim. Here, the defendant would likely prefer arbitration to minimize costs, but the plaintiff would want to proceed in the court system to either increase settlement leverage or potentially obtain a substantial jury award. The result in either case is that the litigation adversaries would be unlikely to agree to the others' preferred means of dispute resolution. This is precisely why the availability of pre-dispute arbitration is so important and desirable; it establishes up-front how a claim will be adjudicated.

### Conclusion

Everyone knows the universal truth; nothing is perfect. Contractual pre-dispute arbitration is not perfect, but I can assure this Committee that the litigation system is not perfect either. My life has taught me that common sense is a good guide. If the concerns put forth by those who oppose pre-dispute arbitration agreements were universal, those concerns would be on the front page of every paper in America. That has not occurred. We see much more in the

media about the pitfalls of litigation. For instance, as the *New York Times* recently observed, “[s]tate courts, which handle the vast majority of civil and criminal cases, are in a state of crisis.”<sup>12</sup> Today, these courts are “less and less able to deliver justice.”<sup>13</sup> Contractual pre-dispute arbitration and our class action and individual litigation systems can both be improved, but abolition of contractual pre-dispute arbitration is not the answer.

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

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<sup>12</sup> Editorial, “Thread Bare American Justice”, N.Y. Times, August 18, 2011, at A20.

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