

**Written Testimony**  
**of**  
**David Arkush,**  
**Director,**  
**Public Citizen's Congress Watch division**

**before the**

**HOUSE OF REPRESENTATIVES COMMITTEE ON THE JUDICIARY,**  
**SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE**  
**LAW**

**Hearing on the "Federal Arbitration Act":  
Is the Credit Card Industry Using the Act  
to Slam Shut the Courthouse Door?"**

**May 5, 2009**

Mr. Chairman and other Members of the Subcommittee, thank you for the opportunity to testify on the critical issue of forced arbitration. My name is David Arkush, and I am the director of Public Citizen's Congress Watch division. Public Citizen is a national nonprofit membership organization that has advanced consumer rights in administrative agencies, the courts, and the Congress, for thirty-eight years.

## INTRODUCTION

The Federal Arbitration Act was intended to provide an informal dispute resolution mechanism for businesses to resolve disagreements.<sup>1</sup> At the time, arbitration was voluntary, chosen by sophisticated parties that had bargaining power with respect to each other.<sup>2</sup> In the early 1980s, the United States Supreme Court opened the door for large corporations to force their customers and non-union employees into arbitration,<sup>3</sup> and many have seized the opportunity. Today, a consumer must forego the right to litigate any future disputes in court to obtain a wide range of goods and services, including credit cards.<sup>4</sup> A consumer with a credit-card dispute must bring a claim individually, not as a member of a class, in a private, secretive forum, chosen by the credit card provider. The San Francisco City Attorney has called the leading arbitrator of credit card disputes, the National Arbitration Forum, an "arbitration mill" that "churn[s] out arbitration awards in favor of debt collectors."<sup>5</sup>

Forcing arbitration on credit card customers has nothing to do with providing them a quicker, simpler, less expensive forum in which to pursue disputes, as its proponents claim. Nor is there any evidence that forced arbitration provides consumers with cheaper credit. The real functions of forced arbitration are (1) to deter consumers from bringing claims at all; and (2) to give creditors a fast-track forum for collecting debts, even unlawful debts, in which they can run up additional fees to charge consumers. In short, forced arbitration is another in a long list of predatory credit card practices.

## DISCUSSION

### I. Forced Arbitration Is One of Many Predatory Credit Card Practices.

American consumers have a strong distaste for credit card providers because of their experiences with abusive practices such as hidden fees and complicated,

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<sup>1</sup> See Jean Sternlight, *Creeping Mandatory Arbitration: Is It Just*, 57 STAN. L. REV. 1631, 1636 (2005).

<sup>2</sup> *Id.* at 1635-36.

<sup>3</sup> See generally David S. Schwartz, *If You Love Arbitration, Set It Free: How "Mandatory" Undermines "Arbitration"*, 8 NEV. L. J. 400 (2007).

<sup>4</sup> See Theodore Eisenberg & Geoffrey Miller, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Non-Consumer Contracts*, 41 U. MICH. J.L. REFORM 871, 871 (2008).

<sup>5</sup> Sam Zuckerman, *S.F. Sues Credit Card Service, Alleging Bias*, S.F. CHRONICLE, Apr. 8, 2008 at D-1.

deceptive pricing. In the past decade, credit card providers have increased their fees and penalties dramatically:<sup>6</sup>

- In 2005 credit card penalty fees totaled \$17.1 billion, a 10-fold increase from 1995, and penalty interest rates averaged 24.2 percent.<sup>7</sup> Lenders collected \$18.1 billion in penalty fees on credit cards in 2007.<sup>8</sup>
- The average late fee over the same ten-year period rose from \$12.38 in 1995 to \$33.64 in 2005.<sup>9</sup> The average overlimit fee is now \$30.18.<sup>10</sup>
- In 2002, credit card lenders introduced tiered fee structures that add an automatic prorated fee based upon the balance that the borrower is carrying.<sup>11</sup>
- Lenders also assess fees for various services and transactions.<sup>12</sup> For example, credit card issuers make an estimated \$36 million annually in interchange fees that credit card companies charge vendors to use their cards, which are then added to the price of goods and services.

It is currently estimated that credit card issuers make over a third of their money in fees.<sup>13</sup> This is an industry that makes most of its money from its least satisfied customers.

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<sup>6</sup> See PUBLIC CITIZEN, THE ARBITRATION TRAP 51 (2007) at <http://www.citizen.org/documents/ArbitrationTrap.pdf> (citing “Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers,” General Accountability Office, Sept. 2006, GAO-06-929); see also Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 46 (2008) (“More recently, long-term interest rates have become more salient to consumers, perhaps reflecting their growing concern over rising balances on credit cards. The design of the credit card product changed in response. Long-term interest rates were reduced to attract and retain customers, as other charges were increased.”); also Kathy Chu, “Facing Losses on Bad Loans, Banks Boost Credit Card Rates”, USA TODAY, Apr. 27, 2008 at [http://www.usatoday.com/money/perfi/basics/2008-02-06-consumer-credit-charges\\_N.htm](http://www.usatoday.com/money/perfi/basics/2008-02-06-consumer-credit-charges_N.htm) (“Bank fees have been rising for years. But as their loan losses have surged, banks have become quicker to raise certain fees and rates, analysts say.”).

<sup>7</sup> See PUBLIC CITIZEN, THE ARBITRATION TRAP at 51 (citing Professor Arthur E. Wilmarth, Jr., George Washington School of Law, testimony before the Financial Institutions and Consumer Credit Subcommittee of the House Financial Services Committee, Apr. 26, 2007).

<sup>8</sup> Chu, *supra*.

<sup>9</sup> Warren & Bar-Gill, *supra*, at 47.

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

<sup>11</sup> See GOVERNMENT ACCOUNTABILITY OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURES TO CONSUMERS 19-20 (Sept. 2006) at <http://www.gao.gov/new.items/d06929.pdf>.

<sup>12</sup> See *id.* at 23.

<sup>13</sup> Elizabeth Hester & Ari Levy, *Credit-Card Users Feel Pain as U.S. Banks Reap Gain*, BLOOMBERG NEWS (Dec. 18, 2008) at [http://www.bloomberg.com/apps/news?pid=20601087&sid=ap\\_9fTPViwzU&refer=home](http://www.bloomberg.com/apps/news?pid=20601087&sid=ap_9fTPViwzU&refer=home).

Last week, the United States House of Representatives passed a Credit Card Holders Bill of Rights that will halt many of the worst credit card practices. The Senate is scheduled to take up similar legislation this week. Neither bill would address forced arbitration, the subject of today's hearing.

Forced arbitration is in some ways similar to other abusive credit card practices; it can operate as just another in a sequence of steps geared to squeeze additional fees from struggling consumers. In one case, 55-year-old Cheryl C. Betts of Cary, N.C., was late with one \$128 minimum payment in August, 2005.<sup>14</sup> Her lender Chase then lowered her credit limit from \$6,000 to \$4,900 causing more fees and penalty interest to accumulate, eventually pushing her over her new lower limit.<sup>15</sup> Her minimum-payment requirements then rose to a level that she says she couldn't afford.<sup>16</sup> In May, 2007, she learned that she'd been taken to arbitration when debt collection specialists Mann Bracken sent her a letter about \$6,027 she owed on a Chase credit card, and requesting an additional \$602 in legal fees related to arbitration.<sup>17</sup>

But forced arbitration is different in one key respect: it permits credit card issuers to shield themselves from accountability, thereby enabling and creating incentives to engage in other abusive practices.

## **II. Forced Arbitration Is Biased Against Consumers, and It Harms Consumers.**

### **A. In Forced Arbitration, the Arbitration Providers Have Strong Incentives to Favor the Business Parties That Choose Them.**

Credit card arbitration is required in millions of "take-it-or-leave it" credit card form contracts.<sup>18</sup> These contracts are non-negotiable, and the credit card companies draft all of the terms, so they determine what arbitration provider will be named in the contract. As a result, arbitration companies like the American Arbitration Association (AAA) and the National Arbitration Forum (NAF) compete to be written into these form contracts.<sup>19</sup> An arbitrator's repeat business and the resulting income are determined by his or her reputation ruling in past cases.<sup>20</sup> Arbitration firms market themselves as the business-friendly alternative to court, and they collaborate with law firms that specialize in debt collection to work with

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<sup>14</sup> Robert Berner & Brian Grow, *Banks vs. Consumers (Guess Who Wins)*, BUS. WK., June 5, 2008.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> See Jean Sternlight, *Creeping Mandatory Arbitration: Is It Just*, 57 STAN. L. REV. 1631, 1650 (2005).

<sup>20</sup> See Peter B. Rutledge, *Toward A Contractual Approach For Arbitral Immunity*, 39 GA. L. REV. 151, 165 (2004) (Arbitrators "may also develop reputations with particular types of parties. For example, an arbitrator may be perceived as 'industry friendly' in securities law disputes or being 'contractor friendly' in construction disputes. Through these activities designed to enhance their reputations, arbitrators generate business in the form of fees and, hopefully, future appointments.").

the law firms' client base.<sup>21</sup> NAF, the preferred arbitration provider for JPMorgan Chase and Bank of America, promises creditors a "marked increase in recovery rates over existing collection methods."<sup>22</sup> Recently, arbitration provider Judicial Arbitration and Mediation Services (JAMS) revoked its policy against enforcing class action bans in an effort to attract more business from creditors who would be subject to class-based claims.<sup>23</sup> Conversely, arbitration providers have no incentive to please consumers. Most consumers are not even aware that their credit card contracts require arbitration.<sup>24</sup>

Once the arbitration providers are written into credit card contracts, they must ensure that their client companies are pleased with the results of their arbitrations, lest they lose business.<sup>25</sup> Our 2007 *Arbitration Trap* report documented cases of arbitrators being blackballed by arbitration providers for ruling against their corporate clients,<sup>26</sup> and AAA's annual reports have referred to the corporations that file arbitrations as its "clients and customers."<sup>27</sup> This business-friendly approach is highly profitable. NAF's net income was \$10 million in 2006, an astounding 26 percent profit margin on revenue of \$39 million.<sup>28</sup>

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<sup>21</sup> See Berner & Grow, *supra* ("NAF sells itself to lenders as an effective tool for collecting debts. The point of these pitches is to persuade the companies to use the firm to resolve clashes over delinquent accounts . . . A September, 2007, NAF PowerPoint presentation aimed at creditors and labeled 'confidential' promises 'marked increase in recovery rates over existing collection methods.' At times, NAF does this kind of marketing with the aid of law firms representing the very creditors it's trying to sign up as clients.").

<sup>22</sup> See *id.*

<sup>23</sup> See Mike Tomkies and Kathleen Caress, "Jams Revises Procedures On Class Wide Arbitration", at <http://consumerfinancelawyers.org/CM/Alerts/Jams-Revises-Procedures.asp> ("[JAMS] recently revised its class action procedure to make clear that it will enforce a class action waiver provision, or its equivalent, contained in an arbitration agreement unless a court orders the matter or claim to arbitration as a class action. This revision is a reversal of JAMS' prior policy, which was to decide the enforceability of class action waivers on a case-by-case basis in each jurisdiction . . . Following the November 2004 policy change, many creditors removed JAMS as a potential arbitrator from their arbitration provisions. Creditors might once again consider JAMS as a potential arbitration administrator for arbitration clauses with class action waivers as a result of JAMS' latest policy move.").

<sup>24</sup> See LAKE RESEARCH PARTNERS, NATIONAL STUDY OF PUBLIC ATTITUDES ON FORCED ARBITRATION 15 (Apr. 2009) (finding that 64 percent of Americans polled cannot remember reading about a forced arbitration provision in Terms of Agreement for goods and services) at <http://www.fairarbitrationnow.org/uploads/Forced%20Arbitration%20Study%20Slides%200409.pdf>.

<sup>25</sup> See Sternlight, *supra*.

<sup>26</sup> See, e.g., PUBLIC CITIZEN, THE ARBITRATION TRAP at 30-31 (Describing the case of Harvard law professor Elizabeth Bartholet, who resigned from NAF in February 2005, citing concern for NAF ethics and "its apparent systematic bias in favor of the financial services industry.").

<sup>27</sup> See Testimony of Laura MacCleery, Director, Public Citizen's Congress Watch division, before House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, October 25, 2007 at 4.

<sup>28</sup> Berner & Grow, *supra*.

It is difficult to overstate the unfairness of a system that forces consumers to resolve disputes against large corporations in forums that compete to please the corporations.

**B. Forced Arbitration Enables and Creates Incentives to Engage in Predatory Practices.**

Because arbitration companies are not required to respect the law and often grant creditors' claims based on exceedingly little evidence,<sup>29</sup> forced arbitration enables creditors and debt collectors to pursue invalid, unlawful debts. For example, there is little to prevent an arbitrator from issuing an award on a debt that had passed the statute of limitations, a so-called "zombie debt." Once that award has been obtained, the creditor can secure a judgment in court confirming the award—effectively laundering it into a valid debt. This possibility is deeply troubling when one considers that as much as \$100 billion dollars worth of debt purchased in 2008 was "junk debt" that was not actually due.<sup>30</sup> The bulk of zombie debt is from credit cards.<sup>31</sup> Therefore, the original contracts likely contained forced arbitration clauses, a nearly universal practice among credit card issuers, and debt collectors may be pursuing roughly \$100 billion of unlawful debt in a forum that has a tendency to rubber-stamp their claims.

Arbitration also makes it easier for debt collectors and creditors to obtain judgments in cases that are disputed, particularly cases that involve mistaken identity or identity theft. Our report examined NAF's credit card arbitrations, finding that corporations beat consumers almost 94 percent of the time. In one of those cases NAF ordered a New Hampshire man, Troy Cornock, to pay MBNA \$9,446.85, despite the fact that the man's ex-wife had actually opened the account, and NAF and MBNA had sent all of their correspondence to his ex-wife's address.<sup>32</sup> MBNA presented the arbitrator with no evidence of a credit card agreement or credit card receipt with the alleged borrower's signature on it, but was able to take the arbitration award to court and secure a judgment.<sup>33</sup>

Anastasyia Komarova was living in San Francisco in 2005 when she was notified that NAF had issued an award for \$11,214.33 against her for an MBNA account. It turned out that the MBNA account belonged to a woman with a similar first name, and that MBNA was aware of the mix-up, but the debt collector that they hired had proceeded in arbitration and obtained a judgment against her anyway. In response to this and many other California cases, the San Francisco City Attorney has filed suit against NAF and Bank of America for "operating an arbitration mill, churning out arbitration awards in favor of debt collectors and against California

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<sup>29</sup> Berner & Grow, *supra*.

<sup>30</sup> See *Zombie Debt: The Bills That Just Won't Die*, ABC NEWS, Feb. 28, 2008, <http://abcnews.go.com/GMA/Story?id=4358702&page=1>.

<sup>31</sup> See Eileen Ambrose, *Debt Can Come Back to Haunt You Years Later*, BALTIMORE SUN, May 6, 2007.

<sup>32</sup> See PUBLIC CITIZEN, THE ARBITRATION TRAP at 11-12.

<sup>33</sup> *Id.*

consumers.”<sup>34</sup> According to the City Attorney’s office, the case is in the discovery phase and litigation is progressing slowly. NAF has asserted arbitral immunity from any lawsuits, a doctrine that ordinarily immunizes arbitrators from claims by the parties to the arbitration. Bank of America has asserted the defense that all local consumer protection actions against banks—including this suit involving only arbitration and no banking laws—are preempted by the Office of the Comptroller of Currency’s exclusive oversight authority of federally chartered banks under the National Bank Act.<sup>35</sup>

### **C. Forced Arbitration Undermines Existing Law and Stymies the Development of the Law.**

Prior to 1985, statutory causes of action reflecting “important public policies” were exempt from mandatory arbitration.<sup>36</sup> A series of Supreme Court decisions from 1985 to 1991 reversed that rule.<sup>37</sup> Important legal protections are now undermined because they are subject to forced arbitration—before arbitrators who are not required to follow the law. Consumer lending laws like the Truth in Lending Act (TILA), Fair Credit Reporting Act, Fair Debt Collection Practices Act (FDCPA), Equal Credit Opportunity Act (ECOA), and Credit Repair Organizations Act (CROA) are all subject to arbitration, leaving them vulnerable to under-enforcement. Future consumer protection and reform efforts will also be undermined by forced arbitration. For example, the valuable reforms in the Credit Cardholders’ Bill of Rights, sponsored by Rep. Carolyn Maloney and Sens. Charles Schumer and Tom Udall, amend TILA. The provisions of this bill might be skirted or ignored by lenders, and consumers who are subjected to arbitration will have virtually no recourse against these violations.

Forced arbitration also hampers the development of the law. The secretive nature of arbitration, including the lack of a written opinion explaining the arbitrator’s interpretation of the law and its application to particular facts, undermines the benefits of transparent public court hearings. Open litigation serves important functions such as educating the public about potential harms and providing a record of how the law is being interpreted and applied. Without this process, the Congress has little way of assessing how laws are applied and whether improvements are needed. The public also loses the benefit of learning facts that might spur political or legal reforms.<sup>38</sup>

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<sup>34</sup> Sam Zuckerman, *S.F. Sues Credit Card Service, Alleging Bias*, S.F. CHRONICLE, Apr. 8, 2008 at D-1.

<sup>35</sup> See 12 C.F.R. § 7.4000.

<sup>36</sup> David S. Schwartz, *If You Love Arbitration, Set It Free*, 8 NEV. L.J. at 406.

<sup>37</sup> *Id.*

<sup>38</sup> See Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1662-63 (2005).

### **III. Forced Arbitration Proponents Have Failed to Demonstrate That Forced Arbitration Benefits Consumers.**

#### **A. In Forced Arbitration, Consumers Win Less Frequently and Are Awarded Less of What They Seek Than Businesses.**

The claim that arbitration is better and fairer for consumers than bringing claims before a judge or jury rings hollow when it comes from the same credit card companies that invented practices like universal default and “any time, any reason” interest rate increases. That these firms would look out for consumers’ best interests regarding the justice system is simply not credible.

It also defies the evidence. There is no empirical evidence to support the conclusion that individual plaintiffs fare better in arbitration than they do in court. Our 2007 Arbitration Trap report found that consumers lose an astounding 94 percent of credit card arbitrations before NAF.<sup>39</sup> A number of industry-backed studies have attempted to refute these findings, however, each of these studies largely suffers from the same three shortcomings: over-counting consumer “victories”; unreliably small sample size; and complete lack of verifiability.<sup>40</sup>

The Searle Center study conducted by Professor Drahozal has been touted as strong, cutting-edge, empirical evidence that arbitration is fair. But there is nothing new about this study or its findings. First, the study focuses on AAA, which has been a focus of most industry studies of arbitration.<sup>41</sup> One obvious shortcoming is that AAA handles relatively few consumer cases,<sup>42</sup> with banks and other lenders preferring the services of the notorious “arbitration mill” NAF. Traditionally, AAA has handled more employment disputes and contractual fights between companies;<sup>43</sup> therefore it is hardly representative of the entire arbitration industry.

The Searle Center study is also similar to earlier industry-supported studies because its overly broad conclusion that arbitration is good for consumers is simply not supported by its own findings.<sup>44</sup> The Searle Center study found that consumers received an award in 53 percent of the cases they initiated and received about 52 percent of the amount they sought in those cases.<sup>45</sup> Businesses received an award in 84 percent of cases they brought and won 93 percent of what they asked for in those cases.<sup>46</sup> This means that businesses received roughly 78 percent of what they

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<sup>39</sup> See PUBLIC CITIZEN, THE ARBITRATION TRAP at 4.

<sup>40</sup> See generally, PUBLIC CITIZEN, THE ARBITRATION DEBATE TRAP 8-12 (2008) at [www.citizen.org/publications/release.cfm?ID=7589&secID=1052&catID=126](http://www.citizen.org/publications/release.cfm?ID=7589&secID=1052&catID=126).

<sup>41</sup> See David S. Schwartz, *Mandatory Arbitration and Fairness*, 84 NOTRE DAME L. REV. 101, 135-36 (2009).

<sup>42</sup> See Berner & Grow, *supra* (“[AAA] says it handled 8,358 consumer arbitration cases in 2007.”).

<sup>43</sup> *Id.*

<sup>44</sup> See PUBLIC CITIZEN, THE ARBITRATION DEBATE TRAP at 13-23.

<sup>45</sup> See SEARLE CIVIL JUSTICE INSTITUTE, CONSUMER ARBITRATION BEFORE THE AMERICAN ARBITRATION ASSOCIATION 109 (2009) at [http://www.searlearbitration.org/p/full\\_report.pdf](http://www.searlearbitration.org/p/full_report.pdf).

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

sought compared to 28 percent for consumers. Both in success rates and award amounts, AAA arbitrations appear to be heavily slanted in favor of businesses.

We are also concerned about the study's reliance on data that comes only from the company, and is not publicly available. In a report that we released last year, Public Citizen attempted to duplicate AAA's 2007 findings that individuals prevailed in 48 percent of consumer-initiated arbitrations by analyzing reports it published as required under California law.<sup>47</sup> Unfortunately, we could discern the victorious party only in approximately 7 percent of the cases.<sup>48</sup> AAA left the "prevailing party" field—a required disclosure—blank in more than 90 percent of the cases it had reported.<sup>49</sup>

Recently, we analyzed AAA's disclosures to the state of California again, examining just over 61,000 cases reported since 2004. Of these, more than 45,000 since September 2007 were filed by Midland Credit Management, a Kansas-based collection agency. AAA arbitrators have provided Midland the precise amount sought—to the penny—in 87 percent of the cases in which they have issued a ruling. Overall, AAA has given Midland more than 94 percent of the amounts it has sought. Midland is notorious for aggressive collection tactics,<sup>50</sup> making it highly unlikely that its claims are consistently fair and accurate.

NAF arbitrators also award creditors nearly all that they request.<sup>51</sup> One former NAF arbitrator reported that NAF provided him with an award form with the amount sought by the creditor already filled in.<sup>52</sup> Arbitration companies also routinely award exorbitant attorney's fees in their collection cases. In one case concerning an alleged debt of \$29,000, the debt collector sought "reasonably anticipated" attorney fees of about \$11,000—about one-third of the underlying debt. The NAF arbitrator awarded the collector a total of \$45,773 based on no evidence other than what was provided by the debt collector. In another case, NAF

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<sup>47</sup> PUBLIC CITIZEN, THE ARBITRATION DEBATE TRAP at 12.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> See, e.g., *Martinez V. Midland Credit Management, Inc.*, 250 S.W.3d 481 (Tex.App.-El Paso 2008). In this case, Midland sought \$2,077 from a woman named Marina Martinez for a purported debt of hers that it had purchased. After a trial court granted summary judgment in Midland's favor, a Texas appeals court found that Midland had not indicated "in any way" that it had knowledge of the record-keeping policies of the predecessor businesses from which it had purchased the debt. The appeals court ruled that "Midland offered no admissible evidence concerning its claim" and dismissed the trial court's ruling. In another case, *Wahl v. Midland Credit Management, Inc.*, 556 F.3d 643 (7th Cir. 2009), Midland tried to collect \$1,149 on a stroke victim's credit card account for a card that had not been used since its balance stood at \$66.98. In fact, the card issuer had been so zealous in applying interest and fees that it pushed the card's amount due from \$66.98 to nearly \$1,000 in just four years. After Midland acquired the debt, it claimed that all \$1,149 was "principal" because that is where the debt stood when Midland took possession.

<sup>51</sup> See PUBLIC CITIZEN, ARBITRATION TRAP at 23 (documenting the case of NAF arbitrator Steven Bromberg, who considered 77 cases on two selected days, and awarded creditors 96.7 percent of the total amount requested).

<sup>52</sup> Berner & Grow, *supra*.

awarded “attorneys fees” of \$10,631.62 on an alleged debt of \$25,798.16. NAF awarded the full amount of fees, despite the fact that the debt collector’s request form was signed by an “arbitration manager,” not an attorney. Attorney’s fees of 33 percent are extraordinary for a process that requires no actual attorney work or documentation and is routinely touted as fast, cheap, and easily navigable without representation. With arbitration firms like NAF, and now apparently AAA, routinely awarding them the full amount that they request, with no questions asked, creditors and debt collectors have scant incentive to treat consumers fairly. In fact, they have every incentive to gouge consumers, even making illegal claims.

## **B. Forced Arbitration Reduces Access to Justice.**

Arbitration is harmful to consumers because it reduces access to justice. The argument that it provides people greater access to justice is appealing, but there is no evidence that one could present to either prove or disprove the point. The win rates and reduced award amounts mentioned above do not measure the number of Americans who are deterred from bringing claims in the first place. Any consumer who consults with a lawyer prior to arbitration will be told that they will face almost insurmountable odds in arbitration. No lawyer can, in good conscience, accept a case that they know to be stacked against consumers, and few consumers pursue claims that legal experts have told them are hopeless.

The blanket argument that all litigation is costly for the individual is misleading. Many small claims filing fees are quite low. Many federal statutes also provide for attorneys fees, making it possible for individuals to pay for counsel and bring claims when they would not otherwise be able to.<sup>53</sup>

The pricing scheme of arbitration also hinders individuals’ ability to bring claims. Neither the company nor the arbitration provider has any incentive to make arbitration cheap or easy. Customers who are angry enough to take a company to court or arbitration are unlikely to give repeat business to that company, so the company has no reason to cater to their needs. Arbitration companies seeking repeat business actually have an incentive to charge *higher* prices to satisfy the corporations that write them into form contracts.<sup>54</sup> Competitive arbitration pricing is an anathema to the primary purpose of arbitration provisions for large corporations, which is stopping any form of dispute resolution.<sup>55</sup> Since large

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<sup>53</sup> *E.g.*, Civil Rights Act of 1964, 42 U.S.C. § 2000e-5(g)(2)(B)(i); Fair Debt Collection Practices Act, 15 U.S.C. § 1692k(a)(3).

<sup>54</sup> See Cary Ichter, *The Special Master Solution To The Hall Street Blues: The Use Of Special Masters As An Alternative To Arbitration*, METRO. CORPORATE COUNSEL, Jan. 2009 at 15 (“Dispute resolution providers have little interest in introducing competitive pricing or any other mechanism to reduce transactional costs of dispute resolution because their principle business sources—the companies that write the arbitration clauses—benefit from higher transactional costs. The higher the transactional cost of arbitration, the lower the probability that arbitration claims will be asserted against them.”).

<sup>55</sup> See *id.*

companies can easily afford any costs that they might be forced to pay, the high-priced fee structure of arbitration only serves to deter individual lawsuits.

Our 2007 report compared the costs, excluding attorneys fees, associated with an arbitration proceeding and a court case involving the same issues and the same termite company. The parties in arbitration incurred \$24,000 in costs, as compared to \$563 paid by the party who took her claim to court. In securities arbitration, securities firms use costly motions to dismiss against individual investors. The Financial Industry Regulatory Authority (FINRA), the private securities regulatory body, recently placed a limit on the number of motions to dismiss that a party can file, in order to prevent companies from repeatedly filing such motions to run up arbitration costs.<sup>56</sup> The pricing structure of arbitration is clearly structured to favor large businesses over individuals.

Unreasonable arbitration fee structures can be particularly useful to manufacturers of low-cost consumer products. Take the example of the computer manufacturer Gateway, whose arbitration clause employed a fee schedule that required a \$2,000 nonrefundable up-front payment plus a loser-pays requirement for the prevailing parties filing fee and attorneys fees.<sup>57</sup> Under this “heads I win, tails you lose” structure, a consumer with a defective computer would have to pay \$2,000 *even if successful*, and at least \$4,000 (plus attorneys fees) in the event that they lost. Since most computers cost less than \$2,000, it’s hard to imagine a scenario in which consumers would have an incentive to participate in arbitration.

The cost of arbitration is less important in some cases. Certain high-probability, low-magnitude harms, like overcharging fees on credit cards and other consumer products,<sup>58</sup> can be challenged only through consumer class actions.<sup>59</sup> In industries where these high-probability, low-magnitude harms are more likely to occur, arbitration clauses often provide that the corporation will pay all or part of the arbitration fees, but include a prohibition on consumer class actions. Companies include the fee provision to make the class action ban appear reasonable.<sup>60</sup> By banning class actions, consumer service providers, like credit card companies, deter

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<sup>56</sup> See Suzanne Barlyn, *SEC OKs Changes to Motion-To-Dismiss Rule*, WALL STREET J., Jan. 8, 2009 (“Finra has received complaints that parties—most often securities firms—were filing dispositive motions routinely and repetitively, causing increased costs for claimants, who are typically retail investors, according to a statement.”).

<sup>57</sup> See Jeff Sovern, *Toward a New Model of Consumer Protection: The Problem of Inflated Transaction Costs*, 47 WM. & MARY L. REV. 1635, 1649-50 (2006) (citing *Brower v. Gateway 2000, Inc.*, 246 A.D.2d 246 (1998)).

<sup>58</sup> See Bar-Gill & Warren, *supra*, at 77; see also *Ross v. Bank of America, N.A.*, 524 F.3d at 224 (2008) (“[A]ctions that result in significant aggregate revenue to the banks (concerning, e.g., late fees, overlimit fees, foreign transaction fees, APR, etc.) generally harm individual consumers in only small amounts[.]”)

<sup>59</sup> See *Scott v. Cingular Wireless*, 161 P.3d 1000, 1005 (Wash. 2007) (“As we have noted before, when consumer claims are small but numerous, a class-based remedy is the only effective method to vindicate the public's rights.”).

<sup>60</sup> See P. Christine Deruelle & Robert Clayton Roesch, *Gaming the Rigged Class Arbitration Game: How We Got Here and Where We Go Now—Part II*, METRO. CORPORATE COUNSEL Sept. 2007 at 5.

consumers from bringing claims that are feasible only if brought on a class basis.<sup>61</sup> They have effectively immunized themselves because, as Judge Richard Posner has said, “[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>62</sup>

The disincentives to arbitrate must be strong because consumers rarely file arbitration claims. Between 1998 and 2000 only four consumers filed arbitration claims against the credit card company First USA, compared to 51,622 arbitration claims filed by First USA against its consumers.<sup>63</sup> Our 2007 report found that consumer brought only 118 claims out of 33,948 credit card arbitrations before the NAF between 2003 and 2007.<sup>64</sup> The number of consumer claims is likely to decrease even further as the economy continues to sour and the cost becomes even more prohibitive.

### **C. Forced Arbitration’s Purported Speed Is of Little Value to Consumers, and Arbitration May in Fact Be Slower than Court.**

Forced arbitration proponents argue that arbitration is faster for consumers than court. This speed harms consumers when arbitrators act as nothing more than a rubber stamp for companies and consider around forty cases in one day.<sup>65</sup> NAF boasts to its corporate clients that the procedural “flexibility” of arbitration can be used to their advantage, advising them that they may request stays and dismissals of actions to “control process and timeline.”<sup>66</sup> None of this provides efficiency benefits to consumers.

Moreover, there is some reason to believe that the arbitration process may take longer than court proceedings. Industry arbitration studies routinely count settlements and dismissals in arbitration to pad the supposedly consumer-friendly

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<sup>61</sup> See Bar-Gill & Warren, *supra*, at 78 (“The widespread inclusion of arbitration clauses in standard credit card contracts inoculates lenders against the possibility of class action lawsuits, which would otherwise change the economics of pursuing debtor’s rights.”); see also Scott, 161 P.3d at 1007-08 (“We . . . conclude that since this clause bars any class action, in arbitration or without, it functions to exculpate the drafter from liability for a broad range of undefined wrongful conduct, including potentially intentional wrongful conduct[.]”). Ironically, consumer service providers actually disfavor arbitration when it is conducted on a class basis. See Eisenberg, Miller & Sherwin, *supra*, at 884 (finding that 60 percent of consumer contracts that contained mandatory arbitration clauses voided the arbitration clause if the arbitration process allowed for classwide activity); see also Christine Deruelle & Robert Clayton Roesch, *Gaming the Rigged Class Arbitration Game: How We Got Here and Where We Go Now—Part I*, METRO. CORPORATE COUNSEL Aug. 2007 at 9 (“Recent developments in class arbitration law have left ‘defendants with the worst of all worlds—the threat of a class action in a forum without the procedural, evidentiary and appellate protections available through the judicial process.’”).

<sup>62</sup> *Carnegie v. Household Int’l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).

<sup>63</sup> Sternlight, *supra*, note 8, at 1655.

<sup>64</sup> PUBLIC CITIZEN, ARBITRATION TRAP at 15.

<sup>65</sup> See *id.* at 23 (documenting the case of NAF arbitrator Steven Bromberg, who considered 77 cases on two selected days, finding for credit card company MBNA in 76 of those cases).

<sup>66</sup> Berner & Grow, *supra*.

outcomes.<sup>67</sup> But industry studies comparing case lengths omit settlements and dismissals in litigation.<sup>68</sup> Settlements and dismissals are final dispositions, and they should be counted along with cases resolved at trial. Additionally, one study simply excluded the arbitrations that were longest in duration: a 2003 study of 998 AAA employment arbitrations filed in 1999-2000 omitted the 632 arbitrations that were decided after 2000.<sup>69</sup> Essentially, this study removed all of the slowest cases because they were taking too long, and only measured the fastest third of the cases. When one considers all of the cases that are filed and all of the venues in which they are filed, such as small claims courts and administrative bodies, there is reason to believe that non-arbitral forums may actually be quicker than arbitration.<sup>70</sup>

#### **D. Arbitration Raises Costs for Consumers Rather Than Lowering Them.**

Many businesses argue that they will be forced to impose additional costs on consumers if Congress curbs forced arbitration. But during the period when forced arbitration proliferated throughout the credit card industry, fees and interest rates only increased.<sup>71</sup> Moreover, consumer class actions, which forced arbitration prevents, have demonstrably reduced costs for consumers by forcing credit card issuers to reduce fees.<sup>72</sup>

We have seen arguments like this one before, in which businesses have argued that a so-called “tort reform” measure—and forced arbitration is undeniably a “tort reform” mechanism—would result in reduced costs for goods and services.<sup>73</sup> They were wrong then as well. For example, sponsors of several “tort reform” bills in Texas in the late 1990s alleged that the legislation saved consumers and businesses \$3 billion in insurance premiums.<sup>74</sup> Data actually shows that insurance premiums were not significantly reduced by the legislation, and insurance companies’ profits increased due to a \$600 million reduction in costs from a combination of the legislation, safer driving, and safer cars.<sup>75</sup> The Congressional Budget Office has estimated that other proposed medical tort reform measures would have a negligible impact on medical costs.<sup>76</sup> The same report found that

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<sup>67</sup> See PUBLIC CITIZEN, *THE ARBITRATION DEBATE TRAP* at 13-23.

<sup>68</sup> David S. Schwartz, *Mandatory Arbitration and Fairness*, 84 NOTRE DAME L. REV. at 163.

<sup>69</sup> *Id.* at 164.

<sup>70</sup> *Id.* at 164-65.

<sup>71</sup> See *supra* § I.

<sup>72</sup> See Public Citizen, *Six Common Transactions That Cost Less Because of Class Actions* (Aug. 30, 2003), at <http://www.citizen.org/congress/civjus/archive/classaction/articles.cfm?ID=10278>.

<sup>73</sup> See, e.g., Letter from Bruce R. Josten, Executive Vice President, United States Chamber of Commerce, to United States Senate in Support of the Class Action Fairness Act, July 6, 2004 at <http://www.uschamber.com/issues/letters/2004/040706classactionfairness.htm> (“This legislation is needed because of the significant increase in national class action lawsuits filed in state courts . . . have significant adverse effects on our economy such as higher prices for goods and services[.]”).

<sup>74</sup> See Richard A. Oppel Jr. & Jim Yardley, *Bush Calls Himself Reformer; the Record Shows the Label May Be a Stretch*, NY TIMES, Mar. 20, 2000, at A16.

<sup>75</sup> See *id.*

<sup>76</sup> See CONG. BUDGET OFFICE, *LIMITING TORT LIABILITY FOR MEDICAL MALPRACTICE 6 (2004)* (“Malpractice costs amounted to an estimated \$24 billion in 2002, but that figure represents less than 2 percent of

“many reported reductions in supply by health care providers could not be substantiated or ‘did not widely affect access to health care.’”<sup>77</sup> These experiences cast doubt on the reliability of claims that prohibiting forced arbitration in consumer contracts would raise consumer costs.

Arbitration is cheaper for one group: businesses. The problem for Americans is that they can’t afford not to fight back against predatory practices, but they also can’t afford to go to arbitration. Between high costs, bans on consumer class actions, and pro-corporate bias, there is no justice in the fine print for individuals when an arbitration clause is included in their credit card contracts.

### **III. The Solution: Ban Forced Arbitration.**

Advocates of forced arbitration paint advocates of voluntary consumer arbitration as “anti-arbitration.” This is simply not the case. We object to the unfair practice of *forcing* people into arbitration as a condition for service, before any dispute has arisen. We support the Arbitration Fairness Act, sponsored by Representative Hank Johnson and Senator Russ Feingold,<sup>78</sup> which would give consumers a meaningful choice between going to arbitration or court. Industry-funded studies that attempt to show benefits of forced arbitration are deeply flawed, and they are a distraction. Common sense says that forced arbitration is unfair. If a particular type of arbitration were truly good for consumers, then corporations shouldn’t have to force it on them.

Indeed, prohibiting corporations from forcing consumers into arbitration is a market-based solution: When consumers can choose whether to arbitrate, and where, arbitration companies must compete for their business. When arbitration is post-dispute—and therefore *voluntary*—arbitration companies must offer a fair process that both parties would choose willingly.

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overall health care spending. Thus, even a reduction of 25 percent to 30 percent in malpractice costs would lower health care costs by only about 0.4 percent to 0.5 percent, and the likely effect on health insurance premiums would be comparably small.”).

<sup>77</sup> *Id.* at 7.

<sup>78</sup> H.R. 1020; S. 931.