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Testimony Presented at the Hearing on: The Federal Arbitration Act: Is the Credit Card Industry Using it to Quash Legal Claims?

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INTRODUCTION

Mr. Chairman, Congressman Franks, honorable members of the Committee, thank you for the opportunity to participate in this important hearing. The current system of binding, mandatory arbitration, while perhaps once motivated by an admirable desire to create a fair and efficient system of voluntary and consensual alternative dispute resolution, has exploded in recent years and expanded far beyond its original purposes. Pervasive use of mandatory arbitration provisions in consumer contracts has turned an "alternative" form of dispute resolution into the only form of dispute resolution for the millions of consumers who use credit cards, cellular phones, and other products.[2] Considering that arbitration clauses are ubiquitous throughout the credit card industry and that most credit card companies include arbitration clauses in standard-form, adhesive, "take it or leave it" contracts in which the consumer has no opportunity to negotiate specific terms, the current arbitration system cannot be classified as

[2] Today, all of the largest credit card companies in the U.S. have binding arbitration clauses, and it is very hard to find any credit card issuer that does not have such a clause. *See, e.g.*, Consumers Union, *Best and Worst Credit Cards*, Consumer Reports, Oct. 2007; Day to Day, *Marketplace Report: Credit Disputes Favor Companies* (NPR radio broadcast Sept. 28, 2007) (available at 2007 WLNR 19048094) ("[I]t's often hard to find a credit card that doesn't make arbitration mandatory."); Simone Baribeau, *Consumer Advocates Slam Credit-Card Arbitration*, CHRISTIAN SCI. MONITOR, July 16, 2007 ("[I]f you own a credit card, chances are you have a mandatory arbitration clause.").

The credit card industry and financial services sector are not alone in requiring consumers to give up their right to go to court. Arbitration clauses have been added to take-it-or-leave-it contracts for many other consumer goods and services, including cell phones, residential phone service, computers, insurance, car sales, rental cars, mortuary services, pest control, and securities broker services.

Mandatory arbitration is also growing rapidly as a requirement for patients to receive necessary medical services, and millions of Americans are required by their employers to submit all claims – wage and hour claims and civil rights claims among others – to binding arbitration. *See, e.g., Garrett v. Circuit City Stores*, 449 F.3d 672 (5th Cir. 2006) (employer's arbitration clause required military reservist to arbitrate his claim that employer did not preserve his job when he was sent to Iraq).

voluntary in any meaningful sense. Many companies – and credit card companies in particular – have used binding, mandatory arbitration to opt-out of the public justice system and to replace it with a process that is closed to the public, insulated from any meaningful review, and unaccountable to the democratic process. The inevitable victims of this truncation of democratic principles are the individual consumers who are bound by these clauses.

Simply put, the current arbitration regime undermines many of the most basic democratic values underlying our system of government, and it is a regime that only Congress can correct. In addressing the effects of mandatory arbitration, this testimony will make the following points:

- Forced arbitration stunts the development of legal principles because arbitrators are not required to give written reasons for their decisions and because their decisions do not create binding law. The lack of reasoned, precedential decisionmaking also threatens to undermine any purported efficiency gains from arbitration because parties likely will end up re-litigating the same issue over and over instead of resolving that issue once and for all in a single, precedential judicial decision.
- The lack of meaningful review of arbitrators' decisions, judicial or otherwise, reduces public confidence in the fairness of mandatory arbitration. Arbitration decisions, except in a few narrowly-defined circumstances, are virtually immune from review, even where the arbitrators ignore the relevant law or the facts of the case.
- Only Congress can act to correct the deficiencies in the arbitral process. The Supreme Court's overly broad interpretation of the preemptive effect of the Federal Arbitration Act (FAA) precludes state legislatures from addressing arbitration and limits judicial authority to determine whether arbitration clauses are unfair or unenforceable.

- Although corporations tout forced arbitration as a fairer, cheaper, and more efficient alternative to litigation, their own behavior belies their position. When corporations fear that they may face substantial damages, such as in a class action lawsuit, they prefer the procedural protections and judicial review of the legal system to arbitration. This behavior suggests that such corporations do not use arbitration clauses because they view arbitration as a superior forum to litigation, but because they desire to keep consumer disputes from reaching any forum whatsoever, arbitral or otherwise.

I. Mandatory Arbitration and Undermines Public Confidence and Hinders the Development of the Law.

The closed, opaque nature of mandatory arbitration demonstrates how arbitration is inconsistent with democratic values of openness and accountability. Many fundamental aspects of the judicial system that we take for granted are absent from the arbitration process. First, our judicial system is open to the public whereas arbitration is not. In general, anyone is free to attend court hearings and trials, and court documents are part of the public record and available for public inspection. Judges not only resolve disputes, but they give written and oral reasons for their decisions that allow both litigants and the public to evaluate whether judges have acted fairly. An open judicial system prevents disputes from being resolved in secret, allows the public to act as a check against judicial abuse and misconduct, and inspires public confidence that the judicial system is fair.[3] A high level of openness is crucial, because the legitimacy of

[3] The Supreme Court has repeatedly emphasized the importance of permitting public access to trials and court proceedings. *See, e.g.*, Richmond Newspapers, Inc. v. Va., 448 U.S. 555, 572-73 (1980) ("[W]here the trial has been concealed from public view an unexpected outcome can cause a reaction that the system at best has failed and at worst has been corrupted. . . . People in an open society do not demand infallibility from their institutions, but it is difficult for them to accept what they are prohibited from observing."); Sheppard v. Maxwell, 384 U.S. 333, 349

any binding dispute resolution tribunal ultimately rests on the acceptance of that tribunal by the public.[4]

Arbitration, by contrast, is a purely private process that gives little reason to inspire public trust and confidence.[5] Arbitration hearings are not open to the public. Arbitrators need not, and often do not, provide written decisions explaining why they reached a particular result.[6] Moreover, "unlike a judge, an arbitrator is neither publicly chosen nor publicly accountable."[7] Some arbitration providers even add an extra layer of secrecy by requiring parties to a dispute to keep the proceedings confidential.[8] Arbitration providers also have resisted publicly disclosing information statistics regarding their arbitrators' decisions, making disclosures only where state law requires them to do so.

This lack of transparency has significant consequences. Closed proceedings, arbitrator-mandated secrecy, and an absence of written decisions prevent both the public as well as arbitration participants from monitoring the fairness of the arbitration process, and from holding arbitrators' accountable for their decisions. Shielding the arbitration process from exposure and

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(1966) ("The principle that justice cannot survive behind walls of silence has long been reflected in the Anglo-American distrust for secret trials.").

[4] "It is the confidence in the men and women who administer the judicial system that is the true backbone of the law." Bush v. Gore, 531 U.S. 98, 128 (2000) (Stevens, J., dissenting).

[5] *See generally,* Richard C. Reuben, *Democracy and Dispute Resolution: The Problem of Arbitration*, 67 LAW & CONTEMP. PROBS. 279, 298-302 (2004).

[6] *See* United Steelworkers of Am. v. Enter. Wheel & Car Corp., 363 U.S. 593, 598 (1960); Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 397-98.

[7] Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1476 (D.C. Cir. 1997).

[8] *See, e.g.*, Am. Arbitration Ass'n, Employment Arbitration Rules & Procedures, Rule 23, *available at* www.adr.org/sp.asp?id=28481; JAMS Streamlined Arbitration Rules & Procedures Rule 23; National Arbitration Forum Code of Procedure Rule 4.

scrutiny signals to the public that arbitrators have little concern for the law that they ostensibly apply and that arbitrators are motivated more by results than by fairness. Eliminating any requirement that arbitrators justify their decisions by providing written reasons sends the message that even the arbitrator may not have full confidence that his or her decision is correct. Even if arbitrators do not actually proceed in such a results-oriented fashion, as long as the public is given reason to believe that they do, public confidence in arbitration as a fair dispute resolution system will be badly damaged.

In addition to diminishing public confidence in a fair and impartial justice system, mandatory arbitration also hinders the development of the law. The law grows and evolves in large part through written, reasoned judicial decisions that explain, clarify, and expound on legal principles. Since *Marbury v. Madison* was decided more than 200 years ago, it has been the role of the judiciary to "say what the law is."[9] Our courts operate in a common-law tradition in which legal principles evolve as judges adapt and interpret the law to meet new situations and changing practices. But judges do more than just build common-law. They also engage in a dynamic relationship with legislative bodies by interpreting ambiguous statutes, by issuing public decisions that signal to lawmakers when legislative reform might be warranted, and by grappling with difficult questions that legislatures may specifically leave for courts to decide. Moreover, judicial decisions communicate important values not only to judges and lawmakers, but also to the public. Specifically, written decisions and public hearings "educate the public and potential wrongdoers about how the law is being interpreted, thereby deterring potential wrongdoers from violating the law, educating victims as to their rights, and inviting the public to

[9] Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803).

take action to help reform the law should it not be satisfied with the public results."[10] Each of these important functions, however, depends on judges issuing written, precedential decisions that explain the law and provide rules to govern future disputes.

Arbitration shares none of these characteristics and therefore threatens to stagnate the development of legal principles. Not only do arbitrators have no obligation to provide reasoned decisions, their decisions, written or otherwise, have no binding effect on courts, other arbitrators, or even themselves.[11] The result is that the law does not grow, no guidance is provided to other courts, arbitrators, or litigants, and legislatures remain in the dark as to whether their enactments are being interpreted correctly or are effectively addressing the problems they intended to address. Arbitration also makes it much more difficult for either legislatures or the public to learn of, and respond to, corporate wrongdoing. Arbitration decisions, especially when they remain private, will not exert the same deterrent effect as public, binding judicial decisions. In other words, arbitration stifles not just the common-law process, but the legislative process as well.

Such a result is regrettable enough when limited to disputes involving private law, but arbitration clauses are now written so broadly as to also sweep in important public rights, such as rights against employment discrimination and consumer fraud. As the Chief Justice of the Texas Supreme Court, Wallace Jefferson, recently stated, "A privately litigated matter may well affect public rights. . . . Its resolution may ultimately harm the public good or, because those decisions

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[10] Jean R. Sternlight, *Creeping Mandatory Arbitration: Is it Just?*, 57 STAN. L REV. 1631, 1662 (2005).

[11] *See, e.g.*, IDS Life Ins. Co. v. SunAmerica Life Ins. Co., 136 F.3d 537, 543 (7th Cir. 1998) ("[A]rbitrators' decisions are not intended to have precedential effect even in arbitration (unless given that effect by contract), let alone in the courts.").

are secret, impede innovation to a recurring problem, much to the detriment of Texas citizens."[12] Given the near-universal presence of arbitration clauses in credit card and other consumer contracts, forced arbitration removes entire areas of consumer protection law from the judicial system and thus prevents the law from evolving to keep up with new and changing predatory and illegal practices.

Finally, because arbitration decisions are not precedential, moving cases out of court and into arbitration undermines any purported efficiency gains from the arbitration process. One of the advantages of a hierarchical judicial system that creates binding precedent is predictability – a single decision can define a legal rule that governs all lower courts within that jurisdiction. Clear decisions setting out legal rules will help future parties conform their behavior to the law and will reduce future lawsuits because parties will have know what the law permits and forbids. Arbitration, by contrast, may lead to re-litigation of the same issue over and over because (a) parties will have little guidance regarding their rights and responsibilities, and (b) even if they do, they know that arbitrators are not required to rigidly apply the law and are perfectly free to reach different results in similar cases. Moreover, arbitration undermines efficiency because the closed nature of each individual proceeding requires attorneys to engage in duplicative discovery practices and prevents attorneys from sharing evidence across individual cases. This not only leads to wasteful repetition, it also disproportionately harms consumers, who often do not have the same access to information as corporate defendants.[13]

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[12] Mike Ward, *Texas' Chief Justice Calls for Overhaul of Courts*, AUSTIN AMERICAN-STATESMAN, Feb. 21, 2007.

[13] *See, e.g.*, Jean R. 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

II. Arbitration Undermines Democratic Values By Insulating Arbitrator's Decisions From Meaningful Review.

Another hallmark of our judicial system is that it creates accountability through the process of judicial review. The judicial system protects against arbitrary decisionmaking by giving litigants an opportunity to seek review of an initial decision, usually to a panel of three judges. Meaningful review is such an important value that virtually every state as well as the federal government provides for an appeal as a matter of right, and for criminal defendants, the Constitution guarantees the right to be represented on appeal by competent counsel.[14]

Judicial review of arbitrators' decisions, however, is not "review" in any meaningful sense. Rather it 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).[15] Consider the following examples:

- The U.S. Court of Appeals for the Seventh Circuit remarked that courts should not review arbitrators' interpretations of contracts even if they are "wacky," so long as the arbitrator

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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)).

[14] Douglas v. People of the State of Cal., 372 U.S. 353 (1963).

[15] *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) ("Judicial review of arbitration awards is tightly limited."); *IDS Life Ins. Co.*, 136 F.3d at 543 ("[J]udges 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).

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 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 U.S. Court of Appeals for the Eleventh Circuit stated that parties who challenge arbitration awards should be sanctioned more often for asking for judicial review, and that this would be "an idea worth considering" in order to discourage future challenges to arbitration. *B.L. Harbert International, LLC v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006).

Moreover, the current trend favors restricting judicial review even further. Some federal courts of appeals have interpreted the U.S. Supreme Court's recent decision in *Hall Street*

Associates v. Mattel, 128 S. Ct. 1396 (2008), as eliminating a court's ability to vacate an arbitrator's decision, even when the arbitrator acts in "manifest disregard" of the law.[16]

The lack of meaningful review is dangerous on several fronts. First, it merely reinforces the perception that arbitration is a private system of justice that is unaccountable either to the public or to any branch of government. Second, it reduces transparency by further discouraging arbitrators from providing reasoned decisions, because without any reasoning, there is no basis for a party to attack those decisions.[17] Third, and perhaps most importantly, the lack of review may discourage individuals injured by corporate misconduct from initiating an arbitration in the first place. The fear of having to pay opposing parties' attorneys' fees and costs if they lose without any opportunity to effectively appeal the decision may make arbitration too risky a proposition for most consumers.[18] In sum, the lack of meaningful review exacerbates some of mandatory arbitration's most fundamental shortcomings.

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[16] *See* Citigroup Global Mkts, Inc. v. Bacon, __F.3d__, 2009 WL 542780 (5th Cir. Mar. 5, 2009) (holding that "manifest disregard of the law is no longer an independent ground for vacating arbitration awards"); Ramos-Santiago v. United Parcel Serv., 524 F.3d 120, 124 n.3 (1st Cir. 2008) (same). *But see* Comedy Club inc. v. Improv West Assocs., 553 F.3d 1277, 1290 (9th Cir. 2009); Stolt-Nielsen SA v. AnimalFeeds Int'l Corp., 548 F.3d 85, 83-85 (2d Cir. 2008); Coffee Beanery, Ltd. v. WW, L.L.C., 300 Fed Appx. 415, 418-19 (6th Cir. 2008).

[17] *See, e.g.*, 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).

[18] *See Mandatory Binding Arbitration Agreements: Are They Fair to Consumers?: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 110th Cong. (June 12, 2007) (Statement of Professor David S. Schwartz).

III. Only Congress Can Reform the Arbitration System Because of the Federal Arbitration Act's Sweeping and Overbroad Preemptive Reach.

Regardless of what is the best solution for the problems posed by the current arbitration system, only Congress can provide that solution. Whereas with other legislative initiatives, Congress can decide not to act in order to allow individual states to first experiment with different reforms, that option is unavailable here because the Supreme Court has adopted an expansive, and in my view, misguided interpretation of FAA preemption that bars States from attempting to regulate or reform the arbitration process in any effective way. The current doctrine of FAA preemption is entirely judge-made and lacks any basis in the FAA's text, as the statute itself contains no preemption provision. Consequently, former Supreme Court Justice Sandra Day O'Connor has explained that "the Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation."[19] The current doctrine not only gives arbitration agreements a specially-protected status, but it also has turned the field of arbitration regulation into a one-way street: states are permitted to adopt legislation that promotes arbitration, but are prohibited from adopting legislation that constrains or regulates arbitration.

The Supreme Court has stated that the FAA was enacted with the original purpose of overcoming judicial refusal to enforce valid, fair arbitration agreements because courts did not want to give up their own jurisdiction.[20] In that respect, the Act simply intended to make

[19] Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 283 (1995) (O'Connor, J., concurring); *see also* Perry v. Thomas, 482 U.S. 483, 493 (1987) (Stevens, J., dissenting) ("It is only in the last few years that the Court has effectively rewritten the statute to give it a pre-emptive scope that Congress certainly did not intend.").

[20] *See Dobson*, 513 U.S. at 270.

arbitration agreements "as enforceable as other contracts, but not more so."[21] Moreover, the text of the FAA expressly preserves state law by declaring that arbitration agreements may be unenforceable "on such grounds as exist in law or equity for the revocation of any contract."[22] Thus, to the extent that the FAA should preempt state law at all,[23] its preemptive effect should be very narrow in scope.

Supreme Court decisions over the last 20-25 years, however, have wildly expanded FAA preemption, invalidating all sorts of state laws. One law professor's sample of court decisions from January 2002 to April 2004 found almost fifty state laws that were declared preempted by courts.[24] Courts have interpreted the FAA as preempting almost any law that has the effect of making arbitration agreements more difficult to enforce. Even laws that do not attempt to make arbitration clauses automatically unenforceable may be preempted. For example the Supreme Court invalidated a Montana law that did not prohibit arbitration but simply required contracts containing arbitration clauses to include a notice regarding the arbitration clause on the front page of the contract.[25]

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[21] Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 n.12 (1967).

[22] Federal Arbitration Act, 9 U.S.C. § 2.

[23] A number of scholars and judges have made a persuasive case that the Congress intended the FAA only to apply procedural rules to federal courts, and did not intend for the FAA to create federal substantive law that was binding on the States. *See, e.g.*, *Allied-Bruce*, 513 U.S. at 285-95 (Thomas, J., dissenting); Southland Corp. v. Keating, 465 U.S. 1, 22-31 (O'Connor, J., dissenting); David S. Schwartz, *The Federal Arbitration Act and the Power of Congress over State Courts* 83 ORE. L. REV. 541, 542 & n.7 (2004).

[24] David S. Schwartz, *State Judges as Guardians of Federalism: Resisting The Federal Arbitration Act's Encroachment On State Law*, 16 WASH. U. J. L. & POL'Y 129, 154-59 (2004).

[25] *See* Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681 (1996).

The Court's current preemption doctrine has caused several adverse consequences. First, it violates basic constitutional principles of federalism. The FAA, as currently interpreted, deprives States of their traditional authority to regulate contracts and to protect the health, safety, and welfare of their citizens. If Congress wishes to deprive States of the authority to protect consumers by regulating forced arbitration, then it may do so. But it should not allow state sovereignty to be so easily circumvented by Supreme Court decisions untethered to the text and intent of the FAA in the absence of clear congressional will.

Second, the current preemption doctrine undermines the democratic process by thwarting the will of democratically-elected state legislatures. Although Congress, in enacting the FAA, was concerned about *judicial* hostility to arbitration agreements, the Court has interpreted the statute to override validly-enacted state *legislation*. It is one thing to say that judges should not be permitted to subvert the democratic process by ignoring state law and state-law contract principles in refusing to enforce arbitration agreements out of a desire to protect their own jurisdiction. It is another to say that state legislatures lack the authority to represent their citizens by passing laws that seek to curb some of the worst abuses of the arbitration system. Current preemption doctrine therefore turns the FAA on its head by short-circuiting the democratic process and by stripping state legislatures of the ability carry out the will of their constituents.

Third, rather than placing arbitration agreements "upon the same footing as other contracts,"[26] FAA preemption has transformed arbitration agreements into super-contracts that are immune from and often override state contract and consumer protection law. Courts have held that state laws and certain state contract doctrines that apply to other contracts cannot be

[26] Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 474 (1989).

applied to arbitration clauses. Courts have held that even if every other provision in a contract is void because the contract is illegal, the contract's arbitration clause is still enforceable.[27]

Fourth, FAA preemption distorts the playing field by permitting legislation that favors arbitration while forbidding legislation that seeks to constrain or regulate arbitration. States are perfectly free to pass laws that expand the scope of arbitration. The FAA therefore places companies that favor arbitration in a great position because arbitration-related legislation can proceed in only one direction. Any "pro-arbitration" legislation that corporate arbitration defenders are able to push through state legislatures are fully enforceable while any efforts to place limits on arbitration or to regulate the most abusive arbitration practices risk preemption. Indeed, corporations have taken advantage of this inequality to push through state legislation condoning some of the most dangerous aspects of arbitration clauses. For example, Utah enacted a statute that expressly permits contracting parties to waive their right to participate in a class action, while state legislation forbidding a waiver of the right to bring a class action has been declared preempted when applied to an arbitration clause.[28]

It is important for Congress to act because, given the expansive and unwise reach of FAA preemption, no other body is capable of doing so. Preemption not only restricts the ability of state legislatures to correct problems with arbitration, it also restricts the authority of courts to protect consumers against unsavory arbitration provisions. Although courts certainly have

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[27] *See, e.g.*, Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006) (holding that the arbitrator must determine whether a contract containing an arbitration provision is illegal and void).

[28] *Compare* Utah Code Ann. § 70C-4-105 (permitting enforcement of class action waivers in creditor-debtor contracts), *with* Ting v. AT&T, 319 F.3d 1126, 1147-48 (9th Cir. 2003) (finding the California Consumer Legal Remedies Act preempted because it was not "a law of general applicability").

declared arbitration clauses unenforceable, the Supreme Court has held that some types of challenges to the enforceability of contracts containing arbitration clauses must be decided by an arbitrator rather than by a court.[29]

Nor is there any reason for Congress to delay in taking action. The original justification for the FAA, overcoming judicial hostility to arbitration clauses, does not reflect current realities. If anything, judges with crowded dockets have an incentive to favor enforcement of mandatory arbitration clauses as a way of managing an overly-burdensome caseload. Moreover, waiting to act only provides additional opportunity for courts to further expand FAA preemption. For example, one strategy being undertaken by corporate defendants is to argue that any law which invalidates any portion of an arbitration clause is preempted because the FAA creates a substantive right to enforcement of an arbitration clause "in the manner provided for" in the clause.[30] Although the Supreme Court has not yet adopted this interpretation of the FAA, the dangers of such a view are evident. Creating a substantive right to enforce arbitration agreements exactly as written would give an incentive for companies to put in as many one-sided arbitration provisions as possible, since they would know that the FAA would insulate those provisions from any challenge.

IV. Corporations' Own Behavior Indicates that They do not Believe that Arbitration is a Fair and Efficient Alternative to Litigation.

Notwithstanding the above-described shortcomings of the arbitration system, corporations defend mandatory arbitration by asserting that it is a faster, cheaper, and fairer

[29] *See, e.g., Cardegna*, 546 U.S. 440 (holding than an arbitrator, rather than a court, must decide if loan contract with a triple-digit interest rate is illegal and void).

[30] *See, e.g.*, Muhammad v. County Bank, No. 06-907, Petition for Writ of Certiorari (Jan. 3, 2007) at 18-21; *see also* Schwartz, *supra* note 23, at 563-68 (describing this trend).

alternative to judicial dispute resolution and therefore should be encouraged, irrespective of any ensuing sacrifice of democratic principles. Given the prevalence of mandatory arbitration clauses in the consumer setting, I wish this assertion was true. However, I remain unconvinced, for several reasons. Initially, it is noteworthy that the only groups touting the benefits of forced arbitration for consumers are those that seek to impose arbitration *against* consumers. No reputable consumer advocacy organizations of which I am aware endorse widespread use of pre-dispute mandatory arbitration provisions. I am hard-pressed to think of another circumstance in which a group's *adversaries* are allowed to decide what is beneficial for that particular group.

More importantly, however, corporations' own behavior concerning arbitration belies their statements that forced arbitration is a superior alternative to the courts. For example, several recent studies show when it comes to business-to-business contracts that are negotiated at arm's-length, companies are much more reluctant to include arbitration provisions than they are in their contracts with consumers.[31] That negotiated contracts typically omit arbitration agreements and that arbitration agreements are most pervasive when imposed through adhesion contracts itself is telling about how fair such provisions truly are.[32] In fact, many of the same

[31] *See* Theodore Eisenberg, Geoffrey P. Miller & Emily L. Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871 (2008) (conducting study showing that more than 75% of company contracts with consumers required arbitration whereas fewer than 10% of nonemployment, nonconsumer contracts contained arbitration clauses); Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in Publicly-Held Companies*, 56 DEPAUL L. REV. 335 (2007) (finding that only 11% of surveyed companies used arbitration clauses in their contracts with other companies).

[32] Theodore Eisenberg, Geoffrey P. Miller & Emily L. Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 876 (2008) ("The systematic eschewing of arbitration clauses in business-to-business contracts also casts doubt on the corporations' asserted beliefs in the superior fairness and efficiency of arbitration.").

business groups that support forced arbitration when imposed on consumers have opposed the Employee Free Choice Act precisely because it would require binding arbitration between a union and a business if the two fail to come to a labor agreement within a certain period of time.[33] Similarly, many car dealers have inserted binding arbitration clauses into their car sales contracts, although those same car dealers lobbied for and won a federal statute that bars car manufacturers from insisting that dealers arbitrate disputes. In the process of lobbying for that statute, auto dealers specifically decried how arbitrators were not required to follow the law, and how arbitration actually had greater out-of-pocket expenses than litigation.[34] If companies truly believe that forced arbitration is a superior system, then they would put their money where their mouth is. To date, they have not.

In my view, one of the most telling examples of how corporations do not actually believe that forced arbitration is a fair and trustworthy system concerns how they deal with the prospect of class actions. Most arbitration provisions in consumer contracts bar the consumer from participating in class actions.[35] The dangers of class-action bans in arbitration clauses are well-documented.[36] Because many instances of consumer fraud involve relatively small-dollar injuries, many cases will never be brought if they can proceed only on an individual basis. Class

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[33] *See, e.g.*, U.S. Chamber of Commerce, Employee Free Choice Act – The "Card Check" Bill, *available at* http://www.uschamber.com/issues/index/labor/cardchecksecrbal.htm.

[34] *See* Public Citizen, *Auto Dealers and Consumers Agree: Mandatory Arbitration Is Unfair*, available at http://www.citizen.org/congress/civjus/arbitration/ articles.cfm?ID=650.

[35] One recent empirical study of arbitration agreements revealed that in its sample, "every consumer contract with an arbitration clause also included a waiver of classwide arbitration." Eisenberg, et al., *supra* note 32, at 884.

[36] *See, e.g.*, Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1 (2000).

actions are specifically designed to deal with the circumstance where "small recoveries do not provide the incentive for any individual to bring a sole action."[37] Barring individuals from bringing class actions, either in arbitration or in litigation, effectively immunizes corporate wrongdoers for certain classes of illegal conduct that cause small-dollar injuries but that affect thousands or millions of individuals.

Despite these concerns, corporations defend class-action bans by arguing that class action litigation is so expensive that arbitration is still a superior alternative. However, while companies apparently have no problem telling consumers that arbitration is a superior alternative when class action bans are in place, they tend to take the opposite view when class-action bans are threatened. A majority of consumer arbitration now state that if the class action ban is declared unenforceable, then the whole arbitration clause is unenforceable.[38] The existence of such exploding arbitration provisions is unsurprising. After all, once corporations face the prospect of a large potential class action judgment, then the limited judicial review and limited procedural protections that corporations champion as necessary for making mandatory arbitration faster and more streamlined no longer are acceptable to them. The use of such arbitration provisions suggests that companies do not necessarily see arbitration as a superior forum to litigation, but that they mandatory contractual arbitration provisions – and class action bans in particular – as a way of keeping consumers out of any forum, either arbitration or litigation.

In my view, any argument that a class action ban promotes cost savings ineluctably rests on the assumption that consumers will not bring individual arbitrations in place of a class action.

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[37] Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997).

[38] *See* Eisenberg, et al., *supra* note 32, at 884 (conducting study finding that 60% of consumer contracts had a provision declaring the whole arbitration clause unenforceable in the event that the class action ban was unenforceable).

Having thousands of separate individualized arbitrations in front of separate arbitrators in which the same documents would be submitted in separate hearings undoubtedly would be more cumbersome, expensive and wasteful than consolidating all of those claims into a single action. As Congress has recognized, the class action mechanism promotes efficiency by aggregating similar claims into a single lawsuit, thereby avoiding the repetition and expense of separate actions for each harmed individual: "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."[39] Thus, corporations' own behavior regarding their arbitration clauses suggests that their true interest is not arbitration, but immunity.

CONCLUSION

The current arbitration system is one that no longer resembles what Congress originally envisioned in passing the Federal Arbitration Act. The private nature of arbitration sacrifices democratic values of openness and accountability. Mandatory arbitration also subverts the democratic process by broadly preempting validly-enacted state statutes relating to arbitration. Because the States and the courts cannot adequately protect consumers from the dangers of arbitration, it is up to Congress to act. I thank the Committee for allowing me to testify today and I hope that the Committee considers reforming the arbitration system to provide consumers with the protections they deserve.

[39] Class Action Fairness Act of 2005, 28 U.S.C. § 1711 (2005).