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October 10, 2018

Hon. Gary Gensler, Chair
Financial Consumer Protection Commission
3E Senate Office Building
Annapolis, MD 21401

Re: State measures to address forced arbitration

Dear Mr. Gensler,

Thank you for the opportunity to testify before the Financial Consumer Protection Commission on the problems posed by forced arbitration and what Maryland can do to address them. I present this testimony on behalf of the low income clients of the National Consumer Law Center.

In brief, forced arbitration harms Maryland consumers, employees and other residents throughout the state. Forced arbitration allows lawbreakers to avoid accountability. Because effective enforcement of consumer protections depends on access to the courts, forced arbitration erodes the rule of law by permitting wrongdoers to get away with systematic violations.

The United States Supreme Court has limited the ways in which states can address forced arbitration. Nonetheless, there are things Maryland can do to address some of the harms, including the decrease in enforcement of Maryland law caused by the proliferation of forced arbitration clauses. Our office has published a model state law that makes a number of recommendations within the scope of state authority.

While all of the recommendations are worth considering, today I would like to focus on one of the ten titles of the model law, the one likely to have the most impact: authorizing whistleblower actions to expand the state's public enforcement capacity. The U.S. Supreme Court has upheld a federal statute that uses whistleblowers to pursue fraud claims on behalf of the government, and Governor Hogan signed a similar law in Maryland in 2015. Our proposal would permit whistleblower actions to pursue claims based on harm to the public, and would leverage the resources of the private sector in a public-private partnership with the State retaining control.

1. Problems with Forced Arbitration

When companies violate the law and harm Maryland residents, forced arbitration clauses take away our day in court. People are forced to bring their claims before a private arbitrator, typically chosen and endorsed by the company, who can ignore the facts and the law, with no right to appeal or review. Arbitration proceedings are often secret and do not afford people the same rights that they have in court to obtain information from lawbreakers to prove the illegal conduct or the extent of harm.

Forced arbitration clauses are in fine-print contracts that are presented to consumers or workers on a take-it-or-leave it basis, requiring them to waive their Seventh Amendment constitutional right to trial by jury. Over 400 law professors and other scholars have decried the use forced arbitration clauses.

Forced arbitration clauses often contain class action bans, preventing people from banding together to pursue claims of repeated or systematic wrongdoing. Class actions allow consumers who have experienced small dollar harm affecting many other consumers, consumers who do not have the resources to hire an attorney or to confront a large corporation, or consumers who are simply too scared to file a lawsuit against a business on their own the opportunity to band together to pursue all of their claims in a single lawsuit. Class actions are an efficient and important tool in holding wrongdoers accountable under Maryland law. In combination, arbitration clauses and class waivers prevent either a judge or arbitrator from holding a company accountable for the full scope of its wrongdoing. Our most hard-fought consumer and worker protections are nothing more than words on a page if they are not enforced, and yet forced arbitration clauses and their class action waivers dramatically undermine enforcement.

In theory, forced arbitration clauses change where disputes are heard. In reality, they frequently prevent lawbreakers from being held accountable at all, in any forum. In an average year, *only 16 consumers* throughout the entire country receive cash relief in arbitration, compared to an annual average of 6.8 million in consumer class actions. Forced arbitration clauses deter consumers and workers from pursuing valid claims, and companies often find ways to delay or frustrate the arbitration proceeding even if the consumer does attempt to arbitrate. The result is that wrongdoers can break the law with impunity and keep their conduct secret.

For consumers, forced arbitration clauses are rampant in the fine print in contracts for bank accounts, cell phone and cable contracts, credit cards, payday loans, student loans, and more. Employees are also frequently forced to give up their day in court as a condition of employment – preventing them from bring claims for harassment, discrimination, or wage theft. Forced arbitration impacted former Fox News anchor Gretchen Carlson's sexual harassment claims. Hundreds of Kay and Jared Jewelers employees attested to widespread sexual harassment and demands for sexual favors, but the full extent of the evidence and harassment was buried for years and out of public courts due to forced arbitration clauses in employment contracts.

A wide variety of other products and services also have forced arbitration clauses, including:

- Nursing homes that exploit fragile seniors;
- For-profit colleges, including those that target veterans;
- Cell phone contracts, including those for Samsung's exploding phones;
- Ride-sharing apps like Uber;
- Car sales;
- Debt relief scams;
- And even your kid's Snuggie.

Responsible companies obey the law, and own up to their mistakes if things go wrong. Two of the largest banks in Maryland, Bank of America and Capital One, do not use arbitration clauses in their consumer contracts. Smaller banks and credit unions — which focus on knowing and working with their customers — are also less likely to use forced arbitration clauses than are large institutions.

History shows us that companies can remain profitable without forced arbitration clauses. Consumers saw no increase in credit card prices after Bank of America, JPMorgan Chase, Capital One, and HSBC dropped their forced arbitration clauses as a result of litigation. Similarly, mortgage rates did not increase after Congress banned forced arbitration in mortgages. There is no data showing that arbitration lowers prices for consumers; but there is significant data showing that forced arbitration hides misconduct and blocks accountability for wrongdoers.

2. Forced Arbitration Harms Marylanders

People in Maryland, like those across the nation, confront forced arbitration clauses every day. Here are just a few examples involving consumer financial products and services. In addition, forced arbitration also harms Maryland employees and many others in our State.

Servicemembers and veterans: Forced arbitration clauses impact Maryland's 47,670 active-duty servicemembers and reservists and Maryland's veterans. Forced arbitration blocks servicemembers' access to the courts for violations of the Servicemembers Civil Relief Act and other misconduct, including illegal repossessions of active-duty servicemembers' vehicles. As a Maryland-based soldier found out, even in the rare cases where an individual pursues a case in arbitration and wins, he may not get fair compensation for his harm and a lawbreaker who has admitted to harming many others gets away with it. A 2006 Department of Defense report emphasized that "loan contracts to Servicemembers should not include mandatory arbitration clauses or…require the Servicemember to waive his or her right of recourse, such as the right to participate in a plaintiff class [action lawsuit]." Efforts to fight forced arbitration have received strong support from The Military Coalition and 29 military groups.

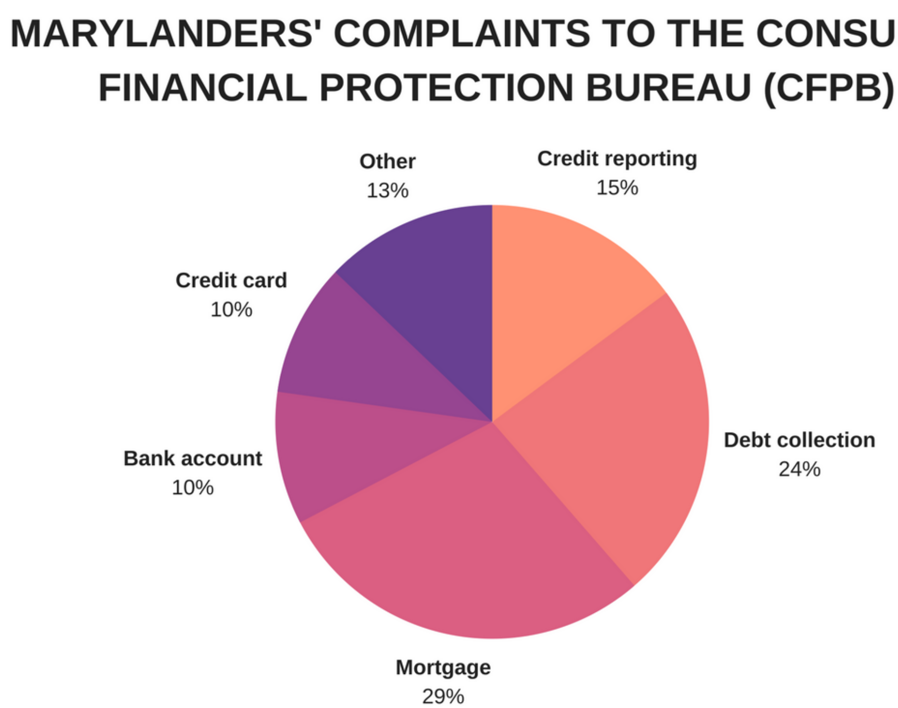
Bank account holders: Wells Fargo opened up to 3.5 million fake accounts – including 15,391 or more in Maryland – without customers' consent. Wells Fargo has tried since 2013 to use forced arbitration to block lawsuits, including a class action that included those 15,391 Marylanders. While the rare and intense publicity in that case eventually led Wells Fargo to settle on a class basis, the consumers undoubtedly accepted a low settlement due to the risks of being sent to pursue arbitration alone, one by one. Wells Fargo also repeatedly tried to use forced arbitration to avoid justice for people in 49 states – including Maryland – who were charged excess overdraft fees when their accounts were not overdrawn.

Consumers with inaccurate credit reports: Thousands of Marylanders have filed complaints with the Consumer Financial Protection Bureau (CFPB) about problems with credit reporting agencies and errors in credit reports, which can increase the cost of a loan or result in a denial of credit. Marylanders falsely matched with a terrorist watch list will get $7,337 in relief from a class action against Transunion. But Transunion and other credit bureaus have tried to use forced arbitration to block other class actions.

Payday loan borrowers: Maryland does not permit payday loans, but Maryland residents are sometimes trapped by illegal, usurious online loans. These out-of-state lenders can be difficult for state regulators to reach, and online lenders aggressively use forced arbitration clauses, found in 86% of online contracts surveyed, to fight lawsuits over illegal loans. Fees associated with payday loans keep consumers in a cycle of debt and subject people to abusive and illegal debt collection practices.

Prepaid card users: More than a quarter of Marylanders are unbanked or underbanked, and many rural and low-income Marylanders rely on prepaid cards to manage their money. RushCard holders, including 15,582 Marylanders, as well as servicemembers serving overseas, were among those harmed when their cards were frozen and people could not access their money for weeks. RushCard chose not to enforce its forced arbitration clause, and a class action gave class members up to $500 for losses and fees they suffered. But the case could have been blocked by a forced arbitration clause, found in 92% of prepaid card contracts.

Families subject to illegal and abusive debt collection practices: Debt collectors are high on the list of Marylanders' and servicemembers' complaints to the CFPB. Out-of-state debt buyers often use illegal harassment and violate state law by adding illegal fees, but forced arbitration clauses block people from court to challenge those practices. Debt buyers also frequently sue the wrong person or seek the wrong amount but prevent people from suing back.



***College students**:* Marylanders are among those harmed by predatory for-profit colleges, such as Corinthian Colleges, that for years have used forced arbitration clauses to block class actions over their fraudulent conduct. Even for those attending nonpredatory schools, Maryland students average over $27,000 in public and private student loan debt and may be impacted by abuses by Navient (formerly Sallie Mae), the largest servicer of private student loans. Navient, which uses forced arbitration, allegedly failed to allocate payments properly and deceived borrowers about how to release co-signers. Marylanders may also fall prey to rampant abuses by sketchy student loan debt relief companies, which also use forced arbitration clauses to take away students' day in court.

3. What Maryland Can Do: NCLC's Model State Consumer & Employee Justice Enforcement Act

The Supreme Court has ruled in a series of decisions that forced arbitration clauses, even those including class action waivers, are widely enforceable as a matter of federal law. Many of these decisions have preempted state laws that nullify unconscionable one-sided contracts of adhesion. The Court has held that states may not broadly prohibit the use of forced arbitration clauses.

Several federal agencies under the Obama Administration – including the Department of Education, the Department of Labor, and the CFPB – made efforts to protect consumers', investors', and workers' ability to enforce federal and state laws. But the Trump Administration and the new Congress have rolled back those efforts, including a CFPB rule that would have prohibited consumer financial contracts from having forced arbitration clauses with class action bans. Unfortunately, right now there is little the federal government appears prepared to do to address the problem.

Fortunately, while states cannot prohibit forced arbitration clauses and cannot single out those clauses for special regulation, there are other ways that states can mitigate some of the harms that flow from forced arbitration.

Mindful of the limits on state authority, the National Consumer Law Center has drafted a model state law that gives states a number of options to promote justice in their states. Our Model State Consumer and Employee Justice Enforcement Act includes ten separate titles crafted around problems with arbitration that states have power to address.[1] We are continuing to refine these titles.

Today, I'd like to propose that Maryland adopt a variation of one of the ten titles, Title I: Whistleblower actions to expand the state's public enforcement capacity. While the other titles in our model law also are worth considering, we believe that this title is the most important one to start with, as it can help to offset one of the most concerning consequences of forced arbitration: the erosion of the rule of law and the undermining of important consumer and workplace protections.

[1] These titles are set out in two separate documents, David Seligman, NCLC, Model State Consumer and Employee Justice Enforcement Act (Nov. 2015) (Titles I to VIII), http://www.nclc.org/images/pdf/arbitration/model-state-arb-act-2015.pdf, and David Seligman, NCLC, Model State Consumer and Employee Justice Enforcement Act: Titles IX & X (January 2017), available at https://www.nclc.org/images/pdf/arbitration/model-arb-law-titles-ix-x.pdf.

4. Whistleblower actions to expand state public enforcement capacity

Forced arbitration clauses in private contracts do not prevent local, state, or federal governments from bringing public enforcement actions. The United States Supreme Court ruled in a 2001 opinion called *EEOC v. Waffle House* that ***public*** enforcement actions are not affected by arbitration requirements.

Public agencies can pursue enforcement actions based on the same conduct that underlies private lawsuits that have been frustrated by forced arbitration clauses. For example, in 2013, a forced arbitration clause blocked a private lawsuit by a Wells Fargo customer who was the victim of fake accounts. Wells Fargo was able to use forced arbitration to keep the problem out of the public eye and to continue creating fake accounts. But eventually the problem caught the attention of the Los Angeles City Attorney, who in 2016, together with the CFPB, announced a consent decree and $185 million penalty against the bank.

Unfortunately, public agencies have limited resources and cannot go after every problem, even ones causing widespread harm. The U.S. legal system depends on private enforcement of rights. Whereas some countries invest substantial resources in large government agencies to enforce their laws, our state and federal consumer protection schemes rely on both private and public enforcement to make sure that the law has meaning and force in the day-to-day lives of consumers and that bad actors do not gain a competitive advantage. We could dramatically increase budgets for state enforcement agencies, but even then, they are unlikely to have nearly enough resources to make up for the stark decrease in private enforcement that has resulted from the proliferation of forced arbitration.

Moreover, as in the Wells Fargo case, it is often a private lawsuit and the information that it brings forward that spotlight a problem for public enforcement agencies and spur them to action. A study by the CFPB shows that, in those cases where there was overlap between private and public enforcement, private action *preceded* government enforcement between 62% and 71% of the time.[2] Thus, without private enforcement, public enforcement suffers as well.

Maryland can build on this type of public-private partnership by adopting a whistleblower provision to expand the state's public enforcement capacity without having to dramatically multiply the resources dedicated to public enforcement agencies. We encourage the state to consider allowing whistleblowers to bring what are called in latin "*qui tam*" actions on behalf of the state to enforce the law and recover civil penalties for the state. *Qui tam* is short for a Latin phrase, "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*" that roughly translates to "he who brings an action for the king as well as for himself."

Whistleblower statutes have a long history and solid constitutional pedigree. The United States Supreme Court has upheld the constitutionality of False Claims Act, passed in 1863, which allows whistleblowers to bring claims on behalf of the United States government.[3] Our nation's First Congress passed at least one whistleblower law, and these types of whistleblower actions

[2] *See* Center for Justice & Democracy, CFPB Arbitration Study: Highlights, https://centerjd.org/system/files/CFPBArbFactSheetF.pdf; CFPB, Arbitration Study: Report to Congress 2015, https://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

[3] Vermont Agency of Natural Resources v United States ex rel. Stevens, 529 U.S. 765 (2000) (majority opinion by Justice Scalia).

have been around, in the words of the Supreme Court, "ever since the foundation of our government."[4]

Maryland has also permitted whistleblower claims. Initially limited to Medicaid fraud, in 2015 Gov. Hogan signed the Maryland False Claims Act, which expanded whistleblower actions in the State to other types of fraud against the State.[5] Like the federal False Claims Act, the Maryland law incentivizes whistleblowers to bring cases on behalf of the State of Maryland for fraud committed against the State.

A Maryland whistleblower law would work very similarly to the Maryland False Claims Act but would include harms to the public rather than monetary fraud against the government. Whistleblowers with information about violations of Maryland law could initiate a public enforcement action against the company on behalf of the State of Maryland. A whistleblower action could not be brought of the State had already cited the company for the same conduct.

Our proposal gives the State of Maryland ample control over a whistleblower action. After the whistleblower filed the action, the State would have an opportunity to review the complaint and the whistleblower's information. If the State decides to take over the action, the State would pursue the case as with any other case, except that the State would also have the resources and assistance of the whistleblower and her attorney as secondary counsel.

If the State feels the case does not have merit, would interfere with other efforts, or for any other reason, the State may dismiss the case.

If the State does not feel that the case warrants dismissal but the State also does not have the resources to join the case, the whistleblower would pursue the case alone. However, any proposed settlement must be submitted to the State and must be approved by a court as fair, adequate and reasonable. The State may express any objections to the court and may intervene at that point for good cause shown.

The only remedies that the whistleblower could pursue would be remedies available to the State of Maryland: civil penalties and injunctive or declaratory relief. To emphasize the public nature of the action, the whistleblower, acting on behalf of the State, could not pursue private damages or even restitution, though the State itself could see restitution to injured consumers (and the whistleblower could pursue a private action).

Ultimately, if the case is successful, the State would retain 70% to 80% to of the penalties, a portion of which would be used for community-based outreach and enforcement activities. Between 20% (if the State intervenes) and 30% (if it does not) of the penalties would be distributed to the whistleblower, but the whistleblower would be obligated to distribute those penalties among other parties aggrieved by the illegal practices. The whistleblower would propose an allocation to the State, which in its discretion could order a different distribution.

Importantly, whistleblower expansion is not a guise for bringing purely private lawsuits. *Qui tam* actions look and function like regular public enforcement actions in many respects. Most importantly, they allow for substantial oversight by public enforcers. However, because the

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[4] Marvin v. Trout, 199 U.S. 212, 225 (1905).

[5] Senate Bill 374 (2015), codified at Md. Code, General Provisions, §§ 8-101 to 8-111.

actions are initiated by private individuals and bring additional information and resources, these actions could serve as an exceptionally efficient and effective mechanism for enforcing state law.

Here are a few examples of whistleblower actions that could be brought under our proposal:

- A Maryland Wells Fargo employee who witnessed the bank's creation of fake accounts could file a lawsuit on behalf of the State of Maryland against Wells Fargo for unfair and deceptive trade practices in violation the Maryland Consumer Protection Act.
- A Marylander who is the victim of an illegal 400% online payday installment loan could file an action in the name of the State for violating Maryland laws requiring lenders to obtain state licenses and limiting the interest rates on a $500, 6-month loan to 33%.
- A recruiter for a for-profit school, or a student who enrolled in the school and paid tuition relying on deceptive representations about placement rates and training, could file suit on behalf of the state for unfair and deceptive trade practices.
- An Army soldier based in Maryland, who was one of 100 people whose cars were improperly repossessed by a buy-here-pay-here dealer despite being current with payments, could file suit in the name of the State for the unfair and deceptive trade practices.
- A worker who, along with many other workers, is denied minimum wage and overtime for her work or is systematically harassed on the job, could sue the company for violations of Maryland labor law.

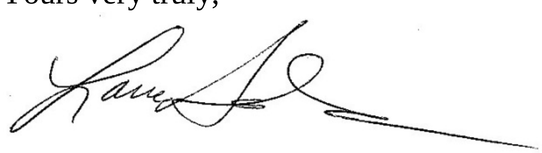
In each of these examples, the whistleblower could seek, for the State of Maryland, the civil penalty specified in the relevant statute or, if there is none specified, $500 per violation for every two-week period. A court could reduce the penalties if appropriate. The whistleblower could also seek an injunction – for example, stopping an illegal lender from making loans in Maryland or prohibiting a for-profit school from making deceptive representations. The State could also pursue other penalties, such as repayment of illegal loan fees.

In short, the action is a form of public enforcement pursuing public claims with the State of Maryland retaining ultimate control. The whistleblower action is a vehicle for providing inside information about illegal conduct to the State; for increasing the resources to enforce state laws and encourage compliance; and for obtaining remedies available to the State. The action would be very different from a private lawsuit focused on individual harm and individual damages. These qualities will protect the proposal from preemption by federal law.

Conclusion

Thank you for the opportunity to present this testimony and for your efforts to protect Maryland consumers. Please let me know if you have any questions.

Yours very truly,



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