

**RECENT DEVELOPMENTS IN THE FORCED ARBITRATION MARKET  
AND THE CONTINUED NEED FOR PROTECTIVE LEGISLATION**

Subcommittee on Commercial and Administrative Law

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Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee, thank you for inviting me to testify today regarding the Arbitration Fairness Act and recent developments in the arbitration industry.

I am the Director of Litigation at the National Consumer Law Center.<sup>1</sup>

For the past 10 years I have been responsible for coordinating and litigating cases at NCLC on behalf of income and/or age qualified individuals, primarily in the areas of consumer financing and affordable housing, in state and federal courts throughout the United States . Prior to my work at the National Consumer Law Center, I served as the Chief of the Trial Division and the Business and Labor Protection Bureau of the Massachusetts Attorney General's Office and worked in private practice. I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing across the country in order to promote economic justice for all consumers.

Over the last ten to fifteen years, there has been a quiet revolution in the way many corporations do business. Practically every credit card agreement, cell phone contract, mortgage and even many non-union employment contracts now contain a pre-dispute mandatory arbitration clause. Buried in the fine print of these agreements, phrased in legalese, is a clause which says that by agreeing to the contract, the consumer or employee has agreed that any

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<sup>1</sup> The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Consumer Arbitration Agreements* (5<sup>th</sup> Ed. 2007), *Fair Debt Collection* (6<sup>th</sup> Ed. 2008) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal with predatory lending, unfair debt collection practices and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Stuart T. Rossman, Director of Litigation and Arielle Cohen, Staff Attorney, NCLC.

dispute which arises will *not* be adjudicated in the court system, with its accountability to the public, but by an arbitration company. Hundreds of millions of contracts now contain these clauses. Hundreds of thousands of consumers forced into arbitration every year discover that they have inadvertently signed away their legal rights.

Arbitration companies are selected by the corporation, are often located far from the consumer's home and – as I will discuss – have strong financial incentives to rule in favor of the corporation regardless of the merits of the dispute. **These incentives are inherent to pre-dispute “forced” arbitration.** Recent voluntary agreements by arbitrators and credit providers to refrain from using arbitration are helpful to consumers, but do not and cannot remedy the inequities that are intrinsic to pre-dispute mandatory arbitration. Prompt legislative action is needed to make pre-dispute binding mandatory arbitration clauses unenforceable in civil rights, employment, consumer, and franchise disputes.

The essential problem with forced arbitration is that it creates a system strongly biased in favor of the corporation and against the individual. This is true for a number of reasons:

- There are a number of private arbitration companies who compete to be selected by corporations in their standard form contracts with consumers and employees. Arbitration companies perceived as less favorable to corporations will not receive any business. This sets up conditions for a ‘race to the bottom’ among arbitration companies to be the most corporation-friendly. The marketing materials of arbitration companies – touting the advantages to businesses of using arbitration – bear this out.
- At the level of individual arbitrators, corporations can “blackball” arbitrators who rule against them. This is possible because the corporations are repeat players, with access to the previous decisions of particular arbitrators. The public, and the individual consumers

- The procedures of arbitration tend to favor the corporations as well. Consumers who are unaware that they agreed to arbitration may fail to respond to notices, resulting in default judgments. The high fees and ‘loser pays’ rules typical of arbitrations also discourage consumers from participating. Even if they do respond, they are at a disadvantage to the repeat players, who understand the process, know what information to submit and how to do so, and have often selected an arbitration company geographically distant from the consumer.

You have heard and will hear from others more regarding the fundamental problems with forced arbitration. Instead of repeating their testimony, I’d like to spend some time going over current events. In recent months, there have been a number of developments in the arbitration industry, with several arbitration companies getting out of the consumer debt arbitration business and at least one corporation voluntarily agreeing to refrain from enforcing forced arbitration clauses. These developments, which I will summarize, certainly are helpful to consumers, but they do not completely or permanently solve the problems I outlined above, and therefore do not obviate the need for legislation.

### I. National Arbitration Forum

On July 14, 2009, Minnesota Attorney General Lori Swanson filed a lawsuit against the National Arbitration Forum. NAF is – or was – the largest arbitrator of consumer credit disputes in the country. According to NAF, it has been appointed as arbitrator in “hundreds of millions” of contracts. In 2006, it processed more than 200,000 consumer collection arbitration claims.

The Attorney General's investigation of NAF revealed a series of agreements and transactions conducted in 2006 and 2007 whereby NAF, a New York based hedge fund group and one of the country's largest debt collection agencies became financially and managerially intertwined. The lofty goal of this alliance was nothing less than the expansion of arbitration (specifically provided by NAF) into "a comprehensive, alternative legal system."

The debt collection agency (a large law firm) was to play "an active role in landing new customers/partners" for NAF – essentially steering customers to NAF over other legal or arbitration-based collection options. It appears that they were quite successful in that regard; in 2006, 60% of the consumer collection claims filed with NAF originated with that particular debt collection law firm.

The Attorney General's lawsuit was based on allegations of consumer fraud, deceptive trade practices and false statements in advertising. The AG alleged that the National Arbitration Forum represented to consumers and the public that it was independent and neutral, operated like an impartial court system, and was not affiliated with and did not take sides between the parties, when in fact, it was closely associated with owners of debt and advertised itself to corporations as a particularly favorable forum for collection actions.

On July 17, 2009, NAF agreed to a consent decree.<sup>2</sup> Without admitting any wrongdoing or liability, NAF agreed to "the complete divestiture by the NAF Entities of any business related to the arbitration of consumer disputes." Consumer arbitration was defined to include "any arbitration involving a dispute between a business entity and an individual which relates to goods, services, or property of any kind... or payment for such goods, services, or property" and "includes any claim by a third party debt buyer against a private individual."

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<sup>2</sup> A copy of the Minnesota Office of the Attorney General's July 19, 2009, press release announcing the agreement with the National Arbitration Forum, with the Consent Decree and the amendatory letter to the American Arbitration Association referenced in the release attached, are provided herewith as Exhibit 1.

Some have argued that the litigation shows that NAF was a ‘bad apple’ and that its departure from the consumer arbitration business will eliminate any unfairness or abuses. This view is mistaken. First, the specific actions which formed the basis for the complaint against NAF are only tangentially related to the basic inequities of the forced arbitration system. As I explained above, all arbitration companies make their money by convincing corporations to select them as a forum for debt collection and other disputes. NAF took this a step further, by actually becoming financially and organizationally entangled with a debt collection agency, but the incentive to look after the interests of corporations exists for all arbitration companies. Second, because the provision of arbitration services is a lucrative business, other companies will step into the void created by NAF’s departure. This may not happen immediately, given the current political and public attention focused on consumer arbitration, but without legislation preventing the use of forced arbitration clauses, it will happen as soon as that attention moves elsewhere. Finally, while the terms of the settlement agreement apply broadly to consumer disputes, employment disputes are not included. Forced arbitration of employment disputes is particularly problematic, because it amounts to a waiver by the employee of civil rights and anti-discrimination laws.<sup>3</sup>

## II. American Arbitration Association

On July 23, 2009, the American Arbitration Association issued a press release announcing its decision not to accept new arbitration filings under pre-dispute arbitration agreements in cases involving credit card bills, telecom bills or consumer finance matters and

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<sup>3</sup> For additional discussion of the limitations of the NAF consent decree, see the July 22, 2009 Testimony of F. Paul Bland, Jr. before the Subcommittee on Domestic Policy of the U.S. House of Representatives’ Committee on Oversight and Government Reform, attached as hereto as Exhibit 2.

calling for “Reform of Debt Collection Arbitration.”<sup>4</sup> AAA identified these categories of arbitration as needing additional protections due to a high rate of non-participation by consumers. Although it came on the heels of the NAF settlement agreement, AAA denied that the decision to stop accepting new arbitration filings was made at the behest of any outside entity.<sup>5</sup>

As in the case of the NAF settlement, the AAA decision is a positive development for consumers, but not a solution to the problem. The decision does not cover the full spectrum of consumer arbitrations. It provides no insights into what reforms AAA might agree to make and what additional protections conceivably could be provided to consumers. Like the NAF settlement, forced arbitration in employment disputes is not addressed. Finally, since AAA’s decision was made voluntarily for business reasons, they may alter it at any time and begin arbitrating cases again.

### III. Bank of America

On August 13<sup>th</sup>, 2009, Bank of America issued a fact sheet announcing that it would not enforce pre-dispute arbitration clauses in certain categories of consumer contracts – specifically, credit card, auto, marine and recreational vehicle loans and deposit accounts.<sup>6</sup> According to company spokespeople, the decision came as a result of customer perceptions that arbitration was unfair. Bank of America’s intention is “to resolve more disputes directly with our customers.”

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<sup>4</sup> See July 23, 2009 American Arbitration Association News Release attached hereto as Exhibit 3.

<sup>5</sup> See July 20, 2009 Letter from American Arbitration Association to Minnesota Attorney General attached hereto as Exhibit 4.

<sup>6</sup> See August 13, 2009 Fact Sheet about Bank of America’s Arbitration Position attached hereto as Exhibit 5.

Once again, while this is a positive development, it is not a permanent or widespread solution. Other financial companies have not leapt to follow Bank of America's lead, and Bank of America may reverse its decision at any time.

#### IV. Conclusion

I want to return to the quotation from the negotiations between NAF and the debt collection agency regarding their goal of turning arbitration into "a comprehensive, alternative legal system." Companies have an obvious interest in circumventing the judicial system in favor of a system they control. Companies must not be allowed to force consumers and employees to give up their substantive and procedural rights in advance and submit to decision-making by profit-motivated third parties selected by the companies. Such a system will always be biased against individual consumers and workers, and is contrary to basic principles of due process and fairness. NCLC strongly supports the passage of enforceable arbitration related consumer protection legislation designed to effectively, fairly and consistently level the playing field between consumers and corporations in the future.