December 19, 2013

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Chuck Grassley
Ranking Member
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing
& Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Mike Crapo
Ranking Member
Committee on Banking, Housing Affairs
& Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Leahy, Chairman Johnson, Ranking Member Grassley and Ranking Member Crapo:

Amalgamated Bank ("Amalgamated"), as Trustee of the LongView® Funds, is a long-term investor in approximately three thousand publicly-listed companies in the United States. We manage approximately $13 billion in assets for institutional investors, which are largely comprised of employee benefit funds. We join the voices of other institutional investors in writing to the committees of jurisdiction to ask the committees to:

1) Support the Securities and Exchange Commission ("SEC") in its exercise of Congressionally-granted authority under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to prohibit the use of mandatory pre-dispute arbitration provisions in broker-dealer and investment advisor agreements; and,

2) Act to formalize the SEC's longstanding policy that mandatory pre-dispute arbitration proposals included in the bylaws of publicly traded corporations are harmful to capital markets, contrary to public policy, and could be subject to enforcement action.

As the "LongView®" name implies, we take a long-term view of shareholder value. The beneficiaries of the funds invested with us, almost exclusively current or former working people, rely on stable and sustainable performance across the marketplace for many decades to come to meet obligations and pay out retirement, health and welfare benefits. To promote long-term performance, we actively advocate rigorous standards for corporate governance at our portfolio companies. But to protect against corporate malfeasance, we also seek strong investor protections that can both deter corporate wrongdoing and ensure that investors will have recourse, if necessary. We believe that both aims are compromised when companies attempt to preempt investors' rights to participate in a class.

While we believe arbitration may play a productive role in certain kinds of dispute resolution, we are concerned by recent attempts by some corporate issuers to unilaterally and preemptively adopt governance provisions requiring all investors to *only* pursue arbitration in event of disputes, generally accompanied by class action waivers. Arbitration may at times be a viable option, but it should not be the only one. We are concerned that remedies provided by Congress and the courts to companies and investors that have been an instrumental means of investor protection are being jettisoned by board fiat. The type of arbitration being imposed in its place is not the result of mutual agreement after arm's-length

negotiation between equals, but the result of a policy decision unilaterally imposed on investors by corporate boards – and, to date, universally without shareholder approval. Removing the option – and right – to participate in a litigated class action, in our view, undermines a careful system of checks and balances in our capital markets.

As a prime example, we note that the LongView® Funds were the first to take action against egregious accounting malfeasance and investor fraud at Enron, becoming a named plaintiff in the ensuing investor class action. In the wake of shareholder losses of over $74 billion, the LongView® Funds and other plaintiffs were able to recover $7.2 billion for all investors in the class. We believe that the case itself was vital not only to obtain some recovery of losses for investors impacted by the fraud, but also to send a strong message to deter malfeasance in the marketplace. Without the option to pursue possible legal action and participate in a class action, we are concerned that deterrence of market fraud will be weakened. Arbitration should be an option, but it should not be the *only* option. We believe that capital markets operate best with a system of checks and balances and believe there is a role for judicial enforcement. The beneficiairies of the funds invested with Amalgamated Bank's LongView® Funds are often pensioners who have worked decades to build their retirement security. When one-off incidents of market fraud prompt companies like Enron to implode, the malfeasance not only creates an immediate economic loss, but also sends shockwaves that undermine all investors' confidence in the market. Providing an appropriate and well-balanced system of potential recourse is crucial for our capital markets to continue to excel.

We therefore join with other investors in asking the Committees on the Judiciary and on Banking, Housing, & Urban Affairs, jointly tasked with protecting American investors from unscrupulous or illegal financial practices, to encourage the SEC to continue its efforts to protect investor rights and restore the balance between those rights and the responsibilities of publicly traded companies and their corporate managers.

Sincerely,

Noel Beasley
Chairman

December 16, 2013

The Honorable Patrick J. Leahy, Chairman
The Honorable Charles Grassley, Ranking Member
U.S. Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

Re: Support for the Arbitration Fairness Act of 2013, S. 878

Dear Chairman Leahy and Ranking Member Grassley:

We, the undersigned organizations, strongly support the Arbitration Fairness Act of 2013 (or "AFA"), S. 878, introduced in the Senate by Senator Al Franken (D-MN). This important legislation would end the growing predatory practice of forcing non-union employees, consumers, and small businesses to sign away their Constitutional rights to legal protections and access to federal and state courts. Predispute binding mandatory (or forced) arbitration clauses are proliferating in employment contracts (including minimum wage-workers, whistleblowers, servicemembers, and executives), and in everyday consumer contracts for products and services such as credit cards, child care, cell phones, car loans, home construction, student loans, rent-to-own products, payday loans, health insurance policies, and nursing homes.

Specifically, the AFA would make forced arbitration unenforceable in civil rights, employment, antitrust, and consumer disputes. It would also restore the congressional intent behind the Federal Arbitration Act (FAA), which was enacted in 1925 to facilitate arbitration of disputes between commercial entities of similar sophistication and bargaining power.

A series of decisions by the U.S. Supreme Court have broadly interpreted the FAA to allow corporations to insert arbitration clauses in one-sided, non-negotiable contracts. The Court further expanded the FAA's meaning to effectively overcome other federal laws, including those that exhibit a clear congressional intent to preserve consumers' rights, and make it significantly more difficult to challenge even the most abusive forced arbitration clauses.

Consumer and employment contracts with arbitration clauses are often non-negotiable, and erode traditional legal safeguards.

Corporations that place forced arbitration clauses in their standard contracts with consumers and non-union employees shield themselves from accountability for wrongdoing. The contracts typically specify who the arbitrator will be, under what rules the arbitration will take place, the state the arbitration will occur in, and the payment terms for the arbitration. Arbitration clauses are often contained in non-negotiable contracts and a person has no choice but to acquiesce or forgo the goods, services, and/or employment altogether.

None of the safeguards of our civil justice system are guaranteed for persons attempting to enforce their employment, consumer, antitrust, and civil rights in forced arbitration. There is no impartial judge or jury, but rather arbitrators who rely on major corporations for repeat business. With nearly no oversight or accountability, businesses or their chosen arbitration firms set the rules for the secret proceedings, often limiting the procedural protections and remedies otherwise

available to individuals in a court of law. In addition, the often exorbitant arbitration fees are prohibitive for most individuals.

Forced arbitration also weakens the value of federal and state laws intended to protect consumers and employees by removing their ability to enforce those laws in court.

Laws at risk include provisions of the Civil Rights Acts of 1964 and 1991, the Age Discrimination in Employment Act, the Americans with Disabilities Act, the Family and Medical Leave Act, the Fair Labor Standards Act, the Equal Pay Act, the Uniformed Services Employment and Reemployment Rights Act (USERRA), the National Labor Relations Act, the Sherman Antitrust Act, the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Servicemembers Civil Relief Act, the National Defense Authorization Act for Fiscal Year 2013 (amending the Military Lending Act), the Lilly Ledbetter Fair Pay Act of 2009, the Telephone Consumer Protection Act, the Fair Debt Collection Practices Act, the Credit Repair Organizations Act, the Electronic Fund Transfer Act, the False Claims Act, the Fair Credit Reporting Act, the Right to Financial Privacy Act, the Real Estate Settlement Procedures Act, the Truth in Lending Act, and the civil provisions of the Racketeer Influenced and Corrupt Organizations Act.

In April 2011, the U.S. Supreme Court dealt a blow to consumers and employees, ruling that companies can ban class actions in the fine print of contracts. In *AT&T Mobility, LLC v. Concepcion*, the Court held that corporations may use arbitration clauses to ban consumers and employees from exercising their right to join together through class actions to hold powerful corporations accountable. As a result, thousands of valid legal claims by consumers and employees that expose clear abuses and corporate misconduct have been suppressed and prevented from being brought in court. In addition, many class actions have been dismissed and sent to arbitration on an individual basis even when judges state that the cases may be best suited to proceed as class actions.

The Supreme Court further expanded corporations' ability to evade the enforcement of critical federal laws with its decision in *American Express v. Italian Colors Restaurant* (June 2013). In this case, small businesses sought a class action to pursue their claims that Amex had violated federal antitrust laws. The Court held that the class action ban and forced arbitration clause in the contracts were enforceable—even in cases where the cost of individual arbitration would, as a practical matter, prevent the vindication of rights under federal law. The arbitration clause in the Amex contract with the merchants prevented the sharing of costs that a class action would allow. Consequently, these contract terms enable companies to insulate themselves from liability even where they have in fact violated the law.

<u>The AFA would allow consumers and employees to choose arbitration after the dispute arises.</u>

The impact of recent Supreme Court precedent should add urgency for Congress to pass the AFA to enable individuals and small businesses to decide how to resolve disputes, after the dispute arises.

The AFA does not seek to eliminate arbitration and other forms of alternative dispute resolution agreed to voluntarily after a dispute arises. Nor would it affect collective bargaining agreements that require arbitration between unions and employers. The AFA would restore transparency and access to our civil justice system and preserve important civil rights, employment, antitrust, and consumer protections.

Congress has passed laws to ban forced arbitration for disputes involving auto dealers, poultry and livestock producers, certain employees of federal contractors, and servicemembers for some credit and loan products. The time has come for Congress to outlaw forced arbitration for all America's consumers and workers.

We urge you and the other members of Congress to pass S. 878.

Sincerely,

9to5
AARP
AFL-CIO
Alliance for Justice
American Association for Justice
American Association of University Women
American Civil Liberties Union (ACLU)
American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO
Americans for Financial Reform
Bazelon Center for Mental Health Law
Center for Justice & Democracy
Center for Responsible Lending
Citizen Works
Committee to Support the Antitrust Laws
Consumer Action
Consumer Federation of America
Consumer Watchdog
Consumers for Auto Reliability and Safety
Consumers Union
ConsumersCount.Org
D.C. Consumer Rights Coalition
Home Owners for Better Building
Homeowners Against Deficient Dwellings
Legal Aid Justice Center
Maryland Consumer Rights Coalition
MFY Legal Services, Inc.
NAACP
National Association of Consumer Advocates
National Consumer Voice for Quality Long-Term Care
National Consumer Law Center
National Consumers League
National Employment Law Project

National Employment Lawyers Association (NELA)
National Partnership for Women & Families
National Women's Law Center
NC Justice Center
People For the American Way
Public Citizen
Reserve Officers Association (ROA)
The Leadership Conference on Civil and Human Rights
U.S. Public Interest Research Group
West Virginia Citizen Action Group

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December 16, 2013

Honorable Al Franken
309 Hart Senate Office Building
Washington, DC 20510

Dear Senator Franken:

Thank you for your commitment to addressing a long series of rulings by the Supreme Court that have unduly expanded the reach of the Federal Arbitration Act (FAA), and for your work in organizing this important hearing, entitled "The Federal Arbitration Act and Access to Justice." I am writing on behalf of Constitutional Accountability Center (CAC), a public interest law firm, think tank, and action center dedicated to fulfilling the progressive promise of the Constitution's text and history, to offer our thoughts on these recent rulings and to place these rulings within the larger context of the Court's business docket.

Having reviewed the history behind the FAA, CAC shares your conviction that in a series of mostly 5-to-4 rulings, the Supreme Court majority has badly misinterpreted the meaning of the law and the intent of Congress. While CAC has not yet endorsed any specific legislative fixes for these misguided rulings, we believe that it is critical that you and the Senate Judiciary Committee are holding hearings and working on a response to these rulings. In that vein, we are troubled by the statistics produced by Professor Richard Hasen that indicate that Congress has been far less active than in the past at passing legislation that effectively reverses Supreme Court rulings that misinterpret statutes.[1] With a conservative Supreme Court that is actively chipping away at some of the most important progressive statutes enacted by Congress since the New Deal, a responsive Congress is more important now than ever.

I am also writing to share the findings from recent research that we have conducted on the U.S. Chamber of Commerce's success before the Roberts Court. We believe that these findings provide useful background information on the important role that the Chamber has played in shaping the Court's recent business decisions, including those addressing arbitration.

Since 2010, CAC has completed a series of empirical studies on the success rate of the U.S. Chamber of Commerce as an *amicus* participant before the Supreme Court.[2] These studies document a

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[1] Richard L. Hasen, *End of the Dialogue? Political Polarization, the Supreme Court, and Congress*, 86 S. CAL. L. REV. 205 (2013). Professor Hasen documents that recent Congresses have been much less active in overriding the Court's statutorily-incorrect decisions than have prior Congresses – with the number of overrides plummeting from 12 during each two-year congressional term from 1975-1990, to 5.8 per term from 1991-2000, and to a mere 2.8 per term from 2001-2012.

[2] *See A Big Term for Big Business*, http://theusconstitution.org/text-history/2094/big-term-big-business; *Not-So-Risky Business: The Chamber of Commerce's Quiet Success Before the Roberts Court – An Early Report for 2012-2013*, http://theusconstitution.org/think-tank/issue-brief/not-so-risky-business-chamber-commerce%E2%80%99s-

sharp increase in the Chamber's success rate before the Court since Chief Justice Roberts and Justice Alito were confirmed. They also show a serious ideological divide in cases with Chamber participation, with the Court's five conservatives – Chief Justice Roberts and Justices Alito, Kennedy, Scalia, and Thomas – virtually certain to rule in favor of the Chamber's position in closely decided cases.

Just last Term, the Chamber participated in nearly a quarter of the Court's cases, compiling an impressive record of 14 wins and 3 losses – an 82% winning percentage. All told, since Justice Alito succeeded Justice O'Connor on the Court in 2006, the Chamber has won 71% of its cases overall (76 out of 107), compared with only 43% in the late Burger Court (15 of 35 from 1981-1986) and 56% in the stable Rehnquist Court (45 of 80 from 1994-2005).

Even more striking is the Chamber's success in 5-to-4 or 5-to-3 rulings – cases in which just one defection from the majority could have swung the case against the Chamber. With its undefeated record in these closely decided cases last Term, the Chamber has won 82% of these cases overall (27 of 33) since Justice Alito joined the Court, and the Court's conservatives have sided with the Chamber's position 85% of the time in these controversial cases. This represents a massive pro-business shift, even when compared to the last eleven years of the conservative Rehnquist Court (from 1994 to 2005), which sided with the Chamber's position in 64% of its close cases (9 of 14) and whose conservatives sided with the Chamber's position 68% of the time.

One area of particular success for the Chamber has been the Roberts Court's decisions regarding arbitration. In recent years, the Chamber and its Institute for Legal Reform have helped lead the charge in Congress against the proposed Arbitration Fairness Act. Our research demonstrates that the Chamber has also played a leading role in shaping the Roberts Court's arbitration rulings. Indeed, the Chamber has filed *amicus* briefs in every major arbitration case decided by the Roberts Court, including *American Express v. Italian Colors Restaurant*, *AT&T Mobility LLC v. Concepcion*, and *Rent-A-Center v. Jackson*.

The Chamber has also been on the winning side in the vast majority of these cases. Since Justice Alito joined the Court, the Chamber has compiled a record of 8 wins and 2 losses in its arbitration cases – an 80% winning percentage. Interestingly, 6 of these cases were decided by 5-to-4 or 5-to-3 majorities, with the Chamber winning 5 of them and the Court's conservatives siding with the Chamber's position 90% of the time.

Through its participation and success before the Roberts Court, the Chamber has continued to push the Court to expand the reach of the FAA, often by manipulating the text of this near-century-old law and disregarding its legislative history. Nearly two decades ago, Justice O'Connor correctly described the Court's arbitration jurisprudence as "an edifice of its own creation."[3] Today, as a product

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quiet-success-roberts-court-%E2%80%93-early; *Big Wins for Big Business: Themes and Statistics in the Supreme Court's 2010-2011 Business Cases*, http://theusconstitution.org/think-tank/issue-brief/big-wins-big-business-themes-and-statistics-supreme-courts-2010-2011-business; *Open for Business: Tracking the Chamber of Commerce's Supreme Court Success Rate from the Burger Court Through the Rehnquist Court and Into the Roberts Court*, http://theusconstitution.org/think-tank/issue-brief/open-business-tracking-chamber-commerces-supreme-court-success-rate-burger; *A Tale of Two Courts: Comparing Corporate Rulings by the Roberts and Burger Courts*, http://theusconstitution.org/think-tank/issue-brief/tale-two-courts-comparing-corporate-rulings-roberts-and-burger-courts; *The Roberts Court and Corporations: The Numbers Tell the Story*, http://theusconstitution.org/think-tank/issue-brief/roberts-court-and-corporations-numbers-tell-story.

[3] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 283 (1995) (O'Connor, J., concurring).

of subsequent arbitration rulings – many of them issued by the Roberts Court at the Chamber's urging – mandatory binding arbitration provisions now pop up, or more often lie hidden in fine print, in just about every conceivable agreement that Americans are obliged to sign, whether to take a job, obtain telephone service, enroll a parent in an assisted living facility, visit a hospital emergency room, purchase a product, or open a bank account; the list goes on and on.

These agreements frequently tilt the arbitration proceedings in a pro-business direction – for instance, by allowing the companies to choose the arbitrator in a given dispute. Other times – as was the case last Term in *American Express* – these agreements include class arbitration waivers, which require ordinary Americans and small businesses to arbitrate their claims individually rather than as a group. From there, each injured party often faces a disturbing choice, described well by Justice Kagan in her *American Express* dissent: "Spend way, way, way more money than your claim is worth," or drop you claim altogether and "relinquish" your legal rights.[4] In turn, Justice Kagan added, the Court has created a "mechanism" that allows businesses "to block the vindication of meritorious . . . claims and insulate wrongdoers from liability."[5]

These are very serious claims that warrant this Committee's full attention. Thank you very much for considering Constitutional Accountability Center's views as part of this process.

Respectfully,

Douglas T. Kendall
President

[4] *American Exp. Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2316 (2013) (Kagan, J., dissenting).
[5] *Id.* at 2320.

Submission by the Committee to Support the Antitrust Laws

To the Senate Judiciary Committee

For the Record of the Hearing Entitled

"The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

December 17, 2013

The Committee to Support the Antitrust Laws (COSAL) was established in 1986 to promote and support the enactment, preservation and enforcement of a strong body of antitrust laws in the United States. COSAL members are law firms based throughout the country that represent individuals and businesses that have been harmed by violations of the antitrust laws. COSAL urges the Senate to enact the Arbitration Fairness Act, which would prohibit the enforcement of binding, mandatory pre-dispute arbitration clauses in certain cases, including antitrust class actions.

The antitrust laws are vital to the health of our economy because price-fixing and other anticompetitive behavior directly harm small businesses and consumers. For example, in recent years, a number of large-scale empirical studies have examined the impact of cartel activity on prices and determined that cartel overcharges substantially raise prices. Antitrust scholars John M. Connor and Robert H. Lande recently conducted an analysis of over 1500 estimates of cartel overcharges.[1] The median average cartel overcharge for all types of cartels and time periods was 23.3 percent.

According to recent testimony before this Committee by William J. Baer, Assistant Attorney General at the Antitrust Division of the Department of Justice and Ronald T. Hosko, Assistant Director of the Criminal Investigative Division of the FBI, antitrust crimes "cause direct and unambiguous antitrust harm" to consumers and businesses.[2] Their testimony stated:

> During Fiscal Year 2013 the Antitrust Division filed 50 criminal cases, and obtained $1.02 billion in criminal fines. The criminal antitrust fines imposed in these cases reflect the harm that cartels inflict on consumers; under the Sentencing Guidelines they take into account the total value of sales affected by the defendant's participation in the cartel. In

[1] John M. Connor & Robert H. Lande, *Cartels as Rational Business Strategy: Crime Pays*, 34 Cardozo L. Rev. 427, 456-57 (2012).
[2] Statement of William J. Baer and Ronald T. Hosko before the Antitrust, Competition Policy and Consumer Rights Subcommittee of the Committee on the Judiciary, United States Senate, November 14, 2013.

> those 12 months we charged 21 corporations and 34 individuals and courts imposed 28 prison terms with an average sentence of just over two years per defendant.[3]

Private enforcement provides virtually the only way to compensate businesses and consumers that are victims of antitrust violations, such as the ones prosecuted by the Justice Department. The importance of private enforcement is underscored by the very language of the United States' antitrust statutes. Congress created a financial incentive to encourage plaintiffs to act as private attorneys general to bring enforcement actions by allowing them to recover treble damages and attorneys' fees under the Sherman and Clayton acts.[4] Courts have also long considered private enforcement of the antitrust laws, including through class actions,[5] an important complement to public enforcement.[6] The Antitrust Division's Workload Statistics underscore this symbiotic relationship, noting "frequently restitution is not sought in criminal antitrust cases, as damages are obtained through treble damage actions filed by the victims."[7]

Where a cartel has injured businesses or individuals, class actions can be an efficient and effective means of ensuring adequate compensation. This is especially true where the violation resulted in harm to many victims with negative value claims – individual claims involving damages that are much smaller than it would cost to litigate the claim. In the most recent of a string of decisions imposing greater barriers on plaintiffs pursuing class action claims, the Supreme Court blocked the ability of some plaintiffs with low or negative value antitrust claims to bring suit in *American Express Co. v. Italian Colors Restaurant* ("*Italian Colors*"). Here, the Court held that a contractual waiver of class arbitration is enforceable even where a plaintiff's costs to individually arbitrate its claim exceed the potential recovery.[8]

In *Italian Colors*, a class of merchants subject to American Express's Card Acceptance Agreement, which contains provisions mandating arbitration, but precluding class-wide

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[3] *Id*.

[4] *See* section 4 of the Clayton Act, 15 U.S.C. § 15 ("[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue . . . and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.").

[5] In particular, the class action mechanism has facilitated the prosecution of meritorious antitrust claims where otherwise there might not have been private enforcement. *See, e.g.*, HERBERT B. NEWBERG & ALBA CONTE, NEWBERG ON CLASS ACTIONS § 18.08, at 18-3 (3d ed. 1992) ("'It may be that a class action lawsuit is the most fair and efficient means of enforcing the law where antitrust violations have been continuous, widespread, and detrimental to as yet unidentified consumers. Sometimes a class-action lawsuit is the only way in which consumers would know of their rights at all, let alone have a forum for their vindication.'") (quoting *Coleman v. Cannon Oil Co.*, 141 F.R.D. 516, 520 (M.D. Ala. 192).

[6] *See, e.g.*, *Zenith Radio Corp., v. Hazeltine Research, Inc.*, 395 U.S. 100, 13031 (1969) ("[T]he purpose of giving private parties treble-damage and injunctive remedies was not merely to provide private relief, but was to serve as well the high purpose of enforcing the antitrust laws."); *Perma Life Mufflers, Inc. v. Int'l Parts Corp.*, 392 U.S. 134, 139 (1968), ("[T]he purpose of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws."), *overruled on other grounds by Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *Minn. Mining & Mfg. Co. v. N.J. Wood Finishing Co.*, 381 U.S. 311, 318 (1965) ("Congress has expressed its belief that private antitrust litigation is one of the surest weapons for effective enforcement of the antitrust laws.").

[7] U.S. Dep't of Justice, Antitrust Division Workload Statistics FY 2003-2012, 11 n.15, http://www.justice.gov/atr/public/workload-statistics.html.

[8] No. 12-133, 133 S. Ct. 2304 (June 20, 2013).

arbitration, brought antitrust claims against American Express. The plaintiff merchants argued that the provision preventing class arbitration was unenforceable because it rendered arbitration prohibitively expensive; it would cost more for individual merchants to arbitrate their claims than they could recover if they succeeded in arbitration. Plaintiffs' expert economist, Dr. Gary L. French, found that total expert fees, even in an individual action, would cost between several hundred thousand dollars to over one million dollars while the average class member (a median volume merchant) might expect damages of $12,850, or $38,549 when trebled.[9]

On *certiorari*, the Supreme Court reversed the Second Circuit's holding that enforcement of the class arbitration waiver would bar "effective vindication" of statutory rights under the federal antitrust laws. The Supreme Court found that even if a class arbitration waiver renders arbitration prohibitively expensive, the arbitration provision must be enforced.[10]

It is not only the cost of experts that makes individual arbitration prohibitively expensive in cases on behalf of small businesses against large corporations that have violated the antitrust laws. Arbitration of a case brought by a small business against another business would generally be governed by the rules of *commercial* arbitration. Under the American Arbitration Association's (AAA) system, for example, standard administrative filing fees for commercial matters are over $1,000.[11] The majority of these fees has to be paid up front, when a party first files its claim. There are also "deficient filing fees" assessed on "[p]arties that file demands for arbitration that are incomplete or otherwise do not meet the filing requirements" and "[t]he AAA may assess additional fees where procedures or services outside the Rules sections are required." Also, if the case requires three or more arbitrators, the minimum filing fees total over $4,000.

If arbitrating with AAA, each plaintiff would likely have to pay $500 to $800 per hour for the services of the arbitrator. *See In re A2P SMS Antitrust Litig.*, Master File 12-cv-2656 (AJN), Declaration of George A. Bermann Regarding Arbitration Issues, ¶28 (Dec. 10, 2012). An antitrust arbitration can last up to 640 hours, if three arbitrators are used and up to 204 hours, if one arbitrator is used. *Id.* at ¶39.

A piece in the New York Bar Journal made the following statement, in regard to commercial arbitration:

> When a commercial agreement containing an arbitration clause is negotiated, often it is by non-litigators unfamiliar with the arbitration process. Parties who agree to arbitrate before a panel of arbitrators of the AAA, JAMS Resolution Centers (JAMS), The American Health Lawyers Association (AHLA), the

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[9] *In re Am. Express Merchants' Litig.*, 554 F.3d 300, 317 (2d Cir. 2009)
[10] *Id.* at 2309.
[11] See *http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_004102*

> International Chamber of Commerce (ICC) or a myriad of others, are unlikely to contemplate that the out-of-pocket outlay can, within a short period of time, easily *reach six figures and be subject to reallocation to impose payment of the entire fee on the losing party.*

Ronald J. Offenkrantz, *Arbitrating Commercial Issues, Do You Really Know the Out-of-Pocket Cost?*, 18 N.Y.ST.B.J. 30, 31 (2009) (emphasis added).

Like the administrative fees, a portion of the arbitrator fees also have to be paid in advance and must be replenished if they run low. A party's inability to pay its share of fees can result in it being prejudiced in the arbitration. Unlike in most litigation, costs, as well as fees, are often imposed on the losing party in an arbitration. Such relief for a winning defendant could expose some antitrust plaintiffs, especially small businesses, to bankruptcy or "bet the company" risks.

In addition, in an antitrust case with a large number of plaintiffs, a number of factors aside from high costs preclude the victims from being able to assert their rights through individual arbitrations. There are myriad reasons why *seriatim* or even concurrent arbitrations are utterly impractical for handling antitrust cases with numerous plaintiffs. To start with, the average antitrust case lasts about six years, even without trial.[12] Once the first plaintiff begins arbitration, all the others may have to wait six years before they can benefit from the outcome of that arbitration and take advantage of any preclusive effects it may have. However, even waiting for the completion of one arbitration will not aid future plaintiffs in pursuing a subsequent arbitration, as arbitration settlements and rulings can be confidential. Even if the arbitrators' rulings were able to be used by subsequent plaintiffs and constituted grounds for collateral estoppel, the other victims would still have to initiate their own arbitrations, and pay their own filing and arbitrator fees, as well as potential expert fees, before they could take advantage of any collateral estoppel. Furthermore, the first arbitration will likely not toll the statute of limitations for subsequent plaintiffs, as a class action litigation would do for putative class members. Under the four-year statute of limitations dictated by the Clayton Act, many may lose their claims, while awaiting the outcome of the first arbitration or simply due to not finding out that they have been injured.

If numerous cases go forward at once, then numerous sets of plaintiffs' lawyers and experts have to separately, repetitively and wastefully perform work that could be done by one team in a class action. And, as set forth above, arbitrators, unlike judges, do not work for free. They must be paid for equally by each single plaintiff.

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[12] Daniel Crane, *Optimizing Private Antitrust Enforcement*, 63 VAND. L. REV. 675, 692 (2010) ("[T]he average private antitrust lawsuit today takes over six years to disposition" and "[t]he Georgetown study of private antitrust litigation conducted in the early 1980s found that antitrust cases take, on average, about three times longer than other federal cases from initiation of the lawsuit to disposition.")

Furthermore, arbitral forums do not allow an individual plaintiff to obtain, or order the defendant to produce, the names and addresses of class members, notify them of settlements or outcomes, create claim forums, distribute money under a formula or conduct any of the other procedures available in class antitrust damage litigation for the compensation of the parties injured by illegal anticompetitive conduct.

District court class action litigation allows one recovery at one time for all victims wishing to join the action or accept its consequences, efficiently distributed by one administrator. This achieves judicial economy and deterrence based on the full effect of the violation. In contrast, if there is an antitrust violation with a hundred similarly-affected victims and single plaintiff arbitration is imposed due to take-it-or-leave-it form agreements, the victims who do not arbitrate individually would be left, at best, with questionable alternatives, and most likely with no recovery at all. And victims who do not even know that they have a claim against a defendant will never be notified of the claim as they would be in a class action. Thus, the named plaintiffs in any given class action may be the only plaintiffs who benefit from arbitration. Nor can a defendant engaging in arbitration obtain global peace from one settlement, but must instead engage in separate proceedings with each plaintiff whose claim it wishes to resolve.

Prohibiting class actions in situations in which numerous plaintiffs have been injured by a widespread antitrust violation will preclude achievement of the antitrust laws' goals of compensation and deterrence. Antitrust violations are criminal acts. In many cases, defendant companies in private antitrust class action suits have pleaded guilty to federal crimes. Often, executives in those companies spend years in prison as a result of their criminal acts. Under the Supreme Court's decision *in Italian Colors*, firms that commit criminal antitrust violations against millions of victims can insulate themselves from most damage liability by selling their goods only on the condition that any antitrust damage case against them must be conducted in bilateral, one-by-one arbitration.

Compensation of all victims of such widespread conspiracies is necessary to achieve the deterrence objective of the antitrust laws. As Profs. Connor and Lande wrote:

> [t]he dominant law-and-economics model of crime posits that rational choices drive corporate decisions (including the decisions of the individuals involved) to commit crimes--a "cost/benefit analysis" of the decision. Consequently, there exists a bundle of sanctions that the legal system can (at least in theory) calculate that optimally will deter the crime.[13]

[13] Connor and Lande, *supra*, at p. 438.

Such sanctions include government fines and private damages, among other fines. "The standard optimal deterrence formula shows that the total amount of cartel sanctions should equal the cartel's "net harm to others" divided by the probability of detection and proof of the violation."[14] Being precluded from having to pay full compensation to its victims will encourage a cartelist to strike again.

If price-fixers who overcharged hundreds of buyers are sued in a federal class action, and succeed in getting the federal case dismissed in favor of bilateral arbitrations, the game is over. The price-fixers win, pay almost nothing, and the victims lose, as does the antitrust enforcement system. This is a death knell for the victims and a triumph for the antitrust violators, guaranteeing that their scheme will be profitable, and making certain that the antitrust statutes will be prevented from serving their compensation and deterrence functions. In order to prevent such unfair and harmful results for consumers, small businesses, and the marketplace, COSAL urges you to enact the Arbitration Fairness Act.

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[14] *Id.* At 455

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October 30, 2013

Mary Jo White
Chair
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Arbitration Provisions Threaten Market Integrity And Are Contrary To The Federal Securities Laws

Dear Chair White:

We are a group of 29 professors from19 different law schools[1] across the country, each with a specialized focus on and expertise in issues of corporate law or the federal securities laws. Although we hold different views on many aspects of the law in these areas, we are in agreement that the judiciary serves an essential role in the development and enforcement of corporate and securities laws and the protection of investors, and that the judiciary's involvement in the resolution of shareholder disputes is necessary to preserve the integrity of this nation's public financial markets.

We write to bring to the Commission's attention a rapidly developing trend whereby publicly traded businesses, without the approval of their shareholders, are attempting, through broadly written provisions, to limit or eliminate access to state and federal courts for adjudication of a broad range of claims that shareholders may have. We therefore urge the Commission to closely review the potentially harmful impact these practices may have on the historic and important role that private rights of action play in protecting investors, and ultimately to make clear that efforts by corporate boards to eliminate the ability of investors and shareowners to enforce their rights in a public judicial forum is contrary to the federal securities laws.

Background

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[1] Each signer does so individually and his or her institutional identification is provided solely for informational purposes and does not reflect the position of an institution.

Recent years have seen substantial increases in state law shareholder litigation relating to corporate transactions, especially mergers and other types of acquisitions.[2] Additionally, more of these cases have been filed outside of Delaware, where almost half of all public corporations in the United States are incorporated, and thus the traditional forum for the resolution of shareholder disputes.[3] In an effort to rein in multi-forum litigation, an increasing number of corporations have adopted bylaws designating an exclusive forum for the resolution of shareholder disputes. As of September 2011, over 300 publicly-traded corporations had adopted such bylaws. (Such provisions, however, are not the focus of this request.)

At the same time, the U.S. Supreme Court has interpreted the scope of the Federal Arbitration Act ("FAA") to allow greater enforcement of arbitration agreements. Notably, in *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011), the Supreme Court held that the FAA requires courts to enforce class-action waivers in arbitration agreements contained in consumer contracts. And more recently in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013), the Court held that the FAA requires courts to enforce arbitration provisions that bar class actions with respect to federal claims, as well as state claims.

These two developments have begun to conflate, with publicly-traded businesses purporting to designate arbitration as the exclusive forum for the resolution of *all forms* of shareholder disputes through, *inter alia*, bylaw amendments and registration statements. For example, as the Commission is aware, the Carlyle Group recently attempted in anticipation of its IPO to amend its partnership agreement and registration statement to require the arbitration of all shareholder disputes on an individual basis in anticipation of its IPO; after the Commission objected, the Carlyle Group removed the provision. And, in *Corvex Management L.P. v. Commonwealth REIT*, No. 24-C-13-001111, Baltimore City, Part 23 (May 8, 2013), the trustees of a REIT similarly adopted an extraordinarily-broad arbitration bylaw that purported to require that *all* shareholder disputes be arbitrated. A circuit court for the City of Baltimore enforced the bylaw to require arbitration of a claim that the company's board of directors had breached their fiduciary duties responding to a proxy contest from an activist shareholder. In so doing, the court relied in part on its interpretation of the requirements of the FAA.

As discussed below, the FAA has never been interpreted to require the enforcement of bylaws or similar provisions unilaterally adopted to remove judicial oversight of investor disputes. Although often analogized to "contracts," corporate bylaws – particularly in public

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[2] In 2007, shareholders filed litigation relating to about forty percent of public company mergers. By the first half of 2011, ninety percent of the deals exceeding $100 million were challenged; the number rises to ninety-six percent for deals above $500 million. *See* Joseph A.Grundfest & Kristen A. Savelle, The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis, 68 Bus. Law. 325, 335 (2013).

[3] Delaware has seen its dominance in the forum of choice for resolving suits against Delaware corporations plummet since 2001, so that the percentage of merger challenges filed exclusively in Delaware reached its lowest point of 30 percent in 2006. There has been no similar change with respect to challenges filed against non-Delaware corporations, which are traditionally brought in the corporation's home state.

corporations that form the basis of the nation's financial markets – are vastly dissimilar to the kind of contractual agreements that have been enforced by courts, including the Supreme Court, under the FAA. We believe that in the absence of a clear Congressional mandate to permit the forced arbitration of shareholder disputes, the Commission should continue to exercise its well-founded and long-held opposition to such provisions as being contrary to the anti-waiver provisions of the securities laws.

Judicial Review Of Investor and Shareholder Disputes Involving Publicly-Traded Businesses Protects The Integrity of the Nation's Financial Markets

We believe that it is essential to maintaining the integrity of our nation's financial markets that investors and shareholders have access to the courts to resolve claims under the federal securities laws. The federal securities laws provide a range of enforceable rights that protect shareholders and thereby significantly enhance investor confidence in U.S. securities markets. An important component in the investors' faith in the U.S. capital markets is the independence and transparency that has historically accompanied their vindication of the rights and protections accorded them through the courts. For example, private litigation of federal securities claims has significantly advanced the development of the federal securities laws, generating a set of standards regarding corporate disclosure duties that guides corporate action and management behavio. Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder in particular, serve a public purpose by providing a means for private investors to police securities fraud and maintain the integrity of the markets. Similarly, private enforcement of the Exchange Act's proxy rules greatly enhances shareholder participation in the governance of public corporations. These are public rights that are being vindicated and their vindication should happen in a public forum.

Arbitration simply is not an equivalent medium for meaningful oversight of the rights of investors and shareholders. Arbitration proceedings are not public, and arbitration decisions do not require written opinions. In arbitration, there is no requirement that principles of *stare decisis* guide decisions, and arbitrators may or may not have the expertise and experience of a judge. Moreover, arbitrators do not face the same level of review or public accountability as do judges generally. And appeals and other important procedures and safeguards that are available in court are not available in arbitration. In short, forcing investor and shareholder disputes into arbitration would fundamentally alter investor confidence in the corporate form, by eliminating any real ability of shareholders – the owners of publicly traded corporations – to rely on the existence and enforceability of the disclosure obligations to which corporations and their managers are subject.

Forcing Arbitration Of Shareholder Disputes Is Contrary To The Federal Securities Laws

In the absence of any statutory presumption in favor of arbitration, the Commission should continue to regard mandatory arbitration provisions as contrary to the public policy concerns that animate the federal securities laws, and as inconsistent with the "anti-waiver" provisions of Section 29(a) of the Exchange Act ("Section 29(a)") and Section 14 of the Securities Act ("Section 14").

For decades, the Commission has taken the view that public policy concerns weigh heavily against the inclusion of arbitration clauses in the corporate documents of public companies. In 1990, then SEC Assistant General Counsel Thomas L. Riesenberg explained that "it would be contrary to the public interest to require investors who want to participate in the nation's equity markets to waive access to a judicial forum for vindication of federal or state law rights, where such waiver is made through a corporate charter rather than an individual investor's decision."[4] And more recently, Commissioner Luis A. Aguilar observed that "[i]t is unrealistic to expect that the Commission will have the resources to police all securities frauds on its own, and as a result, it is essential that investors be given private rights of action to complement and complete the Commission's efforts."[5]

Concerns that such provisions run afoul of the letter of the securities laws are equally well founded. Congress has recognized investors' right to private enforcement of the securities laws in the Private Securities Litigation Reform Act of 1995 (the "PSLRA") 15 U.S.C. §§ 77z-1 *et seq.* and 78u-4 *et seq,*, which sets forth detailed guidance regarding the role of lead plaintiffs in private class actions to enforce the securities laws. This explicit statutory instruction highlights the key function of federal securities class actions in maintaining the transparency and integrity of the U.S. capital markets. *See* Joint Explanatory Statement of the Committee of Conference on H.R. 1058 at 31, reprinted in 2 U.S.C.C.A.N. 730 (104th Cong., 1 st Sess. 1995).

We believe that by substantially weakening investors' access to the courts, mandatory arbitration clauses run afoul of Sections 14 and 29(a), which provide that "any condition, stipulation, or provision waiving compliance with either Act is void.

The nature of the threat mandatory arbitration provisions pose to investor access to the courts is underlined by the Supreme Court's decision in *Shearson-Am. Exp. Inc.* v. *McMahon,* 482 U.S. 220, 228 (1987). In *McMahon*, the Court concluded that only "where the SEC has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights," would enforcement of an agreement to arbitrate not constitute a waiver of compliance with any provision of the Exchange Act under Section 29(a). *Id.* at 238. With respect to mandatory arbitration provisions in corporate bylaws the Commission does not have oversight of the type referred to in *McMahon*. The current mandatory arbitration provisions in broker-customer agreements therefore arise from a very different arrangement than that approved by the Supreme Court The extreme feature of mandatory arbitration clauses is not only the absence of Commission oversight but more importantly the absence of any one-on-one interchange from which consent can be said to arise that arbitration will be the exclusive means for resolving any future dispute. Accordingly, mandatory arbitration provisions violate Section 29(a).

For the above reasons, the undersigned professors respectfully request the Commission evaluate the validity of corporate provisions restricting shareholder access to the courts.

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[4] *See* Thomas L. Riesenberg, *Arbitration and Corporate Governance: A Reply to Carl Schneider*, Insights, Aug. 1990, at 2.

[5] Luis A. Aguilar, Commissioner, U.S. Securities and Exchange Commission, *Statement by Commissioner: Defrauded Investors Deserve Their Day in Court* (Apr. 11, 2012), available at http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171490204#.UjhoQuDDlQs

CC: Commissioner Luis A. Aguilar
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December 16, 2013

Honorable Patrick Leahy, Chairman
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

Honorable Chuck Grassley, Ranking Member
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

Re: The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"
Hearing: December 17, 2013

Dear Chairman Leahy and Ranking Member Grassley:

As Comptroller of New York State, I am the administrative head of the New York State and Local Employees Retirement System (System) and the Trustee of the New York State Common Retirement Fund (Fund). I have a fiduciary duty to invest and safeguard the System's assets, held by the Fund and currently valued at approximately $160 billion, for the exclusive benefit of the System's more than one million members, beneficiaries, and retirees. It is in this capacity that I respectfully request consideration of my comments below in conjunction with the Senate Judiciary Committee's December 17, 2013 hearing entitled "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?" While I appreciate that the focus of the hearing does not specifically encompass the investment community, the issues to be examined are equally important to this community and have equal bearing thereto.

To help me fulfill my fiduciary duty, I have instituted a robust corporate governance program by which I strive to identify and engage with those of the Fund's portfolio companies whose governance and/or business models may expose our investments to undue risk. The Fund has achieved significant results through such engagement; nonetheless, the Fund's portfolio includes companies whose wrongful behavior results in investment losses, leaving me with no recourse other than litigation. In determining whether to pursue litigation, I am mindful of the consequent expense and time commitment – both for the Fund and for our portfolio company.

Thus, it is only in the most egregious circumstances that I will proceed with litigation. And it is in those same circumstances that access to our judicial system in order to adjudicate such disputes is most critical. Courts at both the federal and state level have long provided guidance to corporations and investors alike on their respective responsibilities and rights.

As Congress intended when it enacted the Private Securities Litigation Reform Act in 1995 (PSLRA), the Fund, as a large institutional investor, has served as lead or co-lead plaintiff in nine class actions and, to date, has recovered in excess of $11.5 billion on behalf of investors who incurred losses due to the fraudulent or negligent behavior of corporate actors. Class actions provide, in many instances, the only economically feasible means by which most investors can obtain redress. I believe that exercising this private right of action in our public judicial system in accordance with the PSLRA not only provides for an equitable adjudication of disputes, but also helps maintain the integrity of our capital markets and can act as a deterrent to corporate wrongdoing.

I am concerned that the recent Supreme Court decisions being examined by the Senate Judiciary Committee, as well as rulings by other courts upholding a variety of forced arbitration and class waiver provisions, will restrict or eliminate investors' access to our judicial system. Specifically, such decisions may encourage a trend toward corporate actions to enact or amend bylaws – even by unilateral amendment – in order to include mandatory arbitration and/or class waiver provisions. Such provisions would effectively deny or greatly diminish the ability of investors to seek meaningful recourse for losses incurred as a result of corporate wrongdoing. I do not believe that substituting forced arbitration in the place of access to the judicial system will afford investors the opportunity for reasonable adjudication of disputes, particularly in those instances in which investors are unable to share costs to pursue arbitration. Further, such requirements would directly undermine the PSLRA and enforcement of the federal securities laws generally.

Mandatory arbitration, especially when coupled with class waiver provisions, would all but eliminate meaningful remedies for such investors. I respectfully request that this Committee's focus on the impact of recent court decisions on consumers, workers and small businesses be broadened to consider the related impact on investors.

Very truly yours,

Thomas P. DiNapoli
New York State Comptroller

Cc: Honorable Al Franken
Honorable Charles E. Schumer
Honorable Kirsten Gillibrand
Honorable Tim Johnson
Honorable Mike Crapo

EXPUNGEMENT STUDY OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION[1]

INTRODUCTION

In the context of the securities industry, the term "expungement" refers to the process by which an individual stockbroker licensed through the Financial Industry Regulatory Authority, Inc., ("FINRA") can seek to have removed from his or her public regulatory record maintained through the Central Registration Depository ("CRD") information concerning a complaint or complaints made by investors which arise from the conduct of the broker.[2]

PIABA has undertaken this study of expungement requests in securities arbitration proceedings filed between January 1, 2007 and December 31, 2011, by investors against securities broker/dealers and/or individual brokers. PIABA requested that the Securities Arbitration Commentator ("SAC") search its database for arbitration awards in investor disputes with securities industry members that mention the term "expungement" and to extract from each award and place on spreadsheets specific types of data as requested by PIABA.[3]

The most alarming statistic arising from an analysis of the SAC data is the very high percentage of cases resolved by settlement or stipulated awards in which expungement relief has been granted. For the time period January 1, 2007 through May 17, 2009, expungement was granted in 89% of the cases resolved by stipulated awards or settlement. For the time period

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[1] PIABA is an international, not-for-profit, voluntary bar association of lawyers who represent claimants in securities and commodities arbitration proceedings and securities litigation. The mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration, by seeking to protect such investors from abuses in the arbitration process, by seeking to make securities arbitration as just and fair as systemically possible and by educating investors concerning their rights.

[2] Broker/dealers that are members of FINRA may also seek expungement of customer complaint information.

[3] The analysis, opinions, and conclusions expressed in this study are those of PIABA only. SAC has not participated in the preparation of the text of this study. SAC's role with respect to this study has been limited to providing arbitration award data to PIABA for its review and analysis.

May 18, 2009 through December 31, 2011, expungement relief was granted in 96.9% of the cases resolved by settlements or stipulated awards.

The data also revealed that one individual associated with a brokerage firm during the Review Period requested expungement relief 40 times, and arbitration panels granted expungement relief to that individual 35 times.

The purposes of PIABA's study include the following:

(1) PIABA has analyzed the data provided by SAC with respect to arbitration awards rendered in cases initiated by investors against broker/dealers and/or brokers for cases filed during the five year time period between January 1, 2007 and December 31, 2011, which mention the term "expungement" to determine whether any trends with respect to expungements can be discerned;

(2) To provide context of the above-described analysis, PIABA provides an overview of the Central Registration Depository ("CRD") system, Notices to Members issued by the National Association of Securities Dealers, Inc. ("NASD"), Regulatory Notices issued by FINRA, and rule changes adopted by NASD and FINRA with approval of the Securities and Exchange Commission ("SEC") with respect to the CRD system and expungements;

(3) PIABA discusses issues identified as a result of the analysis of the expungement data, expresses conclusions or opinions with respect to those issues, and expresses ideas about how the issues reflected in the expungement data should be addressed.

THE CENTRAL REGISTRATION DEPOSITORY SYSTEM

FINRA maintains the qualification, employment and disclosure histories of 5100 broker/dealers and approximately 660,000 of their securities employees in the electronic CRD

system.[4] FINRA and the North American Securities Administrators Association ("NASAA") established a CRD system in 1981. In 1999, the CRD system was transformed from a paper-based system under which paper registration forms were submitted to the NASD and entered by it, to a web-based system in which the vast majority of registration forms are filed online via the Internet.[5] FINRA's predecessor, NASD[6], has described the CRD system as follows:

> The CRD system is an online registration and licensing system for the U.S. securities industry, state and federal regulators, and self-regulatory organizations ("SROs"). The CRD system contains broker/dealer information filed on Forms BD and BDW and information on associated persons filed on Forms U-4 and U-5. The CRD system also contains information filed by regulators via Form U-6. The CRD system contains administrative information (*e.g.*, personal, organizational, employment history, registration, and other information) and disclosure information (*e.g.*, criminal matters, regulatory disciplinary actions, civil judicial actions, and information relating to customer disputes) filed on these forms.
>
> NASD operates the CRD system pursuant to policies developed jointly with the North American Securities Administrators Association (NASAA). NASD works with the SEC, NASAA, other members of the regulatory community, and member firms to establish policies and procedures reasonably designed to insure that information submitted to and maintained on the CRD system is accurate and complete. These procedures, among other things, cover expungement of information from the CRD system in narrowly defined circumstances.[7]

Thus, for each associated person licensed by NASD or FINRA, the CRD system contains disclosure information with respect to the associated person having been named in a criminal

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[4] *See* FINRA Dispute Resolution Expungement training materials at p. 5. The FINRA Dispute Resolution Expungement training materials are available at http://www.finra.org/ArbitrationAndMediation/Arbitrators/Training/WrittenMaterials/index.htm.

[5] *See* FINRA Dispute Resolution Expungement training materials at 6.

[6] FINRA was formerly known as National Association of Securities Dealers, Inc. On July 30, 2007, NASD acquired the member regulation, enforcement, and arbitration operations of the New York Stock Exchange and changed its name to FINRA.

[7] NASD Notice to Members 04-16, which is available at http://www.finra.org/Industry/Regulation/Notices/2004/P003233.

matter, having been the subject of a regulatory disciplinary action, having been named in a civil judicial action, and having been named in an investor arbitration proceeding.

For many years, there was an anomaly in the reporting requirements with respect to customer complaints. Until May 18, 2009, the questions on the Form U-4 and Form U-5 only required the reporting of two categories of customer complaints: (1) written or oral customer-initiated, investment-related complaints involving alleged sales practice violations for damages in the amount of $5,000 or more; and (2) customer-initiated, investment-related, arbitration or civil litigation claims in which the broker was named as a respondent or defendant and was alleged to have been involved in one or more sales practice violations. Thus, if a registered representative was the subject of an oral or written investment-related complaint by a customer alleging one or more sales practice violations and seeking damages of $5,000 or more, which was conveyed to the broker/dealer employing the registered representative, that customer complaint had to be reported to NASD or FINRA. Likewise, if a registered representative was named as a respondent or defendant in an investment-related arbitration or civil action filed by a customer in which the customer alleged the registered representative's involvement in one or more sales practice violations, the broker/dealer employing the registered representative had an obligation to report to NASD or FINRA the filing of the arbitration proceeding or civil action. However, prior to May 18, 2009, if a registered representative was identified by name in a customer-initiated arbitration proceeding or civil action or otherwise identified as the person involved in one or more sales practice violations, but the registered representative was not named as a respondent or defendant, there was no requirement to report to NASD or FINRA the filing of the arbitration proceeding or civil action.

Investor advocates and others complained to FINRA about this anomaly. On March 6, 2009, FINRA filed a proposed rule change with the SEC for comment, review, and approval.[8] The rule amendments included in the proposed rule change addressed the above-described anomaly by incorporating two additional questions into the Forms U-4 and U-5. One of those questions required the reporting to FINRA of a registered representative being the subject of (without being named as a respondent or defendant) an investment-related, customer-initiated arbitration claim or civil action within the past twenty-four months in which the customer alleged one or more sales practice violations and requested compensatory damages of $5,000 or more.[9] On May 13, 2009, the SEC approved FINRA's proposed rule change described above[10] In May, 2009, FINRA announced the SEC's approval of the proposed rule change.[11] FINRA announced that the amendments with respect to the reporting of customer complaints on Forms U-4 and U-5 became effective on May 18, 2009. Additional questions on the Forms U-4 and U-5 applied to arbitration claims or civil actions filed on or after May 18, 2009.[12]

PIABA chose to base this study on arbitration awards which mention "expungement" in customer-initiated proceedings filed between January 1, 2007, and December 31, 2011, in part, to analyze the effect that the amendments announced in Regulatory Notice 09-23 have had on expungements. The May 18, 2009, effective date is approximately at the midpoint of the five year time period for which PIABA obtained arbitration award data from SAC.

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[8] *See* Exchange Act Release No. 59916 (May 13, 2009) (SEC Order Approving SR-FINRA-2009-008).

[9] FINRA maintains on its website at www.finra.org a public disclosure database concerning broker/dealers and brokers called "BrokerCheck". FINRA's BrokerCheck database for registered representatives includes employment history, licensure and registration information, and disclosure information, including customer complaints. FINRA's BrokerCheck database is available at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/.

[10] Exchange Act Release No. 59916 (May 13, 2009) (SEC Order Approving SR-FINRA-2009-008), 74 Fed.Reg. 23750 (May 20, 2009) (Order Approving File No. SR-FINRA-2009-008).

[11] Regulatory Notice 09-23 is available at http://www.finra.org/Industry/Regulation/Notices/2009/P118706.

REGULATORY BACKGROUND CONCERNING EXPUNGEMENTS

After the inception of the CRD system in 1981, the NASD generally honored court-ordered expungements.[13] In NASD Notice to Members ("NTM") 01-65, the NASD also stated, "Arbitrator-ordered expungements that met certain requirements also were honored until January 1999."[14] NASD did not describe in NTM 01-65 what those "certain requirements" were. In the same notice, NASD recognized that most customer/broker disputes are resolved in arbitration or are settled without any ruling by a finder of fact. NASD further noted that neither of those customer claim resolution methods results in a document that explicitly identifies the basis for granting expungement relief, because arbitrators are not required to provide the reasoning for a decision or award, and arbitrators typically do not do so.[15]

The reference in NTM 01-65 to arbitrator-ordered expungements that met certain requirements being honored until January, 1999, relates to NASD Regulation imposing a moratorium on arbitrator-ordered expungements effective January 19, 1999.[16] The moratorium was the result of a disagreement between NASD Regulation and NASAA concerning arbitrator-ordered expungements. At that time, the CRD system was operated pursuant to an agreement between NASD Regulation and NASAA. NASD Regulation had taken the position that expungement of information from the CRD system ordered by an arbitrator and contained in an award should be given the same treatment as a court-ordered expungement. NASAA disagreed because it was the opinion of NASAA that under some state laws information submitted to the

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[12] *See* FINRA Regulatory Notice 09-23 at p. 4.
[13] *See* NASD Notice to Members 01-65, p. 564, which is available at http://finra.complinet.com/en/search/search.html?rulenumber=01-65.
[14] *Id.*
[15] *Id.* at p. 566 and fn. 8.
[16] *See* NASD Notice to Members 99-09 ("NTM 99-09") at p. 47, which is available at http://www.finra.complinet.com/en/search/search.html?rulenumber=99-09.

CRD system was a state public record, and such state laws did not recognize the authority of arbitrators to remove a state public record.[17]

Later in 1999, NASD Regulation issued Notice to Members 99-54 ("NTM 99-54") in which it recognized that information on the CRD system "has important investor protection implications, provided it is complete and accurate." NASD Regulation further stated, "Therefore, such information should not be expunged without good reason (*e.g.*, a finding that expungement relief is necessary because information on the CRD system is defamatory in nature, misleading, inaccurate, or erroneous)."[18]

In NTM 99-54, NASD Regulation sought comment on an approach that would establish standards which would have to be satisfied before NASD Regulation would expunge information from the CRD system based on an arbitrators' award.[19] In this notice, NASD Regulation also posed the following question:

> **Should consent awards (*i.e.*, those containing expungement directives) be treated differently than awards issued after full consideration of the merits of the dispute?** (emphasis in the original)[20]

NASD Regulation requested comments on whether the establishment of standards as outlined in the notice would provide a basis for NASD Regulation to treat stipulated awards with expungement directives in the same manner as awards containing expungement directives after a full hearing.[21]

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[17] *Id.*
[18] *See* NASD Regulation Notice to Members 99-54 at p. 2, which is available at http://www.finra.org/Industry/Regulation/Notices/1999/P004218.
[19] *Id.* at p. 2.
[20] *Id.*
[21] *Id.* at pp. 2-3.

NASD Regulation noted the widely accepted authority of arbitrators to award equitable relief. It stated its belief that arbitrators ordering expungement of information from the CRD system which is determined to be defamatory, misleading, inaccurate, or erroneous is equitable relief within the authority of the arbitrators. However, as of the issuance of NTM 99-54, the NASD's Code of Arbitration Procedure and its arbitrator training materials did not address the granting of equitable relief in the form of expungement of information from the CRD system.[22]

NTM 01-65 also included a discussion of stipulated awards which result from a settlement between the parties and do not involve any findings of fact as to the merits of the investor's claim. In the discussion of stipulated awards, the NASD stated:

> [C]oncerns had been raised about the possibility of negotiated arrangements wherein a firm may agree to settle a claim filed by a customer against an associated person and the firm, provided the customer agrees to the inclusion of a directive to expunge all information about the claim from the associated person's CRD record. In some cases, a customer claim/allegation may have merit and, therefore should be reported on the uniform registration forms, included in the CRD system for use by regulators and broker/dealers, and made available to investors through NASD Regulation's PDP [Public Disclosure Program]. Expungement may be inappropriate under these circumstances.[23]

At the conclusion of the foregoing quotation, the NASD appended a footnote, which stated the following:

> **NASD Regulation is aware of allegations that firms have pressed customers/claimants into accepting expungement as a condition of settlement of arbitration proceedings. While we believe that the proposed rules would address these concerns, NASD Regulation would consider this practice to be a possible violation of Rule 2110.**[24] (Emphasis added)

[22] *Id.* at p. 3.
[23] NASD NTM 01-65 at 567.
[24] *Id.* at p. 570, fn 14.

In addition to the discussion in 01-65 described above, NASD stated:

> "Stipulated" (or consent) awards or settlements are a source of particular concern because typically there has been no hearing on the merits, no independent fact finder involved in the negotiations, and no rationale provided for the expungement. While there may be legitimate reasons for the expungement, those reasons generally are not provided in a stipulated award or a settlement. Therefore, NASD Regulation is proposing that any approach dealing with the expungement of customer dispute information must address both expungement orders in arbitration awards after a hearing on the merits and "stipulated" or consent awards in which the parties agree to expungement as part of the settlement and then present the settlement to the arbitrator for inclusion in an award.[25]

Thus, as early as 1999, NASD Regulation had concerns about whether stipulated or consent awards containing expungement relief should be treated differently than awards issued after a hearing on the merits. NASD reiterated those concerns in NTM 01-65. Significantly, NASD Regulation took the position that it would consider respondents conditioning the settlement of arbitration proceedings on customer claimants' agreement to expungement relief to be a possible violation of the just and equitable principles of trade under Rule 2110.

The standards for granting expungement relief proposed by NASD Regulation in NTM 01-65 were factual impossibility or clear error, the claim being without legal merit, and the claim being defamatory in nature. The notice stated that NASD Regulation believed that it would be proper to include expungement relief in stipulated awards only in cases that involve factual impossibility or a party being mistakenly named.[26]

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[25] *Id*. at p. 566.
[26] *Id.* at 567.

NASD's next effort to establish standards for the granting of expungement relief came with the filing of proposed Rule 2130 in a submission to the SEC on November 19, 2002.[27] NASD Rule 2130, entitled "Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD) System", established requirements to be met by member firms or associated persons to obtain the expungement of information from the CRD system arising from a customer complaint. First, the rule required that member firms and associated persons must obtain an order from a court of competent jurisdiction directing expungement or confirming an arbitration award containing expungement relief. Second, member firms and associated persons that petitioned a court for expungement relief or sought judicial confirmation of an arbitration award containing expungement relief were required to name NASD as an additional party and serve NASD with all appropriate documents, unless NASD waived that requirement. Third, the rule set forth three affirmative judicial or arbitral findings that might result in NASD waiving the obligation to name it as a party in a petition to a court for expungement relief or confirmation of an arbitration award granting such relief:

> (A) The claim, allegation, or information is factually impossible or clearly erroneous;
>
> (B) The registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or
>
> (C) The claim, allegation, or information is false.

[27] SEC Order Granting Approval of Proposed Rule Change and Amendment No. 1, Thereto, and Notice of Filing Order Granting Accelerated Approval to Amendment No. 2, Thereto, Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information From the Central Registration Depository System, 68 Fed.Reg. 74667 (December 24, 2003), Exchange Act Release No. 48933 (File No. SR-NASD-2000-168 (Dec. 16, 2003, 68 Fed.Reg. 74667 (December 24, 2003). NASD Rule 2130 has been incorporated into the FINRA Manual as Rule 2080.

Fourth, NASD reserved the discretion under extraordinary circumstances to waive the obligation to name NASD as a party to a petition filed in court if the expungement relief and accompanying findings providing the basis for that relief are meritorious and expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.[28]

In its order approving Rule 2130, the SEC noted that, "Currently, it is possible that respondents may agree to pay damages as a quid pro quo for expungement and obtain court confirmation of the expungement."[29] NASD took the position that the proposed rule would reduce, if not eliminate, the risk of expungement of information critical to investor protection and regulatory interests as a condition in settlement negotiations. NASD believed that any concern about members or associated persons "buying clean records" would be addressed by the requirement in the rule of an "affirmative determination" of one of the grounds specified in the rule by the arbitrators.[30] The SEC expressed its agreement with NASD's position that the "affirmative" determination requirement would provide sufficient regulatory protection and would not allow the "buying of clean records".[31]

Rule 2130 became effective on April 12, 2004, and applied to any request filed with a court of competent jurisdiction to expunge customer dispute information from the CRD system, which was based upon an arbitration proceeding or civil action filed on or after April 12, 2004.[32]

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[28] *Id.*
[29] 68 Fed.Reg. 74667, 74670 (Dec. 24, 2003).
[30] *Id.*
[31] *Id.* at 74671.
[32] *See*, NASD Notice to Members 04-16, at p. 211, which is available at http://www.finra.org/Industry/Regulation/Notices/2004/P003233.

In June, 2004, NASD issued NTM 04-43[33] to provide guidance to member firms and associated persons with respect to the use of affidavits obtained from customers in connection with stipulated awards or settlements to obtain expungement of customer dispute information under Rule 2130. In NTM 04-43, NASD stated that it had recently become aware of situations in which respondents appeared to be settling customer claims, at least in part, for monetary compensation provided to the customer in return for an affidavit from the customer absolving one or more of the respondents from the wrongdoing alleged in the statement of claim.[34] NASD cautioned member firms and associated persons that paying consideration for affidavits from customers as part of settlement negotiations, the content of which is untrue and contradicts the allegations in the statement of claim, exposed member firms and associated persons to a variety of sanctions, including a potential disciplinary proceeding for violation of NASD rules, including Rule 2110.[35] NASD concluded NTM 04-43 by stating:

> NASD believes that abusing NASD's dispute resolution system by negotiating settlements with customers in return for exculpatory affidavits that the member or associated person knows or should know are false or misleading contravenes Rule 2110, which requires members and their associated persons, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade.[36]

Thus, with the issuance of NTM 04-43, NASD put member firms and associated persons on notice that it was a prohibited practice and a violation of NASD rules for member firms and associated persons to bargain for as part of settlement negotiations a contrived affidavit from the customer claimant which contradicts the allegations of the statement of claim for the purpose of

[33] NASD Notice to Members 04-43 is available at http://www.finra.org/Industry/Regulation/Notices/2004/P003014.
[34] *Id.* at p. 544.
[35] *Id.*
[36] *Id.* at p. 555.

obtaining expungement relief. Bargaining for such an affidavit from a customer claimant could clearly result in the "buying of a clean record" and would make a mockery of any "affirmative determination" of one of the three grounds in Rule 2130 by a panel of arbitrators.

NASD issued NTM 04-44 along with NTM 04-43.[37] NTM 04-44 provided guidance to member firms and associated persons concerning impermissible confidentiality provisions in settlement agreements, impermissible complaint withdrawal provisions, and procuring false or misleading affidavits as a condition to settlement.[38] Impermissible confidentiality provisions include those that prohibit, limit, or discourage customer claimants or other persons from disclosing settlement terms or facts giving rise to the dispute in response to inquiries from regulatory agencies.[39] Impermissible complaint withdrawal provisions included conditioning a settlement on a customer claimant withdrawing a pending complaint filed with NASD or another regulatory agency.[40] NASD notified member firms and associated persons that these two practices, as well as the procurement of false or misleading affidavits from customer claimants as a condition of settlement, were violations of Rule 2110.[41]

With NTM 04-43 and NTM 04-44, NASD made it clear that practices designed to "game" the expungement system established by Rule 2130 or to prevent or discourage regulatory inquiry concerning settlement of customer disputes constitute violations of NASD rules, including Rule 2110.

Despite the approval and implementation of Rule 2130, FINRA determined that there were still problems that needed to be addressed with respect to requests to expunge customer

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[37] NASD Notice to Members 04-44 is available at http://finra.org/Industry/Regulation/Notices/2004/P003011.
[38] *Id.* at pp. 558-559.
[39] *Id.* at 558.
[40] *Id.* at 559.

dispute information under the rule. There was no requirement that arbitrators hold a recorded hearing session regarding the propriety of expungement. There was no requirement that in cases involving settlements, arbitrators review the settlement documents and consider them when determining whether expungement was appropriate. There was no requirement that arbitrators base their granting of an award of expungement on one of the three grounds set forth in Rule 2130. There was no requirement that arbitrators provide a written explanation of the reasons for a finding that one or more of the Rule 2130 grounds for expungement apply to the facts of the case. There was no requirement that all forum fees pertaining to a request for expungement relief be assessed against the party requesting that relief.

FINRA addressed these problems in March, 2008, with a proposed rule change, proposing the adoption of Rule 12805 as an addition to the Code of Arbitration Procedure for Customer Disputes and Rule 13805 of the Code of Arbitration Procedure for Industry Disputes.[42] Rule 12805 contains express provisions addressing each of the problems in the expungement process identified above. In its order approving Rules 12805 and 13805, the SEC made note of a number of important statements and positions of FINRA, and the SEC made several statements of consequence with respect to the expungement process.

FINRA advised the SEC that while arbitrators may order expungement after a hearing on the merits in a customer's case, it is more common for arbitrators to order expungement at a party's request to facilitate a settlement. FINRA advised the SEC that the terms of the settlement could require a customer to consent to or not oppose ordering of expungement relief in a stipulated award. In determining whether to grant expungement in conjunction with a settlement

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[41] *Id.* at 558.

or a stipulated award, FINRA expected arbitrators to review the settlement agreement regarding the amount paid and other terms and conditions of the agreement which might raise concerns about whether expungement relief was appropriate. However, apparently, arbitrators frequently did not review the terms of settlement agreements before granting expungement relief.[43]

One of the arguments made by commenters on the proposed rule change was that arbitrators would hear only the position of the party requesting expungement if customer claimants did not participate in the expungement hearing. In response to this argument, FINRA assured the SEC that it would take appropriate steps to ensure that arbitrators perform the essential fact-finding that is required by Rule 12805, whether or not a customer appears at the expungement hearing.[44]

Another argument made in comment letters submitted with respect to the proposed rule change was that the rule should deter excessive expungement relief, particularly in situations involving settlements or the agreement not to oppose expungement relief as a condition of the payment of settlement consideration to the customer. In response to this argument, FINRA stated, as it had many times before, that expungement relief should be an extraordinary remedy.[45] In approving the proposed rule change, the SEC made specific note of FINRA's repeated position that expungement relief is to be an extraordinary remedy and FINRA's position that expungement should be granted only when the information to be expunged has "no meaningful

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[42] *See* Exchange Act Release No. 58886 (October 30, 2008), 73 Fed.Reg. 66086 (November 6, 2008) (File No. SR-FINRA-2008-010).
[43] 73 Fed.Reg. 66086 at p. 66087.
[44] 73 Fed.Reg. 66086 at p. 66088.
[45] *Id.* (citations omitted)

regulatory or investor protection value".[46] The SEC also stated that it believes FINRA should review expungement requests to ensure that expungement is an extraordinary remedy.[47]

The SEC made the following significant statements in support of its decision to approve the proposed rule change:

> **[T]he Commission believes that having accurate and complete information in the CRD is vital; information that has regulatory value or that could assist investors in protecting themselves should not be removed from CRD.**
>
> * * *
>
> **The Commission believes that the training and education FINRA provides in conjunction with the proposed rule change will be critical to the implementation and proper application of the rules. Proper training of arbitrators should help make expungement the extraordinary remedy that it was meant to be and should convey to the arbitrators the importance of their role in maintaining the integrity of the CRD.**
>
> * * *
>
> **Given the importance of CRD for regulators and to customers who want to get information about registered persons or member firms before they do business with them, the Commission urges FINRA in its regulatory role to monitor how this rule is applied by arbitrators to assure that it is achieving its goals, and to propose additional changes if needed.**[48] (Emphasis added)

With Regulatory Notice 08-79 ("NTM 08-79), FINRA announced the SEC's approval of Rules 12805 and 13805 with an effective date of January 26, 2009.[49] In NTM 08-79, FINRA stated the following:

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[46] 73 Fed.Reg. 66086 at p. 66089. (citations omitted)
[47] 73 Fed.Reg. 66086 at p. 66090.
[48] *Id.*
[49] *See* Regulatory Notice 08-79 at p. 1, which is available at http://www.finra.org/Industry/Regulation/Notices/2008/P117541.

> Accurate and complete reporting in CRD, including the reporting of required customer dispute information, is an important aspect of investor protection.
>
> * * *
>
> The new procedures ensure that arbitrators have the opportunity to consider the facts that support or weigh against a decision to grant expungement. The procedures add transparency to the process and safeguards designed to ensure that the extraordinary relief of expungement is granted only under appropriate circumstances.[50]

ANALYSIS OF DATA CONCERNING EXPUNGEMENT REQUESTS AND ARBITRATORS' RULINGS ON THOSE REQUESTS FOR ARBITRATION PROCEEDINGS FILED BETWEEN JANUARY 1, 2007, AND DECEMBER 31, 2011

In preparing this study, PIABA reviewed data that it requested SAC to provide with respect to all arbitration awards entered in cases filed between January 1, 2007 and December 31, 2011 (the "Review Period"), which mention the term "expungement".[51] PIABA requested that SAC identify each arbitration proceeding by docket number and caption in the order in which the cases were filed for two time periods: from January 1, 2007 through May 17, 2009; and from May 18, 2009 through December 31, 2011. For each case, PIABA requested that SAC also provide the following information:

(a) The venue of the proceeding;

(b) The date the claim was filed;

(c) The date the award was issued;

(d) Whether or not the broker was named as a party;

(e) Whether expungement was granted or denied;

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[50] *Id.* at p. 2.

[51] SAC provided data concerning and access to only awards that mention the term "expungement". The awards examined do not include all awards in cases tried on the merits or all awards resulting from cases resolved by settlement.

(f) If expungement was granted, the Rule 2130/2080 basis or bases on which expungement was granted;

(g) Which party prevailed in cases that were tried; and

(h) Identify cases concluded by stipulated awards or settlements.

For each case in which expungement requests were granted, PIABA requested data concerning the amount of compensatory damages claimed and the amount awarded.

SAC provided the requested data for the two time periods on the spreadsheets attached to this study. Each set of spreadsheets is accompanied by a report key to facilitate the interpretation of the data reported on the spreadsheets.

PIABA requested that FINRA provide to it the total number of customer-initiated cases against member firms and/or associated persons in each year. FINRA provided the following information for customer-initiated cases in each of the five years in the Review Period:

2007 – 1,895

2008 – 3,677

2009 – 5,247

2010 – 3,752

2011 – 3,064

PIABA's analysis of the awards in which expungement was requested in cases filed in 2007, 2008, and 2009 on or before May 17, 2009, resulted in the statistics set forth in the charts below:[52]

[52] The term "Respondent" in the charts is abbreviated "Resp." The term "Claimant" in the charts is abbreviated "Cl." The term "Expungement" in the charts is abbreviated "Exp."

2007

Stipulated Awards/Settlements

Exp. Granted	Exp. Denied	Total Stipulated Awards	Percentage of Cases Exp. Granted	Percentage of Cases Exp. Denied
38	5	43	88.4	11.6

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Cl. Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
40	32	6	33	72	39	55.6	44.4	15.4	84.6

2008

Stipulated Awards/Settlements

Exp. Granted	Exp. Denied	Total Stipulated Awards/Settlements	Percentage of Cases Exp. Granted	Percentage of Cases Exp. Denied
53	6	59	89.8	10.2

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Claimant Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
44	32	13	49	76	62	57.9	42.1	21	79

January 1, 2009-May 17, 2009

Stipulated Awards/Settlements

Exp. Granted	Exp. Denied	Total Stipulated Awards/Settlements	Percentage of Cases Exp. Granted	Percentage of Cases Exp. Denied

39	5	44	88.6	11.4

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Cl. Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
48	23	7	38	71	45	67.6	32.4	15.6	84.4

Summary of Expungements for the Time Period January 1, 2007-May 17, 2009

Stipulated Awards

Exp. Granted	Exp. Denied	Total Stipulated Awards/Settlements	Percentage of Cases Exp. Granted	Percentage of Cases Exp. Denied
130	16	146	89	11

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Cl. Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
132	87	26	120	219	146	60.3	39.7	17.8	82.2

PIABA's analysis of the awards in which expungement was requested in cases filed in 2009 on or after May 18, 2009, 2010, and 2011 resulted in the statistics set forth in the charts below:

May 18, 2009-December 31, 2009

Stipulated Awards/Settlements

Exp. Granted	Exp. Denied	Total Stipulated Awards/Settlements	Percentage of Cases Exp. Granted	Percentage of Cases Exp. Denied
133	6[53]	139	95.7	4.3

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Cl. Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
81	41	22	63	122	85	66.4	33.6	25.9	74.1

2010

Stipulated Awards/Settlements

Exp. Granted	Exp. Denied	Total Stipulated Awards/Settlements	Percentage of Cases Exp. Granted	Percentage of Case Exp. Denied
202	6[54]	208	97.1	2.9

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Cl. Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
91	56	18	69	147	87	61.9	38.1	20.7	79.3

[53] During this time period, there were three cases in which expungement was granted to one registered representative and expungement was denied to another. Each of these three awards was treated as two separate awards for calculating the total stipulated awards/settlements and for the purpose of calculating percentages.

[54] During this time period, there was one case in which expungement was granted to one registered representative and expungement was denied to another. This case was treated as two separate awards for calculating the total stipulated awards/settlements and for the purpose of calculating percentages.

2011

Stipulated Awards/Settlements

Exp. Granted	Exp. Denied	Total Stipulated Awards/Settlements	Percentage of Cases Exp. Granted	Percentage of Cases Exp. Denied
133	3	136	97.8	2.2

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Cl. Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
54	30	10	34	84	44	64.3	35.7	22.7	77.3

Summary of Expungements for the Time Period
May 18, 2009-December 31, 2011

Stipulated Awards/Settlements

Exp. Granted	Exp. Denied	Total Stipulated Awards/Settlements	Percentage of Cases Exp. Granted	Percentage of Cases Exp. Denied
468	15	483	96.9	3.1

Cases Tried on the Merits

Resp. Prevails Exp. Granted	Resp. Prevails Exp. Denied	Cl. Prevails Exp. Granted	Cl. Prevails Exp. Denied	Total Cases Resp. Prevails	Total Cases Cl. Prevails	Percentage of Cases Resp. Prevails Exp. Granted	Percentage of Cases Resp. Prevails Exp. Denied	Percentage of Cases Cl. Prevails Exp. Granted	Percentage of Cases Cl. Prevails Exp. Denied
226	127	50	167	353	217	64	36	23	77

ISSUES ARISING FROM THE EXPUNGEMENT DATA AND PROPOSALS TO ADDRESS THOSE ISSUES

The data set forth on the SAC spreadsheets, the foregoing statistics, and a review of the stipulated awards identified on the SAC spreadsheets reveal some expected and some alarming trends.

An expected result of FINRA's amendment of the Form U-4 effective May 18, 2009, requiring associated persons not named as parties in a customer's arbitration claim to report the claim, is in an increase in expungement requests and an increase in non-named brokers seeking expungements. The amount of the increase, however, is dramatic. For the pre-NTM 09-23 time period, January 1, 2007 through May 17, 2009, expungement requests in cases resolved by stipulated awards or settlement and cases tried on the merits totaled 511. For the time period May 18, 2009 through December 31, 2011, expungement requests in cases resolved by stipulated awards or settlements and cases tried on the merits totaled 1,053.[55] For the time period January 1, 2007 through May 17, 2009, there were only 20 cases in which non-named associated persons sought expungement. For the time period May 18, 2009 through December 31, 2011, there were 407 cases in which non-named associated persons sought expungement, a twenty fold increase.[56]

FINRA has repeatedly stated that expungements should be an extraordinary remedy and that a respondent prevailing on the merits or obtaining a dismissal of a customer claimant's claim are not by themselves an appropriate ground for expunging the proceeding from the CRD system.[57] The relatively high percentage of cases reported in the SAC data in which the respondents prevailed and expungements were granted suggests that these pronouncements may not be getting through to arbitrators. For the time period January 1, 2007 through May 17, 2009, arbitration panels granted expungements in 60.3% of such cases. For the time period May 18,

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[55] Part of this increase may be attributable to a greater number of customer-initiated cases filed in 2009 after May 17, 2009, as compared to before May 18, 2009, and the greater number of customer-initiated cases filed in 2011 as compared to 2007.

[56] FINRA is in the process of drafting a proposed rule change for submission to the SEC proposing a rule or rules establishing procedures for non-named associated persons to seek expungements. If the SEC approves the proposed rule change, expungement requests will likely increase even more dramatically.

[57] *See*, *e.g.*, NTM 01-65 at p. 566; FINRA Dispute Resolution Expungement Training Materials at p. 18.

2009 through December 31, 2011, arbitration panels granted expungement relief in 61.9% of such cases.

The most alarming statistic arising from an analysis of the SAC data is the very high percentage of cases resolved by settlement or stipulated awards in which expungement relief has been granted. For the time period January 1, 2007 through May 17, 2009, expungement was granted in 89% of the cases resolved by stipulated awards or settlement. For the time period May 18, 2009 through December 31, 2011, expungement relief was granted in 96.9% of the cases resolved by settlements or stipulated awards.

In cases resolved by settlement, expungement is far from being an extraordinary remedy. To the contrary, it is, indeed, extraordinary for expungement relief not to be granted in cases resolved by settlement. It appears that NASD's and FINRA's attempts to mandate narrow grounds for granting expungement relief and to require arbitrators to hold hearings to receive evidence with respect to expungement relief, to review the terms and provisions of settlement agreements and the amounts paid, and to weigh the evidence and the competing interests regarding the granting or denial of expungement relief have failed with respect to cases resolved by settlement. The apparent result is that the accuracy and completeness of disclosure information concerning customer claims in the CRD system has been adversely affected by the rubber stamping of expungement relief by arbitration panels in cases resolved by settlement. The high percentage of expungement relief granted in cases resolved by settlements or stipulated awards may be attributable to a number of factors, including the following: (1) inadequate training of arbitrators; (2) arbitrators' failure to appreciate the importance of the integrity of the disclosure information in the CRD system; and (3) respondents and their counsel demanding or

requesting as part of settlement negotiations that claimants and their counsel either agree to expungement relief or agree not to oppose expungement relief.

Respondents and their counsel should only be making requests for expungement relief when the facts of the case clearly fall into one of the three Rule 2080 categories. There may be ethical issues with respect to respondents' counsel requesting that claimants agree to expungement relief or agree to not oppose expungement relief. For example, under Rule 4-3.4 of the Florida Rules of Professional Conduct, a lawyer shall not "request a person other than a client to refrain from voluntarily giving relevant information to another party unless the person is a relative or an employee or other agent of a client . . .."

Arbitrators must appreciate the critical importance of the integrity of the disclosure information in the CRD system. Particularly in cases involving expungement relief arising from settlements when the claimant nor his counsel appear at the expungement hearing, arbitrators must ensure that adequate inquiry is made with respect to the one-sided presentation made to them and must critically assess any settlement agreement which provides for payment of more than a nuisance value settlement.

For the cases filed during the Review Period, which were resolved by settlements or stipulated awards and in which expungement relief was granted, the awards in those cases reveal the following information. In the vast majority of those cases, claimants did not oppose expungement, agreed to expungement, or withdrew their claims against the associated person. The awards do not reflect whether the claimants not opposing expungement, agreeing to expungement, or withdrawing their claims against the associated person was a condition of settlement or was requested as part of settlement negotiations. However, the frequency with

which claimants do not oppose expungements, agree to expungement, or withdraw their claims strongly suggests that respondents are demanding or requesting such from claimants.

Arbitrators do not appear to be applying FINRA Rules 2080 and 12805 to make expungement relief an extraordinary remedy as FINRA and the SEC have repeatedly stated it should be, particularly with respect to cases resolved by settlement. Arbitrators do not appear to appreciate the importance of the accuracy of disclosure information in the CRD system to investor protection.

Under the current procedures of FINRA Dispute Resolution, motions seeking expungement relief are filed with FINRA in the arbitration proceeding with respect to which the expungement relief is sought. The FINRA case administrator for that proceeding then mails a copy or copies of the motion for expungement relief to the arbitrator or arbitrators presiding in that proceeding. FINRA does not review or critically assess motions seeking expungement relief. A filed motion for expungement relief is then set for a telephonic or in person hearing before the presiding arbitrator or arbitrators to rule on the motion. It is not until a brokerage firm or broker files an action in court seeking confirmation of an arbitration award granting expungement relief that FINRA undertakes a review of the arbitration award, the motion seeking expungement relief, or any settlement agreement.

At present, the training required by FINRA for arbitrators to be able to rule upon a motion seeking expungement relief is limited. Arbitrators must take an online training course, which takes approximately one hour, and pass a test concerning the materials included in the online training course.

FINRA needs to propose a rule change with respect to respondents and their counsel bargaining for in settlement negotiations or conditioning a settlement upon an investor's agreement to not oppose expungement or an agreement to expungement. Changes need to be made with respect to the content and thoroughness of the training arbitrators are required to complete before they can rule upon a motion seeking expungement relief. Changes should also be made with respect to the procedures applicable to motions seeking expungement relief.

As the SEC suggested in its order approving Rules 12805 and 13805, FINRA should use its authority to review expungement requests, particularly those associated with settlements, to ensure that expungement is an extraordinary remedy. Member firms do not pay substantial sums to claimants when investors' claims are clearly erroneous, factually impossible, or false or when their associated person was not involved in wrongdoing.

FINRA should file a proposed rule change making it a violation of FINRA Rule 2010 for respondents, as part of settlement discussions, to negotiate for claimants to agree to not oppose expungement relief, to agree to expungement relief, or to withdraw their claims against associated persons. FINRA has already advised member firms and associated persons that conditioning settlement on claim withdrawal is a violation of Rule 2010. At a minimum, FINRA should issue a regulatory notice advising member firms and associated persons that bargaining for claimants to agree to expungement or to agree not to oppose expungement in settlement negotiations constitutes a violation of Rule 2010.

FINRA needs to significantly improve the training arbitrators receive concerning requests for expungement relief. That training should include an emphasis on the critical importance of the integrity of the disclosure information on the CRD system. FINRA should also attempt to

ensure that arbitrators make the necessary inquiry during expungement hearings, particularly those arising from settlements at which neither claimants nor their counsel appear. That required inquiry should include the following:

(1) Asking an associated person whether he or she has other customer complaints pending, and if so, the number;

(2) Examining the associated person's CRD;

(3) Inquiring of the associated person whether he or she is or has been the subject of any regulatory proceedings and if so, the outcome;

(4) Inquiring whether the associated person has previously requested expungement relief and if so, the number of times it was granted or denied; and

(5) Inquiring whether in the settlement with the claimant having the claimant agree to not oppose expungement, agree to expungement relief, or withdraw his or her claim against the associated person was bargained for or required.

Finally, for FINRA to fulfill its mission of investor protection, the procedures applicable to motions for expungement relief need to be changed. FINRA needs to play a more active role in arbitrators' rulings on motions for expungement relief. FINRA needs to review and critically assess all motions for expungement relief, particularly those made in cases resolved by settlement. FINRA also needs to review and critically assess settlement agreements. A proposed rule change should include the requirement that the hearing on any motion for expungement relief be scheduled no sooner than 60 days after service of the motion on the customer and FINRA. In cases resolved by settlement, FINRA should require respondents to provide to FINRA the settlement agreement along with the motion for expungement relief. Upon receipt of

any motion for expungement relief and any settlement agreement, FINRA should provide those documents to the securities commissioner for the state in which the case was filed. The amended procedures should provide for FINRA and the designee of the state securities commissioner to have the right to appear at the hearing on the motion for expungement relief and to oppose expungement relief when such opposition is appropriate.

United States Senate

Committee on the Judiciary

113th Congress -- First Session

STATEMENT OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN CONNECTION WITH THE COMMITTEE'S REVIEW OF THE FEDERAL ARBITRATION ACT AND ACCESS TO JUSTICE: WILL RECENT SUPREME COURT DECISIONS UNDERMINE THE RIGHTS OF CONSUMERS, WORKERS, AND SMALL BUSINESS?

My name is Jason Doss. I am a Georgia-based attorney that has been representing public investors in cases against securities broker-dealers for eleven (11) years.

I am president of The Public Investors Arbitration Bar Association (PIABA). PIABA is a non-profit, international bar association, whose members are dedicated to the representation of investors in disputes with members of the securities industry. Formed in 1990, the mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process, making securities and commodities arbitration as just and fair as possible; and creating a level playing field for the public investor in securities and commodities arbitration. Since its founding, PIABA and its individual members have been on "the front lines" of every significant issue relating to the securities arbitration process and the development of law, regulations and rules impacting the process. By virtue of its longstanding commitment to and involvement in the securities arbitration process, PIABA is uniquely qualified to render insight from the perspective of

investors who, in most cases, are contractually bound to resolve their disputes through arbitration.

PIABA supports ending the use of mandatory pre-dispute arbitration clauses in consumer contracts with the securities industry. Consumers should be given the choice as to whether they want to resolve their disputes with their financial professional in arbitration. It should not be forced upon them by the use of pre-dispute arbitration provisions.

In the context of the securities industry, the Financial Industry Regulatory Authority (FINRA) operates the arbitration forum that resolves virtually all investment disputes between investment professionals and their customers. FINRA also maintains the qualification, employment and disclosure histories of 5100 broker/dealers and approximately 660,000 of their registered representatives in the electronic CRD system.[1] Some of the information contained in the CRD system is publicly available. For example, some former customer complaints about a financial advisor can be accessed by the public. As such, the CRD system serves a very important investor protection purpose.

Through its arbitration forum, FINRA provides its financial professionals and their firms a process to request having customer complaints permanently removed (i.e. expunged) from their public regulatory record maintained in the CRD system.[2] FINRA arbitrators decide whether to recommend whether to grant these expungement requests.

PIABA recently conducted a study of FINRA expungement requests and identified many problems with FINRA's expungement process that harm the investing public, which provides

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[1] *See* FINRA Dispute Resolution Expungement training materials at p. 5. The FINRA Dispute Resolution Expungement training materials are available at http://www.finra.org/ArbitrationAndMediation/Arbitrators/Training/WrittenMaterials/index.htm.

[2] Broker/dealers that are members of FINRA may also seek expungement of customer complaint information.

another reason that investors should be able to choose whether they want to resolve their investment disputes in FINRA arbitration. For example, for the time period May 18, 2009 through December 31, 2011, expungement relief was granted by arbitrators in 96.9% of the cases resolved by settlements or stipulated awards even though in many cases the financial firms and/or financial professional paid significant sums of money to settle the disputes. A copy of *Expungement Study of the Public Investors Arbitration Bar Association* (*PIABA Expungement Study*), authored by our Immediate Past-President, Scott C. Ilgenfritz, and released in October 2013 is attached hereto as Exhibit A.

CONCLUSION

We appreciate the opportunity to share with the Committee the *PIABA Expungement Study*. It illustrates one of the many problems facing the consumer public as a result of forced Arbitration. It continues to be PIABA's position that consumers should not be required to arbitrate disputes with their trusted financial professionals.

We thank you for the opportunity to be heard on this important issue.

Jason Doss, President

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December 12, 2013

Senator Al Franken, Chairman
Subcommittee on Privacy, Technology and the Law
Senate Judiciary Committee

Re: December 17, 2013 Hearing, 2:30 PM
The Arbitration Fairness Act of 2013

Statement from Bernardita Duran,
Client of LS-NYC

Dear Senator Franken,

Thank you for asking me to tell my story about arbitration. I am different from many of the witnesses you will speak with at your hearing. I don't have much money and did not go far in school. I live with my three children in a two bedroom apartment in Queens New York. The four of us live-off the wages of my older children, my Social Security check, and food stamps.

Despite my lack of money and education, I probably have something in common with your other witnesses: I don't read the fine print in sales contracts.

In 2007, I found myself in a bad situation. I owed a lot of money to seven credit card companies. Every day, I struggled with paying the monthly minimums and still paying my rent and feeding my children.

Then I heard about a company in Long Island that helped people get out of debt. I called and was referred to a law firm in Arizona called J Hass. To this day, I cannot explain exactly what J Hass was supposed to do other than fix my debts. They called it

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"debt settlement." All I had to do was stop paying my monthly minimum credit card payments and instead send those payments to J Hass. In three years, everything would be fine. So in October 2007, I signed J Hass' three page contract and a form that allowed J Hass to automatically take $492 a month from my bank account.

Everything went bad quickly. By January 2008, two of the seven credit card companies were calling. When I asked the callers whether my attorney, J Hass, had contacted them, they said they had never heard of him.

In February 2008, HSBC sued me. J Hass' employees said this was good, exactly what was supposed to happen, not to worry, and to keep sending the money. Since it was a law firm, I trusted J Hass.

But by July 2008, the collection calls were getting me upset. So I contacted a free lawyer. She told me I was being scammed and that I should stop paying J Hass. She explained that there were hundreds of bogus companies like J Hass that promised to get people out of debt but instead took their money. My lawyer asked J Hass for my money back and complained to the Arizona Bar. But only $185 of over $3,000 I had paid was returned.

I was really upset. Sending $492 each month to J Hass had been difficult. I had paid J Hass before my phone company and had to ask welfare for a one-shot payment to keep my phone on. I had borrowed money from my adult daughter. I had told my son he could not enroll in a basketball league because "fixing Mom's bill problem" was more important.

Having nowhere to turn, I went to court. J Hass had broken a law that said it could not take a cent from me until it made good on its promises. Rather than defend itself (which would have been hard) J Hass pointed to a sentence in the contract that said the judge could not decide my case. Rather, only an arbitrator in Arizona could. And the kicker, I had to present my case in person in Arizona. Of course I had never read that part of the contract, and even if I had, I would have signed the contract anyway. After all, I am a trusting person and I wanted to get out of debt. I also did not understand what the words in the arbitration clause meant.

What these few words meant was that I had to buy a plane ticket to Arizona and pay for a hotel and meals. This meant gambling more than a month's worth of rent ($1,200) in hopes of getting $3,000 back – a gamble I could not take.

With just a few words that no one would read, J Hass had put a mote of lava between me and justice. It did not matter that J Hass had stolen my money. It did not matter that the law it broke was designed to stop fraud. It did not matter that J Hass knew

that very few of its customers could travel to Arizona to get their money back. It did not matter that J Hass had been sued by state regulators in New Hampshire and Arizona, and had been caught lying to regulators in Connecticut. And, it did not matter that 182 customers had complained about J Hass to the Better Business Bureau.

Although I told a federal judge in 2012 that I could not afford to travel to Arizona, the judge said "too bad, you agreed to arbitrate in Arizona." She said if I thought New York was the right place to arbitrate, I should ask the Arizona Arbitrator, not her, to move the case to New York.[1] This still meant I had to travel to Arizona to speak to the arbitrator as my personal appearance was required there. In 2013, the appellate judges agreed.[2]

In September 2013, I followed the judges' orders and asked J Hass to arbitrate in Arizona. But my letter to J Hass was returned. By this time, J Hass had disappeared with my money and lots of other people's money too.

I think that if the judge in New York considered what J Hass did to me, rather what the arbitration clause said, I would have easily gotten my money back. More importantly, J Hass and the hundreds of other businesses that make money off false-promises would have second thoughts about running such businesses if consumers could sue them in court.

Congress should pass the Arbitration Fairness Act to stop unethical businesses from using arbitration as a get-out-of-jail-free card. If the law is not passed, consumers will only be protected from unfair business practices by busy law enforcement officials. That makes no sense. While I don't read the fine print in contracts, I do know that courts were built to provide justice to anyone, not just those without arbitration clauses in there contracts.

Sincerely,
-s-
Bernardita Duran

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[1] *Duran v. J. Hass Group, L.L.C.*, 2012 WL 3233818 (E.D.N.Y., 2012).

[2] *Duran v. J. Hass Group, L.L.C.*, 2013 WL 4732497 (2d Cir. 2013).

Statement from Johnson M. Tyler.
Attorney for Ms. Duran
South Brooklyn Legal Services

Thank you for inviting LS-NYC and our client Ms. Duran to comment on Congress's need to pass the Arbitration Fairness Act of 2013. The Arbitration Fairness Act is needed because pre-dispute arbitration clauses hide the wrong-doings of businesses. Moreover, unless the AFA is passed, the private-right-of-action found in many consumer laws (which enable a regular citizen to sue a bad business) will become meaningless. That will leave only overworked public officials to stop fraudulent, deceptive or unfair business practices that affect consumers. Such a burden is too large for our shrinking governments, and not one that Congress wants.

Legal Services NYC (LS-NYC) is the nation's largest provider of free civil legal services to the poor. For nearly 40 years, LS-NYC has provided critical legal help to low-income residents of New York City. The nineteen neighborhood offices of LS-NYC operate in diverse communities throughout the city, representing over 25,000 clients each year across the five boroughs.

LS-NYC has a long history of litigating consumer cases against debt collectors, debt buyers, debt relief organizations, trade schools, mortgage servicers, and banks. Consumer litigation in a public forum casts light on wrongdoers. Our consumer suits also serve as models others can imitate. In some instances, a consumer suit alerts law makers of new legislation that is needed. Occasionally, it triggers a criminal prosecution.

Much of LS-NYC's consumer litigation has **not** involved contracts containing arbitration clauses. Ms. Duran's case (described in her testimony above) did have such a clause which produced unfair and wrong results.

LS-NYC writes separately to emphasize how the near ubiquitous arbitration clause immunizes not just an individual wrongdoer (such as J Hass) from private law suit, but also an entire industry. Debt settlement's durability is largely due to the arbitration clause.

No Privates Suits against J Hass

When Ms. Duran came to LS-NYC, her case seemed strong. First, mountains of evidence demonstrated that Debt Settlement did not work and was fraudulent. This included a Senate Hearing entitled, *Debt Settlement: Fraudulent, Abusive, and Deceptive*

Practices Pose Risk to Consumers,[3] a Federal Trade Commission report[4], and a memo from 21 Attorneys General who had filed 128 actions against various debt settlement companies.[5]

Second, J Hass's record was consistent with the industry. The internet contained scores of angry posts from J Hass customers residing in 18 different states.[6] The Arizona Better Business Board had received 182 complaints.[7] State regulators in New Hampshire and Connecticut had sued J Hass for defrauding close to 300 of their citizens.[8]

Third, winning a case against J Hass seemed straightforward. Its website boasted that J Hass would improve a client's credit score.[9] This violated the Credit Repair Organization Act (CROA) that prohibited any fee collection before a credit score was improved. On top of that, the Ninth Circuit had just ruled that that a CROA claim could not be arbitrated.[10]

But when LS-NYC tried to find examples of customer suits against J Hass, we could not find any.[11] This was puzzling. There were many unhappy customers. And the CROA provided attorney's fees if you won.

Why no suits? No doubt, some of J Hass' victims did not seek legal help because they were embarrassed about being in debt (or scammed). Others lacked resources to find or pay for a lawyer. But enough disgruntled customers complained in Connecticut,

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3 Senate Hearing 111-1034, Field Hearing before the Comm. on Commerce, Science, and Transportation, (2010).

4 Federal Trade Commission, Press Release: *Debt Services Operations Settle FTC Charges* (Mar. 30, 2005).

5 Nat'l Ass'n of Attorneys General, *Comments in Support of Proposed Rulemaking to Amend the Federal Trade Comm'n's Telemarketing Sales Rule*, 5 (Oct. 23, 2009).

6 The J Hass customers were from: Arizona, California, Connecticut, Delaware, Florida, Illinois, Indiana, Iowa, Michigan, Missouri, New Hampshire, New Mexico Nevada, Pennsylvania, Oklahoma, Utah, Texas, Wisconsin and Washington.

7 On file with LS-NYC.

8 The New Hampshire Banking Department Consent Order, dated February 12, 2010, required Defendant J. Hass Group to pay $31,986.97 in restitution to twelve (12) New Hampshire consumers, as well as $2,600.00 in fines and back fees. On November 5, 2010, the Connecticut Department of Banking issued a temporary cease and desist order against the J. Hass Group for illegally contracting with 274 persons in Connecticut.

9 On file with LS-NYC.

10 *Greenwood v. CompuCredit Corp.*, 615 F.3d 1204 (9th Cir. 2010).

11 One class of suits excluded from this research is "claw back" suits by bankruptcy trustees. LS-NYC found eight such suits against J Hass. The debtors had tried and failed to get out debt with J Hass within two years of filing for bankruptcy. The bankruptcy code allows the trustee to sue J Hass for those moneys. J Hass' arbitration clause provides no shield as claw back suits are "core proceedings" in bankruptcy that cannot be arbitrated. 28 U.S.C. §157(b)(2)(A), (F) & (H).

New Hampshire, Wisconsin, Florida and Arizona that regulators and attorneys general in those states started investigations of J Hass or filed suit.

The (now) obvious answer is that many J Hass victims probably did talk with lawyers but the lawyers recognized Hass' arbitration clause for what it is: "a mote filled with lava" between their clients and a reasonable reward.

Few Privates Suits against other Debt Settlers

When last counted in 2010, there were over 2,000 debt settlement companies in the United States.[12] By 2010, the Federal Trade Commission counted 214 suits against debt settlers by public officials (the FTC, state attorneys general or state regulators).[13] In contrast, LS-NYC could find only 2 actions against a single debt settlers who was not using an arbitration clause (its 2001 contract may have pre-dated the arbitration revolution.)[14] Another seven private actions against debt settlers failed to go to the merits, but instead were removed to arbitrators.[15] Only three cases with arbitration clauses managed to remain in federal court,[16] although the reasoning in those decisions is of no value after a recent Supreme Court ruling.[17] In short, LS-NYC could only find only one private litigant suit involving a debt settler not using an arbitration clause, and that was an old case.

This is an amazing statistic. Here a federal law says debt settlers cannot take up front fees. There are thousands of debt settlement companies violating that law. The law is designed to be self enforcing (and thus not cost the taxpayers anything) because it provides a private right of action and attorneys fees. The scam has received substantial public attention. Yet only tax-paid attorneys are going after debt settlers because of the arbitration clause.

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[12] Federal Trade Commission, 16 C.F.R. 310; Telemarketing Sales Rule, 75 Fed. Reg. 48458, 48503 (Aug. 10, 2010).

[13] Id. at 48509 – 48515.

[14] *Plattner v. Edge Solutions, Inc*., 2004 WL 1575557 (N.D.Ill. Apr.1, 2004); C*ortese v. Edge Solutions, Inc*., 2007 WL 2782750 (E.D.N.Y. 2007).

[15] *Carlsen v. Freedom Debt Relief, LLC*, 2010 WL 1286616 (E.D.Wash. 2010); *Del Rio v. Creditanswers*, 2010 WL 3418430 (S.D.Cal. 2010); *Finely v. CSA-Credit Solutions of America, Inc*., 2008 WL 5280551 (E.D.Okla. 2008); *Picard v. Credit Solutions, Inc*., 564 F.3d 1249 (11th Cir. 2009); *Rex v. CSA-Credit Solutions of America*, Inc., 507 F.Supp.2d 788 (W.D.Mich.,2007); *Schreiner v. Credit Advisors, Inc*. 2007 WL 2904098 (D.Neb. 2007); *Vegter v. Forecast Financial Corp*., 2007 WL 4178947 (W.D.Mich. 2007).

[16] *Alexander v. U.S. Credit Management, Inc.,* 384 F.Supp.2d 1003 (N.D.Tex.,2005); *Greenwood v. CompuCredit Corp*., 615 F.3d 1204 (9th Cir. 2010); *Hollins v. Debt Relief of America,* 479 F.Supp.2d 1099 (D.Neb.,2007).

[17] *CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665 (2012).

Maybe all the private suits against debt settlers are brought in secret arbitration proceedings?

This seems unlikely given the extent that the FTC and General Accounting Office have studied the debt settlement industry. However, if it is true, this "secret docket" exclusively benefits an industry that the Senate and others describe as "fraudulent, abusive, and deceptive."

Epilogue

Without a right to sue in court, what is a debt settlement victim to do if a public official can not get his or her money back? In 2010, 61 year old Brian Yard bared his soul to the Philadelphia Weekly after J Hass took $6,000 in fees while increasing his debt by $14,000.[18] It's unclear whether that front page article triggered any give-back. Two years later, Patricia Aker of Scottsdale Arizona reported her $8,000 loss to *3 On Your Side*.[19] The reporter drove to J Hass' office to confront the owner, but found the office empty of furniture and people. The reporter was told later that J Hass had been sold to an undisclosed foreign company.

Conclusion

Congress passes powerful consumer laws. Hundreds of lawsuits are brought against shady businesses by government officials. And still, desperate men and woman must seek justice from the local media rather than judges whose hands are tied by arbitration clauses. It's time to pass the Arbitration Fairness Act.

For Further Information, Please Contact Johnson M. Tyler at 718-237-5548 or JTYLER@SBLS.ORG

[18] Powell, *A Fate Worse Than Debt*, Philadelphia Weekly, (June 29, 2010).

[19] 3 On Your Side, *Scottsdale Debt Settlement Company Draws Criticism*, AZFamily.com (Sept. 27, 2012). Article on file with LS-NYC.

Statement of Matthew Kilgore, Rohnert Park, Calif.

U.S. Senate
Committee on the Judiciary

"The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

(In support of passage of the Arbitration Fairness Act, S. 878)

December 17, 2013

Thank you for this opportunity to share my experiences with you for the record on forced arbitration and class-action bans. I am a private student-loan borrower who was defrauded by a for-profit college and denied access to court by the bank that made student loans to me and other students at the school.

I thought I was achieving my dream of becoming a helicopter pilot when I enrolled at Silver State Helicopters in Oakland, California. But actually, like the other thousands of students of this school, I was probably the victim of a scam. I first learned of Silver State through an advertisement on the radio for an upcoming seminar in Oakland, California. I learned that the school held similar seminars all over the country, so I decided to attend.

At the seminar, Silver State offered to provide pilot training and certification. My fellow students and I were told that we would earn our pilot's license and an instrument rating in less than two years. As students, we would be able to attend classes and amass actual flight time with instructors. I knew my family would be proud of me when I accomplished this goal.

The school representatives indicated at the seminar that students could obtain loans through KeyBank, National Association, apparently a primary lender for the school, to pay the tuition. Like so many others, I took out a $55,000 loan with KeyBank, to pay the trade school's tuition. On Sunday, February 3, 2008, a short few months after I began my courses, I received a phone call from a flight instructor who told me not to attend class the next day. The school had shut down and filed for bankruptcy.

Earlier this year, a bankruptcy judge who oversaw the bankruptcy proceedings for the school described it as an "airborne Ponzi scheme." The school appeared to have been caught in a credit crunch, and collapsed when it could no longer get funded through private student loans.

When the school abruptly closed, Silver State students, including myself, had no diplomas, certificates, or accreditation, nor any marketable skills, for that matter. We were certainly not qualified to be helicopter pilots. Instead we were left with tens of thousands of dollars in student-loan debt.

With the help of my lawyer, I filed a lawsuit on behalf of myself and other Silver State students against Keybank. As we stated in court, Keybank knew that "the private student loan industry—and particularly aviation schools—was a slowly unfolding disaster," yet it continued on with its business, loaning money to students and handing over the funds to the school. Additionally, my lawyers discovered that Keybank conspired with Silver State to

intentionally omit the so-called "FTC Holder Rule" from both the loan documents and my contract with Silver State.[1]

We sought to enforce our rights under California law and the FTC Holder Rule to prevent the bank from collecting our loans or reporting non-payment of the loans to credit reporting agencies. Although the district court judge that heard the case determined that we stated a proper claim against Keybank for conspiring with Silver State to violate the Holder Rule, we were unable to pursue the case in court because of the pre-dispute forced arbitration clause and class-action waiver. Keybank's loan terms had a provision that said borrowers would be forced to resolve legal disputes with it in private arbitration and on an individual basis. The terms also banned our participation in class actions.

Keybank argued to the court that the arbitration terms and class-action ban should apply. It asked the court to deny the class action and force us students to arbitrate our claims individually. However, the district court judge denied Keybank's motion to compel arbitration and supported our right to go to court.

But then I learned about a Supreme Court decision, *AT&T Mobility v. Concepcion*, that was decided while our case was ongoing. This decision said that companies like Keybank could require arbitration and forbid class actions in their terms of service. As a result, Keybank appealed the district court's decision and because of *Concepcion*, the appeals court said that my fellow students and I would have to settle our disputes individually in private arbitration. We could not go to court to seek redress.

Another striking outcome of my experience with arbitration clauses is that Keybank borrowers like myself are at the losing end of a two-tiered justice system. A second student loan lender, Student Loan Express, Inc. (SLX) also marketed loans to Silver State students. But unlike Keybank borrowers, students who borrowed from SLX received some justice after the school shut down because SLX did not have an arbitration clause in its loan terms. Therefore, they could seek redress.

I later learned that SLX student borrowers, in a class settlement, would receive up to 75 percent debt forgiveness, lowered interest rates and other redress. Although we suffered the exact same injuries and pursued the exact same paths to justice, the arbitration clause denied Keybank borrowers access to the court, while SLX borrowers received substantial relief for their harm and could move on with their lives.

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[1] The FTC Holder Rule, 16 C.F.R. § 433, is an important consumer protection disclosure regulation in the FTC Act which, had it been included in either Keybank's loan documents or in my contract with Silver State, would have enabled the Silver State students to defend themselves against Keybank based on its fraudulent scheme with the school.

Since 2008, my loans have accrued interest and have nearly doubled to $103,000. My wife and children continue to feel the strain of this growing financial burden. The loan debt will take funds that I would have saved for my children. Despite the enormous dollar amount to me personally, I have thus far been unable to attract a lawyer to take my case to arbitration because I cannot afford to pay one on an hourly basis and as a practical matter, nobody is willing to do it on a contingency basis because the amount is too small when my claim is considered alone.

I think most companies are honest, but many of us know that there are others that will seek to take advantage of us. My fellow students and I were caught in an elaborate and deceptive corporate scheme. But I was surprised, outraged and then saddened, like most other Americans would be, that I could not go to the court to seek justice when I was wronged.

Thank you for considering my story.

Matthew Kilgore
Rohnert Park, California

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STATEMENT OF WADE HENDERSON, PRESIDENT AND CEO
THE LEADERSHIP CONFERENCE ON CIVIL AND HUMAN RIGHTS

HEARING BEFORE THE
SENATE COMMITTEE ON THE JUDICIARY
ON

"THE FEDERAL ARBITRATION ACT AND ACCESS TO JUSTICE: WILL RECENT SUPREME COURT DECISIONS UNDERMINE THE RIGHTS OF CONSUMERS, WORKERS, AND SMALL BUSINESSES?"

December 17, 2013

Chairman Leahy, Ranking Member Grassley, and Members of the Committee: thank you for holding today's hearing on the urgent need to outlaw forced arbitration for all America's consumers and workers. On behalf of The Leadership Conference on Civil and Human Rights, I am pleased to provide this written statement for inclusion in the record.

The Leadership Conference on Civil and Human Rights is a coalition charged by its diverse membership to promote and protect the civil and human rights of all persons in the United States. Founded in 1950 by A. Philip Randolph, Arnold Aronson, and Roy Wilkins, The Leadership Conference works in support of policies that further the goal of equality under law through legislative advocacy and public education. The Leadership Conference's more than 200 national organizations represent persons of color, women, children, organized labor, persons with disabilities, older adults, gays and lesbians, and major religious groups. The Leadership Conference is committed to building an America that is as good as its ideals – an America that affords everyone access to quality education, housing, health care, collective bargaining rights in the workplace, economic opportunity, and financial security.

I applaud the Committee for holding this hearing on a matter of great significance to the civil and human rights community. For The Leadership Conference, access to the judicial system is a fundamental right that must be preserved. It is essential to our fair and unfettered democracy. Indeed, it is the language of our democracy.

Forced Arbitration Hurts Consumers and Employees

Arbitration can be a fair and effective method of dispute resolution when parties voluntarily agree to arbitrate. Instead, pre-dispute binding mandatory arbitration clauses are increasingly proliferating in: employment contracts; every day consumer contracts for products and services including credit cards, payday loans, health insurance policies, student loans, cell phones, and car loans; and civil rights disputes. Binding mandatory arbitration clauses are buried in the fine print of contracts and employee handbooks, which burden consumers and deprive them of equal justice under the law.

First, this practice is one-sided because corporations write the forced arbitration clauses in a way that often steers the entire process to the company's advantage, including specifying the arbitrator and

payment terms. Since the clauses are written in the contracts, an individual cannot adjust the process and must abandon or accept the product, service, or job as presented. Second, binding mandatory arbitration does not have legal protections nor is it subject to public review to ensure that the arbitrator's decision was legitimate, avoiding transparency and accountability. Third, the practice removes the fundamental right of equal justice under the law. Forced arbitration makes the dozens of anti-discrimination laws meaningless because they are unenforceable in court, allowing employers the freedom to ignore civil rights laws intended to protect people from employment discrimination on the basis of age, sex, religion, race, and disability. Finally, a dispute under binding mandatory arbitration imposes high costs, including attorney and arbitrator fees, which most individuals cannot afford, while for companies it is the "price of doing business." Thus, the burden to individuals harms their ability to seek justice.

Recent Supreme Court decisions have stripped away statutory rights from consumers and employees. *AT&T Mobility LLC v. Concepcion,* a 2011 consumer rights case, undermined the use of class actions in the pursuit of justice against corporate civil and employment rights infractions. *Concepcion* allowed forced arbitrations and the inclusion of class action bans within arbitration clauses. The decision contradicts at least 20 states that have struck down bans on class action lawsuits, by freeing companies from accountability when they infringe upon civil rights and employment laws.

More recently, in *American Express v. Italian Colors Restaurant et al*, the Court considered a challenge to anticompetitive practices of American Express that violated federal antitrust laws. Despite these violations, the Court ruled that forced arbitration and class action bans are protected even when an individual can prove that the cost of arbitration would be too high to pursue.

Class action lawsuits have long been an important means for individuals to seek remedy for civil rights, consumer, and employee infractions. Many individuals cannot afford to settle disputes through arbitration. This problem is exacerbated when individuals cannot come together to spread the costs of a lawsuit. Corporate bans of class actions allow businesses to evade well-established civil rights and employment laws, rendering them ineffective. The deprivation of rights afforded by the Court's decisions in *Concepcion* and *American Express* could be remedied with the Arbitration Fairness Act.

The Arbitration Fairness Act Would Restore Choice to the Judicial Process

The Arbitration Fairness Act (AFA), S. 878, reestablishes the congressional intent of the Federal Arbitration Act by requiring that agreements to arbitrate employment, consumer, antitrust or civil rights disputes be made after the dispute has arisen. The combined impact of *Concepcion* and *American Express* adds urgency for Congress to pass the AFA to enable individuals and small businesses to decide how to resolve disputes. The AFA would not prohibit arbitration, but would simply ensure that it is a voluntary decision made by both parties once a dispute occurs, making pre-dispute binding mandatory arbitration clauses unenforceable in civil rights, employment, antitrust, and consumer disputes. This legislation would allow pre-dispute mandatory arbitration to continue in business-to-business agreements. The legislation would apply to collective bargaining agreements that require arbitration between unions and employers. Its sole aim is to end the unscrupulous business practice of forcing consumers and employees into biased, costly arbitrations by binding them long before any disputes arise, and ensuring an individual's constitutional rights of access to the judicial system are not waived under coercion.

The ability to access the judicial system is a fundamental civil right. The Arbitration Fairness Act will create a more fair system in which consumers and employees can safely resolve disputes without corporate coercion into arbitration. We urge Congress to pass the Arbitration Fairness Act to protect the legal and civil rights of all Americans.

Thank you for your leadership on this important issue.

Council of Institutional Investors
The Voice of Corporate Governance

Via Hand Delivery

December 12, 2013

The Honorable Patrick J. Leahy
437 Russell Senate Office Building
United States Senate
Washington, DC 20510

The Honorable Charles Grassley
135 Hart Senate Office Building
United States Senate
Washington, DC 2051

Re: Senate Judiciary Committee Hearing on the Federal Arbitration Act

Dear Chairman Leahy and Ranking Member Grassley:

I am writing on behalf of the Council of Institutional Investors ("CII") to bring to your attention the attached letter that we issued yesterday to the staff of the Securities and Exchange Commission relating to CII's membership approved policy discouraging the use of forced arbitration clauses in company governing documents.[1]

CII is a non-profit association of pension funds, other employee benefit funds, endowments and foundations with combined assets that exceed $3 trillion. Many CII members are long-term shareowners responsible for safeguarding the retirement savings of millions of American workers and retirees.[2]

We understand that your Committee has scheduled a hearing for December 17th entitled, "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?" As we believe that issues raised in the attached letter are likely to be relevant to the subject matter of your hearing, we would respectfully request that our letter be submitted as part of the official hearing record.

Thank you for consideration of this request. If you have any questions regarding our letter or this request, please contact me at 202-261-7088 or Jordan@cii.org, or our general counsel Jeff Mahoney at 202-261-7081 or jeff@cii.org.

Sincerely,

Jordan Lofaro

cc: The Honorable Al Franken

Attachment

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[1] CII corporate governance policy 1.9: "Companies should not attempt to restrict the venue for shareowner claims by adopting charter or bylaw provisions that seek to establish an exclusive forum. Nor should companies attempt to bar shareowners from the courts through the introduction of forced arbitration clauses," http://www.cii.org/corp_gov_policies.

[2] For more information about our membership, please visit http://www.cii.org/members.

Council of Institutional Investors

December 11, 2013

Keith F. Higgins
Director
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

John Ramsey
Acting Director
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Forced Arbitration Clauses In Corporate Bylaws

Dear Messrs. Higgins and Ramsey:

I am writing on behalf of the Council of Institutional Investors ("CII") to bring to your attention a recent potential trend in corporate governance that may not only impair shareowners' rights, but also threaten to undermine the integrity of our public markets generally.

CII is a non-profit association of pension funds, other employee benefit funds, endowments and foundations with combined assets that exceed $3 trillion. Many CII members are long-term shareowners responsible for safeguarding the retirement savings of millions of American workers and retirees.[1]

A pair of relatively recent decisions by the United States Supreme Court —*AT&T Mobility v. Concepcion*[2] and *American Express v. Italian Colors Restaurant*[3]—appear to generally support the view that the Federal Arbitration Act ("FAA") requires courts to enforce arbitration provisions that bar class actions with respect to federal and state claims. We are concerned that those decisions could potentially be used in an effort to enable public corporations to avoid liability simply by including a forced arbitration clause in a corporate bylaw.

It is our understanding that some corporations may have already begun to explore forced arbitration provisions in their chartered bylaws as a potential vehicle to limit shareowner rights. Bylaws are considered to establish the "contractual" terms that govern a company's operations, and some might argue that such provisions are sanctioned by the forced arbitration frameworks created by the above referenced Supreme Court precedents.

As you are well aware, bylaw provisions can be adopted unilaterally by corporate boards without shareowner approval. As a result, forced arbitration provisions in corporate bylaws represent a potential threat to principles of sound corporate governance that balance the rights of shareowners against the responsibility of corporate managers to run the business.

[1] For more information about the Council of Institutional Investors ("CII") and our members, please visit our website at http://www.cii.org/members.
[2] AT&T Mobility v. Concepcion, 131 S. Ct. 1740 (Apr. 27, 2011), http://www.supremecourt.gov/opinions/10pdf/09-893.pdf.
[3] American Express Co. v. Italian Colors Restaurant,
133 S. Ct. 2304 (June 20, 2013), http://www.supremecourt.gov/opinions/12pdf/12-133_19m1.pdf.

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For example, in the recent case of *Corvex Management LP v. CommonWealth REIT,*[4] shareowners brought an action on behalf of a real estate investment trust ("REIT") arguing that the company's board breached their fiduciary duties by taking unlawful actions designed to prevent or delay a shareowner vote on a takeover bid.[5] The REIT's bylaws, however, contains a broad mandatory arbitration provision that bans class actions, including shareowner derivative suits.[6] Citing Supreme Court precedent, including *AT&T Mobility v. Concepcion,*[7] a Maryland Circuit Court dismissed the litigation, holding that the shareowners' claims had to be submitted to arbitration even though the REIT's board unilaterally adopted the bylaw without shareowner approval.[8]

Perhaps unwittingly, the Delaware Court of Chancery may have set the stage for this further reduction of judicial oversight of corporations. In his 2013 decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,[9] Chancellor Strine upheld the enforceability of bylaws, unilaterally adopted by two corporate boards, requiring all litigation relating to the internal affairs of the corporations to be conducted in Delaware.[10]

Chancellor Strine's decision in *Boilermakers Local 154 Retirement Fund* may have significant consequences. If, for example, Delaware law allows corporate boards, through the adoption of bylaws, to dictate unilaterally the forum for resolution of all shareowner disputes, directors of Delaware corporations might attempt to dictate arbitration as the mandatory forum for any shareowner disputes, even if Delaware courts are available to hear the case.[11]

More specifically, if it is established that corporate boards are empowered under state law to designate a forum for the resolution of shareowner disputes, those corporate directors could potentially attempt to rely on federal law—in particular the FAA as interpreted by the Supreme Court—to designate forced arbitration as the only available forum. As one commentator earlier noted this year: "It would be frighteningly ironic if Chancellor Strine's ruling on corporate by-laws, which seems intended to drive shareowner litigation to Delaware, ended up driving corporations to arbitration instead of

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[4] Corvex Management LP v. CommonWealth REIT, 24-C-13-001111, slip op. (Cir. Ct. Baltimore City, May 8, 2013), http://www.sec.gov/Archives/edgar/data/803649/000110465913039281/a13-11995_1ex99d2.htm.
[5] *Id.* at 2-3.
[6] *Id.* at 4.
[7] *Id.* at 7.
[8] *Id.* at 27.
[9] Boilermakers Local 154 Ret. Fund v. Chevron Corp., 2013 WL 3191981 (Del. Ch. June 25, 2013), http://scholar.google.com/scholar_case?case=9538516922023907628&q=Boilermakers+Local+154+Ret.+Fund+v.+Chevron+Corp&hl=en&as_sdt=6,47&as_vis=1.
[10] *Id.* Of note, as of September 30, 2012, three hundred publicly traded companies had adopted some form of provision in their bylaws or governing documents purporting to designate an exclusive forum for the resolution of any claim a shareholder may have against, or on behalf of, the corporation. *See* Joseph A. Grundfest & Kristen A. Savelle, The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis, 68 Bus. Law. 325, 330 (2013).
[11] *Cf.* Elf Atochem North America, Inc. v. Jaffari, 727 A.2d 286, 295 (Del. 1999) (enforcing provision in the charter of a Limited Liability Company to require arbitration derivative claims in California), http://de.findacase.com/research/wfrmDocViewer.aspx/xq/fac.19990406_42099.DE.htm/qx; Douzinas v. American Bureau of Shipping, Inc., 888 A.2d 1146, 1149 (Del. Ch. 2006) (enforcing provision in the operating agreement for a Delaware LLC requiring arbitration under Texas law), http://scholar.google.com/scholar_case?case=4285329806925466829&q=Douzinas+v.+American+Bureau+of+Shipping,+Inc.&hl=en&as_sdt=6,47&as_vis=1.

litigation in any forum."[12] We note that such a result would be in direct conflict with CII's membership-approved corporate governance best practices which state:

> Companies should not attempt to restrict the venue for shareowner claims by adopting charter or bylaw provisions that seek to establish an exclusive forum. Nor should companies attempt to bar shareowners from the courts through the introduction of forced arbitration clauses.[13]

Consistent with our membership approved policy, we would respectfully request that, in the absence of a clear Congressional mandate to permit the forced arbitration of shareowner disputes, the Securities and Exchange Commission continue to remain vigilant in exercising its well-founded and long-held opposition to such provisions as being contrary to the anti-waiver provisions of the federal securities laws.[14]

Thank you for consideration of this important matter. If you have any questions regarding this letter, please feel free to contact me directly at 202-261-7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel

Cc: John H. Stout, Chair, Corporate Governance Committee, Business Law Section, American Bar Association (via email)

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[12] Alison Frankel, Wake up Shareholders! Your Right to Sue Corporations May Be in Danger, Reuters, June 25, 2013, at 2; http://blogs.reuters.com/alison-frankel/2013/06/25/wake-up-shareholders-your-right-to-sue-corporations-may-be-in-danger/.

[13] CII, Policies on Corporate Governance **§ 1.9 Judical Forum** (updated Sept. 27, 2013), http://www.cii.org/corp_gov_policies#intro.

[14] *See* Thomas L. Riesenberg. *Commentary, Arbitration and Corporate Governance: A Reply to Carly Schneider*, Insights, Vol. 4, No. 8, Aug.1990, at 2 ("it would be contrary to the public interest to require investors who want to participate in the nation's equity markets to waive access to a judicial forum for vindication of federal or state law rights, where such waiver is made through a corporate charter rather than an individual investor's decision").

December 17, 2013

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Chuck Grassley
Ranking Member
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing
& Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Mike Crapo
Ranking Member
Committee on Banking, Housing Affairs
& Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Chairman Leahy, Chairman Johnson, Ranking Member Grassley and Ranking Member Crapo:

The below signatories to this letter collectively manage approximately $900 billion in capital invested globally and have significant investments in the United States. As investors whose participation in the public markets is vital to the growth of the global economy, we believe that companies should not be permitted to force shareholders into any system under which their rights are limited or their ability to participate in a class is extinguished. Forced arbitration systems—especially those which include class action bans—are not a viable substitute to judicial enforcement of fiduciary obligations owed to investors when the arbitration is an involuntary, costly, and biased dispute resolution system.

We ask that the Committees of Jurisdiction act to preserve the ability of investors to access the judicial system for the enforcement and protection of their legal rights by:

1) Supporting the Securities and Exchange Commission ("SEC") in its exercise of Congressionally-granted authority under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to prohibit the use of mandatory pre-dispute arbitration provisions in broker-dealer and investment advisor agreements; and,

2) Acting to formalize the SEC's longstanding policy that mandatory pre-dispute provisions requiring arbitration of investor disputes in the bylaws and governing documents of publicly traded corporations are harmful to capital markets, contrary to public policy, and could be subject to enforcement action.

Relying on the government to enforce the rights of individuals is no suitable alternative to private enforcement. Requiring the government to bear the expense of prosecuting every investor dispute would place an enormous additional burden on already strained budgets. In private litigation relating to the financial scandals at Enron, WorldCom, Tyco, Bank of America and Global

Crossing, private enforcement returned over $19.4 billion to investors.[1] The SEC's enforcement actions against these same companies relating to the same wrongdoing netted penalties and fees of $1.750 billion.[2] Indeed, in the last three years on litigation relating to the financial crisis, the SEC has recovered $2.73 billion in penalties, disgorgement and other monetary relief.[3] In comparison, private litigation against just four financial institutions arising from their conduct that led to the near collapse of the U.S. economy resulted in judgments or settlements of over $16 billion.[4]

Unfortunately, and perhaps precisely because private litigation provides the most efficient (and in some cases the only) way for investors to enforce their rights, publicly traded corporations have taken steps to eliminate judicial oversight of their fiduciary obligations to investors and their compliance with the federal securities laws. These steps have included inserting pre-dispute, forced arbitration clauses in investment-advisor contracts and corporate by-laws to force all shareholder disputes into arbitrations controlled by the very same corporations against whom the claims are being brought. These forced arbitration clauses also typically require shareholders to waive their rights to participate in any collective or class action.

When forced arbitration clauses and class action waivers appear in corporate bylaws or investor-advisor agreements, they can have the practical effect of preventing shareholders from pursuing any legal remedy whatsoever. When, as is often the case for smaller investors, the cost and expense of pursuing an individual claim far exceeds any possible recovery, a "waiver" of the right to participate in any collective action effectively immunizes wrongdoing corporations and their directors and officers from these smaller claims. These "waivers" are specifically designed to prevent class actions under Rule 10b-5 of the Securities Exchange Act of 1934, and would prevent class actions like the shareholder action brought against Enron Corporation from ever being brought. These forced arbitration clauses and class action waivers represent a real and present threat to principles of sound corporate governance, balancing the rights of shareowners against the responsibilities of corporate managers to run their businesses.

Institutional investors are the foundation of a successful and thriving securities market. The victims of corporate wrongdoing aren't the ultra-wealthy—they are hard-working employees who rely on income from their pension funds. Without sufficient protections and a meaningful way to hold financial institutions accountable when they violate financial or fiduciary obligations to their

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[1] Source: *In re: Tyco International, Ltd., Securities Litigation, U*.S. District Court, District of New Hampshire, 02-266 ($3.2 billion settlement); *In re: Enron Corporation Securities Litigation*, U.S. District Court, Southern District of Texas, 01-3624($7.2 billion settlement); *In re: Worldcom, Inc. Securities Litigation,* U.S. District Court, Southern District of New York, 02-3288 ($6.1 billion); *In re: Bank of America Corp. Securities, Derivative, and Employee Retirement Income Security Act (ERISA) Litigation,* U.S. District Court, Southern District of New York, 09-2058 ($2.4 billion settlement); *In re: Global Crossing Ltd. Securities Litigation,* U.S. District Court, Southern District of New York, 02-910 ($447.8 million settlement).

[2] Source: Tyco SEC Settlement Fair Fund: http://www.tycosecsettlement.com/ ($55.8 million settlement); Enron SEC Settlement Fair Fund: http://enronvictimtrust.com/ ($570 million); Worldcom SEC Settlement Press Release: http://www.sec.gov/news/press/2003-81.htm ($750 million); Bank of America SEC Fair Fund: http://bankofamericafairfund.com/ ($375 million); Global Crossing SEC Settlement Press Release: http://www.sec.gov/litigation/litreleases/lr19179.htm ($300,000).

[3] Source: SEC Enforcement Actions, Addressing Misconduct That Led To or Arose From the Financial Crisis, Key Statistics (through September 1, 2013), available at http://www.sec.gov/spotlight/enf-actions-fc.shtml

[4] Source: Sam Carr, SNL Financial, Largest US banks have built a $60B settlement tab, so far (March 5, 2013), available at http://www.snl.com/InteractiveX/Article.aspx?cdid=A-17047074-12337

shareholders, investor confidence diminishes and market participation suffers, hurting investors, the institutions they invest in, and the American and global economy.

We ask the Committees on the Judiciary and on Banking, Housing, & Urban Affairs, jointly tasked with protecting American investors from unscrupulous or illegal financial practices, to encourage the SEC to continue its efforts to protect investor rights and restore the balance between those rights and the responsibilities of publicly traded companies and their corporate managers.

Sincerely,

AFA Forsakring
Anders Algotsson
Head of Equities

AP7
Richard Gröttheim
Chief Executive Officer

AP1
Anders Rahmn
Administrative Director
Jan Matej
Head of Legal Department

AMF Pension
Anders Oscarsson
Head of Equity

AP4
Agneta Wilhelmson Kåremar
Chief Operating Officer
Ulrika Malmberg Livijn
General Counsel

AMF Fonder
Gunilla Nyström
Chief Executive Officer

APG Asset Management
Guus M. Warringa LL.M (Cantab)
Board Member, Chief Counsel

PFA Pension
Jesper Langmack
Head of Equities

Industriens Pension
Jan Østergaard
Chief Investment Officer

PGGM Investments
Marcel Jeucken
Managing Director Responsible Investment
Femke van't Groenewout
Senior Advisor Responsible Investment

MN Services
Anatoli van der Krans
Senior Advisor Responsible Investment & Governance

Sampension
Mads Smith Hansen
Chief Financial Officer

December 17, 2013

The Honorable Al Franken
U.S. Senate
Washington, DC 20510

Dear Senator Franken:

Re: Statement for the Senate Judiciary Committee Hearing Record: "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

We are members of a law school clinic, Civil Justice Through the Courts, at New York Law School. This is a public policy clinic, the mission of which is to raise awareness about attacks on access to the civil justice system. After studying the issue of forced arbitration, we write today to express our support for the Arbitration Fairness Act of 2013 (AFA), S.878, and to respectfully submit these comments for the hearing record of the December 17 hearing, "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

The AFA is critical to the protection of the American consumer, employee, and small business. The right of injured or violated people to vindicate their rights in court is a fundamental precept of American democracy. However, recent Supreme Court cases have allowed corporations to strip away this basic right by taking away consumers, employees, and small businesses' access to civil trials and forcing them into mandatory, individual, binding arbitration.

A recent Alliance for Justice Report notes a 2007 study that "found that consumers win only five percent of cases brought before an arbitrator."[1] There are many reasons that the process is so one-sided.

To start, the company or corporation typically chooses the arbitrator. Thus the private arbitration company has a financial incentive to side with the corporation – repeat business. Alliance for Justice explains, "[b]ecause major corporations create millions of dollars in business, a firm and its arbitrators have an incentive to keep corporation clients happy or risk losing business. Stark evidence of this 'repeat player bias' was revealed by a study finding that [the National Arbitration Forum's] top arbitrators ruled for businesses against consumers 93.8% of the time."[2]

Further, as *US News and World Reports* points out, arbitration clauses are "inherently unfair, because the companies choose the arbitrators, who know they're unlikely to be re-hired if they make a habit of giving consumers an obviously fair shake. A recent Pew study[3] found that even

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[1] Alliance for Justice, "Arbitration Activism: How the Corporate Court Helps Business Evade Our Civil Justice System," December 16, 2013 http://www.afj.org/wp-content/uploads/2013/12/Arbitration-Activism-Report-12162013.pdf

[2] *Id*. citing Public Citizen, "The Arbitration Trap," at 15-16. September 2007, www.citizen.org/documents/ArbitrationTrap.pdf

[3] The Pew Charitable Trusts, "Banking on Arbitration: Big Banks, Consumers, and Checking Account Dispute Resolution," November 2012, http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_arbitration_report.pdf

when the process leads to financial compensation, the average amount is only about half what a court would bestow."[4]

Court rules of evidence do not apply to arbitration hearings and arbitrators are not required to follow the law – they do not even need legal training. As Public Citizen and the National Association of Consumer Advocates explain, "corporations can write the rules that govern arbitration proceedings involving them – such as rules concerning fees, discovery rights, or hearing venues – giving them the ability to tilt the playing field."[5]

Additionally, arbitration proceedings are secret and decisions are binding. And companies can "contend with complaints one at a time, leaving victims unable to join forces or even to unearth evidence of a pattern of bad conduct."[6]

Arbitration can be very expensive and class action bans prevent consumers from sharing the costs with other wronged parties. Often this prevents consumers from bringing their claims at all.

Over the past several years, more and more Americans have seen their rights taken away as the result of the Supreme Court's interpretation of the Federal Arbitration Act (FAA), passed in 1925, "intended to target commercial arbitration agreements between two companies of generally comparable bargaining power."[7] The Supreme Court expanded the meaning of the FAA far beyond it's original scope and, as a result, forced arbitration clauses are appearing, not just in consumer contracts, but also in employment contracts, nursing home admission forms, online agreements, and more.

The AFA is designed to limit the use of mandatory arbitration – preventing corporations from insulating themselves from liability by forcing consumers to sign away their Constitutional rights. It is intended to "restore[] the original intent of the FAA." Moreover, the AFA "restores the rights of workers and consumers to seek justice in our courts. It ensures transparency in civil litigation. And it protects the integrity of the Civil Rights Act, the Equal Pay Act, the Americans with Disabilities Act, and the Age Discrimination in Employment Act, among others."[8]

Recent Supreme Court Decisions That Have Made Arbitration Fairness Act is Necessary

Three recent Supreme Court decisions in particular have altered the way cases are brought in this country. Those three cases are *Stolt-Nielson S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010); *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011); *American Express Co. v.*

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[4] Jim Lardner, "A Corporate 'Get Out of Jail Free' Card," *US News and World Reports*, September 6, 2013, http://www.usnews.com/opinion/blogs/economic-intelligence/2013/09/06/forced-arbitration-is-a-corporate-get-out-of-jail-free-card

[5] Public Citizen and the National Association of Consumer Advocates, "Justice Denied One Year Later: The Harms to Consumers from the Supreme Court's Concepcion Decision are Plainly Evident," April 2012, http://www.naca.net/sites/default/files/Justice%20Denied%20Concepcion%20Anniversary%20Report.pdf

[6] Jim Lardner, "A Corporate 'Get Out of Jail Free' Card," *US News and World Reports*, September 6, 2013, http://www.usnews.com/opinion/blogs/economic-intelligence/2013/09/06/forced-arbitration-is-a-corporate-get-out-of-jail-free-card

[7] Senator Al Franken, "The Arbitration Fairness Act of 2013," May 7, 2013, http://www.franken.senate.gov/files/documents/130507ArbitrationFairness.pdf

[8] *Id.*

Italian Colors Restaurant, 133 S. Ct. 2304 (2013). While each presents a unique situation, all concern the way in which litigation is directed towards and often squashed under the rules of arbitration.

Stolt-Nielson Decision

Stolt-Nielson concerned international animal feed companies who discovered the shipping companies they had contracted with were engaged in an illegal price-fixing conspiracy. Respondent AnimalFeeds brought suit alleging price fixing under the Sherman Anti-trust Act. The suit was grouped with other similarly situated customers of the shipping companies. The contract was silent on the issue of class arbitration, however, and the issue had to be resolved before the case could continue. The issue was decided before a panel of arbitrators, who found that based on the evidence, there was no "intent to preclude class arbitration"[9], and therefore class arbitration would be allowed. The decision was appealed to the District Court for the Southern District of New York, which vacated the award on the basis the arbitrators failed to conduct a choice-of-law analysis.[10] AnimalFeeds appealed to the Court of Appeals in New York, which again reversed, holding that "because Petitioners had cited no authority…against class arbitration, the arbitrators' decision was not in manifest disregard of federal maritime law."[11] The Supreme Court granted certiorari.

The Court took pains to point out that under the Federal Arbitration Act (FAA), arbitration "is a matter of consent, not coercion."[12] It was undisputed that the contract between the parties required disputes be settled in arbitration, but said nothing about class proceedings.

AnimalFeeds relies on a recently decided Supreme Court decision, *Bazzle v. Green Tree Financial Corp.*, 123 S. Ct. 2402. "In Bazzle, a plurality of the court had ruled that the issue of class arbitration, where not specifically provided for in the contract, should be decided by the arbitrator, not the court."[13]

Many companies after Bazzle attempted to evade its perceived impact by including in contractual arbitration clauses provisions affirmatively prohibiting class action arbitrations. A number of courts, in increasing frequency, however, have stricken such provisions as void against public policy on a variety of grounds.[14]

The Court felt that lower courts had misinterpreted it's holding in *Bazzle*, and used its majority to eliminate the refuge consumers had sought from class action waivers. The Court began by first

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[9] *Stolt-Nielsen S.A.*, 130 S. Ct. at 1766.
[10] *Id.*
[11] *Id.*
[12] *Id.* at 1773, quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 109 S. Ct. 1248, (1989).
[13] Susan Jordan, "Stolt-Nielsen's Effect on Consolidation of Arbitration," *Law360*, July 07, 2010, http://www.lockelord.com/files/News/9424c623-87bd-4514-97a6-9da91766731d/Presentation/NewsAttachment/a4608d66-324a-467c-82dd-9db2056704c4/2010-07_Stolt-NielsensEffect_Jordan.pdf.
[14] D. Matthew Allen & Rebecca N. Shwayri, "The Supreme Court's Class Action "Do Over" in Stolt Nielsen," *Bloomberg Law Reports*, http://www.carltonfields.com/files/Publication/580f5c76-060c-4caf-a39f-c1ade757be5f/Presentation/PublicationAttachment/0ce7a1ad-bc6b-46e4-96ca-c90feb017e23/The%20Supreme%20Court%27s%20Class%20Action%20Arbitration%20-%20Do%20Over.pdf.

noting that "only the plurality decided that question"[15], and with little explanation determined that "*Bazzle* did not establish the rule to be applied in deciding whether class arbitration is permitted."[16]

The Supreme Court ultimately reached the conclusion that "a party may not be compelled under FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so."[17] Because the contract between the companies was silent on the issue of class actions, it couldn't be inferred that either party had consented to class arbitration proceedings.[18] In other words, where an arbitration agreement exists, for class proceedings to proceed, agreement on the issue must be explicit.

AT&T Mobility Decision

A year after *Stolt-Nielsen*, the Court was again called upon to decide whether a class arbitration action should be permitted. Following the *Stolt-Nielsen* decision, companies made sure arbitration agreements expressly prohibited class arbitrations. Such was the case when the Concepcions purchased cellular service through AT&T. The phones that came with the service plan were advertised as free, but the Concepcions "were charged $30.22 in sales tax based on the phones' retail value."[19]

The Concepcions brought suit against AT&T in the United States District Court for the Southern District of California, and were consolidated into a class action, alleging false advertising and fraud.[20] AT&T moved compel individual arbitration, on the grounds the contract the Concepcions signed expressly required arbitration and prohibited class proceedings. The District Court held that based on a rule from the California Supreme Court case *Discover Bank v. Superior Court*, 113 P. 3d 1100 (2005), "the arbitration provision was unconscionable"[21]. The so called *Discover Bank* rule works to nullify class-action waivers in consumer contracts of adhesion where "the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money."[22] That decision was affirmed by the Ninth Circuit, and the case ultimately made its way to the Supreme Court of the United States.

In an opinion written by Justice Scalia, the Court found that the *Discover Bank* rule conflicts with the Federal Arbitration Act (FAA), and was therefore preempted. Section 2 of the FAA says that an arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[23] The majority does not shy away from this language; it is the first sentence of the majority opinion. The Court says that

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[15] *Stolt-Nielsen S.A.*, 130 S. Ct. at 1772.
[16] *Id.*
[17] *Id.* at 1775.
[18] *Id.* at 1776.
[19] *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1744 (2011).
[20] *Id.*
[21] *Id.* at 1745.
[22] *Id.* at 1745.
[23] *Id.* at 1744.

the grounds in which an arbitration agreement can be invalidated are "generally applicable contract defenses"[24], such as fraud or duress.

Like in *Stolt-Nielsen*, the majority focused on the differences between bilateral and class arbitration. "The switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment."[25]

Finally the majority acknowledges the concern of the dissent; "that class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system."[26] This concern is really foundational to the issues raised by predispute arbitration agreements, when a company effectively insulates itself from liability from wrongdoing by making the process of vindicating a right so arduous that it cannot feasibly be done. Again, this important public policy issue was dealt with coldly by the majority; "States cannot require a process that is inconsistent with the FAA, even it if is desirable for unrelated reasons."[27]

The dissent reads the language of Section 2 of the FAA plainly, stating the very wording of Section 2 allows for the operation of the California *Discover Bank* rule.[28] The dissent believes the majority is simply wrong in believing that the FAA and the Discover Bank rule are inconsistent with one another; that by "increasing the complexity of arbitration proceedings"[29], the *Discover Bank* rule discourages "parties from entering into arbitration agreements."[30] The dissent first points out that contrary to the majority's argument, "class arbitration proceedings…take less time than the average class action in court."[31] And if efficiency is such a concern, surely a single class proceeding would be "more efficient than thousands of separate proceedings for identical claims."[32]

Italian Colors Decision

With the *AT&T Mobility* decision having been decided two years prior, the decision in *American Express Co. v. Italian Colors Restaurant* followed the same rationale but went even further. In short, a group of restaurants brought suit against American Express alleging that American Express ("Amex") used it's superior market position in the credit card market "to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards."[33]

The restaurant presented evidence that proving the antitrust claims would require an expert analysis, costing "several hundred thousand dollars, and might exceed $1 million, while the maximum recovery for an individual plaintiff would be $12,850, or $38,549 when trebled."[34]

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[24] *Id*. at 1748.
[25] *Id*. at 1751.
[26] *Id*. at 1753.
[27] *Id*.
[28] *Id*. at 1756.
[29] *Id*. at 1758.
[30] *Id*.
[31] *Id*. at 1759.
[32] *Id*.
[33] *American Express Co*., 133 S. Ct. at 2308.
[34] *Id*.

Like *AT&T Mobility*, there was an explicit agreement against class arbitration in the contracts between American Express and the restaurants. But in this scenario, not only was arbitration an unlikely solution to the issue, but arbitration would have been completely insufficient to find a remedy. Essentially, this was a scenario where, if the court were to find that no class arbitration could proceed, Amex had insulated itself from antitrust violations and realized potentially millions of dollars from their wrongdoing. This concern, however, did not sway a majority of the Supreme Court.

The restaurants attempted to distinguish themselves from the *Stolt-Nielsen* holding by not expressly pursuing a remedy in class arbitration. "As the merchants explain, all they have ever sought is the effective vindication of their statutory rights. It doesn't matter whether that takes the form of class litigation, class arbitration, bilateral arbitration with cost-shifting, or something else."[35] This "effective vindication" argument resonated with the Second Circuit, which held "because respondents had established that 'they would incur prohibitive costs if compelled to arbitrate under the class action waiver,' the waiver was unenforceable and the arbitration could not proceed."[36]

But the Supreme Court was not persuaded by the "effective vindication" argument, holding "the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the right to pursue that remedy."[37]

The Impact of These Supreme Court Cases

Many corporations have taken it upon themselves to revise their contracts to include mandatory arbitration agreements. Public Citizen illustrated the scope of the problem by compiling a list of corporations that force consumers into mandatory binding arbitration and "immuniz[e] themselves from accountability for wrongdoing."[38]

Their list, which is only a sample of the corporations that have started including these clauses in their contracts with consumers includes telecommunications corporations: DirecTV, Verizon, AT&T, Comcast, Sprint Nextel Wireless, T-Mobile, Clearwire, Time Warner Cable, and Tracfone.[39]

It also lists consumer banks and credit corporations, including Wells Fargo, US Bank, Regions Banks, BB&T, Discover, PNC Bank, Chase, TD Bank, Charles Schwab Bank, and American Express.[40]

Corporations that provide students with loan money, including Sallie Mae, Citibank, Sovereign Bank and Discover[41], are including these mandatory arbitration clauses in their contracts with

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[35]David Garcia, "Argument Preview: Under what circumstances are arbitration agreements with class action waivers enforceable?," *SCOTUS Blog*, February 22, 2013, http://www.scotusblog.com/2013/02/argument-preview-under-what-circumstances-are-arbitration-agreements-with-class-action-waivers-enforceable/.
[36] *American Express Co*., 133 S. Ct. at 2308, citing *In re American Express Merchants' Litigation*, 554 F. 3d 300, 315-316 (CA2 2009).
[37] *Id*. at 2311.
[38] Public Citizen, "Forced Arbitration Rogues Gallery," http://www.citizen.org/rigged-justice-rogues-gallery.
[39] *Id*.
[40] *Id*.
[41] *Id*.

students, which is inherently unfair given the fact that the average student in need of a school loan is not financially equipped to bring an individual suit against the corporation in an arbitration forum.

Consumer electronics corporations, such as Sony, Dell, Gateway Computers, Electronic Arts, Xbox Live, and Toshiba,[42] have included these mandatory arbitration agreements in their typical consumer contract to the detriment of all.

Nursing homes, such as Carrington Place Care Center (Candansk, LLC), Covenant Health (Covenant Dove, Inc.), Driftwood Rehabilitation and Nursing Center, Kindred Nursing Center, Manor Care of Florida, OP Winter Haven, Inc., Palm Garden of Sun City Center (SA-PG Sun City Center, LLC), and Tara at Thunderbolt Nursing and Rehabilitation Center (Triad Health Management of Georgia, III, LLC)[43] have all taken advantage of ill, elderly, and disabled consumers who require medical treatment, but lack the negotiation abilities required to avoid agreeing to the pre-dispute mandatory arbitration clauses with class action waivers.

Home builders, such as D.R. Horton, Pulte Homes, Centex, Lennar, KB Home, Hovnanian Enterprises, NVR, The Ryland Group, and Beazer Homes,[44] are all corporations that have selfishly taken advantage of American families who hire the corporation to help them begin their new life.

Starbucks, Pep Boys, Gold's Gym, Ticketmaster, Crocs, In-N-Out Burger, Red Mango, Patagonia, and Discover[45] are corporations that have included pre-dispute mandatory arbitration clauses in their contracts relating to the purchase of gift cards, immunizing themselves from liability, as no rational consumer would individually sue Starbucks over the cost of three cups of coffee.

Pre-dispute mandatory arbitration clauses have also made their way online, with websites such as Amazon.com, Barnes and Noble, Netflix, Hulu, Groupon, Match.com, Ebay, Microsoft, Paypal, Change.org, Spotify, and Stubhub[46] putting online consumers at risk of being unable to vindicate their rights over unfair trade practices relating to their purchase.

Another place people are now finding forced arbitration agreements is in their cruise ship tickets. After the Carnival Cruise Lines ship Triumph disaster in February 2013, where passengers "suffered in sweltering heat, walked through sewage and faced unspeakable conditions,"[47] many assumed they could sue the cruise line. However, as Nan Aron, President of Alliance for Justice noted, "[i]t appears that Carnival is far better prepared to prevent lawsuits than it was to contain the damage aboard the Triumph. In the fine print found in every ticket, there is a clause that bars most lawsuits, passengers must go into forced arbitration."

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[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] Nan Aron, "Arbitration Fairness Act would protect American consumers," *The Reporter*, May 12, 2013, http://www.thereporter.com/ci_23226704/arbitration-fairness-act-would-protect-american-consumers

This list makes clear why forced arbitration is not voluntary. Average consumers buying a cell phone or opening a bank account, students taking out loans, and the elderly and disabled entering nursing homes, lack the ability to fight forced arbitration clauses in the contracts they are signing. Often they don't even know they are there – and even if they do, they don't have a choice but to sign.

Case Examples

Before *Concepcion*, contracts that included forced arbitration agreements with class action waivers could have been invalidated under state contract law. But after *Concepcion*, these agreements are being upheld. Any case that may have been able to get around *Concepcion* is now in danger because of *American Express*. Examples of cases where forced arbitration clauses have prevented victims from bringing claims in court are illustrated below:

- Matthew Wolf, "captain in the Judge Advocate General Corps of the Army Reserves," had to break the lease for his Nissan Infiniti when he was called to join forces in Afghanistan, but fortunately, the Servicemembers Civil Relief Act would have protected him from losing the $400 he had paid in advance towards his monthly payments.[48] But he was deprived of the $400, so in 2010, his attorney brought a claim on behalf of Wolf and other similarly situated service members.[49] Unfortunately for them, the *Concepcion* decision brought their lawsuit to a screeching halt, because the contract between Wolf and Nissan included a pre-dispute mandatory arbitration clause with a class action waiver.[50] On a larger scale, the ramifications of this decision are more severe than a $400 loss; if this claim was tried as a class action, it would have alerted other unaware service members, who were called into active duty, that they were also entitled to reimbursement of the monthly payments that they paid in advance. In fact, Wolf never would have known that he was entitled to this reimbursement if a friend who was also a service member hadn't told him so.[51] There could be thousands of other similarly situated service men, unaware that they are entitled to this right.[52]

- The Alliance for Justice listed several examples of cases thrown out after *Concepcion*. One was the case of Lourdes Cruz. Cruz fell victim to AT&T Wireless's superior contracting power when she was faced with charges of $2.99/month for "roadside assistance service" that she was not even aware she had agreed to. She attempted to bring a class-action suit "under Florida's unfair trade practices law," but due to the Supreme Court's decision in *Concepcion*, she had to individually arbitrate her claim instead.[53] Like Wolf, the court essentially told Cruz that, in order to recover the sum of the monthly charges, she would first have to spend more than that sum individually arbitrating her

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[48] David Segal, "A Rising Tide Against Class-Action Suits," *New York Times*, May 5, 2012, http://www.nytimes.com/2012/05/06/your-money/class-actions-face-hurdle-in-2011-supreme-court-ruling.html?_r=1.
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] Alliance for Justice, "One Year Later: The Consequences of AT&T Mobility v. Concepcion," *Justice Watch*, April 27, 2012, http://afjjusticewatch.blogspot.com/2012/04/one-year-later-consequences-of-at.html.

claim. This situation allows corporations to take advantage of unsuspecting consumers and gives the corporations peace of mind because it is not in the consumers' best interests financially to sue the corporation for their wrongful acts.

- Arbitration clauses have been upheld even when it's clear the person signing the agreement has no idea what they're agreeing to. In *Spring Lake NC, LLC v Holloway*[54] involves the infliction of a mandatory arbitration agreement upon "a 92 year old with a fourth-grade education," who was in a state of increasing confusion and lacking normal memory functionality.[55] The trial court found that this person "could not possibly have understood what she was signing," but the mandatory arbitration clause was enforced regardless.[56]

- Another example of the impact of mandatory arbitration clauses on the elderly involves William Kurth, an eighty-four year old World War II veteran, who passed away due to the negligent staff at Mount Carmel Medical and Rehabilitation Center ("Center"), which is a Kindred Healthcare Inc. owned facility.[57] Within about an hour of arriving at the Center to admit her husband, Mrs. Kurth was fed the plain-English version of more than fifty pages of documents, which included a pre-dispute mandatory arbitration clause at the end.[58] This mandatory arbitration clause was described to Mrs. Kurth as "necessary in order to admit Mr. Kurth into the nursing home."[59] Admitting Mr. Kurth was the only practical option because of Mrs. Kurth's inability to take care of him on her own, so she truly had no choice. Mr. Kurth was immobile after he had hip surgery; the staff at the Center was expected to ensure that he did not develop pressure ulcers due to the lack of mobility. However, Mr. Kurth's care did not change to accommodate his need for increased care, and he "developed 10-11 stage 4 pressure ulcers, [which were] so severe that they left bone and organs exposed."[60] Around the same time that Mr. Kurth developed these ulcers, Kindred switched from having a "wound care team," consisting of multiple nurses, to just one nurse, whose duty was to monitor and treat the wounds of all 155 residents.[61] Unfortunately for Mr. Kurth, the wound care nurse did not treat a single one of his pressure ulcers.[62] These incidents, when taken together, directly caused Mr. Kurth's untimely demise. After two half-hearted offers by Kindred to pay for Mr. Kurth's funeral costs, Mr. Kurth's family attempted to sue Kindred; the pre-dispute mandatory arbitration cause stopped their lawsuit before it began.[63] This case took place before *Concepcion*.

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[54] *Spring Lake NC, LLC v Holloway*, 110 So.3d 916 (Fla. Dist. Ct. App. 2013)
[55] Public Justice, "Comments of Public Justice to the Consumer Financial Protection Bureau," August 7, 2013, http://publicjustice.net/sites/default/files/downloads/Public-Justice-Response-to-CFPB-re-Consumer-Survey.pdf.
[56] *Id*.
[57] American Association for Justice, "The Real Life Consequences of Forced Arbitration," http://www.justice.org/cps/rde/justice/hs.xsl/2961.htm.
[58] *Id*.
[59] *Id*.
[60] *Id*.
[61] *Id*.
[62] *Id*.
[63] *Id*.

- A recent US News article[64] cites a case involving New York citizen, and disabled resident, Bernadita Duran. Duran was a victim of a "last-dollar" scam and lost "$4000 to a 'debt settlement' company, which pocketed the whole amount in fees without settling any of her debts."[65] Because of an arbitration clause, she learned she would be forced to "take her complaint outside the public court system to a private arbitration firm of the company's choosing."[66] In addition to her monetary loss, Ms. Duran was expected to travel to Arizona, where the debt company and its chosen arbitrator were. And, "if she considered that an unfair burden, well, Duran was free to raise the point- with the Arizona arbitrator, once she got there."[67]

- The Second Circuit recently upheld an arbitration clause in an employment contract in *Parisi v Goldman Sachs & Co*.[68] In this case, upon becoming a managing director at Goldman Sachs in 2003, Lisa Parisi "signed a Managing Director Agreement, which contained an arbitration clause. The scope of the clause included any claim arising out of "employment related matters."[69] After she was fired in 2008, Parisi sued Goldman Sachs, alleging Title VII gender discrimination, along with two other former employees, "as part of a putative class, alleging a continued pattern of gender discrimination."[70] Goldman Sachs filed a motion to compel arbitration. The lower courts denied the motion to compel, but on appeal, the Second Circuit "found that Congress has expressly allowed for arbitration of Title VII claims." Doing so, the court recognized "two circumstances in which motions to compel arbitration must be denied because they would prevent plaintiffs from vindicating a statutory right. First, arbitration agreements have been invalidated when they have interfered with the recovery of statutory damages. Second, when dealing with some antitrust actions under the Sherman Act, arbitration clauses containing class waivers have been held unenforceable because individual arbitration would be cost prohibitive to the point of precluding plaintiffs from brining such claims."[71]

  Parisi attempted to argue that the Court should allow her claim to continue because Title VII's "pattern-or-practice" clause was only available only to class plaintiffs, and the arbitration clause prevented her from following through on her "substantive right" on the claim. Unfortunately, but not surprisingly, the Court "disagreed with Parisi, saying that 'pattern-or-practice' is not an independent cause of action, but merely a method of proving the disparate treatment element of a Title VII claim…[and] the Court therefore

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[64] Jim Lardner, "A Corporate 'Get Out of Jail Free' Card," *US News and World Reports*, September 6, 2013, http://www.usnews.com/opinion/blogs/economic-intelligence/2013/09/06/forced-arbitration-is-a-corporate-get-out-of-jail-free-card
[65] *Id*.
[66] *Id*.
[67] *Id*.
[68] *Parisi v. Goldman Sachs & Co*., No. 11-5229-cv (2d Cir. March 21, 2013).
[69] Jeremy Gray, "Parisi v. Goldman Sachs & Co.: Second Circuit Upholds Arbitration Clause Barring Title VII 'Pattern or Practice,'" *LawUpdates.com*, May 22, 2013, http://www.lawupdates.com/commentary/iparisi_v._goldman_sachs_co._isecond_circuit_upholds_arbitration_clau/
[70] *Id*.
[71] *Id*.

held that 'such a right does not exist."[72]

Jeremy Gray, a partner in an employment law firm who wrote about this case for *Lawupdates.com* explains, the "Second Circuit's holding in *Parisi* has demonstrated the strength of the FAA and the courts' subsequent unwillingness to invalidate arbitration agreements, even when they forbid discrimination class actions."[73]

The United States has always been a leader in the right to be guaranteed a fair day in court. Cases like those above are affecting those who most desperately need our judicial system. They clearly illustrate why the Arbitration Fairness Act is so desperately needed.

What the AFA Will Do

Whether or not the AFA remedies the problems that exist because of forced arbitration depends on what exactly the AFA purports to do. The text of the bill itself it short, but the summary does a good job of describing what the bill hopes to accomplish. "Arbitration Fairness Act of 2013 - Declares that no predispute arbitration agreement shall be valid or enforceable if it requires arbitration of an employment, consumer, antitrust, or civil rights dispute."[74] Thus it would give consumers the freedom to choose whether or not to submit themselves to the arbitration process.

There are occasions where people may prefer arbitration; the system of arbitration is faster and easier in some cases. The important point is that this bill would give the injured party a choice.

Thank you for hearing our views on this important legislation. If you have any questions, please contact Zakary Woodruff, Zakary.Woodruff@law.nyls.edu, Jessica Braunstein, Jessica.Braunstein@law.nyls.edu, or Parul Nanavati, Parul.Nanavati@law.nyls.edu.

Respectfully submitted,

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[72] *Id.*
[73] *Id.*
[74] S. 878, 113th Cong. (2013-2014), http://beta.congress.gov/bill/113th/senate-bill/878?q={%22search%22:[%22arbitration%20fairness%20act%22]}.

WRITTEN STATEMENT OF

MIKE ROTHMAN

COMMISSIONER OF THE MINNESOTA DEPARTMENT OF COMMERCE

ON BEHALF OF THE

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION (NASAA)

BEFORE THE

SENATE JUDICIARY COMMITTEE

"The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

DECEMBER 17, 2013
WASHINGTON, DC

Chairman Leahy, Ranking Member Grassley, Senator Franken and Members of this Committee, thank you for the opportunity to submit this statement for inclusion in the record of the hearing by the Senate Judiciary Committee on December 17, 2013 entitled "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

On behalf of the North American Securities Administrators Association, Inc. (NASAA), I appreciate the opportunity to share my views on arbitration as it impacts the public and specifically, investors. As the Commissioner of the Minnesota Department of Commerce, I am the securities regulator for the state of Minnesota and a member of NASAA. I am also a member of NASAA's Board of Directors and serve on its Federal Legislation Committee, which is responsible for developing NASAA's biannual Legislative Agenda and works with NASAA's leadership to set the organization's federal policy priorities. One of NASAA's top legislative priorities for the 113th Congress is to promote efforts aimed at providing aggrieved investors meaningful remedies and a choice of forum in which to pursue those remedies. On June 14, 2013, I spoke to the Upper Midwest Securities Conference in Minneapolis. In my speech, I discussed the need for Congress to encourage the U.S. Securities and Exchange Commission

(SEC) to use its authority granted under the Dodd-Frank Act to take action and curb the use of mandatory pre-dispute arbitration agreements.

From the outset, I want to applaud Senator Franken for introducing the Arbitration Fairness Act of 2013 (S. 878) and for recognizing the importance of including services related to securities and other investments in the definition of "consumer dispute" under the bill. Your bill will help retail investors in Minnesota, and across the country, seek effective recourse through the judicial system to resolve securities disputes. I also wish to recognize Senator Amy Klobuchar, as a member of this Committee, for her leadership and work on behalf of all Minnesotans.

About NASAA

NASAA was organized in 1919 and is the oldest international organization devoted to investor protection. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. Ten securities administrators are appointed by Secretaries of State, five come under the jurisdiction of their states' Attorneys General, some are appointed by their Governors and Cabinet officials, and others work for independent commissions or boards.

NASAA is the voice of these securities agencies that are responsible for both grass-roots investor protection and efficient capital formation. Securities regulation is a complementary regime of both state and federal laws. The securities administrators in your states are responsible for enforcing state securities laws by pursuing cases of suspected investment fraud, conducting investigations of unlawful conduct, licensing firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, and providing investor education programs and materials to your constituents.

State securities regulators have protected Main Street investors for the past 100 years, longer than any other securities regulator. State securities regulators continue to focus on protecting retail investors more so than any other regulator. Our primary goal and mission is to

act for the protection of these investors, especially those who lack the expertise, experience, and resources to protect their own interests. States are also the undisputed leaders in criminal prosecutions of securities violators. In 2012 alone, state securities regulators conducted nearly 6,000 investigations, leading to nearly 2,500 enforcement actions, including 339 criminal actions. Moreover, in 2012, 4,300 licenses of brokers and investment advisers were withdrawn, denied, revoked, suspended, or conditioned due to state action, up 27 percent from the previous year.

Federal Arbitration Act – Legislative History

The Federal Arbitration Act (FAA) was enacted in 1925 to honor agreements to arbitrate between mutually consenting parties. The "principal purpose" of the FAA was to "require courts to enforce privately negotiated agreements to arbitration, like other contracts, in accordance with their terms."[1] Form contracts or "contracts of adhesion," where one party offers terms on a non-negotiated "take-it-or-leave-it" basis, are contrary to the intended purpose of the FAA. In fact, the legislative history makes clear that Congress intended the FAA to target commercial parties of generally comparable bargaining power, rather than consumers or, by extension, investors.

> Legislative history reveals that Congress intended the Federal Arbitration Act to cover disputes between merchants of approximately equal strength, Arbitration of Interstate Commercial Disputes: Hearing of S. 1005 and H.R. 646 Before the J. Comm. of Subcomms. on the Judiciary, 68th Cong. 10 (1924), but not involving disputes with workers, Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration: Hearing on S. 4213 and S. 4214 Before a Subcomm. of the S. Comm. on the Judiciary, 67th Cong. 9, 14 (1923), or disputes where the arbitration agreement could be considered an adhesion contract, Arbitration of Interstate Commercial Disputes: Hearing of S. 1005 and H.R. 646 Before the J. Comm. of Subcomms. on the Judiciary, 68th Cong. 15 (1924)."[2] As Representative Graham noted in the House floor debate in 1924, "[t]his bill simply provides for one thing, and that is to give an opportunity to enforce an agreement in commercial contracts and admiralty contracts—an agreement to arbitrate, when voluntarily placed in the document by the parties to it." 68

[1] *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ. U*, 489 U.S. 468, 478 (1989).

[2] House Committee on the Judiciary, Report on Activities During 111th Congress, H.R. Rep. No. 111-712, at n. 128.

Cong. Rec. 1931 (1924).[3]

Unfortunately, the reach of the FAA has been expanded by the Supreme Court over the last twenty years to apply in contracts between parties of unequal bargaining power. The House Committee on the Judiciary's Report on Activities during the 111th Congress discussed this expansion and some of the benefits associated with traditional litigation.

> Although arbitration was initially conceived as a privately-run, voluntary process for resolving disputes, mainly between businesses, written and oral testimony from Congressional hearings during the 110th Congress indicated that the use of arbitration had expanded in the last twenty years. Many businesses are now requiring arbitration of disputes in their consumer, employment, and franchise relationships. Ironically, during the passage of the Federal Arbitration Act, Congress did not intend to allow binding arbitration agreements on individuals if the contracts were between parties of unequal bargaining power. The secret nature of arbitration, the ability of the drafter to dictate the terms of the arbitration process, and the apparent loss of civil protections when compared to a court proceeding have created controversy among consumer and employee advocates and small business owners.
>
> Because arbitration avoids the public court system in favor of a private industry of arbitration groups, individuals lose some of the benefits and rights associated with traditional litigation. These benefits and rights include lower initial financial hurdles, pretrial discovery, formal civil procedure rules, proximity to the resolution forum, access to counsel, class action options, and fairness. Arbitration clauses may even negate the protection of some federal statutes.[4]

State securities regulators are deeply concerned about the implications of the recent Supreme Court decisions expanding the scope of arbitration, including the Court's recent decision in *American Express Co. v. Italian Colors Rest.*, which held that a group of merchants were bound by individual arbitration agreements with American Express even if a class action was the only way to make their claim – alleging a violation of federal antitrust law – economically viable.[5] As the scope of this hearing suggests, these decisions may further undermine the rights of consumers, workers and small businesses.

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[3] *Id.* at n. 126.

[4] *Id.* at 55-56.

[5] *American Express Co. v. Italian Colors Rest.*, Slip Op. No. 12-133 (S. Ct. June 20, 2013) ("AMEX III").

Mandatory Pre-dispute Arbitration Clauses in Investor Contracts

NASAA has had a longstanding concern about the use and proliferation of mandatory pre-dispute arbitration provisions (i.e., before a dispute or loss is known) that appear in the overwhelming majority of customer agreements used by broker-dealers. This concern has deepened in recent months, in part due to the decision, discussed further below, by one major brokerage firm to expand the scope of its arbitration clause to include a waiver of class action rights, thus further eroding investors' rights to fair recourse.

Prior to 1987, an investor's claim against his or her stock broker for alleged wrongdoing could generally be pursued as a lawsuit against the broker or the brokerage firm. But that year, the Supreme Court upheld the enforceability of agreements to arbitrate investors' claims arising under the Securities Exchange Act of 1934,[6] and subsequently, mandatory pre-dispute arbitration clauses have become a fixture in contracts between investors and brokerage firms. In addition to requiring arbitration, these agreements direct that such arbitration must be conducted in only one forum: the arbitration forum administered by the Financial Industry Regulatory Authority, or FINRA.[7] Increasingly, investment advisers are also requiring that their clients agree to binding pre-dispute arbitration.[8] In fact, a survey conducted by the Massachusetts Securities Division of its registered investment advisers revealed that 87% of those advisers now use a standard form of investment advisory agreement, and of those almost half include a pre-dispute arbitration agreement.[9]

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[6] *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

[7] The Financial Industry Regulatory Authority, or FINRA, is a private non-profit self-regulatory organization for broker-dealers organized as a national securities association pursuant to Section 15A of the Securities Exchange Act. 15 U.S.C. § 78o-3.

[8] In December 2012, FINRA issued "Guidance on Disputes between Investors and Investment Advisers who are not FINRA-Regulated firms." This guidance discusses the conditions required for an investor and registered investment adviser to submit a case to the FINRA arbitration forum, which has traditionally been open only to broker dealers and their customers. This Guidance requires that both parties sign an agreement to arbitrate ***after*** their dispute arises, and then a second agreement to have FINRA arbitrators hear the dispute.

[9] Massachusetts Securities Division, Report on Massachusetts Investment Advisers' Use of Mandatory Pre-Dispute Arbitration Clauses in Investment Advisory Contracts by Massachusetts Securities Division Staff (Feb. 11, 2013), *available at* http://www.sec.state.ma.us/sct/sctarbitration/Report%20on%20MA%20IAs%27%20Use%20of%20MPDACs.pdf.

NASAA believes that investors must have a choice of forum when it comes to resolving disputes with their investment professionals. Investor confidence in fair and equitable recourse is critical to the stability of the securities markets and long-term investments by retail investors. NASAA has argued that participation by "mom and pop" investors in our capital markets, and, by extension, job growth, is directly tied to their level of trust in having a reasonable avenue to seek recovery if they are victimized by securities fraud or other unethical conduct. Unfortunately, investor confidence in the U.S. markets remains low as reflected by a recent Bankrate survey.[10]

As noted above, NASAA was particularly alarmed when, in late 2011, Charles Schwab & Co. sent over 6.8 million existing account holders monthly account statements accompanied by immediately effective amendments to their account agreements. These amendments included a class action waiver (i.e., denial of the right to participate in class action litigation or on a representative basis). The waiver was also included in new account agreements. Schwab's decision to make these changes came after the Supreme Court's decision in *AT&T Mobility v. Concepcion*, holding class action waivers in consumer contracts enforceable.[11] Interestingly, just a few years prior to issuing this amendment, investors that purchased one of Schwab's mutual funds brought class actions against Schwab, including its broker-dealer affiliate, alleging violations of federal and state securities laws.[12] The court approved a $235 million settlement, with an average estimated payment to individual investors of $881, which the court noted offered "substantial recoveries" that "will provide real benefits" to those investors.[13] Had those investors been prohibited from participating in a class action, their potential recovery, even if greater than $881, would have been too small to warrant pursuing an individual arbitration.[14]

In the instance of Schwab seeking to expand its arbitration clauses to include class

[10] When asked to pick the best way to invest money that would not be needed for the next ten years, investors picked cash, real estate, and even precious metals over the stock market. The findings of the Bankrate survey are available at http://www.bankrate.com/finance/consumer-index/financial-security-charts-0713.aspx.

[11] *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011).

[12] *In re Charles Schwab Sec. Litig.*, No. C08-01510 WHA, 2011 WL 1481424 (N.D. Cal. Apr. 19, 2011).

[13] *Id.*

[14] *See* Black, Barbara and Gross, Jill, Investor Protection Meets the Federal Arbitration Act (Sept. 5, 2012), 1 Stan. J. Complex Litig. 1 (2012).

action waivers, FINRA instituted a disciplinary action against Schwab for the violation of its own member rules which preserve judicial class actions as an alternative to arbitration.[15] However, to the detriment of investors, in February 2013 a FINRA Hearing Panel determined that those rules and, by extension, the agreement between Schwab and FINRA to abide by those rules, could not be enforced under *Concepcion*.[16] FINRA has appealed the Hearing Panel ruling and a decision by FINRA's National Adjudicatory Council is forthcoming. However, if Schwab is successful in the appeal,[17] it is likely that every broker-dealer and investment adviser will follow suit and include class action waiver language in their customer agreements.[18] Even publicly-traded companies may attempt to insulate themselves from shareholder liability by including mandatory arbitration and class action waiver language in their governing documents.[19]

A decision in favor of Schwab would pose an imminent threat to investors' ability to

[15] *Department of Enforcement v. Charles Schwab & Co.*, FINRA Disciplinary Proceeding No. 2011029760201 (Feb. 1, 2012), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p210893.pdf; *see also* Letter from Sen. Franken and 36 Members of Congress to SEC Chair Mary Jo White (Apr. 26, 2013), *available at* http://www.nasaa.org/wp-content/uploads/2013/08/Bicameral-Letter-to-SEC-re-Mandatory-Arbitration-April-26-2013.pdf ("While the Supreme Court in *Concepcion* did find that the FAA preempts state actions that would restrict the use of arbitration, the facts in the Schwab case are notably distinguishable—not least because FINRA is a membership organization seeking to enforce its own rules."); *see also infra* n.19 (arguing that the Hearing Panel erred "because FINRA is statutorily required to enforce its rules and its membership agreement with Schwab" and "[t]he only agreement at issue in this enforcement action is the agreement between FINRA and Schwab and that agreement is unquestionably valid and permissible under the [FAA])".

[16] *See Dept. of Enforcement v. Charles Schwab & Co.*, FINRA Disciplinary Proceeding No. 2011029760201 (CRD No. 5393) (Feb. 1, 2012), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p210893.pdf.

[17] On May 15, 2013 Schwab released a statement on its website that it was suspending class action waivers in its account agreements. Notably, however, it qualified this measure as temporary "until the issue is resolved by the appropriate regulatory and/or court decisions." The Schwab statement is no longer available on its website.

[18] As Secretary Galvin has stated "This ruling is akin to giving every rogue broker-dealer the green light to steal from their customers in small dollars amounts." Letter from Secretary William Francis Galvin of the Commonwealth of Massachusetts to SEC Chairman Elisse B. Walter (Feb. 26, 2013), *available at* http://www.sec.state.ma.us/sct/sctschwabarb/Schwab-letter.pdf.

[19] *See supra* n. 13, at pgs. 7-9 (discussing the 2012 attempt by Carlyle Group LP to amend its initial public offering registration statement to require arbitration of investor disputes and recent attempts by shareholders to include in proxy statements of four publicly traded companies bylaw amendments that would require arbitration, and prohibition on class actions, of all shareholder claims including securities law violations); *see also* Letter from Sens. Al Franken, Richard Blumenthal and Robert Menendez to SEC Chair Mary Shapiro (Feb. 3, 2012) (urging the SEC to maintain its policy of opposing the inclusion of provisions requiring mandatory arbitration of shareholder disputes in the corporate documents of public companies in response to Carlyle Group, LP's attempt to amend its registration papers to prohibit litigation and instead require individual arbitration).

seek redress, particularly for small dollar claims.[20] In other words, the practical effect of the Hearing Panel's decision could be the elimination of the ability of investors to bring or participate in class actions, which is the only viable means for most small investors to recoup their losses. As the Seventh Circuit Court of Appeals has correctly observed "[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."[21] The high cost of attorneys' fees and expenses alone makes adequate representation in a FINRA arbitration, particularly against a large and sophisticated brokerage firm, insurmountable for a single investor.

Restoring protections for Americans with limited means to invest is even more critical in light of changes enacted as part of the Jumpstart Our Business Startups Act (JOBS Act), which became law on April 5, 2012. The JOBS Act established a mechanism for small investors to engage in crowdfunding and loosened restrictions on advertising and solicitation of private securities. NASAA anticipates that these provisions of the JOBS Act will lead to an increase in very small investments. If these investors are forced to waive their right to participate in class actions, they will be left with no economically viable remedy when they are defrauded, thereby undercutting the goal of the JOBS Act to spur investment in smaller offerings.

Securities Arbitration and the Dodd-Frank Act

Congress recognized the potential harm to investors from mandatory pre-dispute arbitration clauses when it enacted, on July 21, 2010, Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This section provided the SEC with the authority to prohibit or impose limitations on the use of mandatory pre-dispute arbitration clauses in broker-dealer and investment adviser customer contracts.

Section 921 was included in response to Congressional concern that mandatory pre-

[20] *See* Amicus Curiae Brief of NASAA at 14, *Dept. of Enforcement v. Charles Schwab & Co.*, FINRA Disciplinary Proceeding No. 2011029760201 (Feb. 1, 2012).

[21] *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).

dispute arbitration agreements were unfair to investors.[22] During deliberation, lawmakers observed the following with regard to mandatory pre-dispute arbitration clauses in broker-dealer contracts:

> For too long, securities industry practices have deprived investors of a choice when seeking dispute settlements, too. In particular, pre-dispute mandatory arbitration clauses inserted into contracts have limited the ability of defrauded investors to seek redress. Brokerage firms contend that arbitration is fair and efficient as a dispute resolution mechanism.
>
> Critics of mandatory arbitration clauses, however, maintain that the brokerage firms hold powerful advantages over investors. Brokerages often hide mandatory arbitration clauses in dense contract language. Moreover, arbitration settlements generally remain secret, preventing other investors from learning about the performance of a particular brokerage firm.
>
> If arbitration truly offers investors the opportunity to efficiently and fairly settle disputes, then investors will choose that option. But investors should also have the choice to pursue remedies in court, should they view that option as superior to arbitration. For these reasons, H.R. 3817 [the precursor to Section 921] provides the SEC with the authority to limit, prohibit or place conditions on mandatory arbitration clauses in securities contracts.[23]

Section 921 of the Dodd-Frank Act gives the SEC explicit rulemaking authority to prohibit or limit the use of mandatory pre-dispute arbitration agreements if it finds that doing so is in the public interest and for the protection of investors. Although Congress gave the SEC an important tool to act in this area, in the three years since the Dodd-Frank Act was passed, the SEC has not exercised its authority to conduct rulemaking or even examine the impact of mandatory pre-dispute arbitration clauses on investors and the public.[24] It is uncertain whether

[22] Congress considered the following concerns about the arbitration process: "high upfront costs; limited access to documents and other key information; limited knowledge upon which to base the choice of arbitrator; the absence of a requirement that arbitrators follow the law or issue written decisions; and extremely limited grounds for appeal." AARP letter to Senators Dodd and Shelby, November 19, 2009. *See also* Senate Committee on Banking, Housing, and Urban Affairs on S. 3217, S. Rep. No. 111-176, at 110.

[23] House Committee on Financial Services on H.R. 3817, H.R. Rep. No. 111-687, Part 1, at 50.

[24] Notably, even the SEC has previously advised brokerage firms that "form" contracts requiring mandatory pre-dispute arbitration are against public policy. "Requiring the signing of an arbitration agreement without adequate disclosure as to its meaning and effect violates standards of fair dealing with customers and constitutes conduct that

the SEC will take action in the near future under its Section 921 rulemaking authority,[25] even given the exigent circumstances presented by Schwab.

NASAA has urged the SEC to take such action, and has argued that as the agency chosen by Congress to oversee FINRA arbitration, the SEC's exercise of its specific authority under Section 921 of the Dodd-Frank Act supersedes the FAA's general provisions.[26] ***We are deeply thankful to Senator Franken for spearheading a letter to the SEC along with 36 other Members of Congress urging the SEC to exercise its Section 921 authority in light of the actions taken by Schwab to limit investors' class action rights.***[27]

Conclusion

The Federal Arbitration Act was never intended to enforce contracts of adhesion, where one party offers terms on a non-negotiated, take-it-or-leave-it basis. Unfortunately, these contracts of adhesion containing mandatory pre-dispute arbitration clauses in their fine print are commonplace in the brokerage and investment adviser industry. Schwab's actions to expand these clauses and prohibit class action participation are an example of the pernicious effect of forced arbitration and brokerage "form" contracts. It is also an alarming example of the continued erosion of investor protections. Indeed, without a class action vehicle, many small dollar claims and potentially harmful activity will go undiscovered by the harmed investor, thus resulting in windfalls to violators.

The Arbitration Fairness Act of 2013 reaches beyond the securities regime and eliminates mandatory, pre-dispute arbitration clauses in a wide range of consumer contracts. It restores investors' access to the courts, and allows them to determine, *after a dispute arises*, if arbitration

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is inconsistent with just and equitable principles of trade." Notice to Broker-Dealers Concerning Clauses in Customer Agreements which Provide for Arbitration of Future Disputes," 1979 WL 174165 (S.E.C. Release No. 34-15984), p. 4.

[25] *See* SEC published agency rule list – Fall 2013, *available at* (http://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPubId=201310&showStage=longterm&agencyCd=3235&Image58.x=11&Image58.y=9&Image58=Submit.

[26] *See* Letter from NASAA to SEC Chair Mary Jo White (May 3, 2013), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-to-SEC-on-Arbitration-and-Class-Action-Waivers.pdf.

[27] Letter from Sen. Franken and 36 Members of Congress to SEC Chair Mary Jo White (Apr. 26, 2013), *available at* http://www.nasaa.org/wp-content/uploads/2013/08/Bicameral-Letter-to-SEC-re-Mandatory-Arbitration-April-26-2013.pdf.

is the appropriate and desired forum. This legislation is consistent with the intent and spirit of Section 921 of the Dodd-Frank Act, and it removes the ability of any brokerage firm to unilaterally restrict an investor's ability to seek judicial relief. This legislation goes a long way to restore investor participation and confidence in the markets.

Thank you, Chairman Leahy, Ranking Member Grassley, Senator Franken, and Members of this Committee, for the opportunity to submit this written statement.

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TESTIMONY TO THE UNITED STATES SENATE JUDICIARY COMMITTEE

FORCED ARBITRATION UNDERMINES ENFORCEMENT OF FEDERAL LAWS BY SUPPRESSING CONSUMERS' AND EMPLOYEES' ABILITY TO BRING CLAIMS

December 17, 2013

By Jean R. Sternlight[1]
Michael and Sonja Saltman Professor of Law &
Director Saltman Center for Conflict Resolution
University of Nevada, Las Vegas Boyd School of Law

Introduction

I thank the Committee for scheduling this hearing and for inviting me to present my testimony. I believe that the proposed Arbitration Fairness Act of 2013-14, S. 878, addresses a critically important topic and that it ought to be passed in order to protect United States consumers and employees as well as the sanctity of our laws. There is no point having substantive laws to protect us unless these laws can be enforced, and yet companies are currently using mandatory arbitration to prevent their consumers and employees from enforcing their substantive rights. In particular, companies are using mandatory arbitration clauses both to deter individuals from bringing claims and also to eliminate individuals' opportunity to participate in class actions.

[1] Jean R. Sternlight is the Michael & Sonja Saltman Professor of Law and also Director of the Saltman Center for Conflict Resolution, Boyd School of Law, University of Nevada, Las Vegas.

Personal Background

By way of background, I have studied the topic of what I have called "mandatory arbitration" for almost twenty years. Indeed, I wrote one of the first law review articles on the subject: *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637 (1996). I have since written approximately twenty articles on the subject that have appeared in publications such as the STANFORD LAW REVIEW, the UNIVERSITY OF PENNSYLVANIA LAW REVIEW, and the WILLIAM AND MARY LAW REVIEW. I have also written four books on dispute resolution and been cited or quoted by numerous courts and newspapers. Currently I am employed by the University of Nevada-Las Vegas where I am the Director of the Saltman Center for Conflict Resolution and also the Michael and Sonja Saltman Professor of Law.[2]

As you might imagine, given my titles and interests, I am a big fan of alternative dispute resolution, including arbitration. I believe that disputants are often better served by resolving their disputes through negotiation, mediation or arbitration than through litigation. Nonetheless, I am staunchly opposed to the practice variously known as "mandatory," "forced," or "compelled" arbitration whereby businesses use form contracts to require their employees or consumers to resolve future disputes through arbitration rather than through litigation.[3] Rather, I favor giving businesses and individuals the chance to *knowingly and voluntarily* choose to resolve disputes in the venues they both prefer.

Supreme Court Rulings on Arbitration

The legal landscape governing mandatory arbitration has changed substantially since I began writing on the topic almost twenty years ago. In particular, the U.S. Supreme Court has issued numerous decisions granting companies essentially free rein to require their consumers and employees to resolve disputes through arbitration, rather than through litigation. The Court has for example made clear that companies can use arbitration to eliminate plaintiffs' opportunity to join together in class actions even where the elimination of class actions leaves plaintiffs without an economically realistic opportunity to present their claim.[4] The Court has also largely eliminated states' opportunity to protect

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[2] Of course the opinions I express here are only my own.

[3] While some may suggest that consumers and others can simply refuse to do business or take a job when arbitration is required the practical reality is that they often do not see the clause, understand it, or understand its importance. Moreover, in some fields even educated consumers would have virtually no choice but to agree to arbitration if they want the product or service in question, as the term may be so prevalent in some kinds of contracts.

[4] In *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011), the Court held that the Federal Arbitration Act preempted lower courts' use of California precedent to hold an arbitral class action prohibition unconscionable. Subsequently, in *American Express v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013), the Court held that an arbitral class action prohibition was valid even though it would prevent plaintiffs from vindicating their rights under federal antitrust law.

their citizens from unfair arbitration by interpreting preemption doctrines broadly so as to void most state statutes governing arbitration.[5] Additionally the Court has held that arbitrators rather than courts should interpret many aspects of arbitration clauses, including determining whether the arbitration clause is invalid due to unconscionability, so long as the clause gives that power to the arbitrators.[6] In short, under current law companies are largely allowed to structure arbitration as they wish, subject only to limited regulation by the arbitrators themselves or by arbitration providers. Yet, arbitrators and arbitration providers have little incentive to rein in the practice that provides them with economic remuneration.

Policy Arguments Regarding Mandatory Arbitration

While the legal landscape has changed substantially over the past twenty years, the policy arguments regarding whether mandatory arbitration is good or bad for employees and consumers remain substantially the same. Advocates of the practice urge that arbitration is quicker and cheaper than litigation and that companies who compel arbitration are therefore providing employees and consumers with a better venue than court in which to present their legal claims. Such advocates typically assert that any unfair clauses will generally be weeded out by courts or by arbitration providers. By contrast, critics typically assert that mandatory arbitration is often unfair to the "little guys" -- consumers and employees -- and that forcing disputes into private arbitration also deprives the public of access to the dispute resolution process or resulting precedent.

Very Few Consumers and Employees Bring Claims in Arbitration

Those who focus on the fairness of arbitration *hearings* miss the main impact of mandatory arbitration clauses, which is that they typically deter or sometimes prevent consumers or employees from obtaining access to justice in *any* forum. That is, *almost no consumers or employees actually bring claims in arbitration*. Thus, rather than providing greater access to justice the main function of arbitration clauses is to protect companies from claims brought in any venue. Worrying about whether arbitration hearings are or are not fair largely misses the main point, which is that arbitration hearings are exceedingly rare.

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[5] For example, in *Doctor's Associates Inc. v. Casarotto*, 517 U.S. 681 (1996), the Court held that the FAA preempted Wyoming law requiring arbitration clauses to appear in a particular location and font in contracts. More recently, in *Preston v. Ferrer*, 552 U.S. 346 (2008), the Court held that the parties' arbitration clause superceded a California statute requiring that certain kinds of contractual disputes in the entertainment industry be resolved by a particular state agency.

[6] Rent-a-Center West, Inc. v. Jackson, 561 U.S. 63 (2010) (holding that courts shall enforce arbitration clause written to provide that arbitrator, rather than court, decides whether arbitration clause is unenforceable due to unfairness).

While hard evidence regarding the practice of mandatory arbitration has been scant,[7] the little publicly available data shows that miniscule numbers of consumers or employees end up filing claims in arbitration. The preliminary report of the Consumer Financial Protection Board, which has begun to study consumer arbitration pursuant to Congressional mandate, confirms the point that very few consumers are filing arbitration claims.[8] These small numbers are particularly striking given that so many consumers and employees are required to file claims in arbitration rather than litigation. Professor Alexander Colvin has estimated that more than 20% of employees are covered by mandatory arbitration clauses.[9] We all know that arbitration clauses are even more common in the consumer setting, as we see them in transactions involving banking, credit cards, insurance, schools, gym memberships, telephones, computers, and many many other goods and services.[10]

How few claims are actually filed in arbitration? On the consumer side in one informal report the American Arbitration Association, the largest and best-known arbitration provider in the country, stated that it handled roughly 1,000 claims by consumers per year.[11] The recent Consumer Financial Protection Bureau report is consistent, finding that from 2010 through 2012 consumers filed an average of just 300 arbitrations per year with AAA regarding credit cards, checking accounts, payday loans, or prepaid cards.[12] JAMS, the other major arbitration provider in the United States, states that it handles at most a few hundred consumer claims annually.[13] Data revealed in several lawsuits similarly shows that when companies set up arbitration programs almost no customers bring claims.[14] With respect to employees, the numbers are similar. Researcher Alexander Colvin, a professor at Cornell's International Labor Relations School, looked at the information the American Arbitration Association was required to produce by California law.

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[7] Arbitration providers such as the American Arbitration Association or JAMS or the National Arbitration Forum typically cite both the importance of confidentiality as well as business justifications in refusing to open their files to researchers much less the general public. When providers do make their files available to researchers one can never be sure whether either the researchers or the providers are slanting the data or results to favor a particular perspective.

[8] CONSUMER FINANCIAL PROTECTION BOARD, ARBITRATION STUDY PRELIMINARY RESULTS 13 (December 12, 2013), available at http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf.

[9] Alexander Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury* 11 EMP. RTS. & EMP. POL'Y J., 405, 410 (2004).

[10] A 2001 study showed that thirty-five percent of the consumer contracts in an average California consumer's life required arbitration Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55, 62 (2004). Another more recent study of twenty-one companies with substantial name recognition or market share in the areas of telecommunications, credit, or financial services found that over seventy-five percent of the companies imposed mandatory arbitration on their consumers, and that every consumer arbitration contract included a waiver of class actions. Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J. LAW REFORM 871, 880-83 (2008).

[11] Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SOUTHWESTERN L. REV. 87, 99 (2012).

[12] CFPB ARBITRATION STUDY, *supra* n. 8.

[13] Sternlight, *supra* n. 11.

[14] *Id.* at 99-100.

Examining national data from 2003 through 2007 Colvin found that just 3,945 employees filed arbitration claims with AAA, or less than 1,000 employees per year.[15] While I recognize that AAA and JAMS are not the only arbitration providers, these statistics certainly suggest that neither consumers nor employees are filing lots of arbitration claims. Although the advocates of mandatory arbitration claim that the process is good because it provides inexpensive and quick access to the justice system, no one has produced data substantiating this claim with respect to either consumers or employees.

One thing we can say for sure is that the absence of consumer and employee claims in arbitration does not reflect that consumers and employees have no claims. In 2011, 1.8 million consumers filed claims with the Federal Trade Commission.[16] And, millions of consumers contest charges through their credit card companies.[17] We also know that plenty of employees do have claims they wish to file against their employers. In 2012, for example, just under 100,000 employees filed discrimination claims against their employers with the Equal Employment Opportunity Commission.[18] Of course many other employees filed discrimination claims with state agencies or might have liked to file tort or contract or other claims against their employers.

Courts Offer More Access to Justice than does Mandatory Arbitration

Some may suggest that even if arbitration is not perfectly accessible at least it is better than litigation, which is often slow and expensive. However, the evidence does not support this position. While it is certainly true that individual lawsuits are often difficult and expensive, court, despite all its drawbacks, offers consumers and employees far greater access to justice than does arbitration, particularly when one considers class actions. Federal court statistics show that 17,977 labor claims and 35,965 civil rights claims were filed in 2012.[19] Presumably not all of these were claims brought by employees against employers, but these numbers, from federal court alone, do provide quite a contrast to the scant number of employment claims filed in arbitration. Another study similarly found that 265,356 employment discrimination cases were filed in federal court alone between 1979 and 2000.[20] If state court statistics were added these numbers would be far greater. With respect to lawsuits brought by consumers, the Consumer Financial Protection Board found that consumers had filed more than 3,000 cases in federal court from 2010-2012

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[15] Alexander J.S. Colvin, *An Empirical Study of Employment Arbitration: Case Outcomes and Processes*, 8 J. EMPIRICAL L. STUDIES 1, 4 (2011).
[16] *Id.* at 102.
[17] *Id.*
[18] http://www1.eeoc.gov/eeoc/statistics/enforcement/charges.cfm.
[19] Federal Court Management Statistics June 2013, available at http://www.uscourts.gov/viewer.aspx?doc=/uscourts/Statistics/FederalCourtManagementStatistics/2013/district-fcms-profiles-june-2013.pdf&page=1.
[20] Kevin M. Clermont & Stewart J. Schwab, *How Employment Discrimination Plaintiffs Fare in Federal Court*, 1 J. EMPIRICAL STUDS. 429, 457 (2004).

regarding credit card issues alone.[21] If one adds to this cases involving defective products, illegal fees, fraudulent charges and all the other matters consumers may complain of, and if one also adds consumer litigation in all the fifty state courts, of course the number would be far higher.

Class actions are also a tremendous resource for consumers and employees who would not be able to file individual claims, for example because they were not aware they were injured, because they did not realize the harm violated a law, because they could not afford to litigate their claim on an individual basis, or because they feared retaliation. The annual class action report compiled by law firm Seyfarth Shaw states that in 2011 employees filed 8,414 ERISA class actions, 6,779 Fair Labor Standards Act class actions, and 14,771 employment discrimination class actions.[22] Similarly, the Consumer Financial Protection Board found that more than 400 consumer class actions were brought in federal court alone between 2010 and 2012, just with regard to credit card issues.[23] A single class action may provide hundreds or thousands or even millions of claimants access to relief, and may also deter companies from committing future violations. For example, two California lawsuits brought against Career Education Corporation for making fraudulent representations as to post-school employment prospects led to a $40 million dollar settlement whereby the company agreed to reimburse 8,500 students up to $20,000 apiece.[24] On the employment side, while the Supreme Court's decision in *Walmart v. Dukes*, 131 S. Ct. 2541 (2011), disallowed a proposed employment class action that would have covered more than a million employees,[25] even the far smaller and more targeted classes now being pursued post-*Walmart* could each often include thousands and thousands of members.[26] Yet, companies are increasingly turning to mandatory arbitration precisely as a means to eliminate consumers' and employees' access to class actions. Thus, it appears that mandatory arbitration is limiting rather than broadening access to justice.

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[21] Prepared Remarks of Director Richard Cordray at the Field Hearing on Arbitration (December 12, 2013), available at http://www.consumerfinance.gov/newsroom/prepared-remarks-of-director-richard-cordray-at-the-field-hearing-on-arbitration/.

[22] Seyfarth Shaw, ANNUAL WORKPLACE CLASS ACTION LITIGATION REPORT (2012 edition) at 3, available at http://www.seyfarth.com/dir_docs/publications/2012%20CAR%20short%20final%20(secured).pdf.

[23] Prepared Remarks of Director Richard Cordray, *supra* n. 21.

[24] Public Citizen & Nat'l Assoc. of Consumer Advocates, *Justice Denied – One Year Later: The Harms to Consumers from the Supreme Court's* Concepcion *Decision Are Plainly Evident* (2012) at 10, available at http://www.citizen.org/documents/concepcion-anniversary-justice-denied-report.pdf. For reports on other similar class actions see Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SOUTHWESTERN L. REV. 87, 102-103 (2012).

[25] 131 S. Ct. at 2547.

[26] *See, e.g.*, Easterling v. Connecticut Dept. of Correction, 278 F.R.D. 41 (D. Conn. 2011) (refusing to decertify class, even post-*Wal-Mart*, that challenged the use of a 1.5 mile run as an employment test in the hiring of corrections officers); Ellis v. Costco Wholesale Corp., 285 F.R.D. 492 (N.D. Cal. 2012) (certifying nationwide class of female Costco employees, post *Wal-Mart*, where class identified several companywide policies they claimed reduced their chances of promotion).

Why and How Mandatory Arbitration Suppresses Claims

Why do so few employees and consumers file claims in arbitration? It turns out that the mandatory form of arbitration is often not particularly appealing either to the attorneys who sometimes represent employees and consumers or to consumers and employees trying to proceed without representation. Here are just a few of the reasons why mandatory arbitration suppresses claims:

(1) Attorneys generally (but not always) prefer to file their claims in litigation than in arbitration. Weighing out the costs and benefits of each process attorneys may prefer litigation because they don't have to pay high filing or administrative fees or arbitral salaries, because they believe they will have a higher likelihood of prevailing, because they believe their client's recovery will be greater, because they will not be automatically foreclosed from proceeding in a class action, or because they seek a process in which the decision maker is required to follow the law and issue a written decision that will be publicly available.

(2) Because many plaintiffs' attorneys see mandatory arbitration as inferior to litigation they will be more reluctant to accept contingent fee cases when consumers and employees are arguably covered by arbitration clauses. In this way the imposition of arbitration "disarms" employees and consumers, making it more difficult for them to secure legal representation.

(3) Arbitration does not turn out to be a good vehicle for most unrepresented consumers and employees, as they may not be competent to file or present the claim effectively on their own behalf, and may not be able to afford filing fees and costs imposed in many arbitrations. Many consumer and employment claims are sufficiently complicated as a matter of law or fact that the typical consumer or employee cannot hope to prevail without assistance.

(4) Employees or consumers who are not aware they have been injured, or that the injury violates a law, will not file claims on their own behalf. Examples include consumers harmed by a toxic substance, a discriminatory practice, or a dangerous vehicle, or employees harmed by a discriminatory practice or the failure to pay overtime that is required by law.

While more research is needed to show which of these or perhaps other concerns discourage consumers and employees from filing individual claims in arbitration, we can be sure that arbitration is not providing the fast, cheap, fair access to justice that has been claimed.

Congress Must Act To Ensure Our Laws Are Enforceable

When companies use mandatory arbitration to deprive consumers and employees of access to justice they not only harm those consumers and employees but also prevent enforcement of the laws passed by Congress and state legislatures. In this country we largely rely on private lawsuits to secure enforcement of our laws. When companies can use arbitration to elude such lawsuits by suppressing claims they effectively render our laws toothless. I favor passage of the Arbitration Fairness Act of 2013-14, S. 878, because I believe it is the best means of protecting consumers and employees from unfair arbitration and ensuring that the laws legislatures have passed continue to be enforced.

Written Testimony of Professor Imre Stephen Szalai,
Loyola University New Orleans College of Law

Before the United States Senate Committee on the Judiciary

For the Hearing Entitled "The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?"

December 17, 2013

Thank you for allowing me this opportunity to present testimony regarding the Federal Arbitration Act. As explained in more detail below, recent Supreme Court decisions threaten to undermine the rights of millions of Americans, and I respectfully urge that the Committee on the Judiciary favorably report Senate Bill 878, the Arbitration Fairness Act of 2013, to the full Senate and work toward its enactment.

In order to make this written testimony as useful as possible to the Committee and its staff, I have organized my testimony into the following five sections:

1. My Professional Background and Interest in Arbitration Law

2. The Federal Arbitration Act Was Never Intended to Apply to Employment Disputes or Small Consumer Disputes

3. The Supreme Court's Decisions in *Concepcion* and *American Express* Are Changing the Scope of Judicial Review of Individual Arbitration Agreements

4. The Reformers Who Pushed for the Federal Arbitration Act Understood the Statute as a Work-In-Progress That Would Require Future Amendments

5. The Arbitration Fairness Act of 2013 Contains a Subtle Flaw That Must Be Corrected Before Its Enactment

1. My Professional Background and Interest in Arbitration Law

I am a law professor who is very passionate about the study of arbitration law, and I have written extensively in this area. I am a graduate of Yale University, and I received my law degree from Columbia Law School, where I was named a Harlan Fiske Stone Scholar. In private practice, I litigated many issues regarding the Federal Arbitration Act (FAA). As a law professor, my scholarship concerning arbitration has appeared in top journals regarding alternative dispute resolution, including the Harvard Negotiation Law Review and the Journal of Dispute Resolution. I maintain a blog about arbitration law

developments, www.outsourcingjustice.com, and I recently finished writing a book setting forth a comprehensive legal history regarding the enactment of the FAA. My book, OUTSOURCING JUSTICE: THE RISE OF MODERN ARBITRATION LAWS IN AMERICA, is based on ten years of researching previously-untapped archival materials and other overlooked sources from the drafters of the FAA. My book presents a thorough, almost week-by-week account of the passage of the FAA in 1925, and my book explores why America's arbitration laws radically changed during the 1920s. By examining this history, my book demonstrates how the Supreme Court has grossly misconstrued the FAA and unjustifiably created an expansive, informal, second-class system of justice touching almost every aspect of American society and impacting the lives of millions.

2. The Federal Arbitration Act Was Never Intended to Apply to Employment Disputes or Small Consumer Disputes

The earliest drafts of the bills that would become the FAA did not contain the labor and employment exemption now found in section one of the FAA.[1] There was no need for the exemption because the FAA was drafted and intended for use in simple contract disputes between merchants of relatively co-equal status,[2] and because at the time of the FAA's enactment, most employment and labor disputes were beyond the scope of Congressional regulation through the Commerce Clause.[3] A labor and employment exemption was eventually added to the bills in an abundance of caution. Although most labor and employment issues were generally beyond the scope of the Commerce Clause at the time of the FAA's enactment, a small subset of workers was viewed as engaged in interstate commerce at the time. For example, transportation workers who crossed state lines, such as railroad employees, were considered to be involved in interstate commerce and were, therefore, subject to Congressional regulation.[4]

In January 1923, the bills that would eventually become the FAA were before the Judiciary Committees of the House and Senate, and a hearing was scheduled to occur at

[1] 9 U.S.C. §1 (2012) (the FAA shall not apply to "workers engaged in foreign or interstate commerce"); IMRE STEPHEN SZALAI, OUTSOURCING JUSTICE: THE RISE OF MODERN ARBITRATION LAWS IN AMERICA 132-35, 142-45 (2013); *see also* 45 ANNU. REP. A.B.A. 315-18 (1922).

[2] *See generally* SZALAI, *supra* note 1. The prototypical dispute covered by the FAA was a simple contract dispute regarding the quality of goods sold between two merchants located in different states. For example, during a hearing in 1924, a witness testified that the FAA would help support arbitration of a dispute between a seller of a carload of potatoes from Wyoming and a dealer from New Jersey. *Bills to Make Valid and Enforceable Written Provisions or Agreements for Arbitration of Disputes Arising Out of Contracts, Maritime Transactions, or Commerce Among the States or Territories or With Foreign Nations, Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, 68th Cong., 1st Sess. 7 (1924). *See also id.* at 30-31 (arbitration legislation would help reduce "business litigation" and encourage "business men" to settle their "business differences"); *id.* at 41 ("If business men desire to submit their disputes to speedy and expert decision, why should they not be enabled to do so?").

[3] *See, e.g.*, Hammer v. Dagenhart, 247 U.S. 251 (1918) (striking down as unconstitutional a federal child labor law because the Commerce Clause did not cover employees working within a state to produce items that would be shipped out of state), *overruled by* U.S. v. Darby, 312 U.S. 100 (1941).

[4] Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 136 (2001) (Souter, J., dissenting) (citing The Employers' Liability Cases, 207 U.S. 463 (1908) (regulation of the employment relations of railroad employees engaged in the operation of interstate commerce is permissible under the Commerce Clause, but regulation of a railroad company's clerical force is not)).

the end of the month before a subcommittee of the Senate Judiciary Committee.[5] A few days before the hearing, Senator Thomas Sterling of South Dakota, a member of the Senate Judiciary Committee, received a letter raising concerns about the early drafts of the bills from an important constituent, a prominent South Dakota lawyer whose firm had significant clients with employees involved in interstate transportation, such as large railroad companies and parcel transportation businesses.[6] As explained in more detail in my book, this letter, along with concerns raised by labor groups, gave rise to the language now found in section one of the FAA, which exempts workers "engaged in foreign or interstate commerce" from the coverage of the statute.[7] The main drafter of the FAA, an attorney named Julius H. Cohen, wrote a letter explaining that this exemption, which he drafted in response to the concerns raised by Senator Sterling and his constituent, would have the effect of "leav[ing] out labor disputes" from the coverage of the statute, and he did not view this exemption as materially changing his original draft of bill, which did not contain the exemption.[8] In other words, this labor and employment exemption was added in an abundance of caution to exclude the only possible category of workers subject to the Commerce Clause power at the time. This exemption simply reinforced the original intent behind the statute, which was to cover routine commercial disputes between merchants, not labor or employment disputes of any kind.[9]

Regarding consumer transactions, as explained in more detail in my book, interstate transactions occurred between consumers and large mail-order companies at the time of the FAA's enactment, and disputes regarding such transactions were sometimes resolved through arbitration during the early 1900s.[10] Considering the broad language of the FAA and the existence of such disputes during the early 1900s, one may argue that the FAA could cover arbitration agreements in connection with consumer transactions

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[5] SZALAI, *supra* note 1, at 135.

[6] *Id.* at 133 (citing Letter from Senator Thomas Sterling to Charles L. Bernheimer, Jan. 25, 1923, New York Chamber of Commerce and Industry Records Archival Collection, Series V, Rare Book & Manuscript Library, Columbia University in the City of New York, Box 114, Folder 19).

[7] 9 U.S.C. §1 (2012). For a more detailed discussion of the archival materials demonstrating that the FAA was never intended to apply in the labor and employment context, see SZALAI, *supra* note 1, at 131-33, 134-35, 136, 142-43, 144-45, 147, 148, 149, 150, 151, 152-54, 159, 191-92, 192-98. Many of these materials discussed in my book were not previously known when the Supreme Court issued its flawed decision in 2001 in *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (holding that the FAA covers employment disputes).

[8] SZALAI, *supra* note 1, at 135 (citing Letter from Julius H. Cohen to Charles L. Bernheimer, Jan. 29, 1923, New York Chamber of Commerce and Industry Records Archival Collection, Series V, Rare Book & Manuscript Library, Columbia University in the City of New York, Box 114, Folder 19).

[9] The addition of the exemption language found in section one of the FAA is loosely analogous to the ratification of the Bill of Rights. Some believed the Bill of Rights was unnecessary because the federal government would only have limited, narrowly defined powers, and as a result of such limited powers, the federal government could never threaten the fundamental liberties of American citizens. However, the Bill of Rights was added to the Constitution to alleviate concerns and explicitly confirm that the federal government would never overreach its limited powers and threaten fundamental freedoms. Similarly, the earliest drafts of the FAA did not contain a labor or employment exemption because the FAA was never intended to cover labor and employment disputes to begin with. However, the exemption was eventually added to section one of the FAA to alleviate the concerns of labor interests and to make it absolutely clear that the FAA would never apply in the labor and employment context.

[10] SZALAI, *supra* note 1, at 194-95.

involving interstate commerce. However, this argument is doubtful for at least two reasons.

First, during the January 1923 hearing, Senator Thomas J. Walsh of Montana raised concerns about enforcing arbitration clauses presented by a party with stronger bargaining power on a "take-it-or-leave-it" basis, such as a standard, non-negotiable contract drafted by an insurance company.[11] Senator Walsh explained that such contracts are "not really voluntary contracts."[12] William Piatt, an American Bar Association lawyer who was testifying in favor of the FAA and whose committee helped develop the FAA, agreed with the Senator and explained that the FAA was not intended to apply to such take-it-or-leave-it contracts.[13] Instead, the purpose of the FAA was to facilitate the resolution of commercial disputes between merchants who knowingly and voluntarily agreed to arbitrate.[14] This testimony suggests that it is problematic to apply the FAA to contracts presented on a non-negotiable, take-it-or-leave-it basis. The FAA instead was designed to cover situations where parties knowingly, voluntarily, and with full understanding entered into an agreement to arbitrate.

Second, the jurisdictional scope of the FAA in 1925 helps demonstrate that the FAA was not intended to cover consumer disputes. At the time the FAA was enacted, in order for a federal court to have jurisdiction over a dispute, the dispute generally had to involve at least $3,000.[15] When adjusted for inflation, this amount of $3,000 in 1925 would be more than $40,000 in 2013.[16] Disputes involving small dollar amounts were not intended to be heard by the federal judiciary. An initial draft of the bills that would become the FAA attempted to remove the $3,000 minimum requirement, so that the FAA would cover disputes involving small dollar amounts.[17] However, Congress rejected this early draft of the FAA.[18] Consequently, when the FAA was enacted, it only applied to disputes where at least $3,000 was in controversy, an amount that far exceeded the value of small, routine consumer transactions.

In sum, the FAA was never intended to cover disputes involving employees or routine consumer contracts; the statute was not designed to protect the needs of employees or consumers because they were beyond the scope of the statute. Yet, today, because of expansive and flawed interpretations by the Supreme Court, it is the norm for courts to apply the FAA in these contexts.

[11] *Id.* at 143 (citing *A Bill Relating to Sales and Contracts to Sell in Interstate and Foreign Commerce; and a Bill to Make Valid and Enforceable Written Provisions or Agreements for Arbitration of Disputes Arising out of Contracts, Maritime Transactions, or Commerce Among the States or Territories or With Foreign Nations*, Hearings on S. 4213 and S. 4214 before a Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess. 10 (1923)).

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] Both diversity and federal question jurisdiction required the amount in controversy to exceed $3,000. Act of Mar. 3, 1911, ch. 231, § 24, 36 Stat. 1087, 1091.

[16] *See* US Inflation Calculator, http://www.usinflationcalculator.com.

[17] SZALAI, *supra* note 1, at 123, 134, 181, 182.

[18] *Id.*

3. The Supreme Court's Decisions in *Concepcion* and *American Express* Are Changing the Scope of Judicial Review of Individual Arbitration Agreements

The Supreme Court has recently issued two important decisions involving the enforceability of class waivers in arbitration agreements, *AT&T Mobility LLC v. Concepcion* ("*Concepcion*")[19] and *American Express Co. v. Italian Colors Restaurant* ("*Amex*").[20] In the wake of these Supreme Court decisions, several courts have ended class actions by compelling the named plaintiff to submit his or her claim to individual arbitration.[21] Armed with these decisions, companies and employers can in effect use arbitration agreements to immunize themselves from class action liability.

It is easy to focus on the class action implications of these Supreme Court decisions. *Concepcion* and *Amex* can have a significant impact on the availability of class actions, and the decreasing availability of class actions is highly problematic. However, the reach of these decisions goes far beyond the class action context. These Supreme Court rulings can also undermine the fairness of *individual* arbitration proceedings.

Before these decisions were issued, courts would sometimes strike down and carve out unfair, one-sided arbitration procedures before compelling arbitration of disputes, and in some situations, courts would invalidate an entire arbitration agreement because of unfair procedures. Such a judicial fairness review of an arbitration agreement helped ensure a fair arbitration proceeding would occur, and through this review, courts played an important role in helping to police arbitration procedures. For example, in *Armendariz v. Foundation Health Psychcare Services, Inc.*, the California Supreme Court addressed the arbitrability of antidiscrimination claims.[22] The California Supreme Court held that such claims are arbitrable provided that the arbitration would permit the plaintiff to vindicate his or her rights.[23] In order to help police the fairness of an arbitration agreement, the California Supreme Court in *Armendariz* explained that the plaintiff could vindicate his or her rights only if the arbitration agreement satisfied certain minimum fairness factors (the "*Armendariz* fairness factors"), such as whether the agreement provides for more than minimal discovery, and whether the agreement provides for relief that would be available in court.[24] There are several examples of pre-*Concepcion* court decisions invalidating arbitration agreements with one-sided or unfair arbitration procedures because the agreement failed to satisfy the *Armendariz* fairness factor analysis and/or a general unconscionability analysis.[25]

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[19] 131 S.Ct. 1740 (2011).

[20] 133 S.Ct. 2304 (2013).

[21] *See, e.g.*, Arroyo v. Riverside Auto Holdings, Inc., No. E056256, 2013 WL 4997488 (Cal. Ct. App. Sept. 13, 2013) (plaintiff who filed a class action regarding wage and hour claims must submit his individual claims to arbitration); Ryan v. JPMorgan Chase & Co., 924 F.Supp.2d 559 (S.D.N.Y. 2013) (relying on *Concepcion* and *Amex* to enforce class waiver and compel employee to submit her individual claims to arbitration).

[22] 6 P.3d 669 (Cal. 2000).

[23] *Id.* at 674, 680-82.

[24] *Id.* at 682.

[25] See, e.g., Abrahim v. ESIS, Inc., No. C-07-04014-JCS, 2008 WL 220104, *5-6 (N.D. Cal. Jan. 25, 2008) (relying on *Armendariz* to invalidate an arbitration agreement's requirement that the employee pay a fee to an employer in order to initiate arbitration); Hulett v. Capitol Auto Group, Inc., No. 07-6151-AA,

Unfortunately, in the wake of *Concepcion* and *Amex*, some courts are now changing the scope of judicial review of individual arbitration agreements. For example, some courts are relying on *Amex*'s limiting of the effective vindication doctrine and *Concepcion*'s broad preemption language to find that the FAA preempts consideration of the *Armendariz* fairness factors, and these factors previously provided a valuable tool to help police the fairness of individual arbitration agreements.[26] Moreover, some courts are construing *Concepcion* as changing the nature of an unconscionability review. In *Lucas v. Hertz Corp.*, a federal court addressed an unconscionability challenge to an arbitration agreement for not permitting discovery.[27] The court described how pre-*Concepcion* courts used to invalidate such provisions:

> Prior to the Supreme Court's ruling in *Concepcion*, numerous courts, at both the state and federal level, found arbitration agreements substantively unconscionable where the rules of the arbitral forum allowed for only minimal discovery or where the affect of the discovery rules operated solely to one side's benefit.[28]

The *Lucas* court then stated that under *Concepcion*'s broad preemption analysis, "limitations on arbitral discovery no longer support a finding of substantive unconscionability."[29] Under this court's application of *Concepcion*, an unconscionability analysis that relies on the "uniqueness of an arbitration agreement" is inappropriate and preempted.[30] Under such readings of *Concepcion* and *Amex*, it is becoming more difficult for courts to police the fairness of the arbitration process.

This is a developing area of law, and courts are continuing to define the contours of *Concepcion*'s preemption analysis and the effective vindication doctrine following *Amex*. However, some courts have begun to construe *Concepcion* and *Amex* as changing the scope of judicial review of individual arbitration agreements, and corporations and employers can use these decisions to limit the ability of consumers and employees to challenge unfair arbitration procedures.

To make matters worse, in *Rent-A-Center, West, Inc. v. Jackson*, the Supreme Court expanded the separability doctrine so that an arbitration agreement can delegate to an arbitrator a dispute about the enforceability of an arbitration agreement, and such delegation clauses are generally enforceable unless a party specifically challenges the delegation clause.[31] As a result of the Supreme Court's decision in *Rent-A-Center*,

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2007 WL 3232283 (D. Ore. Oct. 29, 2007) (finding discovery limits in arbitration clause to be substantively unconscionable); Ostroff v. Alterra Healthcare Corp., 433 F. Supp. 2d 538 (E.D. Pa. 2006) (same).

[26] Ruhe v. Masimo Corp., No. SACV-11-00734-CJC(JCGx), 2011 WL 4442790, *2 (C.D. Cal. Sept. 16, 2011) (*Armendariz* fairness factors "appear to be preempted by the FAA under the Supreme Court's reasoning in *Concepcion*"); Baeza v. Superior Court, 135 Cal.Rptr.3d 557, 568 (Cal. Ct. App. Dec. 14, 2011) (describing *Armendariz* as "abrogated in part" by *Concepcion*); Mercado v. Doctors Medical Center of Modesto, Inc., No. F064478, 2013 WL 3892990, *7 (Cal. Ct. App. July 26, 2013). (*Concepcion* and *Amex* "cast doubt on the continued validity of *Armendariz*").

[27] 875 F. Supp. 2d. 991 (N.D. Cal. 2012).

[28] *Id.* at 1007 (citations omitted).

[29] *Id.*

[30] *Id.*

[31] 130 S.Ct. 2772 (2010); *see also In re* Checking Account Overdraft Litigation, No. 09-MD-02036-JLK (S.D. Fla. Aug. 27, 2013) (order enforcing delegation clause and sending to arbitration all arguments regarding arbitration clause's enforceability).

coupled together with *Concepcion* and *Amex*, courts can enforce arbitration agreements in an increasingly rubberstamp-like manner. Slamming the courthouse door shut in this manner undermines public confidence and faith in our judicial system.

This changing and shrinking scope of judicial review of arbitration agreements is problematic for employees and consumers. With less judicial oversight of arbitration agreements, employees and consumers may find it difficult to invalidate one-sided arbitration provisions, and they may be forced to arbitrate with extremely limited procedural rights. Arbitration proceedings with increasingly limited procedural rights can, in turn, undermine the enforcement of critical statutory rights embodied in wage and hour, civil rights, and consumer protection legislation.

4. The Reformers Who Pushed for the Federal Arbitration Act Understood the Statute as a Work-In-Progress That Would Require Future Amendments

As explained in my book, the reformers who lobbied for the FAA viewed the statute as a work-in-progress.[32] In May 1925, immediately after the FAA was enacted, Charles Bernheimer, who was known as the Father of Commercial Arbitration in the United States and who was the main driving force behind the passage of the FAA, wrote that "[w]hen the Federal Arbitration Act is put into operation *there is scarcely any doubt that it will develop the necessity for amendments*."[33] Then-Secretary of Commerce Herbert Hoover explained in 1923 that "[i]f the bill proves to have some defects and we know most legislative measures do," Congress could fix the problems with the FAA at a later time, after its enactment, "in light of further experience."[34] Unfortunately, the FAA has never been significantly amended since its enactment in 1925.

We have now had almost one hundred years of "further experience" with the FAA as a work-in-progress, and amendments are long overdue. Courts and stronger parties are abusing the FAA in ways that were never intended by its drafters. As explained in my book, the drafters of the FAA during the 1920s had a sincerely-held, good faith belief in the use of arbitration to resolve disputes. However, arbitration agreements are often used today with the intent of stripping important rights from consumers and employees. Today, corporate entities often bury complex arbitration clauses in consumer and employment contracts in the nominal name of "efficiency," but their main purpose in including a complex arbitration clause is often to make it more challenging for consumers and employees to assert claims.[35] It is becoming harder for American citizens to access justice and enter the courthouse door envisioned by our Federal and State Constitutions.

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[32] SZALAI, *supra* note 1, at 200-01.

[33] *Id.* at 201 (citation omitted and emphasis added).

[34] *Id.* (citation omitted).

[35] *See, e.g.*, Ting v. AT&T, 319 F.3d 1126, 1133-34 (9th Cir. 2003) (finding that AT&T engaged in marketing studies to determine the best way to conceal an arbitration clause from consumers in order to prevent consumers from objecting or backing out of a transaction covered by an arbitration clause).

5. The Arbitration Fairness Act of 2013 Contains a Subtle Flaw That Must Be Corrected Before Its Enactment

I am very much in favor of the Arbitration Fairness Act of 2013 because I believe it can help protect some of America's most vulnerable citizens and rescue them from a second-class system of justice with very limited rights. As explained above, recent Supreme Court decisions are threatening to undermine judicial oversight of arbitration. Furthermore, all the policies supporting important civil rights, wage and hour, and consumer protection legislation similarly provide support for the Arbitration Fairness Act. If it is more challenging to enforce critical substantive rights because of the limited procedures available in arbitration, those substantive rights are weakened. Although I am in favor of the Arbitration Fairness Act, I am concerned that the current version of the bill, S. 878, will lead to wasteful litigation regarding its applicability in state courts.

From its enactment in 1925 to 1984, the FAA was generally considered a purely procedural statute applicable solely in Federal courts, not state courts.[36] In 1984, the Supreme Court radically transformed the FAA in a flawed decision called *Southland Corp. v. Keating*, where the Supreme Court misinterpreted the FAA and held that the statute applied in state courts.[37] The *Southland* decision involves one of the greatest constitutional errors the Supreme Court has ever made.[38] If the Arbitration Fairness Act of 2013 is intended to restore the FAA to its original meaning, which would include limiting the FAA solely to Federal courts, a good argument can be made that the Arbitration Fairness Act's restrictions would only bind the Federal courts. Under this narrow reading of the Arbitration Fairness Act, state courts would then be free to continue enforcing consumer and employment arbitration agreements. If the Arbitration Fairness Act is enacted in its current form, I am virtually certain that corporations and employers will push for this narrow interpretation of the Arbitration Fairness Act as solely restricting Federal courts. Some state courts, wishing to eliminate cases from their docket by enforcing all arbitration agreements, may go along with this narrow interpretation. Conflicting decisions, with years of wasted litigation and appeals, will likely develop regarding the applicability of the Arbitration Fairness Act in state courts. In order to prevent this problem from occurring, I suggest that the key prohibition in the bill be slightly modified to state something along the following lines:

> No predispute arbitration agreement in connection with a transaction involving interstate commerce shall be valid or enforced ***by a State or Federal court*** if it requires arbitration of an employment dispute, consumer dispute, antitrust dispute, or civil rights dispute.

[36] *See generally* IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION (1992).

[37] 465 U.S. 1 (1984).

[38] David S. Schwartz, Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act, 67 Law & Contemp. Probs. 5, 54 (2004) ("In *Southland*, the Court made an error of constitutional proportions that is in significant respects comparable to the error of *Swift v. Tyson*, which the Court famously corrected in *Erie*.").

Conclusion

While I was in private practice, I must admit that I routinely relied on the FAA to enforce arbitration agreements and compel consumers to arbitrate their disputes with my corporate clients. At the time, I did not deeply consider the impact of these court orders. Frankly, a court order dismissing a class action and compelling a consumer to submit a claim to arbitration was one less complex case for me to work on. However, my view of arbitration agreements began to change when my first child, my daughter Ella, was born.

My wife went into labor a few weeks earlier than expected, and when we arrived at the hospital, my wife was whisked away to the delivery room while I was given a thick stack of papers to sign at the registration desk. Buried in the stack of papers was an arbitration agreement, by which I promised never to sue in court the hospital, doctors, nurses, or insurance companies in connection with the delivery of my daughter. Because of my legal background, I was fully aware of what my signature on the arbitration agreement would mean, and I was shocked and remember thinking how did such agreements become so widespread in American society. Realizing that I was about to become a father and I needed to protect my child, I did not want to sign the arbitration agreement. If someone committed medical malpractice and hurt my daughter or wife, I wanted to have all the procedural rights available in court, as well as a jury from the community, instead of a highly secretive arbitration hearing with virtually no rights. However, the hospital staff was demanding signatures on every page. Thankfully, my wife gave birth to our beautiful, healthy baby daughter, and no disputes arose regarding her delivery. Sadly, other parents have not been so fortunate, and there are reported decisions dismissing lawsuits in connection with the delivery of a baby because of an arbitration agreement.

At that moment in the hospital when I was asked to sign the arbitration agreement, I was furious that I was being forced to give up my rights. I believe most people would feel the same way in these circumstances if they understood the implications of signing an arbitration agreement. I realized at that moment how could I be in favor of imposing on others what I would not be willing to impose on my own family.

In order to protect millions of American consumers and employees, and in order to promote faith in our judicial system as the best in the world, which it is, and open to all, which it is currently not because of the cancerous proliferation of arbitration agreements, I respectfully urge that the Committee on the Judiciary favorably report Senate Bill 878, the Arbitration Fairness Act of 2013, to the full Senate and work toward its enactment.

December 17, 2013

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Chuck Grassley
Ranking Member
Committee on the Judiciary
226 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing
& Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Mike Crapo
Ranking Member
Committee on Banking, Housing Affairs
& Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Chairman Leahy, Chairman Johnson, Ranking Member Grassley and Ranking Member Crapo:

We represent investors that collectively manage assets exceeding $1 trillion USD in capital invested globally and in our nation's public markets. As investors whose participation in our public markets is vital to our economy's growth, we believe that companies should not be permitted to force shareholders into any system under which their rights are limited or their ability to participate in a class is extinguished. Forced arbitration systems—especially those which include class action bans—are not a viable substitute to judicial enforcement of fiduciary obligations owed to investors when the arbitration is an involuntary, costly, and biased dispute resolution system.

We, the undersigned, ask that the Committees of Jurisdiction act to preserve the ability of investors to access the judicial system for the enforcement and protection of their legal rights by:

1) Supporting the Securities and Exchange Commission ("SEC") in its exercise of Congressionally-granted authority under Section 921 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to prohibit the use of mandatory pre-dispute arbitration provisions in broker-dealer and investment advisor agreements; and,

2) Acting to formalize the SEC's longstanding policy that mandatory pre-dispute provisions requiring arbitration of investor disputes in the bylaws and governing documents of publicly traded corporations are harmful to capital markets, contrary to public policy, and could be subject to enforcement action.

Relying on the government to enforce the rights of individuals is no suitable alternative to private enforcement. Not only would requiring the government to bear the expense of prosecuting every investor dispute place an enormous additional burden on already strained budgets, but history has demonstrated that the government is ill-equipped to provide adequate recompense to individual investors injured by corporate fraud. In private litigation relating to the financial scandals at

Enron, WorldCom, Tyco, Bank of America and Global Crossing, private enforcement returned over $19.4 billion to investors.[1] The SEC's enforcement actions against these same companies relating to the same wrongdoing netted penalties and fees of $1.750 billion.[2] Indeed, in the last three years on litigation relating to the financial crisis, the SEC has recovered $2.73 billion in penalties, disgorgement and other monetary relief.[3] In comparison, private litigation against just four financial institutions arising from their conduct that led to the near collapse of our economy resulted in judgments or settlements of over $16 billion.[4]

Unfortunately, and perhaps precisely because private litigation provides the most efficient (and in some cases the only) way for investors to enforce their rights, publicly traded corporations have taken steps to eliminate judicial oversight of their fiduciary obligations to investors and their compliance with the federal securities laws. These steps have included inserting pre-dispute, forced arbitration clauses in investment-advisor contracts and corporate by-laws to force all shareholder disputes into arbitrations controlled by the very same corporations against whom the claims are being brought. These forced arbitration clauses also typically require shareholders to waive their rights to participate in any collective or class action.

When forced arbitration clauses and class action waivers appear in corporate bylaws or investor-advisor agreements, they can have the practical effect of preventing shareholders from pursuing any legal remedy whatsoever. When, as is often the case for smaller investors, the cost and expense of pursuing an individual claim far exceeds any possible recovery, a "waiver" of the right to participate in any collective action effectively immunizes wrongdoing corporations and their directors and officers from these smaller claims. These "waivers" are specifically designed to prevent class actions under Rule 10b-5 of the Securities Exchange Act of 1934, and would prevent class actions like the shareholder action brought against Enron Corporation from ever being brought. These forced arbitration clauses and class action waivers represent a real and present threat to principles of sound corporate governance, balancing the rights of shareowners against the responsibilities of corporate managers to run their businesses.

American investors are the foundation of a successful and thriving securities market. The victims of corporate wrongdoing aren't the ultra-wealthy—they are hard-working employees contributing towards their 401(k) accounts and relying on income from their pension funds, responsible

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[1] Source: *In re: Tyco International, Ltd., Securities Litigation, U*.S. District Court, District of New Hampshire, 02-266 ($3.2 billion settlement); *In re: Enron Corporation Securities Litigation*, U.S. District Court, Southern District of Texas, 01-3624($7.2 billion settlement); *In re: Worldcom, Inc. Securities Litigation,* U.S. District Court, Southern District of New York, 02-3288 ($6.1 billion); *In re: Bank of America Corp. Securities, Derivative, and Employee Retirement Income Security Act (ERISA) Litigation,* U.S. District Court, Southern District of New York, 09-2058 ($2.4 billion settlement); *In re: Global Crossing Ltd. Securities Litigation,* U.S. District Court, Southern District of New York, 02-910 ($447.8 million settlement).

[2] Source: Tyco SEC Settlement Fair Fund: http://www.tycosecsettlement.com/ ($55.8 million settlement); Enron SEC Settlement Fair Fund: http://enronvictimtrust.com/ ($570 million); Worldcom SEC Settlement Press Release: http://www.sec.gov/news/press/2003-81.htm ($750 million); Bank of America SEC Fair Fund: http://bankofamericafairfund.com/ ($375 million); Global Crossing SEC Settlement Press Release: http://www.sec.gov/litigation/litreleases/lr19179.htm ($300,000).

[3] Source: SEC Enforcement Actions, Addressing Misconduct That Led To or Arose From the Financial Crisis, Key Statistics (through September 1, 2013), available at http://www.sec.gov/spotlight/enf-actions-fc.shtml

[4] Source: Sam Carr, SNL Financial, Largest US banks have built a $60B settlement tab, so far (March 5, 2013), available at http://www.snl.com/InteractiveX/Article.aspx?cdid=A-17047074-12337

American families saving for retirement, and parents investing in their children's education and future. Without sufficient protections and a meaningful way to hold financial institutions accountable when they violate financial or fiduciary obligations to their shareholders, investor confidence diminishes and market participation suffers, hurting investors, the institutions they invest in, and the American economy.

We ask the Committees on the Judiciary and on Banking, Housing, & Urban Affairs, jointly tasked with protecting American investors from unscrupulous or illegal financial practices, to encourage the SEC to continue its efforts to protect investor rights and restore the balance between those rights and the responsibilities of publicly traded companies and their corporate managers.

Sincerely,

American Federation of Musicians and Employers' Pension Fund (AFM-EPF)

Ann Arbor City Employees Retirement System

Arizona Public Safety Personnel Retirement System

Arkansas Teachers Retirement System

Board of Trustees of the Employees' Retirement System of the City of St. Louis

Carpenters' Pension Trust Fund of Northern California

City of Dearborn Heights General Government Fund

City of Dearborn Heights Policeman's & Fireman's Retirement System

City of Providence Employees' Retirement System

City of Roseville Employees' Retirement System

City of Southfield Fire & Police Retirement System

City of St. Clair Shores Police & Fire Retirement System

City of Sterling Heights General Employees' Retirement System

City of Sterling Heights Police & Fire Retirement System

City of Sunrise Firefighters' Retirement Fund

City of Westland Police and Fire Retirement System

Cleveland Bakers & Teamsters Pension Fund

Clinton Township Police & Fire Retirement System

Colorado Public Employees’ Retirement Association

Connecticut Retirement Plans & Trust Funds

Connecticut State Treasurer

Daytona Beach Police & Fire Pension System

Erie County Employees’ Retirement System

IBEW Local 110, International Brotherhood of Electrical Workers (St. Paul, Minnesota)

Idaho Diversified Bond Fund

Idaho Diversified Bond Fund Idle

Idaho Millennium Permanent Endowment Fund

Idaho State Treasurer

Ironworkers Local 405 (Philadelphia, PA)

Jacksonville Fire & Police

Key West Police & Fire Pension Plan

Laborers, District Council of Ohio

Los Angeles County Employees Retirement Association (LACERA)

Louisiana Municipal Police Employees Retirement Fund

Luzerne County Retirement System

Maine Public Employees’ Retirement System (MainePERS)

Monroe County Employees Retirement System

Montgomery County, PA

Municipal Police Employees' Retirement System

North Carolina Retirement Systems

Northern CA Pipefitters

Ohio Police and Fire Pension Fund

Oklahoma Law Enforcement Retirement System

Oklahoma Firefighters Pension and Retirement System

Oklahoma Police Pension and Retirement System

Oklahoma Municipal Retirement Fund

Operating Engineers Local 66 (Pittsburgh)

Oregon State Treasurer

Plymouth County Retirement System

Pompano Beach Police & Firefighters Retirement System

San Diego City Employees' Retirement System (SDCERS)

SEIU Pension Plans and Master Trust

Teamsters Union No. 142 Pension, Welfare, Annuity and Training & Apprenticeship Trust Funds (Gary, Indiana)

The Police Retirement System of St. Louis

Utah Permanent School and Institutional Trust Funds

Utah State Treasurer

Virginia Retirement System

Washington State Investment Board

Washington State Treasurer

December 24, 2013

The Honorable Al Franken
309 Hart Senate Office Building
2nd & C Streets, NE
Washington, DC 20510

Re: Statement of the American Antitrust Institute, *The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?: Hearing on S. 878 Before the Senate Committee on the Judiciary*, 113th Cong. (2013)

Dear Senator Franken:

The American Antitrust Institute ("AAI")[1] commends you and your co-sponsors for introducing the Arbitration Fairness Act of 2013, S. 878, 113th Cong. (2013) ("AFA"), and Chairman Leahy, Ranking Member Grassley, and other members of the Senate Judiciary Committee for convening this hearing. AAI supports S. 878 because it would restore consumers' ability to effectively vindicate their Sherman and Clayton Act rights. Section 3 of the AFA would amend the Federal Arbitration Act ("FAA") to invalidate certain agreements that mandate individual arbitration of antitrust disputes. This Section would remedy the negative consequences of recent Supreme Court decisions that prevent effective private enforcement of the antitrust laws by eliminating class actions in a large and important category of consumer cases. Specifically, Section 3 of the AFA would prevent class action waivers inserted into arbitration agreements from acting as de facto exculpatory clauses that eliminate the only procedural mechanisms able to convert certain consumer antitrust claims into financially rational pursuits.

The class action device is essential to consumer antitrust enforcement because it is essential to private enforcement. Because of limitations on government antitrust enforcement,[2] private antitrust enforcement sometimes is the only available means of redressing antitrust violations.[3] Moreover, even when government and private enforcement work in tandem, private enforcement remains the primary means of compensating victims and the principal deterrent against future anticompetitive behavior. Empirical research supported by AAI has shown that (1) conservatively, private enforcement has led to the recovery of at least $33.8 billion in damages over the previous two decades, s*ee* Joshua P. Davis & Robert H. Lande, *Towards an Empirical and Theoretical Assessment of*

[1] The AAI is an independent and non-profit education, research, and advocacy organization devoted to advancing the role of competition in the economy, protecting consumers, and sustaining the vitality of the antitrust laws. For more information, see www.antitrustinstitute.org.
[2] *See* Robert H. Lande & Joshua P. Davis, *Benefits from Private Antitrust Enforcement: An Analysis of Forty Cases*, 42 U.S.F.L. Rev. 879, 906 (2008) (citing budgetary constraints, institutional incentives to pursue certain types of cases, lack of awareness about industry conditions, institutional suspicion of competitor complaints, higher turnover among government attorneys, and political realities).
[3] *See id.*; Spencer Weber Waller, *Symposium: Private Law, Punishment, and Disgorgement: The Incoherence of Punishment in Antitrust*, 78 Chi.-Kent. L. Rev. 207, 211 (2003).

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Private Antitrust Enforcement, 36 Seattle U. L. Rev. 1269, 1272 (2013), and (2) the deterrent effect of private enforcement likely outweighs the deterrent effect of even criminal enforcement by the Department of Justice, *see* Robert H. Lande & Joshua P. Davis, *Comparative Deterrence from Private Enforcement and Criminal Enforcement of the U.S. Antitrust Laws*, 2011 B.Y.U. L. Rev. 315, 347 (2011).

Without a procedural mechanism for aggregating claims, antitrust violations often will go uncompensated, under-deterred, or altogether un-remedied. Worse, private victims can be forced to forego their rights and remedies unknowingly and involuntarily when class action waivers are surreptitiously inserted into mandatory arbitration clauses in standard form "adhesion" contracts. In the Internet era, where pages-long terms and conditions demand instant acceptance in the click of a mouse, such waivers will only grow increasingly pervasive.[4] As Professor Gilles suggested in her testimony, a corporate attorney arguably would commit malpractice if she failed to advise a client to employ such a waiver in a consumer contract.

Without legislative action, the proliferation of class action waivers in mandatory arbitration clauses likely will destroy a wide swath of private antitrust rights. Antitrust violations very often involve high-volume, low-dollar frauds and price fixing in which perpetrators "deliberately cheat large numbers of consumers out of individually small sums of money."[5] Consequently, individual victims' claims often are small in absolute value or small in relation to the significant expenses of developing and prosecuting an antitrust case. Because such claims pose a negative value proposition for an individual claimant, they cannot feasibly be pursued in any forum absent class procedures, which allow for aggregation of claims and pooling of resources. While it may be literally true, as the divided Supreme Court recently declared, that the "antitrust laws do not guarantee an affordable procedural path,"[6] an affordable procedural path to aggregation is essential to an effective antitrust law regime and thus to the maintenance of a competitive free market economy.

The new status quo engendered by the Supreme Court's recent arbitration decisions, including *Italian Colors, Concepcion*, and *Stolt-Nielsen*,[7] is not only problematic as antitrust policy, but as contract policy and arbitration policy. Courts enforce standard form "adhesion" contracts by employing the legal fiction that a consumer has assented to something she almost certainly has not even read, much less understood for its legal implications. Courts employ this fiction on the premise that procedural and substantive unconscionability doctrine will encourage businesses to incorporate only efficiency enhancing terms and not exploitative terms in their standard form contracts.[8] Yet contract terms that exculpate a party for harm caused intentionally, as compared to negligently, are widely recognized as unconscionable.[9] If standard form contract terms that

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[4] As the Consumer Financial Protection Bureau has recognized, class action waivers in mandatory arbitration clauses are already nearly ubiquitous in the consumer financial services industry. *See* Consumer Financial Protection Bureau, Arbitration Study Preliminary Results (Dec. 12, 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf. Moreover, as more and more small business make purchases online, they too will experience this problem.

[5] *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1761 (2011) (Breyer, J., dissenting) (internal quotation and alteration omitted).

[6] *American Express Co. v. Italian Colors Rest.,* 133 S. Ct. 2304, 2309 (2013).

[7] 130 S. Ct. 1758 (2010).

[8] *See* Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. Rev. 429 (2002).

[9] *See, e.g., American Express*, 133 S. Ct. at 2313-2314 (2013) (Kagan, J., dissenting) ("courts will not enforce a prospective waiver of the right to gain redress for an antitrust injury, whether in an arbitration agreement or any other contract") (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U. S. 614, 637 (1985).; *cf*. Restatement (Second) of Contracts § 195(1)b ("A term exempting a party from tort liability for harm caused intentionally . . . is unenforceable on grounds of public policy.").

exculpate defendants for intentional antitrust violations are enforceable simply because they are embedded in arbitration clauses, then unconscionable contracts are not only permitted but encouraged, a result that is both illogical and undesirable.[10]

With respect to sound arbitration policy, the Court has described the goal of the FAA as "encouragement of efficient and speedy dispute resolution."[11] Yet, perversely, when an arbitration agreement is permitted to act as a de facto exculpatory clause, claims are not resolved *at all*. Rather, they are nullified, sometimes with plaintiffs left to incur unjustified losses and defendants left to enjoy ill-gotten gains. The Court's interpretation actually precludes rather than promotes dispute resolution in any form, however efficient or speedy.

For all of these reasons, AAI urges the Committee and other members of Congress to pass S. 878.

Thank you for receiving AAI's input on this subject. We would be pleased to provide additional perspectives and any other assistance that may be requested.

Sincerely,

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cc:

Members of the Senate Judiciary Committee

[10] *See* David Horton, *Unconscionability Wars*, 106 Northwestern Univ. L. Rev. 387, 408 (2012).
[11] *Concepcion,* 131 S. Ct. at 1749 (emphasis added).

Home Owners for Better Building

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December 23, 2013

Senator Franken
Washington, DC
U.S. Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

Re: Support for the Arbitration Fairness Act of 2013, S. 878

The Honorable Al Franken:

This letter is written testimony submitted to The Senate Judiciary Committee reference the hearing of December 17, 2013, to comment on the need to pass the *Arbitration Fairness Act of 2013, Senate Bill 878 to Prevent Big Corporations from Taking Away Consumers' Right to Justice*.

Most exciting is the news by Leslie Overton, deputy assistant director for civil enforcement with the Department of Justice (DoJ), Antitrust Division; confirming that the department recognizes that the high cost of pre-dispute arbitration impinges upon the federal antitrust rights of consumers.

Unfair pre-dispute arbitration opinions today are strikingly similar to those outlined by Home Owners for Better Building when we testified long ago at the *1998 Texas Senate Interim Committee on State Affairs*. See Attached 1998 Report on Pre-dispute Binding Arbitration.

To those who support the idea that pre-dispute mandatory arbitration is good for consumers is analogous to the biblical account of Adam and Eve in the Garden of Eden featuring the cunning serpent and the apple tree.

For buyers betrayed by false promises and the take-it-or-leave-it builder forced arbitration contracts, the results have been emotionally and financially devastating. To the homebuilding industry forced arbitration has been a highly profitable marketing campaign of deceit.

Home Owners for Better Building, as a 501 (C)3 has been dedicated to educating the public for the last decade and a half on how the homebuilding industry has exploited pre-dispute mandatory arbitration clauses. A practice that is the direct result of a 1996 joint venture between American Arbitration Association (AAA) and the National Association of Home Builders (NAHB) which exclusively promulgated the industry contract to its members containing the lucrative forced pre-dispute arbitration clause.

The word "pre-dispute" expresses the ill-will of the industry and its intent to carelessly construct houses. Pre-dispute arbitration provides the perfect means for industry to avoid warranty accountability for repair of defective homes; as arbitrators have become beholden to the industry for repeat business and their livelihood. Equally advantageous to industry is the shield of secrecy surrounding privately held arbitration without public record results. Absent public records business monopolies operate under the radar of the DoJ as infringement upon federal antitrust rights of consumers grow exponentially.

Methods used are simple:
Whether small or major defects, confident builders simply ignore warranty responsibility eventually forcing homeowners into a protracted legal dispute of unaffordable binding arbitration; causing hundreds of thousands owners to give up in financial defeat.

No job is too small for powerful corporate attorneys who cleverly outfox the underdog consumer. Despite the fact that "American Arbitration Association (AAA) rules" specifically allow homeowners the opportunity and the right to have their construction defect claims up to $10,000.00 affordably adjudicated in small claims court, sharp industry attorney successfully argue that the US Supreme Court has spoken.

Unfortunately for many years small claims court Judges routinely disregard AAA rules and order homeowners into the unrealistic financial burdens of AAA arbitration; putting to rest any affordable venue for homebuyers to hold defiant builders accountable.

On a much larger scale is the aftermath of the "housing crisis" that is the result of new homebuilders greedy rush to participate in the massive mortgage fraud that fed the building boom. Yet to be fully appreciated is the depth of financial damage caused by builders who threw up communities overnight with little or no attention to home or community sustainability, quality, or legitimacy of new homebuilder warranties.

Staggering major construction evidence can be seen in the attached photos (attached) of new 2-year-old homes that plague communities with 70% experiencing major construction defects. As it was with the mortgage fraud crisis, builders are inspired with power and confident in knowing they can disregard standards and successfully cheating their customers out of perhaps billions of dollars.

Lastly, probably more advantageous to the homebuilding industry is the secrecy surrounding construction defect arbitration; eliminating any public record of lawsuits that might alert the buying public and tarnish the reputation of builders.

Sparked by public outcry Texas Congressmen Charles Gonzales and Ciro Rodriguez in 2000 filed the American Home Buyer Protection Act to prohibit pre-dispute clauses in new home contracts. After years of public hearings across the country testimony has provide a long record for needed consumer protection reforms. Most promising is the Senate Judiciary Committee Hearing that conveys persuasive evidence for the need to pass consumer protection relief provided in the Senator Al Franken Arbitration Fairness Act of 2013 (S. 878) and US Representative Hank Johnson's Arbitration Fairness Act (H.R. 1844) bills.

It is illogical that a toaster comes with more protection than a new home, the largest and most expensive consumer purchase most people will ever make.

It is with gratitude that I would like to thank you and the committee members for the opportunity to participate in the legislative process. Our organization stands ready and willing to share vital consumer information that supports the need for passage of Senate Bill 878.

Respectfully,

Janet Ahmad
National President
(210) 494-6404

Home Owners for Better Building

Texas Senate Interim Committee On State Affairs

In 1998 the Texas Senate Interim Committee on State Affairs held public hearings. Consumers testified of their heart breaking stories. Bubba Claridge, a native Texan, had difficulty holding back the tears as he testified on behalf of his ailing mother Gladys Claridge.

Home Owners for Better Building presented the following report on Binding Arbitration to the committee.

ARBITRATION DEADLY FOR THE CONSUMER

FOR THE CONSUMER, ARBITRATION IS NOT A JUST ALTERNATIVE TO A TRIAL BY JURY FOR THE FOLLOWING REASONS:

1. **AAA INDUSTRY FRIENDLY, NOT CONSUMER ORIENTED**
   - Builder prepared contract solicits business for American Arbitration Association.
   - Consumer believes the American Arbitration Association is unbiased.
   - Consumer is not informed of connections between the Builder and the American Arbitration Association prior to signing a contract to purchase a home.

2. **COST - VERY EXPENSIVE**

3. **TIME RESTRAINTS**
   - Hearing is held 30 days after choosing Arbitrator (faster than JP courts), representing a clear Builder advantage.

4. **NO DISCOVERY OR CONTINUANCE**
   - Rules of Law not applied to arbitration process
   - Rules of procedure do not apply under AAA
   - No additional time granted for discovery
   - No procedure requiring other side to produce requested discovery
   - Hearsay accepted over sworn testimony
   - No procedure to appeal Arbitrator's decision

5. **METHOD FOR CHOOSING ARBITRATOR**
   - Qualifications and fees of arbitrators designed to be confusing to consumer

6. **NO APPEAL TO JUDGE**
   - No opportunity to appeal matters of law, discovery, or time restraints of Fast Track, etc.

DISTINCT ADVANTAGES FOR BUILDER

- Builder's expertise and what she or he does for a living. All of which is related to protection of profits through limiting Builder responsibilities and warranties to Buyer and through arbitration of all disputes, which is only paperwork to the Builder.
- Relationship with and close ties to AAA
- Experienced legal council (most likely on retainer)
- Expert witnesses readily available to Builder
- Buyer must educate her or himself about arbitration, warranties, relevant legal issues, etc., and take time from work to search for an attorney, an arbitrator, expert witnesses, discovery, etc., all WITHIN 30 DAYS!
- Years of industry experience writing contracts designed to limit (if not eliminate) Buyer's rights and protections

HOME BUYER (CONSUMER) DISADVANTAGES

- Builder's contract uses unclear, ambiguous language along with narrowly worded, specific language to Builder's advantage
- Consumer believes Realtors protect Buyers interests
- No arbitration training in curriculum or continuing education
- Realtor unable to point out contract problem areas related to arbitration
- Extreme difficulty finding an attorney
- Bar Association referral lists no one with construction industry arbitration experience
- Most attorneys tell Buyer arbitration is quicker and cheaper. This usually indicates attorney has not handled Builder/Homeowner cases.
- Attorneys only available on hourly basis, not on contingency basis
- Difficulty finding expert witnesses; while builder has his subcontractors as expert witnesses
- Buyer/Consumer has other full time obligations
- Under old contracts without binding arbitration, Builder did not sue Buyer because the builder did not honor the warranty
- AAA keeps the construction industry informed of all changes to rules of arbitration; Buyers must educate themselves - painful, expensive education
- Home owner arbitration expenses are greater than cost of repairs
- Home buyer does not realize and is not informed they are giving up Constitutional Rights when they sign a contract with the Builder

THE THREAT OF ARBITRATION IS BUILDERS' LETHAL WEAPON!

Home Foundations – 2 Years Old

Home Foundations — 2 Years Old

Home Foundations — 2 Years Old