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January 13, 2014
By email

Senator Patrick Leahy
United States Senate
Committee on the Judiciary
Washington, D.C. 20501-6275

Dear Senator Leahy:

Thank you for your letter of December 30 enclosing written questions from Committee members.

As requested, I submit electronically my answers to the written questions by the deadline specified.

With thanks to you, the members of the Committee and the staff for the opportunity to testify at the hearing, I remain

Sincerely yours,

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RESPONSES TO QUESTIONS FROM SENATOR GRASSLEY

1. In a 2004 article, I advanced the doctrinal argument that arbitrators should not be accorded the same absolute immunity from suit as judges but, instead, should be subject to contractual immunity as often appears in arbitral rules. Peter B. Rutledge, *Toward a Contractual Approach to Arbitral Immunity*, 39 Ga. L. Rev. 151 (2004). In the theoreical section of that article, I wrote that "an arbitrator may be perceived as 'industry friendly' in securities law disputes or 'contractor friendly' in construction disputes." *Id.* at 165. That sentence has been quoted to suggest my belief in the empirical proposition that arbitrators are not neutral. I would encourage you and you colleagues to read the article in full, where I also said:

> Arbitrators who are repeat players in the market for their services have an incentive to develop a reputation for independence. This reputation for independence enhances the likelihood of future appointments, particularly in the case of single-arbitrator disputes, appointments as chairman in three-arbitrators disputes, or other scenarios where the parties lack control over the appointment.
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> Moreover, alternative mechanisms such as neutrality requirements already help to ensure an arbitrator's independence. These neutrality requirements come in a variety of forms. For example, some judicial decisions have specifically held that lack of neutrality supplies a basis for setting aside an arbitral award. Likewise, most institutional rules, at least in international arbitrations, require arbitrators to be neutral. In fulfillment of this obligation, the arbitrator must disclose any past business connections that would suggest an inability to be impartial. *Id.* at 170-71 (footnotes omitted).

In a footnote to this block-quoted passage, I also wrote that "just as competition in the marketplace may provide some arbitrators independence, it may provide other arbitrators incentives to be beholden to particular parties or industries likely to nominate them." *Id.* at 170 n. 76. That sentence likewise sometimes has been read out of context to suggest my belief in the empirical proposition that arbitrators are not neutral. Again, I would encourage you and your colleagues to read the footnote in full. The *very* next sentence makes plain that I am talking about particular, historical phenomenon in domestic arbitration – that is,

so-called "party-appointed, non-neutral arbitrators." These were individuals appointed by the parties in certain arbitrations explicitly to advocate on behalf of the parties. These were not bound by obligations of impartiality and independence. Today, most domestic arbitration rules – with strict requirements for impartiality and independent – do not countenance the use of such party-appointed non-neutrals.

2. The 17% figure mentioned in the CFPB preliminary report and discussed in my oral testimony confirms earlier research conducted by Professor Drahozal and myself on the frequency with which firms in the credit card industry employ arbitration agreements. *See* Christopher R. Drahozal & Peter B. Rutledge, *Arbitration Clauses in Credit Card Agreements: An Empirical Study*, 9 J. Empirical Legal Studies 536 (2012).

   This 17% utilization rate is relevant in two respects. First, it casts doubt on the frequently heard change that "all firms" (generally or in a particular industry) will use arbitration clauses in the wake of a Supreme Court decision like *Concepcion* or *Italian Colors*. The empirical data in the CFPB preliminary report and in our own research rebut that claim. Second, the statistic has potentially important regulatory implications. To the extent the Congress (or the CFPB) believes regulation of arbitration agreements was necessary to preserve some modicum of "choice" for consumers, that choice already exists (at least in certain sectors of the financial services industry). Consequently, outrights bans on the use of arbitration agreements would be ill-designed for the dynamics of the market. Rather, regulators might instead consider rules designed to inform consumers of their choice.

3. Thank you for this question, which I see as an opportunity to elaborate on my answers to the last round of questions from Senator Franken. The answer is quite simple – if a consumer or employee believes that an arbitrator has been biased or partial to the opposing party – and the consumer or employee loses the arbitration – current law gives her an efficacious remedy – namely petitioning to vacate the award under Section 10 of the Federal Arbitration Act. That statute authorizes United States Courts to vacate awards where the award has been "procured by corruption, fraud, or undue means," 9 USC 10(a)(1), or where "there was evident partiality or corruption in the arbitrators, or either of them," 9 USC 10 (a)(2).

4. In the wake of the recent Supreme Court cases at issue in the hearing (*Concepcion* and *Italian Colors*), several safeguards help to ensure that individuals can have their claims adjudicated. Of course, they may proceed individually in the arbitration. Under many rules, including the AAA's Consumer Due Process Protocol, they can proceed individually in small claims court. For certain statutes, public administrative bodies (like

the EEOC) can bring judicial actions on behalf of the individuals or classes of people. The arbitration agreement remains subject to generally applicable contract defenses like unconscionability. If the underlying argument is that the arbitration costs are too financially burdensome, the Supreme Court's decisions in *Green Tree Finance v. Randolph*, 531 U.S. 79 (2000) and *Italian Colors* suggest that the consumer can challenge the proceeding for that reason.

5. Thank you for the opportunity to offer additional thoughts, to expand on my testimony and to respond to the testimony of others:

- First, in light of Professor Gilles' comments on my testimony (Draft Transcript at 78; Final Transcript at __), allow me to make the following point: Contrary to the predictions of some scholars (including Professor Gilles) companies have not unilaterally flocked to arbitration and class waivers as a result of the Supreme Court's decisions in cases like *Concepcion*. Rather, at least as to the industries that have been studied, there is a diversity of approaches by firms, and the reasons for that diversity need to be understood. Having said that, I acknowledge (and have acknowledged) that it is also important to consider not simply firm behavior but the market as a whole (where, prior to a settlement, much of the credit card debt in the United States was subject to arbitration agreements). But, given the diversity of firm practices, the proper regulatory response, if one is warranted, may be to facilitate consumer choice rather than an outright ban on the practice.

- Second, in light of Professor Gilles' characterization of my testimony (Draft Transcript at 90-91; Final Transcript at __), allow me to make the following point: I do not see the support for Professor Gilles' statement that "basically nine out of ten companies are using these forced arbitration clauses." The CFPB preliminary report and Professor Drahozal's and my research do not support the proposition regarding "nine our of ten companies" using these clauses, and I am unsure what's the empirical basis for Professor Gilles' statement. *See, e.g.*, CFPB Preliminary Report at 21, 26. The CFPB found, as did Professor Drahozal and myself, that among companies employing arbitration clauses in the industries under study, there has been an uptick in the use of class waivers, so I must respectfully disagree with Professor Gilles' characterization (Draft Transcript at 91; Final Transcript at __) that my testimony was somehow not "accurate."

  My bottom line is (and has been) this: please let the debate here be driven by sound empirical research and please avoid legislating on the basis of statements that are not backed by facts.

RESPONSES TO QUESTIONS FROM SENATOR HATCH

1. Senator, my understanding of the research largely gels with yours, and I would encourage you, your colleagues and your staff to review one of the seminal reports in this area that discusses several of these points. *See* Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. Disp. Res. 843 (2010). First, as I indicated in my testimony and have indicated elsewhere, there is little doubt that arbitration resolves cases more expeditiously than the civil litigation system. Second, while the point is slightly more debatable, arbitration also tends to be cheaper. Periodically, you hear the argument that arbitration is more expensive because, compared to court, parties have to pay fees, including the arbitrator's fees. But there are two problems with this argument. The first is that the consumer's or employee's share of those fees is often regulated as it is, for example, in the Consumer Due Process Protocol of the American Arbitration Association. Second, a bare focus on fees overlooks other "process costs" that might actually make litigation more costly. For example, if a dispute lasts longer or involves more contested motions (as civil litigation often does), then logically attorneys' fees will be correspondingly higher.

   Third, as to outcomes, most studies show that consumers or employees are at least as likely, if not more likely, to prevail than plaintiffs who sue in court. In the interest of completeness, I should note, as I have noted elsewhere, that some studies cut in the other direction. Some early research of employment arbitration by William Howard found a slightly lower win rate. *See* William Howard, Arbitrating Claims of Employment Discrimination, What Really Happens?, What Really Should Happen?, DISP. RESOL. J., Oct.-Dec. 1995, at 44. But the difference in win rate was not statistically significant, a conclusion confirmed by subsequent papers. *See, e.g.*, Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements,* 16 OHIO ST. J. ON DISP. RESOL. 559, 564-65 (2001); David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research,* 57 STAN. L. REV. 1557, 1569 (2005). Some more recent research by Alexander Colvin also suggested lower win rates. *See, e.g.*, Alexander J.S. Colvin, *Employment Arbitration: Empirical Findings and Research Needs,* Disp. Res. J 6 (Aug.-Oct. 2009). But, as Professor Colvin acknowledges, the record is unclear as to what factors explain these results. *Id.* at 11. It may be due to the employee, or it may be due to other factors like an efficacious internal grievance procedure that, as part of the "quilt" of dispute resolution methods described in my testimony, may help resolve many cases at a pre-arbitral stage. Answering such empirical questions is a critical prerequisite to any regulation.

2. Some studies, including a report by the Federal Trade Commission, have sought to compare individuals' abilities to navigate the small claims system (as compared to arbitration). Otherwise, though, I unfortuntately cannot recall research comparing the ease with which consumers can navigate the litigation and arbitration systems more generally.

3. Based on my reading of the CFPB's preliminary report, I do not believe that the CFPB offered any data regarding whether similar discrepancies exist with respect to litigation. As you are aware, certain judicial districts occasionally have developed reputation as hotbeds for litigation because of the plaintiff-friendly character of their procedures, their laws or their verdicts. My understanding is that one goal of the CFPB's research is to try to develop some metric whereby to undertake meaningful apples-to-apples comparisons of the litigation and arbitration systems so that the systems are not analyzed in isolation but can truly be benchmarked against each other.

4. Yes, I believe it is critical for Congress (and the CFPB) to consider the effect of retroactively invalidating pre-existing arbitration agreements. As I said several years ago in comments at a meeting before the American Bar Association, where will these disputes go? If they are funneled into the civil litigation system (where delays, as noted above, are already endemic), it is difficult to see how that makes consumers or employees better off. This further illustrates the concern that I mentioned to Senator Lee at the hearing that some of the legislative proposals do not necessarily benefit to the very groups whom they purport to help.