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Testimony to the Senate Judiciary Committee
On the Arbitration Fairness Act of 2013 (AFA) [S. 878/H.R. 1844]
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"Too Darn Bad"

Chairman Leahy, Senator Franken, Committee Ranking Member Grassley, and other distinguished members of the Senate Judiciary Committee, thank you for inviting me today to participate in this important hearing. I hope my testimony will help to inform the discussion of the pernicious effects of mandatory, binding, predispute arbitration clauses on consumers, employees and small businesses; I also hope today's hearing will spur this Committee to act on the proposed Arbitration Fairness Act, a vital amendment to the Federal Arbitration Act.

My name is Myriam Gilles, I am a law professor, writing and teaching primarily in the areas of tort law and class action litigation, and I have spent a lot of time over the past eight years researching, writing and lecturing about mandatory arbitration clauses in contracts with consumers, employees and small businesses. These clauses, which mandate one-on-one arbitration of all legal disputes and ban multiple claimants from pooling their claims, prevent individuals from vindicating their rights guaranteed by common law and by federal and state statute.

In 2005, I began studying the effects of mandatory, predispute arbitration clauses on consumers, employees and small businesses. That year, I wrote an article, which appeared in the Michigan Law Review, entitled *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action.*[1] In it, I warned that corporate defendants were beginning to insert in their standard-form consumer contracts liability-avoiding arbitration provisions – clauses

[1] 104 MICH. L. REV. 373 (2005).

requiring that disputes be asserted only in a one-on-one, non-aggregated proceeding. My research also showed that more aggressive clauses provided that consumers could not even be represented or counted as class members (in the event some other injured person managed to commence a class proceeding), and prohibited consumers from participating in the prosecution of any group action in any way. I predicted, back in 2005, that these arbitration clauses had "the capacity to derail putative class actions brought under consumer, antitrust, securities, employment and civil rights statutes, among other areas," and that, absent broad legal invalidation, we would see these clauses in virtually all contracts that could even remotely form the predicate for a class action.[2] As a result, arbitration clauses would undermine corporate accountability and leave widespread wrongdoing unaddressed.

For a period between 2005 and 2011, my prophesies of doom-and-gloom looked like they might be proven incorrect. Just before my article went to press, the California Supreme Court decided a case, *Discover Bank v. Superior Court*, which declared that standard-form contractual prohibitions against class actions embedded in arbitration clauses were unconscionable as a matter of California state contract law and public policy.[3] The *Discover Bank* case ushered in a series of judicial decisions invalidating arbitration clauses on these grounds.[4] State and federal judges, Democrats and Republicans, in courts all around the country, recognized that remedy-

[2] *Id*. at 412-3.

[3] 113 P.3d 1100 (Cal. 2005). The *Discover Bank* decision focused on the "important role of class action remedies in California law" as "the only effective way to halt and redress [consumer] exploitation," and held that class action waivers in consumer adhesion contracts are unconscionable because they "may operate effectively as exculpatory clauses that are contrary to public policy." *Id.* at 1106, 1108.

[4] *See, e.g.,* Cooper v. QC Financial Services, Inc, 503 F Supp 2d 1266, 1290 (D. Ariz 2007) (Arizona law); Caban v J.P. Morgan Chase & Co, 606 F Supp 2d 1361, 1372 (S.D. Fla 2009) (Delaware law); Shroyer v. New Cingular Wireless Services, Inc, 498 F.3d 976, 985 (9th Cir. 2007) (California law); Dale v Comcast Corp, 498 F.3d 1216, 1224 (11th Cir. 2007) (Georgia law); Kinkel v Cingular Wireless LLC, 857 N.E.2d 250, 274 (Ill. 2006); Schnuerle v Insight Communications Company, LP, 2010 WL 5129850, *7 (Ky.); Skirchak v Dynamics Research Corp, 508 F.3d 49, 59–60 (1st Cir. 2007) (Massachusetts law); Ruhl v Lee's Summit Honda, 322 S.W.3d 136, 139–40 (Mo. 2010); Fiser v Dell Computer Corporation, 188 P.3d 1215, 1221 (N.M. 2008); Muhammad v County Bank of Rehoboth Beach, Delaware, 912 A.2d 88, 100–01 (N.J. 2006); Tillman v Commercial Credit Loans, Inc, 655 S.E.2d 362, 373 (N.C. 2008); Schwartz v Alltel Corporation, 2006 WL 2243649, *6–7 (Ohio App.); Vasquez-Lopez v Beneficial Oregon, Inc, 152 P.3d 940, 953 (Or. Ct. App. 2007); Thibodeau v Comcast Corporation, 912 A.2d 874, 887 (Pa. Super Ct. 2006); Herron v Century BMW, 693 S.E.2d 394, 400 (S.C. 2010); Scott v Cingular Wireless, 161 P.3d 1000, 1009 (Wash. 2007); Al-Safin v Circuit City Stores, Inc, 394 F.3d 1254, 1261–62 (9th Cir. 2005) (Washington law); Wisconsin Auto Title Loans, Inc v Jones, 714 N.W.2d 155, 176 (2006) (Wisconsin law).

depriving arbitration clauses violated public policy by preventing people from vindicating the rights that legislatures and the common law give to them.[5]

Enter the Supreme Court of the United States, which has – in just a few decisions in recent terms – brought to life all my dire predictions.

The Supreme Court's 2011 decision in *AT&T Mobility v. Concepcion* (*Concepcion*)[6] and its most recent decision this year in *American Express v. Italian Colors* (*Amex*)[7] broadly upheld the use of mandatory arbitration clauses in contracts with consumers and small businesses, rendering them beyond legal challenge. A slim majority of the Court has repeatedly held that it simply does not matter whether claimants are unable to vindicate their rights in a one-on-one arbitration; all that matters under the Federal Arbitration Act ("FAA") is that the arbitration clause is enforced exactly as the company has written it up. In essence, the Court's recent rulings have interpreted the FAA, enacted in 1925, to mean that any remedy-stripping boilerplate term that is signed, clicked, or otherwise agreed to by consumers here in our 21st century economy must be fully enforced, never mind the policy implications.

For the Court's five-member majority, public policy serves no function in the legal determination of whether arbitration clauses are enforceable. It may well be, Justice Scalia recognized for the majority in *Concepcion*, that countless cases will "slip through the legal system" if boilerplate remedy-stripping arbitration clauses are enforced, but public policy doesn't matter.[8] And the reason policy doesn't matter, the Court held, is because the 1925 text of the FAA mandates that arbitration clauses are sacrosanct, and must be enforced exactly as they are written. As Justice Kagan wrote in her blistering dissent in *Amex*, "the nutshell version" of the majority view is simply this: "Too darn bad."[9] Congress enacted a remedial statute, but a one-on-one arbitration clause prevents you from vindicating your rights under that statute? "Too darn bad."

But here's the thing: "Too darn bad" may or may not be the right answer to an arcane legal question about the preemptive effects of the FAA – I'm not here to argue about preemption

[5] *See, e.g.*, Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of* Concepcion, 79 U. CHI. L. REV. 623, 633 (2012) (noting by, by 2011 when *Concepcion* was decided, fourteen states had ruled remedy-stripping arbitration clauses unenforceable on broad public policy grounds).

[6] 131 S.Ct. 1740 (2011).

[7] 133 S.Ct.2304 (2013).

[8] *Concepcion*, 131 S.Ct. at 1753.

[9] *American Express,* 133 S.Ct. at 2313.

principles – but "too darn bad" is a really lousy policy answer. And in fairness to Justice Scalia and the Court, they were not talking about policy. But we are talking about policy here today. As the preliminary results from the Consumer Financial Protection Bureau's just-released Arbitration Study reveal, "nearly all arbitration clauses studied include provisions stating that arbitration may not proceed on a class basis."[10] These clauses have become common place, and they are harming real people. So let's look at what "too darn bad" means for real people in real cases:

- In recent years, thousands of people – young and old – have enrolled in various schools and programs that purport to offer career-enhancing training that will enable graduates to get better jobs. For-profit programs promising careers as medical assistants, paralegals, executive secretaries, dental hygienists, and assistant chefs are on the rise, as Americans worry about job security and seek ways to ensure continuing employment. But many of these programs systematically mislead prospective students in order to entice enrollment. They misrepresent the quality of the educational program, accreditation, career prospects for graduates, the availability of financial aid, and the actual cost of enrollment. And these institutions now regularly insert mandatory arbitration clauses in their enrollment contracts to ensure they cannot be subject to class actions by defrauded graduates. In case after case, courts have enforced these clauses, denying students the ability to vindicate their rights under state and federal law. In one case, students brought representative actions under California state law seeking injunctive relief against a for-profit school which had illegally targeted veterans and military personnel so that it could receive federal financial aid funds. A federal appellate court enforced the arbitration clauses in the enrollment contracts, finding the FAA preempted the state statute at issue, preventing these students from vindicating their rights.[11]
- Employers can now engage in widespread and difficult-to-detect wrongdoing, with little concern about liability. Even large employers, like Sears Roebuck & Co. and Macy's,

[10] Consumer Financial Protection Bureau, Arbitration Study, Preliminary Results, Dec. 11, 2013, at p. 13, available at http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf. The CFPB reviewed 1241 credit card, checking and payday loan consumer disputes filed between 2010-2012 with the American Arbitration Association – the largest arbitral provider in the country. It found that nearly 90% of these clauses preclude class proceedings. *Id*. at 13, 37.

[11] *See, e.g., Ferguson v. Corinthian Colleges, Inc.*, 733 F.3d 928 (9th Cir. 2013); *Dean v. Draughons Jr. College, Inc.*, 917 F.Supp.2d 751 (M.D. Tenn. 2013); *Kilgore et al. v. KeyBank, National Association*, 2012 WL 718344 (9th Cir. 2012).

have added arbitration clauses to their employment contracts requiring all claims to be resolved in one-on-one arbitration. These arbitration clauses apply to disputes regarding the employment relationship, compensation, benefits, breaks and rest periods, termination, discrimination, or harassment; as well as claims arising under the Uniform Trade Secrets Act, Civil Rights Act of 1964, Americans with Disabilities Act, Age Discrimination in Employment Act, Family and Medical Leave Act, Fair Labor Standards Act, Employee Retirement and Income Security Act, Genetic Information Non–Disclosure Act, and all other state or federal employment statutes. In a recent typical case brought against Sears, Roebuck & Co. in San Diego, a district judge felt constrained to uphold the arbitration agreement, and dismissed the claims that store clerk Felipa Velazquez brought on behalf of herself and other employees who claimed the company failed to pay them minimum wage.[12]

- Many Americans use payday lenders for emergency loans and promise to repay the loan from their next paycheck, but some borrowers find it difficult to pay back the loan and the lender's fee.[13] In response, payday lenders have engaged in illegal and predatory practices: "some have made unauthorized debits from consumers' checking accounts or used aggressive methods to collect debts, such as posing as federal authorities, threatening borrowers with criminal prosecution, trying to garnish wages improperly, and harassing the borrower."[14] Today, nearly all payday lenders include mandatory arbitration clauses in their loan agreements to avoid liability exposure. In a recent case, a payday borrower brought an action against a lender, alleging it imposed a high rate of interest on loans in violation of state law. But her loan contract contained a one-on-one arbitration clause which barred class actions; in grudgingly enforcing the clause, the appellate court observed "post-*Concepcion*, courts may not apply state public policy

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[12] *See Velasquez v. Sears, Roebuck & Co.*, 2013 WL 4525581 (S.D. Cal. 2013). *See also Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2nd Cir. 2013); *Morris v. Ernst & Young LLP*, 2013 WL 3460052 (N.D. Cal. 2013); *Andrade v. P.F. Chang's China Bistro, Inc.*, 2013 WL 5472589 (S.D. Cal. 2013); *Parisi v. Goldman, Sachs & Co.*, 710 F.3d 483 (2nd Cir. 2013).

[13] *See* CFPB Arbitration Study, *supra* note 10, at p. 64 (noting that "the FDIC also estimates that around 2 million households use payday loans annually"); *id.* at n. 152 (noting that "The Pew Charitable Trusts recently estimated that around 12 million individuals use payday loans every year"), *citing* Pew Charitable Trusts, WHO BORROWS, WHERE THEY BORROW, AND WHY: PAYDAY LENDING IN AMERICA (2012) 4.

[14] Prepared Remarks by Richard Cordray, Director of the Consumer Financial Protection Bureau Payday Loan Field Hearing, Birmingham, Ala. (Jan. 19, 2012), *available at* http://tinyurl.com/7mu3hwb.

concerns to invalidate an arbitration agreement even if the public policy at issue aims to prevent undesirable results to consumers."[15]

- And certainly, ordinary small-value, run-of-the-mill consumer cases can no longer be brought in the face of arbitration clauses. For example, Time Warner of New York recently added a $3.95 monthly charge for the modem it has long provided subscribers for free. There was no advance notice of the fee, no method of avoiding the fee (and continuing on as a Time Warner subscriber), and it did not matter that most subscribers are on a set price plan, which the company had promised not to raise for some number of years. But, importantly for Time Warner, the newest iteration of its subscriber agreement contains an arbitration clause, which a federal judge in Brooklyn recently enforced.[16] It is simply unimaginable that any Time Warner subscriber charged the $3.95 monthly fee will bring an individual arbitration; each will pay the fee, or switch to another provider – which can just as easily impose hidden fees and costs without fear of liability or accountability by adding its own arbitration clause.

This body has already recognized the public policy implications of this debate: Congress has made attempts to protect military families by outlawing mandatory arbitration clauses in standard form agreements in payday loan and consumer credit contracts with military families, and has likewise attempted to limit the use of arbitration clauses in residential mortgage loans, as well as in automobile dealer franchise agreements.[17]

It is laudable that Congress has attempted to safeguard the ability of military families and auto dealer franchisees to vindicate their rights, and it is well past time to extend that ability to all consumers, employees, and small businesses – especially in the areas of antitrust and civil rights, as the proposed legislation would. The Supreme Court has squarely placed this issue in the lap of this Congress and this Committee: "Too darn bad" really means "Tell it to Congress." The Court has made plain that it will "rigorously enforce" all the remedy-stripping terms that companies insert in their arbitration clauses – never mind the consequences – unless the FAA's

[15] *Robinson v. Title Lenders, Inc.*, 364 S.W.3d 505 (Mo. 2012).
[16] *Damato v. Time Warner Cable, Inc.*, 2013 WL 3968765 (E.D.N.Y. 2013).
[17] *See* 10 USC § 987(e)(3), (f)(4) (voiding arbitration clauses in payday loan or any consumer credit contracts—with the exception of residential mortgages and car loans—with members of the military or their families); 15 USC § 1639c(e)(1) (barring arbitration clauses in residential mortgage loans); 15 USC § 1226(a)(2) (prohibiting automobile manufacturers from imposing predispute arbitration clauses in their franchise agreements with dealers).

mandate is “overridden by congressional command.”[18] Today, this Committee has the opportunity to accept that invitation and amend the FAA.

The proposed legislation before this Committee is in no sense whatsoever “anti-arbitration.” Arbitration can be an effective alternative to our court system. But make no mistake: the mandatory arbitration clauses that are the subject of this proposed legislation do not – and were never intended to – provide an alternative forum to *resolve* claims. Their one and only objective is simply to provide a way to suppress and bury claims. These clauses injure the institutional integrity of arbitration. The whole point is that consumers and employees seeking redress for broadly distributed small-value harms cannot and will not pursue one-on-one arbitrations.[19] Ever. Thus, mission accomplished for big corporations.

The timing could not be better for Congress to act, as mandatory arbitration clauses have proliferated beyond what anyone could have imagined just a few years ago. Click on the “Terms & Conditions” link in any standard form web transaction and you’ll surely see a mandatory arbitration clause. It may have started with telecom and credit card contracts, but now these clauses are de rigeur in contracts from insurance companies, airlines, landlords, securities brokerages, payday lenders, all banks, gyms, rental car companies, parking facilities, schools, kids’ camps, shippers – even HMOs and nursing homes.[20] Indeed, most nursing homes now use

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[18] *American Express*, 133 S.Ct. at 2309, *citing CompuCredit Corp. v. Greenwood*, 132 S.Ct. 665, 668–669 (2012). *See also* Gilles, 104 MICH. L. REV. at 395 (“[T]he Supreme Court’s arbitration jurisprudence over the past thirty years have evinced an incredibly expansive view of the FAA, and while the full import of this national policy favoring arbitration has been criticized by man – including members of the Court itself – there is no reason to believe the Court will swing back to a more nuanced interpretation of the FAA.”).

[19] The CFPB’s Arbitration Study reveals that very few consumers ever arbitrate disputes. According to that agency, “around 80 million cardholders were subject to arbitration clauses as of the end of 2012,” “tens of millions of households are subject to arbitration on one or more checking accounts,” and “2 million households use payday loans annually.” Despite these vast numbers, from 2010-2012, only 1241 consumers filed arbitrations to resolve disputes with their credit card companies, banks, and lenders. CFPB Arbitration Study, *supra* note 10, at p. 63-64.

[20] Gilles & Friedman, 79 U. CHI. L. REV. at 631 (“[A]bsent broad legal invalidation, it is inevitable that the waiver will find its way from the agreements of ‘early adopter’ credit card, telecom, and e-commerce companies into virtually all contracts that could even remotely form the predicate of a class action someday. After all, the incremental burden of including magic words in dispute resolution boilerplate—or even on point-of-sale purchase receipts or box-stuffer notices—is surely minimal in relation to the benefit of removing oneself from potential exposure to aggregate litigation.”).

these clauses to make sure their residents are unable to bring individual actions or band together to hold them accountable for systemic harms.[21]

In addition, by taking private plaintiff enforcers out of the game, the Supreme Court's decisions also impose an unrealistic burden on our public agencies.[22] The Department of Justice and Federal Trade Commission submitted a powerful amicus brief in the *Amex* case arguing that private enforcement – particularly in the antitrust context but elsewhere as well – is absolutely indispensable to carrying out Congress's will as expressed in the Sherman Act.[23] And they recognized that private enforcement – in this day and age where large companies transact with thousands or millions of consumers and small businesses – means *collective* private enforcement, of the type expressly prohibited by these arbitration clauses. Without robust collective private enforcement, the top antitrust watchdogs told the Supreme Court, the detection and deterrence of antitrust violations will suffer gravely. Furthermore, the Attorneys General of 22 states made the same point in their own submission: banning collective private enforcement "erode[s] the states' ability to protect their citizens and economies."[24] Here, once again, the Court's response was "too darn bad."

Amex is an interesting case in point: this was a case brought on behalf of small merchants, all of whom have contracts to accept Mastercard, Visa and American Express, among others. When those credit card companies engage in illegal acts, these merchants have to band together to prove that wrongdoing in expensive antitrust litigation. This is exactly what has happened in antitrust class actions brought by merchants against Mastercard and Visa – and over the past decade, there have been two class settlements resulting in more than $10 billion in damages and important injunctive relief. American Express, on the other hand, was sued for the

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[21] *See, e.g.*, Myriam Gilles, *Operation Arbitration: Privatizing Medical Malpractice Claims*, THEORETICAL INQUIRIES IN LAW, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2263429.

[22] *See, e.g.*, Gilles & Friedman, 79 U. CHI. L. REV. at 668 (public enforcers "lack the resources to take the laboring oar on many of the large-scale cases that have traditionally been the province of the class action plaintiffs' bar"); *see also* Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. 698, 761 (2011) ("[S]tate attorneys general face resource constraints that limit the scope of possible enforcement actions.").

[23] Brief for the United States as Amicus Curiae Supporting Respondents, available at http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs-v2/12-133_resp_amcu_usa.authcheckdam.pdf.

[24] Brief of the State of Ohio and 21 Other States as *Amici Curiae* in Support of Respondents, available at http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs-v2/12-133_resp_amcu_ohio_etal.authcheckdam.pdf.

same conduct. But because that company had inserted magic words in their boilerplate form contracts – requiring one-on-one arbitration – it has been allowed to avoid liability.

As mandatory arbitration clauses foreclose millions of citizens from vindicating their rights, and as the remedial statutes enacted by this body and the legislatures of the fifty states are thwarted, “too darn bad” just doesn’t cut it. I urge Congress and this body to act swiftly to remedy these wrongs and to pass the Arbitration Fairness Act.