

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

Hearing before the Senate Committee on the Judiciary

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Chairman Leahy, Ranking Member Grassley and Members of the Committee. Thank you for the opportunity to testify today. My name is Peter B. Rutledge, and I am the Associate Dean for Faculty Development at the University of Georgia School of Law, where I also hold the Herman E. Talmadge Chair of Law. I am author of the book *Arbitration and the Constitution*, co-author of the book *International Civil Litigation in United States Courts* and have written (or co-written) several articles and book chapters on the field of arbitration. I am pleased to offer my thoughts on the topic of today's hearing.

In an abundance of caution, I should stress the obvious point that the views expressed in my testimony (both written and oral) are entirely my own. They do not necessarily reflect the views of my employer, the University of Georgia, or my co-authors. I stress this because one of my regular collaborators, Professor Chris Drahozal, with whom I have written several articles on the topic of arbitration, also serves as a consultant to the Consumer Financial Protection Bureau ("CFPB"). While we share the views expressed in our written papers, I would not want anything I say (or write) in connection with this hearing erroneously to be imputed to him (or, indirectly, the CFPB).

At bottom, I wish to make three main points to the committee today:

First, I wish to thank you and your fellow lawmakers for shifting the terms of the debate over arbitration (and dispute resolution more generally) away from legislation by anecdote and more toward policymaking grounded in sound empirical evidence. Earlier iterations of this debate risked reacting to sensationalized stories, irrespective of whether those stories were

representative of the system or whether the proposed reform benefited the very entities whom interest groups were purporting to protect. Now, the debate is firmly anchored in empirical research and should remain so. Sound policy or regulation must not simply examine arbitration proceedings in isolation. Instead, it must both engage in a meaningful apples-to-apples comparison of arbitration with the alternatives (presumably civil litigation) and consider the role of arbitration as part of a broader quilt of dispute resolution options which may well enable consumers and others to achieve fast, equitable results before a full-blown dispute emerges.

Second, consistent with my first observation, Congress should approach with caution claims that some parade of horrors will ensue following the Supreme Court's recent decisions in the area of arbitration. Empirical research that others and I have undertaken does not validate those predictions. Instead, it reveals that the choice whether to utilize an arbitration clause reflects a complex set of factors and preferences that vary among industries and among firms within industries. The recent preliminary report completed by the Consumer Financial Protection Bureau appears to confirm these findings with respect to the consumer financial services industry.

Third, while the *Concepcion* and *Italian Colors* decisions present related (but distinct) questions about the relationship between alternative dispute resolution and aggregate proceedings, arbitration should not become caught in the crossfire of an underlying debate over class actions. The procedural flexibility often afforded by arbitration offers a number of practical options by

which to address aggregate proceedings. Public regulatory authorities can perform an aggregative role even when they are acting on behalf of individuals who are bound by an arbitral commitment. In all events, Congress should resist the temptation to see class actions as a panacea; some research casts doubt on the efficacy of this tool.

I. The Debate Over Arbitration Has Laudably Shifted Toward An Emphasis On Empirical Research, And Investigation Should Continue Into Under-examined Questions.

My first main point is to stress again the importance of sound empirical research to the policy question before you. When I began writing and testifying on this subject over six years ago, empirical research in this field was scarce.¹ We had some, albeit limited, knowledge about several important issues such as (1) the rate at which arbitration clauses were used, (2) the provisions of those clauses, and (3) outcomes in arbitration.²

Against this empirical void, the risks of legislating were grave – not only did Congress risk basing policy on unrepresentative (but sensational) anecdotes, it also risked unintended consequences – whether upending important doctrines

¹ See S. Comm. on the Judiciary, Subcomm. on the Constitution, S. 1782, The Arbitration Fairness Act of 2007 (Dec. 12, 2007); H. Comm. on the Judiciary, Subcomm. on Commercial and Administrative Law, Arbitration Fairness Act of 2007 (Oct. 25, 2007).

² See Peter B. Rutledge, *Arbitration Reform: What We Know, What We Need to Know*, 10 *Cardozo J. Conflict Res.* 539 (2009); David Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 *Stanford L. Rev.* 1557 (2005).

in international arbitration or even undermining the interests of the very groups whom advocates of reform were purporting to advance.³

Since that time, the empirical record has improved – and so too has the degree of sensitivity to the importance of empirical argument in this debate. Scholars, think tanks and advocacy groups have sought to advance the empirical record and give Congress has a clearer picture against which it can consider whether, and to what extent, policy change is appropriate. In several respects, that research generally has vindicated arbitration – it has shown that arbitration yields results far faster than the civil litigation system; it also has shown that arbitration often achieves fair results for employees and consumers, at least as good as those in the civil litigation system; and it has shown that arbitration clauses typically do not contain the sorts of nefarious procedural provisions for which they were at one time roundly criticized.⁴

Against this backdrop of heightened attention to empirical research, Congress should be praised for its decision to insist upon study by the CFPB before deciding whether it should regulate arbitration clauses in the field of

³ In this regard, it is worth noting that the current draft Arbitration Fairness Act has abandoned several of the so-called “findings” that were contained in prior versions and criticized for a lack of empirical foundation. *See* S. 878 & H.R. 1844, Arbitration Fairness Act of 2013 (May 7, 2013); Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 *Cardozo J. Conflict Res.* 267 (2008).

⁴ For a report that both summarized the state of the literature and make an important original contribution to it, see Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Agreements*, 25 *Ohio St. J. Disp. Res.* 843 (2010). In the rare instances where arbitration clauses do contain an objectionable provision (such as a damages waiver or a requirement that the individual arbitrate in an inconvenient location), courts have tools at their disposal to police those terms.

consumer financial services. Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 instructs the CFPB to study the use of arbitration clauses in this industry and requires that any subsequent regulation of those agreements to be consistent with the results of that study.⁵ Last week's release of the CFPB's "preliminary" findings in this area represents another incremental step in flushing out the empirical record. (I will return to the details of those findings later in my testimony.)

While progress has been made, I should sound a note of caution about two challenges facing the ongoing empirical work in this area. First, it is not sufficient to analyze arbitration in isolation from the alternatives. Normative assessments of arbitration, whether praise or criticism, have meaning only when measured against some other baseline such as the civil litigation system. If arbitration is criticized upon some basis – such as the rate at which defendant prevails – that criticism may sound convincing unless, of course, the defendant prevails *at a higher rate* in the civil litigation system (this assumes, of course, that the raw win-rate represents the appropriate metric for assessing the desirability of a system of dispute resolution).⁶ It is akin to castigating someone for his or her choice to drink juice (due to some perceived adverse health effect) if the only alternative were sugary soda.

Second, a bare focus on actual cases may mask less visible, yet no less important, benefits to a system of dispute resolution. As I have explained

⁵ 12 U.S.C. 5518(b).

⁶ For a good example of scholarship debunking these sorts of exaggerated attacks on arbitration, see Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and Court*, 7 *Hastings Bus. L.J.* 77 (2011).

elsewhere, it is essential to consider arbitration as part of a quilt of dispute resolution forms.⁷ Many consumer disagreements may never reach the point of full-blown dispute precisely *because* they are resolved at an early stage. Arbitration, given the predictability and certainty of the forum and procedures, may well enable such amicable resolution. Eliminate arbitration, and one ironically may end up ripping out the keystone upon which these settlements rest.

Both empirical challenges are formidable. The former requires researchers to be able to generate a meaningful metric for comparing like cases and a normative account for the result that a system “ought” to produce. The latter requires researchers to peer behind the curtain of various internal dispute resolution processes to understand how they operate and the factors on which they depend. Unless these steps occur, any regulation of arbitration would rest, at best, on a shaky foundation.

⁷ See *Renting Cars: On Cadillacs, Saturns and Consumer Arbitration*, in *Beyond Elite Law: Access to Civil Justice for Americans of Average Means*, Estreicher and Radice (eds.) (forthcoming); Peter B. Rutledge, *Arbitration Reform: What We Know and What We Need to Know*, 10 *Cardozo J. Conflict Res.* 579 (2009).

II. Congress Should Be Skeptical About Claims That A Particular Supreme Court Decision Will Have A Sudden Impact On Contracting Practices In A Given Industry.

The emphasis in the preceding section on the importance of solid empirical research – and the accompanying skepticism about accepting untested arguments or generalizing from anecdotes – leads naturally to my second point. That is, contrary to the expectations of some observers, the Supreme Court’s decision in *Concepcion*⁸ has not led to some cataclysmic shift in contracting practices. My own research suggests this has been true in the franchising field, and the recent preliminary report from the CFPB shows similar results in the consumer financial services industry. While it is too early to judge the effect, if any, of the *Italian Colors*⁹ decision on contracting practices, these findings again counsel caution before Congress unreflectively embraces the untested arguments of arbitration’s critics.

To put these findings into context, a bit of background is in order. Beginning several years ago, Professor Chris Drahozal and I undertook a series of studies examining various measurable features of arbitration.¹⁰ Those studies drew on two primary sources of data: (1) franchise agreements regularly deposited with Minnesota regulatory authorities and (2) credit card agreements

⁸ *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).

⁹ *American Express Co. v. Italian Colors Restaurant*, 131 S. Ct. 2304 (2013).

¹⁰ See Peter B. Rutledge & Christopher R. Drahozal, *Sticky Arbitration Clauses: The Use of Arbitration Clauses After Concepcion and Amex*, 67 *Vanderbilt L. Rev.* __ (forthcoming 2014); *Contract and Choice*, 2013 *B.Y.U. L. Rev.* 1; Christopher R. Drahozal & Peter B. Rutledge, *The Use of Arbitration Clauses in Credit Card Agreements: An Empirical Study*, 9 *J. Empirical Legal Studies* 536 (2012); Christopher R. Drahozal & Peter B. Rutledge, *Contract and Procedure*, 94 *Marquette L. Rev.* 1104 (2011).

deposited with federal authorities (initially the Federal Reserve and, more recently, the CFPB). Among the major findings of these papers:

- The utilization of arbitration clauses among firms in particular industries (franchise and consumer financial services) was not as widespread as arbitration's critics purported to be the case;
- With the possible exception of class waivers, arbitration clauses generally did not contain the sorts of "unfair" procedural terms that they often were criticized by containing;
- In the credit card industry, the use of arbitration clauses appeared to be correlated with variables such as the corporate form of the issuing institution (for-profit banks were likelier to use them than credit unions) as well as the size, riskiness and composition of the lender's portfolio.

That led to the most recent paper, *Sticky Arbitration Clauses?*, a draft of which I have attached to my written testimony.¹¹ That paper, forthcoming in the *Vanderbilt Law Review*, examined contracting practices in the franchise industry to assess the effect (if any) of *Concepcion* on the use of (and terms of) arbitration clauses. We considered two data sets – a sample of franchise agreements that

¹¹ Peter B. Rutledge & Christopher R. Drahozal, *Sticky Arbitration Clauses? The Use of Arbitration Clauses After Concepcion and Amex*, __ *Vanderbilt L. Rev.* __ (forthcoming 2014).

we tracked since 1999 and a second set that we tracked since 2011 (immediately before *Concepcion* was decided).

At bottom, we discovered that *Concepcion* had little to no effect on the overall use of such clauses. To be specific, in the data set tracing to 1999, the use of arbitration clauses following *Concepcion* increased only from 40.3% to 44.8%. In the sample dating from 2011, the use of arbitration clauses increased from 62.6% to 63.6%. Interestingly, in the latter set, some franchisors actually switched *away* from arbitration after *Concepcion* (while others switched to it). While the *use* of arbitration clauses remained largely unchanged since *Concepcion*, we did note some movement *among those franchisors who used such clauses* – namely, the use of class waivers in arbitration clauses has risen over time: from 51.6% in 1999 to 77.8% in 2011 (immediately before *Concepcion*) to 86.7% in 2013.

Tellingly, the general “stickiness” of dispute resolution clauses did not appear to be coincidence. At the time the dispute resolution provisions of these agreements remained unchanged, other provisions of the franchise contracts *were* changing. Nearly 80% of the franchisors in our sample changed at least one provision of the franchise agreement during the years we studied, and almost half of the franchisors not using arbitration clauses were making major changes to their franchise agreements. Franchisors were not simply leaving provisions of their contracts unaltered but were actively revising them in material ways – but not, by and large, the dispute resolution provisions.

This led us to several important conclusions – (1) that the predicted parade of horrors in the wake of *Concepcion* had not come to pass; (2) that courts and lawmakers should be skeptical in the wake of arguments confidently predicting that some Supreme Court decision will necessarily result in some abrupt change in contracting behavior, and (3) that some theory was needed to explain the apparent stickiness of arbitration clauses, including in the adhesive setting.

While our current paper focused principally on practices in the franchise industry, last week’s CFPB report of preliminary results told a similar story in several sectors of the consumer financial services industry.¹² I trust your staff will examine the report in detail, but I would draw your attention to the finding on page 19 that “most institutions do not use arbitration clauses, and credit unions typically do not, but larger institutions are more likely to use arbitration clauses than small institutions.”¹³ These findings lend further support to the conclusions we drew in *Sticky Arbitration Clauses*. (By contrast, the use of arbitration clauses among general purpose reloadable prepaid cards appeared to be higher).

This naturally leads to the *Italian Colors* case. *Italian Colors* is obviously a quite recent decision, so we are still unable to test whether that decision, unlike *Concepcion*, will have some sort of effect on dispute resolution practices, whether in the franchise industry or the financial services industry. At a

¹² Consumer Financial Protection Bureau, Arbitration Study: Preliminary Results (Dec. 12, 2013) (“*CFPB Report*”).

¹³ CFPB Report at 19.

minimum, the results of our prior research, confirmed by the CFPB's preliminary results, suggest that Congress should be cautious before unreflectively accepting predictions that the decision will result in some sudden shift in contracting practices.

In our paper, we do note one possibility raised by *Italian Colors*: pure "class" waivers" – that is waivers of the right to proceed in a collective manner without an accompanying arbitration clause. While such clauses are not widely reported, our franchise data did reveal some instances. Future research might test whether contracts lacking arbitration clauses begin to employ class waivers or, instead, also remain sticky.

III. Congress Should Approach With Caution Criticisms About Arbitration's Effect on Aggregate Dispute Resolution.

To this point, my testimony has focused on the state of the empirical record and the apparent lack of validity to the predictions that the Supreme Court's decision in *Concepcion* would result in some cascading change in contracting practices. In this final section, I address the questions raised by *Concepcion* and *Italian Colors* for companies that do, in fact, employ arbitration clauses. That is, whether the effect of those clauses, coupled with a collective litigation waiver, effectively insulates the defendant from liability by eliminating the necessary incentives to bring suit.

Up front, it is important to note the different phenomena at work in the two settings. *Concepcion*, a consumer-to-business case, involves a situation

where the stakes of proceeding on an individualized basis are allegedly too small for any individual consumer to have an incentive to bring the claim. *Italian Colors*, a business-to-business case, does not involve allegations about insufficient individual stakes; instead, the claim here is that the costs of marshaling the necessary proof of a claim are so exorbitant that an individual litigant allegedly cannot bear them.

Taking the *Concepcion*-type situation first. A variety of mechanisms can address the apparent lack of incentive to proceed on an individualized basis. Procedural flexibility is a hallmark of arbitration, and it can be designed in a manner to minimize cost to the consumer: the dispute can occur in an on-line or documents-only setting with the company bearing the costs of the dispute; companies can include cost-shifting or fee-shifting provisions in their contracts (including provisions that only shift fees to the prevailing consumer while requiring the company, in all events, to bear its own fees); they can unilaterally offer to pay the attorney's fees of the consumer; a few companies (like AT&T) go one step further and embed reward provisions in their arbitration clauses in the event the consumer recovers more in arbitration than the company offers in settlement. These sorts of procedural innovations, as well as the Consumer Due Process Protocol utilized by the American Arbitration Association, all can address the alleged lack of incentive to proceed on an individualized basis. Indeed, consistent with this general solicitude for arbitration as a flexible device for handling consumer claims, the United States has been working with the Organization of American States to develop methods for addressing cross-border

consumer disputes and has included, as part of its proposal, model rules for arbitration of cross-border business-to-consumer claims.¹⁴

Even assuming these mechanisms were insufficient, other mechanisms can address the aggregation question. Most importantly, public enforcement authorities charged with the civil enforcement of certain statutory remedies, like attorneys general or state regulatory bodies, retain the authority to sue on behalf of a group of affected individuals, even when those individuals may be parties to arbitration agreements. As the Supreme Court has made clear, those public regulatory entities are not bound by the arbitration commitment, even when they are suing on behalf of individuals who are bound by it.¹⁵

Italian Colors presents a different phenomenon. Here, the underlying agreement arises between business entities; moreover, the stakes of the claim are sufficiently high that there is no argument about a lack of incentive to bring suit. Instead, the alleged cost of proving the underlying antitrust claims is sufficiently expensive that it might discourage the individual litigant from proceeding unless he or she can share those costs with other claimants. Here too, the procedural flexibility afforded by arbitration could supply creative solutions. The arbitrator might appoint his or her own expert to resolve the question and allocate the costs across the claimant and respondent. The arbitrator could order the respondent to pay the claimant's expert fees in the event the expert prevailed.

¹⁴ See Michael J. Dennis, *Developing A Practical Agenda for Consumer Protection in the Americas*, available at <http://www.oas.org/dil/esp/14%20-%20dennis.DM.309-328.pdf>.

¹⁵ See *EEOC v. Waffle House*, 534 U.S. 279 (2002).

Beyond arbitration, the market itself might provide such solutions. Multiple claimants could bring single proceedings against a single respondent and then enter into cost-sharing arrangements. Law firms might develop expertise in the field and then either leverage that know-how across cases or spread the costs of developing that know-how across cases. As with the situation presented by *Concepcion*, public enforcement and regulatory authorities, which are not bound by the arbitration agreement, can step in and serve that aggregative function where the public interest requires it.

Against these options, it is often claimed that the true solution lies in invalidation of the class waiver and restoration of the class action as a means of overcoming these aggregation difficulties. Indeed, as I have participated and witnessed these debates over arbitration for several years, one of the unfortunate aspects has been the conflation of a debate about arbitration with a debate about class actions. The risk in framing the debate this way is that it subjects arbitration to unfair broadside criticisms. If groups want to have a debate about class actions, then they should have one, but the arbitration system cannot – and should not – become caught in the crossfire.

Nonetheless, I recognize one reason the two topics have been coupled is the appearance, as described in our research, of arbitration clauses with class waivers. So to the extent class actions are seen as the superior aggregation option, it certainly is important to ask whether this device holds forth the promise touted by arbitration's critics.

There is an extensive literature on class actions, and I do not intend to rehash it here.¹⁶ Rather, I do wish to draw your attention to some research casting doubt on the efficacy of that mechanism. As you know, class actions almost never result in a verdict. Instead, if the class is certified, some settlement which results in a significant fee to the class attorneys and some potential compensation to class members. Yet, according to one recent study, the frequency with which class members actually obtain that relief (known as the claims form completion rate) is astonishingly low.¹⁷ Other research finds similarly low completion rates whenever the consumer must complete a form to receive a share of the settlement, even when the consumer's share is nontrivial.¹⁸ Findings of this sort have prompted my colleague, Professor Jaime Dodge, to express skepticism over the efficacy of privately managed class actions: "Many class actions are only providing compensation to a small fraction of harmed individuals, while preclusion operates to bar these individuals' claims."¹⁹

My claim is measured. My purpose is not to offer some unequivocal criticism (or praise) for class actions. Rather, my goal is simply to sound a note

¹⁶ See, e.g., Richard A. Nagareda *et al.*, *The Law of Class Actions and Other Aggregate Litigation* (2d ed. 2013); Richard A. Nagareda, *Mass Torts in a World of Settlement* (University of Chicago Press 2007).

¹⁷ Rust Consulting, *Anticipating Claims Filing Rates in Class Actions* (2013).

¹⁸ See Nicholas M. Pace & William B. Rubinstein, *How Transparent Are Class Action Outcomes? Empirical Research on the Availability of Class Action Claims Data* (Rand 2008); Nicholas M. Pace *et al.*, *Insurance Class Actions in the United States* (Rand 2007); Deborah Hensler *et al.*, *Class Action Dilemmas: Pursuing Public Goals for Private Gain* (Rand 2000).

¹⁹ Jaime Dodge, *Disaggregative Mechanisms: The New Frontier of Mass-Claims Resolution Without Class Actions*, __ Emory L.J. __ (forthcoming 2014).

of caution: do not be seduced by claims that class actions, or any other mechanism, offers a wholly unproblematic mechanism for addressing the aggregation issues identified by cases like *Concepcion* and *Italian Colors*. Rather, examine the relative efficacy of class actions (or any other mechanism) and consider the available empirical literature. Put another way, to pick up on a theme expressed earlier in my testimony, as you scrutinize arbitration for its effectiveness as a dispute resolution device, it is essential that class actions be subjected to the same level of scrutiny.

CONCLUSION

In sum, Mr. Chairman, thank you for the opportunity to offer these views. At bottom, it is my view that the “parade of horrors” often predicted in connection with Supreme Court decisions on arbitration, particularly *Concepcion*, has not come to pass. While it is simply too early to predict the effects of the *Italian Colors* case, the historical disconnect between the rhetorical criticism and the empirical reality of arbitration counsels caution. Rather, as I have noted elsewhere, the available empirical record on arbitration suggests that the system generally produces sound results.

To be sure, arbitration is not immune from criticism, the empirical record is incomplete, and the subject should continue to be subject to rigorous empirical examination and, where appropriate, refinement. The same can and should be said for our system of civil litigation. Indeed, if sound policy is to emerge from these debates, it is critical that our system of civil litigation, particularly the class action mechanism, be subject to the same level of exacting scrutiny.