STATEMENT ON
CONSUMER ARBITRATION

BY
THE CHAMBER OF COMMERCE OF THE UNITED STATES, THE U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, BUSINESS ROUNDTABLE, AMERICAN INSURANCE ASSOCIATION, NATIONAL ASSOCIATION OF HOMEBUILDERS, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, CTIA – THE WIRELESS ASSOCIATION, AND COUNCIL FOR EMPLOYMENT LAW EQUITY

SUBMITTED TO THE
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES
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I. Introduction

This statement for the record is being submitted on behalf of The U.S. Chamber of Commerce, the U.S. Chamber Institute for Legal Reform, Business Roundtable, American Insurance Association, National Association of Homebuilders, Securities Industry and Financial Markets Association, CTIA – the Wireless Association and the Council for Employment Law Equity. We appreciate the opportunity to submit testimony for the record before the Subcommittee and express our strong support for arbitration agreements and their value in consumer contracts.

First and most important, efforts that would undermine the use of either consumer or commercial arbitration agreements run counter to the basic principle that parties' private contractual agreements should be enforceable. By denying to parties the *ability* to include effective binding arbitration provisions in their contracts, Congress would be directly attacking perhaps the most fundamental principle of our commercial law, that parties should be allowed to enter the binding contracts they choose. Congress has historically recognized the vital principle

of the sanctity of contracts. By seeking to eliminate the use of arbitration in different sectors of the economy, Congress would be undermining voluntarily agreed upon contracts and ignoring the very axiom that, with narrow exceptions, parties should be allowed to enter into and be bound by the agreements they choose.

Second, eliminating the use of consumer arbitration agreements runs counter to the longstanding, uniform view of Congress, the executive branch, and the courts that Alternative Dispute Resolution (ADR) in general, and arbitration in particular, are important and encouraged means for parties to resolve their disputes. Legislative efforts designed to undo arbitration clauses in consumer agreements would undermine clear congressional intent to support the use of ADR. Furthermore, elimination of consumer arbitration clauses would exacerbate problems in the incredibly overburdened civil legal system, and harm not only the parties who have agreed to binding arbitration clauses, but also everyone who chose *not* to agree to arbitration.

The organizations submitting this testimony are strongly in favor of there being continued availability and enforceability of arbitration clauses in all contracts. Removing consumer arbitration clauses has little to do with protecting the little guy from the imagined evils of arbitration, and *everything* to do with allowing a party to a contract to ignore certain terms of that contract at will. Parties that are signatories to a writing purporting to be a contract generally should be bound by that writing and all its terms. To allow otherwise would countermand our collective interest in promoting the finality and certainty of contracts. Down this slippery slope lies increasing uncertainty from which only the plaintiffs' trial bar will prosper.

II. Congress has supported the use of Arbitration Agreements across all segments since passage of the Federal Arbitration Act in 1925

Congress enacted the Federal Arbitration Act (FAA) in recognition of the fact that

arbitration of disputes provides a benefit to consumers. In language remarkably similar to today's, the 68th Congress passed the FAA to give "parties weary of the ever-increasing 'costliness and delays of litigation'" another option.[1] The FAA embodies our "national policy favoring arbitration."[2] The FAA was designed specifically to "reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements on the same footing as other contracts."[3] But arbitration was by no means a new idea in 1925. In an article in the February, 2000 issue of the *Dispute Resolution Journal*, Judge Marjorie Rendell of the Third Circuit in Philadelphia quotes at length from George Washington's will. The father of this nation mandated, in language Judge Rendell correctly describes as eerily "prescient" to modern ADR provisions, that any dispute arising under that should be decided by three impartial arbitrators, two chosen by the parties and the third chosen by the first two.[4]

Our nation is in the midst of a litigation explosion. While there is no question that every American deserves to have legitimate grievances heard, the civil legal system is suffering– becoming more inefficient, less timely and more unpredictable than ever before. The old adage that "justice delayed is justice denied" is a concept that dates back to the Magna Carta.[5] Fortunately, however, we need not make the impossible choice between an increasingly inefficient civil justice system and the denial of a fair hearing for those who require it. The use of ADR to resolve conflicts alleviates some of the negative effects of the current litigation

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1 *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 220 (1985), quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924).
2 *Southland Corp.* v. *Keating*, 465 U.S. 1, 10 (1984).
3 *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 288 (2002) (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 204 (1991)).
4 Rendell, *ADR Versus Litigation*, 55-Feb. DISP. RESOL. J. 69, 69 (2000).
5 *See* 1 Holdsworth, A HISTORY OF ENGLISH LAW 57-58 (3rd ed. 1922).

explosion. Recognizing this, many industries have begun to include clauses in their contracts requiring the parties to submit to binding arbitration should a dispute arise[6]

Under the FAA, a contractual agreement to arbitrate is simply treated as any other enforceable contractual arrangement. In other words, under the FAA ***arbitration provisions just cannot be "singl[ed] out * * * for suspect status.***"[7] Thus, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening" the FAA.[8] These classic exceptions to the enforcement of any contract serve to protect against abuse. But provisions mandating arbitration are no *more* likely to be abusive than any other–in fact, arguably less so, given the uniform federal support for arbitration over the past three quarters of a century.

III. Arbitration Benefits Both Consumers and Businesses

Contrary to the unfounded aspersions cast against arbitration by its opponents, the FAA is not an anti-consumer statute. It is precisely these contractually negotiated arbitration provisions that are critically necessary to help staunch the nation's rush to litigation. Rather, arbitration merely provides an alternative forum for resolving claims that the law has been violated. ADR typically is quicker, cheaper, and more predictable than civil litigation, and is

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[6] Binding arbitration clauses are currently used in a wide range of contracts, including contracts for employment, car and home purchase, service, credit, insurance, and other financial services. In all of these contexts, arbitration provides the parties with a way to avoid the vagaries of our current jackpot legal system by agreeing to submit to a contractually defined method of dispute resolution.

[7] *Doctors Associates, Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996) (citation omitted) (emphasis added). Since "arbitration under the Act is a matter of consent, not coercion," *Volt Info. Sciences, Inc.* v. *Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989), "'an arbitration agreement [must] be placed upon the same footing as other contracts, where it belongs.'" *Southland*, 465 U.S. 1, 15-16, quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924); see also *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 281 (1995).

[8] *Casarotto*, 517 U.S. at 686. As the Fourth Circuit said recently, "singl[ing] out arbitration agreements in standardized contracts [is], in effect, [to] declare their very formation to be unconscionable." *Saturn Distrib. Corp.* v. *Williams*, 905 F.2d 719, 726 (4th Cir. 1990). Barring enforceable arbitration agreements, despite having "no general contract law restricting nonnegotiable provisions in standardized contracts" evinces a "singular hostility" to arbitration fundamentally at odds with the theory of the FAA. *Ibid.*

much less easily abused in this litigation-as-lottery age than the lawsuits favored by the plaintiffs' bar.[9] Far from being inherently unfair, as the plaintiffs' bar sometimes asserts, arbitration provisions provide an invaluable alternative to having one's claim heard in court. Parties to a dispute may have a full and fair hearing of their grievances by presenting witnesses, evidence and case facts to a neutral third party in much the same manner as they would in a court of law. Unburdened by the often rigid rules of civil procedure, parties in arbitration are also free, in many cases, to customize the proceedings to address specific needs and devise the best method to resolve their dispute. Not only do consumers have a fair opportunity to vindicate their rights in arbitration, but government authorities also aggressively exercise the strong enforcement powers at their disposal to protect consumers.

Furthermore, federalism arguments that arbitration subverts state legislative policies fail for at least three reasons. First, it is simplistic to claim that arbitrators will ignore state statutory policies. While it is true that arbitrators frequently are–***by agreement of the parties***–free to balance the equities of a particular case so as to craft an appropriate remedy, it does not follow that arbitrators will always ignore certain statutory provisions. Rather, as would be expected in this more informal, agreed upon procedure, those statutes will be followed to the extent the selected arbitrators find them to be applicable given the details of the situation.

Second, the excessive litigation created by rescinding the validity of consumer arbitration agreements will impose costs broadly on the national economy–costs borne by individual

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[9] Mandatory arbitration clauses make it virtually impossible for some unscrupulous plaintiffs' trial lawyers to engage in many of the abuses that currently mar our civil justice system. Speculative litigation, forum-shopping, and exorbitant legal fees are easily eliminated if parties to a dispute agreed to binding arbitration rather than go to court. *See* Rogers, *Self-Interested Critics Only Spinning Truth About a Process that has been Approved by Congress*, 5-1 DISP. RES. MAG. 5, 6 (1998) (While "there are those who oppose arbitration on mistaken but principled grounds * * * there can be no question that among those who criticize arbitration are advocates who benefit from the unnecessary costs of the civil trial system [and its occasional allowance for] legalized blackmail.").

consumers, employees and shareholders. These costs will be avoided by enhancing the FAA's broad support for arbitration. For businesses to operate efficiently in today's national (and increasingly international) economy there need to be uniform rules in matters involving interstate commerce. As the U.S. Chamber of Commerce pointed out in the *amicus curiae* brief it submitted in the *Geier* case, "[t]he general economic interests of the Nation are increasingly being sacrificed on the altar of the parochial interests of particular states, as declared by local state judges and lay juries."[10] Undermining the preemptive effect of the FAA would continue that negative trend. Finally, all federally preemptive laws have a similar effect on state law, and Congress clearly has, and exercises, the authority to preempt state law under the Constitution's Commerce Clause.

Arbitration has distinct advantages, making it in many cases a highly desirable process.[11] Two parties should be allowed to decide for themselves whether voluntarily to submit their disputes to binding arbitration.[12] By undermining over seventy-five years of consistent congressional, administrative, and judicial support for voluntary arbitration, Congress would subvert settled expectations about the availability of arbitration for disputes. Rescinding the availability of arbitration would not merely lead to questions about the future enforceability of any arbitration provision; more fundamentally, it would lead to real questions about whether parties will be able to presume that *any* of their contracts will, in the future, be enforceable. Congress should insist on an extremely high showing of need before venturing down such a

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[10] Brief *amicus curiae* for the U.S. Chamber of Commerce at 20, *Geier* v. *American Honda Motor Co.*, 529 U.S. 861 (2000).

[11] The speed and affordability of arbitration are perhaps its most discussed benefits, but there are others as well. For example, the control parties have over the process of arbitration, the ability to have an "expert" decisionmaker rather than a generalist judge, and the ability of an arbitrator to craft remedies specific to a dispute are all distinct advantages of arbitration over litigation. See section 2, *infra*.

[12] The FAA's "central purpose" is "to ensure that private agreements to arbitrate are enforced according to their terms."

problematic path.

Opponents to consumer arbitration agreements focus on the fact that many arbitration provisions are contained in contracts drafted by one party, and presented to the other to accept or reject as a whole. Classic principles of contract law allow a party to repudiate a contract–whether it be a contract of adhesion or otherwise–for fraud, unconscionability or various other factors, and the FAA specifically recognizes this right.[13] But unless a contract including an arbitration provision is unconscionable, that arbitration provision should be enforced, just as other provisions of the contract are enforced. One party should not be free to parse out those elements of the contract that, in retrospect, appear to favor the other. As one commentator reminded us very recently, "Courts enforce adhesive contracts. Such contracts are not contrary to public policy."[14]

Given the realities of modern business in this litigious environment, detailed contracts are an unfortunate necessity. Only in instances of compelling need, however, do courts–or should a legislature–set aside or dictate contractual provisions. A party who disfavors arbitration can determine for itself how upsetting the other party's insistence on arbitration is, and weigh that factor in deciding whether to enter the contract that includes the arbitration provision. A statutory provision which revokes the ability of that other party to insist on arbitration *ex post,* however, would substitute the judgment of the legislature for the decisions of the parties.

IV. Empirical Studies Confirm the Public's Support of Arbitration

Empirical studies confirm that consumers gain from arbitration and prefer it to

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Mastrobuono v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (quotation omitted).

[13] Townsend, *State Court Enforcement of Arbitration* Agreements, October 2006. (copy attached).

[14] Orenstein, *Mandatory Arbitration: Alive and Well or Withering on the Vine?* 54-Aug DISPUTE RESOL. J. 57, 59 (1999). It is a commonplace that no contract is *ever* entered into by two people with exactly equal bargaining power.

litigation.[15] For example, in April 2005, Harris Interactive released the results of an extensive survey of arbitration participants sponsored by the U.S. Chamber Institute for Legal Reform.[16] The survey was conducted online among 609 adults who had participated in a binding arbitration case that culminated in a decision. The major findings were that: (1) arbitration was widely seen as faster (74%), simpler (63%) and cheaper (51%) than going to court; (2) two-thirds (66%) of the participants said they would be likely to use arbitration again, with nearly half (48%) saying they were extremely likely to do so; (3) even among those who lost, one-third said they were at least somewhat likely to do so; (4) most participants were very satisfied with the arbitrator's performance, the confidentiality of the process and its length; and (5) predictably, winners found the process and outcome very fair and losers found the outcome much less fair; however, 40% of those who lost were moderately to highly satisfied with the fairness of the process and 21% were moderately to highly satisfied with the outcome.

Similarly, in December 2004, Ernst & Young issued a study, titled "Outcomes of

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[15] Research examining arbitration in the securities industry provides a number of excellent examples. In 1999, West Point conducted an independent analysis of surveys submitted by NASD's arbitration forum's constituents finding that 93.49% of participants felt their cases were handled fairly and without bias. *See* G. Tidwell, K. Foster, and M. Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations* (Aug. 5, 1999), available at: http://www.nasd.com/web/group/med_arb/documents/mediation_arbitration/nasdw_009528.pdf. In the year 2000, the U.S. General Accounting Office recognized that one should not draw conclusions about the fairness of the arbitration process based on case outcome statistics, noting that a declining investor win rate "could indicate little or no change in the fairness of the arbitration processes." *See Actions Needed to Address Problem of Unpaid Awards*, at 4-5 (GAO/GGD-00-115, June 2000), available at: http://www.gao.gov/archive/2000/gg00115.pdf. Professor Michael A. Perino in 2002, conducted a study commissioned by the SEC on the adequacy of arbitrator conflict disclosure requirements at NASD and NYSE finding that available empirical evidence suggested that these arbitrations were fair and that investors perceived them to be fair. See M. Permino, *Report to the SEC Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* (Nov. 4, 2002), available at: http://www.sec.gov/pdf/arbconflict.pdf. In 2005, the editors of the Securities Arbitration Commenter conducted an exhaustive statistical analysis of arbitration awards, testing for potential bias in investor win rates and whether there existed a pro-industry bias. The study found that there was not even any minimal support for a claim of industry bias. Available at: http://www.sec.gov/rules/sro/nasd/nasd2005094/rpryder091905.pdf. Finally, Securities Industry and Financial Markets Association CEO, Marc Lackritze, fully addressed concerns regarding the fairness of arbitration in securities arbitration disputes in testimony before a Congressional committee. Available at: http://www.sifma.org/legislative/testimony/archives/Lackritz3-17-05.html.

Arbitration: An Empirical Study of Consumer Lending Cases," which examined the outcomes of contractual arbitration in lending-related consumer-initiated cases.[17] The study, based on consumer arbitration data from January 2000 to January 2004 from the National Arbitration Forum, observed that: (1) consumers prevailed more often than businesses in cases that went to an arbitration hearing, with 55% of the cases that faced an arbitration decision being resolved in favor of the consumer;[18] (2) consumers obtained favorable results, i.e. results from arbitration decisions, as well as settlements satisfactory to the consumer and cases that were dismissed at the claimants request, in 79% of the cases that were reviewed; and (3) 69% of consumers surveyed indicated that they were very satisfied with the arbitration process.

V. Preventing Consumers and Businesses from using Arbitration Agreements Hurts All Involved

If industries are forced to litigate every dispute that arises out of routine business contracts, almost all parties will suffer. Businesses will spend more of their resources preventing and defending against litigation as opposed to developing and improving products and services; consumers will spend more in transaction costs for routine business matters; and, on the whole, society will bear the cost of managing a burgeoning civil justice system. From a broader standpoint, the availability of arbitration has fairly provided some much needed relief from the congestion of cases currently clogging the civil justice system. If provisions requiring arbitration in consumer contracts are eliminated we believe it could result in thousands of cases that would have otherwise been fairly and easily resolved through arbitration cascading into the

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[16] *See* http://www.instituteforlegalreform.org/issues/docload.cfm?docId=489 (last visited June 8, 2007) (copy attached).
[17] *See* http://adrinstitute.com/edi/Feb_05/022105EYPressReleaseADR.htm (last visited June 8, 2007) (copy attached).
[18] This is the exact win-rate for consumers as exists in state court. *See* Contract Trials and Verdicts in Large Counties, 1996, pg. 5 (April 2000), Bureau of Justice Statistics, http://www.ojb.usdoj.gov/bjs/pub/pdf/ctvlc96.pdf.

federal and state courts.

The assumption that consumers are disadvantaged by arbitration is wholly insupportable under the FAA. As discussed in detail above, arbitration does not deprive parties of any substantive rights. Moreover, it greatly benefits consumers. Empirical studies have confirmed that consumers fare well in and like arbitration. For these reasons, we oppose efforts to eliminate the use of arbitration agreements.