RECENT DEVELOPMENTS IN THE FORCED ARBITRATION MARKET AND THE CONTINUED NEED FOR PROTECTIVE LEGISLATION

Subcommittee on Commercial and Administrative Law

House Committee on the Judiciary

September 15, 2009

Testimony provided by:

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Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee, thank you for inviting me to testify today regarding the Arbitration Fairness Act and recent developments in the arbitration industry.

I am the Director of Litigation at the National Consumer Law Center.[1] For the past 10 years I have been responsible for coordinating and litigating cases at NCLC on behalf of income and/or age qualified individuals, primarily in the areas of consumer financing and affordable housing, in state and federal courts throughout the United States . Prior to my work at the National Consumer Law Center, I served as the Chief of the Trial Division and the Business and Labor Protection Bureau of the Massachusetts Attorney General's Office and worked in private practice. I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing across the country in order to promote economic justice for all consumers.

Over the last ten to fifteen years, there has been a quiet revolution in the way many corporations do business. Practically every credit card agreement, cell phone contract, mortgage and even many non-union employment contracts now contain a pre-dispute mandatory arbitration clause. Buried in the fine print of these agreements, phrased in legalese, is a clause which says that by agreeing to the contract, the consumer or employee has agreed that any

[1] The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Consumer Arbitration Agreements* (5th Ed. 2007), *Fair Debt Collection* (6th Ed. 2008) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal with predatory lending, unfair debt collection practices and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics.
This testimony was written by Stuart T. Rossman, Director of Litigation and Arielle Cohen, Staff Attorney, NCLC.

dispute which arises will *not* be adjudicated in the court system, with its accountability to the public, but by an arbitration company. Hundreds of millions of contracts now contain these clauses. Hundreds of thousands of consumers forced into arbitration every year discover that they have inadvertently signed away their legal rights.

Arbitration companies are selected by the corporation, are often located far from the consumer's home and – as I will discuss – have strong financial incentives to rule in favor of the corporation regardless of the merits of the dispute. **These incentives are inherent to pre-dispute "forced" arbitration.** Recent voluntary agreements by arbitrators and credit providers to refrain from using arbitration are helpful to consumers, but do not and cannot remedy the inequities that are intrinsic to pre-dispute mandatory arbitration. Prompt legislative action is needed to make pre-dispute binding mandatory arbitration clauses unenforceable in civil rights, employment, consumer, and franchise disputes.

The essential problem with forced arbitration is that it creates a system strongly biased in favor of the corporation and against the individual. This is true for a number of reasons:

- There are a number of private arbitration companies who compete to be selected by corporations in their standard form contracts with consumers and employees. Arbitration companies perceived as less favorable to corporations will not receive any business. This sets up conditions for a 'race to the bottom' among arbitration companies to be the most corporation-friendly. The marketing materials of arbitration companies – touting the advantages to businesses of using arbitration – bear this out.
- At the level of individual arbitrators, corporations can "blackball" arbitrators who rule against them. This is possible because the corporations are repeat players, with access to the previous decisions of particular arbitrators. The public, and the individual consumers

involved in arbitration, do not have access to that history. Therefore, the roster of arbitrators becomes heavily tilted in favor of corporate interests.

- The procedures of arbitration tend to favor the corporations as well. Consumers who are unaware that they agreed to arbitration may fail to respond to notices, resulting in default judgments. The high fees and 'loser pays' rules typical of arbitrations also discourage consumers from participating. Even if they do respond, they are at a disadvantage to the repeat players, who understand the process, know what information to submit and how to do so, and have often selected an arbitration company geographically distant from the consumer.

You have heard and will hear from others more regarding the fundamental problems with forced arbitration. Instead of repeating their testimony, I'd like to spend some time going over current events. In recent months, there have been a number of developments in the arbitration industry, with several arbitration companies getting out of the consumer debt arbitration business and at least one corporation voluntarily agreeing to refrain from enforcing forced arbitration clauses. These developments, which I will summarize, certainly are helpful to consumers, but they do not completely or permanently solve the problems I outlined above, and therefore do not obviate the need for legislation.

I. National Arbitration Forum

On July 14, 2009, Minnesota Attorney General Lori Swanson filed a lawsuit against the National Arbitration Forum. NAF is – or was – the largest arbitrator of consumer credit disputes in the country. According to NAF, it has been appointed as arbitrator in "hundreds of millions" of contracts. In 2006, it processed more than 200,000 consumer collection arbitration claims.

The Attorney General's investigation of NAF revealed a series of agreements and transactions conducted in 2006 and 2007 whereby NAF, a New York based hedge fund group and one of the country's largest debt collection agencies became financially and managerially intertwined. The lofty goal of this alliance was nothing less that the expansion of arbitration (specifically provided by NAF) into "a comprehensive, alternative legal system."

The debt collection agency (a large law firm) was to play "an active role in landing new customers/partners" for NAF – essentially steering customers to NAF over other legal or arbitration-based collection options. It appears that they were quite successful in that regard; in 2006, 60% of the consumer collection claims filed with NAF originated with that particular debt collection law firm.

The Attorney General's lawsuit was based on allegations of consumer fraud, deceptive trade practices and false statements in advertising. The AG alleged that the National Arbitration Forum represented to consumers and the public that it was independent and neutral, operated like an impartial court system, and was not affiliated with and did not take sides between the parties, when in fact, it was closely associated with owners of debt and advertised itself to corporations as a particularly favorable forum for collection actions.

On July 17, 2009, NAF agreed to a consent decree.[2] Without admitting any wrongdoing or liability, NAF agreed to "the complete divestiture by the NAF Entities of any business related to the arbitration of consumer disputes." Consumer arbitration was defined to include "any arbitration involving a dispute between a business entity and an individual which relates to goods, services, or property of any kind… or payment for such goods, services, or property" and "includes any claim by a third party debt buyer against a private individual."

[2] A copy of the Minnesota Office of the Attorney General's July 19, 2009, press release announcing the agreement with the National Arbitration Forum, with the Consent Decree and the amendatory letter to the American Arbitration Association referenced in the release attached, are provided herewith as Exhibit 1.

Some have argued that the litigation shows that NAF was a 'bad apple' and that its departure from the consumer arbitration business will eliminate any unfairness or abuses. This view is mistaken. First, the specific actions which formed the basis for the complaint against NAF are only tangentially related to the basic inequities of the forced arbitration system. As I explained above, all arbitration companies make their money by convincing corporations to select them as a forum for debt collection and other disputes. NAF took this a step further, by actually becoming financially and organizationally entangled with a debt collection agency, but the incentive to look after the interests of corporations exists for all arbitration companies. Second, because the provision of arbitration services is a lucrative business, other companies will step into the void created by NAF's departure. This may not happen immediately, given the current political and public attention focused on consumer arbitration, but without legislation preventing the use of forced arbitration clauses, it will happen as soon as that attention moves elsewhere. Finally, while the terms of the settlement agreement apply broadly to consumer disputes, employment disputes are not included. Forced arbitration of employment disputes is particularly problematic, because it amounts to a waiver by the employee of civil rights and anti-discrimination laws.[3]

II. American Arbitration Association

On July 23, 2009, the American Arbitration Association issued a press release announcing its decision not to accept new arbitration filings under pre-dispute arbitration agreements in cases involving credit card bills, telecom bills or consumer finance matters and

[3] For additional discussion of the limitations of the NAF consent decree, see the July 22, 2009 Testimony of F. Paul Bland, Jr. before the Subcommittee on Domestic Policy of the U.S. House of Representatives' Committee on Oversight and Government Reform, attached as hereto as Exhibit 2.

calling for "Reform of Debt Collection Arbitration."[4] AAA identified these categories of arbitration as needing additional protections due to a high rate of non-participation by consumers. Although it came on the heels of the NAF settlement agreement, AAA denied that the decision to stop accepting new arbitration filings was made at the behest of any outside entity.[5]

As in the case of the NAF settlement, the AAA decision is a positive development for consumers, but not a solution to the problem. The decision does not cover the full spectrum of consumer arbitrations. It provides no insights into what reforms AAA might agree to make and what additional protections conceivably could be provided to consumers. Like the NAF settlement, forced arbitration in employment disputes is not addressed. Finally, since AAA's decision was made voluntarily for business reasons, they may alter it at any time and begin arbitrating cases again.

III. Bank of America

On August 13th, 2009, Bank of America issued a fact sheet announcing that it would not enforce pre-dispute arbitration clauses in certain categories of consumer contracts – specifically, credit card, auto, marine and recreational vehicle loans and deposit accounts.[6] According to company spokespeople, the decision came as a result of customer perceptions that arbitration was unfair. Bank of America's intention is "to resolve more disputes directly with our customers."

[4] See July 23, 2009 American Arbitration Association News Release attached hereto as Exhibit 3.
[5] See July 20, 2009 Letter from American Arbitration Association to Minnesota Attorney General attached hereto as Exhibit 4.
[6] See August 13, 2009 Fact Sheet about Bank of America's Arbitration Position attached hereto as Exhibit 5.

Once again, while this is a positive development, it is not a permanent or widespread solution. Other financial companies have not leapt to follow Bank of America's lead, and Bank of America may reverse its decision at any time.

IV. Conclusion

I want to return to the quotation from the negotiations between NAF and the debt collection agency regarding their goal of turning arbitration into "a comprehensive, alternative legal system." Companies have an obvious interest in circumventing the judicial system in favor of a system they control. Companies must not be allowed to force consumers and employees to give up their substantive and procedural rights in advance and submit to decision-making by profit-motivated third parties selected by the companies. Such a system will always be biased against individual consumers and workers, and is contrary to basic principles of due process and fairness. NCLC strongly supports the passage of enforceable arbitration related consumer protection legislation designed to effectively, fairly and consistently level the playing field between consumers and corporations in the future.

STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

LORI SWANSON
ATTORNEY GENERAL

102 STATE CAPITOL
ST. PAUL, MN 55155
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For Immediate Release
July 19, 2009

Contact: Ben Wogsland at: (651) 296-2069
(612) 818-0965 (pager)

NATIONAL ARBITRATION FORUM BARRED FROM CREDIT CARD AND CONSUMER ARBITRATIONS UNDER AGREEMENT WITH ATTORNEY GENERAL SWANSON

Swanson Also Wants Congress to Ban "Fine Print" Forced Arbitration Clauses

Minnesota Attorney General Lori Swanson and the National Arbitration Forum—the country's largest administrator of credit card and consumer collections arbitrations—have reached an agreement that the company would get out of the business of arbitrating credit card and other consumer collection disputes.

"I am very pleased with the settlement. To consumers, the company said it was impartial, but behind the scenes, it worked alongside credit card companies to get them to put unfair arbitration clauses in the fine print of their contracts and to appoint the Forum as the arbitrator. Now the company is out of this business," said Swanson.

Swanson sued the National Arbitration Forum on Tuesday, alleging that the company--which is named as the arbitrator of consumer disputes in tens of millions of credit card agreements--hid from the public its extensive ties to the collection industry. The lawsuit alleged that the Forum told consumers and the public that it is independent and neutral, operates like an impartial court system, and is not affiliated with and does not take sides between the parties. The lawsuit alleged that the Forum worked behind the scenes, however, to convince credit card companies and other creditors to insert arbitration provisions in their customer agreements and then appoint the Forum to decide the disputes. The suit also alleged that the Forum has financial ties to the collection industry. The suit alleged that the company arbitrated 214,000 consumer arbitration claims in 2006, nearly 60 percent of which were filed by laws firms with which the Forum is linked through ties to a New York hedge fund.

Under the settlement, the National Arbitration Forum will, by the end of the week, stop accepting any new consumer arbitrations or in any manner participate in the processing or administering of new consumer arbitrations. The company will permanently stop administering arbitrations involving consumer debt, including credit cards, consumer loans, telecommunications, utilities, health care, and consumer leases.

Credit card companies, banks, retail lenders, and cell phone companies increasingly place—in the fine print of their consumer agreements—what are known as "mandatory predispute arbitration clauses." Through these clauses, the consumers waive, in advance, their

right to have their day in court if a dispute arises. Instead, the consumer agrees—usually without knowing it—that any dispute will be resolved by an arbitrator selected by the credit card company or other creditor. Credit card companies are among the most prolific users of mandatory arbitration clauses. Just by keeping a credit card, the consumer agrees to the terms and conditions of the card, even if the arbitration provision was sent to the consumer after the card was issued. As a result of mandatory arbitration clauses, which appear in tens of millions of consumer agreements, hundreds of thousands of consumer disputes are resolved each year not by a judge or jury, but by a private arbitration system.

Swanson said that late this week she accepted an invitation from Congressman Dennis Kucinich, Chairman of the Congressional Committee on Oversight and Government Reform, to testify before the Committee this coming Wednesday in Washington, D.C. She said she will ask Congress to prohibit the use of mandatory pre-dispute arbitration clauses in consumer contracts.

"The playing field is tilted against the ordinary consumer when credit card companies bury unfair terms like forced arbitration clauses in fine print contacts. Congress should change that," said Swanson.

Swanson also announced that she sent a letter to the American Arbitration Association asking it to play a leadership role by ceasing to accept arbitration filings on consumer credit and collection matters arising out of mandatory pre-dispute arbitration clauses.

Swanson noted that the City of San Francisco is in litigation with the Forum and that other state Attorneys General have contacted her about these issues since the announcement of the lawsuit. "I am very pleased with the results of our lawsuit. It is good for consumers that this company will no longer be able to administer credit card and consumer debt collection arbitrations. I hope other jurisdictions will use whatever authority they have to look at other possible remedial relief in this area," said Swanson.

The settlement allows the Company to continue to arbitrate internet domain name disputes (which the company handles under an appointment from the Internet Corporation for Assigned Names and Numbers (ICANN)), personal injury protection claims (which the company performs under appointment and supervision under the New Jersey state government), and cargo disputes (which the company performs under rules established by the U.S. Department of Transportation). These areas were not part of the lawsuit, and the company performs the work under the supervision of government or non-government organizations (NGOs). Accordingly, the settlement does not affect this very limited activity.

The Consent Decree and amendatory letter are attached.

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STATE OF MINNESOTA

COUNTY OF HENNEPIN

DISTRICT COURT

FOURTH JUDICIAL DISTRICT

Case Type: Other Civil
(Consumer Protection)

State of Minnesota by its Attorney General,
Lori Swanson,

Plaintiff,

vs.

National Arbitration Forum, Inc.,
National Arbitration Forum, LLC, and
Dispute Management Services, LLC, d/b/a
Forthright,

Defendants.

Court File No. 27-CV-09-18550
Judge John L. Holahan

CONSENT JUDGMENT

WHEREAS, Plaintiff State of Minnesota, by and through its Attorney General, Lori Swanson ("State"), filed a Complaint in this matter on July 14, 2009 ("Complaint") against National Arbitration Forum, Inc., National Arbitration Forum, LLC, and Dispute Management Services, LLC, d/b/a Forthright (hereinafter, collectively, the "NAF Entities") (the State, and the NAF entities are hereinafter collectively referred to as the "Parties");

WHEREAS, this Consent Judgment shall not be construed as an admission of wrongdoing or liability by the NAF Entities;

NOW, THEREFORE, in the interest of resolving this action, the State and the NAF Entities hereby stipulate and consent to entry of this Consent Judgment, as set forth below:

1. The purpose of this Consent Judgment is to require the complete divestiture by the NAF Entities of any business related to the arbitration of consumer disputes.

2. The term "Consumer Arbitration" means any arbitration involving a dispute between a business entity and a private individual which relates to goods, services, or property of any kind allegedly provided by any business entity to the individual, or payment for such goods, services, or property. The term includes any claim by a third party debt buyer against a private individual. It does not include, however, the arbitration of internet domain name disputes on behalf of the Internet Corporation for Assigned Names and Numbers (ICANN), the processing of personal injury protection (PIP) disputes, the processing of shipping or storage disputes under 49 CFR § 375.211, or arbitrations where a NAF Entity is appointed and supervised by a government entity.

3. On or after July 24, 2009, no NAF Entity shall:

a. Accept any fee for processing any new Consumer Arbitration.

b. Administer or process any new Consumer Arbitration.

c. In any manner participate in any new Consumer Arbitration.

d. Attempt to influence the outcome of any arbitration proceeding currently pending before it.

4. The NAF Entities shall not engage in any deceptive practices, or make any false or misleading statements, in violation of Minn. Stat. §§ 325F.69, subd. 1; 325D.44, subd. 1; and 325F.67.

5. The NAF Entities shall pay investigative costs to the State of Minnesota within ten days of the date this Consent Judgment is signed. Notwithstanding this payment, the NAF Entities shall also pay the State of Minnesota an amount equal to any amount paid to the City of San Francisco over the next six months, in excess of the City's actual investigative expenses and attorneys' fees.

6. The Parties have read this Consent Judgment and voluntarily agree to its entry.

7. In consideration of the stipulated relief, the sufficiency of which is acknowledged, the Office of the Attorney General, by execution of this Consent Judgment, hereby fully and completely releases the NAF Entities, including all of their past and present agents, employees, officers, directors, subsidiaries, shareholders, and affiliates, of any and all claims of the Attorney General connected with or arising out of the allegations in the State's Complaint in the above-captioned action, up to and including the date of this Consent Judgment.

8. Promptly after receiving notice that the Court executes this Consent Judgment, the State shall voluntarily dismiss the above-captioned action pursuant to Minnesota Rule of Civil Procedure 41.01(a).

9. The Parties shall cooperate to implement and facilitate this Consent Judgment, including the exchange of information reasonably necessary for that purpose or to confirm the NAF Entities' compliance with this Consent Judgment.

10. Any failure by any Party to this Consent Judgment to insist on performance by any other Party of any provision of this Consent Judgment shall not be deemed a waiver of any of the provisions included herein.

11. The Parties agree to bear their own costs and fees in this matter.

12. Each Party participated in the drafting of this Consent Judgment, and each agrees that the Consent Judgment's terms may not be construed against or in favor of any Party by virtue of draftsmanship. Each signatory further agrees they have authority to enter into this Consent Judgment.

13. This Consent Judgment, including any issues relating to interpretation or enforcement, shall be governed by the laws of Minnesota. The Court shall retain jurisdiction over this matter to enforce the terms of this Consent Judgment.

Dated: 7/17/09

National Arbitration Forum, Inc.

By: _____
Its _____

Dated: 7/17/09

National Arbitration Forum, LLC

By: _____
Its _____

Dated: 7/17/09

Dispute Management Services, LLC, d/b/a Forthright

By: _____
Its CEO

Dated: 7/17/09

LORI SWANSON
ATTORNEY GENERAL
STATE OF MINNESOTA

_____
Lori Swanson

IT IS SO ORDERED.

Dated: _____

BY THE COURT:

_____
John L. Holahan
Hennepin County District Court Judge

LET JUDGMENT BE ENTERED ACCORDINGLY.

OFFICE OF THE ATTORNEY GENERAL
State of Minnesota
ST. PAUL, MN 55155

LORI SWANSON
ATTORNEY GENERAL

July 19, 2009

President
American Arbitration Association
Corporate Headquarters
1633 Broadway
10th Floor
New York, New York 10019

Dear President:

This office recently concluded a year long investigation of National Arbitration Forum ("NAF"). The investigation concluded with an agreement by NAF that it would no longer arbitrate consumer debt disputes. I enclose a copy of the Consent Order and the amendatory letter. While the lawsuit focused on conflict of interest issues, our investigators and attorneys also interviewed over one hundred consumers who complained about the arbitration process. Based on our investigation, it is my conclusion that pre-dispute mandatory arbitration provisions are fundamentally unfair to the consumer. This is particularly the case with credit card contracts and other consumer contracts—such as cell phone, utility, loan, and hospital agreements—where the mandatory arbitration provisions are hidden in the fine print. Our findings include the following:

First, pre-dispute mandatory arbitration agreements are nearly always the product of unequal bargaining power between the consumer and the business. In almost every interview we found that the consumer was not aware of the arbitration provision. In many cases the consumer never saw the provision, because it was simply mailed with a monthly statement. The consumer is given virtually no opportunity to reject the provision. Yet, through these provisions, the consumer gives up their important right to have his or her day in court.

Second, because the consumer is unaware of the mandatory arbitration provision, in many cases the consumer ignored the notice of arbitration served on them. Since they did not know that they agreed to arbitration, and were unfamiliar with the arbitration process, they didn't believe they were obligated to respond to an arbitration notice from an office in Minnesota. It is part of our democracy that we have a right to redress in a court of law, and that includes the notion that the court should be easily accessible to the consumer. Through pre-dispute mandatory arbitration clauses, consumers forfeit this important right without even knowing it.

Third, it is apparent, based on many interviews with consumers, arbitrators and employees of NAF, that arbitrators have a powerful incentive to favor the dominant party in an arbitration; namely, the corporation. Indeed, there is a term commonly used in the arbitration industry called "repeat player bias," describing a phenomena describing where an arbitrator is more likely to favor the party that is likely to send future cases. This bias does not exist in a court, where the judge is not reliant on a dominant player for his or her future income. In the case of NAF, arbitrators and employees claimed that arbitrators who issued an award against the corporation, or who failed to award attorney's fees against the consumer, were simply "deselected" and not appointed to future proceedings.

Fourth, consumers are not aware they can submit exhibits, and many are not aware that there will only be a "document hearing" with no opportunity to be heard. For instance, victims of identity theft were not told to submit a copy of a police report, even though arbitrators were advised that, absent such documentation, the claim of identity theft should be ignored.

Fifth, the arbitration process is fundamentally unfair for holding corporations responsible for any wrongdoing. In some cases, consumers forfeited important rights in the fine print of contracts they had never seen. Consumers who we interviewed in the NAF investigation were told that, when they initiated a claim against the corporation, the claim could be delayed for up to one year before there was any review of the matter.

There are many other defects in the process. The fundamental problem with consumer arbitrations under "fine print" contracts is that the arbitration company draws its income from the dominant participant--namely the credit card company, telecommunications company, the hospital, etc.--and personnel have a financial incentive to make sure that the corporation is pleased with the outcome. Otherwise, the corporation will undoubtedly look to other arbitration administrators. As noted above, this "repeat player" bias does not occur in court, since judges rely on taxpayers—not litigants—for their income.

In short, for the above reasons and many others, I ask that your organization take the initiative to announce that it will not accept the arbitration of credit card and other consumer debt claims based on pre-dispute mandatory arbitration clauses. Because the AAA and NAF are the largest arbitration companies, I believe such a proclamation by AAA would be a powerful signal to Congress that reform is desperately needed in this area.

Sincerely,

LORI SWANSON
Attorney General

Enclosure

TESTIMONY TO THE SUBCOMMITTEE ON DOMESTIC POLICY OF THE U.S. HOUSE OF REPRESENTATIVES' COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

ARBITRATION OR "ARBITRARY": THE MISUSE OF ARBITRATION TO COLLECT CONSUMER DEBTS

July 22, 2009

By F. Paul Bland, Jr.*
Staff Attorney
Public Justice

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* F. Paul Bland, Jr., is a Staff Attorney for Public Justice, where he handles precedent-setting complex civil litigation. He has argued or co-argued and won nearly twenty reported decisions from federal and state courts across the nation, including cases in the U.S. Courts of Appeal for the Third, Fourth, Fifth, Eighth and Ninth Circuits, and in the high courts of California, Florida (two cases), Maryland (five cases), New Mexico (two cases), Washington (two cases), and West Virginia. He is a co-author of a book entitled *Consumer Arbitration Agreements: Enforceability and Other Issues*, and numerous articles. For three years, he was a co-chair of the National Association of Consumer Advocates. He was named Maryland Trial Lawyer of the Year in 2009, and in 2006 he was named the "Vern Countryman" Award winner in 2006 by the National Consumer Law Center, which "honors the accomplishments of an exceptional consumer attorney who, through the practice of consumer law, has contributed significantly to the well being of vulnerable consumers." He also has won the San Francisco Trial Lawyer of the Year in 2002 and Maryland Trial Lawyer of the Year in both 2001 and 2009. Prior to coming to Public Justice, he was in private practice in Baltimore. In the late 1980s, he was Chief Nominations Counsel to the U.S. Senate Judiciary Committee. He graduated from Harvard Law School in 1986, and Georgetown University in 1983.

INTRODUCTION AND SUMMARY

For more than ten years, I and other attorneys at Public Justice have spoken to hundreds if not thousands of consumers and consumer attorneys about their experiences arbitrating consumer debts before the National Arbitration Forum (NAF). Consumers and attorneys approaching us for help, or reporting to us on their experiences, have repeatedly reported widespread abuses throughout the NAF system that raise serious doubts about the trustworthiness of the private dispute resolution system that has been increasingly replacing the constitutional civil justice system.

Pursuant to consent decree with the Attorney General of Minnesota, NAF has just announced that it is withdrawing from the business of consumer debt collection. While NAF has publicly stated that it was innocent of any wrongdoing and is just a victim of overzealous pursuit by the Minnesota Attorney General and consumer lawyers, the hard facts establish that NAF pursued the business of debt collection arbitrations by cultivating relationships with and the favor of creditors, fundamentally to the detriment of consumers.

The troubling practices in which the NAF engaged may well reappear before too long (perhaps with some of the same persons operating under some different institutional name). So long as there is money to be made in debt collection arbitrations, arbitration providers will try to make it, even if their efforts mean that consumers are deprived of fair hearings.

This testimony will address the following issues:

1. The collection industry's use of mandatory binding arbitration before the National Arbitration Forum to collect consumer debts; and
2. Concerns about systemic irregularities and abuses that are prevalent in the National Arbitration Forum's debt collection arbitrations.

BACKGROUND ON PUBLIC JUSTICE

Public Justice (formerly Trial Lawyers for Public Justice) is a national public interest law firm dedicated to using trial lawyers' skills and resources to advance the public good. We specialize in precedent-setting and socially significant litigation, carrying a wide-ranging docket of cases designed to advance the rights of consumers and injury victims, environmental protection and safety, civil rights and civil liberties, occupational health and employee rights, protection of the poor and the powerless, and overall preservation and improvement of the civil justice system.

Public Justice was founded in 1982 and is currently supported by more than 3,000 members around the country. More information on Public Justice and its activities is available on our web site at http://www.publicjustice.net. Public Justice does not lobby and generally takes no position in favor of or against specific proposed legislation. We do, however, respond to informational requests from legislators and persons interested in legislation, and have occasionally been invited to testify before legislative and administrative bodies on issues within our expertise. In keeping with that practice, we are grateful for the opportunity to share our experience with respect to the important issues this Committee is considering today. In this connection, we have extensive

experience with respect to abuses of mandatory arbitration, having litigated (often successfully) a large number of challenges to abuses of mandatory arbitration in state and federal courts around the nation.

I. COMPANIES COLLECTING CONSUMER DEBTS HAVE A SYMBIOTIC RELATIONSHIP WITH THE NATIONAL ARBITRATION FORUM

When debt buyers and credit card companies have been unable to collect on a debt, they commonly turn to binding mandatory arbitration before NAF to effect collection of the debt. The relationship between NAF and creditors begins with the credit card contract: credit card companies draft the contract, which includes a clause requiring consumers to arbitrate their disputes—usually before a specific arbitration provider—rather than sue in court. Most credit-card issuers include these mandatory arbitration clauses in their contracts.[1]

NAF, far more so than the two other major players in the arbitration industry, the American Arbitration Association (AAA) and JAMS, has financial interests strongly aligned with credit card companies and debt collectors. Indeed, a recent lawsuit brought by the Minnesota Attorney General against NAF charges that these financial ties run deep: it alleges that NAF "is financially affiliated with a New York hedge fund group that owns one of the country's major debt collection enterprises" and that NAF conceals this relationship from consumers.[2] Even before this lawsuit brought the shared ownership between NAF and debt collectors into the light, however, the impropriety of NAF's financial relationship with debt collectors was perfectly clear. In 2008, CNN's personal finance editor called NAF "the folks who are the worst actors in this industry,"[3]

and the Wall Street Journal observed that, more than other arbitration providers, NAF works with a handful of large companies, and a "significant percentage of its work includes disputes involving consumers, rather than disputes between businesses."[4] In contrast, AAA and JAMS arbitrate more employment disputes and contractual disputes between companies.[5]

As a result of NAF's focus on consumer debt, NAF receives substantial fees from its creditor and debt collector clients. For example, First USA Bank disclosed in court filings that it had paid NAF at least $5 million in fees between 1998 and 2000. During that same period, First USA won 99.6% of its 50,000 collection cases before NAF.[6] While advocates for banks invoke the possibility that the bank could have been equally successful in court, "[m]aybe, however, the millions of dollars it paid the NAF in fees tend to produce overwhelmingly favorable results."[7] In sharp contrast, it would be shocking for a public court to be so financially dependent on a litigant appearing before it.

Among America's major arbitration providers, NAF also has the dubious distinction of most aggressively marketing itself to credit card companies and debt collectors.[8] While NAF trumpets itself to the public as fair and neutral, "[b]ehind closed doors, NAF sells itself to lenders as an effective tool for collecting debts."[9] In its solicitations and advertising, NAF "has overtly suggested to lenders that NAF arbitration will provide them with a favorable result."[10] BusinessWeek revealed one of the most shocking examples of NAF marketing to debt collectors when it described a September, 2007, PowerPoint presentation aimed at creditors—and labeled "confidential"—that

promises "marked increase in recovery rates over existing collection methods."[11] The presentation also "boasts that creditors may request procedural maneuvers that can tilt arbitration in their favor. 'Stays and dismissals of action requests available without fee when requested by Claimant—allows claimant to control process and timeline.'" Speaking on condition of anonymity, an NAF arbitrator told BusinessWeek that these tactics allow creditors to file actions even if they are not prepared, in that "[i]f there is no response [from the debtor], you're golden. If you get a problematic [debtor], then you can request a stay or dismissal."[12] BusinessWeek also highlighted another disturbing NAF marketing tactic: NAF "tries to drum up business with the aid of law firms that represent creditors." Neither AAA nor JAMS cooperate with debt-collection law firms in such a manner.[13]

NAF has an arsenal of other ways of letting potential clients know that NAF can immunize them against liability. In one oft-cited example, an NAF advertisement depicts NAF as "the alternative to the million-dollar lawsuit."[14] Additionally, NAF sends marketing letters to potential clients in which it "tout[s] arbitration as a way of eliminating class action lawsuits, where thousands of small claims may be combined . . . . [Class actions] offer a means of punishing companies that profit by bilking large numbers of consumers out of comparatively small sums of money."[15] NAF's marketing letters also urge potential clients to contact NAF to see "how arbitration will make a positive impact on the bottom line" and tell corporate lawyers that "[t]here is no reason for your clients to be exposed to the costs and risks of the jury system."[16] Finally, in an interview with a magazine for in-house corporate lawyers, NAF's managing director Anderson

once boasted that NAF had a "loser pays" rule requiring non-prevailing consumers to pay the corporation's attorney's fees.[17]

NAF's practices in another dispute resolution arena—that of internet domain name disputes—further demonstrate NAF's willingness to suggest to potential clients that it will decide in their favor. In this area of its business, NAF issues press releases that laud its arbitrators' rulings in favor of claimants. These press releases, which feature headlines such as "Arbitrator Delivers Internet Order for Fingerhut" and "May the Registrant of magiceightball.com Keep the Domain . . . Not Likely," "do little to engender confidence in the neutrality of the NAF." The other two domain name dispute arbitration providers do not issue such press releases.[18]

II. NAF'S ARBITRATIONS ARE RIFE WITH SYSTEMIC IRREGULARITIES AND OVERSIGHTS THAT DENY THE VAST MAJORITY OF CONSUMERS A FAIR HEARING

In September 2007, Public Citizen issued a report analyzing data from NAF consumer arbitrations in California. This report found that, out of the more than 19,000 cases between January 1, 2003, and March 31, 2007, creditors won 94% of the time.[19] In response, some proponents of NAF arbitration have argued that the win rate for creditors is wholly reasonable because so many cases are defaults, where the consumer fails to respond to the notice of arbitration. One arbitrator, for example, said that "[b]ecause they're defaults, the power of the arbitrator is such that *you have no choice* as long as the parties have been informed."[20] In our experience and that of many other consumer lawyers and consumers with whom we've spoken, this NAF arbitrator's approach is

normal and typical of that of nearly all NAF arbitrators. The arbitrator's words are revealing: they suggest that an arbitrator is *compelled* to enter an award for the creditor in the full amount of whatever the creditor claims in the event of a default. In court, however, creditors do not automatically win in the event of a default. Instead, in a properly functioning legal system, a creditor winning a default still should be required to produce evidence that the consumer actually owed the debt, and the creditor still should be required to produce some evidence to verify the amount owed. Any other approach invites abuse – since the vast majority of consumers predictably default, if no proof is required, creditors will be rewarded for adding on imaginary or inflated claims. NAF arbitrators, in contrast to many courts, have demonstrably and notoriously unquestionably accepted creditors' assertions at face value in many tens of thousands of cases, without requiring any proof, breakdown or verification whatsoever, and awarding 100% of the sum demanded.

Another key distinction between collection cases before NAF and in court is the manner in which the decisionmaker is selected. This section will detail these differences between collection cases before NAF and in court, then it will describe the experiences of consumer attorneys representing clients in NAF arbitrations.

A. NAF's Procedures for the Selection and Retention of Arbitrators Are Kept Secret and Favor Creditors

Under NAF Rule 21(c), either party to the arbitration gets one chance to strike a potential arbitrator without cause: "the Forum shall submit one Arbitrator candidate to all

Parties making an Appearance. A Party making an Appearance may remove one Arbitrator candidate by filing a notice of removal within ten (10) days from the date of the notice of Arbitrator selection." Any subsequently appointed arbitrators can be disqualified for bias under NAF Rule 23.

This rule, however, omits a key aspect of NAF's arbitrator selection process: *how arbitrators are assigned to a case in the first place*. NAF keeps that crucial bit of information secret, and there is reason to believe that the selection is not random. On its website, NAF boasts that it has a total of more than 1,500 arbitrators in all 50 states, but that statistic has little significance if the vast majority of cases are steered to a small number of persons. (NAF has also been known to falsely state in court filings that certain lawyers, law professors, and former judges are NAF arbitrators when in fact they are not.[21]) Indeed, a large body of information establishes that NAF intentionally funnels the vast majority of cases to a very small group of selected arbitrators. The evidence further establishes that the major repeat players are more likely to decide cases in favor of creditors. In contrast, those arbitrators who rule for consumers are blackballed, meaning that they are no longer assigned to cases. In effect, this system gives credit card companies and debt buyers an additional strike, since arbitrators to whom they object would never be assigned to their cases in the first instance.

Data provided by the NAF pursuant to California Code of Civil Procedure § 1281.96, which requires arbitration providers to disclose certain information about their arbitrations, reveal that a tiny number of NAF arbitrators decide a disproportionate number of cases. The Center for Responsible Lending recently analyzed this data and

reached two startling conclusions: (a) companies that arbitrate more cases before certain arbitrators consistently get better results from those arbitrators, and (b) individual arbitrators who favor creditors over consumers get more cases in the future.[22] Similarly, the Christian Science Monitor analyzed one year of data and found that NAF's ten most frequently used arbitrators—who were assigned by NAF to decide nearly three out of every five cases—ruled for the consumer only 1.6% of the time. In contrast, arbitrators who decided three or fewer cases during that year found in favor of the consumer 38% of the time.[23] Likewise, Public Citizen's analysis found that one particular arbitrator, Joseph Nardulli, handled 1,332 arbitrations and ruled for the corporate claimant 97% of the time. On a single day—January 12, 2007—Nardulli signed 68 arbitration decisions, giving debt holders and debt buyers every cent of the nearly $1 million that they demanded. [24] If Nardulli worked a ten-hour day on January 12, 2007, he would have averaged one decision every 8.8 minutes. Busy arbitrators like Nardulli are well-compensated for workdays like this one—as one former NAF arbitrator noted, "I could sit on my back porch and do six or seven of these cases a week and make $150 a pop without raising a sweat, and that would be a very substantial supplement to my income . . . . I'd give the [credit-card companies] everything they wanted and more just to keep the business coming."[25]

Further evidence of NAF's propensity for steering arbitrations to those arbitrators who will rule in favor of its clients comes from outside of the consumer realm. In addition to handling consumer debt collection cases, NAF has also handled a large number of internet domain name disputes. A study of its handling of those cases

demonstrates the same patterns NAF has displayed in consumer cases: it curries favor with the party which selects the arbitrator, it determines which of the arbitrators on its panel will favor the party which selects them, and it funnels nearly all of its cases to those arbitrators. Law professor Michael Geist observed that, in domain name arbitrations, NAF's "case allocation appears to be heavily biased toward ensuring that a majority of cases are steered toward complainant-friendly panelists. Most troubling is data which suggests that, despite claims of impartial random case allocation as well as a large roster of 131 panelists, the majority of NAF single panel cases are actually assigned to little more than a handful of panelists."[26] Professor Geist went on to note that "an astonishing 53% of all NAF single panel cases . . . were decided by only six people," and the "complainant winning percentage in those cases was an astounding 94%." Importantly, neither of the other two domain name arbitration services had such a skewed caseload. Like aggressive advertising to potential clients, this method of attracting business is unique to NAF.

The second component of NAF's business-friendly system of arbitrator selection is its documented blackballing of arbitrators who dared to rule in favor of consumers. Harvard law professor Elizabeth Bartholet went public with her concerns that, after she awarded a consumer $48,000 in damages, NAF removed her from 11 other cases, all of which involved the same credit card company, on the credit card company's objection. As Bartholet described her experience to BusinessWeek, "NAF ran a process that systematically serviced the interests of credit card companies."[27] Bartholet told the Minneapolis Star-Tribune that "[t]here's something fundamentally wrong when one side

has all the information to knock off the person who has ever ruled against it, and the little guy on the other side doesn't have that information. . . .That's systemic bias."[28] Another deeply troubling element of Bartholet's experience comes from how NAF explained Bartholet's removal from her cases to the parties in those cases. NAF sent letters to the parties stating that "due to a scheduling conflict, the Arbitrator previously appointed is not available to arbitrate the above case." When Bartholet asked the NAF case administrator about the letters, the administrator "agreed that [Bartholet] was likely being removed simply because of [her] one ruling against the credit card company." NAF's legal counsel did not deny this explanation.[29]

Similarly, former West Virginia Supreme Court Justice Richard Neely stopped receiving NAF assignments after he published an article accusing the firm of favoring creditors. In that article, Justice Neely lamented that NAF "looks like a collection agency" that depends on "banks and other professional litigants" for its revenue; he described NAF as a "system set up to squeeze small sums of money out of desperately poor people."[30]

B. NAF Arbitrations Deny Consumers Some of the Protections They Would Be Granted in Court Proceedings

Other aspects of NAF's arbitration practices raise further doubts about the trustworthiness of the process and the ability of consumers to get a fair hearing in arbitration, as compared to the experiences they would have in court. Proponents of arbitration frequently cite to a law review article from 1990 in support of their argument

that consumers in credit-card collection cases fare equally poorly in court as in arbitration.[31] This article, however, predates the explosion of third-party debt buyers and their inability to provide proper evidence to substantiate their claims. Because of the way debt is now sold and resold, for pennies on the dollar, debt buyers frequently lack any meaningful substantiation of their claims and instead put forward "proof" that, because it fails to comport with the rules of evidence, is admissible in NAF arbitrations but would be insufficient in many courts. Before turning to the protections available in court that are absent in NAF proceedings, it is necessary to briefly discuss the rise of the third-party debt buyer industry.

Third-party debt collection, in which debt buyers pay pennies on the dollar for defaulted consumer debt, is a hugely profitable business. Despite the faltering economy, companies that collect and buy consumer debt are flourishing, and the industry's current revenues of around $17 billion are expected to increase by six percent each year over the next three years.[32] The industry has already undergone massive growth: in 2005, debt buyers purchased $66.4 billion worth in credit card debt, up from $4.4 billion just ten years earlier.[33]

Bad debts are typically sold and resold, at increasingly bargain prices, as new buyers attempt to collect debts that others have given up on. As of 2007, the average price of one dollar in bad credit card debt was 5.3 cents.[34] One debt buyer, Encore Capital Group, recently scored $5 billion worth of credit card loans from Citibank, Bank of America, and Capital One, for 3 cents on the dollar.[35] One court case offers a telling example of the way consumer debts are tossed from debt buyer to debt buyer: the

successor company to Providian assigned an account to Vision Management Services, which three days later reassigned the account to Great Seneca Financial Corporation. Less than a month later, Great Seneca Financial Corporation assigned the account to Account Management Services, which after four months sold the account to Madison Street Investments. After five months, Madison Street Investments sold the debt to Jackson Capital, and on the same day it received the account, Jackson Capital sold the debt to Centurion.[36] A huge number of debt buyers operate out of an endlessly shifting set of corporate shell entities that come into and go out of business regularly, having the same group of employees making calls on behalf of numerous supposedly separate corporations from the same phones and offices.

Moreover, because these consumer debts are bought and resold so many times, as part of enormous portfolios of debt that are divided up and resold to other buyers who do the same, debt buyers frequently lack adequate documentation of the loan, including the original contract between the consumer and the lender. In the case of credit card debt and arbitrations brought to collect this debt, this lack of documentation means that (a) there is no evidence of the consumer's agreement to arbitrate any disputes that arise between himself and the lender, and (b) there is no evidence of the amount the consumer actually owes. Instead, creditors simply offer a generic form contract and an affidavit stating the amount owed. As will be explained below, these and other practices work enormous harm on consumers who find themselves forced into arbitration over credit card debt.

In NAF arbitrations, creditors frequently attempt to demonstrate the amount allegedly owed by simply producing an affidavit from one of their employees. In many

courts, however, such an affidavit, standing alone, is not sufficient to collect a debt. A number of states require that a creditor seeking to collect on a debt must file a copy of the instrument itself. In Connecticut, for example, Practice Book § 17-25 states that in defaults for a failure to appear, "the affidavit shall state that the instrument is now owned by the plaintiff, and a copy of the executed instrument shall be attached to the affidavit." Similarly, pursuant to Ohio Civil Rule 10(D), account or written instrument must be attached to the pleading. If the account or written instrument is not attached, the reason for the omission must be stated in the pleading." Under Florida Rule of Civil Procedure 1.130, "[a]ll bonds, notes, bills of exchange, contracts, accounts, or documents upon which action may be brought or defense made, or a copy thereof or a copy of the portions thereof material to the pleadings, shall be incorporated in or attached to the pleading." In yet more states, including Georgia, "[w]here records relied upon and referred to in an affidavit are neither attached to the affidavit nor included in the record and clearly identified in the affidavit, the affidavit is insufficient."[37]

In contrast, in NAF arbitrations concerning debts in Connecticut, Ohio, Florida, and Georgia, the debt collector has no obligation to produce a copy of the original instrument—which is convenient for the debt buyer, since the repeated sale and resale of the debt as part of an enormous package of debts has likely left the debt buyer without any actual evidence or documentation of an individual account. If called upon to produce a contract, the debt buyer will probably present a generic form contract with no evidence that the consumer was ever bound by that particular contract. This issue is particularly relevant in the arbitration context because creditors must demonstrate that the contract

contained an arbitration clause. But because consumer contracts undergo frequent revisions and are often allegedly amended by "bill stuffers," the version of the contract that the consumer actually received may not have contained the clause. [38]

Even in courts where the debt can be proved using only an affidavit, other basic procedural protections apply in court but can be easily evaded by filing an NAF arbitration instead. For example, some states, including Indiana, Minnesota, and New York, require that sworn pleadings from out-of-state be accompanied by a certificate authenticating the affiant's authority, and courts may reject affidavits submitted without that certificate.[39] NAF arbitrations offer no such protection. Moreover, pursuant to regular rules of evidence, affidavits must be made based on personal knowledge and affirmatively demonstrate that the affiant is competent to testify on the matters contained in the affidavit—a requirement that frequently cannot be met by the debt buyer's affiant.[40]

C. NAF Arbitrations Suffer from a Number of Other Systemic Procedural Irregularities that Raise Doubts About the Trustworthiness of the Process

Over the years, we have spoken to hundreds of consumers and consumer attorneys about NAF. They have told us, again and again, about how NAF takes creditors' assertions at face value, without requiring substantiation, resulting in a system that is rigged against consumers. In preparation for this testimony, we have also conducted an informal poll of a large number of consumer attorneys to survey their experiences of procedural irregularities in NAF debt collection arbitrations. Their stories are too

numerous and too lengthy to report in full, but below we offer some examples of common practices in NAF debt collection arbitrations and the names and contact information of attorneys who can have witnessed these practices. These stories, all of which derive from NAF's willingness to enter awards despite lack of substantiation, give rise to serious concerns about the reliability of the private justice system that is quickly replacing American courts.

1. NAF enters awards against individuals who are the victim of identity theft

The numerous stories of individuals who had NAF awards entered against them even though they were victims of identity theft are among the most troubling of all the NAF horror stories: even the briefest impartial review of the creditor's case would reveal that these individuals did not owe the debt that the creditor claimed.[41] The following individuals represent just a few instances of NAF's entering awards against identity theft victims.

Buddy Newsom never had an MBNA credit card account. When he received a document from MBNA about an account in his name, he immediately contacted MBNA to explain that it was not his. Subsequently, Newsom discovered that an employee in his construction business—who was later prosecuted for embezzlement—had opened credit card accounts in his name. Nevertheless, when MBNA initiated an arbitration proceeding, NAF entered an award against Newsom for $17,759.65, the full amount demanded by MBNA, even though Newsom had objected to arbitration on the ground that there was no account and thus no arbitration agreement. After learning of the award,

Newsom's attorney contacted the arbitrator, who explained that he receives a stack of 40-50 "uncontested" cases from NAF every month, and that Newsom's case was included in that set. The arbitrator simply rubber-stamped Newsom's case with an award for the creditor in the full sum, as he did for all the others. When Newsom's attorney contacted an NAF case manager, he learned that NAF had actually received the information about the identity theft but decided not to forward that information to the arbitrator—because it had been received one day too late.[42]

Six months after Beth Plowman used her MBNA card to pay a hotel bill while on a business trip to Nigeria in 2000, MBNA called her to collect more than $26,000 spent at sporting goods stores in Europe. Plowman had received no credit card statements during those six months; MBNA told her that "her sister"—Plowman has no sisters—had changed the address on the account to an address in London. Plowman filed an identity theft report with the police and heard nothing more from MBNA. But two years later, a debt collection agency that had purchased the debt from MBNA got an arbitration award against her from NAF.[43]

Troy Cornock received a letter from NAF claiming that he owed money on an MBNA credit card, but he had never signed a credit card agreement or made any charges on the account, which had been opened by his ex-wife. NAF ruled against him anyway.[44] But when MBNA attempted to enforce the NAF award in court, the court granted Cornock's motion for summary judgment, stating that "in the absence of a signed credit card application or signed purchase receipts demonstrating that the defendant used and retained the benefits of the card, the defendant's name on the account, without more, is

insufficient evidence that the defendant manifested assent. . . . To hold otherwise *would allow any credit card company to force victims of identity theft into arbitration*, simply because that person's name is on the account."[45]

Irene Lieber, who lives on $759 a month in Social Security disability payments, was hounded by a debt collection agency after her MBNA credit card was stolen. Lieber later received a notice of arbitration from NAF. With the help of a legal services attorney, she asked to see the case against her or for the claim to be dismissed. But Lieber heard nothing until another notice arrived, stating that NAF had issued a $46,000 award against her.[46]

In addition to all of these stories, several attorneys told us that NAF had entered awards against their clients even though they were the victims of identity theft:

- Joanne Faulkner, Connecticut, 203-772-0395, j.faulkner@snet.net
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com
- Jane Santoni, Maryland, 410-938-8666, jane@williams-santonilaw.com

2. NAF enters awards even though consumer never received notice of arbitration

NAF's habitual practice of failing to ensure that consumers receive adequate notice of arbitration has been observed by courts asked to confirm arbitration awards as well as by consumer attorneys.

A Connecticut court, for example, denied a debt buyer's motion to confirm an NAF award noting that NAF rules provide "no procedure by which the arbitrator makes any determination of whether the defendant has received actual notice of the demand for arbitration . . . . and if the defendant does not respond in writing to the demand for

arbitration, NAF simply decides the case 'on the papers.' This certainly results in a high likelihood that the outcome of the arbitration will be in the defendant's favor."[47]

Attorneys frequently reported that NAF entered awards against their client even though the client could affirmatively demonstrate that he or she never received notice of arbitration. New York attorney Kevin Mallon (phone: 212-822-1474; email: kmallon@lawsuites.net), for example, reported that NAF erroneously insisted that his client had been served with notice of arbitration. The client was able to verify that he had not been served, however, by demonstrating that he had, in fact, been getting married on the day that he allegedly received notice of arbitration. Mallon wrote NAF a letter explaining the lack of proper service, but NAF responded by taking his letter as a substantive response to the creditors' allegations and entered an award against his client.

California attorney Aurora Harris (phone: 714-288-0202; email: roraharris@aol.com) noted that an individual in Minnesota is responsible for certifying that notices of arbitration have been sent, even though that certification offers no evidence that the notice of arbitration was actually mailed or that it was sent to the proper address.

Other attorneys who reported that NAF entered awards against their clients despite lack of proper notice of arbitration include:

- Rebecca Covey, Florida, 954-763-4300, rebeccacovey@lemonadvice.com
- Angela Martin, North Carolina, 919-708-7477, martingodawgs@aol.com
- Bob Martin, New York, 212-815-1810, rmartin@dc37.net
- John Mastriani, Texas, 713-665-1777, mrmastriani@gmail.com
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com
- Dale Pittman, Virginia, 804-861-6000, dale@pittmanlawoffice.com

- Rich Tomlinson, Texas, 713-627-2100, rtomlinson@houstonconsumerlaw.com

3. NAF enters awards despite the creditor's failure to prove the existence of an arbitration agreement

One of consumer attorneys' most frequent comments about NAF was that NAF routinely entered arbitration awards against their clients in the absence of any reason to believe that the clients had actually agreed to arbitration. One particularly telling example comes from California attorney Aurora Harris (phone: 714-288-0202; email: roraharris@aol.com). NAF had entered an arbitration award when the purported contract between Chase and her client was three illegible pages. Upon closer inspection, Harris realized that the contract supposedly containing the arbitration agreement was actually three unrelated pages from three different contracts, with inconsistent page numbers and overlapping content—and nowhere in those three pages was there actually an arbitration agreement.

Another example comes from Iowa attorney Ray Johnson (phone: 515-224-7090; email: johnsonlaw29@aol.com) who has had clients who could not possibly have agreed to arbitration, because (a) the account was so old that it predated the use of arbitration clause, and (b) the consumer had closed the account before the credit card company amended the contract to add an arbitration provision.

Other attorneys reporting NAF's failure to verify the existence of an arbitration agreement include:

- Craig Jordan, Texas, 214-855-9355, craig@warybuyer.com
- John Mastriani, Texas, 713-665-1777, mrmastriani@gmail.com
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com

- Dale Pittman, Virginia, 804-861-6000, dale@pittmanlawoffice.com
- Joe Ribakoff, California, 562-366-4715, killerrib@gmail.com

4. NAF enters awards even though debts are past the statute of limitations

We have spoken to a large number of consumers, and to a number of attorneys, who have reported that NAF arbitrators entered awards against consumers clients even though the alleged debts were past the statute of limitations. I have seen NAF enter awards in cases that are more than half a dozen years past the statute of limitations. Some other attorneys who have had this experience include:

- Terry Adler, Michigan, 810-695-0100, lemonade1@sbcglobal.net
- Ray Johnson, Iowa, 515-224-7090, johnsonlaw29@aol.com
- Bob Martin, New York, 212-815-1810, rmartin@dc37.net
- Scott Owens, Florida, 954-923-3801, scott@cohenowens.com

5. NAF enters awards with impermissible fees added on

Several attorneys noted that NAF enters awards that have impermissible junk and attorneys fees added, even when those fees may be prohibited by law.

- Joanne Faulkner, Connecticut, 203-772-0395, j.faulkner@snet.net
- Aurora Harris, California, 714-288-0202; roraharris@aol.com
- Ray Johnson, Iowa, 515-224-7090, johnsonlaw29@aol.com
- Bob Martin, New York, 212-815-1810, rmartin@dc37.net
- Joe Ribakoff, California, 562-366-4715, killerrib@gmail.com

CONCLUSION

In all too many cases, American consumers are denied the fair and impartial arbitration that they are promised. Rather than presenting an expedient and just way to

resolve disputes, arbitrations before the NAF have been operating simply as an arm of the debt-collection industry. Even though NAF has now withdrawn from the business of consumer arbitration, the circumstances that allowed NAF to profit from credit card arbitration remain unchanged, and it would be all too easy for another company to start up where NAF left off.

[1] *See* Consumers Union, *Best and Worst Credit Cards*, Consumer Reports, Oct. 2007. *See also* Day to Day, *Marketplace Report: Credit Disputes Favor Companies* (NPR radio broadcast Sept. 28, 2007) (available at 2007 WLNR 19048094) ("[I]t's often hard to find a credit card that doesn't make arbitration mandatory."); Simone Baribeau, *Consumer Advocates Slam Credit-Card Arbitration*, Christian Sci. Monitor, July 16, 2007 ("[I]f you own a credit card, chances are you have a mandatory arbitration clause.").

[2] Compl. ¶ 2, *State v. Nat'l Arbitration Forum, Inc.*, (Minn. Dist. Ct. filed July 14, 2009).

[3] Am. Morning (CNN television broadcast June 6, 2008) (transcript available at http://transcripts.cnn.com/TRANSCRIPTS/0806/06/ltm.03.html).

[4] Nathan Koppel, *Arbitration Firm Faces Questions Over Neutrality*, Wall St. J., Apr. 21, 2008.

[5] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.

[6] Consumers Union, *Consumer Rights: Give Up Your Right to Sue?* Consumer Reports, May 2000.

[7] Joseph Garrison, *Is ADR Becoming "A License to Steal"?* Conn. L. Trib., Aug. 26, 2002, at 4.

[8] *See* Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One-Sided*, Wash. Post, Mar. 1, 2000, at E1 ("[A]rbitration industry experts say [that] the forum's business involves more corporate-consumer disputes, in large part because of the company's aggressive marketing."). *Cf.* Michael Geist, *Fair.com? An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, 27 Brook. J. Int'l L. 903, 907 (2002) (in analysis of domain name arbitration providers, noting that "[m]arketing techniques clearly illustrate one area of differentiation between providers, with the NAF adopting a far more aggressive approach than the other providers in the marketing of its services").

[9] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008. *See also* Sean Reilly, *Supreme Court Looks at Arbitration in Alabama Case This Week*, Mobile Reg., Oct. 1, 2000, at A1 ("In marketing letters to potential business clients, [NAF's] executives have touted arbitration as a way of eliminating class action lawsuits, where thousands of small claims may be combined."); Sarah Ovaska, *3 Cases Cite Payday Lending: Consumer Groups Say Arbitration Clauses Deny People Recourse to Courts*, News & Observer, Jan. 7, 2007 ("[NAF], which in 2006 resolved $3 billion worth of claims involving debts and other disputes, has been singled out by consumer advocates, who criticize it for advertising its services to businesses.").

[10] Ken Ward, Jr., *State Court Urged to Toss One-Sided Loan Arbitration*, Charleston Gazette & Daily Mail, Apr. 4, 2002, at 5A.

[11] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.

[12] *Id.*

[13] *Id.*

[14] Nadia Oehlsen, *Mandatory Arbitration on Trial*, Credit Card Mgmt., Jan. 1, 2006, at 38

[15] Sean Reilly, *Supreme Court Looks at Arbitration in Alabama Case This Week*, Mobile Reg., Oct. 1, 2000, at A1.

[16] *See* Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One-Sided*, Wash. Post, Mar. 1, 2000, at E1.

[17] *See Do An LRA: Implement Your Own Civil Justice Reform Program NOW*, Metropolitan Corp. Counsel, Aug. 2001.

[18] Michael Geist, *Fair.com? An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, 27 Brook. J. Int'l L. 903, 907 (2002).

[19] Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 15 (2007), http://www.citizen.org/documents/ArbitrationTrap.pdf.

[20] Justin Scheck, *Neutral Takes Path from Construction to Credit Cards*, The Recorder, Oct. 2, 2007 (emphasis added).

[21] This information comes from the declaration of a West Virginia attorney in the case of *McQuillan v. Check 'N Go of North Carolina*, which Public Justice is happy to provide upon request.

[22] Joshua M. Frank, Center for Responsible Lending, *Stacked Deck: A Statistical Analysis of Forced Arbitration* (2009), http://www.responsiblelending.org/credit-cards/research-analysis/stacked_deck.pdf.

[23] Simone Baribeau, *Consumer Advocates Slam Credit-Card Arbitration*, Christian Sci. Monitor, July 16, 2007.

[24] Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 17 (2007), http://www.citizen.org/documents/ArbitrationTrap.pdf.

[25] Chris Serres, Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions? Star Trib. (Minneapolis), May 11, 2008, at 1D.

[26] Michael Geist, *Fair.com? An Examination of the Allegations of Systemic Unfairness in the ICANN UDRP*, 27 Brook. J. Int'l L. 903, 912 (2002).
[27] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[28] Chris Serres, *Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions?* Star Trib. (Minneapolis), May 11, 2008, at 1D.
[29] *Courting Big Business: The Supreme Court's Recent Decisions on Corporate Misconduct and Laws Regulating Corporations*, 110th Cong. (2008) (statement of Elizabeth Bartholet), *available at* http://judiciary.senate.gov/hearings/testimony.cfm?id=3485&wit_id=7313.
[30] Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.
[31] Hillard M. Sterling & Philip G. Schrag, *Default Judgments Against Consumers: Has the System Failed?* 67 Denver U. L. Rev. 357 (1990).
[32] Jessica Silver-Greenberg, *Snagging Debt Collectors*, BusinessWeek, Dec. 1, 2008.
[33] Walter V. Robinson & Beth Healy, *Debt Collectors Hunt the Innocent*, Boston Globe, Sept. 13, 2006.
[34] Robert M. Hunt, *Overview of the Collections Industry*, available at http://www.ftc.gov/bcp/workshops/debtcollection/presentations/hunt.pdf.
[35] Jessica Silver-Greenberg, *Snagging Debt Collectors*, BusinessWeek, Dec. 1, 2008.
[36] *Miller v. Wolpoff & Abramson, LLP*, No. 1:06-CV-207-TS, 2007 WL 2694607, at *8 (N.D. Ind. Sept. 7, 2007).
[37] *Powers v. Hudson & Keyse, LLC*, 656 S.E.2d 578 (Ga. App. 2008).
[38] *See, e.g., Creech v. MBNA Am. Bank, N.A.*, 250 S.W.3d 715 (Mo. Ct. App. 2008) ("In its argument in this Court, Appellant claims that the original agreement with Respondent probably had an agreement to arbitrate and was later amended to include an arbitration agreement. Appellant claims that the amendment was sent by mail to Respondent. Neither party filed with the trial court the original account agreement; instead, Respondent relies upon a copy of the 'amendment' which Appellant claims was mailed to Respondent a short time after the account was opened and which has never been acknowledged as received by Respondent.").
[39] Ind. Code § 34-37-1-7; Minn. Stat. § 600.09; N.Y. C.P.L.R. 2309(c) (McKinney).
[40] For examples of courts rejecting affidavits on this basis, see, e.g., *Palisades Collection L.L.C. v. Gonzalez*, 809 N.Y.S.2d 482 (Civ. Ct. 2005), *Luke v. Unifund CCR Partners*, 2007 WL 2460327 (Tex. App. Aug. 31, 2007).
[41] *See* Sheryl Harris, *Consumers Should Be Suspicious of Arbitration Clause*, Plain Dealer (Cleveland), Feb. 17, 2005, at C5. ("Even victims of identity theft have been wrestled into arbitration [with NAF] and held responsible for charges racked up by thieves.").
[42] Interview with Buddy Newsom and his attorney, Mark Pearson.
[43] Eileen Ambrose, *Read the Fine Print: Arbitration Clause Can Sting You*, Fort Wayne J. Gazette, Mar. 15, 2005, at 8.
[44] Gary Weiss, *Credit Card Arbitration* (Oct. 11, 2007), Forbes.com, http://www.forbes.com/2007/ 10/10/gary-weiss-credit- oped-cx_gw_1011weiss.html.
[45] *MBNA Am. Bank, N.A. v. Cornock*, No. 03-C-0018, slip. op. at 25 (N.H. Super Ct. Mar. 20, 2007) (emphasis added).
[46] Laura Rowley, *Stacking the Deck Against Consumers* (Oct. 17, 2007), Yahoo! Finance, http://finance.yahoo.com/ expert/article/moneyhappy/48748.
[47] *CACV of Colo., LLC v. Corda*, No. NNHCV054016053, 2005 WL 3664087 (Conn. Super. Ct. Dec. 16, 2005). *See also Asset Acceptance, LLC v. Wheeler*, --- S.E.2d ----, 2009 WL 71504, at *1 (Ga. Ct. App. Jan. 13, 2009) (affirming vacatur of NAF arbitration award where consumer had not received proper notice);

American Arbitration Association
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NEWS RELEASE
For Immediate Release

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The American Arbitration Association® Calls For Reform of Debt Collection Arbitration

Largest Arbitration Services Provider Will Decline to Administer Consumer Debt Arbitrations until Fairness Standards are Established

New York, NY– (July 23, 2009) – The American Arbitration Association (AAA), the world's largest conflict management and dispute resolution services organization, today recommended in a House subcommittee hearing that the process surrounding consumer debt collection arbitration needs major reform and recommended a national policy committee to identify and research solutions. AAA said it will not administer any consumer debt collection programs until those solutions are determined.

AAA senior vice president Richard Naimark told the Domestic Policy Subcommittee of the House Oversight and Government Reform Committee that the AAA "has not administered significant numbers of debt collection arbitrations relative to some other organizations," and has not handled any since June after it concluded a single high-volume program. However, he said that AAA had independently reviewed areas of the process and concluded that it had some weaknesses. As a result of that review, it is evident to the AAA that "a series of important fairness and due process concerns must be addressed and resolved before we will proceed with the administration of any consumer debt collection programs." According to Mr. Naimark, areas needing attention from the national policy committee include consumer notification, arbitrator neutrality, pleading and evidentiary standards, respondents' defenses and counterclaims, and arbitrator training and recruitment.

"AAA has been working with the Domestic Policy Subcommittee to review potential improvements in consumer debt collection arbitration procedures for some time. We believe that arbitration can play a major role in consumer debt collection disputes. A national policy committee dedicated to meaningful reform can enhance an array of due process elements so that there is deeper fairness and transparency. Consumers deserve an alternative to litigation, but they also need to be able to trust that option. Our goal will be to achieve that trust," Mr. Naimark said after the hearing.

"We have been studying this issue for some time. We made our decision to impose a moratorium on administering consumer debt arbitration independently and not at the behest of any outside entity as has been claimed. We commend the Domestic Policy Subcommittee for its initiatives to protect consumers in debt collection cases, and we will continue to work with it willingly and enthusiastically," Mr. Naimark said.

About the American Arbitration Association
The global leader in conflict management since 1926, the American Arbitration Association is a not-for-profit, public service organization committed to the resolution of disputes through the use of arbitration, mediation, conciliation, negotiation, democratic elections and other voluntary procedures. In 2008, 138,447 cases were filed with the Association in a full range of matters including commercial, construction, labor, employment, insurance, international and claims program disputes. Through 30 offices in the United States, Ireland, Mexico, and Singapore, the AAA provides a forum for the hearing of disputes, rules and procedures and a roster of impartial experts to resolve cases. Find more information online at www.adr.org.

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July 20, 2009

Ms. Lori Swanson
Attorney General
State of Minnesota
1400 Bremer Tower
445 Minnesota Street
St. Paul, MN 55101

Dear Attorney General Swanson:

I have received your letter dated July 19, 2009 and would like to respond to the very important issues raised and concerns you have expressed about consumer debt arbitration programs. Like you, the American Arbitration Association ("AAA") is deeply committed to providing access to justice for consumers, and we have worked with great dedication over the years to develop widely respected protocols, codes of ethics and other procedures to ensure that arbitrations administered under the auspices of the AAA are handled fairly and efficiently.

The AAA is unique with respect to our governance structure in that other ADR providers are almost exclusively organizations that operate for a profit, whereas the AAA is an 83 year old not-for-profit organization with a mission dedicated to developing the widespread, effective and ethical use of alternative dispute resolution. As part of our governance structure, we have a Board of Directors that provides divergent representative viewpoints of former judges, government and union officials, and the plaintiff and corporate bars. Fortunately, the AAA is able to draw on those varied experiences, in addition to our own, in developing dispute resolution processes that accommodate the needs of parties not only for a cost effective and efficient method of resolving disputes, but more importantly dispute resolution processes that are fair and which accommodate the particular characteristics of the parties.

Regarding some of the specific points you have raised, I would like to first make you aware that the AAA is not currently administering any large debt collection programs of the type described in your letter, and in fact, the AAA has only administered one such program which ended in June of this year. After the

conclusion of the AAA's administration of that caseload, the AAA engaged in a significant effort to identify and consider many of the aspects of debt collection arbitration programs that give rise to legitimate concerns.

Those concerns include issues related to matters such as the notice that is provided to consumers, arbitrator neutrality, the amount and type of evidence that a business is required to submit when they file a demand for arbitration against a consumer, and other matters such as a consumer's ability to defend an arbitration in light of claims such as of identity theft. You have also expressed some thoughts about consumers' knowledge of the arbitration process and their perceived ability to obtain access to the arbitral forum, which are concerns shared by the AAA.

It is the AAA's view that each of these issues must be studied individually to determine whether the arbitration process can be accommodated to address the concerns raised. An AAA representative will be presenting various ideas about how it might be possible to do so at the July 22nd hearing of the Domestic Policy Subcommittee of the House Committee on oversight and Government Reform. I understand that you will be a witness at that hearing as well and we look forward to sharing our views in detail with you at that time. In the meantime, and until such that there is some consensus on how concerns about the administration of debt collection arbitrations might be successfully addressed, the AAA has implemented a moratorium on the administration of any consumer debt collection arbitration programs.

However, I would also like to note that an important distinction should be made between consumer debt collection caseloads that are filed in large numbers almost exclusively by a single business claimant on the one hand, and individual consumer arbitrations on the other. In connection with individual consumer arbitration filings, it is the view of the AAA that considerable success has been achieved in creating an arbitral forum that is accessible and fair to consumers. More specifically, the Searle Civil Justice Institute at Northwestern University recently completed an in depth examination of consumer arbitrations administered by the AAA that found that consumer arbitration is an inexpensive and quick way to resolve consumer disputes, that the "repeat-player" effect was not statistically significant, and that attorneys' fees are granted to consumers in the majority of cases where the consumer sought such an award.

In addition, the Searle Institute found that the AAA's fidelity to the Consumer Due Process Protocol was effective in identifying and responding to consumer arbitration agreements that did not meet the AAA's minimum standards of fairness and due process. Finally, for consumer arbitrations other than debt collection arbitrations administered by the AAA, the vast majority of cases (72% of consumer cases filed with the AAA in 2008) are filed by the *consumer* party. This evidence would suggest that AAA arbitration provides a meaningful avenue for the resolution of consumer disputes. While the Searle study did not investigate consumer debt arbitration caseloads which can fairly be viewed as a subset of consumer arbitration, the Searle institute has now commenced a study of consumer debt collection arbitrations which will also be informative with respect to improvements that might be implemented into the arbitration process.

I hope that this letter adequately explains the AAA's current position and practices with the administration of consumer and debt collection arbitrations. To the extent that you have any additional questions or concerns, we would welcome the opportunity to discuss it with you further.

Sincerely yours,

William K. Slate II

William K. Slate II

Bank of America

Fact Sheet about Bank of America's Arbitration Position

- Bank of America's Consumer businesses will no longer enforce mandatory arbitration in new banking disputes with individual customers. This applies to the bank's consumer credit cards; auto, recreational vehicle and marine loans; and deposit accounts.
    - Bank of America eliminated mandatory arbitration in its mortgage and home equity agreements several years ago.
    - Bank of America dramatically reduced its use of arbitration in credit card collection actions in mid-2008.
- With this additional change, a customer with a new dispute with Bank of America regarding a credit card loan; auto, recreational vehicle or marine loan; or deposit account will no longer be subject to mandatory arbitration.
- Existing individual customers who currently have the right to arbitrate a dispute will retain that right, but the bank will not require it.
- This change will be reflected in future Bank of America customer agreements, as we update those agreements beginning later this year
- This complements other efforts to respond to our customers. In addition to taking actions to avoid serious disputes, Bank of America works closely with customers in distress.
    - In 2008, Bank of America modified nearly one million U.S. consumer credit card and unsecured loans. During the first six months of the year, the company has already modified 600,000 more, representing approximately $6 billion in credit.
    - Bank of America also modified 230,000 mortgage loans in 2008 and 150,000 mortgage loans during the first six months of this year.
    - For more information on Bank of America's lending and investment efforts, our Quarterly Impact Report is available via newsroom.bankofamerica.com.