Testimony Before the United States Senate Committee on the Judiciary

By Richard M. Alderman*

On December 12, 2007, I had the opportunity to testify before the United States Senate Committee on the Judiciary, in support of the Arbitration Fairness Act of 2007. The Act prohibits pre-dispute binding arbitration in consumer and employment contracts. My testimony was directed at consumer arbitration. What follows is a copy of my written testimony.

Chairman Feingold, members of the Committee, thank you for the opportunity to join the discussion of the Arbitration Fairness Act of 2007. I appear before you as someone who has served as an arbitrator and supports arbitration, but who values our courts more.[1]

Not long ago, automobile dealers came to Congress to ask for help. They asserted they were being denied access to the courts through the manufacturers' use of a pre-dispute arbitration provision. The dealers believed it was unfair for the stronger party to the bargain to have the right to unilaterally force the weaker party to forfeit the right to sue as a condition of doing business. In 2002 Congress passed the Motor Vehicle Franchise Fairness Act, with 50 co-sponsors in the Senate and 252 in the House. Today, I am asking that you provide similar protections for consumers.

As some who has taught consumer law for 35 years, and who has worked as a consumer advocate for even longer, I truly believe that the Arbitration Fairness Act is the most important piece of consumer legislation of the past three decades. I say this for one simple reason, excessive pre-dispute mandatory binding arbitration frustrates our system of government by denying courts the ability to perform the vital role the founders of this country envisioned.

You have heard and will continue to hear the debate about whether consumer arbitration is good or bad for consumers. Questions have been raised about the true cost of arbitration, and its fairness. But no one disputes that consumer arbitration is imposed by the stronger party, not voluntarily agreed to.[2]

Ask any school child and he or she will tell you about our system of government, checks and balances, legislative, executive and judicial branches of government.[3] It is the judicial branch that is uniquely American and its role is essential. Our civil justice system provides an open, public forum for juries to resolve disputes. It interprets and applies the laws enacted by the legislature, and it often creates or modifies law through our common law system. The increasing use of consumer arbitration denies the courts the ability to play this vital role. Our current system of arbitration has allowed business to effectively "opt-out" of our civil justice system and replace it with a system of private justice, it controls. Even supporters of consumer arbitration recognize that substance not form is the reason for pre-dispute arbitration provisions.

For example, in a recent law review article the authors note that the auto and home industries have "divorced" themselves from the Alabama justice system, because of the fear of unfair awards.[4] Instead of working through the legislative process to enact change, or using the political process to elect different decision makers, car dealers and home builders simply included a short phrase in their contracts, to enact major substantive changes in the application of the law.[5] [I assume that if a "friendlier" judiciary were elected, the auto and home industries would stop using arbitration to take advantage of the friendlier forum.]

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And our courts do more than just resolve disputes; they interpret statutes and create common law.[6] Through stare decisis and precedent, decisions of higher courts are binding on lower courts, insuring uniformity of results. For example, in 1995, Congress amended the remedy provisions of the Truth-in-Lending Act. Unfortunately, the language used was not the most precise, and courts gave differing interpretations to a significant issue—whether damages were capped at $1,000. In 2004 the United States Supreme Court held the cap applied.[7] Its decision is now binding on all other courts to consider this issue, insuring consistency and a uniform application of the statute.

The widespread use of consumer arbitration means consumers with identical claims and circumstances may all be treated differently, by arbitrators unable to create precedent or establish consistent legal doctrine.

Today, most consumer credit contracts contain an arbitration provision, and it is unlikely a court will be given the opportunity to resolve ambiguities. Instead, we have arbitrators, not bound by the decisions of any other arbitrators, each deciding the issue of how the law should be interpreted and applied. The widespread use of consumer arbitration means consumers with identical claims and circumstances may all be treated differently, by arbitrators unable to create precedent or establish consistent legal doctrine.

And finally, the common law tradition of this country empowers the courts to create and modify legal doctrine.[8] Consumer doctrines such as unconscionability, strict products liability, habitability and good and workmanlike performance have been created, modified, limited and extended by our courts to protect consumers and insure a fair bargain. But arbitrators cannot create or modify the common law.[9] They are bound by existing legal doctrine, essentially freezing the common law of consumer transactions, denying courts the ability to develop and adapt the law.[10]

To me the question is simple, it is not whether arbitration is fair or benefits consumers, it is whether the more powerful party to a bargain should be able to deny the other access to the courts. The answer, as Congress recognized in the case of automobile dealers is clearly no. I encourage you to enact the Arbitration Fairness Act and recognize that automobile dealers and consumers should have the right to sue.

I thank you for the opportunity to discuss this important issue, and welcome any questions you may have.

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1. See generally Richard M. Alderman, *Consumer Arbitration: The Destruction of the Common Law,* 2 J. of American Arbitration 1 (2003); Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform,* 38 Houston L. Rev. 1237 (2001); and Richard M. Alderman, *The Future of Consumer Law in the United States—Hello Arbitration, Bye-bye Courts, So-long Consumer Protection, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1015517*

2. The validity of arbitration clauses is based on the premise that they are a voluntarily chosen alternative forum of dispute resolution. Consumer arbitration is anything but voluntary. It is placed in boiler-plate form contracts, presented on a take it or leave it basis. Perhaps more importantly, it is fast becoming anything but an "alternative." Consumer arbitration is quickly becoming universal. For example, nearly all credit card agreements, bank contacts, home builder agreements and car purchase orders, contain a binding arbitration clause. Consumer arbitration is not an alternative to our courts, it is designed to replace them when it comes to consumer disputes. Today very few consumer disputes may be presented in court, soon there may be none.

3. For example, a popular children's book states:

> There are three branches of federal government, charged with different responsibilities. The legislative branch (the House of Representatives and the Senate) creates laws for the nation. The executive branch (headed by the president of the United States) executes, or carries out, the laws. The judicial branch (The Supreme Court and other lower courts) interprets the law and can overrule them.
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> In addition to separating powers, the Constitution also provides for numerous ways in which these bodies of government overlap. This is so they can check up on one another in case one body does something that isn't good for the country.

Mark Friedman, Government, at 12 (2005).

4. W. Scott Simpson, Stephen J. Ware, and Vickie M. Willard, *The Source of Alabama's Abundance of Arbitration Cases: Alabama's Bizarre Law of Damages for Mental Anguish,* 28 AM. J. TRIAL ADVOC. 135, 177 (2004). As the authors of the article note:

> The auto and home industries, fearing catastrophic verdicts before Alabama juries, now require customers, nearly across-the-board, to enter into pre-dispute binding arbitration agreements as a condition of doing business. These industries have effectively divorced themselves from the Alabama civil justice system in hopes of obtaining fairer and more just awards before arbitrators.

5. A recent study of commercial arbitration clauses supports the proposition that the widespread use of arbitration in consumer cases may be in fact based on something other than the efficiency benefits of an alternative forum:

> We present evidence that large corporate actors do not systematically embrace arbitration. International contracts include arbitration clauses more than domestic contracts, but also at a surprisingly low rate. Our results have implications for the justifications for the widespread use of arbitration clauses in consumer contracts. If the reasons that some have advanced to support the use of arbitration in the consumer context - that it is simpler and cheaper than litigation - are correct, it is surprising that public companies do not seek these advantages in disputes among themselves. In the simple economic view, our results suggest that corporate representatives believe that litigation can add value over arbitration.

Theodore Eisenberg and Geoffrey P. Miller, *The Flight From Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies,* 56 DePaul L. Rev. 335, 373-74 (2007).

6. The need for a common law supplement to legislation has been described as follows:

> Our society has an enormous demand for legal rules that actors can live, plan, and settle by. The legislature cannot adequately satisfy this demand. The capacity of a legislature to generate legal rules is limited, and much of that capacity must be allocated to the production of rules concerning governmental matters, such as spending, taxes, and

> administration; rules that are regarded as beyond the courts' competence, such as the definition of crimes; and rules that are best administered by a bureaucratic machinery, such as the principles for setting the rates charged by regulated industries. Furthermore, our legislatures are normally not staffed in a manner that would enable them to perform comprehensively the function of establishing law to govern action in the private sector. Finally, in many areas the flexible form of a judicial rule is preferable to the canonical form of a legislative rule. Accordingly, it is socially desirable that the courts should act to enrich that supply of legal rules that govern . . . [business] conduct-not by taking on lawmaking as a free-standing function, but by attaching much greater emphasis to the establishment of legal rules than would be necessary if the courts' sole function was the resolution of disputes.

Chris A. Carr and Michael R. Jenks, *The Privatization of Business and Commercial Dispute Resolution: A Misguided Policy Decision,* 88 Ky. L. J. 183, 193 (1999). *See generally,* Jay M. Feinman, *Un-Making Law: The Classical Revival in the Common Law*, 28 Seattle Univ. L. R. 1 (2004) (discussing changes and trends in the development of the common law).

7. *Koons Buick GMC, Inc. v. Nigh,* 543 U.S. 50 (2004).

8. The common law is the system that America has adopted and developed over the centuries for ensuring the law stays current with rapidly changing social and economic conditions. As Justice Harlan F. Stone noted, "If one were to attempt to write a history of the law in the United States, it would largely be an account of the means by which the common-law system has been able to make progress through a period of rapid social and economic change." Harlan F. Stone, *The Common Law in the United States,* 50 Harv. L. Rev. 4 at 11 (1936).

9. Unlike court opinions, most of which are published, most decisions of arbitrators are secret, and are often not even accompanied by a written opinion. Even when published and made available to the public, the decision of one arbitrator or panel of arbitrators, is in no way binding on any other arbitrator or panel. In fact, arbitrators generally are not compelled to follow the law and their decisions may not be appealed.

10. As every first year student at an American law school is taught, precedent and stare decisis are the foundations of the common law. Courts are bound by precedent and must follow decisions of higher courts, and all courts should give serious consideration to the rationale of others. As Justice Stone noted almost seventy years ago, the common law's,

> [D]istinguishing characteristics are its development of law by a system of judicial precedent, its use of the jury to decide issues of fact, and its all-pervading doctrine of supremacy of the law—that the agencies of government are no more free than the private individual to act according to their own arbitrary will or whim, but must conform to legal rules developed and applied by courts.

Harlan F. Stone, *The Common Law in the United States,* 50 Harv. L. Rev. 4, at 5 (1936).Through this process of judicial precedent, courts create and mold legal rights, co-existent with, and supplemental to, those created by statute