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Joan Claybrook, President

**Testimony of Jillian Aldebron  
Civil Justice Counsel, Public Citizen's Congress Watch  
Before the Committee on the Judiciary  
Hearing on the "Uniform Arbitration Act of 2005"  
June 9, 2005**

Chairman Mendelson and Members of the Committee,

Public Citizen is a 150,000-member non-partisan, non-profit organization founded in 1971 to advocate on behalf of consumer interests before the legislative, executive and judicial branches of government. We have some 800 members in the District. Public Citizen is committed to preserving a strong liability system that allows citizens to hold businesses accountable for deceptive, discriminatory, and fraudulent practices. It is in the interest of protecting consumer access to justice that I am addressing this hearing today.

Arbitration has proved to be an expeditious, relatively inexpensive tool for companies to resolve disputes among themselves—which was, in fact, the purpose for which arbitration was originally intended. But the ubiquitous presence of binding, mandatory arbitration (BMA) clauses in form (or adhesion) contracts, where they are imposed on unwitting consumers who may have no knowledge of their existence, no understanding of what it means for their judicial rights, and no recourse but to accept them, has turned arbitration into a mechanism that undermines the traditional American values of justice and fairness.

In the testimony that follows, I will briefly discuss the Revised Uniform Arbitration Act on which the District's bill is based, then review the serious drawbacks of arbitration—and, in particular, binding mandatory arbitration from a consumer perspective, and finally propose both amendments to the bill and separate legislation that would resolve some of these problems and provide broader consumer protections.

**The Revised Uniform Arbitration Act**

The National Conference of Commissioners on Uniform State Laws (NCCUSL) committee that drafted the RUAA, which is substantially the text being addressed by today's hearing, defines arbitration in its prefatory note as "a consensual process," and therefore "the autonomy of the parties who enter into arbitration agreements should be given primary consideration *so long as the agreements conform to notions of fundamental fairness*" [emphasis added]. Adherence to this principle is evident in the language of the RUAA, which refers throughout to "agreements to arbitrate." Of course, some "agreements" are more voluntary than others, and when one party to a contract has significantly greater bargaining power than the other and the deal is offered on a take it or leave it basis—as with employers-employees, businesses-consumers, HMOs-patients,

just to name a few—these are not so much “agreements” as coercive arrangements that have dire consequences for the weaker party.

The Drafting Committee recognized this problem, although it ultimately (and regrettably) chose to stay out of the unconscionability and adhesion contract debate, in a lengthy comment on the validity of arbitration agreements under Section 6, in which it warned that

Because an arbitration agreement effectively waives a party's right to a jury trial, courts should ensure the fairness of an agreement to arbitrate, particularly in instances involving statutory rights that provide claimants with important remedies. Courts should determine that an arbitration process is adequate to protect important rights. Without these safeguards, arbitration loses credibility as an appropriate alternative to litigation.

The RUAA, in fact, offers minimal changes to existing regulation or law. Where it purports to clarify the process or protect consumers, it does nothing more than spell out existing areas of arbitrator discretion. But from a larger policy perspective, the danger of enacting this bill lies in its further institutionalization of the unmitigated threat to consumer rights posed by BMA clauses that pervade virtually every sector of the economy. We are talking here, remember, about a private, relatively expensive legal system subject to limited oversight, where decisions are confidential and can only be appealed on very narrow grounds. And as regards this last matter—appeal—the Drafting Committee of the revised act explicitly *rejected* the suggestion that “manifest disregard of the law” should be considered grounds for vacating an award. (See comments to Section 23.) That makes an arbitrator’s decision more iron-clad than a judge’s order.

## **The Disadvantages of Arbitration**

Even where arbitration is truly voluntary—that is, when the agreement to arbitrate is made *after* rather than *before* a controversy arises—the process has certain unique characteristics that make it much harder for consumers to prevail against a business. These are:

***High costs.*** A consumer must pay steep filing fees just to initiate a case—seldom less than \$750. These fees do not cover the arbitrator’s hourly charges, which are generally in the range of \$200 to \$300 per hour, split between the parties. Because all these fees must be deposited in advance, and usually amount to thousands of dollars, most consumers covered by a BMA clause are forced to drop their cases. Although the proposed statute authorizes, among other things, an award of arbitrator fees in § 16-4421, this section is waivable.

***Bias.*** Arbitration providers are set up to serve businesses, not consumers. Their marketing is targeted primarily at businesses, and their panels of arbitrators typically are dominated by former corporate officials and corporate attorneys. Because only businesses will be repeat users of an arbitrator, there is a disincentive for an arbitrator to rule in favor of a consumer if he expects further retentions. The proposed statute provides only that an award can be vacated on grounds of conflict of interest, but does not address the more subtle types of bias.

***Limited discovery.*** Discovery is the process by which litigants obtain information and evidence in the possession of their opponent or third parties. In arbitration, discovery is a privilege, not a right, and many businesses draft arbitration clauses to severely restrict the consumer’s ability to

obtain necessary evidence. Although the proposed D.C. statute addresses discovery in §16-4417(c), it remains available at the discretion of the arbitrator—a power that, in any event, arbitrators already possess. Worse still, the subsection related to discovery can be waived by the arbitration agreement.

***Ban on class actions.*** Many arbitration clauses bar consumers from participating in class actions. This means that there is no effective remedy for wide-scale scams that rip off individual consumers for small amounts. The proposed revised statute offers no protection from this impediment to judicial redress of injuries. Although §16-4410(c) refers only to consolidation of arbitration—and the comments to the RUAA make it clear that the subsection was not intended to resolve class actions—this provision has been used to argue that class action prohibitions in arbitration clauses should be enforced. In the District there is judicial precedent doing just that (*Adams v. American Residential Services*, No. 02-0410 (JDB)(D.D.C. 5/8/03)).

Although the ability of the District to legislate protective measures is constrained by the Federal Arbitration Act, which preempts most state laws that restrict arbitration, the City Council still has plenty of leeway to act on behalf of consumers without falling afoul of federal law. Dozens of states have taken the lead, either limiting the use of arbitration clauses in insurance contracts, regulating arbitration provider organizations, or prohibiting contracts that require consumers to waive their legal rights prior to a dispute arising. There is no reason that citizens of the District should be less protected from deceptive or coercive consumer contracts than the citizens of other states.

The following are Public Citizen’s recommendations both for amending the arbitration bill, and for additional stand-alone legislation that could complement enacted of an arbitration bill by offering protections that would apply to all contracts and not just arbitration agreements.

## **Proposed Amendments**

### **1. Regulate Arbitration Providers**

The Federal Arbitration Act (FAA) does not preempt reasonable state regulation of arbitration service providers, such as the American Arbitration Association (AAA), JAMS, or the National Arbitration Forum (NAF). As long as the regulation does not indirectly limit the enforceability of an arbitration provision, nothing in the FAA prevents such regulation. California recently enacted a series of such laws regulating arbitration service providers. See, e.g., Cal. Code Civ. Proc. §§ 1281.9, 1281.92, 1281.96, 1284.3.

We strongly urge you to add a provision to the proposed arbitration statute that requires, with respect to organizational (not individual) arbitration service providers: (1) disclosure of information about individual cases and their outcome, how frequently a business uses the same arbitration service provider, how long arbitrations take, how much arbitrators are paid, and who pays them; (2) waiver of filing fees for low income consumers; (3) prohibition against administering an arbitration where a non-prevailing consumer must pay the other side’s arbitration costs or attorney fees; and (4) prohibition against administering an arbitration where the service provider has a financial interest in one of the litigants, or where one of the litigants

has a financial interest in the arbitration service provider. Finally, the provision should include a private remedy in the event that the arbitration provider violates these requirements.

I am submitting along with my testimony a model provision to regulate arbitration providers that was drafted by the National Consumer Law Center and based on the California statute. As part of the disclosure provisions in the California law, arbitration service providers are required to post a variety of information about the cases they have arbitrated on their websites. Sample printouts of these are also included for the record so you can see how the system works and the unprecedented degree of access that California consumers have to arbitration information.

## **2. Protect Class Actions by Amending Section 16-4410(c)**

Because § 16-4410(c) as proposed allows a party to argue for enforcement of an arbitration clause prohibiting participation in class actions, we urge you to add language making it clear that the subsection refers only to consolidation of arbitration. The proposed wording for such an amendment is annexed to my testimony. In the absence of such an amendment, we urge you to delete subsection (c) entirely.

## **3. Require Disclosure of Arbitration Costs**

If consumers know how much arbitration is going to cost and how the cost burden is allocated among the parties, they can assess before commencing the arbitration process whether it will be affordable. Disclosure will also help consumers decide whether or not they should agree to arbitration in the first place. This avoids the problem of businesses picking up the costs only after consumers successfully argue that an arbitration agreement is unenforceable because they cannot afford it.

While it is not possible for a state to precondition an arbitration agreement's enforceability on compliance with disclosure requirements—because of FAA preemption—it is nevertheless possible to furnish a mechanism that will oblige future compliance. We urge you to adopt the proposed language for this amendment, as provided in the appendix to my testimony, which provides for injunctive relief to compel disclosure of certain costs.

## **4. Limit BMA Clauses in Some Consumer Arbitration Agreements**

We urge you to amend the arbitration bill to protect consumers by making BMA clauses in consumer form contracts unenforceable unless the FAA provides for their enforceability. This would have immediate effect *for all transactions not in interstate commerce* and, thus, not subject to the FAA. The additional benefit of such an amendment is that if Congress decided to exempt certain transactions from the FAA's scope (instead of outlawing arbitration clauses in those transactions outright), then state law would be in place to prohibit such clauses. Otherwise, state law might require that the clause be enforceable, despite the amendment to the FAA. I am including model language for this amendment as part of my testimony.

## **Proposed Additional Consumer Protections**

Apart from amendments to the arbitration bill per se, the Council can act to protect consumers from the coercive use of arbitration clauses. Two areas in which such legislation would be effective and feasible are insurance and pre-dispute waivers of legal rights.

### **1. Ban Arbitration Clauses in Insurance Contracts**

Although the Federal Arbitration Act generally preempts state laws that restrict arbitration agreements, state insurance legislation is an exception. The McCarran-Ferguson Act, 15 U.S.C. §1012(b), states that no federal law shall invalidate or impair a state statute regulating insurance unless the federal law specifically relates to insurance. Since the FAA does not specifically relate to insurance, state insurance law can prohibit arbitration agreements in insurance transactions. At least 16 states, including Virginia, currently have statutes banning the use of arbitration clauses in insurance contracts, of which only 3 have failed to pass judicial challenge. Another 10 states have statutes or regulations restricting the use of arbitration by insurers. Maryland prohibits pre-dispute, binding arbitration clauses imposed by HMOs or health insurance plans.

Arbitration clauses are particularly dangerous to consumers when insurance is involved. This is because (1) insurance is often not a discretionary purchase but is required by law (auto insurance or by lending institutions (homeowners insurance), (2) the threat of a lawsuit is an important inducement for insurers to pay claims, and (3) insurance products figure prominently in predatory lending scams.

Getting arbitration out of insurance contracts will benefit those consumers who have been sold credit life and disability policies—which pay a beneficiaries outstanding debts upon death or disablement—by subprime lenders, giving them judicial recourse where they would otherwise not be able to afford to pay potentially thousands of dollars in arbitration fees to get a hearing on the case. It would provide an incentive for insurance companies to fairly process claims through the threat of “bad faith” lawsuits in which an insurer that is proven to routinely deny valid claims or fail to investigate claims properly must pay punitive damages or attorneys fees. It would also prevent credit life and title insurance companies that provide kickbacks to mortgage brokers and lenders, in violation of the Real Estate Settlement Practices Act (RESPA), from prohibiting consumer class actions to enforce the law.

I am submitting model legislative language with my testimony for a provision invalidating arbitration clauses as they apply to insurance contracts, which could be added to the Insurance Code.

### **2. Preserve Legal Rights**

Contracts should not waive, prior to a dispute arising, individual rights that benefit the justice system as a whole. Such important rights include those that encourage private actions where state action would be impractical, such as class actions, and those that deter misconduct, such as punitive damages. A law that invalidates *any* contract that requires a party to waive legal rights, not just a contract to arbitrate, is not preempted by the FAA, which specifically allows courts to

refuse to enforce provisions “upon such grounds as exist at law or equity for the revocation of any contract.” Of course, individuals would still be free to agree to waive certain rights or resolve disputes through alternative means subsequent to a controversy arising. Such a law would offer consumers broad protections from the hidden provisions in form contracts.

A model statute to alleviate the problems inherent in BMA clauses and other obligations tucked away in a contract’s fine print is submitted along with my testimony.

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Thank you for giving me an opportunity to testify on this matter of critical important to consumers. Public Citizen would be glad to work with you on amendments and subsequent legislation.

## Appendix 1

### Proposed Amendments to the “Uniform Arbitration Act of 2005”

#### 1. Regulation of Arbitration Service Providers

1. The following definitions apply for the purposes of this section:
  - (a) Consumer arbitration is a binding arbitration where one party is a consumer.
  - (b) Consumer is an individual who has a dispute relating to that individual’s status as:
    - i) a user, purchaser, or one who attempts to use or purchase, any real or personal property, tangible or intangible goods, services, or credit for personal, family, or household purposes.
    - ii) an enrollee, subscriber or insured under a health care plan or health care insurance, or an individual with a medical malpractice claim;
    - iii) an employee or applicant for employment, except where an arbitration is pursuant to the terms of a public or private sector collective bargaining agreement.
  - (c) "Financial interest" is holding a position in a business as officer, director, trustee or partner or holding any position in management; or ownership of more than five percent interest in a business.
2. (a) Any private arbitration company that administers or is otherwise involved in 50 or more consumer arbitrations a year shall collect, publish at least quarterly, and make available to the public in a computer-searchable format, which shall be accessible at the Internet Web site of the private arbitration company, if any, and on paper upon request, all of the following information regarding each consumer arbitration within the preceding five years:
  - (i) The name of any corporation or other business entity that is a party to the arbitration;
  - (ii) The type of dispute involved, including goods, banking, insurance, health care, debt collection, employment, and, if it involves employment, the amount of the employee's annual wage divided into the following ranges: less than one hundred thousand dollars (\$100,000), one hundred thousand dollars (\$100,000) to two hundred fifty thousand dollars (\$250,000), inclusive, and over two hundred fifty thousand dollars (\$250,000).
  - (iii) Whether the consumer was the prevailing party.
  - (iv) On how many occasions, if any, a business entity that is a party to an arbitration has previously been a party in an arbitration or mediation administered by the private arbitration company.
  - (v) Whether the consumer party was represented by an attorney.
  - (vi) The date the private arbitration company received the demand for arbitration, the date the arbitrator was appointed, and the date of disposition by the arbitrator or private arbitration company.
  - (vii) The type of disposition of the dispute, if known, including withdrawal, abandonment, settlement, award after hearing, award without hearing, default, or dismissal without hearing.

(viii) The amount of the claim, the amount of the award, and any other relief granted, if any.

(ix) The name of the arbitrator, his or her total fee for the case, and the percentage of the arbitrator's fee allocated to each party.

(b) If the required information is provided by the private arbitration company in a computer-searchable format at the company's Internet Web site and may be downloaded without any fee, the company may charge the actual cost of copying to any person who requests the information on paper. If the information required is not accessible by the Internet, the company shall provide that information without charge to any person who requests the information on paper.

(c) A private arbitration company that administers or conducts fewer than 50 consumer arbitrations per year may collect and publish the information required by subdivision (a) semiannually, provide the information only on paper, and charge the actual cost of copying.

(d) No private arbitration company shall have any liability for collecting, publishing, or distributing the information in accord with this section.

3. (a) All fees and costs charged to or assessed in this state upon a consumer by a private arbitration company in a consumer arbitration, shall be waived for any person having a gross monthly income that is less than 300 percent of the federal poverty guidelines.  
(b) Nothing in this section shall affect the ability of a private arbitration company to shift fees that would otherwise be charged or assessed upon a consumer party to another party.

(c) Prior to requesting or obtaining any fee, a private arbitration company shall provide written notice of the right to obtain a waiver of fees in a manner calculated to bring the matter to the attention of a reasonable consumer, including, but not limited to, prominently placing a notice in its first written communication to a consumer and in any invoice, bill, submission form, fee schedule, rules, or code of procedure.

(d) Any consumer requesting a waiver of fees or costs may establish eligibility by making a declaration under oath on a form provided by the private arbitration company indicating the consumer's monthly income and the number of persons living in the household. No private arbitration company may require a consumer to provide any further statement or evidence of indigency.

(e) Any information obtained by a private arbitration company about a consumer's identity, financial condition, income, wealth, or fee waiver request shall be kept confidential and may not be disclosed to any adverse party or any nonparty to the arbitration, except a private arbitration company may not keep confidential the number of waiver requests received or granted, or the total amount of fees waived.

4. No neutral arbitrator or private arbitration company shall administer a consumer arbitration under any agreement or rule requiring that a consumer who is a party to the arbitration pay the fees and costs incurred by an opposing party if the consumer does not

prevail in the arbitration, including, but not limited to, the fees and costs of the arbitrator, provider organization, attorney, or witnesses.

5. No private arbitration company may administer a consumer arbitration to be conducted in this state, or provide any other services related to such a consumer arbitration, if
  - (a) The private arbitration company has, or within the preceding year has had, a financial interest in any party or attorney for a party.
  - (b) Any party or attorney for a party has, or within the preceding year has had, any type of financial interest in the private arbitration company.
6. Where this section is violated, any affected person or entity, including the State Attorney General, can request a court to enjoin the private arbitration company from violating the section and order such restitution as appropriate. The private arbitration company shall be liable for that person or entity's reasonable attorney fees and costs where that person or entity prevails or where, after the action is commenced, the private arbitration company voluntarily complies with the section.
7. Should a court decide that any provision of this section is unconstitutional, preempted, or otherwise invalid, that provision shall be severed, and such a decision shall not affect the validity of the section other than the part severed.

## **2. Amendment to Section 16-4410(c)**

After the last sentence of subsection (c), add : "However, nothing in this section is intended to prevent a party's participation in a class action."

## **3. Disclosure of Arbitration Costs**

1. (a) A "consumer arbitration agreement" is defined as a standardized contract where one party drafts a provision that requires disputes arising after the contract's signing be submitted to binding arbitration, and the other party is a consumer. Such an agreement does not include a public or private sector collective bargaining agreement.  
(b) Consumer is defined for purposes of this Act as an individual who either:
  - i). uses, purchases, acquires, attempts to purchase or acquire, or is offered or furnished any real or personal property, tangible or intangible goods, services, or credit for personal, family, or household purposes; or
  - ii) is an employee of or seeks employment from the other party to the agreement.
2. A party drafting a consumer arbitration agreement shall clearly and conspicuously disclose in regard to any arbitration:
  - a) The filing fee;
  - b) The average daily cost for an arbitrator and hearing room if the consumer elects to appear in person;
  - c) Other charges that the arbitrator or arbitration service provider will assess in conjunction with an arbitration where the consumer appears in person;

- d) The proportion of these costs which each party bears in the event that the consumer prevails, and in the event that the consumer does not prevail.
3. The costs specified in section (2) need not include attorney fees, and, to the extent that, with regard to the disclosures required by section (2), a precise amount is not known, the disclosures may be based on reasonable, good faith estimates. A party providing a reasonable, good faith cost estimate shall not be liable in any manner for the fact that the actual cost of a particular arbitration varies from the estimate provided.
  4. Failure to comply with this Act is not grounds to refuse to enforce an arbitration agreement. However, the information provided in the disclosure can be considered in a determination whether an arbitration agreement is unconscionable or otherwise is not enforceable under other law.
  5. Where this Act is violated, any person or entity, including the State Attorney General, can request a court to enjoin the drafting party from violating the Act as to agreements it enters into in the future. The drafting party shall be liable to the person or entity bringing such an action for that person or entity's reasonable attorney fees and costs where the court issues an injunction or where, after the action is commenced, the drafting party voluntarily complies with the Act.
  6. Should a court decide that any provision of this act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed, and such a decision shall not affect the validity of the act other than the part severed.

#### **4. Limitation on Consumer Arbitration Agreements**

1. (a) A "consumer arbitration agreement" is defined as a standardized contract where one party drafts a provision that requires disputes arising after the contract's signing be submitted to binding arbitration, and the other party is a consumer. Such an agreement does not include a public or private sector collective bargaining agreement.  
(b) Consumer is defined for purposes of this Act as an individual who either:
  - i). uses, purchases, acquires, attempts to purchase or acquire, or is offered or furnished any real or personal property, tangible or intangible goods, services, or credit for personal, family, or household purposes; or
  - ii) is an employee of or seeks employment from the other party to the agreement.
2. A consumer arbitration agreement is void and unenforceable except to the extent federal law provides for its enforceability.

## Appendix 2

### Proposed Consumer Protection Legislation

#### 1. An Act to Amend the Insurance Code Relating to Arbitration Agreements

1. For purposes of this act, “consumer” shall mean any individual who uses, purchases, acquires, attempts to purchase or acquire, or is offered or furnished insurance for personal, family, or household purposes.
2. Provisions in any written agreement that involve the offering of insurance and that require a consumer to submit a controversy relating to insurance thereafter arising to arbitration are contrary to the established public policy of this state.
3. The inclusion of such mandatory arbitration clauses in insurance policies involving consumers, or in other written agreements involving the offering of insurance to a consumer, materially affects an integral part of the policy relationship between the insurer and insured and impacts upon the transfer or spreading of risk between insurer and insured.
4. A written contract for insurance with a consumer or other written agreement involving the offering of insurance to a consumer, that requires the submission to arbitration of any controversy related to the insurance transaction thereafter arising between the parties, is hereby prohibited, and any such arbitration provision is hereby declared invalid, unenforceable, and void. Any such arbitration provision shall be considered severable, and other provisions of the contract for insurance shall remain in effect and given full force.
5. If a written agreement that involves both insurance and any other services, goods, property, or credit includes a mandatory arbitration provision, there shall be a clear and conspicuous disclosure that the mandatory arbitration provision does not apply to any insurance-related dispute.
6. A party violating this Act shall be liable to the consumer in an amount equal to the sum of any actual damage sustained by the consumer as a result of the violation, plus \$100, even if no actual damage is proved, plus costs of the action, together with a reasonable attorney’s fee. Any provision requiring that such an action to enforce this Act be submitted to arbitration is void and unenforceable, unless the consumer agrees to arbitration after filing suit or after otherwise notifying the other party as to the violation.
7. Should a court decide that any provision of this act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed, and such a decision shall not affect the validity of the act other than the part severed.

## **2. Preservation of Legal Rights**

1. Prior to a dispute arising, a written agreement shall not waive or have the practical effect of waiving the rights of a party to that agreement to resolve that dispute by obtaining:
  - a) Injunctive, declaratory, or other equitable relief;
  - b) Relief on a class-wide basis;
  - c) Punitive damages;
  - d) Multiple or minimum damages as specified by statute;
  - e) Attorney fees and costs as specified by statute or as available at common law; or
  - f) A hearing where that party can present evidence in person.
2. Prior to a dispute arising, a written agreement shall not require or have the practical effect of requiring that any aspect of a resolution of a dispute between the parties to the agreement be kept confidential. This provision shall not affect the rights of the parties to agree that certain specified information is a trade secret or otherwise confidential or to later agree, after the dispute arises, to keep a resolution confidential.
3. Any provision in a written agreement violating this Act shall be void and unenforceable. A court may refuse to enforce other provisions of the agreement as justice dictates.
4. Any person who is a party to such an agreement can bring an action in court to reform such an agreement so that it complies with this Act. The party or parties responsible for drafting the offending provisions shall be liable for the reasonable attorney fees and costs of the person or entity bringing the action, where that action prevails or where, after the action is commenced, the parties reform the contract voluntarily.
5. Should a court decide that any provision of this Act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed and such decision shall not affect the validity of the Act other than the part severed.

## **Appendix 3**

### **Printouts of Arbitration Service Provider Web Pages In Compliance with California Law**

[Please see the relevant sections of the websites for American Arbitration Association [www.adr.org](http://www.adr.org); JAMS [www.jamsadr.com](http://www.jamsadr.com); and the National Arbitration Forum [www.arb-forum.com](http://www.arb-forum.com).]