



# Private Actions, Public Benefits

Private Litigation Aids Public Enforcement of Consumer Protection Laws

## **Acknowledgments**

This report was written by Adam Crowther, Researcher for Public Citizen’s Congress Watch division, and edited by Congress Watch Director Lisa Gilbert, Congress Watch Consumer and Civil Justice Counsel Christine Hines, and Congress Watch Research Director Taylor Lincoln.

## **About Public Citizen**

Public Citizen is a national non-profit organization with more than 300,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.



Public Citizen’s Congress Watch

215 Pennsylvania Ave. S.E

Washington, D.C. 20003

P: 202-546-4996

F: 202-547-7392

<http://www.citizen.org>

© 2013 Public Citizen.

## Contents

I. Introduction .....	4
II. Depleted Budgets Hinder Ability of Attorneys General to Enforce Consumer Protection Laws .....	5
III. Case Studies: Private Action Complements Public Action to Provide Justice for Consumers .....	7
A. Tobacco Master Settlement Agreement .....	7
B. Vanishing Premiums and “Churning” .....	8
C. Discriminatory Insurance Policies .....	9
D. Allianz Life Insurance and Predatory Annuities .....	11
IV. Forced Arbitration and Class Action Bans Hinder Private Actions and Their Potential to Yield Public Benefits .....	12
Conclusion and Policy Options.....	14

## I. Introduction

Private lawsuits seeking damages for violations of consumer protection laws complement, and sometimes even spur, federal and state enforcement of these laws. The need for private lawsuits is enhanced because public officials increasingly lack sufficient resources to effectively enforce consumer protection laws. State officials have acknowledged that private litigation—particularly class action litigation—is an essential tool that complements their enforcement work.

However, business practices limiting the rights of consumers, coupled with recent Supreme Court decisions that have given businesses significant latitude to use such practices, threaten the ability of private actions to deliver compensation to consumers. Many consumer and employment contracts contain clauses that force consumers to resolve any potential disputes through private arbitration. These clauses not only prevent people from pursuing claims in court as individuals but also often prohibit people from pursuing class actions in court or in arbitration. These class action bans are particularly harmful to consumers because many fraudulent and deceptive practices used against consumers involve damages that likely are too small to be pursued on an individual basis. The Supreme Court's rulings in *AT&T Mobility LLC v. Concepcion* (2011) and *American Express Co. v. Italian Colors* (2013) solidified businesses' ability to use arbitration clauses to prevent consumers from bringing class actions.<sup>1</sup>

When functioning effectively, private and public actions form an effective, complementary enforcement system that provides multiple levels of remedies for consumers. Private lawsuits often provide relief to consumers who have been defrauded or mistreated, while public actions provide both relief to consumers and result in systemic changes that prevent future abuses. This report reviews four examples in which private actions seeking damages for harms caused by violations of consumer protection laws were mirrored by successful litigation by state attorneys general or other public entities.

In some of the cases described in this report, a direct link can be drawn between the private and public actions. In other cases, the similarity between claims made both by private attorneys and public officials suggests, but stops short of proving, that the private lawsuits were responsible for generating the subsequent actions taken by public officials.

The benefits outlined in this report are jeopardized by the increasing use of consumer contract language that deprives consumers of the ability to seek redress. But solutions are

---

<sup>1</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). See also *American Express Co. v. Italian Colors* 570 U.S. \_\_\_ (2013). See also Binyamin Applebaum, *Justices Support Corporate Arbitration*, THE NEW YORK TIMES (June 20, 2013), <http://nyti.ms/15kba1l>.

at hand. Legislation pending in Congress would help protect consumers' rights by prohibiting the inclusion of forced arbitration clauses in consumer contracts. In addition, the Consumer Financial Protection Bureau and the Securities and Exchange Commission have the authority to ban forced arbitration clauses in certain types of financial contracts, which would protect consumers by preserving individual and class-based litigation.

---

“In order to ensure that maximum pressure is brought to bear on violators of the commonwealth’s consumer protection statutes and to provide maximum deterrent to prospective violators, the ability of an individual to bring private cause of action is imperative.”

—*Kentucky Attorney General Jack Conway, 2008*

---

## II. Depleted Budgets Hinder Ability of Attorneys General to Enforce Consumer Protection Laws

Two types of lawsuits will be discussed in this report: those initiated by private citizens and those initiated by public officials. In the first, individuals can file private lawsuits to seek redress on behalf of themselves and— sometimes—other similarly situated people for harms caused by another’s actions. In the second, state attorneys general and other public officials enforce consumer protection laws. They prosecute cases on behalf of the public. Depending on the statute they are enforcing, states can seek restitution, injunctive relief, fines, and other civil and criminal penalties against companies that violate state or federal laws.

However, state officials have acknowledged that shrinking budgets make enforcement of consumer protection laws in the public forum more challenging. Several state enforcement officials have publicly recognized that their limited resources highlight the importance of a strong, private civil justice system.

For example, in a 2010 amicus brief to the New Mexico Court of Appeals, the state of New Mexico explained that “state regulatory and enforcement agencies are confronted with limited (and diminishing) resources, and cannot possible pursue every law breaker.”<sup>2</sup>

---

<sup>2</sup> Brief for the Attorney General of New Mexico as Amicus Curiae Supporting Plaintiff-Appellee (2010) at 9, *Felts et al v. CLK Management Inc. and Cash Advance Network, Inc.*, in the New Mexico Court of Appeals (decided March 2, 2011), <http://bit.ly/1aMUWXF>

Kentucky Attorney General Jack Conway offered similar sentiments. “With the limited resources of the commonwealth, the attorney general is simply unable to pursue each and every violator and must limit its case selection to those matters involving the greatest public interest,” Conway wrote in an amicus brief to the Kentucky Supreme Court. Moreover, Conway explained, “to ensure that maximum pressure is brought to bear on violators of the commonwealth’s consumer protection statutes and to provide maximum deterrent to prospective violators, the ability of an individual to bring a private cause of action is imperative.”<sup>3</sup>

Several other state attorneys general have stated that shrinking state enforcement budgets elevate the importance of the availability of private actions, and particularly class actions. For instance, in the landmark *AT&T Mobility LLC v. Concepcion* case, several states submitted an amicus brief noting, “The efforts of ‘private attorneys general’ are especially valuable in this era of state budget cuts and limited resources, and [the company’s] attempt to do away with consumer class action is a further affront to the States’ interests.”<sup>4</sup>

In fiscal year 2013, 31 states reported a combined budget shortfall of \$55 billion, which contributed to significant cuts, including those to attorneys general offices and other enforcement agencies.<sup>5</sup> For example:

- Between 2008 and 2012, the budget for the Kentucky attorney general’s office was cut 37 percent, triggering the prospect of layoffs that would further hinder enforcement of consumer protection laws.<sup>6</sup>
- Idaho’s attorney general’s budget decreased by \$1.9 million from 2009 to 2013.<sup>7</sup>
- Between 1999 and 2013, the operating budget for the Illinois’ attorney general’s office decreased from \$33.9 million to \$30.7 million, or about 9 percent.<sup>8</sup>

---

<sup>3</sup> Brief for the Attorney General of Kentucky as Amicus Curiae Supporting Appellants (2008) at 4, *Michael Schnuelre et al v. Insight Communications Co. LLP and Insight Communications Midwest, LLC*, in the Supreme Court of Kentucky (decided December 16, 2010).

<sup>4</sup> Brief for the States of Illinois, Maryland, Minnesota, Montana, New Mexico, Tennessee, Vermont, and the District of Columbia as Amicus Curiae Supporting Respondents, S. Ct. Nos. 09-893 (2010) at 6, *AT&T Mobility LLC v. Concepcion*, 131 S. Ct 1740 (April 27, 2011), <http://bit.ly/Wfl7OX>.

<sup>5</sup> PHIL OLIFF, CHRIS MAI, AND VINCENT PALACIOS, CENTER ON BUDGET AND POLICY PRIORITIES, STATES CONTINUE TO FEEL RECESSION’S IMPACT 1 (June 2012), <http://bit.ly/16XB9x9>.

<sup>6</sup> Tom Kenny, *Are Layoffs Possible in Kentucky Attorney General’s Office*, WTVQ-DT LEXINGTON (January 31, 2012), <http://bit.ly/12QrTlQ>.

<sup>7</sup> Pool Reporters, *Budget Cuts Forced Idaho AG to Hire Outside Help*, IDAHO STATE JOURNAL (February 6, 2013), <http://bit.ly/1bgTex4>

<sup>8</sup> *Illinois State Budget, 2008-2009*, BALLOTPEDIA (viewed July 15, 2013), <http://bit.ly/13dYpsy>. See also Christopher Wills, *Illinois Attorney General Pushes Back on Budget*, THE STATE JOURNAL-REGISTER (March 8,

- In fiscal year 2012, New York reduced its attorney general's budget by 10 percent, which far exceeded a general cut of 2 percent to the state budget.<sup>9</sup>
- The South Carolina Department of Consumers Affairs is responsible for enforcing South Carolina's consumer protection laws. Its budget has been decreased significantly over the past several years, dropping from more than \$4 million in fiscal year 2009 to \$2.5 million in fiscal year 2013, or about a 38 percent.<sup>10</sup>

### III. Case Studies: Private Action Complements Public Action to Provide Justice for Consumers

The following case studies illustrate how enforcement actions by public officials and litigation by private individuals serve as distinct but complementary components of the civil justice system. In some instances, the private lawsuit spurred public enforcement action. In other instances, private and public actions complemented each other, providing multiple levels of remedies for consumers.

#### A. Tobacco Master Settlement Agreement

Between 1954 and 1983, individuals brought more than 800 private lawsuits alleging "negligent manufacture, negligent advertising, fraud, and violation of various state consumer protection laws" against tobacco companies in state courts.<sup>11</sup> The tobacco companies successfully defended every suit.<sup>12</sup> Although tobacco companies were successful in defending against private lawsuits brought by individuals, many of these cases thrust important internal tobacco company documents into the public domain. In particular, the case brought by Rose Cipollone and her family against the Liggett Group in 1983 resulted in the release of thousands of damaging documents that were instrumental in the decisions of more than 40 states to bring suit against tobacco companies to recover medical expenses paid by the state or territory to treat smoking-related illnesses.<sup>13</sup>

---

2012), <http://bit.ly/13IN0CD> and Public Citizen Analysis of Illinois Budget Documents (downloaded July 16, 2013), <http://1.usa.gov/15yefNg>.

<sup>9</sup> Leigh Remizowski, *N.Y. Governor, Legislature Agree on State Budget*, CNN (March 28, 2011), <http://bit.ly/gRmqUF>.

<sup>10</sup> SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS, ANNUAL ACCOUNTABILITY REPORT, FISCAL YEAR 2011-2012 7 (September 2012), <http://1.usa.gov/XKVlQs>.

<sup>11</sup> Robin Miller, *Validity, Construction, Application, and Effect of Master Settlement Agreement (MSA) Between Tobacco Companies and Various States, and State Statutes Implementing Agreement; Use and Distribution of MSA Proceeds* 25 American Law Reports 6<sup>th</sup> at 17 (2007) [hereinafter *Miller Report*].

<sup>12</sup> *Id.*, 17.

<sup>13</sup> Laurie P. Cohen and Alix M. Freedman, *Cracks Seen in Tobacco's Liability Dam*, WALL STREET JOURNAL (June 16, 1988). See also *Timeline: Inside the Tobacco Deal*, PBS NEWS (viewed September 12, 2013), <http://to.pbs.org/17S9NFN>.

In 1994, Mississippi became the first state to bring a suit against the tobacco industry. By 1997, more than 40 states filed similar suits.<sup>14</sup>

In November 1998, 46 states, the District of Columbia, and five U.S. territories entered into a combined settlement of the states' lawsuits with the four largest tobacco companies, which agreed to pay an estimated \$206 billion.<sup>15</sup> Additionally, the settlement imposed significant changes on the industry, including, restrictions on advertising to children, outdoor advertising, and advertising in public transit.<sup>16</sup> The settlement also prohibited tobacco manufacturers from opposing or judicially challenging state or local legislation aimed at reducing youth smoking.<sup>17</sup>

Here, documents unearthed by private attorneys were instrumental in propelling the state lawsuits against the tobacco companies. Without the private litigation and the information that they brought to light, state officials would have been far less likely to bring their own suits and to extract such significant concessions from the companies.

### **B. Vanishing Premiums and “Churning”**

In early 1994, customers sued Prudential Financial Inc. (“Prudential”), alleging deceptive marketing and sales practices that violated the Securities Exchange Act of 1934.<sup>18</sup> Suits against other insurance companies, including New York Metropolitan Life Insurance Co. and John Hancock Life Insurance Co., were also filed.

One challenged practice was known as “vanishing premiums,” in which insurance brokers would sell customers policies with large upfront premiums with the promise that the initial premiums would earn enough interest to avoid future premium payments. In reality, interest payments often were too small to cover the new premiums, leaving unsuspecting customers to pay the balance.<sup>19</sup>

Another challenged practice was “churning,” which consisted of convincing existing policy holders to add newer, more expensive policies, with the promise that the customer would not have to pay additional premiums.<sup>20</sup> In fact, the company would use the cash value of the initial policy to pay for the premium on the new policy. When the cash value from the initial

---

<sup>14</sup> *Miller Report*, 17.

<sup>15</sup> *Id.*, 18.

<sup>16</sup> *Tobacco Project*, NATIONAL ASSOCIATION OF ATTORNEYS GENERAL (viewed July 16, 2013), <http://bit.ly/12ueh7h>.

<sup>17</sup> *Id.*

<sup>18</sup> *In re Prudential Ins. Co. America Sales Litigation* 148 F.3d 283, 290 (3<sup>rd</sup> Cir. 1998).

<sup>19</sup> Scot J. Paltrow and Willam C. Rempel, *Unsettlement: For Prudential Clients, It Won't be Easy to Collect in Fraud Suit*, LOS ANGELES TIMES (December 6, 1996), <http://lat.ms/9EOm46>.

<sup>20</sup> *Id.*



policy ran out, customers were then required to pay large premiums to maintain their coverage.<sup>21</sup>

In 1996, Prudential settled a class action lawsuit alleging deceptive sales practices policies by agreeing to pay \$2.8 billion to millions of customers.<sup>22</sup>

As the federal court of appeals reviewing the private settlement noted, the accumulation of private lawsuits alleging deceptive marketing tactics by Prudential prompted the Insurance Commissioner of New Jersey to open an investigation into the sales practices of the company.<sup>23</sup> The New Jersey investigation spurred the National Association of Insurance Commissioners (NAIC), a “standard setting and regulatory support organization” that consists of state insurance regulators, to form a task force to investigate churning and vanishing premiums.<sup>24</sup> Regulators from 45 states and the District of Columbia joined the task force.<sup>25</sup>

In July 1996, Prudential was fined \$35 million by the NAIC task force.<sup>26</sup> Later, Prudential agreed to pay an additional \$35 million to regulators from California, Florida, Texas, Massachusetts, and Virginia—states that did not participate in the broader investigation by the NAIC.<sup>27</sup> Finally, in July 1999, the National Association of Securities Dealers fined Prudential \$20 million, which at the time was the largest fine issued by the NASD.<sup>28</sup>

Here, private litigation against Prudential was instrumental in prompting public officials to investigate insurance company practices, which resulted in significant penalties for the offending company.

### C. Discriminatory Insurance Policies

Throughout the first half of the 20th century, insurance companies sold burial insurance policies, particularly in the southeastern United States. Many insurance companies charged black customers higher premiums for these policies than they charged white customers.

---

<sup>21</sup> Marylynn Pitz, *Met Life Settles Suit, Earmarks \$1.7 Billion for Deception Claims*, PITTSBURGH POST-GAZETTE (August 19, 1999), <http://bit.ly/146kVWh>.

<sup>22</sup> Kimberly Lankford, *Nightmare on Main Street*, KIPLINGERS PERSONAL FINANCE MAGAZINE (May 2000), <http://bit.ly/1goLUxw>.

<sup>23</sup> *In re Prudential Ins. Co. America Sales Litigation* at 290, 148 F.3d 283, 290 (3<sup>rd</sup> Cir. 1998).

<sup>24</sup> *In re Prudential Ins. Co. America Sales Litigation* at 290, 148 F.3d 283, 290 (3<sup>rd</sup> Cir. 1998). See also *About the NAIC*, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (viewed August 9, 2013), <http://bit.ly/135WGrl>.

<sup>25</sup> Chris Mondics, *Prudential Will Pay Record Fine over Deceptions*, PHILADELPHIA INQUIRER (July 10, 1996), <http://bit.ly/1apYStR>

<sup>26</sup> *Id.*

<sup>27</sup> Jeffrey Gold, *Auditor: Prudential Dragged Feet Despite 12 Years of Warnings on Abuses*, ASSOCIATED PRESS (August 7, 1997), <http://bit.ly/1dAGQF0>.

<sup>28</sup> Joseph D. Allegro, *NASD Fines Prudential Unit \$20 Million*, LIFEHEALTHPRO (July 19, 1999), <http://bit.ly/13MFN63>.

In 1988, the National Association of Insurance Commissioners (NAIC) distributed a survey to insurance companies in which it asked whether the companies had charged different prices for burial insurance based on policy-holders' race.<sup>29</sup> Responding to the survey, 52 insurance companies admitted that they at some point had used race as a factor in calculating premiums.<sup>30</sup> Despite this revelation, the NAIC took no action against those companies at that time.

In October 1999, policyholders brought a class action lawsuit against American General Life and Accident Insurance Co., alleging racial discrimination in pricing of burial insurance policies.<sup>31</sup> Information unearthed in the course of the litigation revealed that American General Life and its subsidiaries used discriminatory pricing to sell more than 5 million policies to more than 2 million customers.

Also in 1999, the Florida Insurance Commissioner began investigating the pricing practices of America General. The Florida investigation later expanded into a broader investigation by the NAIC.<sup>32</sup> In June 2000, American General Life settled both actions. The class action suit with 9.1 million private plaintiffs was settled for \$206 million; the regulatory enforcement action with all 50 states was settled for \$7.5 million.<sup>33</sup>

In June 2000 and July 2000, private plaintiffs filed class action lawsuits alleging discrimination in burial insurance sales against Prudential and New York Metropolitan Life Insurance Co., respectively.<sup>34</sup> In August 2002, the lawsuit against New York Metropolitan Life Insurance Co. was settled,<sup>35</sup> with the company agreeing to pay \$157 million in connection with discriminatory pricing of 1.9 million policies.<sup>36</sup> The case against Prudential was resolved in December 2002, with the company agreeing to equalize pricing of the policies and to donate \$1 million to charitable organizations.<sup>37</sup>

---

<sup>29</sup> TEXAS DEPARTMENT OF INSURANCE, IN THE MATTER OF AMERICAN NATIONAL INSURANCE COMPANY: MULTI-STATE REGULATORY SETTLEMENT AGREEMENT 1 (June 2004), <http://bit.ly/18lrF5w>.

<sup>30</sup> Larry Fish, *21 Companies Have Insurance Policies Based on Race*, PHILADELPHIA INQUIRER (August 3, 1988), <http://bit.ly/1apZPSP>.

<sup>31</sup> Steve Nesius, *Insurance Industry Face Lawsuits After Century of Race-based Charges*, USA TODAY (October 10, 2004), <http://usat.ly/13qs7WX>.

<sup>32</sup> Bill Carey, *State, 79,000 Residents to Receive Checks from American General*, NASHVILLE POST (July 10, 2000), <http://bit.ly/1e6ekuZ>. See also Joseph B. Treaster, *Insurer Agrees It Overcharged Black Clients*, NEW YORK TIMES (June 22, 2000), <http://nyti.ms/1aLRpsC> and *States Ratify Commissioner Nelson's \$213.5 Settlement on Discriminatory Burial Insurance Rates*, PR NEWSWIRE (July 10, 2000), <http://bit.ly/1ccLrSn>.

<sup>33</sup> *\$214M Insurance Settlement Approved*, WASHINGTON POST (September 10, 2000), <http://wapo.st/19b5yPG>.

<sup>34</sup> Insure.com, *Bias on Burial Insurance*, MARKETWATCH (July 17, 2000), <http://on.mktw.net/1dCnWgX>.

<sup>35</sup> *Metlife is Settling Bias Lawsuit*, NEW YORK TIMES (August 30, 2002), <http://nyti.ms/13gvELP>.

<sup>36</sup> Steve Nesius, *Insurance Industry Face Lawsuits After Century of Race-based Charges*, USA TODAY (October 10, 2004), <http://usat.ly/13qs7WX>.

<sup>37</sup> Staff Writer, *Prudential Agrees to Settle Race-Based Underwriting Claims*, LIFEHEALTHPRO (December 20, 2002), <http://bit.ly/1bFDMsV>.

Here, private litigation worked in concert with public enforcement, leading to monetary compensation.

#### **D. Allianz Life Insurance and Predatory Annuities**

Beginning in 2003, consumers filed several class action lawsuits against Minnesota-based Allianz Life Insurance Co., claiming that it used deceptive marketing and sales tactics to convince seniors to purchase deferred annuities that would not mature until after the seniors had died.<sup>38</sup> Many senior citizens who purchased these annuities wanted to withdraw money prior to the maturity date, often to pay health-related expenses. However, if they withdrew money before the maturity date, they were charged exorbitant fees, often called “surrender charges.”<sup>39</sup>

The lawsuits were filed under federal and state statutes, including the federal Racketeer Influenced and Corrupt Organizations Act, California’s Elder Abuse Act, and Minnesota’s Prevention of Consumer Fraud Act.<sup>40</sup> One class action case was settled in 2007. This settlement provided varying amounts of cash relief (depending on the surrender date) to more than 60,000 consumers who were forced to pay the surrender charge.<sup>41</sup>

In 2006, the California Department of Insurance filed suit against the insurance company. California’s claims were similar to private claims that the company had engaged in deceptive sales tactics when selling annuities to senior citizens. In February 2008, Allianz settled with California by agreeing to pay \$10 million.<sup>42</sup>

In January 2007, Minnesota sued Allianz, claiming that the company used deceptive sales tactics to sell unnecessary and unsuitable annuities to senior citizens.<sup>43</sup> In a settlement reached in October 2007, Allianz agreed to pay millions of dollars in total (depending on the response rate to the settlement by the victims) to about 7,000 seniors who had purchased Allianz annuities since 2001.<sup>44</sup> Under the terms of the settlement, any Minnesota resident more than 65 years old who purchased an Allianz deferred annuity on January 1,

---

<sup>38</sup> Thomas Lee, *Allianz Close to Settling Class Action Annuity Suit*, STAR TRIBUNE (August 17, 2007), <http://bit.ly/169Y6jl>. See also Chris Serres, *A Split Decision in Allianz Life Annuity Lawsuit*, STAR TRIBUNE (October 13, 2009), <http://bit.ly/1sHURh> and Thomas Lee, *Allianz Settles First Annuity Lawsuit*, STAR TRIBUNE (October 3, 2007), <http://bit.ly/144CoZH>.

<sup>39</sup> *Annuities Alert for Senior Citizens*, ANAPOL SCHWARTZ (viewed July 15, 2013), <http://bit.ly/12Exodz>.

<sup>40</sup> Gavin Brody, *Allianz Can’t Dodge Racketeering Claims in Annuities Suit*, LAW360 (March 5, 2013), <http://bit.ly/13G697Q>.

<sup>41</sup> Thomas Lee, *Allianz Settles First Annuity Lawsuit*, STAR TRIBUNE (October 3, 2007), <http://bit.ly/144CoZH>.

<sup>42</sup> Thomas Lee, *Allianz to Pay \$10 Million to Settle Lawsuit*, MINNEAPOLIS STAR TRIBUNE (February 14, 2008), <http://bit.ly/13eBU6X>.

<sup>43</sup> Thomas Lee, *Allianz Suit Settlement May Bring Full Refunds*, MINNEAPOLIS STAR TRIBUNE (October 8, 2007), <http://bit.ly/18hnYuc>.

<sup>44</sup> *Id.*

2001, or later would be eligible for a full refund of the premium, plus 4.15 percent interest if it were determined the sale was “unsuitable or based on misrepresentations.”<sup>45</sup> The settlement also put into place new procedures to govern Allianz’s scrutiny of annuity applications.<sup>46</sup>

Here, state lawsuits that mirrored earlier private actions provided citizens compensation and resulted in the implementation of systemic consumer protections.

#### **IV. Forced Arbitration and Class Action Bans Hinder Private Actions and Their Potential to Yield Public Benefits**

The cases described above often resulted in benefits both to consumers who had been harmed and to the public at large. Many of the lawsuits brought by state attorneys general were based on cases brought by consumers. However, recent developments permitting the proliferation of forced arbitration clauses and class action bans threaten the ability of consumers to pursue lawsuits that can achieve meaningful relief.

In 1984, the Supreme Court ruled in *Southland Corp et al. v. Keating* that in the Federal Arbitration Act of 1925, Congress had “declared a national policy favoring arbitration.”<sup>47</sup> Although the Federal Arbitration Act had historically been viewed as governing disputes between businesses, the *Southland* decision meant that state law could not prohibit businesses from requiring consumers to settle disputes through mandatory arbitration. Following this decision, businesses began a now widespread practice of inserting forced arbitration clauses into consumer contracts.

These clauses require that any potential disputes must be settled through private arbitration. Consumers are harmed by these clauses because they are denied the opportunity to have their case heard in a neutral court of law that is subject to public oversight. In forced arbitration, the company selects the arbitration firm that will conduct the hearing, giving the arbitration firm a financial incentive to favor the business. Moreover, arbitration proceedings are often conducted in secret, may be adjudicated in a manner that does not follow the law, and frequently limit many common legal principles, including the use of discovery. Also, there is scant opportunity to appeal an arbitrator’s ruling.

The Supreme Court’s 2011 ruling in *AT&T Mobility LLC v. Concepcion* compounded the effects of its ruling in *Southland* (and of several post-*Southland* Supreme Court rulings not

---

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

mentioned here) by permitting companies to insert language banning the use class actions into arbitration clauses.<sup>48</sup> Class action bans often have the practical effect of preventing consumers from seeking redress of any sort, whether in arbitration or in court, because the alleged harms to individual consumers often are not large enough to make it economically feasible to bring a case.<sup>49</sup>

This conclusion has been supported many times in viewpoints offered in lawsuits relating to class action bans. For instance, an affidavit submitted by private attorneys in a state payday lending case that came before the New Mexico Supreme Court stated that the authors had never witnessed a lawsuit brought against a payday lender that was *not* a class action suit because the claims were too small to justify individual suits.<sup>50</sup>

Additionally, the Washington attorney general's office has noted the indispensability of class actions in consumer protection suits, writing:

Consumers are unlikely to invest the time, expense, and effort necessary to bring individual claims to recover small amounts of money that they are wrongfully charged. Without a class action, consumers will have no redress for their claims, and the businesses who unfairly collect a small amount of money from millions of consumers will keep their unlawful profits with impunity.<sup>51</sup>

Even the U.S. Supreme Court has recognized the vital role that class actions play. "The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring solo action prosecuting his or her rights," the Supreme Court noted in its 1997 ruling in *Amchem Products, Inc. v. Windsor*. "A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor."<sup>52</sup>

Even the *Concepcion* decision recognizes that class actions are sometimes essential to achieve justice. The majority decision acknowledges that "class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system." But, it goes on to state, "[s]tates cannot require a procedure that is inconsistent with the FAA."<sup>53</sup>

---

<sup>48</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (April 27, 2011), <http://bit.ly/Wf17OX>.

<sup>50</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (April 27, 2011), <http://bit.ly/Wf17OX>.

<sup>50</sup> Brief for the Attorney General of New Mexico as Amicus Curiae Supporting Plaintiff-Appellee (2010) at 14, *Felts et al v. CLK Management Inc. and Cash Advance Network, Inc.* in the New Mexico Court of Appeals (decided March 2, 2011), <http://bit.ly/1aMUWXF>.

<sup>51</sup> Brief for the Attorney General of Washington as Amicus Curiae Supporting Appellants (2006) at 16, *Doug Scott et al v Cingular Wireless, LLC.* in the Supreme Court of the State of Washington (decided July 12, 2007).

<sup>52</sup> *Amchem Products, Inc v. Windsor*, 521 U.S. 591, 617 (1997).

<sup>53</sup> *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (April 27, 2011), <http://bit.ly/Wf17OX>.

More recently, in 2013, the court ruled in *American Express Co. v. Italian Colors* that an arbitration clause that bans class actions is binding even when class actions are the only economically feasible way of pursuing claims because the costs of arbitrating individually exceed the possible recovery for any one person.<sup>54</sup>

Maintaining the availability of class actions is essential to preserve consumers' right to seek meaningful redress for wrongdoing that affects many people but injures each only in a small way. Class actions enable consumers to seek compensation for a wrongdoing. They complement state or federal officials' enforcement efforts, which often achieve injunctive relief or restitution.

## Policy Options

To address the issue of forced arbitration and protect consumers' access to the courts, Congress should pass the Arbitration Fairness Act ("AFA"), which would ban the use of forced arbitration clauses in consumer contracts. The AFA would restore the original intent of the Federal Arbitration Act ("FAA"), which was passed in 1925 and was meant to apply to contracts entered into by businesses.<sup>55</sup> The AFA would increase fairness in many types of contracts, including consumer and employment contracts, by invalidating forced arbitration clauses that are entered into before a dispute over the contract even arises.<sup>56</sup>

Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act granted the Consumer Financial Protection Bureau and the Securities and Exchange Commission the authority to ban forced arbitration clauses in certain types of consumer financial contracts. The CFPB recently banned forced arbitration in consumer mortgage and home equity loan agreements, and in April 2013, initiated a study into the use of forced arbitration in non-mortgage financial products.<sup>57</sup> Both agencies should issue rules to ban forced arbitration in the contracts under their jurisdiction. This would be another crucial step toward restoring the ability of consumers to remedy violations of consumer protection laws and enable complementary private and public actions to maintain an effective and responsive civil justice system.

---

<sup>54</sup> *American Express Co. v. Italian Colors* 570 U.S. \_\_\_ (2013).

<sup>55</sup> *The Arbitration Fairness Act of 2013*, THE OFFICE OF SENATOR AL FRANKEN (D-MINN.) (viewed July 17, 2013), <http://1.usa.gov/12wBENf>.

<sup>56</sup> *Id.*.

<sup>57</sup> Jann Swanson, *CFPB Reminds Lenders of Changes to Mandatory Arbitration Provisions*, MORTGAGE NEWS DAILY (May 17, 2013), <http://bit.ly/186lgau>.