TESTIMONY TO THE NEW YORK STATE ASSEMBLY

STANDING COMMITTEE ON CONSUMER AFFAIRS AND PROTECTION

AND STANDING COMMITTEE ON JUDICIARY

PUBLIC HEARING ON ARBITRATION

February 10, 2016

By Karla Gilbride

Cartwright-Baron Staff Attorney

Public Justice

Introduction

Pre-dispute binding arbitration clauses[1] are ubiquitous in modern society, and it is virtually impossible to purchase products or sign up for services these days without, knowingly or (more likely) unknowingly, committing to give up the right to go to court if a problem should later arise. From transactions as seemingly frivolous as downloading a new iPhone app to decisions as monumental as admitting an ailing relative to a nursing hoem, somewhere in the fine print of "terms and conditions" that are presented in long, complex forms or in scrolling text on a computer or smartphone screen there will be a paragraph or two specifying that any future dispute must be brought in private arbitration rather than before a judge or jury. Usually these clauses also prohibit consolidating claims with others affected by similar conduct, whether that means joining forces with one or two other consumers or filing or participating in a class action with hundreds or thousands of similarly harmed individuals. And with increasing frequency, these arbitration provisions are appearing in employment applications and manuals as well, such that giving up the right to a trial by jury has become a condition of employment for more and more New Yorkers, and residents of other states.

Advocates of arbitration insist that this is a positive, or at least a neutral, development: that arbitration simply represents an alternative forum for resolving disputes and that in many ways it is a better forum for consumers and employees because it is faster, cheaper, less formal

[1] [1] The concerns addressed in this testimony all relate to "pre-dispute arbitration agreements," meaning contract provisions agreed to in advance of any dispute or claim that require a party to take any claims that may later arise to arbitration instead of to court. The concerns discussed here do not relate to post-dispute arbitration, in which two parties to an existing dispute agree after the dispute arises to submit that dispute to arbitration.

and less intimidating to navigate than the court system. But there are several reasons to question this narrative. To the extent that empirical information is available, it shows that far fewer consumers and employees bring claims in arbitration than in court, due in part to the high costs associated with arbitration. Those who do pursue arbitration fare demonstrably worse than those who are able to bring their disputes in court, especially when they must proceed without an attorney. And the secrecy surrounding arbitration proceedings and awards, the repeat-player effects that allow employers and companies to pick arbitrators who tend to favor their position, and the limited grounds for judicial review of arbitrators' decisions all add to the inherent unfairness and imbalance of the arbitral system. The reforms proposed in Assembly Bills A.108 and A.8191 would address some of these problems by creating more transparency around arbitral proceedings and requiring arbitrators to disclose facts that might affect their impartiality.

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 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 these Committees are 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. Arbitration Is Not a Cheaper Option Than Court for Most Consumers or Employees, Who Are Routinely Deterred by Its Costs.

The mantra that proponents of arbitration will often repeat is that it is a faster, cheaper, and easier system for consumers and employees to bring their disputes as compared to courts, whose dockets are crowded and whose formal procedures many people find confusing or overwhelming. There is truth to some of these assertions. An article published in 2015 in the Brooklyn Law Review by Professor Jean Sternlight[2] found that employment cases brought in arbitration took about a year to reach a hearing whereas those filed in court took at least two years to go to trial. But the notion that arbitration is cheaper for consumers and employees is far more controversial.

[2] Jean R. Sternlight, Disarming Employees: How American Employers are Using Mandatory Arbitration to Deprive Workers of Legal Protection, 80 Brook. L. Rev. (2015). Available at http://brooklynworks.brooklaw.edu/blr/vol80/iss4/3.

Because the court system is subsidized by the taxpayers, litigants must only pay a filing fee in the hundreds of dollars to initiate a suit, and even this fee can be waived with a showing of poverty. By contrast, arbitration is entirely private, and arbitrators are paid by the hour for their time. The parties to an arbitration also must often pay to rent the conference rooms where arbitration hearings are held and must pay all costs associated with bringing witnesses to testify, including the costs of court reporters to transcribe the testimony. None of these costs would be the parties' responsibility if the proceedings were taking place in a public court.

These cost concerns are magnified when, as is often the case, the arbitration clause also contains a ban on class or collective actions. For consumers or employees with relatively low-value claims, combining forces with others to share the costs of vindicating their rights is often the only way to make pursuing a dispute possible.

The experience of Stephanie Sutherland illustrates this point. Ms. Sutherland worked for Ernst& Young as a low-level accountant mostly performing clerical tasks. She was paid a flat salary of $55,000 a year regardless of how many hours she worked per week. Because she routinely worked more than 40 hours per week and believed she was entitled by federal and New York labor law to overtime wages for those extra hours, she filed a lawsuit seeking back pay for 151.5 hours of overtime, adding up to approximately $1,800. But because an arbitration provision was included in her application materials when she applied to work for Ernst & Young and that provision also banned her from pursuing a class or collective action, the Court of Appeals for the Second Circuit ruled that she could only bring her claim on an individual basis.[3] The court made this ruling despite the fact that Ms. Sutherland had submitted an affidavit

[3] *Sutherland v. Ernst & Young LLP*, 726 F.3d 290, 296 (2d Cir. 2013).

explaining that the costs and attorneys' fees associated with bringing her case in arbitration would amount to $200,000, all in order to pursue a claim worth less than $2,000.

The way in which the costs of arbitration will be split is sometimes specified in the arbitration clause or by the rules of the arbitration service provider named in the clause, such as the American Arbitration Association ("AAA"). If the rules are not specified in advance, however, then the ultimate discretion to allocate costs will rest with the arbitrator. Perhaps the arbitrator will split costs down the middle, perhaps he or she will force the party that loses the arbitration to pay all of the costs, or perhaps he or she will require the employer or company, as the party with greater financial resources, to pay all or most of the costs. But without knowing ahead of time how this will all shake out, it is rational for a consumer, or an attorney deciding whether or not to represent a consumer, to pass on a forum where a bill for thousands of dollars might or might not come due at the end of the process, and where costs may have to be advanced along the way only to perhaps be reimbursed later if the arbitrator so chooses. This is simply not the sort of roll of the dice that most consumers, especially low-income consumers, are willing or able to make.

This uncertainty around the costs of arbitration no doubt explains, at least in part, why the Consumer Financial Protection Bureau found, in its 2015 study of pre-dispute arbitration in the financial services industry,[4] that even with the proliferation of arbitration clauses preventing many consumers from going to court, there were still around twice as many non-class-action cases filed in federal court by consumers regarding credit cards, payday loans and other financial products between 2010 and 2012 than in arbitration. This trend became especially pronounced

[4] A blog post summarizing the CFPB's 700+-page report to Congress on mandatory arbitration clauses in consumer financial markets, including credit cards, checking accounts, payday loans, and private student loans, is available at http://1.usa.gov/1GBjDoQ.

for relatively low-value claims, as the CFPB found that the AAA handled only around 25 arbitrations per year by consumers seeking damages of $1,000 or less. The New York Times uncovered a similar dearth of low-value arbitrations in a study that it conducted for a series of articles on arbitration published last year: between 2010 and 2014, only 505 consumers went to arbitration over disputes of $2,500 or less.[5]

The same sort of picture appears by digging beneath the surface of arbitrations involving employment claims, though again, getting a solid empirical handle on what is happening in arbitration is difficult given the secrecy in which it is shrouded. A survey of lawyers who represent employees in arbitration found that AAA handles about half of the employment-related arbitrations, and Professor Alexander Colvin found that AAA handled only 946 employment arbitrations in 2008, 10% of which were filed by employers. Putting these numbers together in her article in the Brooklyn Law Review, Jean Sternlight estimated that employees were filing less than 2000 arbitrations per year, which contrasts sharply with the 30,000 cases filed in federal court each year by employees regarding civil rights, ERISA and the Fair Labor Standards Act ("FLSA") and the 75,000 to 99,000 complaints filed each year by employees with the Equal Employment Opportunity Commission ("EEOC").[6]

Clearly, arbitration is not a favored forum for employees to file claims, even as more and more employees are left with no other option. According to a survey of nearly 350 companies conducted by management-side law firm Carlton Fields Jorden Burt LLP, the percentage of companies attempting to impose arbitration provisions and class action bans on their employees

[5] Jessica Silver-Greenberg and Robert Gebeloff, "Arbitration Everywhere, Stacking the Deck of Justice": New York Times, November 1, 2015. Available at http://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html.

[6] Sternlight, *supra* note 2, at 22-24.

jumped from 16% in 2012 to 43% in 2014.[7] And perhaps because of the financial uncertainties of arbitration described above, those employees who do try their luck in arbitration (at least among those who are represented by counsel) tend to be higher-income than those who file claims in court.[8] In short, the notion that arbitration is preferable for consumers and employees because it is cheaper than going to court has almost no support in the empirical record.

II. Consumers and Employees Who Pursue Arbitration Generally Fare Worse Than Their Corporate Adversaries and Their Peers Who Can Go to Court.

Another aspect of the narrative that arbitration is good for consumers that does not stand up to actual data is the question of arbitration outcomes. The CFPB studied all of the arbitrations handled by AAA between 2010 and 2012 in the consumer financial markets that it regulates and found that of the 158 disputes in which an arbitrator issued a decision on a consumer's affirmative claim, the consumer received some relief in 20.3% of cases, winning an average of 57 cents for every dollar claimed across those 32 cases and an average of twelve cents for every dollar claimed across all 158 cases. Meanwhile companies did exceptionally well in arbitration: of the 244 disputes involving corporate claims or counterclaims resolved by the arbitrator in this same sample of AAA arbitrations, the company won in 93% of cases and received 91 cents for every dollar claimed.[9]

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[7] Lauren Weber, "More Companies Block Employees From Filing Suits," Wall Street Journal, March 31, 2015. Available at http://www.wsj.com/article_email/more-companies-block-staff-from-suing-1427824287-lMyQjAxMTA1NTMzMTUzNTEyWj

[8] Sternlight, *supra* note 2, at 32 n.186.

[9] Lauren Guth Barnes, "How Mandatory Arbitration Agreements and Class Action Waivers Undermine Consumer Rights and Why We Need Congress to Act," Harvard Law & Policy

The figures are equally stark when it comes to employment arbitrations. Professor Alexander Colvin found in a comparison of AAA arbitrations with federal and state court judgments that employees' win rate was 21.4 % in AAA arbitration, 36.4% in federal court employment discrimination cases, and 57% in state court non-civil rights cases. Employees also won nnotably smaller damage awards in arbitration even when they did prevail: comparing mean damages, including cases in which plaintiffs recovered nothing, Colvin found a mean recovery of $109,858 in AAA arbitration, $394,223 in federal court employment discrimination cases, and $575,453 in state court non-civil rights employment cases.[10]

Another oft-repeated claim that the data seems to refute is that because arbitration is simpler and less formal than court, employees can easily proceed there without an attorney. A survey of AAA data found that only 31.4% of employee claimants in arbitration were self-represented, and they had considerably poorer outcomes than those who went through arbitration with an attorney. Specifically, those employees who participated in AAA arbitrations with an attorney won 27.9% of the cases they brought, whereas only 17% of the self-represented employees prevailed. And the represented employees who were victorious in arbitration won an average of $99,217 in damages, while the employees who proceeded pro se and prevailed won just $11,071, on average.[11]

III. Beyond the Numbers: Secrecy, Repeat Player Bias and Lack of Judicial Review

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Review, Vol. 9:2, pp. 330-355 (June 2015). Available at http://harvardlpr.com/print-archive/volume-9-2/ (summarizing results of CFPB study).

[10] Sternlight, *supra* note 2, at 19-20.

[11] Sternlight, *supra* note 2, at 34-35.

But the problems with forced arbitration go beyond the empirically verifiable issues of cost and outcome. The system creates a culture of secrecy, where largely unaccountable arbitrators hear disputes behind closed doors and render decisions without being bound to follow legal precedents and often without publishing a written decision that explains their reasoning. This culture of secrecy prevents consumers and employees who are having a dispute from learning whether others have experienced a similar problem before and how that problem was resolved. It also leads to arbitrary and inconsistent results in the arbitral forum because arbitrators, unlike judges, are not required to follow precedents created by earlier-decided cases with similar facts.

And in the most egregious situations, this culture of secrecy can allow corporate misconduct and abuse to go on unchecked for years without the knowledge of investors or customers, as we learned recently when Dov Charney was forced to resign as CEO of American Apparel after untold numbers of sexual harassment claims were resolved in arbitration, under confidentiality clauses that prohibited employees from saying anything about the arbitrations—even that they had occurred.[12] Former Bear Sterns managing director Maureen Sherry made similar observations in her recent editorial in the New York Times about the culture of harassment towards women endemic in the finance industry, contending that confidential

[12]Steven Davidoff Solomon, "Arbitration Clauses Let American Apparel Hide Misconduct," New York Times, July 15, 2014. Available at http://dealbook.nytimes.com/2014/07/15/arbitration-clauses-let-american-apparel-hide-misconduct/.

arbitrations to resolve complaints keep many women entering careers on Wall Street in the dark about what their predecessors have experienced.[13]

But while arbitration remains cloaked in secrecy from the perspective of outsiders, the employers and companies that participate in multiple arbitrations, and the lawyers who represent those companies, are not outsiders. This repeat player bias benefits employers and other corporate participants in arbitration in many ways, from giving them a sense of what arguments an arbitrator is likely to favor to allowing them to select, in advance, an arbitrator who they believe will support their position. A federal court in the Ninth Circuit Court of Appeals has acknowledged that this non-transparent system of arbitration may be unfair to consumers because it perpetuates a disparity in knowledge between consumers and businesses. If a business repeatedly has cases before a particular set of arbitrators, it will know much more than consumers about which arbitrators to select. When a situation is created where only corporate repeat players have ready access to information about arbitration decisions, consumers are disadvantaged. Such a system puts the corporate repeat player "in a vastly superior legal posture since as a party to every arbitration it will know every result and be able to guide itself and take legal positions accordingly, while each [consumer] will have to operate in isolation and largely in the dark."[14]

One particularly troubling aspect of the repeat-player syndrome is the tendency of corporate repeat-players to blackball arbitrators who might rule against them. This tendency was revealed by a study of mandatory arbitration in managed care cases in California, which found a small number of cases in which an arbitrator awarded a plaintiff more than one million dollars against

[13] Maureen Sherry, "A Colleague Drank My Breast Milk and Other Wall Street Tales," New York Times, January 24, 2016. Available at http://mobile.nytimes.com/2016/01/24/opinion/a-colleague-drank-my-breast-milk-and-other-wall-street-tales.html?_r=1

[14] *Ting v. AT&T*, 182 F. Supp. 2d 902, 933 (N.D. Cal. 2002) (footnote omitted), aff'd in relevant part and reversed in part on other grounds, 319 F.3d 1126 (9th Cir.), cert. denied, 319 S. Ct. 53 (2003).

a health maintenance organization (HMO).[15] In each instance, that was the only HMO case that the arbitrator ever handled, suggesting that every time an arbitrator entered a substantial verdict against an HMO, the arbitrator was unable to get any further work from an HMO in the state. That same study also found that arbitrators were twenty times more likely than judges to enter summary judgment for defendant HMOs.

The reverse pattern has also been observed, where the same arbitrators are selected over and over again by the same companies who know the arbitrators will rule in their favor. A 2015 report from the Economic Policy Institute described a study of 2802 employment-related arbitrations, conducted pursuant to mandatory pre-dispute arbitration clauses, between 2003 and 2014. The study found that when the employer and employee were both appearing before an arbitrator for the first time, the employee had a 17.9% chance of winning. But once the employer had appeared before that same arbitrator four times, the employee in the fifth case had only a 15.3% chance of winning, and by the time the employer had appeared before the same arbitrator 25 times, the twenty-sixth employee's chance of winning dropped to 4.5%.[16] Assembly Bill 108 would address some of these concerns around repeat players and information asymmetry by allowing a consumer to consult a database to find out whether an arbitration firm has handled other cases involving the same corporation, but a database that includes more fine-grained information involving specific arbitrators would provide more information to a consumer being asked to choose between a slate of arbitrators all affiliated with the same arbitration firm, such as AAA or JAMS.

Finally, the problems associated with arbitration are compounded by the fact that arbitral awards are insulated from almost any sort of appellate scrutiny. Judicial review of arbitration is

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[15] Marcus Nieto & Margaret Hosel, Arbitration in California Managed Health Care Systems 22 23 (2000).

[16] Katherine V.W. Stone and Alexander J.S. Colvin, "The Arbitration Epidemic: Mandatory Arbitration Deprives Workers and Consumers of Their Rights," Economic Policy Institute, December 7, 2015. Available at http://www.epi.org/publication/the-arbitration-epidemic/.

less than minimal; it approaches non-existent. The general rule is that judicial review of arbitrators' decisions "is very narrow; one of the narrowest standards of judicial review in all of American jurisprudence." *Lattimer-Stevens Co. v. United Steelworkers of Am. Dist. 27*, 913 F.2d 1166, 1169 (6th Cir. 1990).[17] Consider a couple of illustrations:

- The U.S. Court of Appeals for the Seventh Circuit remarked that courts should not review arbitrators' interpretations of contracts even if they are "wacky," so long as the arbitrator attempted to "interpret the contract at all." *See Wise v. Wachovia Securities, Inc.*, 450 F.3d 265, 269 (7th Cir. 2006).
- The U.S. Court of Appeals for the Third Circuit considered an arbitrator's decision that "inexplicably" cited and relied upon language that was not included in a key document. The court held, though, that "such a mistake, while glaring, does not fatally taint the balance of the arbitrator's decision in this case. . . ." *Brentwood Medical Associates v. United Mine Workers of America*, 396 F.3d 237 (3d Cir. 2005). This vividly demonstrates how narrow the review of arbitration

[17] *See also First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) ("the court will set aside [an arbitrator's] decision only in very unusual circumstances."); *Baravati v. Josephthal, Lyon & Ross*, 28 F.3d 704, 706 (7th Cir. 1994) ("[j]udicial review of arbitration awards is tightly limited."); *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998) ("judges follow the law . . ., while arbitrators, who often . . . are not lawyers and cannot be compelled to follow the law and their errors cannot be corrected on appeal (there are no appeals in arbitration), although there are some limitations on the power of arbitrators to flout the law."); *Di Russa v. Dean Witter Reynolds Inc.*, 121 F.3d 818, 821 (2d Cir. 1997) (to modify or vacate an arbitration award, a court must find both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case), *cert. denied*, 118 S. Ct. 695 (1998); *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998) (arbitrator's decision may only be overturned for manifest disregard of the law in "severely limited" circumstances, where a court finds that "the arbitrators knew of a governing legal principle yet refused to apply it . . .").

decisions is – they are upheld even when they are based upon "glaring mistakes" of law.

- In a case involving baseball player Steve Garvey, the U.S. Supreme Court held that "courts are not authorized to review the arbitrator's decision on the merits" even if the arbitrator's fact finding was "silly." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2002).
- In another case, the California Supreme Court held that even when an arbitrator's decision would "cause substantial injustice" on its face, it was not subject to judicial review. *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992).

The law governing judicial review of arbitration also encourages arbitrators not to give any reasons for their decisions, because then it is entirely impossible to attack their decisions. *See Fellus v. AB Whatley, Inc.*, 2005 WL 9756090 (N.Y. Sup. Ct. Apr. 15, 2005) (in the absence of a reasoned decision supporting an arbitration award, there was no basis for the court to decide whether the arbitrator manifestly disregarded the law.); *H&S Homes v. McDonald*, 2004 WL 291491 (Ala. Dec. 17, 2004)(in the absence of an explanation of damages awarded by the arbitrator, the court had no basis to determine whether the arbitrator manifestly disregarded the law; the arbitrator's failure to give reasons for the award did not itself constitute manifest disregard of the law). As a result, many arbitrators have reported that they are discouraged by the major arbitration firms from producing written decisions in most cases, because doing so basically gives arbitrators a means of putting themselves beyond any scrutiny. The upshot of all this is clear – arbitration is largely a system above and beyond the law.

However, one of the few bases on which an arbitrator's decision can be vacated is a finding that the arbitrator was biased. For this reason, the proposals in Assembly Bill 8191

requiring arbitrators to disclose material facts that might affect their impartiality would give reviewing courts, and parties seeking to have an arbitral award vacated for lack of impartiality, a more well-defined standard of what would constitute bias. Just as important, it would provide parties going into an arbitration with more information about that arbitrator's affiliations so that they can make more educated decisions about whether to proceed with that arbitrator. However, I do have some concerns about whether some of the provisions of Assembly Bill 8191, as currently drafted, would render it vulnerable to a claim of FAA preemption in that the bill targets, and imposes specific regulatory requirements on, arbitrators and arbitration providers that could be seen as posing obstacles to the use of the arbitral forum.

Conclusion

I appreciate the opportunity to speak with you today to share the widespread concerns of the public interest legal community about mandatory pre-dispute arbitration as it is currently being imposed upon consumers and employees. I am glad that the Committees are seriously addressing the trend of ever more prevalent forced arbitration and looking for ways to better protect New Yorkers from its adverse effects. I look forward to answering any questions that you might have.