STAFF REPORT

of the

Domestic Policy Subcommittee Majority Staff
Oversight and Government Reform Committee
House of Representatives

Dennis J. Kucinich, Chairman

Arbitration Abuse: an Examination of Claims Files of the National Arbitration Forum

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EXECUTIVE SUMMARY

"Arbitration Abuse: an Examination of Claims Files of the National Arbitration Forum"

The Domestic Policy Subcommittee Majority staff reviewed hundreds of individual case files from the largest provider of arbitration for debt collection, the National Arbitration Forum (aka Forthright LLC). A summary of our findings follows:

1. Virtually all NAF "consumer arbitrations" are in fact debt collection actions brought by creditors or assignees of creditors, not by the consumers themselves, and almost all consumer arbitrations are decided in the creditor's favor.

2. Decisions in identical cases differed depending on the identity of the arbitrator to whom the claim was assigned (See Exhibit A, attached).

3. Arbitrators in most of claims ignored the absence of evidence of whether or not the claims were brought within the statute of limitations.

4. Arbitrators in most of the claims ignored the lack of specific evidence of who was actually served with the notice of the arbitration.

5. Where there was specific evidence of how the notice was served, it often showed that the signature on the receipt was illegible, was a name different from the person who was supposed to be served, or was on one occasion an "X" and on two occasions a "John Doe."

6. All of the arbitrators ignored evidence that should have resulted in dismissal of most of the claims (See Exhibit B, attached).

7. One Maine arbitrator, who did not ignore such evidence and did dismiss a lot of cases, ended up without any additional cases being assigned to him in Maine.

8. The NAF, itself, did not follow its own rules and sent claims to arbitrators despite the fact that those claims should have been dismissed for failure of the creditor to serve the notice or arbitration "promptly."

9. The NAF is violating California statutory law by refusing to publish the results of many of its California arbitrations.

10. The NAF's failure to publish the results of all of its California arbitrations is assisting at least one collection company in an illegal effort to obtain awards of attorney's fees in amounts that violate Delaware law.

I. Background

Congress passed the Federal Arbitration Act[1] in 1925. The original intention of the FAA was to overcome the reluctance of federal courts to entertain or to enforce arbitration clauses in contracts between commercial business entities. In 1984, the Supreme Court decided *Southland Corp. v. Keating*,[2] which characterized the FAA as declaring "a national policy favoring arbitration" in federal and state courts, and held that the FAA preempts all inconsistent state arbitration laws. Despite severe criticism of this holding, in the dissenting opinion of Justices O'Connor and Rehnquist and in numerous subsequent dissents,[3] the Supreme Court has consistently upheld both arbitration clauses and the authority of arbitrators[4] in the 25 years since its *Southland* decision.

The number of arbitrations has grown exponentially in the 25 years since the *Southland* decision. Virtually all consumer transactions with large businesses are now subject to pre-dispute, mandatory arbitration clauses. The pervasiveness of these arbitration "agreements" in consumer contracts has created a separate system of "justice" for consumers.

Several bills have been introduced, in this session and past sessions, to prohibit pre-dispute arbitration clauses in consumer transactions, employment agreements, franchise agreements and nursing home admissions.[5] The Subcommittee undertook to investigate the nature of pre-dispute mandatory arbitration and whether or not the process was producing fair results.

II. The Nature of Consumer Debt Collection Arbitration

Arbitration creates a third system of justice that operates parallel to the federal and state judicial systems. In the context for which the FAA was enacted, i.e., commercial disputes between businesses, arbitration can be more expeditious, less costly and as fair as the two other judicial systems. However, most "consumer arbitrations" present a totally different situation.

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[1] 9 U.S.C. § 1, *et seq.*

[2] 465 U.S. 1 (1984).

[3] *See, e.g., Allied-Bruce Terminix Cos. V. Dobson*, 513, U.S. 265, at 292 (1995)(Justices Thomas and Scalia dissenting).

[4] For example, the Supreme Court had held that the arbitrator, not a court, must decide whether the arbitration agreement precludes class actions, *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), and whether the credit agreement violates state usury laws, *Buckeye Check Cashing v. Cardegna*, 546 U.S. 440 (2005).

[5] *See, e.g.*, Arbitration Fairness Act of 2009, H.R.1020; Fairness in Nursing Home Arbitration Act of 2009, H.R.1237; Consumer Fairness Act of 2009, H.R.991.

The arbitrators in consumer claims are attorneys or retired judges and their decisions are, in most cases, based solely upon written statements made by the attorneys representing the creditor. The claims are sent to the arbitrator in batches by the arbitration provider. Responses by the consumer are very rare. Usually, the "hearing" is nothing more than a review by the arbitrator of the written statements provided by the creditor or its attorney, without physical appearances by either the creditor or the consumer.

Consumer arbitration lacks the safeguards that have been designed into our judicial system by our Constitution, by state and federal statutes, and by centuries of judicial decisions. The differences between the procedures in courts and in arbitrations can be seen in the following table:

Table A. Court and Arbitration: Comparison of Policies and Procedures

COURT	ARBITRATION
Consumer is served process by a court officer who has no interest in the proceeding	Consumer is served by the creditor, who has a financial incentive for the consumer not to appear
Case is randomly assigned to a judge who has no interest in the proceeding	Case is assigned 1) by a business entity that has a financial incentive to seek additional cases from the creditor, 2) to a sole-proprietor (the arbitrator) who has a financial incentive to seek additional cases from the creditor, and who is subject to removal at the whim of the creditor (under NAF rules w/ 10 days)
The entire proceeding is open and public	The process is closed and secretive. Virtually nothing is publicly known, other than what California requires to be disclosed
The process is familiar to anyone who has watched television	The process is unfamiliar and intimidating. The NAF advertises to collection companies that when you explain to debtors what arbitration is "they basically hand you the money"
Due process is required and is enforced by neutral parties	Due process is only enforced by an arbitrator who has a financial incentive to seek additional cases from the creditor
Decisions must be based on reliable evidence	Decisions are usually based on hearsay and often double-hearsay
Consumer incurs virtually no cost	Everything the consumer asks for comes only at an extra cost, including a hearing
Judge must follow the law	Arbitrator can ignore the law, and is not subject to any review
Consumer can appeal any failure to follow law or facts	No viable appeal of anything but fraud by the arbitrator

Almost all of these mass debt collection arbitrations are conducted by the National Arbitration Forum.[6] On July 14, 2009, the Attorney General of the State of Minnesota filed a lawsuit against the NAF in which she included detailed allegations of financial connections between the NAF and debt collection companies and law firms. Those allegations seem to show that the NAF is ultimately owned and controlled by the same business entities that own and control the three largest collection companies in the country, companies that file over half of the claims that are processed through the NAF. Those allegations also recite that the NAF, those three collection companies, and the business entities that now own and control them, all sought to conceal the existence of the relationship among them, in order to maintain the façade that the NAF was truly independent in its administration of the debt collection arbitrations that are filed by those three companies. On July 17, 2009, the NAF and the Minnesota Attorney General entered into a settlement agreement in which the NAF agreed to discontinue all consumer arbitrations.

III. The Domestic Policy Subcommittee Staff Investigation

The Subcommittee's staff began our investigation last fall, by assembling and reviewing all of the publicly-available literature and commentary on pre-dispute, mandatory arbitration clauses in all contexts, including consumer agreements and employment agreements. On March 18, 2009, Chairman Kucinich sent a document request to the three major providers of arbitration services,[7] asking for documents that related to all of the concerns that were discussed in the available literature. Staff reviewed over 50,000 pages of documents that were produced by the three services. That review led the Subcommittee to focus on the use of arbitration in consumer debt collection, because it appeared that different arbitrators might be issuing opposite decisions based on the same or similar facts. In order to determine if that was the case, the Subcommittee requested files in 159 claims administered in California by the NAF. All of these claims were filed by the same creditor at approximately the same time. Two arbitrators dismissed all of the 58 claims that were assigned to them. The third arbitrator issued awards to the creditor in every one of the claims assigned to him. The staff reviewed all of those files and could not discover any differences that would justify the different decisions, so the Subcommittee requested the files in 80 additional claims decided by two other arbitrators that had also issued awards to the same creditor. The findings recited below are the result of the Subcommittee's analysis of those files and other documents that have been reviewed.

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[6] The AAA has conducted one trial program (the "Encore/MCM" program) that ended in June of this year. In contrast, the NAF administered over 30,000 consumer debt collection arbitrations in California alone between January 1, 2003 and March 31, 2007.

[7] The American Arbitration Association (AAA), Judicial and Mediation Services (JAMS) and the National Arbitration Forum (NAF).

IV. Findings

Very few "consumer arbitrations" are filed by consumers. The only available data indicates that more than 99% of "consumer arbitrations" are debt collection claims filed by businesses, usually credit card companies or collection companies, against consumers, seeking to collect past due balances under arbitration "agreements" that were unilaterally imposed by the businesses.[8]

The claim files that the Subcommittee's staff examined were decided prior to the date on which the NAF rearranged its structure to become part of a debt collection conglomerate. Even before the consummation of that financial arrangement, the claim files showed the kind of problems that would occur in the administration of debt collection claims by an arbitration service that had close ties to the debt collection industry.

Our analysis of the claim files demonstrates that the absence of essential safeguards produces exactly the results that one would expect.

1. Service of process. Obviously, it is easier for a creditor to prevail if the consumer does not respond to the notice. In consumer debt collection arbitration, the notice is served and verified by the creditor. In the AAA/MCM case files, the arbitration notice was often delivered to addresses that differed from the billing address, and the delivery receipts were often signed with names that were illegible and/or differed from the name of the consumer on the bill. In one case, the receipt was signed "x." In three cases, the bills were in Spanish (indicating that the consumer was not an English speaker), but all of the arbitration notices were in English. In the NAF case files, delivery receipts were generally not provided. But, two verifications of delivery upon "John Doe" raise the same concerns.

2. Case assignment. NAF filings are assigned by NAF staff. The studies of the California NAF filings, by Public Citizen and by The Center for Responsible Lending, demonstrate that the vast majority of cases are assigned to a small number of arbitrators who routinely rule in favor of the creditors. The few arbitrators whose rulings are more favorable to consumers are given few cases or reduced numbers of cases. Our analysis of a more recent period of NAF filings found the same disproportionate distribution.[9] This disproportion may be

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[8] The NAF produced records that show only 7 of 4,894 NAF arbitrations in West Virginia (0.14%), and only 79 of 14,408 in Minnesota (0.5%) were filed by consumers. The General Counsel of First USA Bank testified in an August, 1999 deposition that fewer than 10 of their 40,713 arbitrations after January of 1998 were filed by consumers.

[9] The Public Citizen data analyzed NAF California filings from Q1'03 through Q1'07. NAF provided the Subcommittee with its California filings through Q4'08 and has Q1'09 filings on its website.

augmented by the NAF's disqualification rule. When a case is assigned to an arbitrator whom the creditor considers unfavorable, the creditor can remove the arbitrator with a simple form letter, without any need to recite a justification.[10] This rule can greatly increase the likelihood of a creditor gaining the assignment of a favorable arbitrator. It also provides notice to an arbitrator that he/she will get fewer cases, and consequently reduced income, in the future if his/her decisions do not become more favorable to creditors. In Maine, one arbitrator who was actually following the NAF's rules, and dismissing cases that were deficient, found himself without any subsequent case assignments.[11]

3. Closed proceedings. Closed proceedings have at least two significant effects. First, they make it difficult, if not impossible, to evaluate the fairness of arbitration. California is the only state that requires reporting of results, and the information provided by the three organizations is incomplete.[12] We have no information on 46 states and only limited information from three others.[13] We discovered during the course of our investigation that the NAF was violating California law[14] and was not publishing the results of thousands of arbitrations filed by Columbia Credit Services and others. By concealing these files, the NAF was assisting Columbia (and possibly others) in seeking and obtaining awards of attorney's fees that violate Delaware law.[15] Second, closed proceedings produce arbitrary results, where different arbitrators produce diametrically-opposed decisions in the same cases or virtually identical cases.[16] The result the consumer gets depends on the arbitrator to whom the case is assigned. As shown in the preceding paragraph, NAF case assignment is not random and appears to be designed to maximize decisions favorable to the creditors.

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[10] The attorney for Columbia Credit Services, Inc. obtained the disqualification of one arbitrator merely by stating that the arbitrator "is prejudiced [sic] my client or me or my client's interest or my interest...."

[11] The NAF promulgated a written rule, the result of which was to stop sending Maine cases to that arbitrator, purportedly because he was not a Maine attorney. No prior written rule existed on that subject.

[12] We discovered during the course of our investigation that the NAF California filings are incomplete and do not disclose any cases filed by Columbia Credit Services, Inc. NAF did not disclose names of arbitrators in their Q4'08 filings and do not breakdown the components of the awards in any of its filings.

[13] NAF provided the Subcommittee with Excel spreadsheets of filings and decisions in ME, MN and WV, but the information provided was different in each spreadsheet and did not allow for a group analysis. Names of arbitrators were only provided in the ME spreadsheet.

[14] CAL. CIV. PROC. § 1281.96

[15] DEL. CODE ANN, tit. 10, § 3912

[16] In 230 cases filed by one creditor with NAF, two arbitrators dismissed all their cases, while the three other arbitrators ruled in the creditor's favor in all their cases in the full amount requested.

4. Due process. NAF has rules that, if enforced and followed, would provide some due process protections. However, the enforcement of these rules appears to be left in the hands of each individual arbitrator. It appears that the NAF does not care whether or not its rules are enforced. In the claims we reviewed, 70% of them should have been dismissed by the NAF, and not forwarded to arbitrators, because the delay in service of the notice violated NAF Rule 6 (See Exhibit B, attached). The NAF's lack of concern about due process is clearly shown by its disingenuous response to one consumer whose notice was served upon his landlord, with whom he was not speaking at the time. The NAF responded that "the adequacy of service in this case would be decided by the arbitrator hearing the case," ignoring the fact that specific information about service was not provided to the arbitrator.[17] Occasionally, there are arbitrators who enforce deficiencies of service, inadequacy of allegations, absence of sworn evidence, excessive requested attorney's fees, etc. In the case files we reviewed, and in the NAF reported cases, those arbitrators appear to be the exception and their decisions appear to result in their receiving fewer subsequent case assignments.

5. Standard of evidence. In a court, a creditor would have to submit admissible evidence of the amount of the debt, even if the debtor failed to respond to the suit. The awards we reviewed were based entirely on statements of the creditor, usually by the creditor's attorney, sometimes unsworn, sometimes made on the basis of "information and belief." The most documentary evidence that was provided was a "final bill" that recited the past due amount or the total amount owing, without any itemization of charges or any indication of when those charges were incurred. Since all of these claims were made by assignees of the original creditor, they were at least single hearsay, and probably double hearsay. The responses of the consumers, which had to have been based on the first-hand knowledge of the consumer, appeared to be given no weight.

6. Application of law. A judge must follow the law. If a judge does not follow the law, a court of appeals can reverse the incorrect decision. If two judges make rulings that are opposite, appeals can reverse the incorrect decision and guide all future decisions. That procedure does not exist in arbitration. The decision of the arbitrator is final and can only be reviewed on a very limited basis. There is no procedure to correct a decision that is against the law or a decision that totally different from another decision issued by that arbitrator or another arbitrator. Our review disclosed decisions that were totally opposite, depending on whether or not the arbitrator was concerned with deficiencies in the claim documents or ignored them entirely (See Exhibit A, attached).

[17] In the files we reviewed, the only information given to the arbitrator was that service was made in compliance with NAF Rule 6. In 70% of the cases, that sworn statement was untrue, because the service was not "prompt" as required by NAF Rule 6.

V. Conclusion

Mass-production collection of consumer debts through arbitration is not "arbitration." It is debt collection made simpler, for the benefit of the creditor and to the detriment of consumers. While it is true that the vast majority of consumers default and do not appear when claims are brought against them in courts, there are consumers who have legitimate defenses to the claims against them or who have become victims of identity theft or mistaken identity. The arbitration system, as it is currently operated by NAF, does not provide protection for those consumers. The system is ripe for abuse, and it has been abused by the largest administrator of "consumer arbitrations."

Exhibits

Exhibit A: Arbitrator Decisions in Claims Reviewed

Arbitrator:	Claims Reviewed	Awards Granted	Dismissals
Jennings	40	0	40
Krotinger	18	0	18
Tassopulos	44	44	0
Williams	31	31	0
Schneider	97	97	0

Consumer debt claims brought by Worldwide Asset Purchasing ("WAP") heard by NAF-assigned arbitrators. All claims originated from consumer credit card debt and assigned to WAP, and were otherwise identical except for date of default, amount of debt, and identity of respondent.

Exhibit B: Claims Violating NAF Rule 6 and Rule 41B(3)

Arbitrator:	Claims Reviewed	Total Dismissible Under NAF Rule 41B(3)	Total No. Dismissed Under NAF Rule 41B(3)
Jennings	40	39	39
Krotinger	18	9	9
Tassopulos	44	31	0
Williams	31	21	0
Schneider	97	60	0

NAF Code of Procedure Rule 6, "Service of Claims Responses, Requests and Documents" states that once a claim has been filed with the NAF, Claimant "shall promptly serve Respondent" with a copy of the initial claim documents. NAF Rule 41B(3) empowers an arbitrator to dismiss a claim if more than one hundred twenty (120) days have elapsed between the filing date of the claim and the date of service on the Respondent. However, of the 230 total claims reviewed, 160 were dismissible under Rule 41B(3) for failing to comply with Rule 6. Further, in 224 of 228 claims reviewed, there was no other evidence of service on any Respondent save for an affidavit of service stating that Respondent was served at his or her address.