No. 09-497

In The
Supreme Court of the United States

RENT-A-CENTER, WEST, INC.,

Petitioner,

v.

ANTONIO JACKSON,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF NATIONAL CONSUMER LAW CENTER AND CONSUMER ACTION AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICI CURIAE*[1]

The National Consumer Law Center (NCLC) is a non-profit corporation organized in 1969 to conduct research, education and litigation to promote consumer justice. One of the NCLC's primary objectives is to provide assistance to attorneys advancing the interests of their low-income and elderly clients in the area of consumer credit and sales transactions. Accordingly, NCLC has focused considerable attention on laws to prevent abusive debt collection, including the unfair imposition of arbitration requirements on consumers and unfairness in the arbitration process itself. To that end, NCLC publishes a practice manual for attorneys entitled "Consumer Arbitration Agreements" (5th Ed. 2007 and supp.), and NCLC's Director of Litigation, Stuart T. Rossman, recently testified before the House Subcommittee on Commercial and Administrative Law on the need for legislation to protect consumers from inequitable arbitration proceedings. (September 15, 2009).

Since 1971 Consumer Action has been a pioneer in the consumer movement, working to advance consumer literacy and protect consumer rights in many areas, including credit, banking, privacy, insurance, healthcare, and utilities. With offices in San Francisco,

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[1] Letters granting blanket consent to the filing of *amicus curiae* briefs have been filed with the Clerk. This brief was not authored in whole or in part by counsel for a party. No person or entity other than *amici curiae* or their counsel made a monetary contribution to the preparation or submission of this brief.

Los Angeles and Washington, D.C., Consumer Action has evolved from a small basement operation to one of the most trusted national consumer organizations in the country.

As a service to consumers and community organizations in California and elsewhere, Consumer Action publishes and distributes approximately one million pieces of literature per year, free of charge, in eight different languages, on banking, credit and utility issues, including an annual survey of bank credit card interest rates and fees. In addition, the organization is a member of the Consumer Federation of America, and is actively involved in policy development, research, and legislative advocacy on credit and banking issues on behalf of consumers at both the state and national levels.

Amici have an interest in this case because arbitration agreements are implicated in many consumer disputes, and particularly in debt collection disputes. It will be increasingly difficult for consumer to have their disputes fairly heard, however, unless courts can continue to play their traditional role of ensuring that unconscionable and unfair arbitration provisions are not enforced.

SUMMARY OF ARGUMENT

The issue at stake in *Rent-A-Center, West, Inc. v. Jackson* is whether a corporation can impose a contract that strips courts of the ability to review the fairness of an arbitration provision and instead vests all power over that question in the hands of the arbitrator himself. This Court should affirm the decision below and hold that unconscionability is a question for a court to decide because judicial review of unconscionability challenges to arbitration clauses is necessary to maintain the fairness and integrity of arbitration proceedings. While arbitration can be a fair process when conducted properly, in the absence of judicial oversight, it is all too easy for greed and self-interest to corrupt it. Courts play an indispensible role in keeping arbitration fair by striking down unconscionable arbitration provisions and thereby directing the companies that use them to make their provisions fairer.

The story of the National Arbitration Forum ("NAF"), formerly the nation's largest provider of consumer arbitrations, dramatically illustrates why judicial oversight is the only way to get bad actors to change their practices. NAF's arbitration proceedings were infected by a major conflict of interest, as NAF had the same owner as a debt collection company that brought hundreds of thousands of arbitrations before NAF. Even aside from that conflict of interest, NAF also demonstrated its pro-business bias by actively seeking out corporate clients and all but promising them that they would win their cases if they brought them before NAF. NAF made sure that pro-business arbitrators decided the overwhelming majority of cases and steered cases away from arbitrators who ruled for consumers. Although NAF is not the arbitrator designated by the parties here, NAF's actions show how easily both arbitration provider and companies that utilize arbitration clauses in their contracts can abuse arbitration to give one side an unfair advantage.

While NAF has changed some of its rules to make them fairer, it has done so only after court decisions exposed the unfairness of those rules and struck them down as unconscionable. Even before NAF was bought by the same company that owned one of the nation's largest debt collectors, NAF's rules favored businesses over consumers in many ways. Specifically, its venue rule permitted corporations to draft arbitration clauses requiring consumers to travel across the country to arbitrate small-value claims, and its fee schedule often made arbitration prohibitively expensive for individuals of limited financial means. Only after courts declared that those rules could not be enforced – thereby threatening NAF's ability to conduct future arbitrations – did NAF reform those rules to address the courts' concerns. Absent judicial intervention, those unfair rules could still be in place today.

Allowing parties to delegate unconscionability decisions to the absolute control of an arbitrator, rather than to a court, makes it much less likely that inequitable arbitration practices will be cured. First, arbitrators, particularly NAF arbitrators, have strong disincentives to strike down arbitration provisions as unconscionable, regardless of whether those provisions are imposed by the company mandating arbitration or by the arbitration service for which they work. If they do so, they will earn no future fees in the case before them, and they also risk not getting selected for future arbitrations. Second, arbitrator's decisions place much less pressure on companies to change their practices than court decisions because these decisions are confidential, non-binding, and often unwritten. Actors like NAF will change their practices only if they have no other choice; and they will only have no other choice if courts retain the authority to review arbitration clauses for unconscionability.

ARGUMENT

I. JUDICIAL REVIEW OF UNCONSCIONABILITY CHALLENGES TO ARBITRATION CLAUSES IS NECESSARY TO MAKE ARBITRATION AS FAIR AS POSSIBLE.

Arbitration can be a fair and efficient process for resolving disputes and lightening the burdens of the courts. At the same time, the risk that bad actors will take advantage of and undermine the fundamental goals of arbitration system for financial gain is significant. This risk is not a theoretical problem but an actual one, as evidenced by the gross misconduct of the National Arbitration Forum ("NAF"), which until several months ago was the nation's largest provider of consumer arbitrations. NAF's actions show why courts need to be able to police arbitration by reviewing arbitration provisions for unconscionability and why such decisions should not be left solely to arbitrators.

The "neutral" forum that NAF held itself out to be was anything but impartial. First, as alleged in exhaustive detail by the Minnesota Attorney General in a recent lawsuit, NAF operated under a major conflict of interest because it shared the same parent company as one of the nation's largest debt collectors, Mann Bracken. At the same time, Mann Bracken was bringing over 125,000 arbitrations, more than half of NAF's caseload, to NAF annually. Complaint, *State of Minnesota v. National Arbitration Forum*, No. 27-CV-09-18550, ¶ 3 (Minn. Dist. Ct. July 14, 2009) [hereinafter "*Minnesota Complaint*"].[2] NAF's pro-business policies extended beyond its conflict. Even before it developed a financial connection to Mann Bracken, NAF marketed itself and its business-friendly procedures as a way to attract corporate clients, and virtually guaranteed those clients successful results in arbitration. Finally, NAF steered cases towards pro-business arbitrators and blackballed arbitrators that decided in favor of consumers. The result of these practices was that consumers virtually never prevailed in NAF arbitrations.

NAF's anti-consumer behavior was not simply the aberrational activity of a small rogue arbitration

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[2] The full text of this complaint can be found at: http://www.ag.state.mn.us/PDF/PressReleases/SignedFiledComplaintArbitrationCompany.pdf.

company. Until recently, NAF was the leading forum for consumer arbitrations. Conducting over 200,000 arbitrations per year, NAF "dominated the credit card arbitration market." Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, Bus. Wk., June 16, 2008. [Hereinafter "Banks v. Consumers (Guess Who Wins)"]. NAF proclaimed that it had been selected as an arbitrator in "hundreds of millions" of contracts. *Minnesota Complaint*, ¶ 18. Thus, misuse of arbitration does not affect just a few cases at the margins, but potentially hundreds of thousands of cases. As explained below, NAF's behavior demonstrates that some companies will misuse the arbitration system if given the opportunity, and shows why courts must play a role in reviewing unconscionability challenges.

A. NAF Operated Under a Major Conflict of Interest Because It Shared the Same Owner as the Debt Collection Agency that Brought the Majority Of NAF's Consumer Arbitrations.

The first, and most glaring, example of NAF's unfair practices was the fact that the company operated under a massive conflict of interest. This supposedly neutral arbitration forum was owned by the same company that also owned one of the nation's largest debt collection firms, which in turn was a party in hundreds of thousands of NAF's consumer arbitrations. This placed consumers in an unfair forum and is emblematic of an NAF structure "in which it is exceedingly difficult for individuals to prevail." Banks v. Consumers (Guess Who Wins), *supra*.

In a methodically detailed complaint filed by the State of Minnesota against NAF, the State alleged that unbeknownst to consumers, a New York based hedge fund owned both a governing interest in NAF and the assets of the debt collection company Mann Bracken. *Minnesota Complaint*, ¶ 2. According to the lawsuit and Minnesota Attorney General Lori Swanson's testimony to Congress, Mann Bracken in turn brought hundreds of thousands of debt collection suits before NAF. *Id.*, ¶ 3; *Arbitration or 'Arbitrary': The Misuse of Mandatory Arbitration to Collect Consumer Debts: Hearing Before the H. Subcomm. on Domestic Policy of the H. Comm. on Oversight and Gov't Reform*, 110th Cong., July 22, 2009, at 2-4 [hereinafter *Arbitration or 'Arbitrary'*] (testimony of the Honorable Lori Swanson, Minn. Atty. Gen.).

The lawsuit alleged that this intertwined relationship between NAF and Mann Bracken began in 2006 when Accretive, LLC formed several equity companies including Agora and Axiant. *Id.*, ¶ 32. Agora acquired a significant financial interest in NAF while Axiant acquired the assets of three large debt collectors of consumer credit card debt: Mann Bracken, Wolpoff & Abramson, and Eskanos & Adler, which all subsequently merged into the single entity called

Mann Bracken.[3] *Id*. This affiliation allowed Accretive to control both one of the largest debt collecting agencies and the arbitration forum that would decide the cases that this debt collection agency brought. *Id*. In fact, the Minnesota lawsuit states that in 2006 alone, Mann Bracken brought more than 125,000 debt-collection arbitrations, or 60% of NAF's consumer caseload, in front of NAF. *Id*., ¶ 3.

This relationship resulted in a debt collection echo chamber that gave Mann Bracken an unfair advantage and required individual debtors to resolve disputes in a forum that was in the pocket of the opposing party. Consistent with the allegations in Minnesota's lawsuit, the C.E.O. of NAF admitted at a congressional hearing that $42 million in profits from this debt collection enterprise were distributed to NAF and its management team. *Arbitration or 'Arbitrary'*, *supra* (statement of Michael Kelly, Chief Executive Officer, National Arbitration Forum and Forthright).[4] By contrast, it would be shocking for public courts to be beholden to a private party and to have a financial incentive to rule for one party over another.[5]

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[3] A chart depicting these interweaved business interests can be at pages 11 and 20 of the Minnesota complaint.

[4] Video Webcast available at: http://oversight.house.gov/index.php?option=com_content&task=view&id=4013&Itemid=31.

[5] NAF's actions are strikingly parallel to the actions of juvenile court Judges Marc Ciavarella and Michael Conahan of Luzerne County, Pennsylvania who were disgraced for lining

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The profit stream that debt collection arbitration generated for NAF was directly tied to the success rate of debt collectors in NAF arbitrations. Even aside from revenue generated by affiliated companies, NAF received considerable fees from its creditor clients. For example, First USA Bank disclosed in court filings that it paid NAF $5 million in fees in just two years. Consumers Union, *Consumer Rights: Give Up Your Right to Sue?*, Consumer Reports, May 2000. During that period, First USA won 99.6% of its 50,000 collection cases that came before NAF. *Id*. While advocates for banks invoke the possibility that First USA could have been equally successful in court, "[m]aybe, however, the millions of dollars it paid the NAF in fees tend to produce overwhelmingly favorable results." Joseph Garrison, *Is ADR Becoming "A License to Steal"?* Conn. L. Trib., Aug. 26, 2002, at. 4.

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their own pockets by sending children to jail. The judges had a financial interest in a privately run juvenile detention facility, and over the course of four years, made millions of dollars by incarcerating without basis and for otherwise minor infractions. Dave Janoski, *Conahan, Ciavarella face new charges*, The Times-Tribune, Sept. 10, 2009. When this scandal was exposed, the Pennsylvania Supreme Court had to vacate over 5,000 cases handled by the two judges. Ryan Coyle, *Ciavarella Juvenile Cases Thrown Out*, wnep.com, Jan. 25, 2010, http://www.wnep.com/news/countybycounty/wnep-luz-ciavarellas-juvenile-cases-tossed,0,3512993.story. Similarly, NAF generated millions of dollars for Axiant by deciding cases brought by Mann Bracken when Axiant had a financial interest in that company.

First USA's overwhelmingly high success rate was hardly unusual. According to data disclosed pursuant to Cal. Civ. Proc. Code § 1281.96, NAF handled 33,933 debt collection arbitrations in California from January, 2003, through March, 2007. Banks v. Consumers (Guess Who Wins), *supra.* Of the 18,075 arbitrations that were not dropped by creditors, dismissed, or settled, consumers won just 30, or 0.2%. *Id*.

Not only did NAF fail to disclose to consumers that it shared the same owner as Mann Bracken at the same time it was resolving hundreds of thousands of disputes that Mann Bracken brought, it did the opposite. NAF held itself and its services as "not affiliated or owned by any party who files a claim before the forum" and "far from being aligned with lenders or other business parties" to provide "neutral and unbiased dispute resolution." *Minnesota Complaint*, ¶ 23.

Once this conflict was exposed by the State of Minnesota, NAF quickly folded rather than vociferously disputing the complaint's allegations. Just three days following the filing of this complaint, NAF signed a consent decree with the State of Minnesota, and while not admitting liability, it made little effort to rebut the charges.[6] Consent Decree, *State of Minnesota*

[6] Notably, NAF and Forthright C.E.O. Michael F. Kelly testified to Congress just five days after the consent decree was signed and did not explicitly deny the truth of Minnesota lawsuit's allegations. Mr. Kelly said that NAF is "no longer accepting consumer arbitrations" because it "lacks the necessary

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v. National Arbitration Forum, No. 27-CV-09-18550 (July 17, 2009).[7] NAF instead agreed to immediately cease its consumer arbitration business and to divest any interest in any business related to consumer debt disputes. *Id*. Moreover, the co-ownership of NAF and Mann Bracken was so central to Axiant's operation that both Axiant and Mann Bracken could not continue functioning following NAF's cessation of handling consumer debt disputes and had to declare bankruptcy. Nathan Koppel, *Mann Bracken, Debt Collecting Firm Extraordinaire, To Shut Down*, Wall St. Journal, Jan. 20, 2010.

NAF's structural biases demonstrate the need for judicial review of unconscionability to constrain unfair behavior. Without court involvement, other bad actors – either other arbitration providers, or companies that include arbitration clauses in their contracts – may emerge and undermine the foundations of the arbitration process. Although NAF has temporarily dropped out of the consumer arbitration business, other companies may easily fill its place, as the arbitration system remains "ripe for abuse."[8] *Staff*

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resources" to defend itself against an increasing number of legal challenges. Written Testimony of Michael F. Kelly at 1, *Arbitration or 'Arbitrary'*, *supra*, at 1. Mr. Kelly never stated, however, that the complaint's allegations were false. *Id.*

[7] The full text of the Consent Decree can be found at: http://pubcit.typepad.com/files/nafconsentdecree.pdf.

[8] NAF is hardly the only company to create arbitration procedures that deny consumers the right to an impartial forum, which demonstrates the need for court involvement regardless of

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of Subcomm. on Domestic Policy of H. Comm. on Gov't Reform, *Report on Arbitration Abuse*, at 10 (July 21, 2009). When abuse occurs, courts must be able to step in to ensure the playing field remains level.

B. NAF Aggressively Marketed Itself To Creditors As a Forum In Which They Were Virtually Guaranteed Success.

NAF's pro-business practices were not limited to its dealings with Mann Bracken. Even before NAF became financially linked to Mann Bracken, it demonstrated that it was not a fair forum for consumers by marketing its services to creditors and all but promising them successful results. A Business Week investigation documented that while NAF publicly hailed itself as a fair and neutral forum "behind closed doors, NAF sells itself to lenders as an effective tool for collecting debts." Banks v. Consumers (Guess Who Wins), *supra*. Business Week revealed one of the most egregious examples of NAF's marketing to

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whether NAF continues to operate. *See, e.g.*, *Walker v. Ryan's Family Steak Houses*, 400 F.3d 370, 386 (6th Cir. 2005) (finding arbitral bias where the defendant company "accounted for over 42%" of the arbitration provider's gross income); *Murray v. United Food & Commercial Workers Union*, 289 F.3d 297, 303 (4th Cir. 2002) (striking down arbitration clause for bias where the arbitration clause placed sole control over arbitrator selection in the employer's hands); *Buhrer v. BDO Seidman, L.L.P.*, 16 Mass. L. Rptr. 551 (Mass. Super. Ct. 2003) ("[T]he financial interests of the arbitrators are identical to those of the defendant; this is clearly inequitable and unjust.").

businesses and debt collection agencies. *Id*. It published a confidential NAF PowerPoint presentation designed to curry favor with potential corporate clients. *Id*. In the presentation, NAF promised that arbitrating with NAF would lead to a "marked increase in recovery rates over existing collection methods." *Id*.

Additionally, the Minnesota complaint quotes NAF marketing materials that emphasized to companies that consumers facing arbitration would "just hand over the money" because they would be "totally intimidated by the arbitration process." *Minnesota Complaint*, ¶ 96. According to the complaint, NAF stressed that "you [the creditor] have all the leverage and the customer has no choice but to take care of the account," and that "the customer does not know what to expect from arbitration and is more willing to pay." *Id*. In short, NAF tried to drum up businesses by telling corporations that they would be more successful in front of NAF than in any other venue.

NAF's presentation also "boasts that creditors may request arbitration maneuvers that can tilt the arbitration in their favor" by using "stays and dismissals that are free to the Claimant – to control the process and timeline." Banks v. Consumers (Guess Who Wins), *supra*. This type of marketing was done to show that filing an arbitration with NAF was a no-lose proposition for the creditor. As one NAF arbitrator told Business Week, "[i]f there is no response, you're golden. If you get a problematic [debtor], then you can request a stay or dismissal."

Id. By actively trying to persuade corporations to include provisions in their consumer agreements that require binding arbitration of disputes, in the hopes that those creditors would bring repeat business, NAF sold itself as an ally of creditors and compromised its impartiality.

C. NAF Steered Cases To Arbitrators With Track Records Of Deciding Cases For Creditors And Blackballed Arbitrators Who Awarded Money To Consumers.

Third, NAF steered cases to pro-creditor arbitrators and away from those that ruled for consumers and against creditors. Several studies of NAF arbitrations have found that NAF's case allocation practice was heavily biased toward ensuring that business-friendly panelists heard most cases. *See, e.g.*, Simone Barubeau, *Consumer Advocates Slam Credit-Card Arbitration*, Christian Sci. Monitor, July 16, 2007; Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* (2007); Joshua M. Frank, Center for Responsible Lending, *Stacked Deck: A Statistical Analysis of Forced Arbitration* (2009), http://www.responsiblelending.org/credit-cards/research-analysis/stacked_deck. pdf. Data from the state of California reveals, for example, that although NAF claims to have a roster of 1,500 arbitrators, ninety percent of its debt collection cases

(17,265 cases) were decided by just 28 arbitrators.[9] *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* (2007) at 15. Similarly, the Christian Science Monitor found that NAF's ten most frequently used arbitrators were assigned almost 60% of NAF's collections cases. *Consumer Advocates Slam Credit-Card Arbitration*, *supra.* Those ten arbitrators, not surprisingly, ruled for the consumer only 1.6% of the time. *Id*. By contrast, arbitrators who got three cases or fewer during that year found in favor of the consumer 38% of the time. *Id*.

This steering of cases to pro-creditor arbitrators and away from those who ruled against the creditor with even moderate frequency virtually guaranteed positive results for creditors, who were then further incentivized to given NAF additional business. One NAF arbitrator, Joseph Nardulli, once decided 68 arbitrations in a single day, giving debt holders and buyers every cent of the $1 million they demanded. *The Arbitration Trap: How Credit Card Companies Ensnare Consumers*, *supra*, at 3. Assuming Nardulli worked a 10-hour day he would have issued one decision every 8.8 minutes. *Id*. Indeed, arbitrators like Nardulli whose are paid on a per-case or hourly basis find it against their financial interest to strike down arbitration clauses and losing the associated fees. As one former NAF arbitrator noted, "I could sit on my

[9] California and the District of Columbia are the only jurisdictions that require arbitrators such as NAF to publicly report outcome data.

back porch and do six or seven of these cases a week and make $150 a pop without raising a sweat. . . . I'd give the [credit-card companies] everything they wanted and more just to keep the business coming." Chris Serres, *Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions?* Star Trib. (Minneapolis), May 11, 2008, at 1D.

The studies also show a direct correlation between ruling for creditors and getting more business. One study revealed a linear relationship between the amount the arbitrator awarded to a creditor and the number of future cases that arbitrator was assigned, meaning that arbitrators who favored creditors were rewarded with more cases. Joshua M. Frank, Center for Responsible Lending, *Stacked Deck: A Statistical Analysis of Forced Arbitration, supra*, at 9. Similarly, companies who appeared more often before NAF received a higher percentage of the amount requested in their arbitrations than did companies who appeared less often. *Id*. at 8.

NAF's other strategy was the blackballing of arbitrators who ruled in favor of consumers. Harvard Law School professor Elizabeth Bartholet testified before the Senate Judiciary Committee about how she was shut out of future cases after awarding a consumer $48,000 in damages in one case. *Courting Big Business: The Supreme Court's Recent Decisions on Corporate Misconduct and Laws Regulating Corporations*, S. Comm. on Judiciary, 110th Cong. (July 23, 2008) (statement of Elizabeth Bartholet, Harvard

Law School Professor).[10] Professor Bartholet explained that when she ruled for creditors as she did in 19 of her first 20 cases (one was dismissed), she continued to get more assignments. *Id*. As soon as she awarded damages to a consumer a single time, however, NAF removed her from 11 other cases she had pending against the same credit card company. *Id*. That her single ruling in favor of a consumer prompted her removal from her remaining cases is not just speculation. Professor Bartholet testified that an NAF administrator told her that she was likely removed from her other cases because of that decision. *Id*. Professor Bartholet concluded from her experience that "the NAF process was systematically biased in favor of credit card companies" and was one that allowed credit card companies to "purchase all the justice they want." *Id*.

The NAF example reveals how easily bad actors can abuse arbitration for financial gain. If those bad actors can then require a consumer to contractually agree to take away a court's authority to address unconscionability, there will be no adequate way to rein in that abuse.

[10] Video of this testimony is available at: http://judiciary.senate.gov/hearings/testimony.cfm?id=3485&wit_id=7313.

II. Judicial Review Of Arbitration Provisions For Unconscionability Prompts Reform More Effectively Than Allowing Arbitrators To Review Such Questions.

Courts play a vital role in ensuring the arbitration system remains a fair forum for consumers. Court decisions striking down unconscionable arbitration provisions have proven effective in forcing even bad actors like NAF to reform their practices. Leaving unconscionability questions to arbitrators, however, is much less likely to spur reform because arbitrator decisions are secret, unwritten and non-binding, and because arbitrators have strong incentives to uphold arbitration clauses in order to maximize their fees and to continue receiving business. Allowing companies to strip courts of their authority by delegating decisions about the fairness of arbitration clauses to the arbitrator removes a crucial mechanism for reform and leaves consumers at the mercy of arbitration providers and corporations.

When bad actors like NAF have reformed their rules, they usually have not done so willingly. Instead, those revisions have come on the heels of judicial unconscionability decisions. Two examples illustrate this point. In cases occurring prior to when NAF and Mann Bracken became financially linked, courts found arbitration clauses utilizing NAF's venue and fee provisions unconscionable. *See Patterson v. ITT Consumer Financial Corp.*, 14 Cal. App. 4th 1659 (Cal. Ct. App. 1993); *Eagle v. Fred Martin Motor Co.*, 809 N.E.2d 1161 (Ohio Ct. App. 2004). Following those decisions, NAF changed its rules to make its venue and cost rules fairer to consumers because, if it wanted to continue profiting from arbitration, it had no other realistic choice.[11] Although these decisions did not put an end to NAF's unfair practices – as evidenced by NAF's subsequent conflict of interest – they did succeed in forcing NAF to change unfair rules that it most likely would not have changed on its own. And while this case does not involve NAF, these examples show that allowing companies that conduct arbitrations or that impose unconscionable terms in their arbitration provisions to also remove a court's ability to address unconscionability takes away an important mechanism for making arbitration fairer.

A. Court Unconscionability Decisions Spur Reform of Unfair Arbitration Provisions.

Two examples show how court decisions finding NAF's rules and procedures unconscionable have caused NAF to change some of its rules. In *Patterson v. ITT Consumer Financial Corp.*, the California

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[11] It is not just arbitration providers that respond to unconscionability decisions, but also the companies that impose arbitration on consumers and employees in their standard-form contracts. As Respondent explained, numerous courts have found unconscionable arbitration clauses that impose excessive costs, and many companies as a result now will pay all arbitration fees in consumer or employment disputes. *See* Resp. Br. 37 & n.8.

Court of Appeals struck down as unconscionable a clause in the defendant's arbitration agreement that would have required a consumer in California to travel from California to Minnesota to arbitrate a $2,000 dispute. 14 Cal. App. 4th at 1665. The NAF rule at the time of *Patterson*, required the arbitration to take place at the location designated in the agreement. *Id*. at 1665. This rule provided no exception where the agreement inflicted hardship by requiring a party to travel long distances. The Court found the agreement required arbitration in Minnesota, and that the hearing would only be held upon payment of approximately $850 in fees in addition to the time and expense of traveling to Minnesota. *Id*. The court found that given the small size of the plaintiff's claim, the sheer costs of traveling all the way to Minnesota and of the arbitration itself would functionally deny the plaintiff the opportunity for a hearing. *Id*. at 1666. The court declared the arbitration provision unconscionable and unenforceable. *Id*. at 1667.

Following *Patterson*, NAF amended its venue rule to allow consumers to avoid traveling to locations that would cause significant hardship. The amended rule stated that regardless of where a contract requires arbitration to take place, "[a]n In-person Participatory Hearing shall be held, . . . for all Consumer cases, at a reasonably convenient location within the United States federal judicial district or other national judicial district" where the consumer resides. NAF Code of Procedure, Rule 32(a) (2003).[12] The *Patterson* decision likely played a significant role in the ensuing rule change. Once a state appellate court declared that NAF's rule would not be enforced within that court's jurisdiction, NAF had little choice but to change its rule or else it would lose the ability to conduct arbitrations. Absent the *Patterson* decision, which directly implicated NAF's bottom line, there is no reason to believe that NAF would have changed its rule.

Similarly, court decisions striking down unconscionable arbitration fee provisions have led companies like NAF to amend their rules to comply with those decisions. In *Eagle v. Fred Martin Motor Co.*, 809 N.E.2d at 1177, the Ohio Court of Appeals found that fees charged by NAF to hear a dispute were so excessive that they denied the plaintiff meaningful access to the arbitral forum and were unconscionable. Ms. Eagle sued Fred Martin Motor Company over a dysfunctional vehicle worth approximately $10,000 that she purchased from the dealership, and the dealership in turn sought to enforce the arbitration clause in the purchase agreement that required arbitration before NAF. *Id.* at 1164.

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[12] The NAF Code of Procedure can be found at: http://www.adrforum.com/main.aspx?itemID=609&hideBar=False&navID=162&news=3.

In addressing NAF's fees, the court found that along with a basic filing fee of over $750, which far exceeded what it would have cost the plaintiff to file her case in court, NAF's rules imposed fees for virtually every type of filing, including pleadings, subpoenas, discovery orders, and continuances. *Id.* at 1173, 1176. Some fees were particularly large, including $2,500 for a document hearing, $1,500 for an initial participatory hearing, and $1,250 for written findings of fact. *Id*. The court found that based on NAF's fee schedule, Ms. Eagle would have to spend at least $4,200-$6,000, and likely more, to have her case heard. *Id*. The court found that such fees were prohibitively expensive for a person with an annual income that ranged from $14,500-$21,000 like Ms. Eagle. *Id*. at 1175.

The court also found that while NAF had procedures for providing waivers for indigent litigants, such waivers were discretionary and therefore provided insufficient protection against high costs. *Id*. at 1177. The court noted that NAF's waiver rule did not guarantee that an indigent party would receive a waiver because it stated only that NAF's director *may*, in its discretion, grant a waiver. *Id*.

Following *Eagle*, NAF revised its fee schedules in several ways to make them fairer to individuals. First, NAF changed its waiver rule to make fee waivers mandatory for eligible parties rather than discretionary. NAF Rule 45 now states that "[t]he Forum *shall* promptly issue a full or partial waiver to a Consumer Party eligible" for a waiver. NAF Code of

Procedure, Rule 45 (emphasis added). This amendment is directly responsive to the court's concerns in *Eagle*, and absent *Eagle*, it is highly unlikely that NAF would have corrected its fee waiver provision to make it fairer.

Second, NAF also enacted a new rule for requesting fee waivers in claims over $75,000, as was the claim in *Eagle*. NAF Rule 42(g), adopted after the *Eagle* decision, states that for large claim cases, a consumer "who asserts that arbitration fees prevent the Consumer Party from effectively vindicating the Consumer's case in arbitration" either can be relieved of any fee obligation or instead can "litigate the case instead of arbitrating the case." NAF Code of Procedure, Rule 42(g) (2008).

Finally, NAF also reduced some its fees for large claim hearings following *Eagle*. NAF eliminated the $2,500 hearing fee, previously the largest single cost, and now includes a hearing with its basic filing fee of $1,100. NAF Fee Schedule (2008).[13] NAF also mandates that parties split costs for written decisions where the contract requires that findings of fact be made. *Id*. As a result of these changes, if Ms. Eagle were still not eligible for a fee waiver, her case would now cost less than half of what it did when she brought it. Instead of costing $4,200-$6,000 or more to pursue her claim, *Eagle*, 809 N.E.2d at 1176, under the current fee

[13] NAF's Fee Schedule can be found at http://www.adrforum.com/users/naf/resources/2008FeeSchedule1.doc.

schedules she would be able to file the same claim for as little as $1,100.[14]

These two examples show how court decisions declaring arbitration provisions unconscionable can induce even the worst actors to reform their practices. The notion that judicial unconscionability decisions prompts reform is not controversial, as even arbitration proponents admit that unconscionability rulings have had a positive effect. *See* Resp. Br. 41-43. Ruling in favor of Petitioner, however, will make all of these previous judicial unconscionability decisions irrelevant because judges will no longer be deciding unconscionability questions.

The value of judicial review of unconscionability challenges is significant. The fact that NAF changed its rules does not show that NAF is now a fair arbitration provider. The current allegations of NAF's conflict of interest in resolving debt collection arbitrations reveal as much. Rather, these cases show that when NAF has adjusted its rules to be a little fairer, it has done so because judicial unconscionability decisions forced its hand. Preserving the ability of neutral courts to address unconscionability in published and precedential decisions provides critical oversight of an otherwise self-regulated arbitration market.

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[14] NAF's Fee Schedule does not list a written decision fee. Even if it remained the same as in *Eagle* ($1,250), the cost of arbitration would still only come to $2,350, which is significantly less expensive than the costs Ms. Eagle faced.

B. Allowing Arbitrators To Decide Unconscionability Will Not Be Effective in Making Arbitration a Fairer Process.

By contrast, allowing parties to bypass courts and vest unconscionability decisions solely with arbitrators is much less likely to lead to fairer arbitration rules and provisions. First, the structural features of arbitration create less incentive for parties to respond to an arbitration decision than to a court decision. Unlike court decisions, arbitration decisions do not need to contain reasons, or even to be written at all. *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 598 (1960) ("Arbitrators have no obligation to the court to give their reasons for an award."). Additionally, arbitrator decisions are typically kept confidential under arbitrator rules. *See, e.g.*, NAF Code of Procedure, Rule 4 (2008).

Consequently, even if an arbitrator were to declare a provision unconscionable, no one other than the parties involved would even know that the arbitrator did so or what the basis was for the arbitrator's decision, and the parties themselves would be prohibited from sharing the decision with others. Even if an arbitrator's decision were publicly known, unlike a precedential decision that would be binding in future cases, no future arbitrator would be required to follow that arbitrator's decision. *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998) ("Arbitrators' decisions are not intended to have precedential effect in arbitration . . . let alone in courts."). Thus, arbitrator unconscionability decisions, unlike court decisions, do not force companies to amend their practices and provide almost no incentive for bad actors like NAF to make their arbitration procedures fairer.

Second, as the experience of NAF demonstrates, the incentive structure facing many arbitrators pushes them to uphold arbitration provisions, even unfair ones, instead of finding them unconscionable. As mentioned earlier, NAF arbitrators who ruled for creditors were steered more cases while those who ruled against companies found themselves blackballed. *See* Part I.C., *supra*. Additionally, an arbitrator who finds a clause unconscionable and unenforceable also loses the opportunity to arbitrate that case and to collect the associated fees. Thus, arbitrators have every reason to uphold arbitration clauses and little reason to find particular provisions unfair.

Although *Amicus* Pacific Legal Foundation notes that arbitrators on occasion have found arbitration provisions unconscionable, *see Amicus* Br. of Pacific Legal Foundation at 14-15, the cases it cites merely reinforce the leading role that courts play in policing unfair arbitration agreements in the consumer and employment settings. In the primary case *amicus* cites, *Labor Ready Nw., Inc. v. Crawford*, 2008 WL 1840749, at *2-4 (D. Or. Apr. 21, 2008), *amicus* correctly states that the arbitrator struck down as unconscionable an arbitration provision banning class actions, but fails to point out that the arbitrator did so *only after* the Oregon Court of Appeals had issued a decision finding a similar class action ban in an arbitration provision unconscionable. *See id.* at *4 (citing *Vasquez-Lopez v. Beneficial Oregon, Inc.*, 152 P.3d 940, 948 (Or. Ct. App. 2007)). But if the court's role in addressing unconscionability is eliminated, there will be no more precedent to guide arbitrators, and it is much less certain that future arbitrators will make unconscionability findings.

Similarly, while the court in *Smith v. Gateway, Inc.*, 2002 WL 1728615, at *3 (Tex. App. July 26, 2002), noted that an arbitrator found unconscionable an arbitration provision barring the claimant from recovering consequential, indirect or punitive damages, that decision was consistent with prevailing law – established by judicial decisions – that arbitration provisions that strip parties of available remedies are unenforceable. *See, e.g.*, *In re Poly-Am. Ltd. P'ship*, 262 S.W.3d 337, 351-53 (Tex. 2008) (finding unconscionable an arbitration provision that prohibited punitive damages and reinstatement); *see also Hadnot v. Bay, Ltd.*, 344 F.3d 474, 478 n.14 (5th Cir. 2003) (declaring unenforceable an arbitration agreement's ban on punitive damages in a Title VII action).

The other cases *amicus* cites are inapposite because they involve business-to-business or labor arbitrations. *See* Pacific Legal Foundation Br. 14-15. In those contexts, unlike the consumer or non-union employment context, both parties are repeat players, which removes the incentive for the arbitrator to favor one side over the other. In NAF consumer arbitrations, by contrast, the creditor party was the repeat player while the consumer was not, which gave the arbitrator a much stronger incentive to uphold the arbitration clause in order to continue getting chosen by companies for future arbitrations. Finally, even if arbitrators do on occasion find an arbitration provision unconscionable, because those decisions are private, confidential and unpublished, there is no guarantee that the decisions will prompt bad actors to change their practices. As explained above, judicial review of unconscionability challenges is much more likely to have that reforming effect.

CONCLUSION

For the foregoing reasons, the decision below should be affirmed.

Respectfully submitted,

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Dated: March 31, 2010