Pre-Dispute Consumer Arbitration Clauses: Good Public Policy?

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Today, a person cannot obtain a credit card, buy a car, open a bank account, or use a cell phone without signing a pre-dispute consumer arbitration clause. Thus, consumers are forced to unknowingly contract away their access to the courts. This controversy has sparked a divide between two branches of government. While the Supreme Court has continued to expand the enforcement of arbitration clauses, Congress has responded with many attempts to reform and even abolish all arbitration clauses in consumer agreements. This project seeks to investigate whether pre-dispute consumer arbitration clauses are good public policy by analyzing the criticisms of arbitration, and the proposed solutions. Although many recent court decisions have answered some of the concerns, this debate is far from being decided.
INTRODUCTION

The use of arbitration as an alternative to traditional litigation has been in the United States since the colonial period. Prior to 1925, arbitration was seen as a hostile process that was not enforceable in court. In response to the increasing number of disputes during the Industrial Revolution, Congress passed the Federal Arbitration Act in 1925 to provide more stability and certainty to the arbitration process. The advantages of arbitration, including being a faster, and generally cheaper option than traditional litigation, have established the process as a valuable tool in commercial and labor arbitration.

However, the broad interpretation of the FAA by the Supreme Court in the last three decades has lead businesses to expand their arbitration agreements into other types of contracts with highly controversial circumstances. While the traditional uses of arbitration in commercial and labor disputes are considered voluntary, consumer arbitration is criticized as being “forced.” The consumer does not have the ability to negotiate the terms of the contract, and is forced to take-it-or-leave-it when every business in the industry also demands arbitration. This difference has infuriated critics and brought about impassioned attacks that have flooded the courts with a substantial number of cases in the last decade.

This thesis seeks to explore whether the current system of consumer arbitration is good public policy based on the two extreme stances that the Supreme Court and Congress have each taken. The Supreme Court’s extreme stance to always enforce arbitration clauses based on their terms has lead Congress to call for reform. Unfortunately, after closer examination of the current issues, the current arbitration reform pending in Congress is too broad and does not address the real issues. A more tempered approach to reform is needed to resolve the current issues and will be discussed at the end of this paper.
DEFINITION OF ARBITRATION

Arbitration is a voluntary and private dispute resolution process that is used as an alternative to litigation. Using this process, the disputing parties agree to submit present their evidence and arguments in the form of a hearing to a selected neutral third party (an arbitrator) who issues a binding decision on the dispute.\(^1\) Arbitration has a long successful history of use in the United States in commercial (between two businesses) and labor disputes (between employers and employees over their collective bargaining agreements, which is the negotiated contract between the union and management).\(^2\)

ORIGINS OF ALTERNATIVE DISPUTE RESOLUTION

The origins of alternative dispute resolution can be traced back to Greek and Roman law.\(^3\) The basis of modern arbitration comes from medieval England and France, beginning as a form of mediation between friends trying to bring peace to a dispute.\(^4\) Mediation morphed into the use of arbitration as the primary method of resolving commercial disputes during the 17\(^{th}\) and 18\(^{th}\) centuries.\(^5\) The use of arbitration to resolve commercial disputes was developed by the European trading community as a means for trading partners to avoid the delay of traditional

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\(^2\) *Id.*


\(^4\) *Id.* at 238.

litigation. However, this practice was met with hostility by the English court system because the use of arbitration circumvented court procedures and judicial salaries.

**Passage of the Federal Arbitration Act of 1925**

Prior to 1925, American court system adopted this hostility toward arbitration and refused to enforce arbitration clauses if one party challenged them. However, as the court system started seeing an increased number of disputes during the Industrial Revolution, businesses searched for an alternative to traditional litigation. So, Congress passed the Federal Arbitration Act of 1925 (FAA) in response to the perceived hostility by the courts and at the behest of lobbying from businesses and the American Bar Association (ABA). The stated purpose of the act was to remove the past judicial hostility toward the process and to place agreements to arbitrate as no less enforceable than other contracts. The act expanded the validity of arbitration, enforcement of the process and allowed parties litigating a dispute to suspend the hearing in order to arbitrate the dispute instead. Section four of the act gave the federal courts power to compel parties that refuse or fail to arbitrate under a written contract to preform such process. The FAA also provides for very limited review of arbitrators’ awards. Judicial review of arbitrators’ awards under the FAA, are so limiting that they have been described as “among the narrowest known to the law.” The FAA received strong support from

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6 See Buchele, *supra* note 5.
7 See Doneff, *supra* note 3 at 238.
8 See Doneff, *supra* note 3 at 238.
9 Id.
13 Federal Arbitration Act, 9 USCS § 4 *et seq.*
14 Lindamood, Darren P. "Redressing The Arbitration Process: An Alternative To The Arbitration Fairness Act Of
commercial and legal bodies at the time of its passage.\textsuperscript{15} In fact, no one testified at the congressional hearing in 1924 in opposition of the bill.\textsuperscript{16}

**Judicial Expansion of the FAA**

The courts initially interpreted the FAA very narrowly. For example, the FAA was originally only applied to federal courts, not state courts.\textsuperscript{17} Employment and consumer disputes were also presumed to be beyond the scope of the arbitration agreements.\textsuperscript{18} The Court may have based these decisions on their concern that the advantages of arbitration may not outweigh the costs, which might cause individuals more harm than businesses.\textsuperscript{19} However, courts had to start looking at expanding the use of alternative dispute resolution with the increasing court backlog in the late 1970s and early 1980s.\textsuperscript{20} Courts eventually expanded the use of arbitration into the consumer context because of the long history of success in commercial and labor arbitration.

The Supreme Court opened the door to broad interpretation and enforcement of the FAA as they started to broadly interpret the Commerce Clause. The Court began to substantially expand the reach of the FAA in the 1980s. First, the Court held that ambiguous arbitration clauses should be construed in favor of arbitrating disputes.\textsuperscript{21} Then, the Court significantly expanded the reach of the FAA in *Southland Corp. v. Keating* by determining that states could...

\textsuperscript{15} See Lindamood, *supra* note 14, at 292.
\textsuperscript{16} Id.
\textsuperscript{18} Id.
\textsuperscript{19} See Doneff, *supra* note 3 at 241.
\textsuperscript{20} Id.
no longer pass laws to exempt certain types of agreements from arbitration. Since *Southland* in the early 1980s, courts have used a “hands off” approach in enforcing arbitration agreements.

Once the Supreme Court began to issue decisions favoring commercial and labor arbitration, businesses took the opportunity to apply arbitration clauses in contexts not previously thought to be enforceable. Businesses expanded into consumer arbitration to settle disputes involving an individual and a business. This shift was spurred by fear of certain aspects of litigation including publicity, punitive damages, extensive discovery, jury awards and class actions. Companies in a wide array of industries began to require their customers to sign pre-dispute arbitration agreements including financial institutions (house and car loans, and credit cards), sellers of goods (eBay, PayPal, and Apple), and service providers (internet/cable providers, and cell phone providers). In the new millennium, consumer arbitration quickly expanded to health care, educational institutions and nursing homes.

**Benefits of Arbitration**

American businesses support the FAA because they recognize that arbitration has many advantages. Businesses urge that arbitration can help consumers by providing them with a forum that is cheaper, quicker, and more accessible than traditional litigation. Arbitration provides speed and efficiency by streamlining the discovery, pleadings and motion practice. These advantages include having greater control over the process, and offering a faster and cheaper alternative to traditional litigation.

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24 *Id.* at 1638.
25 *Id.* at 1638.
26 *Id.* at 1638.
A major advantage in arbitration is that the parties may choose an arbitrator with subject area expertise to hear and decide their dispute, unlike in litigation where you cannot choose the judge that hears your case. This could be important with highly technical disputes because many judges will not be familiar with the specifics of the topic of your dispute. Arbitration also gives the disputing parties more flexibility in their schedule by working with the arbitrator to schedule the hearings at a more convenient time and place. Having the ability to choose the venue is a great advantage in international disputes where an appropriate venue can be difficult to determine. Since the parties maintain greater control over this process, they are generally more satisfied and willing to comply with the final decision.

Another strong advantage of arbitration is that it generally faster than traditional litigation due to the streamlined nature of the process. Due to congested court backlogs, lawsuits may take several months to even years to be tried in court, which can end up costing a lot of time and money before the case is settled. According to a 2009 study of 301 cases by the American Arbitration Association (AAA), the average time from the filing to an award was 6.9 months. This is favorably compared to the 2.5 years it takes to reach trial in federal and states courts through litigation. Many parties cannot or do not want to wait that long so they can turn to

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29 *Id.*
30 *Id.*
31 See Padis, *supra* note 17, at 695.
33 *Id.*
arbitration to get their case settled more quickly. This is extra important in time-sensitive industries, such as the technology industry, where speed is crucial.\footnote{See Padis, supra note 17, at 693.}

Another argument for pre-dispute arbitration agreements is that their enforcement lowers business costs, and these savings are then passed on to the consumers in the form of lower prices. By avoiding unpredictable juries, businesses can reduce the likelihood of high damages awards.\footnote{Id.} The streamlined discovery process of arbitration also saves businesses both time and money.\footnote{See Ware, supra note 27.} Finally, arbitration’s near absence of judicial review saves businesses the additional costs of appeals. Proponents of arbitration claim that basic economics explains that lower costs to businesses ultimately leads to lower prices for consumers.\footnote{See Ware, supra note 27.} While arbitration provides parties some benefits, there are many criticisms of the current system.

**CRITICISMS OF CURRENT SYSTEM**

In a long line of cases between 1983 and 1995, the Supreme Court rejected any legal doctrine that limited the use of arbitration, thereby freeing it from judicial supervision.\footnote{Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc, 73 U.S. 614, 636-40 (1985); Southland Corp. v. Keating, 465 U.S. 1, 16 (1984); Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 272-73 (1995).} This expansion of the FAA has infuriated critics of arbitration and Congress, who believe that the Supreme Court has expanded the reach of the FAA to far broader areas than was originally intended. Critics claim that consumer arbitration violates the core principles of alternative dispute resolution. These concerns include the adhesive quality of arbitration agreements, power imbalance, the lack of transparency and the signing away of due process rights.
Contract of Adhesion

One of the most discussed criticisms of consumer arbitration is the “adhesive” quality of the arbitration agreement.41 This problem arises when large businesses insist upon arbitration agreements in contracts that consumers have no ability to negotiate.42 The consumer is forced to take-it-or-leave-it because either the corporation has a practical monopoly, or the entire industry also demands arbitration.43 Not only can consumers not influence or avoid these arbitration agreements, most consumers are unaware that they have waived their right to court.44 An empirical study conducted in 2009 found that 64% of consumers report never noticing an arbitration clause in any contract for goods or services.45 An even greater number of consumers, at 79%, mistakenly believe that they retain their right to sue in court.46 There has even been evidence that some companies may even design their arbitration agreements to deliberately decrease the likelihood that the consumer will focus on the agreement.47 Given that consumers do not typically read or understand the clauses, opponents of arbitration insist that pre-dispute arbitration agreements are nonconsensual.48

Imbalance of Power

As the drafting party, there are virtually an unlimited number of ways in which a company can try to use a pre-dispute arbitration agreement to gain the upper hand, including

41 See Padis, supra note 17.
43 See Padis, supra note 17.
44 See Lindamood, supra note 14, at 293.
45 Id.
47 Ting v. AT&T, 182 F. Supp. 2d 902 (N.D. Cal. 2002) (showing AT&T spent substantial resources on market research to determine how best to implement their binding arbitration provision so that it would not be opposed by consumers).
48 See Sternlight, supra note 23, at 1649.
arbitrator selection, imposition of high costs, and limitation of remedies. The drafter of the arbitration clause has the opportunity to select the arbitrator or arbitration provider. Since large businesses often exercise these arbitration clauses, they have the benefit from increased familiarity with the arbitrators and the arbitration process. As repeat players, businesses can use this knowledge and experience to tilt the systems in their favor by banning class actions, limiting remedies and choosing an arbitrator that is more likely to rule in its favor.\footnote{See Lindamood, supra note 14, at 303.} Businesses are at an advantage in the process because they know what information to submit, and how to do so.\footnote{Id.} Further, as repeat players, businesses are more likely to seek the arbitrator’s services in the future. This could lead to a financial incentive for arbitrators to lose neutrality and decide in favor of the business.\footnote{Id.}

Arbitrators are hired by the conflicting parties to settle their dispute in an unbiased and fair manner. However, this is complicated by the fact that arbitrators receive compensation from the business to settle their dispute. Since the business is more likely to be a source of future income, the arbitrator may have a financial incentive to ensure the corporation is satisfied with the award.\footnote{Id.} Critics charge that arbitrator’s neutrality is called into question because many businesses retain a single company to provide arbitrators for all disputes involving that a certain matter.\footnote{Id.} Under these conditions, even the most honorable arbitrators may find themselves unconsciously influenced to make findings that favor the business.\footnote{Id.}

The recent withdrawal of two large arbitration firms from the mandatory consumer arbitration market has drawn nationwide attention to the problem of the repeat player bias.\footnote{See Smith, supra note 42.} On
July 19, 2010, the nation’s largest arbitration firm, National Arbitration Forum, exited the business due to an increasing number of allegations of bias in favor of the credit-card companies for whom it regularly arbitrated.56 Days later, the American Arbitration Association (AAA) announced that it would no longer participate in the arbitration of consumer debt-collection disputes until new guidelines are established.57 An investigation into the actual practices of these two firms by the Domestic Policy Subcommittee revealed “deeply disturbing” abuses by the two firms.58 While some empirical data indicates that there is no such bias59, there is limited empirical evidence that shows that the repeat player does somewhat better in arbitration than the nonrepeat player.60

**Issues of Privacy**

Arbitration is a private process. The arbitration hearing is held in a non-public forum, such as law firms, hotel conference rooms, or a private space provided by the arbitrator. In some situations, both parties want privacy so they are able to resolve the disputes without embarrassment. However, this is not the case in all situations. The privacy of arbitration eliminates the deterrent of the public eye for businesses not to engage in bad practices. Businesses may use arbitration to hide problems from the public.61 Businesses may want to use

59 See Searle, *supra* note 34.
61 See Padis, *supra* note 17, at 685.
arbitration to hide disputes concerning a sensitive matter, like discrimination. The last thing a business wants is to publically air its dirty laundry involving allegations of discrimination.

The privacy aspect of arbitration also leads to worries of collusion. Since there is no public record, businesses could collude with the arbitrator to bring about unjust awards. If this were to happen in the traditional court system, the other party would have the opportunity to appeal. However, in arbitration, arbitrators typically submit their awards without reasoning. These awards are not generally open to the public and do not create precedent.

**Due Process Rights**

Critics of consumer arbitration often argue that consumers surrender important procedural safeguards by waiving their day in court. Some of these procedural safeguards include right to a jury trial, extensive discovery and judicial review. With the loss of the jury trial, consumers also lose the perceived possibility of a large judgment. The arbitration process often extremely limits the discovery phase for both parties, which can be problematic in certain types of disputes when in-depth discovery would be more effective in defending against the opposing party’s claims. The limited discovery process in arbitration may not be suited for technically complex disputes. The limitation on discovery is a trade-off for the speedy resolution of arbitration.

One of the largest criticisms of arbitration is the extremely limited judicial review that is provided for by the FAA. Unlike decisions in traditional litigation, an arbitrator’s award can only

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63 See Padis, *supra* note 17, at 685.
64 *Id.*
65 *Id.*
66 *Id.*
67 See Doneff, *supra* note 3, at 240.
be appealed in very few instances. Under section 10 of the FAA, the main grounds for appeal are: 1) arbitrator corruption, fraud or bias, 2) arbitrator failure to comply with procedural due process laws, and 3) arbitrator conduct that exceeds their authority under the terms of the agreement to arbitrate.\(^{68}\) Section 11 of the FAA also allows for modification of the arbitrator’s award if technical errors were made.\(^{69}\) The courts have also overturned arbitration awards that clearly violate law or public policy. This rule comes from basic contract law, in which any contract that violates public policy cannot be enforced.\(^{70}\) Public policy challenges must be based on a well-known public policy concern and the arbitrator’s decision must explicitly violate that policy.\(^{71}\) However, the general stance of the court is that they should recognize the authority of the arbitrator’s award as long as the decision draws from the “essence of the agreement” to arbitrate.\(^{72}\)

In *United Steelworkers of America v. Enterprise Wheel & Car Corp*, the Supreme Court ruled on the arbitrator’s extent of power to interpret the law and facts of the dispute.\(^{73}\) In this case, the Supreme Court decided that the courts have no power to overturn an arbitration award just because they would have interpreted the facts differently.\(^{74}\) The Supreme Court also determined that the arbitrators have “no obligation to the court to give their reason for an award.”\(^{75}\) In making this decision, the court recognized its support for arbitration and the importance of allowing a neutral party to render a binding decision without the interference of the court in second-guessing their interpretation of the fact and law.\(^{76}\)

\(^{70}\) See Coltri, supra note 11.
\(^{71}\) See Ponte, supra note 28.
\(^{73}\) Id.
\(^{74}\) Id.
\(^{75}\) Id.
EMPIRICAL DATA ON CONSUMER ARBITRATION

While it is difficult to assess how common pre-dispute arbitration clauses have become, a summary of the empirical data confirms that arbitration agreements have become practically ubiquitous in the past decade.\(^{77}\) Readers can actually do their own empirical research by noting how often they come across pre-dispute arbitration clauses in their own lives. I have seen arbitration mandated by my social media providers, my cell phone provider, various credit cards and my student loan provider.

A 2004 study of the “average Joe” in Los Angeles found approximately one-third of his consumer transactions were covered by arbitration clauses.\(^{78}\) The highest prevalence of these arbitration clauses was found in the financial industry at 69.2%.\(^{79}\) Although the scope of the arbitration clauses surveyed varied, the study concluded that 30.8% of consumer contracts contained class action waivers.\(^{80}\) This number has escalated in recent years. A more recent study from 2008 found arbitration clauses in 76.9% of consumer contracts.\(^{81}\) Every one of these consumer contracts with an arbitration clause also included a class action waiver.\(^{82}\) At the same time, the study also found that the same businesses surveyed found arbitration clauses in only 6.1% of their negotiated, nonconsumer, nonemployment contracts.\(^{83}\) The study concluded that businesses’ selective use of arbitration clauses against consumers, but not against each other,

\(^{77}\) See Padis, supra note 17, at 685.


\(^{79}\) Id.

\(^{80}\) Id.


\(^{82}\) See Eisenberg, supra note 83, at 886.

\(^{83}\) Id.
suggests that their use of arbitration clauses may be “based more on strategic advantage than on a belief that businesses are better serving customers.” The concerns raised by the pervasiveness of these clauses have flooded the court system with cases.

JUDICIAL BRANCH’S RESPONSE

There was practically no significant litigation regarding the enforcement of arbitration agreements for many years after the enactment of the FAA. However, now is a time of powerful, significant activity by the Supreme Court, as a period in which a closely divided Court handed down a series of important decisions involving binding arbitration. Even though the legality of mandatory consumer arbitration has been firmly established, it remains extremely controversial.

Unconscionable as a Defense

Under the current law, a consumer or employee is barred from bringing a dispute to traditional litigation if they entered into a binding agreement to arbitrate. The plaintiff is compelled to arbitrate unless he can prove that the agreement to arbitrate is unconscionable. An unconscionable contract is unjust or too one-sided in favor of the person with superior bargaining power to be enforced.

First, the courts needed to determine who has the authority to decide whether the arbitration agreement is unconscionable and therefore unenforceable. This question arose in

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84 See Eisenberg, supra note 83, at 886.
85 See Buchele, supra note 5, at 37.
87 See Padis, supra note 17, at 669.
Rent-A-Center, West, Inc. v. Jackson. An employee of Rent-A-Center had signed a contract that contained a pre-dispute arbitration agreement. The employee sued for unlawful discrimination and alleged that the agreement was unconscionable under state law. The arbitration agreement provided that the arbitrator had the authority to resolve any dispute related to enforceability. In a 5 – 4 decision, the Supreme Court held that the issue of unconscionability was for the arbitrator to decide. Until this decision, the courts had determined the issue of whether an arbitration agreement was unconscionable. Now, arbitrators have the power to decide whether or not they will be paid by making the parties arbitrate, which creates a serious conflict of interest.

Attack on Class Action Waivers

The most recent Supreme Court cases have addressed the attacks on class action waivers. The first of the latest three decisions on the topic, determined if class action was prohibited if the arbitration agreement was silent on the issue. The two latest cases argued that class action waivers should not be enforced under two rubrics: state law unconscionability statutes and on the basis that they deprive litigants of justice because costs of individual arbitration would be prohibitive.

In the first of the latest three decisions, Stolt-Nielsen v. AnimalFeeds involved a commercial shipping contract with a standard arbitration clause. AnimalFeeds wanted to use class arbitration to air allegations of price-fixing against Stolt-Nielsen. The two agreed that their

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90 Id.
91 Id.
contract did not define whether class arbitration was authorized. The parties agreed to submit this
question to a panel of arbitrators. The panel decided that the agreement permitted class
arbitration, and the Second Circuit agreed.\(^\text{94}\)

However, the Supreme Court reversed the decision holding that class arbitration cannot
be imposed on the parties if the parties did not clearly agree to it in the arbitration agreement.\(^\text{95}\) The Court determined that arbitrators must look to the language of the agreement to find
authority to proceed on a class basis.\(^\text{96}\) The Court found that the FAA prohibits arbitrators from
interpreting an arbitration agreement that is silent on the issue of class action arbitrations to
allow for such arbitrations unless the parties, post-agreement, explicitly consent to the class
action arbitration process.\(^\text{97}\) The FAA mentions nothing about class arbitration, and the Court
noted that class arbitration is so different from traditional litigation that it is hard to imagine
finding that the FAA is a source of authority for ordering class arbitration.\(^\text{98}\)

**Attack as Unconscionable under State Law**

Following *Stolt-Nielsen*, it was still unclear if a consumer could argue that an arbitration
agreement that is silent on the issue of class arbitration is unconscionable if it is interpreted to
preclude class actions or class arbitration. This question is unlikely to arise due to the Court’s
more recent decision in *AT&T Mobility v. Concepción*.\(^\text{99}\) *Concepcion* raised the question of
whether the FAA prevents states from deciding the enforceability of certain consumer arbitration
agreements based on the availability of class arbitration procedures.

\(^{95}\) *Id.*
\(^{96}\) *Id.*
\(^{97}\) *Id.*
\(^{98}\) *Id.*
The Concepcion’s and other plaintiffs claimed that AT&T had violated California consumer protection law by marketing a cell phone as "free" and then charging them $30 in sales tax. The plaintiff’s believed that the company should have either disclosed the tax or swallowed the tax as part of the promotion. They filed a class action in federal court in California and AT&T moved to compel arbitration. The plaintiffs argued that the agreement’s ban on class arbitration was unenforceable, and the Ninth Circuit agreed using an earlier California Supreme Court ruling in Discover Bank v. Superior Court.100 The California Supreme Court had held that contractual bans on class actions were unconscionable when they appeared in a "consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money."101

The technical legal question in Concepcion was whether the FAA preempted the Discover Bank rule. However, the larger question seemed to be whether businesses could insulate themselves from class liability by inserting language in a contract of adhesion. The Supreme Court held that businesses can shield themselves from class liability using this method. In a 5-4 decision, the Court held that the FAA preempts the Discover Bank rule because the rule conflicted with the pro-arbitration policy of the FAA.102 In Concepcion and Stolt-Nielsen, the Court closed the door on the possibility of courts offering assistance to parties seeking a way to aggregate their claims in class arbitration, unless the parties clearly express their intent to permit class arbitration.

100 Discover Bank v. Superior Court, 113 P.3d 1100, 1110 (Cal. 2005).
101 Id.
Attack as Prohibitive-Costs-Based Vindication of Statutory Rights

Since Concepcion closed the door on the defense that class action waivers in arbitration agreements are unconscionable under state law, opposing parties have relied on the prohibitive-costs-based vindication of statutory rights defense. However, the Court struck down this attack as well. The Court held in American Express Co. v. Italian Colors Restaurant, that an arbitration agreement with a class waiver will not be unenforceable under a “prohibitive costs” defense simply because the plaintiffs have no economic incentive to pursue their claims without the class mechanism.103

In American Express, a group of merchants who accept American Express credit cards filed a class action against American Express for violations of the federal antitrust laws.104 American Express moved to compel individual arbitration under the agreement to arbitrate, which included a class action waiver. The merchants responded by arguing that the provisions restricting class actions were unenforceable because it would cost more to pursue individual arbitration than the maximum amount of recovery that could be won in arbitration. In support of this argument, the merchants pointed out that the cost of retaining an expert witness to surmise the merits of such a suit might exceed $1 million, while the maximum recovery for an individual plaintiff would be capped at an estimated $38,549.105 The question before the court was whether a class action waiver in an arbitration agreement is enforceable under the FAA when the plaintiff’s cost of individually arbitrating a claim exceeds the potential recovery. In a 5 – 3 decision, the court held that the class action waivers were not unenforceable simply because the

104 Id.
105 Id.
plaintiff has no economic incentive to pursue their claims without class action.106

In rejecting the plaintiff’s “prohibitive costs” defense, the Court has closed the door on one of the last plausible limits on the enforcement of arbitration agreements. Following the Concepcion and American Express decisions, critics worried that every business would soon use an arbitration clause that includes a class action waiver in their standard form contracts to avoid the risk of class actions.107 Studies have found that several large businesses started to introduce arbitration agreements into their consumer contracts after these last two decisions.108 According to a CNN article, Sony added an arbitration clause to their terms of service because “the Supreme Court recently ruled in the AT&T [AT&T Mobility v. Concepcion] case that language like this is enforceable.”109 An empirical study conducted in 2013, found that other companies have added arbitration provisions to their consumer contracts after Concepcion, including Netflix, eBay, PayPal, Instagram and StubHub.110

LEGISLATIVE BRANCH’S RESPONSE

Congress has proposed several pieces of reform legislation in response to these concerns. First, Congress enacted a rider to a 2010 appropriations bill to prohibit government defense contractors from including arbitration clauses in their employment agreements.111 Second, Congress created and empowered the Consumer Financial Protection Bureau (CFPB) under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to evaluate and regulate

106 *Id.*
110 See Rutledge and Drahozal, *supra* note 110.
the use of consumer arbitration in the financial services industry.\textsuperscript{112} Third, Congress proposed the Arbitration Fairness Act to abolish pre-dispute mandatory arbitration clauses concerning consumer, employment, antitrust and civil rights disputes.

The fiscal year 2010 Defense Appropriations rider calls for the withholding of federal funds in excess of $1,000,000 to any contractor who requires the signature of an arbitration agreement as a condition of employment.\textsuperscript{113} The Dodd-Frank Act created the CFPB and gave it authority to issue rules prohibiting, or imposing conditions or limitations on the use of arbitration clauses in consumer financial services contracts.\textsuperscript{114} Before the CFPB can regulate, they must conduct a study on the use of pre-dispute arbitration clauses in such contracts and report to Congress.\textsuperscript{115} The study has not been completed, but their preliminary results have been recently published.\textsuperscript{116}

Finally, Congress is proposing to ban pre-dispute arbitration clauses all together in certain kinds of disputes. In 2007, Congress first proposed amending the FAA with the initial Arbitration Fairness Act (AFA).\textsuperscript{117} The AFA would abolish pre-dispute arbitration agreements in consumer disputes, employment disputes, antitrust disputes, and civil rights disputes.\textsuperscript{118} This initial Arbitration Fairness Act and all of the subsequent re-proposals have failed to make it out of committee. The latest Arbitration Fairness Act was introduced on May 7, 2013.\textsuperscript{119} The findings section stated:

A series of decisions by the Supreme Court of the United States have interpreted the Act so that it now extends to consumer disputes and employment disputes,

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\item[112] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 1414 (2010).
\item[114] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 1414 (2010).
\item[115] Id.
\item[118] Arbitration Fairness Act of 2013, S. 878, 113\textsuperscript{th} Cong. (2013).
\item[119] Id.
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contrary to the intent of Congress. Most consumers and employees have little to no meaningful choice whether to submit their claims to arbitration. Often, consumers and employees are not even aware that they have given up their rights…

The drafter of the bill, Senator Franklin, contends that the AFA will restore the original intent of the FAA by clarifying the scope of its application. The AFA will not restrict the use of arbitration agreements when two parties choose to arbitrate after a dispute arises. The bill currently has 23 cosponsors in the Senate and 71 cosponsors in the House. The Senate version of the bill is currently in the Senate Committee on Judiciary. The House version is currently in the House Subcommittee on Regulatory Reform, Commercial And Antitrust Law.

IS THIS GOOD PUBLIC POLICY?

The Judicial and Legislative Branch’s have each taken an extreme position on consumer arbitration. The Supreme Court has adopted the position of enforcing all arbitration clauses based on the terms of the contract. On the opposite extreme, Congress is trying to eliminate pre-dispute consumer arbitration clauses all together. In light of issues laid out in the sections above, enforcing all arbitration clauses is not the answer. However, completely doing away with pre-dispute arbitration clauses in consumer contracts is not the answer either.

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122 Id.
A closer review of the Congress’ proposed legislation to reform the FAA has led to several critiques. The primary critique of this proposed legislation is that it is simply too broad, and does not correct the problems underlying these type of pre-dispute arbitration agreements.\textsuperscript{127} The Association for Conflict Resolution (ACR), a professional organization of more than 3,000 mediators, arbitrators, facilitators, educators, and others involved in the field of conflict resolution, issued a report critiquing the Arbitration Fairness Act.\textsuperscript{128} Even though the report recognized that some pre-dispute arbitration agreements created defective processes, it concluded that the AFA’s solution to prohibit all of such agreements is not the correct solution to solve the problems.\textsuperscript{129}

The report identified a number of potential benefits the arbitration process could have on consumers including a “fast, efficient, fair and low-cost dispute resolution process to which all citizens could gain access and whose procedures and practices are fair and transparent.”\textsuperscript{130} The report pointed out that the complete elimination of pre-dispute arbitration processes in these categories would result in less access to a remedy for plaintiffs with small claims.\textsuperscript{131} As a result of having to participate in the default system of litigation in the courts, businesses will abandon arbitration and leave the vast majority of consumers with small claims without any meaningful remedy.\textsuperscript{132} Further, invalidating numerous arbitration agreements will send these disputes

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\textsuperscript{128} Fincher, Richard D., Ass'n for Conflict Resolution, An Examination of the Arbitration Fairness Act of 2009, passim (2009). (Critiquing the reach of the 2009 AFA, which is essentially the same as the 2013 version). \\
\textsuperscript{129} \textit{Id.} \\
\textsuperscript{130} \textit{Id. at 7}. \\
\textsuperscript{131} \textit{Id.} \\
\end{flushright}
through traditional litigation. The increased number of cases in the court system would increase the caseload and negatively impact the efficiency of the court system.

ALTERNATIVE APPROACHES

With the extreme divide between the Judicial and Legislative Branch’s, scholars on the subject have offered their own suggestions to reform the current system. These approaches take a more tempered approach, and work to reform the current system without completely abolishing consumer arbitration. Scholars believe that Congress’ current approach to reform is misguided. Instead of focusing on the issue of enforceability and invalidating countless arbitration agreements, Congress should focus on the major issues of the uneven balance of power between the parties and the lack of meaningful judicial review. Some of the proposed alternative approaches to reform include increasing judicial review of the arbitrator’s award, increasing discovery, and shifting the burden of proof from the consumer to the business.

After analyzing each of these proposed solutions, I believe that increasing the judicial review of the arbitrator’s award would address the most criticisms. I propose providing judicial review of arbitrators’ awards at the election of the plaintiff only. So, arbitration will still be mandatory, but the result will be binding on the business and not necessarily on the plaintiff. In order to allow for a review of the award, an arbitrator must submit the reasoning behind their decision. Explanation of the award requires the arbitrator to justify the award by explaining their thought process behind the decision. This approach would help to alleviate the issue of

133 See Lindamood, supra note 14, at 308.
134 See Fincher, supra note 130, at 7.
135 See Lindamood, supra note 14, at 295.
137 See Lindamood, supra note 14, at 312.
138 Id.
repeat player bias by improving the accountability of the arbitrator. In theory, as the accountability increases, the effect of the repeat player bias should decrease.\textsuperscript{139} Courts could reverse arbitration awards that are ill reasoned or that lack support and correct the arbitrator.\textsuperscript{140}

Further, allowing the plaintiff to seek judicial review of an award is a step toward resolving the issue of the power imbalance. The power balance is somewhat evened out when the arbitration award is binding on the business, but not on the consumer. Parties will still have the opportunity to settle their dispute in arbitration, which can be more time-efficient and less costly than litigation. However, now if the arbitrator fails to perform their duties in a fair and unbiased manner, the plaintiff has the opportunity to seek judicial review. This would allow someone trained in the law and without a financial incentive to review the award in an unbiased manner.

With the current political situation, where Congress has a hard time passing any legislation, change is unlikely to be coming soon. So, along with these proposed solutions for reform in Congress, businesses and consumers can take some steps in the right direction now. Businesses should take steps to make their arbitration clauses more consumer-friendly to avoid outright bans on consumer arbitration by the federal government. They can do this by making several changes to their current clauses. First, businesses should consider offering to pay the full or partial costs of arbitration for modest-size claims. Second, businesses should reconsider their confidentiality clauses in their arbitration agreements since courts have expressed concerns with arbitration agreements that require a consumer or employee to keep the results of arbitration secret.\textsuperscript{141} Finally, businesses should ensure that the organization they select as the forum for

\textsuperscript{139} See Lindamood, \textit{supra} note 14, at 312.
\textsuperscript{140} See Lindamood, \textit{supra} note 14, at 314.
arbitration of disputes is reputable and unbiased. By taking these steps and becoming more consumer-friendly, businesses can try to attract consumers from competitors on the basis of such arbitration terms.

Businesses are not the only ones that should be making some adjustments. Consumers also need to take steps to ensure that they are knowledgeable about the issues and protected. Since consumers are unlikely to be able to avoid signing a pre-dispute arbitration clause in today’s society, consumers need to increase their awareness of what they are signing. Consumers should increase their awareness by reading all of the terms before they sign. Some companies, like DropBox, are even allowing consumers to opt-out of these clauses within so many days of signing. Finally, consumers should consider securing legal representation to assist them with the arbitration process when the stakes are high. While this will increase the overall costs, a lawyer can help consumers understand what information to submit and how to do so. There is even empirical data that has shown that consumers represented by counsel generally won some relief and won a higher average amount than consumers appearing alone.

CONCLUSION

The use of arbitration as an alternative to traditional litigation has around in the United States since the colonial period. Prior to 1925, arbitration was less effective because arbitration agreements were seen as a hostile process that was not enforceable in court. In response to increasing backlog, Congress passed the FAA to provide more stability and certainty to the
arbitration process. The advantages of arbitration have established the process as a valuable tool in commercial and labor arbitration.

However, the broad interpretation of the FAA by the Supreme Court has lead businesses to expand their arbitration agreements into many contracts where the circumstances are highly controversial. With the use of consumer arbitration clauses, the consumer seldom has any meaningful input in the terms of the contract, and is likely forced to take-it-or-leave-it because every business in the industry also demands arbitration. The Supreme Court’s stance to always enforce arbitration clauses based on their terms has lead Congress to call for reform.

Unfortunately, after closer examination of the current issues, the current proposal for reform pending in Congress is too broad and does not address the real issues. The AFA will eliminate all pre-dispute arbitration clauses in consumer contracts and effectively flood the already backlogged court system and bar some consumers with small claims from resolution. The alternative solution of allowing the plaintiff to seek judicial review of the award, thereby making it binding on the business, but not necessarily on the consumer, will help address the issues of power imbalance and the repeat player bias.

However, change is unlikely to happen quickly with the current political situation, so businesses and consumers should take measures now. Businesses can add consumer-friendly provisions in their pre-dispute arbitration clauses, including covering the costs of arbitration, reconsidering their confidentiality clauses and ensuring the neutrality of their arbitrator. Finally, consumers need to increase their awareness of what they are signing, the arbitration process, and consider seeking legal representation when the stakes are high.
WORKS CITED


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