

CONSUMER GUIDE TO MANDATORY ARBITRATION CLAUSES (Issued 9/02)

WHAT IS MANDATORY ARBITRATION?

Arbitration is an alternative dispute resolution (ADR) technique that provides an alternative to litigation. If parties voluntarily agree to arbitrate after a dispute arises, arbitration may be less expensive and less time-consuming than litigation.

Mandatory arbitration clauses require one party to agree to another's pre-dispute arbitration provision. When used in consumer contracts, they are more likely to eliminate citizens' rights to go to court and settle disputes.

Mandatory arbitration clauses are becoming increasingly common in everyday transactions, yet many consumers are unaware that they are subject to mandatory arbitration provisions.

SIGNATURE PLEASE:

Jane Consumer

Consumers may unknowingly agree to arbitrate disputes by signing contracts for:

- a new credit card;
- a car lease;
- an apartment rental;
- predatory lending agreements;
- home construction agreements.

"Stuffers" sent with long-distance or cell phone statements can also subject consumers to a change-in-terms clause simply by the consumer's continued use of the service.

Typical Example:

By enrolling in, using, or paying for the services, you agree to the prices, charges, terms and conditions of this agreement. If you do not agree to these prices, charges, terms and conditions, do not use the services, and cancel the services immediately...

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Companies argue that arbitration is a less costly and less time consuming alternative to litigation but **many consumers abandon the arbitration process because of overwhelming upfront costs.**

A mandatory arbitration clause does not prevent issues from entering in the judicial system! Consumers may end up in court in order:

- to challenge the validity of the arbitration clause;
- to compel discovery to support their claim;
- to enforce an arbitrator's decision.

Equal Bargaining Power: Corporation vs. Corporation

The Federal Arbitration Act (FAA) developed in the commercial arena to enforce agreements between corporations with equal bargaining power. Since the enactment of the FAA in 1925, national policy and the judicial system favor enforcement of arbitration agreements because courts are over-burdened and litigation is often expensive and time-consuming.

Legislators did not envision that mandatory arbitration would be used as a tool to avoid corporate accountability to consumers by binding consumers to a pre-dispute arbitration requirement before they have an opportunity to evaluate the advantages and disadvantages of arbitration versus litigation.

Unequal Bargaining Power: Corporation vs. Consumer

A consumer and a business do not have equal bargaining power and a mandatory arbitration clause is in no way negotiated or bargained-for.

Mandatory Arbitration clauses are hidden in the small print of many **adhesion contracts**. Businesses include mandatory arbitration provisions in contracts because these one-sided agreements will almost always work to the business's advantage. For example, the clauses often prohibit class action suits, discourage individual consumer claims due to the high cost of arbitration, and increase the business's advantage in multiple suits as **repeat players**.

Proponents of mandatory arbitration argue these provisions provide one way to address an over-burdened court system. However, a number of arbitration enforceability issues still end up in court. For example, a party may have to go to court to compel discovery or enforce a subpoena because an arbitrator has no authority to do so. It is less likely that the suit will stay out of court because mandatory arbitration provisions are

one-sided and the opposing side/business often retains its right to sue.

Problems with Mandatory Arbitration Clauses

1. ONE-SIDED AGREEMENTS

Consumers do not voluntarily enter into mandatory arbitration agreements or negotiate their terms. These provisions are imposed on consumers and are often hidden in the small print of adhesion contracts, or implemented under a change-in-terms clause. Consumer may not even be aware that they are subject to the mandatory arbitration provision until a dispute arises.

2. PROHIBITION OF CLASS ACTIONS

Class actions are a tool to strengthen consumer's bargaining power against a corporation because an individual consumer may not have the time or resources to bring an action against fraudulent practices alone. Class actions also magnify the potential damages that a corporation is required to pay. Many mandatory arbitration provisions expressly prohibit class action suits.

For example, the third page of a six-page Initial Disclosure Statement sent with a credit card application included the following provision:

*Arbitration: The Card Agreement that you will receive with your card if you are approved for credit provides that disputes are subject to binding arbitration. **Arbitration replaces the right to go to court, including the right to a jury and the right to participate in a class action or similar proceeding.** Please read the "Arbitration" section of the Card Agreement carefully (emphasis added).*

3. SUBSTANTIAL UPFRONT COSTS

According to a recent report by *Public Citizen* (www.citizen.org), the consumer/plaintiff's arbitration **costs are almost always higher than initiating a lawsuit**, especially if the issue could have been tried in small claims court. The report also found that arbitrators tend to "split the difference," meaning, an arbitration award may be much lower than what a judge or jury might award.

Up- Front Costs in Arbitration: \$\$\$\$

- Hundreds of dollars for filing fees and potentially thousands more in advance for arbitrators' daily or hourly fees;
- Additional fees for subpoenas, discovery and continuances are a *right* in litigation, but a *privilege* in arbitration (i.e. up to the arbitrator to permit these actions). Because the arbitrator does not have the authority to enforce discovery requests, the consumer might have to go to court to compel discovery, incurring even more costs as a result;
- Consumers might have to bear the costs of travel to an inconvenient venue pre-determined by the business;
- The costs are higher in pre-dispute arbitration actions because there is no competition among providers. In post-dispute actions, the parties have the opportunity to negotiate with a variety of arbitration service providers.

RESULT: Consumers are precluded from seeking a remedy against the business because the upfront cost of the arbitration process is too expensive, or consumers abandon the action due to unforeseen costs.

4. BUSINESS DEREGULATION AND LACK OF PUBLIC RECORD

Businesses are immunized from liability because consumers are deterred from bringing claims to arbitration due to the high costs. In addition, written opinions of arbitration proceedings are rare so arbitrators and businesses are insulated from public scrutiny.

Most clauses require that the arbitration proceedings be kept confidential. As a result, no precedent is established, but businesses have an advantage as repeat players to anticipate how certain issues will be decided as they strategize in future claims.

5. LIMITED JUDICIAL REVIEW

Decisions may only be overturned if there is an applicable contract defense, or "manifest disregard" of the law. This is a difficult standard to meet where there is no written opinion of the arbitration proceedings.

To vacate a decision, a party must show:

- A serious conflict of interest on part of neutral arbitrator;
- The award wasn't "final";
- The decision covered a subject outside the scope of the agreement;
- The decision provided an amount or kind of relief that arbitrator was expressly precluded from awarding.

ENFORCING CONSUMER RIGHTS

The validity of a mandatory arbitration provision is based on contract law, and the strongest arguments against these provisions are contractual ones, such as that the agreement is unconscionable, but a court will not assume that an agreement is unenforceable just because the consumer did not read the contract.

Many courts have ruled that the consumer agreed to the provision by signing the contract, even if it is buried in the fine print!

In addition, courts assume voluntary consent when a consumer is free to shop around for better terms. As more and more companies include mandatory arbitration clauses in contracts, it more difficult for consumers to negotiate around them or to find alternatives.

The result of consumer action in the courts has been split. For example, in *Hill v. Gateway 2000 Inc.* (1997) the District Court found that a mandatory arbitration clause shipped to the consumer with a computer was unenforceable because the consumer did not have adequate notice. However, the Seventh Circuit Court of Appeals (in Illinois) reversed this decision. The Court determined that consumers are bound to such agreements under the Federal Arbitration Act, and that the contract does not have to be read by the consumer to be effective.

Some organizations are beginning to address consumer concerns. For example, recently the American Arbitration Association (AAA) implemented a cap to consumers' arbitration costs at \$375, requiring businesses to pay the rest. In addition, the AAA will no longer enforce pre-dispute arbitration clauses in health insurance contracts.

Reforms have not gone far enough! The cap does not apply to cases over \$75,000, and many predatory lending and home construction claims exceed this amount. Furthermore,

businesses can easily switch from using the AAA to other arbitration providers.

Consumer action and revised legislation are the key to protecting citizens' substantive rights to engage the judicial system and ensure the effectiveness of consumer protection laws.

TAKE ACTION

When entering into any agreement, especially one that may eliminate a right to go to court, it is important for consumers to be aware of their right to negotiate contract terms before entering into an agreement.

Read the contract thoroughly

Do not feel pressure to sign an agreement at the site of a purchase. Instead, take time to look over the contract by bringing it home to review each of the terms thoroughly. In addition, take time to review "stuffers" such as a "change-in-terms" notice sent with bills and statements through the mail. Be wary that these notices may affect the status of your account through continued use of the service.

Do not hesitate to negotiate terms

Even though an adhesion contract is presented as a completed form on a "take it or leave it" basis, do not hesitate to negotiate terms. If there is a provision that you do not agree with cross it off and initial next to the change. If the seller does not agree to the change, you can take your business elsewhere.

Keep a copy of all agreements

Copies of contracts are extremely important if revisions have been made to an adhesion contract. Be sure to keep a signed/initialed copy for your records should a dispute arise.

LEGISLATIVE REFORM - Federal

As more and more businesses include mandatory arbitration clauses in their adhesion contracts, it is increasingly difficult for consumers to avoid them. The increased use of mandatory arbitration and adhesion contracts may lead courts to realize that these agreements are not voluntarily entered into, but are imposed upon consumers. Therefore, it is important to take action and change the existing national policy that favors an over-broad interpretation regarding the validity of mandatory arbitration clauses.

Consumer Credit Fair Dispute Resolution Act of 2001

S. 192; suggested amendment to Title IX
Introduced in Senate January 25, 2001

CONSUMER CREDIT CONTRACTS –

- (1) IN GENERAL – A written provision in any consumer credit contract to settle by arbitration either a controversy arising out of the contract, or the refusal to perform the whole or any part thereof shall not be valid or enforceable.
- (2) LIMITATION – Nothing in this section shall prohibit the enforcement of any written agreement to settle by arbitration a controversy arising out of a consumer credit contract, if such written agreement has been entered into by the parties to the consumer credit contract after the controversy has arisen.

LEGISLATIVE REFORM - State

State power to regulate arbitration is generally pre-empted by the Federal Arbitration Act. However, some states have prohibited arbitration clauses in insurance policies, and others have considered legislation to regulate arbitrators and to make arbitration more fair to consumers. These issues are addressed at the

state level under a model bill called the Revised Uniform Arbitration Act.

The **Illinois Uniform Arbitration Act** (710 ILCS 5/1) includes an exception to arbitration provisions in agreements between a patient and hospital regarding claims arising out of (1) injuries alleged to have been received by a patient, or (2) death of a patient – subject to the Health Care Arbitration Act (710 ILCS 15/1).

The Health Care Arbitration Act states that an arbitration agreement is “not a condition to the rendering of health care services” and “may not limit, impair, or waive any substantive rights or defenses of any party”(710 ILCS 15/8). The Health Care Arbitration Act addresses just a few of the concerns associated with mandatory arbitration. The Revised Uniform Arbitration Act would address additional concerns regarding the consumer’s substantive right to access the court system, and as well as lending, construction, goods and services, and other consumer agreements.

RESOURCES

<http://www.citizen.org/congress/civjust/arbitration>

Hill v. Gateway 2000 Inc., 105 F.3d 1147 (7th Cir. 1997).

Ting v. AT&T, 182 F.Supp.2d 902 (N.D.Cal. 2002).

Shelly Smith, Comment, *Mandatory Arbitration Clauses in Consumer Contracts: Consumer Protection and the Circumvention of the Judicial System*, 50 DePaul L. Rev. 1191 (2001).

John Vail, *Defeating Mandatory Arbitration Clauses*, 36-JAN Trial 70 (2000).

David G. Wirtes, Jr., *Suggestions for Defeating Arbitration*, 24 Am. J. Trial Advoc. 111 (2000).

VOCABULARY

Arbitration is a process in which parties submit their disputes for resolution by one or more impartial third parties (arbitrators), instead of to the judicial system.

Mandatory arbitration clause is a *pre-dispute* provision included in contractual agreements. Mandatory arbitration clauses require consumers to waive their right to go to court, and force consumers to submit claims to arbitration.

NOTE: A mandatory *pre-dispute* arbitration clause is distinct from *post-dispute* arbitration agreements. In post-dispute arbitration agreements, the party has the opportunity to weigh the benefits of arbitration versus court litigation to determine which method is better for the particular situation.

Binding arbitration does not allow parties the right to a subsequent trial. However, parties may still be required to go to court if, for example, the opposing party fails to comply with the arbitrator's decision.

Non-binding arbitration allows parties to bring a lawsuit if they are not happy with the arbitrator's decision.

Adhesion Contract is a form contract offered on a non-negotiated ("take it or leave it") basis,

thereby giving a business the upper hand in bargaining power. These contracts are common to everyday transactions including credit card, cell phone, or long distance agreements, car leases/loans, apartment leases, and often include a mandatory arbitration clause

Change-in-terms clause is a provision in the original agreement between the parties, giving one party the unilateral right to modify the agreement after it has been entered into.

For example:

By your continued use of the Company's service following receipt of notice of such changes or modifications, you will be deemed to have accepted and agreed to them.

"Stuffers" are often used to notify consumers of a change-in-terms modification and are sent after the execution of the original contract; this notice is often "stuffed" into the envelope along with a bill, statement, or other general information.

Repeat Players are parties (generally businesses) who are likely to hire arbitrators in the future. Because of their prior experience and knowledge within the arbitration system, these parties have a distinct advantage over an individual consumer bringing an arbitration action for the first time.

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Citizen Advocacy Center
238 N. York Rd.
Elmhurst, IL 60126
(630) 833-4080

www.citizenadvocacycenter.org
cac@citizenadvocacycenter.org

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