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June 18, 2008

Joint Hearing on "S.2838, the Fairness in Nursing Home Arbitration Act"

Senate Committee on the Judiciary
Subcommittee on Antitrust, Competition and Consumer Rights
And
Senate Special Committee on Aging

Chairman Kohl, Ranking Member Hatch, Ranking Member Smith and Members of the Judiciary and Aging Committees. Thank you for inviting me to testify. My name is Stephen Ware, and I am a Professor of Law at the University of Kansas. I speak to you today, not on behalf of my university, but as an individual scholar who specializes in arbitration law.

I have written two books on arbitration and 20 arbitration articles in scholarly journals, as well as several arbitration-related articles in non-academic publications. Within the field of arbitration law, I have devoted special attention to the arbitration of disputes involving consumers and other ordinary individuals. In fact, I have devoted much of the last 15 years of my professional life to researching the law, economics and policy of such arbitration. Based on this experience, I oppose S. 2838 because I believe it would tend to harm those its aims to help, that is, nursing-home residents and their families.

The Fairness in Nursing Home Arbitration Act (S. 2838) would prevent courts from enforcing pre-dispute arbitration agreements between a long-term care facility (such as a nursing home) and a resident of a long-term care facility or anyone acting on behalf of such a resident. I expect that enactment of this bill would largely end arbitration of disputes between such parties.

S. 2838 Would "Gut" Arbitration of Nursing-Home Disputes

During a recent hearing on the House version of The Fairness in Nursing Home Arbitration Act (H. R. 6126) Representative Hank Johnson stated that the bill "would not gut arbitration as an alternative dispute resolution; it would simply bar pre-dispute mandatory arbitration agreements in nursing home agreements."[1] This sets up a false choice. In fact, the most likely result of barring pre-dispute arbitration agreements is to "gut" arbitration. That is because arbitration almost never occurs except as a result of pre-dispute agreements. If those agreements are gone, then so is nearly all arbitration. To understand why, requires stepping back to see the big picture.

[1] *Hearing on H.R. 6126, the "Fairness in Nursing Home Arbitration Act of 2008" Before the Subcomm. on Comm. and Admin. Law of the H. Comm. on the Judiciary,* 110th Cong. (2008) (statement of Rep. Hank Johnson), *transcript available at* 2008 WL 2381657.

Litigation in the court system is the default process of dispute resolution. Parties can contract into alternative processes of dispute resolution, but if they do not do so then each party retains the right to have the dispute resolved in litigation. By contrast, a dispute does not go to arbitration unless the parties have contracted to have an arbitrator resolve that dispute.[2] In other words, arbitration binds only those who contracted for it.[3]

A contract for binding arbitration can be made before or after a dispute arises. In rare instances, parties agree to arbitrate a dispute that has already arisen between them. Far more commonly, the agreement to arbitrate is formed prior to any dispute. Contracts of all kinds include clauses obligating the parties to arbitrate, rather than litigate, disputes arising out of or relating to the contract. These are pre-dispute arbitration agreements.

Critics of pre-dispute arbitration agreements involving ordinary individuals (such as nursing home residents and their families) argue that arbitration must be bad for such individuals if businesses (such as nursing homes) obtain individuals' consent to arbitration through pre-dispute form contracts in which the arbitration clause is unlikely to be the focus of attention.[4] The argument continues by suggesting that if arbitration really was good for them, individuals would choose it post-dispute, when they have had time to consider (perhaps in consultation with a lawyer) the pros and cons of arbitration versus litigation. According to this view, only post-dispute arbitration agreements should be enforced. As explained below, this view is simplistic and erroneous.

Arbitration's Lower Process Costs Benefit All Concerned (Except Lawyers)

Available empirical data indicates that arbitration tends to have lower process costs than litigation.[5] By "process costs," I refer to the time and legal fees spent on

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[2] Here, I am speaking of the contractual, binding arbitration at issue in the nursing-home context. By contrast, non-binding, court-annexed arbitration is an entirely different animal. *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION 339-41 (2d ed. 2007).

[3] In this important sense, arbitration is not "mandatory" but litigation is. Parties who never contracted to be bound by the results of litigation may be lawfully subjected to binding litigation. By contrast, parties who never contracted to be bound by the results of arbitration may not be lawfully subjected to binding arbitration. To call arbitration arising out of form contracts "mandatory" is inaccurate rhetoric. *See* Stephen J. Ware, *Contractual Arbitration, Mandatory Arbitration, and State Constitutional Jury-Trial Rights*, 38 U.S.F. L. REV. 39, 40-44 (2003); IAN R. MACNEIL, RICHARD E. SPEIDEL, THOMAS J. STIPANOWICH, G. RICHARD SHELL, FEDERAL ARBITRATION LAW § 2:36 n.5 (1995) (using the term "mandatory" to describe arbitration resulting from pre-dispute agreements "is extremely confusing language because it ignores altogether the consensual element in contracts . . . . [I]ts usage resolves linguistically the issues of the reality of consent and the effect to be given to consent by fiat, rather than by analysis revealing the nature of the issues.")

[4] *See* Stephen J. Ware *The Case for Enforcing Adhesive Arbitration Agreements - with Particular Consideration of Class Actions and Arbitration Fees,* 5 J. AM. ARB. 251, 262 n.21 (2006) (citing those who make this argument).

[5] *See* Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 753-55 (2001) (citing and summarizing studies); Peter B. Rutledge, *Arbitration – A Good Deal for Consumers: A Response to Public Citizen* 22-24 (2008) (refuting Public Citizen's charge that "Arbitration often costs consumers more than court.") By contrast, Dr. Hall provided no empirical data to support the dubious assertion that "[a]rbitration usually is extremely

pleadings, discovery, motions, trial or hearing, and appeal.[6] Lower process costs obviously benefit a nursing home resident and the resident's family to the extent they (or their lawyer) bear those costs. Lower costs to plaintiffs increase access to justice, especially in smaller cases for which it can be difficult to attract a lawyer.[7] In addition, lower process costs paid by nursing homes also benefit others to the extent that nursing-home costs are ultimately paid for by residents and their families or by the taxpayers through the Medicare and Medicaid programs. The only harm from process-cost savings comes to those (like lawyers) who sell process, but even this is part of the overall social benefit from reducing the costs of processing cases.[8]

Limiting arbitration so that only post-dispute agreements are enforced would fail to produce all the social gains produced by enforcing pre-dispute arbitration agreements. That is because arbitration will not occur nearly as often if an enforceable arbitration agreement can only be made after a dispute arises. Neither party is likely to agree, post-dispute, to arbitrate claims for which arbitration is expected to be less favorable to that party than litigation would be.[9] Thus post-dispute arbitration agreements are unlikely to occur even if both parties and their lawyers expect that the process costs (for both sides) are lower in arbitration than litigation. By contrast, pre-dispute agreements are formed at a time when both parties are uncertain about whether there will be a dispute and, if so, what sort of dispute it will be.[10] That is the time when both sides have an incentive to choose the forum that reduces process costs.

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expensive for consumers." *Hearing on H.R. 6126, the "Fairness in Nursing Home Arbitration Act of 2008" Before the Subcomm. on Comm. and Admin. Law of the H. Comm. on the Judiciary,* 110th Cong. (2008) (statement of William J. Hall, Board Member, AARP), *available at* 2008 WL 2359190.

[6] A separate question is whether the outcomes of arbitration (who wins, how often and how much) are systematically different from the outcomes of litigation.

[7] As plaintiffs' attorney Kenneth L. Connor acknowledged during the subcommittee hearing on H.R. 6126, "lawyers are businesspeople too, and they simply, from an economic feasibility standpoint, can't handle a case that is not likely to yield back a return to the client and to the lawyer who represents him." *Hearing on H.R. 6126, the "Fairness in Nursing Home Arbitration Act of 2008" Before the Subcomm. on Comm. and Admin. Law of the H. Comm. on the Judiciary,* 110th Cong. (2008) (response of Ken Connor to question from Ranking Member Chris Cannon), *transcript available at* 2008 WL 2381657. Available research bears this out. *See, e.g.,* William M. Howard, *Arbitrating Claims of Employment Discrimination: What Really Does Happen? What Really Should Happen?*, DISP. RESOL. J., Oct.-Dec. 1995, at 40, 44 (reporting, based on survey of employment lawyers, that before accepting a case lawyers required, on average, minimum provable damages of $60,000 to $65,000 and a retainer of $3,000 to $3,600).

[8] "To the extent that the costs of adjudication are reduced, disputes can be resolved more efficiently, *i.e.*, fewer resources need to be devoted to adjudication. Some bright young people who would have become trial lawyers enter other fields instead. Whatever those people produce is a gain to society from the cost savings of arbitration." Stephen J. Ware, *Arbitration under Assault: Trial Lawyers Lead the Charge*, CATO Institute Policy Analysis no. 433, April 18, 2002, at 9, http://www.cato.org/pubs/pas/pa-433es.html.

[9] Several commentators have made this point with respect to employment arbitration. *See* Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 567-68 (2001); David Sherwyn, *Because it Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 BERKELEY J. EMP. & LAB. L. 1, 57 (2003); Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 314 (2003) .

[10] Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 746 (2001).

This point about arbitration generally also applies to arbitration of nursing-home disputes in particular. After a dispute arises, the nursing home can consult its lawyers to assess whether arbitration or litigation will be more favorable to its side of the case. If litigation is more favorable than arbitration for the nursing home then the nursing home will not agree to arbitration if proposed by the nursing-home resident (or resident's family) post-dispute. Conversely, after a dispute arises, the resident and/or resident's family can similarly consult one or more lawyers to assess whether arbitration or litigation will be more favorable to their side of the case. If litigation is more favorable than arbitration to them then they will not agree to arbitration if proposed by the nursing home post-dispute.

Enforcement of Pre-Dispute Arbitration Agreements is Good Policy

To reiterate, post-dispute agreements to arbitrate nursing home disputes are unlikely to be more than rare events. This rarity is not due to any fault of arbitration. This rarity is due to litigation's status as the default process of dispute resolution. Once a dispute arises, parties are unlikely to contract out of the default process because of one party's self interest in whatever tactical advantages it can gain from litigation, whether from an easily-impassioned jury or expensive and time-consuming pre-trial discovery and post-trial appeals. Only a naively simplistic view would deny that disputing parties and their lawyers assess the case before them and try to maneuver into a process that is expected to advantage their side. That sort of self-interested maneuvering is inherent in the adversary system and lawyers might not be fully serving their clients if they did not engage in it.

In sum, the enforcement of pre-dispute agreements to arbitrate is needed to produce most of the social benefits resulting from arbitration's lower process costs. Enforcement of these agreements allows nursing-home residents and their families to compel arbitration of disputes when, post-dispute, the nursing home would prefer litigation. Similarly, it allows nursing homes to compel arbitration of disputes when, post-dispute, the resident (or resident's family) would prefer litigation. Allowing each side to compel the other to perform the contract is good policy for the same reason that enforcing contracts generally is good policy. Enforcing contracts constrains opportunistic behavior and allows people to rely on each other's promises. These policies are especially important with respect to contracts in which parties promise to use a relatively quick and efficient dispute-resolution process like arbitration.

Current Law Protects Against Unfair Arbitration Agreements

Finally, I note that current law does not require courts to enforce all arbitration agreements. The Federal Arbitration Act allows courts to invalidate unconscionable arbitration agreements.[11] And this is not just a theoretical protection. Each year, there

[11] 9 U.S.C. § 2 (arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.")

are many cases in which courts hold particular arbitration agreements unconscionable.[12] Among these are cases involving nursing homes.[13] So we currently have a very sensible system in which courts determine, case by case, which arbitration agreements should not be enforced and which provide for a fair process and so should be enforced. As every case is different and arbitration agreements can be written in a wide variety of ways, I believe these issues are better handled on a case-by-case basis in the courts, rather than with the overly broad brush of legislation. In short, I recommend that you allow arbitration law to continue to develop in the courts, rather than enact a statute such as S. 2838.

Thank you very much for your time and attention. I would be happy to answer any questions that you may have.

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[12] *See* STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION 61-65 (2d ed. 2007) (collecting representative cases).
[13] *See* Romano ex rel. Romano v. Manor Care, Inc., 861 So.2d 59 (Fla. Ct. App. 4 Dist. 2003); Howell v. NHC Healthcare-Fort Sanders, Inc., 109 S.W.3d 731 (Tenn. Ct. App. 2003); Woebse v. Health Care & Ret. Corp. of Am., No. 2D06-720, 2008 Fla. App. LEXIS 1446 (Fla. Dist. Ct. App. Feb. 6, 2008).