"ARBITRATION: IS IT FAIR WHEN FORCED?"
OCTOBER 13, 2011

Answers to Questions for the Record
Christopher R. Drahozal

Questions for Mr. Drahozal from Senator Cornyn

- At the hearing, we heard from Mr. Bland that businesses are "essentially picking the judges" in arbitration. Please explain the typical procedures for selecting the arbitrator who will decide a given dispute. Can you explain the difference between an arbitration organization or administrator and the arbitrator himself or herself? How does existing law prevent the imposition of a biased decisionmaker by one party?

By definition, arbitration is a process in which a neutral decision maker — the arbitrator — chosen by the parties (not just one of them) resolves the parties' dispute. The arbitrator is distinct from the arbitration provider or organization. The arbitrator is the private judge, the person who resolves the parties' dispute. The arbitration provider or organization provides administrative services to the parties to facilitate the resolution of the dispute, but is not the arbitrator. An agreement that sets up a dispute resolution process in which one party unilaterally picks the arbitrator would not be enforceable under federal or state arbitration law.[1] Courts would invalidate such an agreement under general contract law principles,[2] and would vacate an award arising out of such a process on grounds of "evident partiality."[3]

Parties can agree to a variety of mechanisms for selecting arbitrators, all of which are designed to result in a neutral decision maker. First, the parties can agree on the arbitrator themselves.[4] Second, some arbitration providers use a listing process, under which the parties rank a list of prospective arbitrators and the highest ranked arbitrator is selected.[5] Third, with a three-arbitrator panel, each party can pick an arbitrator and have the two party-appointed arbitrators pick the presiding arbitrator.[6] Fourth, parties can agree to have the arbitration provider select the arbitrator, subject to a party's ability to strike an arbitrator the party finds objectionable.[7] Whatever the mechanism chosen, standards such as the Consumer Due Process Protocol make clear that "[a]ll parties are entitled to a Neutral [i.e., an arbitrator] who is

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1 Cheng-Canindin v. Renaissance Hotel Assocs., 57 Cal. Rptr. 2d 867 (Cal. Ct. App. 1996) (denying petition to compel arbitration because "there is no third party decision maker, the procedure totally lacks impartiality, and it is controlled exclusively by one of the parties to the dispute").

2 Hooters of Am., Inc. v. Phillips, 173 F.3d 933 (4th Cir. 1999) (refusing to enforce arbitration agreement when all arbitrators "must be selected from a list of arbitrators created exclusively by [the employer]").

3 9 U.S.C. § 10(a)(2).

4 *E.g.*, Am. Arb. Ass'n, Commercial Arbitration Rules, Rule R-12(a).

5 *E.g.*, *id.* Rule R-11(a), (b).

6 *E.g.*, *id.* Rule R-13(a).

7 *E.g.*, Am. Arb. Ass'n, Consumer-Related Disputes Supplementary Procedures, Rule C-4. For a description of the arbitrator selection process used in a AAA debt-collection arbitration program, see Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 HASTINGS BUS. L.J. 77, 105 (2011) (pre-screening of arbitrators to avoid conflicts of interest and random assignment of cases to arbitrators).

independent and impartial" and that "[t]he Consumer and Provider should have an equal voice in the selection of Neutrals [i.e., arbitrators] in connection with a specific dispute."[8]

Mr. Bland's characterization seems to be based on the allegations of bias against an arbitration provider, the National Arbitration Forum (NAF). Even assuming the truth of those allegations (of which I have no personal knowledge), the NAF no longer administers consumer arbitrations. In 2009, the NAF agreed to stop administering new consumer arbitrations in settlement of Attorney General Swanson's consumer fraud suit against it.[9] And this year, the NAF agreed to stop administering consumer arbitrations altogether (when not prohibited from doing so), as part of a settlement of private litigation brought against it.[10] A federal statute making pre-dispute arbitration agreements unenforceable was not necessary to deal with the NAF; existing law proved adequate.

By comparison, for consumer arbitrations administered by the American Arbitration Association (AAA) (another arbitration provider), the Searle Study found: (1) no evidence of bias by arbitrators in favor of repeat businesses (instead the evidence suggests that any repeat-player effect is due to better case screening by those businesses);[11] (2) that the AAA's review of arbitration clauses for compliance with the Consumer Due Process Protocol "appears to be effective at identifying and responding to those clauses with protocol violations";[12] and (3) that the AAA refused to administer a significant number of consumer arbitrations because the business failed to comply with the Consumer Due Process Protocol.[13] In short, the available empirical evidence provides every reason to believe that the AAA does not engage in the sort of behavior that resulted in the demise of the NAF.

- Arbitration is different from litigation in court because parties have greater flexibility to vary applicable procedures by contract. How do current law and market dynamics ensure that the parties with greater bargaining power (usually companies) do not impose an arbitration system that deprives consumers or employees of access to fair procedures for resolving their disputes?

Both current law and the dynamics of the marketplace provide protections to consumers and employees from unfair arbitration clauses.

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8 Consumer Due Process Protocol, principle 3, *available at* http://adr.org/sp.asp?id=22019.

9 Consent Judgment, Minnesota v. National Arbitration Forum, Inc., No. 27-CV-09-18550 (Minn. Dist. Ct. July 17, 2009), *available at* http://pubcit.typepad.com/files/nafconsentdecree.pdf.

10 Stipulation and Agreement of Settlement, In re: National Arbitration Forum Trade Practices Litigation, Civ. No. 10-2122 (PAM/JSM) ¶ 4.1.1 (D. Minn. Apr. 6, 2011), *available at* http://www.arbitrationsettlement.com/pdf/settlement-agreement.pdf; Memorandum and Order, In re: National Arbitration Forum Trade Practices Litigation, Civ. No. 10-2122 (PAM/JSM) (D. Minn. Aug. 8, 2011), *available at* http://www.lieffcabraser.com/media/pnc/9/media.899.pdf (approving settlement). In addition, the settlement includes stipulated facts to assist parties in challenging awards made under the NAF's auspices. Stipulation and Agreement of Settlement, *supra*, ¶ 2.

11 Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association 80 (Mar. 2009), *available at* http://adr.org/si.asp?id=6610.

12 *Id.* at 110.

13 *Id.* at 93.

First, courts can and do police unfair arbitration clauses using a variety of contract law doctrines. The most common, of course, is unconscionability, which courts have used to invalidate a variety of provisions in arbitration clauses deemed to be unfair.[14] Although the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion* held that the Federal Arbitration Act preempted California's use of its unconscionability doctrine to invalidate arbitration clauses with class arbitration waivers,[15] the Court's holding does not purport to preclude use of the unconscionability doctrine (much less other contract law doctrines) to police other provisions in arbitration clauses.[16]

Second, private regulation by arbitration providers enhances the fairness of consumer and employment arbitration clauses. As noted above and in my written statement, both the AAA and JAMS have promulgated "due process protocols" and enforce those protocols by refusing to administer arbitrations under agreements that do not comply. Such private regulation "complements existing public regulation of the fairness of consumer arbitration clauses," and "[a]ny consideration of the need for future legislative action should take into account the effectiveness of such private regulation."[17]

Third, businesses face reputational constraints in promulgating form contract terms, including arbitration clauses. As I have written previously:

> A business that develops a reputation for sharp dealing, whether through low-quality goods, arbitrary dealings with employees, or unfair contract terms — including arbitration clauses — will suffer in the marketplace. A good reputation is valuable to a business. Individuals regularly consider reputation in deciding whether to contract with a corporation. The individual need not have particularized knowledge of the "fine print" in the contract if he or she can rely on the corporations' general reputation for fair dealing.[18]

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[14] *E.g.*, David Horton, *Arbitration as Delegation*, 86 N.Y.U. L. REV. 437, 460 (2011).

[15] 131 S. Ct. 1740 (2011).

[16] *E.g.*, Mission Viejo Emergency Med. Assocs. v. Beta Healthcare Group, 128 Cal. Rptr. 330, 339 n.4 (Cal. App. 2011) ("Defendants appear to argue that *AT&T* essentially preempts all California law relating to unconscionability. We disagree, as the case simply does not go that far. General state law doctrine pertaining to unconscionability is preserved unless it involves a defense that applies 'only to arbitration or that derive[s] [its] meaning from the fact that an agreement to arbitrate is at issue.' This simply does not apply here."). Indeed, Mr. Bland has identified a number of grounds on which courts might continue to police the use of class arbitration waivers in arbitration clauses. Leslie Bailey & Paul Bland, How Courts Can and Should Limit AT&T Mobility v. Concepcion, *available at* http://www.publicjustice.net/Resources/How-Courts-Can-and-Should-Limit-ATT-v-Concepcion.aspx (last visited Oct. 31, 2011). While I do not agree with all of their positions, the listing certainly suggests that courts might continue to play an important role in regulating the use of class arbitration waivers even after *Concepcion*.

[17] Christopher R. Drahozal & Samantha Zyontz, *Private Regulation of Consumer Arbitration*, 79 TENN. L. REV. ___ (forthcoming 2012).

[18] Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 768-69.

As I concluded then: "Certainly reputation does not perfectly constrain corporations from cutting corners at times (or just making mistakes), but it is a constraint that arbitration critics frequently fail to consider."[19]

- I want to be sure that consumers and employees have realistic opportunities to obtain redress for legal violations. Please explain how we can secure the most justice for the most people and why.

I agree that the goal of securing the most justice for the most people is an important and desirable one. In addition, of course, the cost of any dispute resolution system also must be taken into account. Such a cost constraint seems implicit in the question, which I understand to be asking how to provide the most justice to the most people given resource constraints.

I cannot (although I wish I could) explain how to accomplish that goal for every party and under every circumstance. As indicated in my written statement, however, arbitration pursuant to pre-dispute agreements can enhance the availability of justice for consumers and employees in ways that would not be possible if pre-dispute agreements were unenforceable. Employment lawyer Lewis Maltby, who I quoted in my statement, provides an illustration: "most employees will not be able to secure their employer's agreement to arbitrate once a dispute arises. The vast majority of employment disputes, however, do not involve enough damages to support contingent fee litigation. Therefore, outlawing pre-dispute agreements to arbitrate will leave many employees with no access to justice."[20]

Moreover, to the extent that arbitration reduces the process costs of resolving disputes, it will free up resources to be put to other uses, which may include dispute resolution or may include other things that benefit consumers (such as lower prices) and employees (such as higher wages).

- Are there any recent technological innovations that make arbitration more accessible, user-friendly, or efficient? Please describe.

The Internet and other technological innovations can be used to make arbitration more user-friendly and more accessible to consumers and employees. Online arbitration can provide a more flexible means of resolving disputes (consumers and employees can participate without having to miss work to appear in court, for example). It can also be faster (enhancing the speed of communications) and cheaper (permitting face-to-face hearings over the Internet and thus reducing or eliminating the need to travel).

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[19] *Id.*

[20] 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).

QUESTION FOR THE RECORD FROM SENATOR CHARLES GRASSLEY
TO
PROFESSOR CHRISTOPHER R. DRAHOZAL

1. Please provide any additional thoughts that you might have on the issues raised by the hearing, including but not limited to expanding on your testimony, responding to the testimony of the other witnesses and/or anything else that came up at the hearing, which you did not have a chance to respond to.

I appreciate the opportunity to conclude with a final comment on the current state of the empirical research on consumer and employment arbitration. It is simply not the case, as Mr. Bland seems to suggest, that I or others insist on the need to do more research in the face of repeated studies finding arbitration is bad for consumers.[21] The empirical record in fact shows the opposite: as I explained in my written statement, the available empirical evidence "suggests that pre-dispute arbitration clauses make some, if not many, consumers better off, and that broad-ranging restrictions on arbitration may well be counter-productive." That research, like all empirical research, is subject to caveats and limitations. But despite the caveats and limitations, such empirical research remains essential for sound policy making, and does not support broad-ranging restrictions on the use of pre-dispute arbitration clauses.

[21] Hearing Tr. at 92 (comparing defenders of consumer and employment arbitration to "people who say we have to keep studying global warming until it is too late to do anything" or objecting in the face of repeated studies that smoking does not cause cancer).