Mandatory Arbitration Clauses

Mandatory arbitration clauses are used to deny millions of Americans their right to sue in court. State legislatures have three options to attack unfair arbitration clauses.

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Summary

- **Mandatory arbitration clauses are used to deny millions of Americans their right to sue in court.**
- **Mandatory arbitration clauses undermine consumer protections that were designed to level the playing field between big businesses and individuals.**
- **Private arbitration is much more expensive than going to court.**
- **A pro-business bias is built into the arbitration system.**
- **Arbitration clauses affect the most important aspects of people's lives, including their jobs, homes and health.**
- **The courts continue to enforce the most egregious arbitration clauses, even when judicial discretion allows them to be struck down.**
- **State legislatures have three options to attack unfair arbitration clauses.**

Mandatory arbitration clauses are used to deny millions of Americans their right to sue in court.

Buried in the fine print of many form contracts—for employment, rental, credit, phone service, and insurance—are mandatory arbitration clauses that waive the right to access the courts. They force individuals to argue their cases through private arbitration, a costly private legal system that favors defendants.

Mandatory arbitration clauses undermine consumer protections that were designed to level the playing field between big businesses and individuals.

Since 1970, a wide range of laws have been enacted to protect Americans from defective products, negligent business practices, and discrimination in the workplace. Mandatory arbitration clauses circumvent many of these laws and deny Americans their day in court. In addition, the long-standing tendency among arbitrators to "split the difference" between the two sides results in awards to plaintiffs that are substantially lower than court-ordered awards.

Private arbitration is much more expensive than going to court.

Claimants must pay steep filing fees just to initiate a case—seldom less than $750—not including the arbitrator's hourly charges, which range from $200-$300 per hour, split between the parties. Further, these fees must be paid in advance, and almost always amount to thousands of dollars.[1] For example, an $80,000 consumer claim that would cost $221 to bring in the Circuit Court for Cook County, IL, would cost $11,625 at the National Arbitration Forum, a major arbitration firm.[2] In addition, individuals filing claims have usually already sustained a serious economic loss in their dispute with the business—foreclosure on a home, firing from a job, termination of a franchise or dealership. As a result, many people cannot afford the costs of arbitration and are forced to drop their cases.

Mandatory arbitration clauses are used to defeat class action lawsuits.

Nearly every arbitration clause prohibits participation in class action lawsuits. Class actions are the only effective remedy for wide-scale scams. Individuals seldom have the time or resources to recognize, investigate or prove the existence of such fraudulent practices in order to recover their losses.

A pro-business bias is built into the arbitration system.

Arbitration providers are organized to serve businesses, not consumers. Their marketing is targeted entirely at businesses, and their panels of arbitrators consist primarily of corporate executives and their lawyers. Since only businesses are repeat users of an arbitrator, there is a disincentive for an arbitrator to rule in favor of a consumer or employee. In arbitration, discovery is a privilege, not a right, and

many businesses draft arbitration clauses to severely restrict a claimant's ability to obtain necessary evidence.

Arbitration clauses affect the most important aspects of people's lives, including their jobs, homes and health.

■ **At work:** Arbitration firms have convinced employers that the solution to discrimination lawsuits is not to monitor offices and shop floors for harassment, but to impose so-called "early dispute resolution" requirements, including mandatory arbitration. This process reduces an employer's incentive to keep workplaces free from harassment and discrimination.

■ **Small business:** Operating a franchise or dealership is difficult enough without worrying about termination or unfair treatment by a powerful corporate partner. Mandatory arbitration clauses make it harder to redress bad faith practices and easier to mistreat franchisees, dealers and contract farmers.

■ **Homeownership:** In an era of increased complaints about defective construction, homebuilders use mandatory arbitration clauses to deflect lawsuits. Mandatory arbitration clauses are also an important tool in the predatory mortgage lender's bag of tricks, preventing a victim of predatory practices from suing lenders.

■ **Health care:** Insurance companies frequently use mandatory arbitration clauses to fend off appeals of denied medical coverage, and HMOs have also used them to avoid medical malpractice suits. More recently, nursing homes and even physicians are using them.

The courts continue to enforce the most egregious arbitration clauses, even when judicial discretion allows them to be struck down.

Judges have the power to invalidate mandatory arbitration clauses that are unconscionable, but few have done so. Many judges see arbitration as a way of clearing their dockets quickly. Unfortunately, judges' desire to reduce their workloads eliminates the deterrent—the possibility of court action—that motivates businesses to voluntarily comply with the law.

State legislatures have three options to attack unfair arbitration clauses.

Preemption by the 1925 Federal Arbitration Act forbids states from banning mandatory arbitration outright. But states can:

■ Use existing powers through the federal McCarran-Ferguson Act to prohibit arbitration clauses in insurance policies.

■ Ban contract provisions that forbid a party from bringing or benefitting from a class action lawsuit.

■ Adopt the California approach of disclosure, access and impartiality. It requires full disclosure of consumer arbitration outcomes, so that any patterns of bias can be detected. Texas enacted a similar provision for residential construction arbitrations in 2003. It increases access to justice by requiring that fees be waived for indigent claimants and banning any shift of arbitration fees to a claimant who does not prevail. It also improves impartiality of arbitrators by prohibiting conflicts of interest.

This policy summary is based in large part on information from Public Citizen.

Endnotes

[1] Public Citizen, "Mandatory Arbitration Clauses: Undermining the Rights of Consumers, Employees, and Small Businesses," 2002.

[2] Public Citizen, "The Costs of Arbitration," 2002.

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For more information...

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Voluntary Arbitration for Insurance Consumers Act

SECTION 1. SHORT TITLE

This Act shall be called the "Voluntary Arbitration for Insurance Consumers Act."

SECTION 2. MANDATORY ARBITRATION CLAUSES UNENFORCEABLE

After section, paragraph XXX, the following new paragraph XXX shall be inserted:

Any contract or agreement between an insurance carrier and the beneficiary of such contract or agreement, or a third party acting on the beneficiary's behalf, that contains any clause or provision providing for an adjustment by arbitration shall not preclude any party or beneficiary under the contract or agreement from instituting a suit or legal action on the contract at any time, and the compliance with the clause or provision shall not be a condition precedent to the right to bring or recover in the action. A party is bound by an arbitration provision only when the agreement to arbitrate is entered into knowingly and voluntarily by the parties involved after the dispute has arisen, or exists pursuant to the terms of a collective bargaining agreement.

SECTION 3. EFFECTIVE DATE

This Act shall take effect on July 1, 2004.

Preservation of Class Action Remedies Act

SECTION 1. SHORT TITLE

This Act shall be called the "Preservation of Class Action Remedies Act."

SECTION 2. RESTRICTIONS ON CLASS ACTION REMEDIES UNENFORCEABLE

After section, paragraph XXX, the following new paragraph XXX shall be inserted:

Every contract, or restriction contained in any contract, that waives or has the practical effect of waiving a party's right to resolve a dispute by obtaining class-wide relief is void and unenforceable, unless the parties agree to such a waiver after the dispute has arisen.

SECTION 3. EFFECTIVE DATE

This Act shall take effect on July 1, 2004.

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Arbitration Reform Act

SECTION 1. SHORT TITLE

This Act shall be called the "Arbitration Reform Act."

SECTION 2. FAIR ARBITRATION OF CONSUMER CONTRACTS

After section XXX, the following new section XXX shall be inserted:

(A) DEFINITIONS—In this section:

1. "Consumer arbitration" means an arbitration conducted under a predispute arbitration provision where: the contract is with a consumer party; the contract was drafted by or on behalf of the nonconsumer party; and the consumer party was required to accept the arbitration provisions in the contract. "Consumer arbitration" excludes arbitration proceedings conducted under or arising out of public or private sector labor relations laws, regulations, or agreements.

2. "Consumer party" means a party to an arbitration agreement who, in the context of that arbitration agreement, is any of the following:

a. An individual who seeks or acquires, including by lease, any goods or services, including but not limited to financial services and insurance, primarily for personal, family, or household purposes.
b. An individual who is an enrollee, subscriber or insured under a health care plan or health care insurance, or an individual with a medical malpractice claim; or
c. An employee or applicant for employment, in a dispute arising out of or relating to the employee's employment or the applicant's prospective employment that is subject to the arbitration agreement.

3. "Financial interest" means holding a position in a business as officer, director, trustee or partner or holding any position in management; or ownership of more than five percent interest in a business.

(B) FAIR DISCLOSURE BY ARBITRATION COMPANIES

1. Any private arbitration company that administers or is otherwise involved in 50 or more consumer arbitrations a year shall collect, publish at least quarterly, and make available to the public in a computer-searchable format, which shall be accessible at the Internet Web site of the private arbitration company, if any, and on paper upon request, all of the following information regarding each consumer arbitration within the preceding five years:

a. The nonconsumer party, if the nonconsumer party is a corporation or other business entity that is a party to the arbitration, specifying the posture of the nonconsumer party as claimant or respondent;
b. The type of dispute involved, including goods, banking, insurance, health care, employment, and, if it involves employment, the amount of the employee's annual wage divided into the following ranges: less than $100,000, $100,000 to $250,000, and over $250,000.
c. Whether the consumer or nonconsumer was the prevailing party.
d. On how many occasions, if any, the nonconsumer has previously been a party in an arbitration or mediation administered by the private arbitration company.

e. Whether the consumer party was represented by an attorney.
f. The date the private arbitration company received the demand for arbitration, the date the arbitrator was appointed, and the date of disposition by the arbitrator or private arbitration company.
g. The type of disposition of the dispute, if known, including withdrawal, abandonment, settlement, award after hearing, award without hearing, default, or dismissal without hearing.
h. The amount of the claim, the amount of the award, and any other relief granted, if any.
i. The name of the arbitrator, his or her total fee for the case, fees assessed by the private arbitration company, and the percentage of the arbitrator's fee allocated to each party.

2. If the required information is provided by the private arbitration company in a computer-searchable format at the company's Internet Web site and may be downloaded without any fee, the company may charge the actual cost of copying to any person who requests the information on paper. If the information required is not accessible by the Internet, the company shall provide that information without charge to any person who requests the information on paper.

3. A private arbitration company that administers or conducts fewer than 50 consumer arbitrations per year may collect and publish the information required by subdivision (a) semiannually, provide the information only on paper, and charge the actual cost of copying.

4. No private arbitration company shall have any liability for collecting, publishing, or distributing the information in accord with this section.

(C) LIMITS ON COST SHIFTING

1. All fees and costs charged to or assessed upon a consumer by a private arbitration company in a consumer arbitration, [exclusive of arbitrator fees] shall be waived for any person having a gross monthly income that is less than 300 percent of the federal poverty guidelines.

2. Nothing in this section shall affect the ability of a private arbitration company to shift fees that would otherwise be charged or assessed upon a consumer party to another party.

3. Prior to requesting or obtaining any fee, a private arbitration company shall provide written notice of the right to obtain a waiver of fees in a manner calculated to bring the matter to the attention of a reasonable consumer, including, but not limited to, prominently placing a notice in its first written communication to a consumer and in any invoice, bill, submission form, fee schedule, rules, or code of procedure.

4. Any consumer requesting a waiver of fees or costs may establish eligibility by making a declaration under oath on a form provided by the private arbitration company for signature stating his or her monthly income and the number of persons living in the household. No private arbitration company may require a consumer to provide any further statement or evidence of indigence.

5. Any information obtained by a private arbitration company about a consumer's identity, financial condition, income, wealth, or fee waiver request shall be kept confidential and may not be disclosed to any adverse party or any nonparty to the arbitration, except a private arbitration company may not keep confidential the number of waiver requests received or granted, or the total amount of fees waived.

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(D) NEUTRALITY OF ARBITRATOR

1. No arbitrator or private arbitration company shall administer a consumer arbitration under any agreement or rule requiring that a consumer who is a party to the arbitration pay the fees and costs incurred by an opposing party if the consumer does not prevail in the arbitration, including, but not limited to, the fees and costs of the arbitrator, provider organization, attorney, or witnesses.

2. No private arbitration company may administer a consumer arbitration or provide any other services related to such a consumer arbitration, if:

a. the private arbitration company has, or within the preceding year has had, a financial interest in any party or attorney for a party; or
b. any party or attorney for a party has, or within the preceding year has had, any type of financial interest in the private arbitration company.

SECTION 3. SEVERABILITY

The provisions of this Act shall be severable, and if any phrase, clause, sentence or provision is declared to be invalid or is preempted by federal law or regulation, the validity of the remainder of this Act shall not be affected.

SECTION 4. EFFECTIVE DATE

This Act shall take effect on July 1, 2004.