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# How Bad Are Mandatory Arbitration Terms?

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# HOW BAD ARE MANDATORY ARBITRATION TERMS?

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There is a new bad boy in the contract law block: the *mandatory arbitration clause.* Increasingly pervasive in the boilerplate portion of mass contracts, the mandatory arbitration clause controls the manner by which aggrieved parties can vindicate their rights, and—according to a widely held view—effectively diminishes access to justice.

Arbitration, a type of ADR, is surely a cheaper method, compared to litigation, to resolve contractual disputes. It may be a bit crude in terms of administering ex-post justice, but it is accessible, relatively simple and procedurally-light. Many standard form contracts issued to consumers and employees now require arbitration as a mandatory forum to resolve disputes with the seller, service provider, or employer. But parallel to the rise of the mandatory arbitration clause, we are witnessing a counter-movement among commentators and in many courts, condemning this practice as unconscionable.

There is by now plenty of legal thought on the question of whether mandatory arbitration is an unconscionable commercial practice.[1] This line of inquiry explores the opportunities that aggrieved individuals have to vindicate their legal rights through arbitration. It tries to draw a line between types of arbitration procedures that are legitimate and ones that are unconscionable. It focuses on factors like the cost of filing a claim for arbitration, the types of remedies individuals can get through arbitration, the location of the arbitration proceedings, and the ability to aggregate claims.

But while much legal attention has been directed to resolving this unconscionability question and to mapping the various answers that come out in court decisions almost daily, less attention has been directed to the more fundamental issue: is arbitration indeed worse for individuals? Could it be that arbitration is actually a better regime, ex ante, for aggrieved claimants? Do they fare better in arbitration?

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1. *See, e.g.*, EDWARD BRUNET ET AL., ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 141–154 (2006).

In much of the legal commentary, arbitration terms are denounced as "the Yellow Dog Contract of the 1990's,"[2] a "monster,"[3] and that as a result of them "large areas of U.S life and commerce have silently been insulated from the lawsuit culture."[4] It is striking, though, that courts which make policy decisions condemning or approving of arbitration do so with very little reference to any empirical grounding. To illustrate the paucity of empirical knowledge, compare these two statements in two prominent court decisions. The first was made in the leading California Supreme Court case *Armendariz v. Foundation Health Psychcare*,[5] in which the court decided that a mandatory arbitration clause was unconscionable. Underlying the decision was a conjecture voiced by the court that arbitration is an unfavorable forum for employees to vindicate their claims, because they win less. Empirically, the court noted, "[v]arious Studies show that arbitration is advantageous to employers not only because it reduces the costs of litigation, but also because it reduces the size of the award that an employee is likely to get, particularly if the employer is a 'repeat player' in the arbitration system."[6]

The court cited, in making this empirical generalization, two published scholarly studies.

The second statement was made in another leading case, the Seventh Circuit's decision in *Oblix, Inc. v. Winiecki*,[7] in which the court decided to enforce a mandatory arbitration clause and referred the case to arbitration. Here, underlying the decision was an opposite conjecture, that employees are better able to vindicate their claims through arbitration. Empirically, the court noted,

> Employees fare well in arbitration with their employers—better by some standards than employees who litigate, as the lower total expenses of arbitration make it feasible to pursue smaller grievances and leave more available for compensatory awards. . . . Perhaps this is why unions find arbitration so attractive and insist that employers agree to this procedure.[8]

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2. Katherine Van Wesel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENV. U. L. REV. 1017, 1017 (1996).

3. David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in the Ages of Compelled Arbitration*, 1997 WISC. L. REV. 33, 36 (1997).

4. Patti Waldmeir, *How America is Privatizing Justice by the Back Door*, FINANCIAL TIMES, June 30, 2003, at 12.

5. 6 P.3d 669 (Cal. 2000).

6. *Id.* at 690.

7. 374 F.3d 488 (7th Cir. 2004).

8. *Id.* at 491.

The court cited, as a reference for this empirical generalization, one published study.

Surely, one's view about the empirical reality of arbitration—on how well claimants fare relative to litigation—is not the only relevant factor in evaluating the legality of arbitration clauses. For example, one might think that arbitration is bad but that arbitration clauses cannot be vacated under state contract law or the Federal Arbitration Act. But it is striking that many of the attempts to justify the competing views on legality are based on alleged empirical underpinnings. Unfortunately, these underpinnings have not been fully developed to provide the desired foundations. We simply do not know enough facts to pass a judgment on arbitration as a mandatory procedure.

This symposium aims at strengthening the empirical basis of the debate over arbitration clauses. The four articles included all pursue the same question: Do we know whether arbitration is better or worse for individual claimants, relative to litigation? The four articles approach this question without ideological priors, with various methodologies and with different strategies on how to collect clues.

In the first article, *Mandatory Arbitration: Why It's Better Than It Looks*,[9] Theodore St. Antoine surveys much of the literature on arbitration in employment settings. He argues that, based on cost data, arbitration is the only practical venue for low-paid aggrieved employees. Arbitration does eliminate some remedies which are potentially available in litigation, but renders the remaining remedies more accessible and effective. Still, St. Antoine's empirical analysis suggests that the problems with arbitration can best be resolved, not by a preference for litigation, but rather by minimal due process assurances.

The next two articles provide a broad overview of the entire existing stock of empirical studies. Each of these two articles tackles a different empirical puzzle. In *Arbitration Costs and Forum Accessibility: Empirical Evidence*,[10] Christopher Drahozal provides a comprehensive and critical assessment of the accessibility issue: Is arbitration less accessible, due to upfront filing costs, relative to litigation? Or is it more accessible, due to the relatively quicker resolution of the dispute? The answer, it turns out, is more nuanced and more interesting than some have perceived it, and depends on factors that the analysis in the article makes explicit.

9. 41 U. MICH. J. L. REFORM 783 (2008).
10. 41 U. MICH. J. L. REFORM 813 (2008).

Drahozal also highlights the important empirical inquiry into the comparative success of class arbitration.

In his article *From Court-Surrogate to Regulatory Tool: Re-Framing the Empirical Study of Employment Arbitration*,[11] Mark Weidemaier explores the other "big" question regarding arbitration versus litigation: Do arbitration outcomes vary systematically from litigation outcomes? Do claimants win more or less often? Do they get higher or lower awards, on average? Are outcomes reached faster? Of course, underlying this empirical comparison lies a fundamental methodological problem of "filtering"—the cases in which the outcomes are being compared are not necessarily comparable because of "selection" problems. Parties who arbitrate might differ systematically from parties who litigate, and within each procedure there are different factors that force cases to settle and thus to "exit" the outcome sampling pool. Weidemaier surveys prior studies that compared outcomes and examines the perceived regularity that plaintiffs win more often in arbitration, but the size of awards is also smaller. He explores some concrete implications of the selection problems to this perceived regularity. He also notes, in the employment context, that internal dispute resolution procedures add an important and otherwise overlooked layer of filtering that has immediate implications for the empirical comparison between arbitration and litigation.

Finally, the fourth article in this symposium provides a new empirical study of the use of arbitration clauses by large corporations. In *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*,[12] Theodore Eisenberg, Geoffrey Miller, and Emily Sherwin compare the contracts issued by big public corporations to their consumers with the ones that they use in their business dealings. This comparison is telling, because terms in negotiated business agreements are not likely to be unconscionable. If the same terms are offered to consumers or employees, there is a lesser basis to object to them. In fact, in his *Oblix Inc. v. Wienicki* decision cited above, Judge Easterbrook suggested this precise logic: "Businesses regularly agree to arbitrate their disputes with each other; giving employees the same terms and forum (the AAA) that a firm deems satisfactory for commercial dispute resolution is not suspect."[13]

Again, Judge Easterbrook's statement is based on an empirical conjecture, which Eisenberg et al. set out to explore. They report a

11. 41 U. MICH. J. L. REFORM 843 (2008).
12. 41 U. MICH. J. L. REFORM 871 (2008).
13. 374 F.3d at 491.

striking regularity: arbitration clauses are used much more often in consumer contracts than in business dealings. One possible interpretation of this finding, suggested in their article, is that the arbitration clauses are used as a bar to class claims. Of course, one might subscribe to a different interpretation, that the difference in the complexity of the dealings and the economic stakes is the reason for different dispute resolution procedures. Still, regardless of the interpretation placed on this finding, if it is indeed general it suggests an empirical pattern that was previously overlooked.

This symposium was presented in the 2008 Annual Meeting of the Contracts Section of the American Association of Law Schools. Indeed, studying the unconscionability of arbitration terms has become a standard feature of first-year contracts courses. This is perhaps one of the hotter topics in today's contract law and policy. Contractual rights, as they are enforced by contract law, might have substantially different values depending on the venue through which they can be vindicated. It is hard to predict how these values differ, but hopefully this symposium will inform some of these predictions.