

ARBITRATION REFORM: WHAT WE KNOW AND WHAT WE NEED TO KNOW

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The future of commercial arbitration has become a centerpiece of the domestic congressional agenda. According to one estimate, ten different bills introduced in the 110th Congress would chip away at the enforceability of pre-dispute arbitration agreements.¹ By far the most significant bill, the Arbitration Fairness Act, would retroactively invalidate arbitration agreements in all employment, consumer, securities and franchise contracts.² An especially vague provision in a prior version of the bill would invalidate agreements involving claims under statutes intended to protect civil rights or designed to regulate transactions between parties of unequal bargaining power.³ Are these wise moves?

FRAMING THE DEBATE

In answering this question, I find it helpful to refer to Jean Sternlight's 2005 Stanford Law Review article.⁴ While Sternlight and I may disagree on the ultimate answer to this question, we conceptualize the issue in similar terms. We approach it from one of two vantage points. We may apply some strong normative principles. Alternatively, our answer may turn on one or more empirical points about outcomes in dispute resolution systems. As I hope to make clear, these two vantage points are closely related.

The normative arguments typically align around two poles. At one polar extreme, defenders of enforceable arbitration agreements point to freedom of contract values. An agreement to arbitrate is nothing more than a contract to resolve a dispute extrajudicially and in a private forum, and it serves neither the parties' interests nor society's interest for these contracts to be invali-

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¹ U.S. Chamber Institute for Legal Reform, *110th Congress: Trial Lawyer Assault on Arbitration Through Legislative Efforts/Earmarks*, http://www.instituteforlegalreform.com/get_illr_doc.php?id=1089 (last visited Jan. 14, 2009).

² See Arbitration Fairness Act, H.R. 1020, 111th Cong. § 4 (2007).

³ See Arbitration Fairness Act, S. 1782/H.R. 3010, 110th Cong. § 4 (2007).

⁴ See generally Jean R. Sternlight, *Creeping Mandatory Arbitrations: Is It Just?*, 57 STAN. L. REV. 1631 (2005).

dated. At the other polar extreme, opponents of arbitration agreements point to the lack of bargaining power or the lack of information available to individuals in consumer, employment and franchise contracts.

These conceptions, while perhaps easy to grasp intellectually, are too facile and ignore the proper fault lines in the debate. Advocates of enforceable arbitration agreements do not necessarily embrace all agreements; rather they recognize that Section 2 of the Federal Arbitration Act provides that these agreements may be deemed unenforceable on the basis of generally applicable contract defenses.⁵ Conversely, opponents of enforceable arbitration agreements do not necessarily oppose all agreements. Even arbitration's harshest critics accept that such agreements can be enforceable, provided that they are offered on a post-dispute (as opposed to a pre-dispute) basis.⁶

Seen in this light, the positions in this debate yield some common ground and help to identify a more nuanced fault line than the typical, if simple, divide between advocates of freedom of contract and advocates of paternalistic regulation. Both advocates and opponents of arbitration embrace some degree of freedom of contract. Where they differ—and this is the first real fault line—is over the conditions under which a contract will be enforced. Opponents of enforceable pre-dispute agreements submit that the individual often will have more—or, at least, better—information after the dispute arises, in order to decide whether to consent to an arbitration forum.

Yet the plausibility of this position depends on the definition of “dispute.” Consider the following example: Suppose that I receive my cell phone bill and question certain charges on it. When does the dispute regarding these charges arise? Is it when I receive my bill, or when I first call the company to contest the charges? Is it when (but not before) I have consulted a lawyer about possible claims against the company, or is it after the company (or I) has filed a claim in federal or state court? The answer to this question is critical to proper resolution of the normative debate. If a statute defines “dispute” as having arisen chronologically too early, then the underlying goal of enabling the individual to make decisions with complete information is not advanced. Alternatively, if “dispute” is defined as having arisen too late in a given context, one

⁵ See Federal Arbitration Act, 9 U.S.C. § 2 (2006).

⁶ See John O'Donnell, *The Arbitration Trap: How Credit Card Companies Ensnare Customers*, PUBLIC CITIZEN 4 (2007), available at <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

may meaningfully preclude the essential cooperation upon which successful commercial arbitration depends.

The second fault line concerns the baseline from which the enforceability of arbitration agreements will be evaluated. Proponents of enforceable agreements start from a baseline of enforceability and then rely on courts to resolve questions of unenforceability on a case-by-case basis. Conversely, opponents of enforceable agreements rely on a baseline of unenforceability and then rely on the parties to enter into enforceable post-dispute agreements on a case-by-case basis. I return to the topic of post-dispute resolution later in the article.

WHAT WE KNOW

If we shift from the normative issues to the positive ones, the central question becomes whether arbitration is a superior form of dispute resolution. In beginning to answer this question, several threshold challenges present themselves.

The first challenge is identifying the proper benchmark from which to evaluate arbitration. For example, should the goal be maximum recovery for one party, speedier outcomes, maximum win rates or lowest costs? The answer to this normative question fundamentally shapes this empirical inquiry.

The second challenge is to identify the proper point of comparison. It is of little value to criticize arbitration if individuals would be worse off without it. As an example, a recent report on arbitration in the consumer debt collection context bemoaned that most debtors lose their cases in arbitration.⁷ But win rates in small claims courts were no better; and, by contrast, the individual debtor had to take time off from work to personally appear in small claims court, whereas arbitration enabled the parties to present their case without a personal appearance.⁸ Moreover, the report failed to explain precisely where these disputes would be settled if the underlying agreements taking them out of court were no longer enforceable. It would tax an already overburdened justice system, and prolong the time everyone else waits in the queue for justice.

⁷ See *id.* at 13–17.

⁸ See Peter B. Rutledge, *Arbitration—A Good Deal for Consumers: A Response to Public Citizen*, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM 11, 28 (2008), available at http://www.instituteforlegalreform.com/get_ilr_doc.php?id=1091 [hereinafter *Response*].

The third challenge is comparability. Two cases are rarely identical, whether in their procedural posture, their underlying facts, or their substantive legal rules. Thus, it is difficult to compare transactions across cases and attribute these outcomes to features of the dispute resolution system in which they were resolved unless other variables that might explain the difference can be controlled.

These preliminary difficulties do not render the positive analysis unmanageable but merely bespeak caution before drawing broad conclusions about the matter.

With these background principles in mind, we can then turn to the current state of knowledge about arbitration. Certain baselines are relatively clear. Arbitration produces quicker results. All of the available studies have found the time from the commencement of the dispute to its resolution is shorter in arbitration than litigation.⁹ A second empirical proposition, considered somewhat more contentious, is that arbitration is cheaper than litigation. The validity of that proposition depends both on how costs are allocated and whether to include attorneys' fees in the calculation.¹⁰ Some opponents of arbitration maintain that attorneys' fees are not properly included.¹¹ Yet, that position takes an unrealistic view of the individual's perspective; it matters little to the individual whether she is paying attorneys' fees or arbitration fees. At the end of the day, both costs represent out of pocket expenses to her.

However, speed or cost might not be the appropriate baselines from which to evaluate the desirability of arbitration. Outcomes might be much more important. For this reason, it is critical to examine the state of knowledge in each of the areas that the Arbitration Fairness Act seeks to regulate:

Employment. This is the area in which we have the most data concerning outcomes.¹² Much of the research concerns arbitrations conducted under the auspices of the American Arbitration Association, one of the most respected, but certainly not the only, provider of dispute resolution services. In brief,

⁹ See Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. & PUB. POL'Y 549, 571 (2008) [hereinafter *Whither*]; *Response*, *supra* note 8, at 6.

¹⁰ See *Whither*, *supra* note 9, at 577–79.

¹¹ See O'Donnell, *supra* note 6, at 8.

¹² See *Whither*, *supra* note 9, at 556–60; *Response*, *supra* note 8, at 6. *But see* Taylor Lincoln & David Arkush, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration*, PUBLIC CITIZEN 8–23 (2008), available at [http://www.citizen.org/documents/ArbitrationDebateTrap\(final\).pdf](http://www.citizen.org/documents/ArbitrationDebateTrap(final).pdf).

the data shows that individuals in arbitration generally obtain outcomes comparable to, and in some cases better than, those in litigation.

One exception to this trend appears in cases of individuals earning income below a certain threshold, or those arbitrating pursuant to promulgated (as opposed to individually negotiated) agreements.¹³ Arbitration's opponents cite as evidence that the process systematically discriminates against lower-income workers.¹⁴ Yet, cautious scholars have noted that there may be more benign explanations, including both the fact that meritorious claims for this cohort may settle at an earlier stage and the fact that, absent arbitration, this group might not have a day in court.¹⁵

Consumer. Until recently, we only had more limited data on outcomes, either in the form of reports provided by the arbitration associations themselves, or by public interest groups.¹⁶ A very recent study by the Searle Civil Justice Institute suggests that consumer arbitration generally produces positive results for individuals, whether measured by reference to outcomes or costs.¹⁷ Apart from outcome studies, we have some information about the rate in which various industries utilize arbitration clauses in consumer contracts.¹⁸ Yet we

¹³ See Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?*, 11 EMP. RTS. & EMP. POL'Y J. 405, 416–17 (2007); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RESOL. J. 44, 48–49 (Nov. 2003–Jan. 2004).

¹⁴ See Lincoln & Arkush, *supra* note 12, at 8.

¹⁵ See Eisenberg & Hill, *supra* note 13, at 50–52, 47–48.

¹⁶ See generally Mark Fellows, *The Same Results as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, 7/06 METRO. CORP. COUNS. 32 (2006); American Arbitration Association, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload* (2007), available at <http://adr.org/si.asp?id=5027>; California Dispute Resolution Institute, *Consumer and Employer Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure* (Aug. 2004), available at http://www.mediate.com/cdri/cdri_print_aug_6.pdf; O'Donnell, *supra* note 6.

¹⁷ See Searle Civil Justice Institute, *Consumer Arbitration Before the American Arbitration Association* (Mar. 2009).

¹⁸ See Linda J. Demaine & Deborah R. Hensler, "Volunteering" to Arbitrate Through Pre-dispute Arbitration Clauses: The Average Consumer Experience, 67 L. & CONTEMP. PROBS. 55, 63 (2004); Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts* (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1076968. For industry-specific research involving the cellular telephone industry, see Amy J. Schmitz, *Dangers of Deference to Form Arbitration Provisions*, 7 NEV. L.J. 37, 38 (2007); Amy J. Schmitz, *Curing Consumer Warranty Woes Through Regulated Arbitration*, 23 OHIO ST. J. ON DISP. RESOL. 627, 635 (2008).

have virtually nothing on the economic impact of these clauses, or how they influence the resolution of disputes before they reach arbitration.

Franchise. Among the areas regulated by the Arbitration Fairness Act, this is the one about which we know the least. Christopher Drahozal has done a series of thoughtful papers analyzing the frequency with which such clauses are used and their particular features.¹⁹ Beyond that, however, we do not have adequate data on outcomes.

The bottom line is that the empirical picture is hazy: Congress cannot draw confident conclusions about the effect of invalidating wide swaths of arbitration agreements, as the Arbitration Fairness Act would do. To the extent that empirical evidence permits predictions, it suggests a far more complex picture than arbitration's opponents would paint.

WHAT WE NEED TO KNOW

If this is the state of affairs on what we know about arbitration, what is it that we don't know—but need to know—about the field? Here, I would suggest four critical factors:

- 1) **What are the outcomes?** We need more data for all areas, but especially regarding consumer arbitration and franchise arbitration. Without this research, Congress is ultimately flying blind on the matter.
- 2) **Does post-dispute arbitration work?** This is a critical question underpinning the fault lines in this debate. If there is empirical verification that post-dispute arbitration is effective, then the normative debate can appropriately take place along the lines I have described above. On the other hand, if there is no empirical verification of the proposition, then the promise of post-dispute arbitration is a false one.

We do not lack opportunities to investigate this hypothesis. In recent years, Congress has enacted two bills

¹⁹ See Christopher R. Drahozal, *Arbitration Clauses in Franchise Agreements: Common (and Uncommon) Terms*, 22 *FRANCHISE L.J.* 81, 81–83 (2002); Christopher R. Drahozal, “Unfair” *Arbitration Clauses*, 2001 *U. ILL. L. REV.* 695, 720–41 (2001).

that invalidate arbitration agreements in discrete areas—one in the automotive industry and the other involving military servicemembers.²⁰ To date, there has not been extensive research on the impact of those laws on the outcomes and costs of dispute resolution, nor on the economic impact and frequency of “post-dispute arbitration.” We should learn more from these experiences in order to understand the real impacts of broader reform.

- 3) What is the financial impact of arbitration?** As I have suggested elsewhere, preliminary data suggest arbitration is cheaper than litigation, both in the aggregate and for the individual litigant (particularly under protocols that some arbitration associations have adopted which cap the individual share of the arbitration fees).²¹ If this preliminary research proves valid, abolishing arbitration will result in a net social cost, thus increasing the expense of resolving disputes and benefiting only the lawyers.
- 4) What about the cases we never see?** One of the most critical, yet under-investigated aspects of arbitration is how it fits into a company’s broader quilt of dispute resolution. Studies of individual companies have shown two important phenomena in this regard. First, after a company adopted an ADR program, of which arbitration was a part, the dispute resolution costs dropped. Second, when disputes did occur, most of them could be solved before the dispute reached the point of arbitration.²² If these experiences are representative, legislation such as the Arbitration Fairness Act may well be making consumers and employees worse off.

CONCLUSION

In sum, the debate over arbitration will unfold on both normative and positive fronts. These fronts are related, but involve dis-

²⁰ See Motor Vehicle Franchise Contract Arbitration Fairness Act, 15 U.S.C. § 1226 (2006); Military Lending Act, 10 U.S.C. § 987(f)(4) (2006).

²¹ See *Whither*, *supra* note 9, at 568.

²² U.S. GEN. ACCOUNTING OFFICE, ALTERNATIVE DISPUTE RESOLUTION: EMPLOYERS’ EXPERIENCE WITH ADR IN THE WORKPLACE 18 (1997), available at <http://www.gao.gov/archive/1997/gg97157.pdf>.

tinct sets of arguments and evidence. On the normative side, the debate turns on the question about the baseline from which the enforceability of arbitration will be assessed. On the empirical side, we know a good bit about the speed and cost of arbitration, but data remains incomplete about outcomes (whatever the appropriate measure). Finally, there are at least four looming gaps in our awareness of the broader empirical points, and it behooves Congress—perhaps in the context of a GAO study—to discover answers to these questions before acting precipitately as they are poised to do through the Arbitration Fairness Act.