

Arbitration under Assault Trial Lawyers Lead the Charge

by Stephen J. Ware

Executive Summary

Arbitration is a private-sector alternative to the government court system. Compared with litigation, arbitration is typically quick, inexpensive, and confidential. It generally operates in a commonsense way, without all of the legal jargon and procedural maneuvering that go on in court. Unlike judges, arbitrators are chosen by the parties to the dispute. Cases are resolved by respected professionals with technical, as well as legal, expertise.

Until recently, arbitration was confined to a few narrow categories of disputes. Those categories are expanding rapidly because of a renewed emphasis on freedom of contract, which is the central principle of the Federal Arbitration Act and recent Supreme Court cases applying that act. Arbitration agreements now cover the broad range of civil disputes among all sorts of parties, including consumers and employees. That opens up great potential for civil justice reform by fostering private-sector, market-oriented alternatives to the government court system.

Unfortunately, trial lawyers are trying to kill those alternatives. Enforcement of arbitration agreements is especially threatening to trial lawyers because those contracts are the means by

which disputing parties escape the litigation process that enriches so many lawyers.

The trial lawyers' fight against arbitration reached the Supreme Court during the 2000–01 term in two cases, one involving consumer arbitration and the other involving employment arbitration. The trial lawyers' lobby had hoped for rulings that would effectively end enforcement of consumer and employee arbitration agreements. Fortunately, the Supreme Court reaffirmed arbitration in both cases, although it did so by bare five-to-four majorities.

Having failed in the Supreme Court, trial lawyers are taking their fight to the halls of Congress. They support bills to end enforcement of large categories of arbitration agreements. Several such bills have been introduced, and one recently advanced out of the Senate Judiciary Committee. Enactment of any of those bills would squelch private-sector alternatives to the lawyer-dominated court systems, violate freedom of contract, and raise costs to American business. While the bills purport to advance the interests of consumers and employees, they would likely harm most of the people they purport to help.

The vast majority of consumers, employees, and others benefit from the power to commit to arbitration.

Introduction

Since the September 11 attacks on our nation, the public and its leaders have been focusing on terrorism and military action. With attention thus diverted, some special interest groups are quietly lobbying the political system to their advantage. For example, trial lawyers are backing a number of bills that would help them tighten their grip on the court system and restrict the freedom of people to opt for alternatives.

The bill that is advancing most rapidly through Congress is the Motor Vehicle Contract Arbitration Fairness Act.¹ Its passage would increase the chance that other anti-arbitration bills will become law. Thus it is now time to assess the trial lawyers' multifaceted attack on arbitration.

This paper begins with an overview of arbitration and the benefits it provides. Those benefits include savings of time and money, more knowledgeable adjudicators, and confidentiality. Current arbitration law facilitates those benefits by enforcing arbitration agreements, regardless of whether the agreements are entered into before or after a dispute arises. The paper then highlights the threat to current, pro-contract arbitration law. That law is under attack by trial lawyers who would prefer to confine disputes to a court system where they exercise more control. The trial lawyers' lobbies support several bills in Congress that would render unenforceable large categories of predispute arbitration agreements. To put it another way, those bills seek to deprive consumers, employees, and others of the power to enter into binding predispute arbitration agreements. The bills are premised on the false assumption that such power harms those who possess it.

Careful analysis shows, however, that the vast majority of consumers, employees, and others benefit from the power to commit to arbitration. Arbitration tends to reduce consumer prices, raise employee wages, and

increase access to justice for meritorious claims. Those benefits would not be fully realized if binding arbitration agreements could be entered into only after a dispute arose. Enactment of these anti-arbitration bills would further enrich trial lawyers at the expense of nearly everyone else.

Benefits of Arbitration

Arbitration is simply a private court. Just as Federal Express is a private-sector alternative to the government post office for sending packages, arbitration is a private-sector alternative to the government court system for resolving disputes.

Arbitration is free enterprise. It is private businesses competing for customers. The businesses are those that provide arbitration, such as the American Arbitration Association, the National Arbitration Forum, and individual arbitrators who "hang out a shingle" as sole proprietors. The customers are people and organizations with disputes. Those customers have a choice, an alternative to the government court system. The alternative is arbitration—which is actually not one but many alternatives because there are many providers of arbitration and there are differences in the services they offer. There are, however, certain common features that set arbitration apart from litigation in government courts.

Parties using arbitration generally find that it saves them time and money in comparison with litigation. Arbitration is typically quick, inexpensive, and confidential. It generally operates in a commonsense way, without all of the legal jargon and procedural maneuvering that go on in court.

To put it bluntly, what goes on in court is often absurd. One need only remember the O. J. Simpson trial to appreciate the point. Furthermore, the Simpson case was a criminal trial, which usually proceeds to resolution faster than a civil trial.

The procedures of civil litigation are slow, costly, and inefficient. Before trial, lawyers routinely produce enormous amounts of paper-

work. They write and file numerous pleadings and motions. Those often-lengthy documents are typically filled with legalistic jargon, technicalities, formalities, and tedious repetition.

The biggest source of cost and delay in civil litigation, however, is often discovery. Lawyers serve, respond to, and often argue about interrogatories and document requests. Especially in high-stakes litigation, lawyers are prone to exchange boxes and boxes of documents relating to the parties but too often not really relating to the case. Since broad discovery rules were enacted in the 1930s, technological advances such as photocopiers and computers have caused exponential growth in the number of documents and the burden of document discovery.

After document discovery, lawyers continue discovery with depositions of potential witnesses. That can involve teams of lawyers traveling around the country for months on end, with the lawyers often “on the clock” while waiting in airport lines or stuck in traffic. The Committee for Economic Development, an organization of business and education leaders that addresses economic and social issues, estimates that discovery alone is 80 percent of the cost of a fully litigated case.² Other surveys of a wide range of cases estimate much lower percentages but nevertheless conclude that the litigation activity accounting for the most lawyer time is discovery.³ And, of course, the cost to the parties is delay as well as money spent on lawyers. A recent study of state courts of general jurisdiction in 45 of the nation’s 75 most populous counties found that the average “length of all civil cases that reach a jury trial is just over two and one-half years.”⁴

In contrast, arbitration typically reduces costs. Arbitration gains speed and efficiency by streamlining discovery, pleadings, and motion practice. The streamlined process generally results in much lower legal fees and related process costs. That is certainly the received wisdom about arbitration,⁵ and while empirical studies cannot prove it with certainty,⁶ they conclude that process costs are much lower in arbitration than in litigation.⁷

At trial, there is an elaborate and compli-

cated set of evidentiary and procedural rules. Lawyers spend time and money quibbling over those rules. It sometimes seems that they talk about everything but the underlying dispute itself. In contrast, arbitration cuts to the chase. In an arbitration hearing, little time is wasted on technicalities. Instead, the parties tell their sides of the story and the proceeding gets quickly to the heart of the matter.

One of the reasons arbitration can do that, but litigation cannot, is that arbitrators tend to be more knowledgeable than judges or juries. Arbitrators are chosen by the parties, often because of their expertise in a particular type of dispute. For example, the arbitrator of a construction dispute might be an engineer with experience in the kind of construction involved in that case. Such an arbitrator does not need to be brought up to speed on the technical aspects of the case, the way a judge or a jury does. The pressing need to educate judges, and especially juries, is so widely accepted that it is the premise of several rules of evidence and has spawned an entire industry of professional expert witnesses. That industry has grown to the point that “it is the rare civil trial that does not present some kind of expert, such as a doctor, an accountant, a mechanic, or an engineer.”⁸ But there are severe doubts about whether jurors generally succeed in finding the truth amidst the starkly clashing views of paid, partisan experts. In any case with technical facts—for instance, about engineering, medical science, or financial matters—it may be impossible to educate the jury adequately. It is simply not feasible to send jurors to medical school or business school so they will be able to understand the case.

In contrast, arbitration allows parties to have their cases resolved by respected professionals who understand the nature and consequences of their rulings. Such arbitrators are unlikely to deliver the off-the-wall verdicts sometimes issued by jurors. Arbitrators know that their rulings must be sensible if they are to be invited to arbitrate future cases. There is a built-in market constraint on arbitrator discretion that is completely absent with respect to the discretion of jurors and judges.

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Finally, arbitration is confidential. That is particularly valuable to parties who want their disputes resolved discretely, away from the prying eyes of business rivals, voyeur journalists, and lawyers who might stir up copycat lawsuits.

A Brief History of Arbitration Law

Although the benefits of arbitration are well established, they were long confined to two categories of disputes: (1) disputes among businesses and (2) labor disputes in unionized workplaces.⁹ Recent years, however, have seen an enormous expansion in arbitration law. That expansion has, for the first time, led to arbitration agreements that cover the broad range of civil disputes among all sorts of parties.

For centuries, Americans have used arbitration to resolve their disputes. Sometimes they agree to arbitrate a dispute that has already arisen. More commonly though, the agreement to arbitrate is entered into before any dispute. Many contracts include clauses obligating the parties to arbitrate, rather than litigate, any and all disputes arising out of or relating to the contract. Those *predispute* arbitration agreements are, like other contracts, sometimes breached. An example of such a breach is the initiation of a lawsuit on a claim arising out of a contract containing an arbitration clause. Another example is a party's refusal to arbitrate a claim asserted against it. Until the 1920s, courts in the United States provided no meaningful remedy for those breaches. Parties could breach their arbitration agreements without fear of any court-ordered sanction beyond nominal money damages.¹⁰

To provide an effective remedy for breach, predispute arbitration agreements would have to be enforceable by specific performance. That is, a court would issue an order staying litigation and compelling arbitration. Precisely that change was effected by the Federal Arbitration Act of 1925.¹¹ The FAA makes arbitration agreements enforceable by specific performance.

The FAA is resolutely pro-contract. Its pri-

mary substantive command is that 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."¹² In other words, courts must enforce an arbitration agreement unless there is a contract-law ground, such as misrepresentation or duress, for denying enforcement.¹³ The FAA's contractual approach

was designed to overrule the judiciary's long-standing refusal to enforce agreements to arbitrate and to place such agreements on the same footing as other contracts. While Congress was no doubt aware that the act would encourage the expeditious resolution of disputes, its passage was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered.¹⁴

That is the core of the FAA and its contractual approach to arbitration law, overruling the judiciary's long-standing refusal to enforce agreements to arbitrate. The pro-contract stance of the FAA frequently conflicts with state law designed to make arbitration agreements harder to enforce than other contracts. In the event of such a conflict, the state law is preempted (trumped) by the FAA under the Supremacy Clause of the U.S. Constitution.¹⁵

For about 50 years (1925–75) after the enactment of the FAA, significant remnants of the judiciary's refusal to enforce arbitration agreements remained unchallenged. Most significant, courts often refused to enforce agreements to arbitrate claims created by "public interest" statutes in such areas as employment discrimination, antitrust, and securities.¹⁶ Courts did that on the ground that it would violate "public policy" to enforce such agreements.

That began to change about 1975. The Supreme Court's arbitration decisions since then have been remarkably faithful to the contractual approach of the FAA. Most important, the Court has held that if the parties contract to resolve a dispute in arbitration then that contract must be

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enforced even if the dispute involves claims in the employment discrimination, antitrust, and securities areas.¹⁷ The Court has repeatedly emphasized that courts should send claims to arbitration when, and only when, contract law analysis would call for that.

Furthermore, parties are largely free to specify by contract the procedures governing their arbitration. The Court has even suggested that parties may be free to specify by contract the remedies the arbitrator may award, specifically, whether punitive damages are available in arbitration.¹⁸ The Court's post-1975 fidelity to the contractual approach extends beyond business and labor disputes. The contractual approach applies to all arbitration agreements, including those found in the contracts of consumers, employees, and other individuals.¹⁹

Over the past quarter century, not only the substance of the Court's arbitration decisions, but also the Court's rhetoric has been pro-contract. The Court invokes the libertarian philosophy underlying contract law when it declares that "[a]rbitration under the [FAA] is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit."²⁰ "Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude" enforceability.²¹ The Court has repeatedly emphasized that it seeks "to ensure the enforceability, according to their terms, of private agreements to arbitrate."²²

None of that sits well with those trial lawyers who have made careers out of undermining the enforceability of contracts.²³

Trial Lawyers against Arbitration

The Supreme Court's adoption of the contractual approach to arbitration law opens up great potential for civil justice reform because it permits private-sector, market-oriented alternatives to the government court system. But there is a special interest group trying to kill the arbitration alternative. That group

consists primarily of trial lawyers.

Not all trial lawyers, of course, are involved in lobbying for anti-arbitration bills. The American Trial Lawyers Association, however, has generated countless publications and speakers opposing enforcement of arbitration agreements. One of them says: "Clearly the FAA needs to be amended and restored to its original purpose: to regulate agreements between large commercial entities, not between large commercial enterprises and consumers. ATLA and other groups are working in Congress to that end."²⁴

Another organization, Trial Lawyers for Public Justice, has been especially focused on the anti-arbitration agenda. Its staff attorneys have published a book "designed to be an attorney's primary practice guide and legal resource in the battle against compulsory arbitration."²⁵ As TLPJ's website says, "The authors are among the nation's leading experts in challenging mandatory arbitration and helping clients get their day in court."²⁶

It is common for a special interest group to have a symbiotic relationship with particular government officials. The officials enact laws or regulations favoring the special interest group, and the special interest group provides campaign contributions and other support for those particular government officials.²⁷

Not surprisingly, that pattern also applies to some judges.²⁸ Activist judges favor trial lawyers by expanding the grounds for imposing liability on defendants. Trial lawyers in turn underwrite the election campaigns of activist judges in states where judges are elected.²⁹ In other states, trial lawyers can support helpful judges at the time judicial appointment and retention decisions are made.

Lawyer self-interest also infects the courts in other, less blatant, ways. For example, lawyers have promoted rules of evidence and pretrial procedures that generate more work for lawyers. Those rules make litigation costly, time-consuming, and just plain baffling for people with cases in court. Naturally, lawyers can make an argument that each of the byzantine rules and procedures reduces the chance of some particular injustice. But the combination

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of all the rules and procedures has produced the gross injustice of making the court system too costly to even hear many disputes.

Like labor unions that push wage hikes until jobs move overseas, lawyers inflate litigation costs until disputing parties flee to a more efficient alternative, arbitration. Predictably, the lawyers want to close that escape route so they can confine disputes to a court system where they exercise more control.

The plaintiffs' lawyers' fear of arbitration was apparent from the desperate tactics they used in Alabama's latest judicial elections. They littered the state with road signs and bumper stickers castigating arbitration as a "license to steal."³⁰ They even ran television commercials claiming that in Alabama victims of Firestone tires and Ford Explorers "don't even have the right to confront Ford or Firestone in court . . . because a Republican Supreme Court has ruled that binding arbitration is the only option."³¹

The trial lawyers' fight against arbitration reached the U. S. Supreme Court during the 2000–01 term in two cases, one involving consumer arbitration and the other involving employment arbitration.³² In both cases, the trial lawyers' lobby hoped for rulings that would effectively end enforcement of consumer and employee arbitration agreements. Fortunately, the Court reaffirmed arbitration in both cases. It did so, however, by bare five-to-four majorities.

In a more recent case, *EEOC v. Waffle House, Inc.*,³³ the Supreme Court ruled against arbitration by a six-to-three vote. Even though employees had signed an agreement that required arbitration of workplace disputes, including discrimination claims, the Court held that the Equal Employment Opportunity Commission can pursue victim-specific judicial relief, such as back pay, reinstatement, and damages, in an enforcement action under the Americans with Disabilities Act. Because the EEOC was not a party to the arbitration agreement, said the Court, there was no conflict between such remedies and the FAA.

Waffle House does not, however, indicate a major departure from the Court's pro-con-

tract interpretation of the FAA. First, *Waffle House* affects only a tiny percentage of arbitration cases, those in which the EEOC acts as a party to litigation against an employer. Second, the Court had to grapple with more than the FAA in *Waffle House*. The Court had to reconcile the FAA with the EEOC's enforcement powers under federal employment discrimination statutes. In any event, *Waffle House* provides no support to the vast majority of opponents of arbitration who are unable to persuade a federal agency to intervene in their particular cases.

Trial Lawyers' Bills in Congress

Having failed in the Supreme Court, trial lawyers are taking their fight against arbitration to Congress. They support bills to end enforcement of large categories of consumer, employee, and other arbitration agreements. Eleven such bills have been introduced.³⁴ One of them, the Motor Vehicle Contract Arbitration Fairness Act, recently advanced out of the Senate Judiciary Committee. That same bill passed the House of Representatives in the previous Congress.³⁵ Thus there is a real risk of a major trial lawyer victory—enactment of an anti-arbitration statute—in the near future.

Each of the bills would make arbitration agreements unenforceable in a particular context: consumer credit agreements (S. 192, H.R. 1051, H.R. 2531); other consumer agreements (H.R. 1057, H.R. 2053); employment agreements (S. 163, H.R. 1489, H.R. 2282); agricultural agreements (S. 20); and automobile dealers' franchise agreements (S. 1140, H.R. 1296). Those bills would squelch private-sector alternatives to lawyer-dominated court systems, violate freedom of contract, and raise costs to American business. While purporting to advance the interests of consumers, employees, farmers, and auto dealers, the bills would likely harm most of those very people. Consumers and employees are the principal focus of this paper, but the reasoning applies to farmers, auto dealers, and others.

Amount of Awards and Access to Justice

Assessing whether arbitration is good or bad for consumers and employees is complicated. Opponents of arbitration oversimplify when they assert that claims by consumers and employees against business win more dollars from juries than from arbitrators, so arbitration must be harmful to consumers.

First, there is little reliable data on the relative sizes of litigation and arbitration awards. The data might depend on the type of claims, characteristics of parties and lawyers, region of the country, method of selecting the arbitrator, and other factors.

There are two well-known empirical studies comparing arbitration with litigation in the employment area. Both find that employees win a much higher percentage of their claims in arbitration than in litigation but that employees who win in litigation win substantially more money than employees who win in arbitration.³⁶ One of the studies combines data on arbitration's higher employee win rates and lower awards to calculate that employees have a higher adjusted outcome in arbitration than in litigation.³⁷

While such studies may have some probative value, they may be comparing apples and oranges. There is no satisfactory way to determine whether the studied cases going to arbitration are comparable on the merits to the studied cases going to litigation.³⁸ Furthermore, any comparison of awards in litigation and arbitration presents an incomplete picture if it does not also account for settlement payments in litigation and arbitration and dismissal before trial by summary judgment and motion to dismiss. Such dismissals occur more frequently in litigation than in arbitration.³⁹ Consequently, there is reason to believe that claims going all the way through litigation to trial tend to be concentrated among the strongest, while those going all the way through arbitration to hearing tend to be more mixed.

Finally, any comparison of awards in litigation and arbitration would be misleading

if it did not also compare the cost of pursuing a case to decision, including the costs of legal fees, discovery, and delay. Those costs are generally lower in arbitration. Indeed, litigation costs are so high as to effectively preclude a remedy for many meritorious claims. For a business case, some analysts suggest, it costs a minimum of \$100,000 to litigate a straightforward claim.⁴⁰ That is why “[a]lternative dispute resolution methods, including mandatory and binding arbitration, have become essential components of many business strategies for survival.”⁴¹ The problem is not limited to business cases.

A survey of plaintiff employment lawyers found that a prospective plaintiff needed to have a minimum of \$60,000 in provable damages—not including pain and suffering or other intangible damages—before an attorney would take the case.

Even this, however, does not exhaust the financial obstacles an employee must overcome to secure representation. In light of their risk of losing such cases, many plaintiffs' attorneys require a prospective client to pay a retainer, typically about \$3,000. Others require clients to pay out-of-pocket expenses of the case as they are incurred. Expenses in employment discrimination cases can be substantial. Donohue and Siegelman found that expenses in Title VII cases are at least \$10,000 and can reach as high as \$25,000. Finally, some plaintiffs' attorneys now require a consultation fee, generally \$200–\$300, just to discuss their situation with a potential client.

The result of these formidable hurdles is that most people with claims against their employer are unable to obtain counsel, and thus never receive justice.⁴²

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limits vary widely, from a low of \$1,000 in Virginia to a high of \$15,000 in Delaware and Tennessee.⁴³ A Washington, D.C.-based legal reform group, HALT,⁴⁴ proposes raising the limit for each state's small claims court system to \$20,000. "For most, if not all, lawyers in private practice, a dispute where there is less than \$20,000 in issue is below their radar," says James Turner, HALT's executive director.⁴⁵ Of course, the dollar amount required to attract a lawyer varies from case to case, place to place, and year to year. But no doubt there are many meritorious claims too small to attract a lawyer but too large for small claims court. The availability of class actions only partially addresses that concern and does so at the cost of abusive class actions.

Predispute and Postdispute Arbitration Agreements

Opponents of consumer and employment arbitration often say that they oppose only "mandatory" arbitration. Many businesses present consumers and employees with the take-it-or-leave-it choice of agreeing to arbitrate disputes or not doing business. Opponents of arbitration incorrectly characterize that as "mandatory" arbitration even though the consumer or employee has a choice to do business or not.⁴⁶ What opponents of so-called mandatory arbitration really oppose is freedom of contract. In particular, they oppose enforcement of a particular category of contract, the predispute arbitration agreement.

In contrast to the predispute arbitration agreement is the postdispute arbitration agreement. If a consumer or employee who has not previously agreed to arbitrate has a claim against a business, he may agree to arbitrate the dispute that has arisen. Postdispute arbitration agreements are uncontroversial. Nobody seems to mind when courts enforce them. For example, S. 192, the Consumer Credit Fair Dispute Resolution Act, would continue enforcing postdispute arbitration agreements in the consumer credit context,

but not predispute agreements in that context. Employment (for example, S. 163) and auto franchise (for example, S. 1140) bills also distinguish between predispute and postdispute agreements.

Effects of Enforcing Predispute Arbitration Agreements

Opponents of predispute arbitration agreements suggest that businesses that want to arbitrate with consumers or employees should be limited to postdispute agreements. When consumers or employees enter into postdispute agreements, they are likely to be advised by a lawyer and mentally focused on the dispute. In contrast, when they enter into predispute agreements, they are unlikely to be advised by a lawyer, unlikely to be focused on the possibility of a dispute, and perhaps unaware of the existence of the arbitration clause in the contract. The argument seems to be that if arbitration is truly beneficial to consumers and employees, as well as to businesses, then consumers and employees will agree to it postdispute.⁴⁷

That argument mistakenly assumes that the consumer or employee will always be able to obtain a postdispute arbitration agreement if he wants one. There is no support for that assumption, however. Lewis Maltby—formerly of the American Civil Liberties Union, now of the National Workplace Institute—made the point well with respect to employment arbitration. He said it is "not a good idea to bar pre-dispute arbitration agreements because it is hard to get employers to agree post-dispute to use arbitration to resolve disputes. . . . People who want to bar all pre-dispute arbitration agreements are making a huge assumption they don't recognize." They "assume that employees will be able to get post-dispute" agreements to use arbitration to resolve employment disputes. That assumption is "questionable at best." Maltby added that the "point of employment arbitration is to give some justice to the run-of-the-mill cases the private bar is not interested in taking." If employees try to get postdispute arbitration agreements, employers will not agree to use arbitration because "employers can calculate the

value of the dispute,” and if it is small they will decline and “kill the case in court.”⁴⁸

Maltby’s reasoning applies just as well to consumers. There are consumers who have meritorious claims but who can get access to justice only if they have a predispute arbitration agreement. Those claims involve too little money to attract a lawyer but too much money for small claims court. Without a predispute arbitration agreement, the business-defendant has an incentive to stonewall the consumer, knowing that the consumer has no practical recourse, no access to justice.

Lower Prices, Efficient Production

Another argument for predispute arbitration agreements is that their enforcement lowers prices or, in the case of employees, raises wages.

Arbitration of consumer disputes almost certainly lowers prices.⁴⁹ Arbitration reduces a business’s costs, just like a technological advance or a better way of organizing an assembly line. Ultimately, lower costs to business lead to lower prices to consumers. That is basic economics, as well as plain common sense about how markets work. Moreover, it does not assume that consumers understand, or even read, the contracts they sign. Arbitration clauses give consumers lower prices regardless of how many consumers are aware of the arbitration clause in their contracts.

An assessment of predispute arbitration agreements, therefore, must not be limited to a consideration of consumers with disputes. A proper assessment must consider consumers as a whole. Consumers without disputes are the main beneficiaries of the lower prices caused by arbitration agreements.

Here is the bargain that seems to be implicit in most consumer predispute arbitration agreements: The consumer gets lower prices and, perhaps, better access to justice for meritorious claims that are too small for a lawyer to litigate. In exchange, the business gets lower process costs and, perhaps, reduced exposure to big-dollar jury awards and class actions.

That exchange is not zero-sum. In other words, the gain for one side is not entirely offset

by an equal loss for the other side. The exchange is positive-sum because some of the gain comes from cost savings when arbitration replaces litigation. Much of the extra costs would have been paid to trial lawyers, so lawyers may lose from the exchange. But both the consumer and the business benefit. And society as a whole benefits. To the extent that the costs of adjudication are reduced, disputes can be resolved more efficiently, that is, 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.

That gain is realized, however, only if predispute arbitration agreements are enforced. Socially beneficial exchange will not occur nearly as often if it can occur only postdispute. That is because, postdispute, both consumer and business know what the dispute is. If the dispute is a consumer’s meritorious low-dollar claim, then the business will generally not agree to arbitration. (While arbitration will cost the business something, litigation will cost the business nothing if the consumer cannot get a lawyer to take the case.) Conversely, if the dispute could lead to a big-dollar jury award or class action then the consumers will generally not agree to arbitration. (Litigation’s higher expected award more than compensates for litigation’s higher expected cost of getting the award.) It is precisely the predispute uncertainty about whether there will be a dispute and, if there is, what sort of dispute it will be that makes the deal implicit in the arbitration agreement appeal to both sides.

That explains why enforcement of predispute arbitration agreements benefits consumers as a class even though it would be against some particular consumers’ interests to agree to arbitration once a dispute has arisen.

Under the implicit bargain noted above, predispute arbitration agreements give consumers as a class (1) lower prices and (2) extra postdispute leverage in small but meritorious cases but deny consumers (3) extra postdispute leverage in cases that could lead to a big-dollar jury award or class action. For con-

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sumers in the aggregate, gaining 1 and 2 is surely worth giving up 3. If a large liability dispute has already arisen, however, the price that a particular consumer requires for giving up 3 increases dramatically. In other words, it is entirely rational for a consumer to prefer, at the time of contracting, that an arbitration clause be in the contract even if, at the time of a particular dispute, the consumer prefers that an arbitration clause not be in the contract.

Benefiting the Majority

To put a finer point on it, the question of predispute arbitration agreements may cut differently for different consumers. In the consumer credit context, if you are the sort of consumer-borrower who is especially likely to have a large liability dispute with your lender, then you may be better off if predispute arbitration agreements are unenforceable, as under S. 192. By contrast, if you are the typical consumer who is unlikely to have a dispute with your lender, then you are better off under current law, which enforces predispute agreements, thereby encouraging lower interest rates. Similarly, if you are the sort of consumer who is likely to have a small but meritorious claim against your lender, then you are better off under current law. In sum, current law is better for all consumers except those few who are especially likely to have large liability claims against lenders.

The logic is identical for auto dealers. Auto franchise arbitration almost certainly lowers the cost of becoming a franchisee and increases franchisees' access to justice for small but meritorious claims. Enforcement of franchise arbitration agreements, therefore, benefits all franchisees except those few who are especially likely to have large liability claims against franchisors.

The same reasoning applies to employees. Employment arbitration almost certainly raises the wages employees receive⁵⁰ and increases employees' access to justice for small but meritorious claims. Thus, enforcement of employment arbitration agreements benefits all employees except those few who are especially likely to have large liability claims against employers.

Similarly, arbitration clauses in farmers' production agreements yield higher wages for farmers and give them increased access to justice for small but meritorious claims. Enforcement of farmers' arbitration agreements, therefore, benefits all farmers except those few who are especially likely to have large liability claims against the dealer, processor, or broker to whom they sell farm products.

In sum, enforcement of arbitration agreements benefits the vast majority of consumers, auto dealers, employees, and farmers. Proposed legislation backed by trial lawyers, purporting to help those groups, would have the opposite effect.

Regrettably, the pro-consumer benefits of arbitration (lower prices and increased access to justice for small but meritorious claims) have a lower profile than the large liability claims so dear to trial lawyers. Well-organized and well-funded trial lawyers eagerly draw media attention to the drama of the large liability claim. By comparison, price reductions and wage increases due to arbitration's lower costs cannot be easily dramatized. Furthermore, benefits spread over so many consumers and employees are individually too small to justify political action. So too with access to justice for small but meritorious claims. The many people who would benefit from increased access to justice do not have a political organization as focused and effective as the trial lawyers who seek to restrict access.⁵¹

Finally, there is individual freedom. Those consumers, auto dealers, employees, farmers, and others who do not wish to enter into arbitration agreements are under no obligation to do so. Current law does not make arbitration "mandatory"; it makes arbitration a matter of contractual choice. That is how a free society is supposed to work.

Legislation vs. Case Law

There are cases in which arbitration agreements (whether by consumers, franchisees, employees, farmers, or anyone else) should not be enforced. For example, some agreements are induced by misrepresentation, duress, undue influence, and other circum-

stances that, under ordinary contract law, make any contract unenforceable. The FAA already applies those contract law doctrines to arbitration agreements, so no further legislation is needed on that score.

Some advocates of the anti-arbitration bills are concerned about arbitration agreements that require the consumer, farmer, employee, or franchisee to use arbitrators allegedly sympathetic to the opposing party. But arbitration awards are not enforced if “there was evident partiality or corruption in the arbitrators.”⁵² Case law under that provision of the FAA requires arbitrators to disclose “any dealings that might create an impression of possible bias” or “even an appearance of bias.”⁵³

Advocates of the anti-arbitration bills are also concerned about arbitration agreements that are unconscionable because they require the consumer, farmer, employee, or franchisee to pay high arbitration fees. But the FAA gives courts the tools to avoid enforcing unconscionable arbitration clauses. A growing body of case law clarifies which arbitration agreements are unconscionable.⁵⁴ And the people who draft standard arbitration agreements seem to be responding to that case law. In the dozen or so years that I have been studying arbitration cases, I have noticed a marked increase in the number of arbitration agreements that eliminate or cap the fees required of the consumer or employee.⁵⁵

Issues covered by ordinary contract law doctrines, including unconscionability, necessarily require a case-by-case analysis. In short, they should continue to be handled by case law made in the courts. They are not suited to the broad brush with which legislation necessarily paints. That is an area in which the case law is evolving. Further legislation would be counterproductive.

The Political Picture

So far, only one of the anti-arbitration bills has advanced out of committee in this Congress. That bill, the Motor Vehicle Franchise Contract Arbitration Fairness Act, is sponsored by Rep. Mary Bono (R-Calif.) in the House and Sen. Orrin Hatch (R-Utah) in the Senate. The bill

passed the House by voice vote in the last Congress and recently passed the Senate Judiciary Committee by voice vote with only Sen. Jeff Sessions (R-Ala.) requesting that the record reflect his opposition to passage. Because the Bono-Hatch bill covers only a narrow category of contracts (franchise agreements between automobile manufacturers and dealers), the negative consequences of enacting the bill may not seem severe. Indeed, the nearly unanimous Judiciary Committee included many senators ordinarily wary of trial lawyers. That too might suggest that the bill's harm is minimal. A complacent attitude, however, plays right into the hands of the trial lawyers' political strategy.

A few months ago, I received a call from the Washington, D.C., office of a major public relations firm. The firm was working with Trial Lawyers for Public Justice to find a law professor to join them in lobbying for the Bono-Hatch bill. Think about that for a moment. Why does Trial Lawyers for Public Justice, the leader of the trial lawyers' fight against arbitration, believe that a Republican-sponsored bill affecting only the narrow area of auto dealer-manufacturer contracts is important enough to justify hiring a major public relations firm for a full-scale lobbying push? Is it because trial lawyers have abandoned their usual personal injury and class action cases to specialize instead in disputes between auto dealers and manufacturers?

Not likely. Trial lawyers have little at stake in disputes between auto dealers and manufacturers. The Bono-Hatch bill is important to activist trial lawyers, not on its own, but as a means of enacting other anti-arbitration bills—the bills they really care about, the bills that cover the consumer and employment cases that enrich so many trial lawyers.

The Bono-Hatch bill is the camel's nose under the tent flap. If that bill passes, it will be much harder, politically and logically, to argue against anti-arbitration bills in the consumer and employee contexts. How can “millionaire auto dealers” deserve “protection from mandatory arbitration” while “grandma, the consumer,” does not deserve it? Republican supporters will be easy to caricature as beholden to

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There is a lot at stake. And the trial lawyers' lobby knows it.

business interests, as insensitive to the ordinary voter, if they do not also support the anti-arbitration bills in the consumer, employment, and farmer contexts.

The Bono-Hatch bill would create a loophole in the FAA, a statute that has stood for freedom of contract for more than 75 years. Once created, that loophole could easily expand. People who care about enforcing consumer, employee, and farmer arbitration agreements should be troubled by the Bono-Hatch bill. Those who care about private-sector alternatives to lawyer-dominated court systems should be troubled by the Bono-Hatch bill. Those who care about freedom of contract should be troubled by the Bono-Hatch bill. There is a lot at stake. And the trial lawyers' lobby knows it.

Notes

Many of the arguments in this paper previously appeared in letters available at <http://www.ftc.gov/bcp/altdisresolution/comments/ware.htm> and in Fairness and Voluntary Arbitration Act: Hearing before the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary, 106th Cong. (2000), http://commdocs.house.gov/committees/judiciary/hju65871.000/hju65871_0.htm.

1. Motor Vehicle Franchise Contract Arbitration Fairness Act of 2001, S. 1140 and H.R. 1296, 107th Cong. (2001).

2. Committee for Economic Development, "Breaking the Litigation Habit: Economic Incentives for Legal Reform," 2000, p. 5, www.ced.org/docs/report/report_legal.pdf.

3. See, for example, James S. Kakalik et al., "Discovery Management: Further Analysis of the Civil Justice Reform Act Evaluation Data," RAND Corporation, 1998, Table 2.2, pp. 28-29; Judith A. McKenna and Elizabeth C. Wiggins, "Empirical Research on Civil Discovery," *Boston College Law Review* 39 (1998): 796-99; and J. Stratton Shartel, "More Female Litigators Relegated to Non-Trial Work, Survey Finds," *Inside Litigation* 9 (February 1995): 12.

4. Michael Heise, "Justice Delayed? An Empirical Analysis of Civil Case Disposition Time," *Case Western Reserve Law Review* 50 (2000): Table 4, pp. 834-35.

5. See, for example, Jacqueline M. Nolan-Haley, *Alternative Dispute Resolution*, 2d ed. (St. Paul: West, 2001), p. 144; and Stephen B. Goldberg et al., *Dispute Resolution: Negotiation, Mediation, and Other Processes*, 3d ed. (New York: Aspen, 1999), p. 234.

6. Stephen J. Ware, "The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration," *Ohio State Journal on Dispute Resolution* 16 (2001): 755-57.

7. U.S. General Accounting Office, *Alternate Dispute Resolution: Employers' Experiences with ADR in the Workplace* (Washington: GAO, 1997), p. 19; William M. Howard, "Mandatory Arbitration of Employment Discrimination Disputes" (Ph.D. diss., Arizona State University, 1995), pp. 124-42; and Lewis L. Maltby, "Private Justice: Employment Arbitration and Civil Rights," *Columbia Human Rights Law Review* 30 (1998): 46-55.

8. Thomas A. Mauet and Warren D. Wolfson, *Trial Evidence*, 2d ed. (New York: Aspen, 1997), p. 275.

9. The material in this section previously appeared, in slightly different form, in Stephen J. Ware, "Arbitration and Unconscionability after *Doctor's Associates, Inc. v. Casarotto*," *Wake Forest Law Review* 31 (1996): 1002-6.

10. See, for example, *Munson v. Straits of Dover S.S. Co.*, 101 Fed. 926 (2d Cir. 1900); and Ian R. Macneil, *American Arbitration Law* (New York: Oxford University Press, 1992), p. 20. See generally Ian R. Macneil et al., *Federal Arbitration Law* (London: Little Brown, 1994), § 4.3.2.2.

11. 9 U.S.C. §§ 1-16 (2000). The statute was originally named the United States Arbitration Act and was renamed the Federal Arbitration Act in 1947. Act of July 30, 1947, ch. 392, 61 Stat. 669.

There is debate about whether the FAA was enacted pursuant to Congress's power to regulate interstate commerce (Article I, sec. 8, of the Constitution) or its power to establish, and make procedural rules for, federal courts (Article III of the Constitution). Stephen J. Ware, *Alternative Dispute Resolution* (St. Paul: West, 2001), §§ 2.6-2.8. In *Southland Corp. v. Keating*, 465 U.S. 1 (1984), that issue split the Supreme Court between a majority finding that the FAA was enacted pursuant to the Commerce Clause and a dissent finding that it was enacted pursuant to Article III.

In concluding that the FAA was enacted pursuant to the Commerce Clause, the Supreme Court tied the reach of the FAA to the reach of the Commerce Clause. In other words, an arbitration agreement is governed by the FAA only when it is sufficiently connected to interstate commerce to meet the constitutional standard. *Allied-Bruce Terminix Cos., Inc. v.*

Dobson, 513 U.S. 265 (1995). There are strong arguments that the Court has interpreted the Commerce Clause overly broadly. See, for example, Richard A. Epstein, "Constitutional Faith and the Commerce Clause," *Notre Dame Law Review* 71 (1996): 167; and Glenn Harlan Reynolds, "Kids, Guns, and the Commerce Clause: Is the Court Ready for Constitutional Government?" Cato Institute Policy Analysis no. 216, October 10, 1994. Those arguments are beyond the scope of this paper. They apply to the FAA no differently than they apply to countless other federal statutes whose constitutional authorization the Court finds in the Commerce Clause.

Some scholars have suggested a reading of the Fourteenth Amendment's Privileges or Immunities Clause that would provide constitutional authority for the FAA and other statutes embracing freedom of contract. See Kimberly C. Shankman and Roger Pilon, "Reviving the Privileges or Immunities Clause to Redress the Balance among States, Individuals, and the Federal Government," Cato Institute Policy Analysis no. 326, November 23, 1998.

12. 9 U.S.C. § 2 (2000).

13. For a defense of the contractual approach, see Stephen J. Ware, "Consumer Arbitration as Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen)," *McGeorge Law Review* 29 (1998): 195.

14. *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 478 (1989)(citations omitted).

15. U.S. Constitution, Article VI, clause 2. See Ware, *Alternative Dispute Resolution*, §§ 2.9-2.14.

16. See Ware, "Arbitration and Unconscionability," pp. 1004-5.

17. *Ibid.*, p. 1005.

18. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 58 (1995).

19. See, for example, *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991); *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995); *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996); and *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000).

20. *Volt* at 479.

21. *Gilmer* at 26 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

22. *Mastrobuono* at 57 (quoting *Volt* at 476).

23. Much of what has gone wrong in our court system

in recent decades is the overriding of contract law by tort law. See, for example, Peter W. Huber, *Liability: The Legal Revolution and Its Consequences* (New York: Basic Books, 1988); and Michael I. Krauss, "Restoring the Boundary: Tort Law and the Right to Contract," Cato Institute Policy Analysis no. 347, June 3, 1999.

24. John Vail, "Defeating Mandatory Arbitration Clauses," *Trial*, January 2000, www.atlanet.org/homepage/triaj00.htm.

25. F. Paul Bland Jr. et al., *Consumer Arbitration Agreements: Enforceability and other Topics* (Washington: Trial Lawyers for Public Justice, 2001).

26. See www.tlpj.org/caa.htm.

27. This is one of the central insights of public choice theory. See, for example, Daniel A. Farber and Philip P. Frickey, *Law and Public Choice* (Chicago: University of Chicago Press, 1991); and Fred S. McChesney, *Money for Nothing: Politicians, Rent Extraction and Political Extortion* (Cambridge, Mass.: Harvard University Press, 1997).

28. See, for example, Richard L. Hasen, "High Court Wrongly Elected: A Public Choice Model of Judging and Its Implications for the Voting Rights Act," *North Carolina Law Review* 75 (1997): 1308-34.

29. See, for example, Stephen J. Ware, "Money, Politics and Judicial Decisions: A Case Study of Arbitration Law in Alabama," *Journal of Law & Politics* 15 (1999): 645; and Stephen J. Ware, "Truce Possible in GOP-Dominated High Court," *Birmingham News*, December 3, 2000, p. 1C.

30. Stephen J. Ware, "The Alabama Story: Arbitration Shows Law's Connection to Politics, Culture," *Dispute Resolution Magazine*, Summer 2001, p. 24.

31. *Ibid.*

32. *Green Tree Financial* at 79 (consumer); and *Circuit City Stores, Inc. v. Adams*, 121 S.Ct. 1302 (2001)(employment).

33. 2002 WL 46763 (U.S. no. 99-1823 January 15, 2002).

34. Securing a Future for Independent Agriculture Act of 2001, S. 20, 107th Cong., § 128 (2001); Civil Rights Procedures Protection Act of 2001, S. 163, 107th Cong., § 9 (2001); Civil Rights Procedures Protection Act of 2001, H.R. 1489, 107th Cong., § 9 (2001); Consumer Credit Fair Dispute Resolution Act of 2001, S. 192, 107th Cong., § 2 (2001); Motor Vehicle Franchise Contract Arbitration Fairness Act of 2001, S. 1140, 107th Cong., § 17 (2001); Motor

Vehicle Franchise Contract Arbitration Fairness Act of 2001, H.R. 1296, 107th Cong., § 17 (2001); Predatory Lending Consumer Protection Act of 2001, H.R. 1051, 107th Cong., § 2 (2001); Truth in Savings Enhancement Act of 2001, H.R. 1057, 107th Cong., § 2 (2001); American Homebuyers Protection Act, H.R. 2053, 107th Cong., § 2 (2001); Preservation of Civil Rights Protections Act of 2001, H.R. 2282, 107th Cong., § 3 (2001); and Save Our Homes Act, H.R. 2531, 107th Cong., § 2 (2001).

35. Vehicle Franchise Contract Arbitration Fairness Act of 2000, H.R. 534, 106th Cong. (2000).

36. Maltby, "Private Justice," pp. 46–55; and Howard, "Mandatory Arbitration of Employment Discrimination Disputes," pp. 124–42.

37. Maltby, "Private Justice," pp. 48–49.

38. Ware, "The Effects of Gilmer," pp. 755–57.

39. See, for example, Lewis Maltby, "Employment Arbitration: Is It Really Second Class Justice?" *Dispute Resolution Magazine*, Fall 1999, p. 23.

40. Gillian Hadfield, "The Price of Law: How the Market for Lawyers Distorts the Justice System," *Michigan Law Review* 98 (2000): 957.

41. Joseph M. Matthews, "Is It Possible to Try a \$100,000 Business Case to a Jury without Bankrupting Yourself and Your Client?" *Florida Bar Journal* 71 (1997): 65.

42. Maltby, "Private Justice," pp. 57–58.

43. Jill Schachner Chanen, "Pumping Up Small Claims: Reformers Seek \$20K Court Limits—With No Lawyers," *A.B.A. Journal* 84 (December 1998): 18.

44. HALT is an acronym for Help Abolish Legal Tyranny.

45. Quoted in Chanen, p. 18.

46. See, for example, Vail, pp. 70–71.

47. See, for example, Paul D. Carrington and Paul

Haagen, "Contract and Jurisdiction," *Supreme Court Review* (1996): 331; and comments of Jean Braucher and Charles Knapp, in "Common Sense and Contracts Symposium: The Gateway Thread," *Touro Law Review* 16 (2000): 1167, 1173.

48. Quoted in Justin Kelly, "Bill Would Bar Pre-Dispute Arbitration for Civil Rights Claims," April 10, 2001, www.adrworld.com/opendocument.asp?Doc=mG3XhW8Oq4&printerfriendly=1&limit=300&code=p8viHA2D.

49. Stephen J. Ware, "Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements," *Journal of Dispute Resolution* (2001): 90–93.

50. Ware, "The Effects of Gilmer," p. 735.

51. See, for example, Tom Gordon, "Small-Claims Reform Defeated," *Legal Reformer*, Spring 2001, p. 1, www.halt.org/News/page.cfm?page=tlrpg1.

52. 9 U.S.C. § 10(a)(2) (2000).

53. *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 149 (1968).

54. Ware, *Alternative Dispute Resolution*, § 2.25(a). Because there is a wide variety of views on the proper scope of the unconscionability doctrine—see, for example, Richard A. Epstein, "Unconscionability: A Critical Reappraisal," *Journal of Law & Economics* 18 (1975): 293—there is a correspondingly wide variety of views about which arbitration clauses should be held unconscionable. The proper scope of the unconscionability doctrine is beyond the range of this paper, which merely notes that the FAA prevents courts from applying the doctrine more aggressively against arbitration agreements than against contracts generally. Ware, *Alternative Dispute Resolution*, § 2.25(b). Whatever the proper scope of the unconscionability doctrine, the doctrine cannot be applied more aggressively in the arbitration context.

55. See, for example, *Lloyd v. MBNA America Bank, N.A.*, 2001 WL 194300 (D. Del. No. Civ. A. 00-109-SLR February 22, 2001).

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