TRIAL LAWYERS FOR PUBLIC JUSTICE

SECURING ACCESS TO JUSTICE

Fighting Mandatory Arbitration

By F. Paul Bland, Jr. and Michael J. Quirk*

Part Two in a series.

In an alarming trend, corporations are waging a sweeping campaign to privatize justice and rewrite consumer protection laws in their own favor. For example, in July 2001, AT&T mailed a brochure to its long distance telephone customers telling them that they were forfeiting their constitutional right to have their day in court. Those few customers who scrutinized the fine print learned that they would have to submit major legal claims to private arbitration, that they would be prohibited from taking part in any class action against AT&T, that they would have to submit claims to arbitration within two years regardless of applicable statutes of limitations, and that they would never be able to recover consequential or punitive damages from AT&T in these arbitration proceedings.

While a federal district court has ruled in a case brought by Trial Lawyers for Public Justice and The Sturdevant Law Firm after a trial on behalf of a class of seven million California consumers that this particular contract is unlawful, this type of compulsory arbitration clause is hardly unique to AT&T. More and more companies in a growing number of business fields across the country are adding mandatory arbitration clauses to their standard form contracts to shield themselves from liability to consumers and workers and to conceal their wrongdoing from public scrutiny.

Mandatory arbitration too often works to the disadvantage of consumers, workers, and other victims of corporate wrongdoing. Although mandatory arbitration clauses are generally legal and enforceable, there are nonetheless a number of arguments we have used in particular cases to preserve the rights of individuals to go to court. This article gives a brief overview of some of the problems of mandatory arbitration and some of the leading arguments available to parties opposing it. For a comprehensive discussion of the arguments used to defeat arbitration, see our book, *Consumer Arbitration Agreements: Enforceability and Other Topics* (NCLC and The TLPJ Foundation, Second Edition, 2002), co-authored with Jon Sheldon of the National Consumer Law Center. (The book can be ordered by calling TLPJ headquarters or visiting our web site at www.tlpj.org.)

A federal magistrate judge found the arbitration clause in AT&T's customer service agreement illegal, unconscionable, and unenforceable.

Problems with Mandatory Arbitration

Private arbitration generally benefits corporate defendants while working to the disadvantage of consumers, workers, and other individual claimants. Perhaps most significant, there is a shared perception among plaintiff advocates and corporate representatives alike that arbitrators are more likely than judges or juries to bring pro-defendant attitudes to their decision-making. Many lawyers have told us of cases where they sought arbitration and then received a list of potential arbitrators, all of whom were either employed in the defendant's field of business or were lawyers who regularly represented businesses in the defendant's field. There is evidence that arbitrators tend to favor "repeat players," the institutional parties most likely to appear in future arbitrations, over individual parties such as consumers or workers who are not likely to be back in arbitration again. This bias is predictable where arbitrators compete to be selected by corporations, work under short-term contracts, and will lose future work if corporate parties perceive their decisions as too favorable or generous to plaintiffs.

Arbitration proceedings can also be exceedingly expensive for consumers, with filing fees of several hundred dollars and arbitrators' fees (typically $200 to $450 *per hour*) running into the thousands of dollars. Arbitration is also typically enshrouded in secrecy, with many arbitration services adopting rules that bar parties from telling anyone about cases in arbitration. If Bridgestone and Ford dealers had adopted arbitration provi-

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sions five years ago, they might well have succeeded in concealing their tire failures from the press and the public. The dangers posed by this secrecy are compounded by the nearly unbridled discretion that arbitrators have in deciding cases. Courts have repeatedly held that arbitration decisions are subject to the most limited judicial review, with the U.S. Supreme Court recently finding in *Major League Baseball Players Ass'n v. Garvey* that "improvident, even silly fact finding" was not grounds for overturning an arbitrator's ruling. Finally, arbitration is often imposed without the meaningful consent of individuals because businesses write their arbitration clauses in legalese tucked in the middle of fine-print in standard form contracts.

Fighting Mandatory Arbitration

The Supreme Court has proclaimed that the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.*, creates a liberal federal policy favoring arbitration, but that does not mean that courts will enforce unfair arbitration clauses. The FAA provides that arbitration agreements shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Supreme Court has held that the FAA preempts state laws that single out all arbitration clauses for disfavored treatment, but also has recognized that courts may refuse to enforce specific arbitration clauses that violate generally applicable rules of contract law. The key to making a successful challenge is to direct these arguments not at all arbitration generally, but at the specific abuses of arbitration that are involved in particular cases.

Many arbitration clauses are vulnerable to challenge under the state law doctrine that courts will not enforce contract provisions that are unconscionable. To establish that a contract provision is unconscionable, a party typically has to show that there is a substantial imbalance in bargaining power between the contracting parties or that the provision was hidden or concealed (so-called "procedural unconscionability") and that the provision's terms are unfairly one-sided in favor of the stronger party (so-called "substantive unconscionability"). While arbitration clauses are not *per se* unconscionable, some companies cannot resist writing them in such a one-sided manner that they become unconscionable.

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Photos by Herman Farrer

TLPJ, along with Garve Ivey and Barry Ragsdale of Alabama, recently represented consumer plaintiffs in a case where we argued that the arbitration clauses at issue were unconscionable because, among other things, consumers had no choice regarding arbitration. In *American General Finance, Inc. v. Branch*, the Alabama Supreme Court found that the plaintiffs established procedural unconscionability by building a factual record showing that virtually every local sub-prime lender required arbitration so that borrowers were forced to surrender access to courts as a condition for obtaining loans. The plaintiffs argued substantive unconscionability based on one-sided contract terms exempting the lender's claims from arbitration. When the borrower petitioned to the U.S. Supreme Court, we joined the case to write the successful brief opposing *certiorari* on the ground that this application of ordinary rules of state contract law is expressly permitted under the FAA.

Individuals can also use the high costs of arbitration to argue that a defendant's arbitration clause is unconscionable. Here again, the party challenging arbitration must produce evidence to support his or her claim that arbitration is too expensive. In *Sanderson Farms, Inc. v. Gatlin*, TLPJ joined Larry Abernathy and Dudley Butler of Mississippi in representing an individual farmer opposing enforcement of a poultry company's mandatory arbitration clause on the ground that it imposes excessive costs. By its terms, the clause requires use of a three-arbitrator panel with arbitration to be conducted under the American Arbitration Association's (AAA's) Commercial Rules. When the farmer attempted to arbitrate under these rules, AAA billed him for more than $10,000 (mostly for the arbitrators' hourly fees) before there was even a hearing on his underlying claims. Our argument that these costs render the poultry company's arbitration requirement unconscionable is now before the Mississippi Supreme Court.

We also made this argument in *Ting v. AT&T*, our suit seeking to enjoin enforcement of AT&T's consumer arbitration clause as unconscionable under California's Consumer Legal Remedies Act. As evidence that AT&T consumers will face prohibitive costs if the company's arbitration clause is enforced, we put into the record the fee requirements of AAA's Commercial Arbitration Rules (used by AT&T for certain consumer claims) and a study showing that AAA arbitrators in California charge parties an average of $1,899 per day for their

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Supreme Court Tosses Arbitration Clause

Home equity loan provision hurts borrowers, justices rule

By KEN WARD, JR.
GAZETTE STAFF WRITER

The state Supreme Court has struck down a one-sided arbitration clause included in some home equity loans.

Justices agreed with consumer advocates who said the clause was "unconscionable because the lender chose arbitrators whose income depended on continued referrals from the lender."

On Wednesday, the court unanimously ruled that Meritech Mortgage Services violated the law by inserting the mandatory arbitration clause into its form contract with customers.

Generally, when legal disputes go to arbitration, both sides approve the arbitrators.

In the case, Meritech required borrowers to resolve any disputes with lenders through arbitration.

The lenders mandated that the disputes be arbitrated by the National Arbitration Forum.

Consumer lawyer Dan Hedges alleges that the forum, a private company, almost always favors lenders because its business is dependent on being chosen by lenders to arbitrate loan cases.

In the case decided Wednesday, Hedges represents Margaret and Roger Toppings of Lincoln County.

Margaret Toppings is 65 and has a fifth-grade education. Roger Toppings has a seventh-grade education and cannot read, according to court records.

In November 1999, the Toppings obtained a home equity loan. Companies involved in the loan included Meritech Mortgage Services, Saxon Mortgage, Platinum Capital and Chase Manhattan Bank.

The Toppings were told that the loan had a 6.9 percent interest rate. It turned out to have a 10 percent interest rate, according to court records. To pay off indebtedness of $37,000, the couple would have to pay $104,000, including a $36,600 balloon payment.

"Meritech has a profit motive for selecting the National Arbitration Forum to replace judges and juries for all disputes."

As part of the deal, the Toppings signed an "arbitration rider." This required all disputes, claims or controversies to be resolved through binding arbitration by an arbitrator designated by the National Arbitration Forum.

"Our clients stood to lose their home because of a predatory loan," Hedges said Friday.

"The court rightly recognized that it would be outrageous to trust such a crucial decision to a system where the private judges have powerful built-in incentives to favor the finance company over the consumer."

F. Paul Bland, of the Washington, D.C., group Trial Lawyers for Public Justice, also represented the Toppings.

"Meritech has a profit motive for selecting the National Arbitration Forum to replace judges and juries for all disputes," Bland said.

"The record shows that the forum has repeatedly demonstrated favoritism toward lenders over consumers, and that the forum represented itself to lenders as a way for them to shield themselves from legal accountability."

In the Toppings' case, the court cited a lengthy footnote in a case decided last week concerning a jewelry chain's arbitration clause with its customers.

"Neutrality in the selection and composition of any forum or tribunal is essential to the legal validity of contractual provisions providing for dispute resolution mechanism," the court said in the previous case.

In the Toppings' case, the high court issued a short, unsigned order rather than a full opinion. The order said that Justice Elliott Maynard would have issued a full opinion instead.

The case now returns to Lincoln County Circuit Court. ■

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own compensation. When AAA offered an affidavit regarding its fee reductions and deferrals, we deposed AAA officials and proved at trial that AAA rarely reduces its fees, but merely delays its collection of them. The federal district court held that the cost provisions of AT&T's arbitration clause are unconscionable because they threaten consumers with costs in excess of $5,000 in a case and will therefore "deter many litigants from proceeding" with their claims.[1]

In addition to unconscionability, the entire range of contract law rules and requirements are available to parties fighting arbitration. When TLPJ, along with John T. Ward of Baltimore and Michael Malakoff of Pittsburgh, represented credit cardholders suing Chevy Chase Bank for raising their interest rates above 24% after promising never to do so, we opposed Chevy Chase's motion to force the case into arbitration primarily by arguing that Chevy Chase's attempt to unilaterally amend pre-existing cardholder agreements did not result in a valid contract under applicable state law. Maryland's highest court ruled that the precise language of Chevy Chase's arbitration clause made arbitration voluntary rather than mandatory for consumers.

Finally, parties may also be able to beat arbitration in some settings by making arguments under *federal* law. While the FAA permits enforcement of arbitration agreements, Congress is free to override this policy and to prohibit arbitration of claims under any particular federal statute. Consumers have had some success arguing that the Magnuson-Moss Warranty Act, 15 U.S.C. §§ 2301-2312, prohibits binding arbitration of certain breach of warranty claims through its provisions requiring that informal dispute resolution systems be non-binding.

We are making this argument, along with E. Powell Miller, Christopher Lovasz and Mark Romano of Michigan, in *Abela v. General Motors Corp.*, an appeal from a trial court order denying GM's motion to compel binding arbitration of breach of express warranty claims asserted by consumers. Parties should always examine the text and legislative history of a federal statute before conceding that claims arising under it are subject to arbitration under the FAA.

Conclusion

The ability of corporations to opt out of the public civil justice system poses fundamental policy questions for Congress and the courts. TLPJ will continue to use innovative strategies to fight arbitration abuses and preserve Americans' right to their day in court. We encourage all who encounter this problem to contact us or visit our web site at www.tlpj.org. ■

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1) *Ting v. AT&T*, 182 F. Supp. 2d 902, (N.D. Cal. 2002)

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- and inspire lawyers and others to serve the public interest. ■

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