# "VOLUNTEERING" TO ARBITRATE THROUGH PREDISPUTE ARBITRATION CLAUSES: THE AVERAGE CONSUMER'S EXPERIENCE

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## I

## INTRODUCTION

Private arbitration, enabled by predispute agreements whereby parties waive their rights to resolve future disputes in a public courtroom, has a long history in the United States.[1] Until recently, arbitration reigned in two domains: commercial transactions and labor-management relations. Businesspersons generally chose arbitration over litigation for several reasons. First, they preferred to select the people who would decide their disputes, often opting for decisionmakers with relevant expertise, rather than having courts assign generalist judges to their cases. Second, they tended to prefer resolutions based on commercial norms rather than legal standards that might be less appropriate for their disputes. Finally, they commonly anticipated that resolution by arbitration would be quicker and cheaper than court resolution, with its potential for protracted pretrial adversarialism, extensive discovery, and multiple appeals.

Labor unions and management included arbitration provisions in collective bargaining agreements for different, albeit overlapping, reasons. Both labor and management believed that resolving disputes through arbitration would minimize industrial conflict over worker grievances. They had more confidence in decisionmakers whom they selected from their own ranks than court-appointed judges from outside the affected industries. Furthermore, they wanted a conflict resolution process that would keep businesses running and avoid losses in productivity and employment. In both the commercial and labor-management domains, arbitration agreements were negotiated by sophis-



This Article is also available at http://www.law.duke.edu/journals /67LCPDemaine.

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This research was funded by a grant from the Hewlett Foundation. The authors thank Norman Brand, Aaron X. Fellmeth, Tom Metzloff, and especially Jean Sternlight for their helpful comments on an earlier version of this Article. They thank Craig Martin and Elif Yarnall-Cuceloglu for their research assistance.

1. *See* Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595 (1928).

ticated parties of approximately equivalent bargaining power who understood the benefits and costs of their bargains.[2]

Over the past several decades, as a result of some remarkable lawmaking by federal and state appellate courts, the profile of arbitration has changed dramatically.[3] Arbitration is no longer the province of sophisticated participants. Instead, individuals pursuing long-established statutory claims, such as those brought under the federal securities[4] and antitrust laws,[5] and newer but long-sought civil rights claims, including race, sex, age,[6] and disability discrimination,[7] may now be forced to arbitrate if the parties are deemed to have assented to a predispute arbitration clause.[8] Consumer claims have followed a similar course, such that consumers who enter into contracts that substitute binding arbitration for the public court system may be required to arbitrate disputes that arise in the course of their relationships with service or product providers.[9]

The merits of this consumer arbitration jurisprudence have been debated heatedly by members of the judiciary, legal commentators, commercial interests, and public advocacy groups. Perhaps most central to the debate are concerns that consumers do not fully understand the terms of these agreements,[10] and that, even if they did, they cannot negotiate those terms, which are offered on a "take-it-or-leave-it" basis.[11] In accordance with the current arbitration jurisprudence, however, consumers are bound by the terms of these contracts

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2. For the history of commercial and labor-management arbitration in the United States, see BRUCE BENSON, THE ENTERPRISE OF LAW: JUSTICE WITHOUT THE STATE (1990); ROBERT COULSON, BUSINESS ARBITRATION: WHAT YOU NEED TO KNOW (4th ed. 1991); William Jones, *Three Centuries of Commercial Arbitration in New York: A Brief Survey*, 1956 WASH. U. L.Q. 193; Dennis R. Nolan & Roger I. Abrams, *American Labor Arbitration: The Maturing Years*, 35 FLA. L. REV. 557 (1983).

3. *See, e.g.*, Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 132 (2001) (Stevens, J., dissenting) ("There is little doubt that the Court's interpretation of the [Federal Arbitration Act (FAA)] has given it a scope far beyond the expectations of the Congress that enacted it.").

4. *See, e.g.*, Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987); Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477 (1989).

5. *See, e.g.*, Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).

6. *See, e.g.*, Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991). The issue in *Gilmer* was age discrimination, but the language used by the Court would apply equally to race and sex discrimination. Specifically, as Congress did not "evince[] an intention to preclude a waiver of judicial remedies for the statutory rights at issue," *id.* at 26, in either Title VII of the Civil Rights Act of 1964, 42 U.S.C. §2000e (2000), or the Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1071 (codified as amended in scattered sections of 42 U.S.C.), the same rule would be expected to apply to claims brought under these statutes.

7. *See, e.g.*, EEOC v. Waffle House, Inc., 534 U.S. 279 (2002).

8. For a discussion of general trends in the expansion of mandatory arbitration beyond the commercial realm, see Jean Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to that of the Rest of the World*, 56 U. MIAMI L. REV. 831 (2002).

9. On the expansion of mandatory arbitration into consumer contracts, see Katherine Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931 (1999).

10. *See, e.g.*, Russell D. Feingold, *Mandatory Arbitration: What Process is Due?*, 39 HARV. J. ON LEGIS. 281, 284 (2002); Lee Goldman, *Contractually Expanded Review of Arbitration Awards*, 8 HARV. NEGOT. L. REV. 171, 190 (2003).

11. *See, e.g.*, David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 76.

unless their terms are deemed unconscionable or otherwise faulty under general principles of contract law.[12]

The debate surrounding consumer arbitration has lacked a strong empirical foundation. For example, although it is generally believed that predispute arbitration clauses in consumer contracts have become ubiquitous during the last decade,[13] discussions of the extent to which consumers are exposed to arbitration clauses have been driven by headline cases, investigations of specific industries, and broader, unsystematic searches.[14] Also lacking is systematic information regarding the features of the arbitrations that are required by these clauses, and what consumers are told about these features. Without such information, it is impossible to determine whether arbitration is simply another forum in which parties can freely pursue their legal rights, as the Supreme Court has held,[15] or whether consumers' rights are being negatively and substantively affected without their true knowledge or consent.

The purpose of this Article is to help build the empirical foundation necessary for an informed debate regarding arbitration clauses in consumer contracts by providing preliminary insight into how businesses' use of these clauses affects consumers' ability to pursue their legal rights. To this end, the Article reports the results of a study investigating, in a wide variety of consumer purchases, the frequency with which the average consumer encounters arbitration clauses, the key provisions of these clauses, and the implications of these clauses for consumers who subsequently have disputes with the businesses they patronize.

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12. *See, e.g.*, Doctor's Assocs. v. Casarotto, 517 U.S. 681, 683 (1996) (stating that, pursuant to the Federal Arbitration Act, written provisions for arbitration are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract") (quoting 9 U.S.C. §2).

13. *See, e.g.*, Edward Brunet, *Arbitration and Constitutional Rights*, 71 N.C. L. REV. 81, 119 (1992); M.D. Donovan & D.A. Searles, *Preserving Judicial Recourse for Consumers: How to Combat Overreaching Arbitration Clauses*, 10 LOY. CONSUMER L. REV. 269, 269 (1998).

14. *See, e.g.*, Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. ON DISP. RESOL. 267 (1995); Stephanie Armour, *Consumers in Bind? Clauses Require Arbitration, Bar Lawsuits*, USA TODAY, Nov. 27, 1998, at 6B; Barry Meier, *In Fine Print, Customers Lose Ability to Sue*, N.Y. TIMES, Mar. 10, 1997, at A1; Michael G. Wagner, *Private Judges Arbitrate More Consumer Suits*, L.A. TIMES, Mar. 10, 1997, at 3.

15. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985) ("By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.").

## II

## METHODOLOGY

Data from the 1999 *Annual Demographic Survey* (March Current Population Survey (CPS) Supplement),[16] published by the Bureau of Labor Statistics and the Bureau of the Census, were used to create a statistical profile of the average U.S. consumer. We grouped the CPS data by age (18 to 34, 35 to 54, and over 55), gender, race (white, black, Asian/Pacific Islander, and Native American/Eskimo), and family income (below median, above median). The most populated cell, which accounted for approximately 11% of the U.S. population, was comprised of white males, aged 35 to 54, with above median incomes. We assigned these characteristics to our average U.S. consumer,[17] whom we affectionately termed "Joe," and placed him in Los Angeles, California.[18]

We selected the industries from which Joe made purchases on the basis of two criteria. First, we used the Bureau of Labor Statistics's *Consumer Expenditure Survey* to identify the categories of potential industries into which Joe's purchases would fall.[19] Within these categories, we selected for study industries from which Joe would make "important" purchases, which we defined as purchases that are expensive, ongoing, or have a potentially large impact on his life. Table 1 lists the categories and industries studied. In total, thirty-seven industries were included.

16. These data are available at http://www.bls.census.gov/cps/ads/1999/sdata.htm (last revised Sept. 30, 1999).

17. We identified the average U.S. consumer to have an objective basis for deciding which categories of purchases to consider and to maximize the generalizability of the study's results. An analysis of the data reveals that 83.2% of the purchases attributed to Joe were from businesses that cater to the average consumer, 11.2% were from businesses catering to those of high socioeconomic status (SES), and 5.6% were from businesses catering to individuals of low SES. While the sample sizes are small, the findings suggest that businesses catering to high SES individuals are the most likely to use arbitration clauses (50.0%), followed by those catering to the average consumer (35.1%) and, finally, those catering to low SES individuals (11.1%).

18. We placed Joe in a precise geographic location to identify his purchases. We chose Los Angeles for both substantive and practical reasons. First, Los Angeles is the second largest metropolitan area in the United States, consisting of a diverse conglomeration of businesses. Second, RAND is located there, which facilitated data collection. Whether these results would replicate in other geographic locations is a question for future study. Differences between the California legal environment and that of other states may cause businesses to behave differently. However, given that 81.4% of the businesses surveyed operate both outside and inside California, and that a smaller percentage of the California-only businesses used arbitration clauses (16.7%) than did the businesses that operate outside and inside the state (39.7%), the results may generalize fairly well to other states, to the extent that interstate businesses do not vary the use and content of arbitration clauses by state.

19. These categories consisted of food and alcohol, housing, apparel and services, transportation, health care, entertainment, personal-care products and services, and personal insurance. *See* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER EXPENDITURES IN 2000 (Apr. 2002), *available at* http://www.bls.gov/cex/csxann00.pdf.

TABLE 1:
INDUSTRIES SELECTED FOR STUDY

| Category | Industry |
|---|---|
| Housing and Home Services | Home Repair/Remodeling; Home Protection; Homeowners' Insurance; Apartment Rental; Renters' Insurance; Moving; Real Estate; Long Distance Telephone Service; Internet Service |
| Retail Services | Department Store; Online Retail |
| Transportation | Auto Purchase/Lease; Gas Card; Auto Insurance; Auto Repair/Maintenance |
| Health | Hospital; Health Care Provider; Health Insurance; Health Club |
| Food and Entertainment | Grocery Store; Restaurant; Theme Park; Cultural/Sports Event |
| Travel | Airline; Auto Rental; Hotel; Travel Agent; Tour Operator |
| Financial | Credit Card-General; Credit Card-Airline; Credit Card-Department Store; Banking; Investment; Accountant/Tax Consultant |
| Other | Attorney; Cell Phone; Life Insurance |

The goal of the study was to investigate the arbitration policies of the businesses Joe was most likely to patronize. Our three-tiered sampling strategy for identifying Joe's purchases within the selected industries was therefore purposive, rather than strictly random. When Scarborough Research data were available for a selected industry,[20] they served as the criterion for sampling businesses within that industry. Scarborough data were available for the following industries: auto purchase/lease, auto insurance, health insurance, airline, auto rental, hotel, department store, Internet service, long distance telephone service, cell phone, general credit card, airline-affiliated credit card,[21] department store–affiliated credit card, banking, grocery store, restaurant, and theme park. When Scarborough data were not available for a selected industry, but the industry was dominated by a few businesses, we gathered information from those dominant businesses.[22] The following industries fit this profile: life insur-

20. Scarborough Research is a company that collects data on consumer purchases in selected markets throughout the United States. The Scarborough data used in this study relate the frequency with which individuals in the Los Angeles area with Joe's demographic characteristics make purchases from businesses within particular industries.

21. Businesses in this industry are assumed to be the same as those in the airline industry.

22. Whether an industry was dominated by a few businesses was determined by a combination of

ance, homeowners' and renters' insurance, travel, tour, moving, home protection, auto repair/maintenance, gas card, health club, real estate, hospital, and investment. In the absence of both Scarborough data and industry domination by a small number of businesses, we randomly sampled businesses within the selected industries. Industries falling within this category include home repair/remodeling, apartment rental, health care, accounting/tax consulting, attorney/law, on-line retail, and cultural/sports events.

When Scarborough data were used, five businesses were sampled within each industry, with the exception of the long distance telephone service (three sampled)[23] and general credit card (two sampled)[24] industries. When industries were dominated by a small number of businesses, we sampled those dominant businesses up to a maximum of five, with the exceptions of home protection (one missing), investment (one missing), hospitals (two missing), travel agents (three missing),[25] and real estate agents (three missing).[26] Finally, when businesses were randomly sampled, five were sampled within each industry, with the exception of attorneys (three sampled). In all, we identified 167 businesses for study and obtained information on use of arbitration clauses from 161 of those.[27] The data were collected in 2001 and reflect contract language for that year.

The data reported in this Article were not easily collected. Many businesses were not willing to participate in the study, although they were informed that the data would be reported *en masse* without revealing businesses' names; others would not provide information even when the authors inquired in the role of potential consumers. For many clauses, the authors sought assistance from third parties who had retained their paperwork from recent purchases. For others, the authors purchased products or services. For example, one coauthor acquired four credit cards while conducting the study, as that was the only means by which to obtain the clauses used by these businesses. Even when businesses were legally bound to provide the information, it was not always as

industry data and physical presence in the Los Angeles area.

23. The fourth long distance company refused to participate, and information on its use of arbitration clauses was otherwise unavailable.

24. Excluding credit cards available through multiple sources, such as Visa and MasterCard, the general credit card sample was limited to two companies.

25. Although only two large travel agencies were surveyed, neither used an arbitration clause, and both reported that travel agents in the area do not use them. Accordingly, any arbitration clause applying to the consumer as a result of patronizing a travel agency would result from the tour operator's contract.

26. Only two very large brokers were surveyed; however, both used the same form arbitration agreement and reported that the form is used statewide within the industry.

27. In four contexts, single businesses were sampled multiple times: (1) airlines were sampled once for their use of arbitration clauses in airline tickets and again for airline-affiliated credit cards; (2) department stores were sampled once for their use of arbitration clauses for store purchases and again for store credit cards; (3) the businesses sampled for auto, life, homeowners', and renters' insurance overlap substantially; and (4) the businesses sampled for Internet, long distance telephone, and cellular telephone service overlap to a lesser extent. The total number of businesses sampled (161) reflects these businesses being counted as one business each time they were sampled. The total number of independent businesses sampled is 138.

readily available as one might expect. The following exchange between one coauthor and a long distance telephone service provider is illustrative:

> *Dear Customer Service Personnel,*
>
> *I hope you can help me with the following question, as both my fiancé and I have asked it of you more than once during the last few months and have received no answer. Specifically, we are wondering if an arbitration clause applies to our account. That is, is there a clause that specifies that any dispute between us and [Company] has to be resolved in arbitration rather than in court? Neither one of us is displeased with our [Company] service, except for the failure to answer this question. We've asked the question because I'm doing some research on dispute resolution.*
>
> *Thank you.*
>
> *Linda Demaine*
>
> ---
>
> *Dear Ms. Demaine,*
>
> *Thank you for contacting [Company] e-Customer Service. In regards to your . . . e-mail, [Company] does not participate in any arbitrary disputes.*
>
> *[Company] is committed to ensuring you make the most of your service. If you have any additional questions or concerns, please visit On-line Account Manager at [Company URL].*
>
> *Sincerely,*
>
> *Melissa _____*
>
> *e-Customer Service*
>
> ---
>
> *Dear Melissa,*
>
> *Thank you for your statement that [Company] does not participate in any arbitrary disputes. . . . My question did not address "arbitrary disputes," but, rather, "arbitration clauses." Again, I would like to know if an arbitration clause applies to my residential long distance account. Thank you.*
>
> *Linda Demaine*
>
> ---
>
> *Dear Ms. Demaine,*
>
> *Thank you for contacting [Company] e-Customer Service.*
>
> *In response to your e-mail, please reply with what the difference [sic] between an arbitrary dispute and an arbitration clause so we can better answer your question.*
>
> *[Company] is committed to ensuring you make the most of your service. If you have any additional questions or concerns, please visit On-line Account Manager at [Company URL].*
>
> *Sincerely,*
>
> *Michelle _____*
>
> *e-Customer Service*[28]

28. The coauthor involved in this exchange subsequently explained the difference between arbitrary disputes and arbitration clauses to the customer service representative and was informed that no arbitration clause applied to her account.

These data-collection challenges are also likely to be faced by consumers who attempt to learn about businesses' use of arbitration clauses.

## III

## RESULTS

Across the industries studied, fifty-seven of the 161 sampled businesses (35.4%) included arbitration clauses in their consumer contracts. (See Table 2.)[29] The prevalence of arbitration clauses is highest (69.2%) in the financial category (credit cards, banking, investment, and accounting/tax consulting), and lowest (0) in the food and entertainment category (grocery stores, restaurants, theme parks, and cultural/sports events). This pattern is not surprising, as the financial category is characterized by industries that rely heavily on written contracts, often for ongoing services, whereas the food and entertainment category is characterized by industries that engage in isolated transactions with no written contract between businesses and consumers. A similar pattern holds to some extent across industries. The auto insurance and health insurance industries, for example—both of which typically provide ongoing services under written contract—are more likely to require arbitration than are the auto repair/maintenance and health-care–provider industries. This pattern is not universal, however. For example, none of the home protection companies and only one health club surveyed required arbitration, although consumers usually contract in writing for these ongoing services.[30] Customary practice and industry regulations likely explain some of the patterns found.

29. The auto, homeowners', and renters' insurance contracts referred to "appraisal" rather than "arbitration." They are included in the results because, under California law, agreements to appraise are treated as agreements to arbitrate. *See* CAL. CIV. PROC. CODE § 1280(a) (2003) ("'Agreement' [as used in this title] includes but is not limited to agreements providing for valuations, appraisals and similar proceedings . . . .").

30. Overall, 55.1% of businesses that offer an ongoing product or service and use a written contract included an arbitration clause, whereas only 9.4% of businesses that provide a one-time product or service without a written contract did so.

TABLE 2:
PREVALENCE OF ARBITRATION CLAUSES, BY INDUSTRY

| Category | Number of Businesses Sampled | Number Using Arbitration Clause | Percentage Using Arbitration Clause |
|---|---|---|---|
| Housing and Home Services | 35 | 13 | 37.1 |
| Home Repair/Remodeling | 5 | 2 | |
| Home Protection | 3 | 0 | |
| Homeowners' Insurance | 4 | 4 | |
| Apartment Rental | 5 | 1 | |
| Renters' Insurance | 4 | 3 | |
| Moving | 4 | 0 | |
| Real Estate | 2 | 2 | |
| Long Distance Service | 3 | 0 | |
| Internet Service | 5 | 1 | |
| Retail Services | 10 | 3 | 30.0 |
| Department Store | 5 | 0 | |
| Online Retail | 5 | 3 | |
| Transportation | 20 | 10 | 50.0 |
| Auto Purchase/Lease | 5 | 1 | |
| Auto Repair/Maintenance | 5 | 0 | |
| Gas Card | 5 | 4 | |
| Auto Insurance | 5 | 5 | |
| Health Care | 17 | 6 | 35.3 |
| Hospital | 2 | 0 | |
| Health Care Provider | 5 | 0 | |
| Health Insurance | 5 | 5 | |
| Health Club | 5 | 1 | |
| Food & Entertainment | 20 | 0 | 0 |
| Grocery Store | 5 | 0 | |
| Restaurant | 5 | 0 | |
| Theme Park | 5 | 0 | |
| Cultural/Sports Event | 5 | 0 | |
| Travel | 22 | 3 | 13.6 |
| Airline | 5 | 0 | |
| Auto Rental | 5 | 0 | |
| Hotel | 5 | 0 | |
| Travel Agent | 2 | 0 | |
| Tour Operator | 5 | 3 | |

| | | | |
|---|---|---|---|
| Financial | 26 | 18 | 69.2 |
| Credit Card - General | 2 | 2 | |
| Credit Card - Airline | 5 | 4 | |
| Credit Card - Store | 5 | 3 | |
| Banking | 5 | 3 | |
| Investments | 4 | 4 | |
| Accountant/Tax Consultant | 5 | 2 | |
| Other | 11 | 4 | 36.4 |
| Attorney | 3 | 2 | |
| Cellular Telephone | 5 | 2 | |
| Life Insurance | 3 | 0 | |
| Total | 161 | 57 | 35.4 |

Of the fifty-seven businesses sampled that use arbitration clauses in their consumer contracts, we obtained clauses from fifty-two.[31] We analyzed the main features of each of these clauses, focusing on those features that are most likely to determine consumers' understanding of arbitration and its implications for the resolution of disputes with a business, and on those with the greatest potential to influence consumers' ability to pursue or defend a claim against a business.

## A. Scope of Arbitration Clause

In reviewing the scope of the arbitration clauses, we focused on four dimensions: (1) the subject matter of the disputes covered; (2) any provision for the consumer or the business to seek interim relief from a court prior to an arbitration decision; (3) any exemption of small claims actions from the arbitration requirement; and (4) any preclusion of class actions within required arbitrations.

### 1. Subject Matter of Dispute

Thirty-four of the fifty-two arbitration clauses (65.4%) apply to all disputes that arise under the contract. Fifteen of these (28.8%) explicitly reach beyond the contract in some manner, sometimes in multiple ways. Nine of the clauses apply to prior agreements between the business and the consumer, and an additional two apply to at least some preexisting disputes between the consumer and the business (regardless of whether there was a prior agreement between the consumer and business). Nine of the clauses apply to relationships that result from the agreement. One clause applies to related purchases. Four apply to any dispute between the business and the consumer, and one applies to "[a]ny subject matter whatsoever." In addition, many of the clauses do not constrain themselves to disputes between the consumer and the business, and thus

31. The missing clauses are as follows: health insurance (3), home repair/remodeling (1), and homeowners' insurance (1).

may be interpreted to apply to third parties who are not signatories to the agreement.

The remaining eighteen clauses (34.6%) apply only to certain classes of disputes. An Internet service provider and a cell phone company exempt disputes involving the consumer's failure to pay billed charges. An apartment lessor's clause applies only to personal injury and property damage claims (thus exempting unlawful detainer actions). The two real estate brokers exempt numerous actions, including foreclosure proceedings, unlawful detainer actions, and matters within the jurisdiction of a probate or bankruptcy court. Eleven insurance clauses cover only disputes regarding the amount the insured is entitled to recover, sometimes under a particular section of the policy. An accountant limits the clause's application to fee disputes in divorce cases. And an attorney states that the clause applies only to claims concerning the performance of services.

2. Provision for Interim Relief

Ten of the fifty-two clauses (19.2%) provide for some form of interim relief from a court, including injunction, sequestration, attachment, garnishment, repossession, replevin, appointment of a receiver, or any other provisional remedy relating to "any collateral security or property interests for contractual debts owed by either party to the other under the agreement." Eight of these clauses state that the provisional remedy may be exercised by either the consumer or the business, whereas two allow for only the business to do so.

3. Small Claims Exception

Sixteen of the fifty-two clauses (30.8%) exempt small claims from the arbitration requirement. Half of these clauses state that either party may pursue an action in small claims court; the other half state that the business will refrain from invoking the clause if the consumer pursues an action in small claims court.[32]

4. Class Action Preclusion

Sixteen of the fifty-two arbitration clauses (30.8%) explicitly prohibit class actions within the arbitration proceeding, and none of the remaining clauses explicitly provide for class actions.

The claims covered by the clauses are summarized in Table 3.

32. This exclusion may reflect a considered judgment by businesses that, however inexpensive or expeditious arbitration may be, it will nevertheless require more time and resources than resolving a dispute in small claims court. Whatever the actual transaction-cost differences may be, businesses do not face significant exposure in small claims courts. *See* Barbara Yngvesson & Patricia Hennessey, *Small Claims, Complex Disputes: A Review of the Small Claims Literature*, 9 LAW & SOC'Y REV. 219, 235-43, 247-54 (1975); *see also* Susan Raitt et al., *The Use of Mediation in Small Claims Courts*, 9 OHIO ST. J. ON DISP. RESOL. 55, 1 & n.11 (1993).

TABLE 3:
SCOPE OF ARBITRATION CLAUSE

| Claims Covered | Number | Percent |
|---|---|---|
| All claims arising under contract | 34 | 65.4 |
| Claims beyond immediate contract | 15 | 28.8 |
| Provision for interim relief | 10 | 19.2 |
| Small claims exemption | 16 | 30.8 |
| Class action preclusion | 16 | 30.8 |

B. Notice that Consumer is Waiving Right to Court

Twenty-nine of the fifty-two clauses (55.8%) state that consumers are waiving their right to resolve a dispute through the court system. (See Table 4.) Two additional clauses (3.8%) state only that consumers are giving up the right to a jury trial, and another (1.9%) simply states that consumers are giving up the right to proceed in any other forum. The remaining twenty clauses (38.5%) are silent on what rights consumers are waiving.[33]

TABLE 4:
NOTICE TO CONSUMER

| Waiving Right to . . . | Number | Percent |
|---|---|---|
| Court | 29 | 55.8 |
| Jury trial | 2 | 3.8 |
| Any other forum | 1 | 1.9 |
| No mention that consumer is waiving right | 20 | 38.5 |

C. Providers and Rules of Arbitration

The U.S. Supreme Court and state supreme courts have interpreted arbitration statutes to allow contracting parties to decide what rules should govern arbitration proceedings, subject only to the general proviso that arbitrators must be unbiased and uncorrupted.[34] Consequently, arbitration clauses may vary greatly in the amount of information they convey to consumers about what arbitration is or what consumers can expect if they participate in an arbitration. In the present study, we focused on the following fundamental points regarding

33. This silence is puzzling given the holding by the California Court of Appeals, in *Badie v. Bank of America*, 79 Cal. Rptr. 2d 273 (Ct. App. 1998), that "to be enforceable, a contractual waiver of the right to a jury trial 'must be clearly apparent in the contract[,] and its language must be unambiguous and unequivocal, leaving no room for doubt as to the intention of the parties.'" *Id.* at 289 (quoting Trizec Properties, Inc. v. Superior Court, 280 Cal. Rptr. 885 (Ct. App. 1991)).

34. *See* Volt Info. Sciences, Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 479 (1989); Ebasco Constrs. v. Ahtna, 932 P.2d 1312 (Alaska 1997); Moncharsch v. Heily & Blase, 832 P.2d 899 (Cal. 1992).

arbitration providers and rules of arbitration: (1) which organization will provide the arbitration; (2) the qualifications of the arbitrators; (3) the method for selecting the arbitrators; and (4) the rules of procedure governing the arbitration.

1. Providers and Rules Generally

Thirty-six of the fifty-two clauses (69.2%) designate the entity that will conduct the arbitration. (See Table 5.)[35] Twenty-nine of these clauses designate a single entity as the arbitration provider: nineteen specify the American Arbitration Association (AAA), five specify the National Arbitration Forum (NAF), two specify JAMS, two investment companies designate the National Association of Securities Dealers (NASD), and one health insurer names a local law firm. Seven additional clauses provide for a choice by the party initiating the arbitration among two or more possible providers: six allow the party to choose between two or more of the aforementioned providers, and one investment company offers the NASD or the New York Stock Exchange (NYSE), unless the consumer prefers the Municipal Securities Rulemaking Board.

Fourteen of the clauses that specify an arbitration provider also specify the rules that will govern the arbitration proceeding, such as the AAA Commercial Arbitration Rules or the AAA Wireless Industry Association Rules. In other cases in which a provider organization is specified, the organization's consumer or other applicable rules presumably would govern.[36] Seven of these clauses address the implications of a conflict between the clause and the arbitration provider's rules. Each of these clauses states that, in the event of a conflict between the two, the arbitration clause will govern.

Sixteen clauses (30.8%) are silent on both who will conduct the arbitration and what rules will apply.

35. A few companies specified that a particular provider's rules would be used but did not explicitly designate a provider. These companies are treated as having specified the provider whose rules they designated.

36. The health insurance clause that designates a particular law office as arbiter states that the governing rules of procedure are developed by the law office, in conjunction with the business and an advisory committee.

TABLE 5:
SPECIFICATION OF ARBITRATION PROVIDER

| Arbitration Provider | Number | Percent |
|---|---|---|
| Specified | 36 | 69.2 |
| AAA | 19 | 36.5 |
| NAF | 5 | 9.6 |
| JAMS | 2 | 3.8 |
| NASD | 2 | 3.8 |
| Choice of two or more of above | 6 | 11.5 |
| NASD or NYSE | 1 | 1.9 |
| Other | 1 | 1.9 |
| Not specified | 16 | 30.8 |

2. Qualifications and Selection of Arbitrator

Eight of the fifty-two clauses (15.4%) specify the arbitrators' qualifications. These clauses require that the arbitrators be retired judges or practicing lawyers, often with a stated minimum number of years of experience in law generally or in the area of law governing the dispute. Fourteen of the fifty-two clauses (26.9%) explain how the arbitrators will be selected. All but one provide that the consumer and the business each will select an arbitrator and that these two arbitrators will select a third, with almost half of these providing that a judge of a court that would have had jurisdiction over the dispute in the absence of the arbitration clause will choose the third arbitrator if the selected two are unable to agree on a third. The remaining clause provides for a single arbitrator to be selected by mutual agreement of the parties or, if this is not possible, by the selection rules of the stated arbitration provider.

3. Procedural Rules

Seventeen of the clauses (32.7%) discuss discovery, and eleven (21.2%) discuss evidentiary standards. In most instances, these clauses alert consumers that discovery may be limited and evidentiary standards may be relaxed by comparison to litigation. Twelve of the clauses that address discovery convey that discovery may or will be limited. Three state that no discovery will be allowed. The remaining two specify that local discovery rules will apply. Three of the clauses that address evidentiary issues state explicitly that neither federal nor state procedural or evidentiary rules will apply, and another two state that evidentiary standards in arbitration may be less rigorous than in court. Three provide that either the Federal Rules of Evidence or state and local rules of evidence will apply. The remaining three convey partial evidentiary guidelines for the arbitration—for example, by stating that the arbitrator may compel the attendance of witnesses and the production of documents at the hearing.

Thirteen of the clauses (25.0%) address whether arbitrators must issue written opinions. Three of these clauses specify that arbitrators will provide the

reasons for their decisions in writing, whereas four state that arbitrators will not do so. Another five clauses state that arbitrators will provide a written opinion at the request of either party, and one states that arbitrators will do so at the request of the parties.

Seven of the fifty-two clauses (13.5%) provide that at least some aspect of the arbitration will be confidential. Three clauses preclude the parties from disclosing the existence, content, or result of the arbitration without the consent of all parties. Two preclude discussions with outside parties—one regarding the arbitration proceedings and the other regarding the arbitration award. Another two merely refer to "confidential arbitration."

None of the clauses restrict parties' rights to representation at any stage of the arbitration process.

The arbitrator and procedural rules are summarized in Table 6.

TABLE 6:
ARBITRATOR AND PROCEDURAL RULES

| Rules Regarding . . . | Number of Clauses That Describe This Feature | Percent |
|---|---|---|
| Arbitrator qualifications | 8 | 15.4 |
| Arbitrator selection | 14 | 26.9 |
| Discovery | 17 | 32.7 |
| Evidence | 11 | 21.2 |
| Written decision | 13 | 25.0 |
| Confidentiality | 7 | 13.5 |

## D. Access to Arbitration

Mandatory arbitration effectively closes the doors to the courthouse. But because litigation is so expensive, many plaintiffs who are not formally barred from the courthouse find it virtually impossible to get through its doors.[37] Hence, for claims involving modest amounts of money, arbitration may have no greater tendency than court litigation to preclude access to justice. Arbitration may, however, impose its own barriers and costs on consumers. We therefore reviewed the collected clauses for indications of the degree to which consumers would find it *logistically feasible* and *affordable* to arbitrate their disputes.

37. There is extensive commentary on the barriers to court access imposed by delay and expense. *See, e.g.*, MARK H. GITENSTEIN & ROBERT LITAN, BROOKINGS INST., JUSTICE FOR ALL: REDUCING COSTS AND DELAY IN CIVIL LITIGATION (1989).

1. Initiation of Arbitration

All fifty-two clauses allow either the consumer or the business to initiate arbitration proceedings.

2. Location of Hearings

Twenty-six of the clauses (50.0%) specify where the arbitration hearings would be held. In all but three cases, that location was near the consumer's residence or where the consumer receives service. Two of the exceptions were on-line businesses: one states that California Joe would have to go to Seattle, Washington, to arbitrate his case; the other would send him to Baltimore, Maryland. The other exception was a tour operator that requires that the arbitration take place in San Diego, California.

3. Fees and Other Expenses

Thirty of the fifty-two clauses (57.7%) specify, to some extent, how the expenses of arbitration would be divided between the parties. These clauses offer a plethora of allocation rules. The most common overarching rule (found in thirteen of the thirty clauses that mention expenses) is that the parties will divide the expenses of arbitration equally.[38] Two additional clauses state that the losing party will be responsible for all expenses of the prevailing party, and another states the same but makes responsibility conditional on the arbitrators' deeming that such an award would not cause a substantial injustice. One clause mentions only that the non-fee portions of the arbitration expenses will be borne equally between the parties. The thirteen remaining clauses that address expenses refer to arbitration fees only. Three of these provide that the party initiating the arbitration will pay the filing fee, and one provides that the party initiating the arbitration will pay all arbitration fees. Two state that the arbitrator will decide who is responsible for the arbitration fees. Four clauses provide for the possibility of some reimbursement of fees by the business to the consumer after the arbitration. One states that the prevailing party may recover the arbitration fees from the losing party, and another implies this by limiting the consumer's liability to the amount of fees that would have been paid in court. The remaining clause limits the consumer's liability for arbitration fees to $25 for claims of less than $1,000.

Twelve clauses (23.1%) make some provision for aiding consumers who request assistance in paying filing, administrative, and hearing fees. Seven of these clauses state that the business will advance, or consider advancing, all or some portion of the fees, to be reimbursed after the arbitration. Two clauses state that the business will pay all or a portion of the fees and arbitrator expenses in cases of extreme financial hardship (presumably with the business deciding what constitutes "extreme financial hardship"). Three clauses state that the business will pay at least some portion of the consumer's expenses.

38. One of these allows arbitrator discretion, stating that the costs of arbitration will be split equally between the parties unless the arbitrator allocates them differently.

One of these provides for the business to pay up to $250 toward the filing, administrative, and hearing fees once the consumer has paid the first $50 of the filing fee. Another states that the business will pay all provider fees, up to $2,500, for claims asserted by the consumer, after the consumer has paid an amount equivalent to the filing fee for such claims in the court in the consumer's judicial district. Beyond $2,500, the business will consider paying additional provider fees, and if it does not approve the consumer's request, and the consumer prevails, the business will reimburse the consumer for the additional fees. The final clause states that the business will pay the portion of the filing fee that exceeds $50 and any administrative and hearing fees on any claim submitted by the consumer—up to a maximum of $1,500—and will consider paying any additional provider fees.

The expense provisions are summarized in Table 7.

TABLE 7:
ARBITRATION EXPENSES MENTIONED IN CLAUSE

| | Number of Clauses | Percentage |
|---|---|---|
| Mention of expenses | 30 | 57.7 |
| All expenses | 16 | 30.8 |
| Divided equally, with arbitrator discretion | 13 | 25.0 |
| Loser pays | 3 | 5.8 |
| Partial expenses | 14 | 26.9 |
| Non-fee expenses divided equally | 1 | 1.9 |
| Initiator pays filing fee | 3 | 5.8 |
| Initiator pays all arbitration fees | 1 | 1.9 |
| Arbitrator decides fee allocation | 2 | 3.8 |
| Provision for some consumer reimbursement of fees | 4 | 7.7 |
| Loser pays some or all fees | 2 | 3.8 |
| Cap consumer's portion of fees | 1 | 1.9 |
| Provide for indigency | 12 | 23.1 |
| No mention of expenses | 22 | 42.3 |

E. Remedies

1. Limitations on Damages

Four of the fifty-two clauses (7.7%) explicitly limit consumers' substantive rights by placing limits on damages. A health provider's contract states that if the damages claimed by the consumer are less than $200,000, the arbitrator will have no jurisdiction to award more than that. A clause in a tour operator's contract provides that under no circumstances will the business be liable to any trip participant for more than $500. An auto insurer's contract states that no non-

economic or punitive damages will be awarded. And another auto insurer's contract states that arbitrators may not award damages in excess of the coverage limits.

2. Availability of Review

Twenty-one of the clauses (40.4%) explicitly state that arbitrators' decisions may not be challenged in court.[39] Another nineteen clauses (36.5%) merely refer to arbitration awards as "final" or "binding," or to the arbitration itself as "binding." The remaining twelve clauses (23.1%) omit any reference to the finality of the arbitration.

Generally, no opportunity for review or appeal is provided for within the arbitration process. However, five of the credit card clauses provide that, in the event of an award greater than $100,000, either party may appeal to a panel of three arbitrators, who will hear the dispute de novo.

## IV

## CONCLUSION

Critics of arbitration pursuant to predispute contracts between consumers and businesses have questioned whether arbitration provides the same substantive remedies and procedural protections as would be accorded by a court.[40] The consumer arbitration clauses we reviewed offer mixed evidence with regard to these concerns.

Few of the fifty-two clauses reflect the type of egregious self-dealing that has been identified in publicized cases. Most of the clauses appear in many respects to put consumers on equal terms with the businesses that drafted them, a key feature if businesses are to defend successfully against claims of unconscionability. Arbitration is available at either party's request and is held (almost always) at a location convenient to the consumer and the business. Either party may be represented by counsel. Either party may pursue specified means of provisional relief. When small claims and other types of actions are exempted from arbitration, they are exempted (almost always) for both the consumer and the business. Discovery is limited for both parties, and the rules of evidence are relaxed for both parties. Expenses often are split equally between consumers and businesses. The vast majority of clauses place no limits on substantive remedies. And the arbitrator's decision is equally binding on both parties. These terms suggest *prima facie* that businesses are placing consumers on equal footing with themselves in resolving any future disputes.

A closer look at the clauses sampled, however, suggests that there are grounds for concern. For example, if consumers challenge business practices, limitations on discovery will disadvantage them more than the businesses, as the

39. Four of these refer to possible exceptions under the Federal Arbitration Act and state law, without explaining what those exceptions might be.

40. *See, e.g.*, Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 638 (1996).

businesses will hold most of the relevant information. If filing, administrative, and hearing fees add significantly to transaction costs, this burden will fall disproportionately on the (ordinarily less financially able) consumer, even when such fees are split equally. Class actions, which are almost exclusively used by consumers against businesses, are often precluded.[41] The nature of the interim relief provided for is more suited to the business than the consumer. And the types of claims exempted from arbitration tend to be those brought by businesses against consumers. In sum, the appearance of a level playing field between the parties may be deceptive.

Moreover, this study provides little basis for believing that consumers are making informed decisions when they "agree" to arbitrate in predispute arbitration clauses. More than a third of the clauses obtained fail to inform consumers that they are waiving their right to litigate disputes in court. A fifth of the clauses do not explicitly state that the outcome of arbitration is final and binding. More than a third do not provide consumers with any information regarding the expenses they should expect to incur in an arbitration proceeding. Many clauses are silent on key aspects of arbitration, such as arbitrator qualifications and selection or the rules of discovery and evidence. And almost a third of clauses fail to state what organization will provide the arbitration. Moreover, to be fully informed of the features of the arbitration to which they are "agreeing," consumers would need to review the applicable provider rules, a daunting task (made impossible when the arbitration provider is not named in the clause).

The Supreme Court has stated that arbitration "is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit."[42] This view is not supported by the results of the present study. Given the lack of information available to consumers in predispute arbitration clauses, and the difficulty of obtaining and deciphering these clauses, it is likely that most consumers only become aware of what rights they retain and what

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41. The concern with class action preclusion is illustrated in *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867 (Ct. App. 2002). According to the California Court of Appeals,

> Although styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which [a class action preclusion] provision might negatively impact [the business], because credit card companies typically do not sue their customers in class action lawsuits. This provision is clearly meant to prevent customers, such as Szetela and those he seeks to represent, from seeking redress for relatively small amounts of money, such as the $29 sought by Szetela. Fully aware that few customers will go to the time and trouble of suing in small claims court, Discover has instead sought to create for itself virtual immunity from class or representative actions despite their potential merit, while suffering no similar detriment to its own rights.

*Id.* This excerpt also conveys the more general concern that terms that appear facially neutral, avoiding claims of unconscionability, may, in reality, gravely disadvantage the consumer.

Class action preclusion also occurs in provider rules. The NAF, for example, has marketed its services to businesses as a means of eliminating class actions and improving businesses' bottom lines. *See* Caroline E. Mayer, *Hidden in Fine Print: 'You Can't Sue Us"; Arbitration Clauses Block Consumers from Taking Companies to Court*, WASH. POST, May 22, 1999, at A1.

42. Volt Info. Sciences, Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989).

rights they have waived after disputes arise.[43] Moreover, given the frequency with which these clauses are used in some industries, consumers are often in a poor position to negotiate terms or seek services or products from other businesses. The prevalence of arbitration rules that subtly or more strongly tilt the playing field in the business's favor provides grounds for concern about how consumers actually fare in arbitration. In summary, the evidence to date suggests that there is little reason to believe consumer arbitration is—in the conjecture of the Court—only another forum.[44]

43. One potential explanation for the lack of arbitration clauses by medical providers in the study is that California law requires arbitration clauses concerning medical malpractice to be more elaborate, explicit, and salient than arbitration clauses generally. *See*, e.g., Rosenfield v. Superior Court, 191 Cal. Rptr. 611 (Ct. App. 1983) (discussing CAL. CIV. PROC. CODE § 1295(a)-(b)).

44. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985).