

6.4: Arbitration

Learning Objectives

- Explore the option of arbitration as an alternative dispute resolution (ADR) strategy.
- Explore contemporary issues of fairness in arbitration.
- Determine when arbitration is a viable option for dispute resolution.
- Examine the benefits and drawbacks of arbitration as a form of ADR.

Arbitration is a method of ADR in which parties vest authority in a third-party neutral decision-maker who will hear their case and issue a decision, which is called an arbitration award.

An arbitrator presides over arbitration proceedings. Arbitrators are neutral decision-makers who are often experts in the law and subject matter at issue in the dispute. Their decisions do not form binding precedent. Arbitrators may be members of the judiciary, but in arbitrations they are not judges. Arbitrators act in an analogous capacity to judges in trials. For instance, they determine which evidence can be introduced, hear the parties' cases, and issue decisions. They may be certified by the state in which they arbitrate, and they may arbitrate only certain types of claims. For instance, the Better Business Bureau trains its own arbitrators to hear common complaints between businesses and consumers (B2C).

Participation in the arbitration proceeding is sometimes mandatory. Mandatory arbitration results when disputes arise out of a legally binding contract involving commerce in which the parties agreed to submit to mandatory arbitration. Arbitration is also mandatory when state law requires parties to enter into mandatory arbitration.

Although perhaps not obvious, federal law lies at the heart of mandatory arbitration clauses in contracts. Specifically, Congress enacted the Federal Arbitration Act (FAA) 9 U.S.C. §1 et seq. through its Commerce Clause powers. This act requires parties to engage in arbitration when those parties have entered into legally binding contracts with a mandatory arbitration clause, providing the subject of those contracts involves commerce. 9 U.S.C. §2. In *Southland Park v. Keating*, the U.S. Supreme Court interpreted this federal statute to apply to matters of both federal and state court jurisdiction. Indeed, the Court held that the FAA created a national policy in favor of arbitration. It also held that the FAA preempts state power to create a judicial forum for disputes arising under contracts with mandatory arbitration clauses. *Southland Corp. v. Keating*, 465 U.S. 1 (1984). In a later decision, the Court held that the FAA encompasses transactions within the broadest permissible exercise of congressional power under the Commerce Clause. *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003). This means that the FAA requires mandatory arbitration clauses to be enforceable for virtually any transaction involving interstate commerce, very broadly construed.

Some states require mandatory arbitration for certain types of disputes. For instance, in Oregon, the state courts require mandatory arbitration for civil suits where the prayer for damages is less than \$50,000, excluding attorney fees and costs. ORS 36.405. Many parties accept the arbitration award without appeal. However, when state law requires mandatory arbitration of certain types of disputes, parties are permitted to appeal because the arbitration is nonbinding. In nonbinding arbitration, the parties may choose to resolve their dispute through litigation if the arbitration award is rejected by a party. However, some states have statutory requirements that, in practice, create a chilling effect on appealing an arbitration award. For example, in the state of Washington, if the appealing party from a nonbinding mandatory arbitration does not do better at trial than the original award issued by the arbitrator, then that party will incur liability not only for its own expenses but also for those of the opposing side. Washington State Court Rules of Procedure, Superior Court Mandatory Arbitration Rules 7.3. In nonbinding arbitration, this is a powerful incentive for parties to accept the arbitration award without appealing to the judicial system.

Voluntary arbitration also exists, and it is frequently used in business disputes. Sometimes parties simply agree that they do not want to litigate a dispute because they believe that the benefits of arbitration outweigh the costs of litigation, so they choose voluntary arbitration in hopes of a speedy and relatively inexpensive outcome. Other times, parties are not certain how strong their case is. In such cases, arbitration can seem much more attractive than litigation.

Arbitration awards can be binding or nonbinding. Some states, like Washington State, have codified the rule that arbitration decisions are binding when parties voluntarily submit to the arbitration procedure. Uniform Arbitration Act, RCW 7.04. In binding arbitration, the arbitration award is final; therefore, appealing an arbitration award to the judicial system is not available. In many states, an arbitration award is converted to a judgment by the court, thereby creating the legal mechanism through which the judgment holder can pursue collection activities. This process, called confirmation, is contemplated by the FAA and often included

in arbitration agreements. But even if the FAA does not apply, most states have enacted versions of either the Uniform Arbitration Act or the Revised Uniform Arbitration Act. These state laws allow confirmation of arbitration awards into judgments as well.

Like any other form of dispute resolution, arbitration has certain benefits and drawbacks. Arbitration is an adversarial process like a trial, and it will produce a “winner” and a “loser.” Arbitration is more formal than negotiation and mediation and, in many ways, it resembles a trial. Parties present their cases to the arbitrator by introducing evidence. After both sides have presented their cases, the arbitrator issues an arbitration award.

Rules related to arbitration differ by state. The rules of procedure that apply to litigation in a trial do not typically apply to arbitration. Specifically, the rules are often less formal or less restrictive on the presentation of evidence and the arbitration procedure. Arbitrators decide which evidence to allow, and they are not required to follow precedents or to provide their reasoning in the final award. In short, arbitrations adhere to rules, but those rules are not the same as rules of procedure for litigation. Regardless of which rules are followed, arbitrations proceed under a set of external rules known to all parties involved in any given arbitration.

Arbitration can be more expensive than negotiation or mediation, but it is often less expensive than litigation. In *Circuit City Stores Inc. v. Adams*, the U.S. Supreme Court noted that avoiding the cost of litigation was a real benefit of arbitration. *Circuit City Stores, Inc., v. Adams*, 532 U.S. 105 (2001). The costly discovery phase of a trial is nonexistent or sharply reduced in arbitration. However, arbitration is not necessarily inexpensive. Parties must bear the costs of the arbitrator, and they typically retain counsel to represent them. Additionally, in mandatory arbitration clause cases, the arbitration may be required to take place in a distant city from one of the disputants. This means that the party will have to pay travel costs and associated expenses during the arbitration proceeding. The *Circuit City* Court also noted that mandatory arbitration clauses avoid difficult choice-of-law problems that litigants often face, particularly in employment law cases.

Arbitration is faster than litigation, but it is not as private as negotiation or mediation. Unlike mediators, arbitrators are often subject-matter experts in the legal area of dispute. However, as is true for mediators, much depends on the arbitrator’s skill and judgment.

A common issue that arises is whether mandatory arbitration is fair in certain circumstances. It’s easy to imagine that arbitration is fair when both parties are equally situated. For example, business to business (B2B) arbitrations are often perceived as fair, especially if businesses are roughly the same size or have roughly equal bargaining power. This is because they will be able to devote approximately the same amount of resources to a dispute resolution, and they both understand the subject under dispute, whatever the commercial issue may be. Moreover, in B2B disputes, the subjects of disputes are commercial issues, which may not implicate deeper social and ethical questions. For example, contract disputes between businesses might involve whether goods are conforming goods or nonconforming goods under the Uniform Commercial Code (UCC). No powerful social or ethical questions arise in such disputes. Indeed, resolving such disputes might be seen as “business as usual” to many commercial enterprises.

However, issues of fairness often arise in business to employee (B2E) and business to consumer (B2C) situations, particularly where parties with unequal bargaining power have entered into a contract that contains a mandatory arbitration clause. In such cases, the weaker party has no real negotiating power to modify or to delete the mandatory arbitration clause, so that party is required to agree to such a clause if it wants to engage in certain types of transactions. For example, almost all credit card contracts contain mandatory arbitration clauses. This means that if a consumer wishes to have a credit card account, he will agree to waive his constitutional rights to a trial by signing the credit card contract. As we know, the FAA will require parties to adhere to the mandatory arbitration agreed to in such a contract, in the event that a dispute arises under that contract. In such cases, questions regarding whether consent was actually given may legitimately be raised. However, the U.S. Supreme Court has held that in B2E contexts, unequal bargaining power alone is not a sufficient reason to hold that arbitration agreements are unenforceable, *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991). and it is not sufficient to preclude arbitration. *Lozano v. AT & T Wireless*, 504 F.3d 718 (9th Cir. 2007).

Additionally, concerns about fairness do not end at contract formation. If a dispute arises and mandatory arbitration is commenced, the unequal power between parties will continue to be an important issue. In the case between a credit card company and an average consumer debtor, the credit card company would clearly be in a more powerful position vis-à-vis the debtor by virtue of the company’s financial strength and all that comes with it, such as experienced attorneys on staff, dispute-resolution experience, and contractual terms that favor it, rather than the consumer debtor. In such cases, if the consumer debtor is the aggrieved party, he may very well decide to drop the matter, especially if the arbitration clause requires arbitration proceedings to occur in a distant city. The credit card company will have vast financial resources as compared to the consumer debtor. Moreover, in this example, the credit card company’s legal counsel will know how to navigate the arbitration process and will have experience in dispute

resolution, processes that often confound people who are not trained in law. Additionally, the list of arbitrators may include people who are dependent on repeat business from the credit card company for their own livelihoods, thereby creating—or at least suggesting—an inherent conflict of interest. Many mandatory arbitration clauses create binding awards on one party while reserving the right to bring a claim in court to the other party. That is, a mandatory arbitration clause may allow the credit card company to appeal an arbitrator's award but to render an award binding on the consumer debtor. Obviously, this would allow the credit card company to appeal an unfavorable ruling, while requiring the consumer debtor to abide by an arbitrator's unfavorable ruling. To a consumer debtor, the arbitration experience can seem like a game played on the credit card company's home court—daunting, feckless, and intimidating.

Additionally, some types of disputes that have been subjected to mandatory arbitration raise serious questions about the appropriateness of ADR, due to the nature of the underlying dispute. For example, in some recent B2E disputes, claims relating to sexual assault have been subjected to mandatory arbitration when the employee signed an employment contract with a mandatory arbitration clause. Tracy Barker, for example, was reportedly sexually assaulted by a State Department employee in Iraq while she was employed as a civilian contractor by KBR Inc., a former Halliburton subsidiary. When she tried to bring her claim in court, the judge dismissed the claim, citing the mandatory arbitration clause in her employment contract. After arbitration, she won a three-million-dollar arbitration award. As KBR Inc. noted, this “decision validates what KBR has maintained all along; that the arbitration process is truly neutral and works in the best interest of the parties involved.” Despite this statement, KBR Inc. has filed a motion to modify the award. Juan A. Lozano, “Woman Awarded \$3M in Assault Claim against KBR,” *AP News*, November 19, 2009, www.thefreelibrary.com/Woman+awarded+%243M+in+assault+claim+against+KBR-a01612064743 (accessed September 24, 2010).

In a similar case, employee Jamie Leigh Jones worked for KBR Inc. in Iraq when she was drugged and gang raped. She was initially prohibited from suing KBR Inc. in court because her employment contract contained a mandatory arbitration clause. However, when considering this case, the Fifth Circuit Court of Appeals ruled that sexual assault cases may, in fact, be brought in court rather than being subjected to mandatory arbitration, despite the contract language requiring mandatory arbitration. *Jones v. Halliburton Co.*, 583 F.3d 228 (5th Cir. 2009). Jones's claims were beyond the scope of the arbitration clause, because sexual assault is not within the scope of employment. Moreover, under Senator Al Franken's lead, the Senate took action to prohibit the Department of Defense from contracting with defense contractors that require mandatory arbitration for sexual assault claims. If such action is passed, it would essentially allow the Fifth Circuit's holding to apply in all federal jurisdictions rather than just in the Fifth Circuit. Check out “Video Clip: Al Franken” to hear the details of Senator Franken's work on this matter. One might think that passing such a law would be a “no brainer” to lawmakers. However, some Senators voted against the measure, arguing that the federal government should not insert itself into rewriting contracts. Instead, some argued that the use of arbitration and mediation should be expanded for such cases.

Video Clip: Al Franken

Watch Senator Al Franken discuss the facts of the Jamie Leigh Jones case here:

([click to see video](#))

In B2C cases, different issues of fairness exist. As noted previously, when the disputants possess unequal power, these issues can be magnified. Public Citizen, a nonprofit organization that represents consumer interests in Congress, released a report concerning arbitration in B2C disputes. Specifically, the report argued that arbitration is unfair to consumers in B2C disputes and that consumers fare better in litigation than in arbitration. According to the report, incentives exist to favor businesses over consumers in the arbitration process. It pointed to the lack of appeal rights, lack of requirement to follow precedents or established law, limits on consumers' remedies, prohibitions against class-action suits, limitations on access to jury trials, limitations on abilities to collect evidence, and greater expense as additional factors speaking to the unfairness of arbitration over litigation in B2C disputes. Check out “Hyperlink: Arbitration” for the full report.

Hyperlink: Arbitration

[www.citizen.org/documents/ArbitrationDebateTrap\(Final\).pdf](http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf)

Check out this Public Citizen report, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration*, which argues arbitration is bad for consumers in B2C disputes.

Importantly, and despite the FAA's broad interpretation, not all binding arbitration clauses have been upheld by courts in B2C cases. In 2007, the Ninth Circuit Court of Appeals ruled that AT&T's binding arbitration clause for wireless customers is unenforceable under California state law. *Lozano v. AT & T Wireless*, 504 F.3d 718 (9th Cir. 2007). The court further noted that the relevant state law is not preempted by the FAA, because the FAA does not prevent the courts from applying state law. In this case, that law involved unconscionability of contract terms. As noted previously, the FAA requires parties to submit to mandatory arbitration when they agree to do so in a legally binding contract, and it preempts state powers to provide a judicial forum in those matters. However, the Ninth Circuit's holding in this case underscores the fact that state contract law is not circumvented by the federal statute.

Arbitration is a widely used form of ADR, but important questions have been raised about its appropriateness in certain types of disputes. Before signing a mandatory arbitration agreement, it's important to realize that under current law, your opportunity to bring your claim in court will be severely restricted or entirely precluded. Moreover, if you sign such an agreement with a party who holds inherently greater power than you, such as your employer, then you may find yourself at an extreme disadvantage in an arbitration proceeding.

Key Takeaways

Arbitration is a form of ADR in which parties vest authority to decide a dispute with a third-party arbitrator, who hears the evidence and issues an arbitration award. Arbitration may be binding or nonbinding, and it may be mandatory or voluntary. Arbitration awards issued by arbitrators can be confirmed to judgments by judges. Issues of fairness arise in arbitration when disputants possess unequal power, such as arbitration in employment or consumer disputes. Questions concerning the appropriateness of mandatory arbitration arise in cases involving issues of civil rights violations. The Federal Arbitration Act requires enforcement of mandatory arbitration clauses in contract disputes involving commerce where mandatory arbitration clauses exist. The Arbitration Fairness Act of 2009 would resolve several issues of unfairness, but this act has not yet been passed into law.

? Exercise 6.4.1

1. Check out Jon Stewart's perspective on Senator Franken's proposed measure to prevent the Department of Defense from contracting with defense contractors that require mandatory arbitration for disputes arising from sexual assaults at <http://www.thedailyshow.com/watch/wed-october-14-2009/rape-nuts>. Does the comedian accurately portray this issue? What role does popular culture have in shaping our opinions and conceptions of our legal system?
2. In the *Barker v. Halliburton Inc.* case, does the three-million-dollar arbitration award in favor of the sexual assault victim prove that arbitration works, even in violations of civil rights disputes? Why or why not?
3. Choose one argument in *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration* in "Hyperlink: Arbitration" and develop a counterargument to support the contention that arbitration is good in B2C disputes. Compare your argument with the argument in the report. Which side is the most persuasive? After completing this exercise, do you believe that arbitration is good or bad for consumers in B2C disputes? Why?
4. Bank of America announced that it would no longer require mandatory arbitration in disputes arising between it and consumer credit card account holders. Review the story here: <http://www.reuters.com/article/idUSTRE57D03E20090814>. What are the benefits and drawbacks to Bank of America's credit card account customers with respect to this change?
5. In what contexts have you entered into an arbitration agreement (e.g., home purchase, credit card agreement, cell phone agreement)? Write a short essay discussing the implications of entering into that agreement.

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