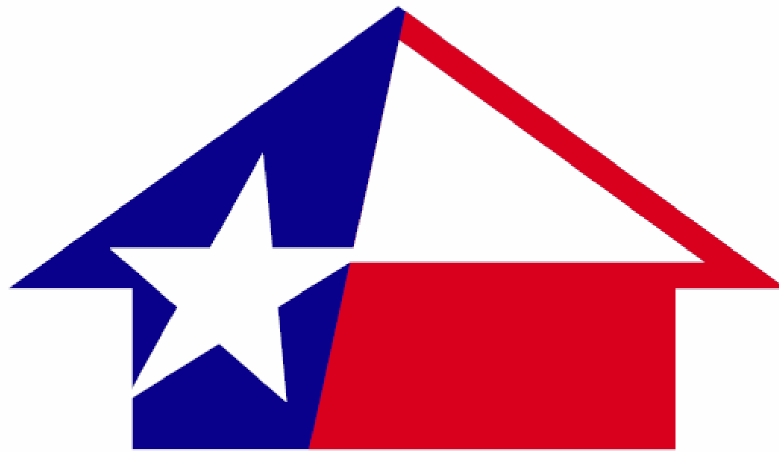

Texas Residential Construction Commission

Quality Construction for Texans

Report to the Texas Residential Construction Commission and the 79th Texas Legislature

January 2005

311 E. 14th Street, Suite 200
Austin, Texas 78701
(512) 463-1040
1-877-651-8722
www.trcc.state.tx.us

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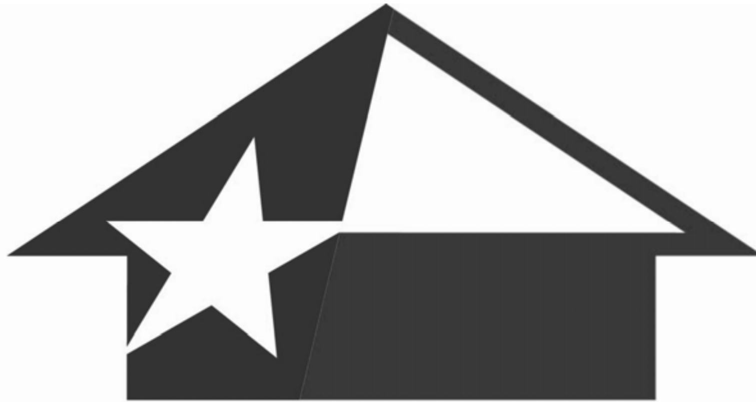
EXECUTIVE SUMMARY



Arbitration Task Force
January 2005

EXECUTIVE SUMMARY

THE TASK FORCE

The Arbitration Task Force (task force) of the Texas Residential Construction Commission (commission) was formed in April 2004. Its membership includes homeowners and homebuilders, attorneys with practices representing homeowners and homebuilders, and representatives of the Texas Association of Builders, the American Arbitration Association, The Better Business Bureau and Texas Watch. A list of members of the task force members is included in Appendix A.

STATUTORY AUTHORITY

Texas Property Code §436.004: RESIDENTIAL CONSTRUCTION ARBITRATION TASK FORCE:

(a) The commission shall appoint a task force to study residential arbitrators and arbitration and advise the commission with respect to residential arbitrators and arbitration.

(b) The task force established under this section shall report to the 79th and 80th Legislatures on the task force's recommendations and the effect of the implementation of those recommendations and of the provisions relating to arbitrators and arbitration in this subtitle.

TASK FORCE CHARGE

- Identify different types of arbitration agreement characteristics including but not limited to:
    - Percentage of arbitration agreements or clauses which are binding;
    - Percentage of arbitration agreements or clauses which include personal injury claims;
    - Percentage of agreements or clauses in which the builder assumes fees and/or related costs; and
    - Percentage of agreements or clauses which identity the arbitrator or arbitration service provider.
- Determine the percentage of home building contracts mandating arbitration before HB 730;
- Determine the percentage of home building contracts mandating arbitration after HB 730;
- Determine the instances where agreements or clauses have been declared invalid;
- Determine the instances where parties have agreed to remove agreements or clauses from the contract;
- Determine the length of time, from filing to conclusion, to conduct an arbitration proceeding;

- Determine the cost of arbitration to the builder;
- Determine the cost of arbitration to the consumer (please note whether the builder is assuming consumers' costs and if so, how much is being assumed);
- Determine the percentage of arbitration agreements/rulings being complied with;
- Determine the percentage of arbitration agreements/rulings not being complied with;
- Ascertain the percentage of rulings favoring home builder vs. consumer;
- Estimate the number of satisfied customers by type (builder vs. consumer);
- Identify issues and/or issue categories which are being arbitrated;
- Study characteristic backgrounds and qualifications of arbitrators;
- Obtain feedback from consumers to ascertain their satisfaction level with arbitration; and
- Make recommendations addressing, but not limited to, oversight or legislative changes necessary to insure that the arbitration process, particularly with regard to residential construction consumers, is fair and balanced.

RECOMMENDATIONS

- The Legislature enact a provision providing that the statute of limitations calculation exclude the time from filing the request to the final outcome of a mandatory arbitration.

- The commission develop educational materials regarding residential construction arbitration to be made available to the public.

- The Legislature amend Chapter 27 of the Property Code, to include a mandatory disclosure statement in residential construction contracts regarding the effect of a binding arbitration agreement when such an agreement is included in the contract. In an effort to avoid possible issues of federal preemption it is recommended that a provision be enacted with the stipulation that failure to provide the disclosure would not void the arbitration clause. To ensure compliance the statute should include provisions that will subject the builder promulgating the contract to monetary penalties.

- The Legislature require, in each residential construction contract that contains an arbitration clause, a disclosure stating that arbitration may be more or less expensive than a court proceeding.

- The Legislature allow for information to be provided to the commission regarding arbitration awards by arbitration service providers maintaining suitable safeguards to keep confidential the identities of the parties. At a minimum, the information filed should include the identity of the arbitration service provider, the arbitration service provider's fees, the arbitrator's decision including the amount of any monetary award, month and year of arbitration and the amount in controversy.

- The Legislature authorize the commission to conduct a statistically valid statewide survey to capture the data requested in the charge.

OVERVIEW

Any review of arbitration activities must include a discussion of federal arbitration law and the impact on the state's ability to act in this area; therefore it was necessary for the task force to review the Federal Arbitration Act[1] (FAA). Additionally, the task force reviewed Chapter 171 of the Texas Civil Practices and Remedies Code, commonly referred to as the "Texas General Arbitration Act" (TGA), the interim report to the 78th Legislature by the House Committee on Business & Industry's Subcommittee on Binding Arbitration in Consumer Contracts (Appendix B) and the Consumer Pitfalls of Binding Arbitration published by the Texas Watch Foundation (Appendix C).

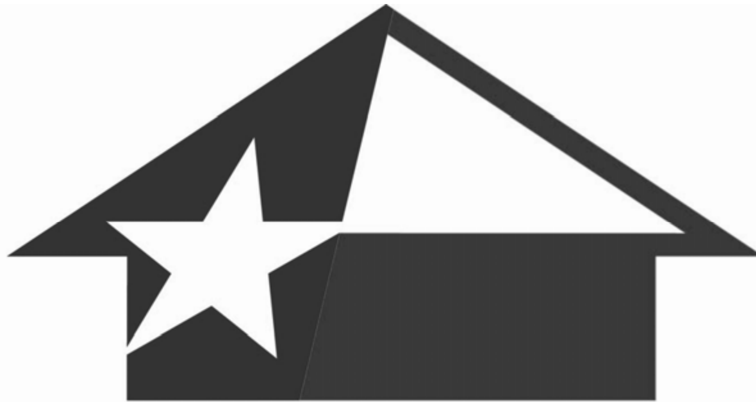
Additionally, to the degree possible, the task force made several attempts to gather data about arbitration volumes and outcomes, therefore:

- The task force first sought information from public filings; however, this information is generally unavailable. As a result, it limited the data collected by the task force sought to address the majority of the statistics requested in the task force charge.
- The task force then sought to obtain information by utilizing survey instruments. The lack of survey responses limited the usefulness of the collected data in providing a reliable foundation for making evaluations and recommendations to the Legislature. Two public surveys were created by the task force and published on the commission's Web site and advertised through press releases: one for homeowners and one for builders (respectively, Appendices D and E). Each survey sought information on actual arbitration experience, related to residential construction.
- In addition, the task force held nine town hall meetings throughout Texas to solicit public comment from homeowners and home builders on their personal experiences with arbitration. (A list of the dates and cities of the town hall meetings is included in Appendix F). The response at the town hall meetings was not significant and did not allow the task force to draw substantive conclusions. However, the town hall meetings did provide some insight into the public's perception of arbitration.

  This report provides specific recommendations to the commission and the Legislature as a result of the data collected. Additionally, several of the recommendations include provisions for collecting additional information. Collecting additional information would allow the task force to gather and provide a more substantive analysis of the assigned charge for the next report to the Legislature.

[1] 9 U.S.C.A. §§ 1-15.

REPORT BACKGROUND



Arbitration Task Force
January 2005

TEXAS STATUTORY DEFINITION

Texas Civil Practice and Remedies Code §154.027:

(a) Nonbinding arbitration is a forum in which each party and counsel for the party present the position of the party before an impartial third party who renders a specific award.

(b) If the parties stipulate in advance, the award is binding and is enforceable in the same manner as any contract obligation. If the parties do not stipulate in advance that the award is binding, the award is not binding and serves only as a basis for the parties' further settlement negotiations.

WHAT IS ARBITRATION?

Arbitration is a type of alternative dispute resolution (ADR) procedure where two parties present their views of a dispute to a neutral third party (arbitrator) who will weigh the evidence presented and render an award.

Generally, the parties to a contract containing a binding arbitration clause waive their rights to bring suit in a court of law in favor of placing a dispute arising from the contract before an arbitrator that makes final and binding decisions on the issues presented. Many arbitration agreements do not allow for an appeal on the merits of an arbitrator's decision to a civil court. This is referred to as "binding arbitration." Therefore the binding arbitration proceeding replaces the civil courts as a means to resolve disputes.

However, arbitration is not necessarily totally independent from the civil court system. While arbitration and the civil court system provide different means to resolve the dispute, the enforceability of the finding can be the same. Parties to arbitration can bring the arbitrator's award into the civil court system to get the full benefit of the laws relating to the collection of judgments.[1] The prevailing party then has the full benefit of all of the judgment collection laws, rather than being limited to contractual remedies.

ARBITRATION DISTINGUISHED FROM CIVIL TRIALS AND MEDIATION

Although less formal and more flexible than a civil trial, arbitration is not mediation. In mediation, a third-party facilitates discussion about the strengths and weaknesses of each party's case and assists, not directs, the parties in coming to a mutually agreeable settlement. In arbitration, the role of the third-party is judicial in nature. That is, the arbitrator's objective is not for the arbitrator to help the parties reach agreement, but instead to weigh the evidence and issue a ruling deciding the contested issues. Under binding arbitration, the determination is final, barring exceptional circumstances such as fraud or misconduct by the arbitrator.

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[1] Tex. Civ. Prac. & Rem. Code Ann. §171.092 (Version 2002)

KEY CHARACTERISTICS OF ARBITRATION

The nature of arbitration as a contractual agreement between two or more parties provides flexibility in the arbitration proceeding. Typically, a single arbitrator is used in smaller disputes. In larger disputes, parties may agree to have a panel of arbitrators work together rather than a single decision maker. Additionally, the parties often are afforded the right to strike undesired arbitrators from their panel. In some cases each party selects an arbitrator to participate on the panel and the two arbitrators select the third and final panel member. Generally, arbitration proceedings are not recorded unless the parties agree. Furthermore, depending upon the agreement, arbitrators associated with an arbitration service organization use guidelines adopted by that organization, in the conduct of the proceedings. Although time frames vary with each case, generally it is believed that arbitration proceedings and hearings are shorter in length than civil trials because of expedited procedures and, in some cases, limited discovery.

THE FEDERAL ARBITRATION ACT (FAA)

In 1925, Congress passed the Federal Arbitration Act, 9 U.S.C.A. §§1 -15 (FAA), which generally provides claims subject to an arbitration agreement must be decided by arbitration without any judicial intervention. Under the FAA, a party does not waive any substantive rights by agreeing to arbitration, but merely submits its claim for binding resolution in an arbitral, rather than a judicial forum.[2]

Where there is conflict, federal law overrides state statutes as applied to residential construction contracts. Federal policy favors the ability of parties to choose arbitration as an alternative dispute resolution mechanism and prohibits states from treating arbitration clauses any differently than other general contractual provisions.

Due to the Supremacy Clause of the United States Constitution, the FAA preempts state laws that prohibit the formation of agreements to arbitrate,[3] as well as state laws that prohibit the enforcement of these agreements. Once a dispute is covered by the FAA, federal law applies to all questions of interpretation, construction, validity, revocability and enforceability.[4]

In *Allied-Bruce Terminix Companies v. Dobson,* 115 S.Ct. 834 (1995), the U.S. Supreme Court held that the words “involving commerce” were meant to be interpreted as broadly as the words “affecting commerce,” signaling an intent to exercise Congress’s Commerce Clause power to the fullest degree possible. The court said that the FAA gives states a method for protecting consumers against unfair pressure to agree to a contract with an unwanted contract provision. “What states may not do is decide that a contract is fair enough to enforce all its basic forms but not fair enough to enforce its arbitration

[2] *Gilmore v Interstate Johnson Lane Corp*., 111 S.Ct.1647, 1652 (1991).

[3] See *Volt Information Sciences Inc. v. Board of Trustees of Leland Stanford, Jr. Univ.*, 109 S.Ct. 1248, 1255 (1989); *Jack B. Anglin Co. v. Tipps*, 842 S.W. 2d 266, 271 (Tex. 1992).

[4] *Mitsubishi Motors Co. v. Soler Chrysler-Plymouth, Inc.*, 105 S.Ct. 3346, 3353 (1985); *Neal v. Hardy’s Food Systems, Inc.*, 918 F. 2d 34, 37 f. 5 (5th Cir. 1990); *Shearson Lehman Hutton, Inc. v. McKay,* 763 S.W. 2d 934, 937 (Tex. App. -- San Antonio 1989, orig. proceeding).

clause."[5] In *Allied-Bruce,* the Court upheld a boilerplate arbitration provision in a termite inspection contract and ruled that the FAA preempted an Alabama statute that invalidated pre-dispute arbitration provisions. Both federal and state courts have ruled that residential construction contracts involve interstate commerce.

ARBITRATION IN TEXAS

EARLY STATUTES

Texas has recognized the concept of private arbitration since the Texas Constitution of 1845. However, before 1965, Texas courts followed common law concepts of arbitration that had remained substantially unchanged since the passage of Texas's first arbitration statute in 1846. Under common law, parties could voluntarily submit a dispute to arbitration, and if they did so, the award would be considered binding. However, a party could revoke an agreement to submit a future dispute to arbitration at anytime before the arbitrator issued an award, and the courts, which were generally hostile towards arbitration agreements, would not specifically enforce an agreement to arbitrate an existing or future dispute. Thus, a party could deprive the arbitration agreement of any effect by simply refusing to participate in the process.

TEXAS GENERAL ARBITRATION STATUTE

Chapter 171 of the Texas Civil Practices and Remedies Code, commonly referred to as the "Texas General Arbitration Act" (TGA), became effective January 1, 1966, and provides that a written agreement is valid and enforceable if the dispute:

(1) exists at the time of the agreement; or

(2) arises between the parties after the date of the agreement.

The provisions of the statute do not apply to:

(1) a collective bargaining agreement between an employer and a labor union;

(2) an agreement for acquisition by one or more individuals or party, services, money or credit in which the total consideration to be furnished an individual is not more than $50,000, unless the agreement is signed by all parties and their attorneys;

(3) a claim for personal injury unless each party to the agreement, on the advice of counsel, agrees in writing to arbitrate and the agreement is signed by each party and each party's attorney; or

(4) a workers' compensation claim.

THE STATE'S AUTHORITY IN ARBITRATION

The TGA specifically provides that an arbitrator's award does not have to adhere to Texas statutes such that the arbitrator may make an award that a judge could not make in a civil court.[6] An arbitration agreement is between or among parties and is enforceable

[5] *Allied-Bruce,* 115 S.Ct. at 843.

[6] Tex. Civ. Prac. & Rem. Code Ann §171.090 (Version 2002) (an award may include relief not otherwise available through a civil court of law).

under state law. To void an arbitration agreement, a party must claim fraud, duress or unconscionability in the inducement of the contract.[7]

To succeed with a claim of fraud, the party must demonstrate a false representation was made and, as a result, the party has suffered damages. The fraud must be specific with respect to the arbitration agreement. If the party is unable to prove all the elements of fraud, then there is insufficient evidence to void the arbitration agreement on that basis.

To succeed with a claim of duress, the duress must be either physical or economic. Economic duress is alleged in suits challenging the validity of arbitration agreements more frequently than physical duress. In a home builder versus homebuyer situation, the party alleging economic duress is generally a home buyer or homeowner who is considered to be in a weaker bargaining position than the opposing party. To succeed on an economic duress theory, the party must show they were placed in an economic position from which they could not reasonably refuse to enter into the contract.

To claim unconscionability, all the elements of fraud must be proven along with proof of grossly inequitable results. Any of these three theories of fraud, duress or unconscionability are difficult to prove, so the presumption generally favors enforcement of arbitration agreements.

APPOINTMENT OF ARBITRATORS

The TGA statute provides that the method of appointment of arbitrators will be specified in the arbitration agreement and if the agreement does not specify a method of appointment, or if the appointed arbitrator fails or is unable to act and a successor has not been appointed, the court, on application of a party, shall appoint one or more qualified arbitrators. Unless otherwise provided by the agreement, all members of an arbitration panel conduct the hearing and a majority may determine a question of fact and render a final award.

ENFORCEABILITY OF ARBITRATION AGREEMENTS

Arbitration agreements are contracts. Therefore, the validity of arbitration agreements are analyzed under contract law principles, with emphasis on the parties' freedom to contract. Usually a good faith attempt at drafting an arbitration clause in the context of residential construction that binds both parties and allows for the selection of a neutral arbitrator will be held enforceable.

Bilateral contracts require mutuality of obligation to be enforceable. One Texas appellate court has held that an "opt-out" provision, enabling only one of the parties to opt-out of the arbitration process renders an arbitration agreement invalid because of the lack of mutuality of obligation. Currently, arbitration clauses that give sole discretion to one party to compel arbitration or clauses agreed to by both parties that allow one party to

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[7] See *In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002); *Anzilotti v. Gene D. Liggin, Inc.*, 899 S.W.2d 264, 266 (Tex. App. – Houston [14th Dist.] 1995, no writ).

retain the sole ability to opt-out of the arbitration are unenforceable.[8] The Texas Supreme Court has not addressed this issue.

In addition to being governed by general principles of contract law, arbitration agreements are subject to state and federal laws. For example, the Texas Property Code §438.001 provides that "a court shall vacate an award in a residential construction arbitration upon a showing of manifest disregard for Texas law." Although Texas has this and other laws directly addressing arbitrations, federal law will preempt these statutes when a conflict exists, including in the area of residential construction contracts.

Under federal law, an arbitration agreement is binding if:

a) it is based "on a transaction involving commerce"[9]
b) it is not a "contract of employment of seaman, railroad employees, or any other class of workers engaged in foreign or interstate commerce,"[10] and
c) the parties have agreed in writing to the arbitration provisions.

IMPACT ON STATE AUTHORITY

Principles of federal preemption and the applicability of the FAA limit Texas' ability to enact laws affecting arbitration agreements. Neither states nor state courts may take actions that conflict with the FAA provisions if those actions effectively prohibit or limit parties' freedoms to enter into arbitration agreements. Specifically, states may not prohibit the use of arbitration agreements in residential construction contracts or exclude the use of arbitration for resolving certain claims arising from those contracts. Federal authority has been exercised to the degree that the Unites States Supreme Court has invalidated a state statute that required a notice of arbitration provision be placed on the first page of a contract.[11]

THE COMMISSION'S ROLE IN ARBITRATION

The Texas Residential Construction Commission has four responsibilities regarding arbitration of residential construction issues:

1. Certify residential construction arbitrators;
2. Publish a list of certified arbitrators;
3. Accept arbitration award filings; and
4. Form and support an Arbitration Task Force.

The commission does not have the authority to conduct arbitration proceedings, dictate the contents of an arbitration clause, mandate its inclusion or exclusion in a residential construction contract, compel participation or release a party from participation in an

[8] *In re Palm Harbor Homes, Inc.* 129 S.W.3d 636 (Tex. App.--Houston [1st Dist.] 2003, orig. proceeding), *app. for writ of mandamus filed May 24, 2004.*
[9] 9 U.S.C.A. §2.
[10] 9 U.S.C.A. §1
[11] In *Doctor's Associates v. Casarotto,* 116 S.Ct. 1652 (1996), the Supreme Court held that a state law may not limit the validity of an arbitration agreement in a manner different from any contract.

arbitration proceeding, compel award compliance or review the findings of an arbitrator or arbitration panel.

EXAMPLES OF ARBITRATION CLAUSES

The task force sought examples of arbitration clauses. These examples are listed in Appendix G and include a variety of arbitration agreement characteristics, although they are not inclusive of all clauses currently in use. The examples were voluntarily provided by builders across the state including both large "production" builders and smaller "custom" builders.

Example 1 – Requires mediation and arbitration with a single arbitrator; however, it does not establish the rules for arbitration.
Example 2 – Establishes the cost of arbitration and mediation administered by the American Arbitration Association (AAA) under the AAA's consumer rules. Additionally, it provides information on appeals and who pays appeal costs.
Example 3 – Establishes arbitration for specific types of claims other than a homeowners limited warranty claim.
Example 4 – Modified version of Example 1 designed to include maximum disclosure.
Example 5 – A post contract agreement to resolve a dispute using arbitration.

- **Recommendation 1:** THE LEGISLATURE ENACT A PROVISION PROVIDING THE STATUTE OF LIMITATIONS CALCULATION EXCLUDE THE TIME FROM FILING THE REQUEST TO FINAL OUTCOME OF A MANDATORY ARBITRATION

The task force recommends enacting legislation to state with certainty that, when a residential construction or residential remodeling contract contains a mandatory arbitration clause, the filing of an arbitration demand by either party to the contract will toll the applicable statutes of limitations. The proposed legislation places the filing of an arbitration demand on the same footing as filing a lawsuit. As a result, parties to a dispute subject to mandatory arbitration will not have to first file a lawsuit to prevent expiration of statutes of limitations. The effect of the recommendation is to reduce the overall cost of utilizing arbitration. Currently, parties to contracts that contain arbitration clauses must incur court filing and litigation costs in addition to arbitration filing costs in order to prevent statutes of limitations from expiring during the course of the arbitration. Additionally, parties involved in binding arbitration would not unwittingly lose the ability to pursue legal actions as a result of a technical limitation.

RECOMMENDATION 2: THE COMMISSION DEVELOP EDUCATIONAL MATERIALS REGARDING RESIDENTIAL CONSTRUCTION ARBITRATION TO BE MADE AVAILABLE TO THE PUBLIC.

Although testimony during the task force's town hall meetings were limited, a consistent message was clear: the home buying public has little understanding of the arbitration process or the impact of arbitration on the right to litigate when an arbitration clause is part of the construction contract. Educational materials - written in plain language - (preferably in English and Spanish) will assist the buyers' understanding of contracts that contain arbitration clauses, and help Texans make informed decisions.

The materials should assist the consumer in understanding arbitration as a method of dispute resolution outside of a court of law and the affect of the inclusion of such clauses in both residential construction contracts and home warranties.

The task force recommends the home buyer advisory materials at a minimum address the following:

- the right to select a lawyer to represent one's interests in an arbitration;
- the opportunity for homeowners and home builders to negotiate arbitration clauses in or out of the contract or to modify the terms of the clause**;**
- the manner that arbitration proceedings are initiated;
- the manner arbitrators are appointed or selected;
- the opportunity to have the dispute heard by a neutral decision-maker;
- the fact that the dispute will not be heard by a jury of their peers;
- the finality surrounding arbitration decisions and the difficulty of appeal;
- general information on the applicability of the Texas General Arbitration Act and the Federal Arbitration Act;
- the opportunity for the parties to agree beforehand on the specific rules under which the dispute will be heard. For example, limiting the number of witnesses each will present or set boundaries on the amount and type of evidence that will be presented; and
- the costs associated with arbitration.

Because the arbitration process varies from case to case, the task force recommends that the commission consult with stakeholder organizations to help develop appropriate general educational information including:

- The American Arbitration Association;
- Better Business Bureau;
- Texas Association of Builders;
- The State Bar of Texas;
- Homeowners groups (e.g., Homeowners and consumer advocacy groups and Homeowners Associations); and
- The Texas Association of Realtors.

RECOMMENDATION 3: THE LEGISLATURE AMEND CHAPTER 27 OF THE PROPERTY CODE, TO INCLUDE A MANDATORY DISCLOSURE STATEMENT IN RESIDENTIAL CONTRACTS REGARDING THE EFFECT OF A BINDING ARBITRATION AGREEMENT WHEN SUCH AN AGREEMENT IS INCLUDED IN THE CONSTRUCTION CONTRACT. IN AN EFFORT TO AVOID FEDERAL PREEMPTION IT IS RECOMMENDED THAT A PROVISION BE ENACTED WITH THE STIPULATION THAT THE FAILURE TO PROVIDE THE DISCLOSURE DOES NOT VOID THE ARBITRATION CLAUSE. TO ENSURE COMPLIANCE THE STATUE SHOULD INCLUDE PROVISIONS THAT WILL SUBJECT THE BUILDER PROMULGATING THE CONTRACT TO MONETARY PENALTIES.

One of the most important consumer issues identified by the task force with regard to arbitration is that consumers are generally unaware of the existence and effect of binding arbitration clauses in residential construction and remodeling contracts. The task force examined several options to make arbitration clauses more conspicuous and more comprehensible to the average consumer. After research and deliberation, the task force rejected several of these proposals because of concerns that the proposed legislation would be struck down on federal preemption grounds.

The above recommendation reflects the task force's position that an arbitration disclosure statement could survive a preemption challenge if the failure to post the disclosure would not void the arbitration clause. Nevertheless, in order for the recommendation to be an effective consumer protection tool, the task force recognized that the failure to post the disclosure would have to carry some form of statutory penalty. Using the disclosure statement in the Residential Construction Liability Act (RCLA) as a guideline, the task force proposes that the failure to post the disclosure in the place and manner required would result in a monetary penalty per violation to the party promulgating the contract.

RECOMMENDATION 4: THE LEGISLATURE REQUIRE, IN EACH RESIDENTIAL CONSTRUCTION CONTRACT THAT CONTAINS AN ARBITRATION CLAUSE, A DISCLOSURE STATING THAT ARBITRATION MAY BE EITHER MORE OR LESS EXPENSIVE THAN A COURT PROCEEDING.

An issue of consistent concern among homeowners is the cost of arbitration and litigation. As in litigation, there are considerable variations in the costs of arbitration, and there is a perception that arbitration exceeds the cost of going to court. Since many consumers have no personal experience in either pursuing a court case or arbitration, they have little or no information concerning relative costs. The task force's recommendation to provide a mandatory disclosure that arbitration can be more or less expensive than a trial may assist consumers in making an informed decision when signing an agreement with binding arbitration.

Arbitration costs vary from civil litigation costs for a variety of reasons. Although arbitration requires payment of arbitration fees and the civil court system does not include added costs on the judicion, there are added costs, discovery, and motion practice in protracted civil litigation proceedings that may increase costs.

The task force examined the various issues concerning cost. Some alternative dispute resolution organizations have developed consumer rules and fee schedules to lower the cost of smaller claims and to shift more of the cost to the business participant. Some builders agree to subsidize a portion of the costs. As a result, arbitration may be more expensive than litigation, but in other instances it may be less expensive.

Due to the limited ability to identify specific costs of arbitration, the task force suggests including a notice concerning cost as the best alternative. Such a notice regarding relative costs could be included in the arbitration notice recommended for inclusion in the RCLA.

RECOMMENDATION 5: THE LEGISLATURE ALLOW FOR INFORMATION TO BE PROVIDED TO THE COMMISSION REGARDING ARBITRATION AWARDS BY THE ARBITRATION SERVICE PROVIDERS[12], MAINTAINING SUITABLE SAFEGUARDS TO KEEP CONFIDENTIAL THE IDENTITIES OF THE PARTIES. AT A MINIMUM: THE INFORMATION FILED SHOULD INCLUDE THE IDENTITY OF ARBITRATION SERVICE PROVIDER; THE ARBITRATION SERVICE PROVIDER'S FEES; THE ARBITRATOR'S DECISION INCLUDING THE AMOUNT OF ANY MONETARY AWARD; MONTH AND YEAR OF ARBITRATION; AND THE AMOUNT IN CONTROVERSY.

The lack of information or a data bank with information on the costs and results of arbitration has proved to be an obstacle to providing a reliable response to many of the task force charges. In addition, the lack of data available to participants in the arbitration process is also problematic. If such information were available, participants could evaluate results and better estimate the settlement value of claims. The dearth of information makes it difficult to test the prevailing perceptions (or myths) concerning the process.

One great concern about creating a public database of information on arbitration awards is confidentiality. Because arbitrations are the result of private contracts, the parties often agree to terms of confidentiality. Although redaction of party information would alleviate the confidentiality concern, there is recognition that the application of the Public Information Act to award information filed with the commission may require legislative action to protect party information. Another potential obstacle to creating a public database is that a court may find the mandatory filing of arbitration awards conflicts in some way with the Federal Arbitration Act.

In an effort to obtain more information regarding arbitration costs and results, the task force held town hall meetings around the state in September and October 2004, to attempt to glean the unreported information. The meetings garnered very little public participation and even less direct information of first hand experience in arbitration. As a result of the continuing problems with obtaining a good data bank of information about arbitration, the task force reconsidered the prospects for mandatory reporting.

Currently Prop. Code §437.001 mandates reporting of arbitration awards that are filed in a court of competent jurisdiction in Texas. Filing of awards with a court is not routinely done at the conclusion of the arbitration process, as filing is not required by either the state or federal statute governing arbitration, so numerous awards are not made a part of any public record. If an award is filed, it is done so to collect a judgment. Under Texas Property Code §437.001, award summaries filed with the commission following the court filing include the identities of parties, attorneys and arbitrators. The task force recommendation is tailored to reconcile confidentiality concerns with the collection of information by eliminating several of the categories of information required under the Texas Property Code §437.001. Implementation of the recommendation could result in a wealth of information that is now very difficult to obtain.

[12] A service provider is either the agency or organization providing the service or, if rendered outside of the umbrella of an agency or organization, the individual retained as the arbitrator.

RECOMMENDATION 6: THE LEGISLATURE AUTHORIZE THE COMMISSION TO CONDUCT A STATISICALLY VALID STATEWIDE SURVEY TO THE CAPTURE THE DATA REQUESTED IN THE CHARGE.

The task force sought information from both homeowners and builders through survey instruments distributed to the public in town hall meetings and via the commission's website. The survey was conducted in an effort to respond to the task force charges addressing length of time to arbitrate, the cost of arbitration, the number of contracts containing an arbitration clause, a change in the number of contracts (if any) containing an arbitration clause post HB 730, the willingness of the involved parties to negotiate the terms of an arbitration clause, the costs and allocation of costs to the home builder and homeowner, the percentage of awards favoring the homeowner versus the builder, compliance with findings, the characteristics, background and the qualifications of the involved arbitrators. The response to the survey has been limited at best.

A survey professionally designed and conducted will provide statistically reliable data and substantive information necessary to assess whether there is the need for oversight and/or legislated mandates. It would also assist in ensuring that the arbitration process, as it relates to residential construction consumers, is fair and balanced.

A review of anecdotal data provided some general information about arbitration, although the diversity of responses makes it difficult to draw substantive conclusions.

LENGTH OF TIME TO ARBITRATE

Due to the limited individual circumstances of each arbitration, an assessment of the duration of a "standard" arbitration is inexacting. The American Arbitration Association (AAA) reports the hearing of a case can take from 4 hours to several days with a national average of its residential and commercial cases taking about four months from filing to conclusion. The Better Business Bureau (BBB) in Texas reports the consumer case hearing can take 3 hours to 2 days with an average of 60 days from filing to conclusion.

COST TO ARBITRATE

The costs reported by the AAA and BBB vary depending on the set of arbitration rules applied during the hearing. In general, the AAA reported arbitrations conducted under AAA consumer rules were less expensive than arbitrations conducted under AAA construction rules, but most residential construction cases are handled under construction rules. BBB arbitration fees vary among its local offices. As a rule, there is no fee charged for arbitrations involving BBB member businesses. In addition to organizations providing arbitration services, attorneys representing both homeowners and home builders report there is a growing contingent of individuals providing arbitration services. It has been difficult to obtain fee information from individuals not affiliated with an arbitration service provider. Generally, fees are assessed on an hourly or daily rate, the type of case being heard, or, as in the case of the BBB and other organizations that may provide arbitration as a member service, the fees are waived or discounted when the dispute involves the organization's member.

In addition to filing fees provided to the arbitrator or arbitration firm, the disputing parties may choose to incur additional expenses during the preparation of the case. These expenses may include discovery fees, evidence preparation costs, expert witness fees, travel expenses and attorney fees. Similar expenses are often incurred when using the court system to resolve the dispute.

Ascertain the Prevailing Party (Homeowner or Home Builder) and the Satisfaction Level of the Involved Parties

Arbitrated findings, outside those that may be filed with the commission pursuant to the provisions in the Prop. Code §437.001, are not filed in the public arena. Accordingly, historical data is not available from which the percentage breakdown of prevailing party can be ascertained. In addition, factual data would not provide information regarding the satisfaction level of the participants.

For comparative purposes, the AAA orally reported provided its nationwide consumer arbitration statistics to the task force. However, these statistics do not distinguish residential construction cases from the cumulative number of cases conducted. Nationwide, AAA reported that arbitrations end with the consumer winning an award in 55 percent of the hearings versus the 59.5 percent of civil hearings that result in an award to the consumer.

Most disputes are resolved prior to reaching trial or arbitration. Accordingly, any data collected on the percentage of disputes reflecting that one party or another prevails will not reflect the fact that the disputes had advanced to arbitration or litigation.

The Percentage of Home Builder Contracts Containing an Arbitration Clause

Attempts to assess the percentages of contracts including arbitration clauses or agreements are, at best, a poor estimate due to the anecdotal quality of the data. However, the Texas Association of Builders (TAB) estimates that 80% of the new home construction in Texas is built by 20% of its builder members and that the contracts of its member builders almost all contain arbitration clauses.

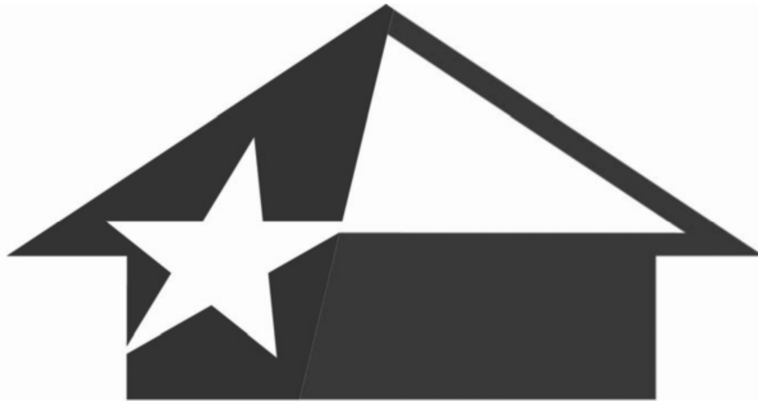
Characteristic Backgrounds and Qualifications of Arbitrators

The AAA reports the majority of its construction arbitrators are experienced in the construction industry, both residential and commercial. The BBB reports that many of its experienced, well-trained arbitrators do not have any less experience in construction than most courtroom judges. However, the requirements to serve as an arbitrator for either of these organizations are set by the organization itself. There are no mandated qualifications for arbitrators, other than qualifications adopted by the Texas Residential Construction Commission for those who voluntary apply for commission certification as an arbitrator.

The commission requires an applicant to:

- demonstrate a minimum of five (5) years of experience conducting arbitrations between homeowners and builders involving construction defects;
- attest that the applicant is familiar with the statutory warranties and building and performance standards established by the commission;
- attest that the applicant has not had any professional license or certification suspended or revoked in any jurisdiction;
- disclose whether the individual is currently a member of a professional association of arbitrators or licensed as a member of a bar association; and
- disclose any person known by the applicant to be registered as a builder or registered as a third-party inspector by the commission with whom the applicant has a direct or indirect personal, financial or business relationship that could reasonably be considered to create a conflict of interest for that applicant in serving as an arbitrator in a dispute involving the person listed as a party or a witness.

APPENDIX A: TASK FORCE ROSTER



Arbitration Task Force
January 2005

Texas Residential Construction Commission
ARBITRATION TASK FORCE

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American Arbitration Assoc.
Dallas

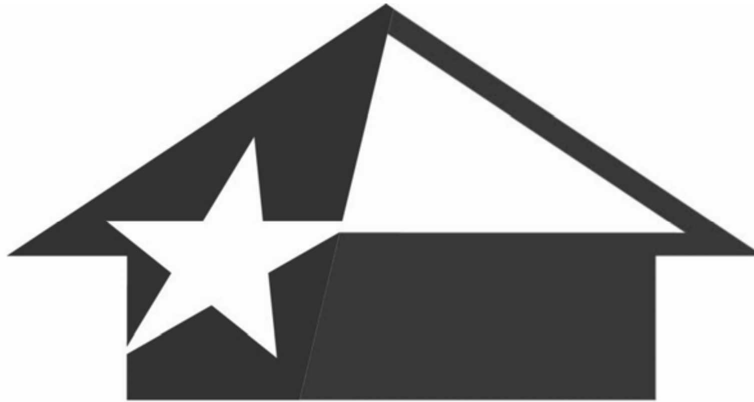
Ware Wendell
Texas Watch
Austin

Richard Naimark
(alternate member)
American Arbitration Assoc.
New York

(September 2004)

APPENDIX B: BUSINESS & INDUSTRY'S SUBCOMMITTEE REPORT

BINDING ARBITRATION IN CONSUMER CONTRACTS



Arbitration Task Force
January 2005

HOUSE COMMITTEE ON BUSINESS & INDUSTRY
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2002

A REPORT TO THE
HOUSE OF REPRESENTATIVES
78TH TEXAS LEGISLATURE

REPRESENTATIVE KENNETH "KIM" BRIMER
CHAIRMAN

COMMITTEE CLERK
BONNIE BRUCE

SUBCOMMITTEE ON BINDING ARBITRATION IN CONSUMER CONTRACTS

BACKGROUND

During the 77th Legislature, Representative Frank Corte filed HB 2465 requiring the following notice on any contract that contained a binding arbitration provision:

> "By signing this contract you are agreeing to have any issue arising under this contract decided by neutral arbitration and you are giving up your right to a jury or court trial. The law does not require that you submit to binding arbitration."

The bill failed to pass out of a committee. Interest in binding arbitration intensified due to the veto of HB 1862, a bill to address the prompt payment of healthcare providers for services. The veto was based on the bill not including binding arbitration as an alternative dispute resolution ("ADR"). During the interim both the Committee on Business & Industry and the Committee on Civil Practices were assigned interim charges that focused on different aspect of ADR.[1] The Committee on Business & Industry is charged with "reviewing trends in the use of binding arbitration requirements in consumer agreements, with special attention to transactions in which the consumer has little or no bargaining power."

WHAT IS BINDING ARBITRATION?

Binding arbitration is a type of ADR, which refers to the use of a neutral third party facilitator to help the settlement of a dispute between two parties outside a court of law. There is no judge and no jury.

Some ADR methods are the beginning of the dispute process. Mediation and non-binding arbitration are pre-trial attempts to settle, described and governed by the 1987 **Texas Alternative Dispute Resolution Procedures Act ("ADR Act")**.[2] The Texas ADR Act outlines five basic non-binding ADR procedures: mediation, mini-trial, moderated settlement conference, non-binding arbitration and summary jury trial. Other types of non-binding ADR procedures can be created by agreement of parties. The ADR Act states it is the policy of the State to encourage the early resolution of pending litigation through voluntary settlement procedures. Therefore, it is required of every Texas lawyer and court to become informed on the appropriate use of alternative procedures for settling disputes.

Contrary to mediation or non-binding arbitration, binding arbitration is a complete alternative to a trial. Binding arbitration is not mediation. It is <u>not</u> an attempt to find a mutually agreeable solution between the disputants. Rather, it is a dispute resolution method that allows parties to plead their

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[1] The Committee on Civil Practices was charged to "examine changes over the last decade to the civil justice system that affect the right of litigants (citizens or businesses) to receive appropriate review by a judicial body, including arbitration, mediation, other types of alternative dispute resolution."

[2] Tex. Civil Practice & Remedies Code, Chapter 154, May 21, 2002, <http://www.capitol.state.tx.us/statutes/statutes.html>

case to a neutral third party, the arbitrator. Either both sides agree on one arbitrator, or each side selects one arbitrator and the two arbitrators elect a third to comprise a panel. Arbitration hearings usually last only a few hours and the opinions are not public-record. Upon listening to and reviewing evidence and testimony, the arbitrator will make a ruling that all parties are bound to uphold. There are limited appeals and judicial review. Arbitration has long been used in labor, construction, and securities regulation, but is now gaining popularity in other business disputes.

Binding arbitration may be voluntary or mandated. Voluntary binding arbitration is agreed to by all parties after a dispute has arisen. Mandated binding arbitration is a stipulation of a contract or agreement and is agreed upon at the time of the contract, before a dispute arises. Mandated arbitration is only available under the **Texas General Arbitration Act ("TGAA")**[3] or the **Federal Arbitration Act ("FAA")**.[4]

REGULATION OF BINDING ARBITRATION

Regulation of arbitration is done on both the state and federal levels. The FAA is Title 9 of the United States Code (9 U.S.C.A. Sec. 1-15 West 1970 and Supp. 1990). The FAA is a statute based on Congress' plenary power over interstate commerce. It includes sanctioning and encouraging binding arbitration by private agreement in maritime transactions and contracts evidencing a transaction involving interstate or international commerce. Where it applies, its terms prevail over state law.

The FAA mandates that all arbitration clauses be enforced by the courts, and preempts state legislatures from banning them. The exception to this rule; however, is an arbitration clause in insurance contacts. The McCarran-Ferguson Act "reverse preempts" FAA and allows states to restrict the use of arbitration by insurance companies.[5]

Another federal law that is frequently mentioned during consumer disputes is the **Magnuson-Moss Warranty Act**.[6] The Magnuson-Moss Warranty Act is the federal law that governs consumer product warranties. Passed by Congress in 1975, the Magnuson-Moss Act covers only warranties on consumer products, not services. Thus only warranties on tangible property normally used for personal, family, or household purposes are covered (this includes property attached or installed to real property). However, if the warranty covers both the parts provided for a repair and the

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[3] Texas Civil Practice and Remedies Code, Chapter 171, May 21, 2002, <http://www.capitol.state.tx.us/statutes/statutes.html>

[4] U.S.C. Title 9, *n.d.*, <http://www4.law.cornell.edu/uscode/>

[5] Some states ban the use of arbitration by insurers. In eleven states there is a statutory ban applying across the board to any insurance contract, although three of those states' courts have not upheld the ban. In three other states, there is no statutory ban, but courts have refused to permit arbitration of bad faith lawsuits. Texas has no statute or regulation prohibiting or restricting the use of arbitration clauses in insurance contracts.

[6] U.S.C. Title 15, Chapter 50, *n.d.*, <http://www4.law.cornell.edu/uscode/>

workmanship in making that repair, the Act does apply.

This Act makes it easier for purchasers to sue for breach of a warranty by making breach of a warranty a violation of federal law, and allowing consumers to recover court costs and reasonable attorney fees. However, the Act allows warranties to include a provision that requires customers to try to resolve warranty disputes by means of an informal dispute resolution mechanism before going to court. If a warranty includes such a requirement, the dispute resolution must meet the requirements stated in the Federal Trade Commission's Rule on Informal Dispute Settlement Procedures (the "Dispute Resolution Rule") which includes the following provisions for ADR:

- Be available free of charge to the consumers;
- Be resolved within 40 days of receiving a notice of dispute;
- Be non-binding;
- Keep complete records on all disputes; and
- Be audited annually for compliance with the Rule.

However, the Texas Supreme Court has found that the Magnuson-Moss Act does not preempt the Federal Arbitration Act, therefore, a consumer can be forced into binding arbitration to arbitrate defects that would otherwise be covered under a consumer warranty.[7]

There are numerous states laws on ADR. In Texas, the TGAA provides this regulation. Both the FAA and the TGAA have similar requirements for an agreement to arbitrate, which is normally a contract. Both find an agreement to arbitrate valid unless the contract on the whole is invalid or the agreement was made under duress. The TGAA requires a notice on the actual contract, not unlike HB 2645, but this provision was eliminated by a 1987 amendment to the Act. Many of the limitations[8] for applicability of an agreement to arbitrate in the TGAA are not found in the FAA. The only limitation that would apply to consumer contracts states that:

> "an agreement for the acquisition by one or more individuals of property, services, money, or credit in which the total consideration to be furnished by the individual is not more than $50,000."[9]

However, this exception can be waived if the parties agree in writing after being advised by counsel. Therefore, a contract between a consumer and a multi-state business containing a binding arbitration clause could be enforceable under federal or state statute for any binding arbitration clause. Both statutes express that the method for choosing an arbitrator will either be determined by the arbitration agreement or the courts. But the TGAA clarifies that for a panel all arbitrators must be present for a hearing, and if an arbitrator ceases to act, the remaining arbitrators may make an award.

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[7] *In re American Homestar of Lancaster and Nationwide Housing Systems, Inc. Realtors* 10-99-00134-CV, 3 SW3d 57, 06-29-99 (Tex. June 7, 2001), and *In re First Merit Bank, N.A. f/k/a Signal Bank N.A. and Mobile Consultants, Inc. Realtors* (Tex. June 14, 2001)

[8] Texas Civil Practice and Remedies Code, §171.002, May 21, 2002, <http://www.capitol.state.tx.us/statutes/statutes.html>

[9] Texas Civil Practice and Remedies Code, §171.002(a)(2), May 21, 2002, <http://www.capitol.state.tx.us/statutes/statutes.html>

Both allow arbitrators to summon witnesses and material evidence. These summonses are enforceable by the court, with failure to appear considered contempt of court. Expert witnesses are paid the same as the witness fee in stated District courts.

In addition to these requirements, the TGAA provides a variety of substantive and procedural rules that govern arbitration unless otherwise specified by the parties. The TGAA qualifies that arbitrators shall set a time and place for the hearing and notify each party not later than the fifth day before the hearing. The arbitrators may also postpone or adjourn hearings (a hearing is delayed automatically if a party, who was notified, fails to appear). Parties have the right to testify, present evidence and cross-examine witnesses. The parties also may not waive their right to an attorney. The arbitrator may award separate payments for attorney fees only if the fees are provided for: 1) in the agreement to arbitrate; or 2) by law for a recovery in a civil action in a district court on a cause of action on which any part of the award is based.

The requirements for an arbitrators award is very different in the FAA and TGAA. The FAA declares that arbitrator awards are enforceable by a court. After a review the court may enforce an award, or modify the award based on a material mistake or omission. The court may also invalidate the award, but only for the following reasons:

- The award is procured by corruption, fraud, or undue means.
- There is evident partiality or corruption in the arbitrators, or either of them.
- The arbitrators are guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy or of any other misbehavior by which the rights of any party have been prejudiced.
- The arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

If an award is invalidated, the only option the court has is to reappoint another arbitrator or panel of arbitrators to rehear the dispute. Expenses for a rehearing would be borne by the parties.

The TGAA requires the arbitrator's award be determined in writing by the time line established in the contract or court, and delivered to each party personally or by registered or certified mail. The arbitrator's fee and expenses are either determined by contract or determined in the arbitrator's award. The TGAA also places time restrictions on a party to dispute an award. To dispute the timeliness of a decision, a party must notify the arbitrators of the objection before the delivery of the award to that party. A dispute to modify an award must be submitted within 20days.

Neither the FAA nor the TGAA require the arbitrator to follow Texas or Federal laws in making an award. In fact, the TGAA specifically states that an arbitrator's award does not have to follow Texas statutes.[10]

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[10] Texas Civil Practice & Remedies Code, §171.090, May 21, 2002, <http://www.capitol.state.tx.us/statutes/statutes.html>

Another state law which is frequently mentioned in conjunction with regulation of ADR is the **Texas Residential Construction Liability Act**.[11] The Texas Residential Construction Liability Act was passed in 1989 and outlines the liability of a contractor for defects to a residential dwelling which was constructed or on which repairs were negotiated through a residential construction contract. In 1999, a mandatory, non-binding mediation provision was added which requires a consumer and a contractor to submit to mediation before a trial if one party requests mediation. Therefore, if a party disputes a binding arbitration clause in their contract through the court system (i.e., based on duress) and prevails, mediation is still mandatory if the other party requests it.

In addition to these regulations, some states regulate the qualifications of the arbitrators themselves. The American Bar Association surveyed[12] dispute resolution practices in 52 state bar associations (representing all 50 states and the District of Columbia and Puerto Rico) and 30 local associations. Forty-four state bars reported that individuals from backgrounds other than law are used as dispute resolution providers. Only eighteen states reported that an entity (bar, courts, legislatures, etc.) certifies, approves or maintains a roster of dispute resolution providers. Further, twenty-seven state bar associations have mandatory training requirements for either mediators or arbitrators in the court annexed context, and only eight states require training for mediators and arbitrators in contexts other than court. Texas is not one. In Texas, 40 hours of basic mediation training, plus 24 hours of family training is required for family dispute mediators. However, arbitrators are not required to have any type of training. In addition, neither mediators nor arbitrators in Texas have to be licensed to practice law, even though they act as a judge. However, the lack of required training in Texas may provide more options.

In Texas, a consumer has several options for choosing an arbitrator. The Better Business Bureau operates a free arbitration program for consumers doing business with a member of the Better Business Bureau. Awards under this program are binding on the business, but not on the consumer. If the consumer is not pleased with the results of the award, they could file suit against the business.

Further, a consumer and business could obtain an arbitrator from a consumer group. No licensing requirements mean that the parties are free to obtain any arbitrator with which they mutually feel comfortable.

WHO ARE THE ARBITRATORS

Unless arbitration is ordered by a court or the arbitrator is chosen by the parties, most arbitrations are done through an arbitration association. The three largest of those are the American Arbitration

[11] Texas Property Code, Chapter 27, May 21, 2002, <http://www.capitol.state.tx.us/statutes/statutes.html>

[12] " State and Local Bar Alternative Dispute Resolution Survey" 2001 Edition, American Bar Association, *n.d.*, <http://www.abanet.org/statelocal/disputesurvey.html>

Association; the National Arbitration Forum; and the Judicial Arbitration and Mediation Services.

The American Arbitration Association ("AAA") was founded in 1926 (soon after the passage of the Federal Arbitration Act) and now has 37 offices in the United States and Europe and 55 cooperative agreements with arbitral institutions in 39 countries with 11,000 neutrals. The non-profit organization claims to be the largest provider of dispute resolution services, with 50 different speciality procedures including construction, automotive insurance claims, healthcare and consumer finance. The AAA's construction dispute process (which was designed by a group of construction industry associations) is endorsed by the Texas Builders Association. In their 2000 annual report, the AAA reported the sixth successive year of record caseloads, with 198,491 cases filed and more than 218,000 cases administered in 2000 alone. Each year more than 6,000 corporations, organizations, professional firms, unions, academic institutions, governmental agencies and individuals provide membership support for the AAA. Members are kept informed of current industry trends, creative uses of ADR, case management techniques, case preparation and presentation recommendations, suggestions for drafting clauses for business contracts, and invitations to educational programs. Another primary benefit of membership is subscription to a number of award-winning periodicals, such as the *Dispute Resolution Journal* and *ADR Current*s, that offer articles, editorial views, and reports on current developments in conflict avoidance and management. Members are also entitled to discounted subscriptions to ADRWorld.com, the Internet-based ADR news service acquired by the AAA in 2000.

> The American Arbitration Association is dedicated to the development and widespread use of prompt, Effective, and economical methods of dispute resolution. As a not-for-profit organization, our mission is one of service and education.
>
> We are committed to providing exceptional neutrals, proficient case management, dedicated personnel, advanced education and training, and innovative process knowledge to meet the conflict management and dispute resolution needs of the public –now and in the future.
>
> *-AAA Mission Statement*

Founded in 1986, **The National Arbitration Forum ("NAF")** is a private company, independent from any association with organizations or trades, with an international network of former judges, senior attorneys, and law professors who share the NAF principle that legal disputes should be decided according to established legal principles. Arbitrators for the NAF are retired judges, attorneys, and law professors, and are required to have more than 15 years experience, to have arbitrated commercial, financial and business disputes, and to be qualified under any local rules in his or her community. NAF arbitrators render decisions according to the law. Unlike other arbitration systems, NAF arbitrators are not permitted to ignore the law and make decisions based on "equity."

The Judicial Arbitration and Mediation Services ("JAMS") does mainly commercial

> The Mission of JAMS is to provide the highest quality dispute resolution services to our clients and to our local, national and global communities. We respect the parties and their representatives and commit to achieve the best possible resolution of their disputes.
>
> *- JAMS Mission Statement*

arbitration, but does accept a few consumer arbitrations. After 20 years of providing clients with a complete range of ADR services, a group of 45 JAMS neutrals and management purchased the company from institutional investors in August 1999. JAMS has twenty offices in the United States and provides services to thousands of client here and abroad. All of their neutrals are either attorneys or judges.

Issues	**National Arbitration Forum (NAF)**	**American Arbitration Association (AAA)**		**Judicial Arbitration and Mediation Services (JAMS)** Founded in 1979, primarily for commercial disputes. Last year performed only 150 consumer disputes out of 12,000.
		Consumer Disputes	**Construction Disputes**	
Are the Arbitrators independent contractors	Yes	Yes	Yes	No. Some arbitrators have an ownership interest in the company.
Arbitrators are all legal professionals	Yes	No	No	Yes
Arbitrators must apply the laws	Yes	Rules are silent	No	No

REASONS FOR ARBITRATION

Arbitration agreements have been used for centuries, and are even noted in the Bible.[13] In Texas, arbitration was recognized in the state constitution.[14] However, most courts refused to enforce pre-dispute mandatory arbitration clauses.[15] In 1925, the enactment of the FAA gave binding arbitration clauses, and the private justice system legitimacy. In the beginning, arbitration clauses were commonly used in disputes between businesses as a means to keep trade secrets confidential. In fact, the Texas Watch Foundation states in its report on Binding Arbitration:

> "Original participants in the debate did not envision that the FAA would be applied in a consumer context. Mr. W. H. H. Piatt, the American Bar Association point person proposing the legislation, stated that the FAA would apply, 'between merchants one with another, buying and selling goods.' The bill's authors and supporters emphasized the FAA would only apply to 'merchants,' as opposed

[13] "If only there were someone to arbitrate between us, to lay his hand upon us both, someone to remove God's rod from me, so that his terror would frighten me no more." *Job* 9:33 (NIV Version)

[14] TX Const Art. VII, §15 (1845) This section charges the legislature the duty "to decide differences by arbitration, when the parties shall elect that method."

[15] Paul L. Sayre, *Development of Commercial Arbitration Law,* 37 Yale L.J., 595 (1928)

to consumers. For over half a century, that sentiment prevailed."[16]

Use of arbitration clauses grew in popularity in the mid-seventies, when state bars and law schools across the country started recognizing the need for an alternative to the judicial system. By the Eighties arbitration clauses made their way to consumer contracts, where they quickly became pervasive.

Originally, according to University of Houston Law Center Professor Richard M. Alderman, the reason for binding arbitration's popularity was simple: "The legal system had become too expensive, too slow, and too inefficient to deal with the myriad of problems it was being asked to resolve."[17] In 1998, it was reported that "many small claims courts cannot take cases less than $20,000 because the amount exceeds their jurisdictional limit. And many lawyers wouldn't take the case because it just isn't worth their time."[18] A year later, The American Bar Association found that "75% of all consumers have no access to the courts. Either they can't afford a lawyer, or they don't understand the legal system. 'Arbitration lets people process smaller claims that a lawyer would never take on,' says India Johnson, American Arbitration Association's senior vice-president."[19]

Binding arbitration was to be the remedy by providing accessible, impartial decisions in a quick, cost efficient and private manner. Texans for Lawsuit Reform assert that "arbitrations can be a faster, and less cumbersome method of resolving a wide variety of disputes. Arbitration agreements can also provide a means for parties to ensure — before a dispute arises — that it will be resolved by an independent, unbiased arbiter or arbiters with special expertise in the subject matter of the dispute."[20]

The efficacy of arbitration is achieved through a less formal process allowing more flexibility in the scheduling, the evidentiary proceedings and the actual hearings. This reduction in the schedule allows for a cost savings in legal representation expenses alone. However, the inability to appeal an arbitrator's award saves greater time and money which is why businesses include binding arbitration clauses in almost every consumer contract. Binding arbitration can be found in the fine print or "terms and conditions" of almost every contract a consumer signs, whether the risk is large or small. Arbitration is included in department store lay-away plans to a contract for some of the largest investments a consumer will ever make: a new home contract or an automobile purchase contract.

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[16] Cris Feldman, "The Consumer Pitfalls of Arbitration," **Issue Paper**, Texas Watch Foundation, 2002, pg. 3

[17] Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform.*, Vol. 38, Number 4 Houston L. Rev., 1237, 1238 (Winter 2001)

[18] Channen, AMA J., (December, 1998)

[19] "When you want to sue — but can't" *Business Week*, June 10, 2002

[20] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

The Consumers' Union admits that "When it works well, however, arbitration can help consumers settle their disputes faster and cheaper than by litigation. It commonly takes anywhere from two to five years to get a civil case before a judge; an arbitration case can often be resoled within a matter of weeks."[21]

The United States Supreme Court Justice Burger, in support of arbitration, has said that "The notion that most people want black-robed judges, well-dressed lawyers and fine paneled courtrooms as the setting to resolve their dispute is not correct. People with problems, like people with pains, want relief, and they want it as quickly and inexpensively as possible."[22] Indeed the idea of an informal procedure that avoids the need to appear before a judge may be the very appeal for consumers to ADR. A recent study conducted on behalf of the Institute for Advanced Dispute Resolution found that when informed of how the arbitration process works, 82% of adults said they would opt for arbitration over filing a lawsuit.[23]

PROBLEMS INHERENT IN PRE-DISPUTE CONSUMER BINDING ARBITRATION

As a business-to-business ADR process, pre-dispute binding arbitration provides an informal, cost efficient and speedy access to justice. These advantages are desirable in business-to-consumer contracts as well. Texans for Lawsuit Reform state that "As long as the arbitration agreement is fair, balanced, and not forced on someone without informed consent, it is inherently fair and reasonable to allow Texans the option to agree to arbitrate"[24] Certainly, with its advantages, it is hard to imagine why a consumer would not opt for arbitration. In determining whether pre-dispute binding arbitration is fair, balanced and not forced on consumers without informed consent, the committee staff examined the agreement to arbitrate, the consumer's access to justice in this alternative system and whether the process provides balanced and fair outcomes.

Common sense and both federal and state laws, require that a contract be voluntarily agreed to by both parties to be valid. To voluntarily agree to a contract a consumer must have an option of whether to enter into the contract or not. However, many consumers find themselves left with little or no alternatives.

Contracts of Adhesion

The committee is charged with looking at contracts in which the consumer has little or no bargaining

[21] Consumers' Union "The Arbitration Trap: How consumers pay for 'low cost' justice" **Issue Paper**, August, 1999, pg. 1

[22] Justice Warren Burger, *Our Vicious Spiral*, Judges Journal 22, 49 (1977)

[23] "Roper Poll Reveals American's Preferences for Resolving Legal Issues: Majority Believe Arbitration is their Best Option" *Archived News Items*, Jan. 27, 2000, < http://www.texasadr.org/newsitems.cfm#roper> Note: It is unclear how binding arbitration was explained.

[24] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

power. These types of contracts are called contracts of adhesion. Contracts of adhesion are used in most consumer transactions and are presented to the consumer in a take-it-or-leave-it fashion. A consumer has little ability to negotiate the terms of the contract for their credit cards, their long distance service, their lay-away at the local department store or a contract for a new home. Certain parts of these contracts are negotiable, like a price for a product or service. However, consumers are finding that clauses on binding arbitration and liability are non-negotiable.

One business owner who testified before the Subcommittee[25] stated that he would walk away from a deal before he negotiated the clause out. One contract submitted as testimony to the Subcommittee gave the consumer the option of filing a lawsuit or going to binding arbitration. However, if the consumer chose to file a suit, they had to immediately pay the business $10,000 in liquidated damages.[26] Most businesses that utilize these clauses routinely tell consumers if they will not accept the binding arbitration clause, to "go do business with someone else." But the question is — can consumers readily find a business that does not require a binding arbitration clause?

This trend of using binding arbitration clauses has not only become common practice in individual businesses; It has spread to whole industries. A majority of the witnesses that testified before the Subcommittee, were either consumers or purveyors of new home construction. Consumers were at a disadvantage in negotiating these clauses out of their contracts, not only because the builder had more power in the individual transaction, but also because almost every builder in the state has binding arbitration clauses in their contracts. The Texas Association of Builders' model Residential Construction Contract includes a binding arbitration clause. Further, it stipulates that all disputes are governed by Federal, not State, laws and that all arbitrations will be done by the American Arbitration Association. The recommended contract for the Texas Association of Realtors for preexisting homes does not include a binding arbitration clause, because the association feels that the public is uneducated about its scope or consequences.[27]

Texans for Lawsuit Reform believes that Texas law already has consumer protections to ensure that consumers are properly informed as to the consequences of signing an arbitration agreement. The organization feels the TGAA requirement that any valid arbitration agreement for an amount totaling <u>less</u> than $50,000 must be signed by an attorney as well as the consumer ensures that consumers are educated in the majority of consumer disputes.

> "The practical effect of this law is that enforceable arbitration provisions in consumer contracts will be rare under Texas law because it will be highly unusual for businesses to insist consumers retain a

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[25] Ray Tonjes Testimony, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

[26] D.R. Horton new home contract submitted by Steven Pawlowski, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

[27] Tom Morgan (Texas Association of Realtors) Testimony, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

> lawyer and seek legal counsel in order to sell their service or product in transactions under $50,000. When this does occur, the consumer will be entering the transaction informed of the effect of the arbitration provision and electing to accept it as part of the deal. This is a very practical method of addressing the 'contract of adhesion' issue because it essentially eliminates form arbitration agreements in most consumer transactions."

Although courts previously had a history of voiding any contract of adhesion, most arbitration clauses today are upheld by courts, whether or not the consumer had any real ability to negotiate the clause out of the contract.[28]

Mutual Agreement to Arbitrate

It would appear from recent court decisions that if a consumer signs a contract which contains an arbitration clause, they have voluntarily entered into a mutual agreement to arbitrate. However, many consumers do not ever sign a contract which binds them to arbitration and the courts have upheld these contracts. Binding arbitration clauses are incorporated in the terms and agreements included with the instructions on many household appliances. If the item is not returned within 30 days, the consumer is bound by arbitration for any future disputes.

Many consumers find themselves bound to arbitrate because of slips of paper known as bill stuffers. Included in the advertisements for vacation discounts, free phones and other goods that are "stuffed" into consumers' bills for cable, phone or credit cards are important notices of any changes to the terms of their service agreement. They require no signature, no affirmative opt-in action. On the contrary, a consumer does not even have to read the notice, but any further use of the service or goods provided by the business binds the consumer to any changes, including binding arbitration. These "bill stuffers" were upheld in the courts as legitimate agreements to arbitrate.[29]

Further, even though a consumer reads, acknowledges and signs a binding arbitration agreement, he may not understand the differences between binding arbitration and mediation. Dawn Richardson, an Austin resident who testified at the Subcommittee hearing, stated "My husband and I are both college-educated, but we did not know that signing a construction contract meant that we forever gave up our constitutional rights to a trial by jury for any and all future disputes with our builder."[30]

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[28] For examples of cases in which the court has refused to find a lack of consent based on a contract of adhesion, see the following cases cited in the article "Pre-dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform" (previously cited): *Great W. Morgage Corp. v. Peacock*, 110 F .3d 222, 229-30 (3rd Cir. 1997) (refusing to find a lack of consent in an arbitration agreement even when the plaintiff-employee would have been fired had she not signed the agreement); *Hill v Gateway 2000, Inc.* 105 F .3d 1147, 1148 (7th Cir. 1997) (enforcing an arbitration agreement when the plaintiff failed to read the contract closely enough to discover the arbitration clause); *Engalla v. Permanente Med. Group, Inc*., 938 P .2d 903, 924-25 (Cal. 1997) (rejecting the claim that the arbitration agreement was unconscionable because it resembled an adhesion contract). *See generally* Ian R. MacNeil et al., Federal Arbitration Law: Agreements, Awards, and Remedies Under the Federal Arbitration Act §19.3 (1999 & Supp.) (discussing the relationship between unconscionability and adhesion contracts.)

[29] *Marsh v. First USA Bank, N.A.*, North Texas Federal District Court (2000) (A billing insert amending a credit card agreement to include an arbitration clause creates a valid agreement to arbitrate when the consumer continues to charge to the account after the insert is mailed.); In Re Alamo Lumber Co., 4th Court of Appeals (2000) (If an employee continues to work after being presented with a binding arbitration clause, it may form a unilateral contract.)

[30] Caroline E. Mayer, "No Suits Allowed: Increasingly, Arbitration Is the Only Recourse," *Washington Post,* July 14, 2002

Many consumers echo the same disbelief. They simply do not understand that they can waive all their rights for a judge or jury to decide their case. However, as in other areas of the law, ignorance of the law is no defense, especially not in court.[31]

In some cases, consumers seek legal counsel before signing these clauses, yet are no more informed or protected. Laura Munoz, an Austin city resident, gave the following testimony at the Subcommittee hearing:

> "I knew we had an arbitration clause in our contract, maybe unlike some other people, but we had an attorney look over the contract before we signed it. So, I thought we were in good shape. And I learned later that this particular attorney represented that same construction association of contractors (that the builder belonged to), and so maybe there was some bias there, I don't know. But I was told that arbitration was cheaper and more expedient than going to court."

Particularly vulnerable, are the elderly in nursing homes. Quality nursing homes are rare and often have long waiting lists for available space. However some nursing home patients are being forced to sign binding arbitration agreements for admittance into or continued treatment at nursing homes. These clauses state:

> "This plan spells out the only way to deal with any and all disputes or differences between the nursing home and its residents. Residents cannot sue in a court of law the nursing home or its officers, directors, employees or agents..."[32]

Even if an elderly consumer, or her family, understands what an arbitration clause means, it is unlikely that either wish to jeopardize the continued living and medical arrangements. It is questionable whether any arbitration clause agreed to under this kind of duress could be voluntary. However, Federal law instructs courts to conclude that any consumer that signs a contract which includes arbitration voluntarily consented to the arbitration provision.

In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), the Supreme Court observed that:

> [T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute. The court is to make this determination by applying the 'federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.' And that body of law counsels 'that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration...The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of

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[31] *Hill v Gateway 2000, Inc.* 105 F .3d 1147, 1148 (7th Cir. 1997) (enforcing an arbitration agreement when the plaintiff failed to read the contract closely enough to discover the arbitration clause); Doctor's Assocs., Inc. v Stuart, 85 F .3d 975, 980 (2d Cir. 1996) (refusing to find that the arbitration agreement was fraudulently induced when the defendants failed to read or inquire into the meaning of the arbitration clause)

[32] Feldman, pg. 20

> arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability,' Thus, as with any other contract, the parties' intentions control, but those intentions are generously construed as to issues of arbitrability."

Cost of Arbitration

Binding arbitration is often touted as being a cheaper alternative to lawsuits, and thus valuable to the judicial system as a whole. Limited discovery, less formal procedures and lack of an appellate review reduce the expense associated with litigation. However, both pro-tort reform organizations like Texans for Lawsuit Reform and consumer groups like Public Citizen agree that arbitration may be just as expensive, if not more than a lawsuit.

> While it is true that an open-ended arbitration proceeding can be as costly as a traditional trial, experienced parties have the option to cut costs by agreeing to allow only discovery and evidence that is truly essential to the resolution of the dispute.
>
> Texans for Lawsuit Reform
> Position Paper on Arbitration

While different arbitration associations have different fee schedules, almost all charge the following fees:

- Non-refundable filing fee
- Arbitrator's Fee
- Arbitrator's Expenses

Filing fees just to initiate a case can range from $40 to over $13,000, depending on the size of the claim and the arbitration association. In a study published May 1, 2002, Public Citizen found the filing fee for an $80,000 consumer claim in the Circuit Court of Cook County, Illinois is $221. The NAF fee would be $11,625, a 5,260% difference. These high costs are not restricted to NAF; for the same $80,000 claim, the AAA would charge up to $7,950, amounting to a 3,009% and 3,597% difference in cost, respectively.[33] These high up-front costs strip away the benefits of attorney contingency fee arrangements in a court system, by which plaintiffs receive legal representation without advancing any money.

These fees can be cost prohibitive for consumers to even file a claim. "Lorraine Aho had to make that choice earlier this year in her wrongful firing case against Maxager Technology in San Rafel (CA). The American Arbitration Association ordered her to pay a $3,000 filing fee, plus any fees the arbitrator might charge. Her attorney, Mary Dryovage, says the fees could have topped $50,000. 'We told them to forget it,' Dryovage says. 'I wasn't going to let one of my clients get into a

[33] Jackson Williams, "The Costs of Arbitration" **Issue Paper**, Public Citizen, May 1, 2002, pg. 2

situation of having to declare bankruptcy to pursue her case."[34]

The AAA responded to court rulings[35] which addressesd the validity of arbitration that is cost-prohibitive to consumers and initiated changes in their fee structure for consumer cases. The intent of the new fee structure is to ensure access to consumers. Beginning March 1, 2002, where a consumer's claim is between $10,000 and $75,000, the consumer will only be responsible for one-half of the arbitrator's fee, capped at a maximum of $375. The business will pay the $750 administrative fee and the remaining balance of the arbitrator's fee. Furthermore, filing fees will be calculated on the basis of compensatory or actual damages, and will not include any additional claims for punitive damages or attorneys' fees, although these claims may be pursued before the arbitrator. AAA hopes that these restraints on the filing fees increase consumers' access to arbitration, by ensuring that, for claims under $75,000, arbitration "fees are equivalent to the cost of filing a lawsuit, and AAA has procedures to waive or defer the costs charged to consumers when appropriate."[36]

AAA's hardship provisions for fee reduction or waiver is based on the Federal Poverty Guidelines. They are issued each year in the *Federal Register* by the Department of Health and Human Services (HHS). The guidelines are a simplification of the poverty thresholds for use for administrative purposes — for instance, determining financial eligibility for certain federal programs. AAA's guidelines are 200% of the Federal Poverty Guidelines.[37] The average annual wage in Texas is $33,171.[38]

Family Size	2002 Federal Poverty Level[39]	AAA Hardship Provisions
1	$8,860	$17,720

[34] Reynolds Holding,"Private Justice: Millions are losing their legal rights" *The San Francisco Chronicle*, October 7, 2001

[35] *Green Tree Financial Corp. - Ala. v. Randolph* 99-1235 U.S. Supreme Court (December 11, 2000)

[36] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

[37] "American Arbitration Association Continues Implementation of Changes Aimed at Fairness for Consumers in Arbitration" **Press Release** , American Arbitration Association, February 11, 2002 <http://www.adr.org/index2.1.jsp?JSPssid=15766&JSPsrc=upload \LIVESITE\About\..\NewsAndEvents\Press\Employment%20Release.html> (March 5, 2002)

[38] Texas Workforce Commission "Statewide Occupational Wage Data" *n.d.*, <http://www.twc.state.tx.us/lmi/lfs/type/wages /texaswages.pdf> (August 1, 2002)

[39] United States Department of Health and Human Services "Annual update of the HHS Poverty Guidelines" Feb. 14, 2002 <http://aspe.hhs.gov/poverty/02fedreg.htm> (August 1, 2002)

2	$11,940	$23,880
3	$15,020	$30,040
4	$18,100	$36,200
5	$21,180	$42,360
6	$24,260	$48,520
7	$27,340	$54,680
8	$30,420	$60,840

Proponents of arbitration reason that while these filing fees are higher than filing in court, arbitration is still a less expensive alternative for businesses and consumers, as well as for society. Texans for Lawsuit Reform argue "[a]rbitration opponents, including Public Citizen and Texas Watch, discuss only the cost of *initiating* an arbitration versus the cost of *initiating* a lawsuit. The cost of initiating either process is only a small part of the entire cost. The principal drivers of costs in litigation are discovery and attorneys' fees. These costs dwarf the cost of initiating either an arbitration or a lawsuit....While it is true that the cost of simply initiating an arbitration can be higher than the filing fee for a lawsuit, these fees are typically a fraction of the cost of the entire litigation."[40]

> A business will use an arbitration clause when it anticipates being the defendant in a civil lawsuit. Businesses generally do not use them if they anticipate being a plaintiff in a lawsuit, and usually draft the clauses so that only the business can force the consumer, employee, or franchisee into arbitration, and not the other way around. Because the high costs of arbitration and inability to bring class actions in arbitration discourage claims from being brought, arbitration clauses give an advantage to a potential defendant.
>
> *- Public Citizen*
> *Arbitration Watch Website*

Filing fees for a lawsuit is a fraction of the cost of litigation, however it is also just one fee in the arbitration process. The additional fees required by every arbitration association are the arbitrator's fees and expenses. An arbitrator's fees cover the actual time spent in deciding motions and the actual dispute, while arbitrator's expenses include any travel or administrative expenses. Rules laid out by arbitration associations indicate that an arbitrator's fee may range from $0 (in small claims for NAF) to over $8,000. Most consumers testified before the Subcommittee that arbitrators charged an hourly fee that was between $200-600.

In addition to these fees, "[a]rbitration saddles claimants with a plethora of extra fees that they

[40] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

would not be charged if they went to court."[41] For example, one arbitration association charges the consumer an administrative fee, another charges hearing fees, both paid simultaneously with the filing fee. Other fees include fees for requests (i.e., requests for injunctive relief or written awards), motions (i.e., subpoenas, discovery orders, continuances) and facilities for hearings. For example, the AAA has two office locations in Texas, but provide services to individuals throughout the state.[42] Parties in a hearing in San Angelo would be required to secure and pay for hearing facilities, while a party who lives near the AAA San Antonio office would not. Some of these fees are either split between the consumer and the business or paid solely by one party.

Many of these fees are to handle the administrative work that is usually done in the court system by support personnel. "The same support staff that expedite cases at a courthouse, such as file clerks and court administrators, are also necessary to manage arbitration cases. But because arbitration provider organization handle fewer cases over larger geographic areas, the economy of scale in a court clerk's office cannot be achieved, increasing administrative cost per case. Thus, while it costs the Clerk of the Circuit Court of Cook County an average of $44.20 to administer a case, AAA's administrative cost per case averages $340.63, about 700%more."[43]

However, proponents of arbitration say it is this exact expense that arbitration saves society as a whole. "..[T]he plaintiff is imposing on several citizens who must go to the courtroom to possibly be picked as a juror, taking the better part of a day, a week, or a month, of people's time. Nor does this consider the cost to the tax payers, who have to support the court system. These are huge costs to society that arbitration does not impose."[44]

Finally, consumers and businesses alike must pay for attorney representation and expert witness fees, however, these expenses are common to both arbitration and litigation.

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[41] "The Costs of Arbitration" Public Citizen, April 2002

[42] May 31, 2002 letter to the Subcommittee from India Johnson, Senior Vice President for American Arbitration Association

[43] "The Costs of Arbitration" Public Citizen, April 2002

[44] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

What Law Applies

When a dispute first occurs the consumer usually assumes that he will go to court to dispute his claim under Texas law. But as Texans for Lawsuit Reform recognize "...protections under the Texas Arbitration Act rarely come into play because of the broad reach of the Federal Arbitration Act and its preemption of state law."[45] Most consumer disputes arise against businesses that operate nationally. Unless jurisdiction is specified in the contract, the business has the option to invoke their rights under the TGAA or the FAA.

If arbitration is to be regulated under the federal statutes, state authority to provide additional guidelines beyond the federal statutes is preempted.

Venue

Unless specified in the agreement, the venue of where the arbitration is to occur is unregulated by either the federal or state statutes.

When dealing with a national company, a consumer can be directed to travel to the business' national headquarters to arbitrate a dispute. The online auction service E-Bay mandates all disputes must go to an arbitrator in San Jose, California.[46]

Disputes in Texas can still be onerous because of the size of the state. "...[I]t is possible that venue in a location that is inconvenient for a consumer can operate as a barrier to meaningful access to arbitration" says Texans for Lawsuit Reform. "This type of venue requirement when applied to a consumer would likely be found to be unconscionable and, therefore unenforceable under Texas law."[47]

However, the Subcommittee heard testimony that a consumer from Austin was required to drive to San Antonio to resolve her dispute. Leslie Pettijohn, Commissioner of the Texas Consumer Credit Commission indicated that burdensome travel for venue requirements was not a common complaint that the Commission incurred when dealing with credit card consumers, although disputes about binding arbitration is increasing.

Confidentiality of Proceeding

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[45] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

[46] "User Agreement" April 19, 2002, <http://pages.ebay.com/help/community/png-user.html> (August 1, 2002) See Section 17 of the Agreement

[47] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

Consumer complaints to a state agency, on binding arbitration is unique, first because many consumers are unsure if and which state agency might have jurisdiction, and secondly because of the confidentiality provisions of arbitration. While neither the FAA nor the TGAA require the proceeding to be private, most arbitration agreements require not only that non-parties to the dispute not be involved or contacted by the consumer, but also require confidentiality for the hearing and final award.

As discussed previously, the FAA was originally intended to provide a means to resolve business to business disputes. The advantage was a means for businesses to inexpensively resolve disputes without having to disclose trade secrets in court documents. "...[Confidentiality is generally important to businesses to protect private business matters and trade secrets and avoid being a target for litigation. The benefits of making arbitration awards public to competitors, plaintiff lawyers, the media, and others does not outweigh the parties' right to contract for confidentiality in their arbitration agreements. In addition, settlements in lawsuits are often confidential for similar reasons."[48]

While in business to business disputes confidentiality requirements provide protections for both businesses involved, confidentiality agreements in business to consumer disputes hinder consumers and continued responsible business practices.

One witness before the Subcommittee testified that because her contract prohibited the involvement of outside entities "there's no record of our builder's misconduct with the Better Business Bureau or the Attorney General's Office. Further, our arbitration records are closed, which means that home buyers have no way of accessing builders previous track records when it comes to arbitration, so my builder can continue to do this and nobody will ever know about it."[49]

This situation begs the question of whether confidentiality endangers consumers economically and even physically. A case involving the molestation of a forty-five year old woman with severe head injuries living in a nursing home by a nursing home employee was forced into binding arbitration agreed to upon admittance to the facility.[50] A confidentiality requirement in this case would not only prevent vital information about the safety and backgrounds of the employees of a facility from potential clients, but it could also possibly prevent a full investigation and criminal charges.

The pervasive use of confidentiality agreements and the lack public record of proceedings, further

[48] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

[49] Laura Munoz Testimony, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

[50] Ziva Branstetter, "Nursing Home Sues Family," *Tulsa World*, March 1, 2002

prohibit consumers from truly understanding the operations and reputation of a business.

Moreover, the removal of these cases from the court system and into arbitration, creates a lack of legal precedence and guidance of business operations and responsibilities. Private dispute resolution results in private punishment.

Repeat Players/Unbiased Arbitrators

Whether private resolution can actually distribute justice is a major concern of consumers. Although arbitration is supposed to be a neutral process presided over a neutral third party, the arbitration associations attempt to match arbitrators with experience in the field of the dispute and the actual financial structure of the associations themselves lead to the perception of a biased process.

Most arbitration associations retain arbitrators based on subject matter. For example, arbitrators may have professional experience in construction, fiduciary, or employment law. The purpose is to bring to the dispute "...independent arbitrators who have experience and/or education in the relevant subject matter and who bring a greater level of expertise to the issues in the case than a lay jury."[51]

While it sounds appropriate in theory, in practice this experience in and of itself can create the perception of bias for the consumer. If consumers learn that their arbitrator has represented the business party in past disputes or court proceedings or that the arbitrator has previously ruled in favor of the business party, consumers may question the neutrality of the arbitrator and possibly for good reason. Once a company wins before an arbitrator, the company may repeatedly choose the arbitrator. Conversely, a company is likely to strike an arbitrator that has previously awarded a consumer a large award against the company. According to Michael Young, co-chair of JAM's Committee on Professional Standards and Public Policy, "the risks of the repeat player advantage are real and can be disturbing."[52]

AAA responded to repeat player concerns from a Congressional inquiry. "At the request of aides to a federal senate legislative committee, we ran a computer search of twenty-seven companies in one industry for a period of 2.5 years, by company name, whom the aides had identified to us as citing the AAA as an arbitration provider in consumer dispute resolution clauses. Of these 27 companies, only eight had been involved in cases at the AAA. Of the 8 companies that did have AAA cases filed, a total of 51 cases were filed and no arbitrator served on more than one case."[53]

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[51] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

[52] Feldman, pg. 7

[53] Ibid., pg. 3

Texans for Lawsuit Reform also refute the idea of the repeat player by quoting one working paper that found that arbitrators tend to rule in favor of the plaintiff more than juries, and arbitrators and juries award similar amounts of damages in comparable cases.[54] They feel that the idea of bias because of repeat players "is not supported by evidence nor is it corroborated by any actual information of partiality by arbitrators on a systematic basis....If bias does unfairly affect the outcome of an arbitration or if arbitrators are biased toward either party, the party affected has grounds to vacate the award under Texas Arbitration Act section 171.088."[55]

AAA reports that it "receives over 95% of its cases as a result of either being named as the administrative agency in an arbitration clause or because of a citation in a contract clause to one of the AAA rules, which are in the public domain."[56]

In addition, the arbitration association's ties to businesses involved in disputes is questioned by consumers. Texas Watch ponders the true neutrality of an association that is invested by or in a business that utilizes the association's arbitration services.

> "At time it can be hard to distinguish between arbitration firms from major clients. The AAA has held shares in AT&T, Bank of American, Aetna, Cigna Corp., General Electric — all of which the AAA has resolved disputes for. General Electric and Sprint corporate officers have sat on the AAA board. In 2000, the AAA received 2.1 million dollars in membership fees from GE industrial systems, Aetna, and other corporate interests."[57]

But the AAA disputes this link claiming that "about half of AAA's 6,000 members are individuals. The remaining members are law firms, corporations, unions, students, libraries and other groups interested in alternative dispute resolution. Members' fees support education, training, and public service programs, and members receive a number of publications and other benefits for their dues. Members represent 2% of (the) revenue. Independent investment funds manage the AAA'd assets — both its operating investments and pension funds. AAA staff members do not select the particular stocks or bonds that comprise the AAA's portfolio."[58]

In fact, two Texas Supreme Court decisions have vacated an award by an arbitrator when the

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[54] Donald Whitman "Lay Juries, Professional Arbitrators and the Arbitration Selection Hypotheses," **working paper no. 462**, University of California Sana Cruz, July, 2000, <http://econ.ucsc.edu/faculty/workpapers.html>

[55] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

[56] May 31, 2002 letter to the Subcommittee from India Johnson, Senior Vice President for American Arbitration Association

[57] Feldman, pg. 7

[58] May 31, 2002 letter to the Subcommittee from India Johnson, Senior Vice President for American Arbitration Association

arbitrator failed to notify all parties of former representation of one of the parties to the arbitration.[59] However, whether biases are detected is questionable, and consumers must bear a costly burden of proof. First USA, the nation's second largest issuer of credit cards is in the middle of a class-action lawsuit over their binding arbitration clauses. Data revealed in court proceedings show "...that not only has the company sought arbitration far more often that consumers, it has also won in 99.6% percent of the cases that went all the way to an arbitrator."[60]

Since arbitration associations do not routinely share its dispute information or statistics, there have been no scientific studies, however some reputable sources, like *Business Week*, report that arbitration awards are in favor of a business over a consumer 70% of the time and awards are usually much larger than they would have been in a court[61].

Limited Discovery

One reason many consumers feel like they are losing in arbitration is that they do not have the ability to fully develop their case because of limited discovery. While both the FAA and the TGAA allow for full discovery, most arbitration agreements limit discovery or charge for discovery motions. Proponents encourage limited discovery as a means to limit the length a dispute is in arbitration and the amount of attorneys fees. Opponents say limited discovery also hinders necessary discovery of evidence that may be crucial to the claims in dispute. David Bragg, from the AARP, reports that by withholding documents revealing evidence of liability, manufacturers can prevent consumers from proving the validity of their claims, no matter how egregious the harm.[62]

Efficiency of Procedure

One of the stated advantages of arbitration is efficiency to resolution. However, many participants feel that this purported advantage has not materialized.

The Houston Chronicle reported that arbitration cases in Harris County run an average of "nine or more months" which is about the same time it takes a case to work through the civil justice system in the greater Houston area.[63] Vice President of Phillips Petroleum, Bryan Whitworth, has stated that "Arbitration may seem like it is an easy single way to solve problems. But we've found time delays;

[59] *Texas Commerce Bank, National Association v. Universal Technical Institute of Texas, Inc*. (1999) 1st Court of Appeals,; also *Burlington Northern Railroad et al. v. TUCO Inc. et al.* (1997) TX Supreme Court

[60] Caroline Mayer, "Win Some, Lose Rarely?; Arbitration Forum's Rulings Called One-Sided" *Washington Post*, March 1, 2000

[61] "Forced into Arbitration? Not Anymore." *Business Week*, March 16, 1998

[62] David Bragg, "Binding Arbitration: A Wolf in Contract Clothing" **Issue Paper**, Texas AARP, 2001

[63] Mary Flood, "Arbitration Not Always Fair, Cheap for Parties in Dispute" *Houston Chronicle,* April 11, 2001

it's not saving expenses; and the courts offer just as good an opportunity." Whitworth stated that Phillips Petroleum hopes to keep arbitration clauses out of most future contracts. In addition, one witness testified before the Subcommittee that it took over a year to force their issue before an arbitrator. As with other statistical data, length of time till resolution is information that arbitration associations consider confidential.

Prohibition Against Class Action

A class action is a legal method that allows an individual to sue on behalf of a class of similarly situated individuals in any federal or state court.[64] This allows a consumer to dispute a claim in which the claim of anyone individual would not justify the time and expense of a lawsuit. This method provides not only an incentive for attorneys to take a case, but it also acts as a deterrent for wrongful action.

Most arbitration clauses include a prohibition on the consumer from joining a current or future class action regarding the claim that is being disputed. Thus, each consumer is required to individually arbitrate the same claim while bearing the expense individually. The effect is to prevent a consolidation of similar claims qualifying for class action status.

However, Texans for Lawsuit Reform counter that there is no inherent right to be a participant in a class action lawsuit or an inherent right to class action plaintiff lawyers to have a class to certify.[65] And many small businesses feel that this is the only option to protect themselves against a frivolous lawsuit.[66]

One bank, FleetBoston Financial Corp., has gone one step further. Consumers that continue to use FleetBoston credit cards after receiving a recent bill stuffer, have given up their rights to file a lawsuit over current and future class action disputes because FleetBoston's binding arbitration clause is retroactive. In the name of fighting frivolous lawsuits, "We see no reason to distinguish between existing and potential class actions for the purposes of our arbitration in all cases," says Deborah Pulver, a spokeswoman for Fleet's credit card division.[67]

No Right to Appeal

[64] 28 U.S.C. Appendix - rule 23

[65] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

[66] Tonjes testified "For a small business owner, this [arbitration] is our only protection."

[67] Jess Bravin, "Banks seek to Halt Suits by Cardholders" *The Wall Street Journal*, May 2, 2001

The fact that there are few grounds to appeal an arbitration award is a plus to some and a bane to others. The only reason a contract can be reviewed by a court of law is if the contract as a whole is invalid, or if the arbitration clause itself was agreed to under extreme duress or is unconscionable.

The only reason an award can be reviewed and invalidated by a court of law is because of bias, misconduct or coercive behavior by an arbitrator. However, if the courts find that the award is invalid, the only option the court has is to appoint a completely new arbitrator(s) and have the parties begin all over, at their expense. The Judge in the 3rd Court of Appeals case *Koch v. Koch* (2000) concluded that although the TAA states that a court "may" order a rehearing before arbitrators[68], it provided the courts no other options, and therefore courts are compelled to order a rehearing before new arbitrators if an award is invalidated.

Consumers who are denied written decisions or rationales for the decision are also frustrated by the finality of the process. Laura Munoz's testimony at the Subcommittee hearing:

> "Well, it took us over a year to force our builder to go to arbitration and by the time the dust settled we spent a total of $11,625 in arbitration and legal fees, not including witness fees etc. ... Although we were damaged to the tune of $111,000 in arbitration we only recouped $50,000 of our monies, which is less than half of our loss. And I have no idea why our arbitrator awarded us this amount and I was not allowed to ask him this. He doesn't have to tell me why he decided that was the right figure."

Appropriately summarized, Representative Giddings told a business owner at the Subcommittee hearing that "The same finality that gives you comfort, makes a consumer anxious."

However, proponents claim that this lack of appeal, except in the most egregious of cases is what provides the greatest cost savings.

[68] §179.089

SUGGESTED REFORMS

When arbitration was first formalized by the FAA, it was intended for business to business transactions, which has caused a lack of protections for consumers. However, when the TGAA was created in 1965 it was obviously intended for use in both business-to-business and business-to-consumer transactions. Certain consumer protections were included in the TGAA, but because of the ever more pervasive use of binding arbitration consumers perceive them to be lacking.

Binding arbitration clauses are being insisted on by individual companies and by entire industries, leaving consumers with little or no option for services or goods without accepting arbitration. In a Dissent Opinion from the U.S. Supreme Court on arbitration, Justice Ginsberg states that "... the Court blends two discrete inquiries: First, is the arbitral forum *adequate* to adjudicate the claims at issue; second, is that forum *accessible* to the party resisting arbitration." Thus, it is the duty of the state to govern contractual law just to the extent to ensure that the agreement, the process and the award between a business and a consumer are fair and accessible.

The first concern is to ensure the agreement to arbitrate is voluntarily entered into by both parties after they are fully educated about the process. In order to guarantee that an agreement is entered into freely, the committee recommends that consumer arbitration agreements be separate addendums with disclosure notices. The disclosure clause should state that the addendum permanently removes a consumers right to dispute any claim on the contracted goods or services in a trial before a state or federal court and acceptance of the addendum is not required by state or federal law. Further, the committee recommends not only keeping the current consumer protection in the TGAA of exempting personal injury disputes from arbitration, but recommends strengthening other consumer protections. Currently binding arbitration under the TGAA is not applicable to any dispute under $50,000 unless both the consumer and an attorney representing them sign a waiver. The committee would recommend increasing this threshold to $150,000.

In addition to these current consumer protections, the committee recommends prohibiting the use of arbitration under the TGAA to dispute possible misdemeanor or felony crimes. The committee also recommends prohibitions against contractually creating incentive or penalizing consumers from choosing either arbitration or filing suit. In addition, the committee strongly recommends that any arbitrator's award must follow applicable state statute regulating the issue at dispute. These reforms should improve the fairness of an agreement between a business and a consumer, but the committee is also concerned about accessibility to the process itself.

One of the first and most egregious barriers to the arbitration process are the fees charged by arbitration associations. Since the objective of arbitration is to provide a less expensive alternative to suing, it would only be sensible that filing for arbitration should be no more expensive than filing for litigation. In addition, the consumer should not be burdened with fees or travel expenses that

would not be applicable in the court system. Thus, the committee would recommend that filing fees be prohibited from being higher than the filing fees in the consumer's local court that would adjudicate the dispute if it were not being arbitrated. Further, the venue for any arbitration should not be a greater distance than the jurisdictional boundaries of the consumer's local court. While the consumer and the business should remain responsible for the costs of any legal representation or expert witness testimony, any additional fees from the arbitration association should, the committee recommends, be paid by the business and not the consumer.

While fees present a barrier between consumers and arbitration, some clauses prevent consumers from seeking other avenues of justice. For example, some arbitration agreements prohibit consumers from joining current or future class action suits. While the committee feels that class actions provide avenues for consumers with small damages to collectively address egregious wrongs that would be impossible or not worthwhile for an individual to address, the committee also recognizes the risk to a business. A business enters into arbitration, willing to accept the denial of an appeal because arbitration shelters the company from future litigation risks. The committee would recommend the statutory creation and guarantee of class action arbitration.

Access to an arbitrator, mutually agreed upon, is also essential in guaranteeing the fairness of the process. The committee recommends that an agreement for arbitration be prohibited from naming a particular arbitration association by name or reference. While a consumer may be bound to arbitrate, this provides consumers a chance to investigate the rules, fees and records of arbitration associations. This would also help address the perception of a bias due to prior relationships between a business and an arbitrator. Further, it gives the consumer more control over the entire process of choosing an arbitrator, which can only lead to a more impartial procedure.

An impartial procedure is also an open one. The committee recommends that arbitration associations be required to file a list all consumer arbitrations with the County Clerk in which the arbitration was held. The filing should include:

- The names of the parties;
- The name of the parties' attorneys;
- The name of the arbitration association and the arbitrator;
- The disputed claim and relief sought;
- The date the arbitrator was chosen and the date an award was issued;
- The fees charged by the arbitration association and the arbitrator; and
- The award of the arbitrator.

In addition, the committee would recommend that an arbitration award be prohibited from being sealed. This would allow a consumer to search the complaint record of a business, the frequency of

a single arbitration association to arbitrate a single company's disputes, and if requested, the frequency of arbitrators to rule either for or against a consumer or business. Disclosure of this type would not only address the concerns of consumers of repeat/biased arbitrators, but it would also address consumers' perception that arbitration is a private justice system owned by and for the benefit of big business. Although business and arbitration associations assert that arbitration is fair and awards are statistically equally awarded to both parties, there is no access to data to prove this without disclosure.

While consumers complain of limited discovery and the efficiency of the procedure, the committee is not making any recommendations in these areas. The TGAA does not limit discovery, and with a more level negotiating field, the committee hopes that the parties to the contract can mutually agree either in advance or at the time of dispute as to the process of discovery. Further, the committee feels that tactics of both sides can delay the arbitration process. Many consumers testified before the Subcommittee that they were doing all they could to delay going to arbitration. The efficacy of the process is not only based on the terms agreed to by both parties, but also by their action or inaction, which cannot be legislated.

However, another efficiency of the process which concern consumers is the very strict limitation on judicial appeal. The committee understands that this lack of judicial appeal, except to dispute the validity of an agreement or award, is the majority of the cost and time savings afforded by arbitration. However, the committee does not find it a less expensive or a more efficient process to require a judge to send the parties back to arbitration with new arbitrators after invalidating an award or agreement. Therefore the committee recommends permitting a summary judgement of a dispute if an arbitration is determined to be invalid.

Arbitration is a useful alternative to the costly and sometimes intimidating judicial system. With some stronger consumer protections to address the issues of accessibility and fairness, the committee feels that arbitration can be a vital option for businesses and consumers.

All of the recommendations of the committee are specifically to address *consumer* contracts with pre-dispute, mandatory arbitration clauses. The committee did not address issues of binding arbitration in clauses in business-to-business contracts because of the limit of the committee's charge.

EXECUTIVE SUMMARY

The committee is charged with "reviewing trends in the use of binding arbitration requirements in consumer agreements, with special attention to transactions in which the consumer has little or no bargaining power." The committee has found that industry-wide adoption of pre-dispute binding arbitration clauses traps consumers in a take-it-or-leave-it position when purchasing some of the most vital goods and services of their life; i.e., homes, vehicles, insurance, and even nursing homes.

This creates an extremely uneven bargaining power between a consumer and a business about how, by whom and how much will it cost to resolve disputes. Testimony taken by the Subcommittee on Binding Arbitration emphasized that current consumer protections under the Texas General Arbitration Act are insufficient. Although testimony from the business community was supportive of arbitration, they admitted that there may be some perception problems regarding bias of arbitrators from certain national arbitration associations. Support from the business community for binding arbitration is beginning to waiver as more and more encounter the same issues described by consumers. Doctors[69], auto dealers[70] — even the arbitrators themselves[71] — recognize the many problems with binding arbitration.

While there may be problems with arbitration, Texans for Lawsuit Reform state that "As long as the arbitration agreement is fair, balanced, and not forced on someone without informed consent, it is inherently fair and reasonable to allow Texans the option to agree to arbitrate"[72] and the committee agrees. By adding additional consumer protections, and strengthening the current ones already provided in statute, the committee feels that arbitration can and should remain a viable option for parties. Reforms should include protections to level the bargaining power of consumers and businesses in contract negotiation, provide greater financial access to arbitration for consumers, and to ensure a procedure that is fair, unbiased and lives up to the promise of a more efficient, less expensive alternative to the court system.

To this end, the committee has made the following recommendations.

- Arbitration agreements in consumer contracts should be separate addendums with conspicuous disclosure notices.

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[69] Walt Borges, "In a Bind: Binding Arbitration Not Always Preferable to Lawsuits" *Texas Medicine,* September 1, 2001

[70] National Automobile Dealers Association, "House Passes NADA-backed Arbitration Bill Unanimously" **Press Release**, October 4, 2000 <http://www.nada.org/Content/NavigationMenu/MediaCenter/PressReleases/Leg_10_04_00.htm> (August 1, 2002)

[71] Charles Ornstein,"Arbitration Provider Breaks with HMOs" *Los Angeles Times*, March 11, 2002

[72] August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

- The disclosure notice should be in 12-pt or larger type and should state:
  - THIS CONTRACT REMOVES ANY RIGHTS TO ADJUDICATE A DISPUTE ARISING FROM THIS CONTRACT IN A JURY TRIAL. STATE NOR FEDERAL LAW REQUIRES THE ACCEPTANCE OF THIS ADDENDUM, AND YOU SHOULD CONSULT AN ATTORNEY BEFORE SIGNING.

- The Texas General Arbitration Act exempts personal injury disputes from the scope of any binding arbitration clause. This provision should be maintained.

- The Texas General Arbitration Act exempts any dispute under $50,000 from binding arbitration unless both the consumer and their attorney sign the contract. This threshold should be raised to $150,000.

- An exemption should be added to prohibit the use of arbitration under the Texas General Arbitration Act to dispute possible misdemeanor or felony crimes.

- The Texas General Arbitration Act should be amended to prohibit contractually incentivizing or penalizing consumers from choosing either arbitration or filing suit.

- The Texas General Arbitration Act should be amended to require an arbitrator to follow applicable state and federal statutes in deciding the findings and conclusions of any dispute.

- Arbitration associations that administer arbitration should be prohibited from charging filing fees higher than the filing fees in the consumer's local court that would adjudicate the dispute if it were not being arbitrated.

- Venue for any arbitration should not be a greater distance than the jurisdictional boundaries of the consumer's local court.

- Any fees charged by an arbitration association after filing fees should be borne by the business, not the consumer.

- The Texas General Arbitration Act should be amended to permit and guarantee class action arbitration.

- An arbitration agreement should be prohibited from naming a particular arbitration association by name or reference to their rules or procedures.

- Arbitration associations should be required to disclose all consumer arbitrations with the County Clerk of the County in which the Dispute was conducted.
  - The disclosure should contain the following:
    - The names of the parties;
    - The name of the parties' attorneys;
    - The name of the arbitration association and the arbitrator;
    - The disputed claim and relief sought;
    - The date the arbitrator was chosen and the date an award was issued;
    - The fees charged by the arbitration association and the arbitrator; and
    - The award of the arbitrator.

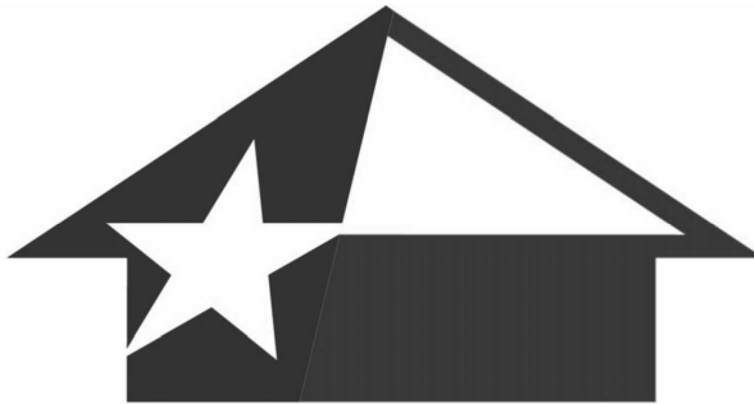
- Arbitration awards should be prohibited from being sealed.

- If a judge determines that a contract or arbitration award is invalid, a summary judgement should be permitted of the dispute.

The committee recognizes that these reforms will only affect consumer contracts with binding arbitration provisions under the regulation of the Texas General Arbitration Act. Further, the committee recognizes that a majority of consumer-to-business contracts are with national companies that will claim federal jurisdiction under inter-state commerce. However, to the extent that Texas can provide consumer protections to its citizens it should provide a fair, balanced, accessible and voluntary alternative to the judicial system.

APPENDIX C: THE CONSUMER PITFALLS OF BINDING ARBITRATION

A REPORT BY THE TEXAS WATCH FOUNDATION



Arbitration Task Force
January 2005

THE CONSUMER PITFALLS OF BINDING ARBITRATION

A Report by the Texas Watch Foundation

Executive Summary

Most people would think twice before they signed away their right to free speech. Many would hesitate before they agreed to waive the right to vote, and more than a few would pause before they passed on the right to freely worship the god of their choosing. The same can be said of the fundamental right to a jury trial. However, it is now simply commonplace for Texans to unknowingly sign away this cornerstone of democracy.

Everyday, folks from all walks of life—parents, homeowners, medical professionals, business executives, consumers, small business owners, and nursing home residents—unknowingly encounter binding arbitration agreements. These hidden contract clauses may pose significant pitfalls for consumers as they take conflict resolution out of the public domain of court proceedings and into private venues controlled by profit-driven arbitrators.

The first and most significant pitfall occurs as the vast majority of hard working Texans to inevitably and unsuspectingly waive their constitutional right to a jury trial[1].

Other consumer pitfalls include:

- The loss of time-tested court procedures and processes designed to produce impartial and fair justice;
- Secrecy of legal proceedings;
- Limited public accountability over entities rendering decisions;
- Increased potential for bias against consumers; and
- Higher costs to consumers making claims.

"Binding arbitration" arises out of a purported agreement between two or more parties where disputes arising from a contract are to be resolved before a private judge called an "arbitrator." A ruling by the arbitrator is by and large final, leaving unsatisfied participants with no place to turn.

By all accounts, binding arbitration has increased largely through the careful and methodical use of adhesion contracts.[2] Contracts of adhesion are large boiler-plate documents with a dizzying amount of fine print. By definition, adhesion contracts occur in take it or leave it scenarios, where the consumer has no other choice but to accept the terms of the contract.[3]

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[1] U.S. CONST. amend. VII (amended 1798); Tex. CONST. Art. I, Section 15 (1876)("The right of trial by jury shall remain inviolate.").

[2] "Arbitration: Happy Endings Not Guaranteed," Business Week, Nov. 20, 2000.

[3] "Some sets of trade and professional forms are extremely one-sided, grossly favoring one interest group against others, and are commonly referred to as contracts of adhesion. From weakness in bargaining position, ignorance, or indifference, unfavored parties are willing to enter transactions controlled by these lopsided legal documents." Quintin Johnstone & Dan Hopson, Jr., *Lawyers and Their Work* 329-30 (1967)." Black's law Dictionary, 7th Ed., 1999; "[C]ourts traditionally have reviewed with heightened scrutiny the terms of contracts of adhesion, form contracts offered on a take-or-leave basis by a party with stronger bargaining power to a party with weaker power. Some commentators have questioned whether

At one point, binding arbitration was widely endorsed in the business community as the best way to resolve disputes in a quick, unbiased, economical manner. However, the consensus formerly endorsing binding arbitration in the business community no longer exists. Doctors[4], car dealers[5] - even the actual arbitrators[6] – recognize the many pitfalls of binding arbitration.

This report is intended to serve as a comprehensive overview of arbitration in the state of Texas, including information on:

I. History of binding arbitration and prevailing myths;
II. Relevant law;
III. Advocates of arbitration;
IV. How arbitration actually harms consumers; and
V. What consumers can do to protect themselves.

The report raises questions about the quality of justice delivered through binding arbitration between parties of different bargaining levels and documents the uneven playing field binding arbitration offers consumers and citizens seeking justice.

The report was prepared on behalf of the Texas Watch Foundation by Research Fellow Cris Feldman. The Texas Watch Foundation, a 501(c)(3) organization is the research and education arm of Texas Watch, the statewide consumer advocacy organization. For more information on this report or the Texas Watch Foundation, please contact Abby Sandlin at (512) 381-1111.

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contracts of adhesion can justifiably be enforced at all under traditional contract theory because the adhering party generally enters into them without manifesting knowing and voluntary consent to all their terms. See, *e.g.,* Rakoff, Contracts of Adhesion: An Essay in Reconstruction, 96 Harv.L.Rev. 1173, 1179-1180 (1983); Slawson, Mass Contracts: Lawful Fraud in California, 48 S.Cal.L.Rev. 1, 12-13 (1974); K. Llewellyn, The Common Law Tradition 370-371 (1960)." *Carnival Cruise Lines v. Shute*, 111 S.Ct. 1522, 1530-31 (1991).

[4] See Chapter IV *infra*.

[5] National Automobile Dealers Association, press release, October 4, 2000: http://www.nada.org/Content/NavigationMenu/MediaCenter/PressReleases/Leg_10_04_00.htm

[6] Charles Ornstein, *Arbitration Provider Breaks with HMOs,* Los Angeles Times, March 11, 2002 ("Patients should have the right to forgo arbitration in health care disputes and file lawsuits directly in court, the nation's largest arbitration provider plans to tell California lawmakers")

Chapter I
Overview

Historical Development

The early arbitration movement culminated in 1923, when legislation was first introduced that would make arbitration agreements enforceable in federal courts. By 1925, the Federal Arbitration Act[7] (FAA) became law, allowing businesses to contractually agree to private resolution of commercial disputes. The FAA, as passed, expressly endorsed arbitration of disputes arising from maritime and commercial contracts.[8]

Original participants in the debate did not envision that the FAA would be applied in a consumer context. Mr. W.H.H. Piatt, the American Bar Assoication (ABA) point person proposing the legislation, stated that the FAA would apply, "between merchants one with another, buying and selling goods."[9] The bill's authors and supporters emphasized the FAA would only apply to "merchants," as opposed to consumers.[10] For over a half century, that sentiment prevailed.

Sixty years later, a new interpretation of the FAA emerged. In 1983 the U.S. Supreme Court suddenly interpreted the FAA as overcoming "longstanding judicial hostility to arbitration provisions that had existed in English common law and had been adopted by American courts and to place arbitration agreements upon the same footing with other contracts."[11]

According to the Court, the FAA created a "liberal federal policy favoring arbitration," stamping arbitration clauses with a presumption of enforceability.[12] This new found judicial policy preference arose in the consumer context, but was soon extended to civil rights claims by employees against employers[13] and statutory claims previously immune to stealth arbitration clauses.[14] Today, arbitration agreements dominate modern life as clauses appear in everything from credit card agreements to nursing home admission papers.[15]

[7] 9 U.S.C. §1, *et. seq* (2001).
[8] 9 U.S.C. §2 (2001).
[9] Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration. Hearing S. 4213 and 4214 before Subcommittee of the Committee on the Judiciary, 67th Cong., Sess. 9-10 (1923).
[10] *Id.*
[11] *Cone Memorial Hosp. v. Mercury Const.*, 460 U.S. 1, 42 (1983).
[12] *Id.*
[13] *Gilmer v. Johnson Lane Corporation*, 500 U.S. 20 (1991)(age discrimination case can go through arbitration).
[14] The U.S. Supreme Court originally held that claims brought under the 1933 Securities Act could not be subjected to binding arbitration. *Wilko v. Swan*, 346 U.S. 427, 435 (1953). However, the court reversed itself as it found new meaning in the FAA. *Rodriguez de Quijas v. Shearson*, 490 U.S. 477, 481 (1989).
[15] Mary Flood, *Arbitration Not Always Fair, Cheap for Parties in Dispute*, Houston Chronicle, April 11, 2001.

The Industry of Arbitration

An entire economy of private civil justice administration provides the structure for implementing binding arbitration.[16] With the civil justice system in many instances privatized and displaced by rampant use of adhesion contracts, numerous arbitration firms fill the void, effectively serving as judge and jury, while providing rules of procedure. Binding arbitration provisions in consumer and employee contracts normally specify which arbitration firm will fill the vacuum and step in for the courts. Three representative firms, and selected statements from each, follow:

A. American Arbitration Association (AAA).
"Most of the recent growth in contractual arbitration has been in the consumer, employment, health care and international arenas. For example, nearly 400 companies and 4 million employees worldwide turn to the American Arbitration Association to resolve workplace conflicts. To hear and resolve these cases, the AAA offers a national panel of experts – diverse in gender and ethnicity – who have significant employment law experience."[17]

B. National Arbitration Forum (NAF).
"Everyone, big or small, is on equal footing with the Forum. We are only compensated for administering cases. We receive this compensation in the form of filing fees and hearing fees from the parties who file a dispute with us. The arbitrators are compensated for their time, regardless of who prevails in each individual case. As a neutral arbitration administrator, the Forum has no exclusive client relationships. We do not contract with, represent or counsel our users, whether they are businesses or individuals."[18]

C. JAMS (formerly known as Judicial Arbitration and Mediation Service).
"Arbitration -- either entered into voluntarily after a dispute has occurred, or as agreed to in a pre-dispute contract clause -- is generally "binding." By entering into the arbitration process, the parties have agreed to accept an arbitrator's decision as final. There *are* instances when an arbitrator's decision may be modified or vacated, but they are extremely rare. The parties in an arbitration trade the right to appeal for a speedier, less expensive, private process in which it is certain there will be a resolution."[19]

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[16] The arbitration industry is also lobby, advocating for expansion of arbitration. See Chapter IV.
[17] AAA Overview http://www.adr.org/
[18] NAF "How Is The Forum Compensated," http://www.arb-forum.com/about/questions.asp#20
[19] JAMS Ethics Guidelines for Arbitrators http://www.jamsadr.com/ethics_for_arbs.asp

Differences Between Courts and Private Arbitration

Arbitration advocates, including the arbitration firms listed in the previous section, argue that the distinctions between arbitration and civil court make binding arbitration a more desirable avenue for dispute resolution. However, opponents of binding arbitration argue that the policy goals of arbitration are rarely met, and that arbitration inherently favors repeat defendants, as opposed to our civil courts. The following chart lists the inherent traits of public court proceedings as opposed to private binding arbitration.

Things Inherent to Public Court Proceeings:	**Things Inherent To Binding Arbitraion:**
Right to an appeal	Very limited ability to appeal[20]
Development of case law/precedent	No case law/precedent
Public proceedings	Private proceedings[21]
Public records	Private records
Mandatory record of proceedings	No mandatory record of proceedings
Injunctive relief	No injunctive relief
Discovery	Limited discovery
Trial by jury/peers	Trial by privately paid for judge
Rules of evidence	Rules of evidence optional
Class actions	No Class actions[22]

These differences present several issues for parties to consider before they enter into binding arbitration:

- Limited discovery in the course of arbitration, for example, can limit the ability of a plaintiff to establish what went wrong if there is a product failure;
- Lack of evidentiary rules in arbitration can allow hearsay and other typically inadmissible evidence to come into play with no way of appealing their submission to the arbitrator;
- The secrecy of arbitration can permit a biased arbitrator to rule with impunity;
- Arbitrators cannot force bad actors to cease harmful acts through injunctive relief;
- The absence of an appeal makes an arbitrator's decision final;
- The absence of case law can make a proceeding unpredictable for consumers; and

[20] See, e.g., Major League Baseball Players Association v. Garvey, 532U.S.504,509 (2001); United Transportation Union v. Gateway Western Railway Co., _F3d_, 2002 WL437949 (7th Cir. March 21, 2002) (Posner, J.) (Felony conviction of arbitrator while proceedings are pending is not grounds to vacate later award.

[21] See, e.g., National Arbitration Forum, Code of Procedure Rule 4 (entitled "Confidentiality") ("Arbitration proceedings are confidential unless all parties agree otherwise. A party who discloses confidential information shall be subject to sanctions.").

[22] See, e.g., Champ v. Siegel Trading Co., 55F.3d269 (7th Cir. 1995).

- The absence of class actions makes it impossible for consumers who suffered serious harm unable to band together and seek redress in an economically efficient manner.

Policy Objectives Of Arbitration—Failed Promises

The peculiarities of arbitration can serve the needs of parties of equal bargaining strength who voluntarily agree to private dispute resolution. In such circumstances, the objectives of arbitration - quick, unbiased, economical resolution of disputes – may be attained. However, in numerous arenas, binding arbitration fails to achieve the goals its advocates tout.

A. "Arbitration Is Quick"

One of the biggest draws to arbitration is the purported speedy nature of proceedings. Advocates of arbitration argue that the industry of arbitration provides a more rapid resolution of grievances. However, a wide array of business interests with first hand knowledge of binding arbitration now agree that arbitration is not as quick as thought.

For example, in an interview with the Houston Chronicle, Bryan Whitworth, Executive Vice President of Phillips Petroleum, stated. "Arbitration may seem like it is an easy single way to solve problems. But, we've found time delays; it's not saving expenses; and the courts offer just as good an opportunity."[23] Whitworth stated that Phillips Petroleum hopes to keep arbitration clauses out of most future contracts.[24]

On the opposite end of the business spectrum, arbitration agreements in trial attorney contracts with clients are no longer widely endorsed because of time delays. For example, in Harris County, arbitration cases run an average of "nine or more months," which is about the same time it takes a case to work through the civil justice system in the greater Houston area.[25]

To be sure, there are those occasions where arbitration may run more quickly than a civil court proceeding. However, that is in large part because arbitration proceedings can vastly limit discovery. By limiting discovery, bad actors easily avoid liability, for the consumer never can prove how the bad act occurred. For example, by withholding documents revealing the faulty engineering of a car tire or the blueprints of a shoddily assembled living structure, manufacturers can prevent consumers from proving the validity of their claims, no matter how egregious the harm.[26]

B. "Arbitration Is Unbiased"

Arbitration firms confront conflicts of interest far exceeding those faced by the courts. In many instances arbitration firms contract with major corporations to handle all consumer disputes. Arbitrators then feel pressure to rule in favor of the corporation in order to

[23] Mary Flood, *Arbitration Not Always Fair, Cheap for Parties in Dispute*, Houston Chronicle, April 11, 2001.
[24] *Id.*
[25] *Id.*
[26] David F. Bragg, *Binding Arbitration: A Wolf In Contract Clothing,"* 2001.

retain the business for their firm.[27] The NAF handled collection disputes for the bank First USA. First USA paid NAF several million dollars as a result of the contract, and First USA won 99.6% of the cases out of 50,000 total.[28]

At times it can be hard to distinguish arbitration firms from major clients. The AAA has held shares in AT&T, Bank of America, Aetna, Cigna Corp., General Electric - all of which the AAA has resolved disputes for. General Electric and Sprint corporate officers have sat on the AAA board. In 2000, the AAA received 2.1 million dollars in membership fees from GE Industrial Systems, Aetna, and other corporate interests.[29]

Arbitrators must also grapple with the "repeat player" phenomena, where one arbitrator is repeatedly chosen to hear a company's disputes. Once a company wins a dispute before a certain arbitrator, the company may repeatedly choose the arbitrator.[30] This gives the arbitrator the financial incentive to rule for the company. According to Michael Young, co-chair of JAM's Committee on Professional Standards and Public Policy, "the risks of the repeat player advantage are real and can be disturbing."[31]

C. "Arbitration Is Economical"[32]

Advocates of arbitration claim that arbitration saves money.[33] However, a simple examination of the filing fees and price of a private judge show otherwise. The high price of arbitration actually dissuades injured parties from seeking redress, in turn encouraging bad actors to persist in their negligent, if not dangerous, behavior.

For example, if the homeowner of a $110,00 house sued a homebuilder because of a cracked slab foundation, the homeowner would face a potential cost of $3,500 for a two day arbitration hearing under the AAA. The $3,500 includes a mandatory $2000 filing fee, the fees for the arbitrators on the panel, and room rental. The cost of $3,500 does not cover the cost of attorneys or expert witnesses.[34] This is more than ten times the $300 filing fee if the homeowner were allowed to go to court.[35]

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[27] Carolyn E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings called One-Sided*, Washington Post, March 1, 2000.

[28] Reynolds Holding, *Private Justice: Can Public Count On fair Arbitration? Financial Ties To Corporations Are Conflict Of Interest, Critics say,* October 8, 2001.

[29] *Id.*

[30] The inverse is true as well. When an arbitrator rules for a plaintiff the defendant will not rehire the arbitrator. In a study of HMO disputes in California, arbitrators who awarded damages exceeding $1 million for the plaintiff did not hear additional HMO cases. Marcus Nieto & Margaret Hosel, *Arbitration In California Managed Health Care Systems*, 22-23 (2000).

[31] *Id.*

[32] Arbitration advocates discuss this point at length. However, Texans everyday pay for the upkeep of state courts via state taxes. Therefore, when someone is forced into a private court, they are paying twice – once for the public court, and once for the private court.

[33] It is probably cheaper for a large corporate defendant to use arbitration as opposed to individual consumers. However, as consumers increasingly challenge the validity of binding arbitration in court, the economic advantage for institutional defendants may cease to exist.

[34] See Ting v. AT&T, 182F.Supp.2d 902,917 (N.D. Cal. 2002) (citing studies showing average filing costs and arbitrator's compensation.

[35] David F. Bragg, *Binding Arbitration: A Wolf In Contract Clothing,"* 2001.

Furthermore, arbitration clauses often specify the venue for the arbitration. For example, the online auction service E-Bay mandates all disputes must go to an arbitrator in San Jose, California.[36] This automatically elevates the cost for people traveling from Texas.

With the policy objectives of binding arbitration in question it is hard to understand why courts repeatedly find a strong policy toward enforcement of murky binding arbitration clauses hidden in fine print. One could surmise that courts may seek to employ arbitration as a mechanism for lightening the docket, allowing for quicker resolution of other cases. What follows is a brief synopsis of relevant case law.

[36]http://pages.ebay.com/help/basics/f-agreement2.html#13
"Section 17. Arbitration. Any controversy or claim arising out of or relating to this Agreement or our services shall be settled by binding arbitration in accordance with the commercial arbitration rules of the American Arbitration Association. Any such controversy or claim shall be arbitrated on an individual basis, and shall not be consolidated in any arbitration with any claim or controversy of any other party. The arbitration shall be conducted in San Jose, California, and judgment on the arbitration award may be entered into any court having jurisdiction thereof. Either you or eBay may seek any interim or preliminary relief from a court of competent jurisdiction in San Jose, California necessary to protect the rights or property of you or eBay pending the completion of arbitration."

Chapter II
The Law of Arbitration

The law of binding arbitration is perhaps best explained by the hypothetical purchase of an "Acme Computer."[37] Assume Acme Computer is a national computer manufacturer with distributors here in Texas. Assume you buy an Acme Computer and after 120 days a major defect with the hard drive caused by faulty engineering wipes all stored information off your unit. You feel that you just blew $1,500 and want to see what recourse you have. You scour all the documentation that came with the system and find a pamphlet. On the front, the pamphlet states:

> "NOTE TO THE CUSTOMER:
>
> This document contains Acme's Standard Terms and Conditions. By keeping your Acme computer system beyond five (5) days after the date of delivery, you accept these Terms and Conditions."

The notice is in emphasized type and is located inside a printed box, which sets it apart from other provisions of the document. The "Standard Terms" referenced above are four pages long in ten-point font and contain sixteen numbered paragraphs. Paragraph Ten provides the following arbitration clause:

> DISPUTE RESOLUTION. Any dispute or controversy arising out of or relating to this Agreement or its interpretation shall be settled exclusively and finally by arbitration. The arbitration shall be conducted in accordance with the Rules of the American Arbitration Association. The arbitration shall be conducted in Chicago, Illinois, U.S.A. before a sole arbitrator. The parties to this agreement agree that use of classes is prohibited. Any award rendered in any such arbitration proceeding shall be final and binding on each of the parties, and judgment may be entered thereon in a court of competent jurisdiction. Illinois law will apply.

A. Which law applies?

As a consumer the first question you are confronted with regarding binding arbitration is which law applies - state or federal law. This question could have great ramification and determine whether or not you actually waived your right to a jury trial. However, keep in mind that both the U.S. Supreme Court and the Texas Supreme Court consistently hold that there is a strong policy favoring binding arbitration.[38] The U.S. Supreme Court premises this conclusion upon the FAA, while the Texas Supreme Court recognizes such a policy via the FAA as well as the Texas General Arbitration Act (TAA).[39]

The TAA actually provides greater protection for Texas consumers. For example, in disputes involving $50,000 or less, the consumer can only enter into binding arbitration if

[37] For the most part, binding arbitration is a creature of contract. All defenses against binding arbitration are basic contract law arguments.

[38] *Southland Corp. v. Keating*, 456 U.S. 1, 104S.Ct. 852 (1984); *Green Tree Financial v. Randolph*, 531 U.S. 79 (2000); *Capital Income Properties v. Blackmon* , 843 S.W.2d 22, 23 (Tex. 1992).

[39] TEX. CIV. PRAC. & REM. CODE §§171.001-.023.

both the consumer and the consumer's attorney sign the contract.[40] This same basic protection applies to arbitration agreements pertaining to personal injury.[41]

Unfortunately, the vast majority of consumer transactions fall under the Interstate Commerce Clause of the U.S. Constitution.[42] Whenever a transaction falls under the commerce clause it is subject to the provisions of the FAA, as opposed to the TAA.[43] Parties to a contract can specify that they would like the TAA to apply, as opposed to the FAA.[44]

Pursuant to the terms of your Acme Computer purchase, you would be subject to the terms of the FAA and forced to forgo the limited protections found in the TAA. If the TAA applied, the binding arbitration agreement would probably be declared void. However, your Acme Computer cost under $50,000. Your computer would also be considered part of interstate commerce. As such, the FAA would apply. Hence, federal law would dictate that you probably waived your right to a jury trial.[45]

B. **Is there a voluntary agreement to enter into binding arbitration**

The next question is a matter of contract law – did you voluntarily agree to the arbitration agreement discussed above. Both federal courts[46] and Texas courts[47] provide minimal protection to consumers in this area.

A good example of Texas courts' hostility to consumers attempting to argue they did not voluntarily agree is *Emerald Texas, Inc. v. Peel.*[48] In *Emerald* a Texas court held that a homeowner entered into binding arbitration with a homebuilder, despite all evidence

[40] Tex. Civ. Prac. & Rem. Code §171.002(a)(2).
[41] Tex. Civ. Prac. & Rem. Code §171.002(c).
[42] *In re First Merit Bank*, 52 S.W.3d 749, 754 (Tex. 2001).
[43] *Jack B. Anglin v. Tipps*, 842 S.W.2d 268 (Tex. 1992)
[44] *Hearn v. Gonzalez*, 18 S.W.3d 684,688 (Tex. App. – Houston [14] 2000).
[45] In the housing context it is especially hard to escape the FAA and seek the protection of the TAA in order to protect oneself from binding arbitration. Permanent dwellings in Texas normally cost over $50,000. As such, even if one were to argue the transaction did not involve interstate commerce, the TAA would not apply for the transaction would exceed the $50,000 cap. When manufactured homes are involved it is possible to stay below the $50,000 cap. However, in that scenario the commerce clause would force coverage by the FAA, thus eliminating the protection of the TAA.
[46] On the federal side the Fifth Circuit established some vague parameters for assessing whether an actual agreement to arbitrate exists in the context of an adhesion contract. In the case of an investor trying to avert binding arbitration forced upon him by a brokerage firm, the Fifth Circuit attempted to establish how one would show a contract was not voluntary:

> A party to an arbitration agreement cannot obtain a jury trial merely by demanding one. *Saturday Evening Post Co. v. Rumbleseat Press*, 816 F.2d 1191, 1196 (7th Cir. 1987)_Our case law has not established the precise showing a party must make. We have, however, suggested that the party must make at least some showing that under prevailing law, he would be relieved of his contractual obligation to arbitrate if his allegations proved to be true. In addition he must produce at least some evidence to substantiate his factual allegations. *T&R Enterprises v. Continental Grain Co*., 613 F.2d 1271, 1278 (5th Cir. 1980).

[47] *In re American Homestar*, 50 S.W.3d 480 (Tex. 2001).
[48] *Emerald Texas, Inc. v. Peel*, 920 S.W.2d 398 (Tex.App. – Huoston [1st Dist] 1996, no writ).

indicating the homeowner knew nothing about the arbitration agreement, had no understanding of what the agreement meant, and no experience in real estate deals.[49] The home-buyer tried to argue he was forced to sign the agreement, and that the contract was "unconscionable." Still, the court ruled in favor of the homebuilder because "Texas law favors arbitration" and the best proof of whether the waiver of a jury trial was voluntary "is the contract" itself.[50]

Based on the poor case law developed in Texas and relevant federal courts, you would most probably have found that you "voluntarily agreed" to engage in binding arbitration. The court would probably come to this conclusion even if you did not know what binding arbitration meant. Even the fact that you did not read the agreement until well after the purchase of the product would be considered irrelevant. According to current law, the mere purchase of the product indicates that you voluntarily agreed to binding arbitration.

C. Does the dispute fall outside the scope of the arbitration agreement?

The next question is whether the parties intended to address the Acme Computer failure via binding arbitration. Put another way, does the dispute fall outside the scope of the contract? For example, if your Acme Computer blew up and caused severe burns to your body, you may be able to argue such events were not contemplated by the binding arbitration clause.

This level of analysis offers minimal recourse to consumers seeking to avoid binding arbitration.[51] Texas and federal courts broadly interpret binding arbitration clauses. Both have repeatedly held that any doubt about the scope of arbitrable issues should be resolved in favor of binding arbitration.[52]

As such, you would have to accept that a failure of your hard drive would undoubtedly fall within the scope of the arbitration provision discussed above. Alas, you and your faulty Acme Computer would probably end up in binding arbitration. Pursuant to the terms of the arbitration agreement, you would be unable to band together with other aggrieved consumers and bring a class action. Furthermore, you would probably be

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[49] Another example is *In re Oakwood.* In that case the state's high court articulated its resistance to homeowners overcoming arbitration agreements, even if the agreement was not voluntary: In support of their claims of unconscionability and duress, the Brandons contend the Agreement "is a classic example of a contract of adhesion where one party had absolutely no bargaining power or ability to change the contract terms." Even if this contention is true, however, adhesion contracts are not automatically unconscionable or void. See *Dillard v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 961 F.2d 1148, 1154 (5 th Cir.1992), cert. denied, 506 U.S. 1079, 113 S.Ct. 1046, 122 L.Ed.2d 355 (1993) (citing 6A ARTHUR CORBIN, CONTRACTS § 1376, at 20-21 (1962) & 7-9 (Supp.1991)). Moreover, "there is nothing per se unconscionable about arbitration agreements." *EZ Pawn*, 934 S.W.2d at 90; *see Emerald Tex., Inc. v. Peel*, 920 S.W.2d 398, 402-403 (Tex.App.--Hous. [1 Dist.] 1996, no writ) (holding that to find the arbitration provision unconscionable under the evidence presented would negate the public policy in favor of arbitration). *In re Oakwood Mobile Homes, Inc.* 987 S.W.2d 571, 573 (Tex. 1999).

[50] *Id.* at 403.

[51] *In re Oakwood* at 573; *In re Delta Homes, Inc*., 5 S.W.3d 237, 239 (Tex. App. Tyler 1999, orig. proceeding).

[52] *In re American Homestar* 50 S.W.3d 480, 484 (Tex. 2001*); Moses H. Cone Mem. Hosp. V. Mercury Constr. Corp*., 460 U.S. 1,24-25 (1983).

unable to take advantage of key consumer protection provisions found in the Texas Deceptive Trade Practices Act. In the end, it would cost you much more to challenge Acme on your own than it would cost to buy another computer. In the end, you will have lost $1500 and all the information stored on your hard drive. Your inability to legally challenge the faulty engineering of the Acme Computer would encourage Acme to continue to produce the faulty system.

D. A Case Study

Texas courts exhibit a great deal of hostility toward consumers seeking relief from the stranglehold of hidden arbitration provisions. A telling example is the recent Texas Supreme Court case involving the De Los Santos family. *In re First Merit Bank*, 52 S.W.3d 749, 754 (Tex. 2001). The De Los Santoses bought a mobile home for their daughter and son-in-law. The home was defective and the family sued to be removed from the bank contract after the manufacturer refused to repair the defects. However, the De Los Santoses soon found out that they were not going to have their day in court. Illustrating the extent of the uneven playing field, an arbitration provision waived judicial relief for all disputes "relating to the loan" for the home. Ironically, the clause stated the bank—and not the family—could still go to court! Below are defenses the De Los Santoses asserted to be exempted from the arbitration clause.

De Los Santos Defense Against Arbitration Clause	**De Los Santos Argument**	**Texas Supreme Court Holding**
The Federal Arbitration Act does not apply.	Purchase of a mobile home in Texas does not involve interstate commerce.	As long as the transaction somehow "relates" to interstate commerce, the FAA applies.
The dispute falls outside of the scope of the arbitration provision.	The defects to the mobile home did not "relate to the loan" for the home.	The buying of the home, and the home itself, "relate to the loan," and are therefore within the scope of the provision.
The arbitration clause was not voluntary and it was "unconscionable."	The De Los Santos family was in a very weak position—either sign contract or forfeit home—and had no choice but to sign the agreement and waive their right to the courts, despite the bank's ability to still seek judicial redress.	This type of agreement is the industry standard. Therefore, it is not "unconscionable" for the bank to have access to the courts, while the De Los Santos family would not.
Arbitration in this case would cost a substantial sum, and is "unconscionable."	The provision calls for three arbitrators for a total of $250 each day and an additional $2000 filing fee.	Part of the arbitration agreement which the De Los Santoses signed stated "that arbitration is a less expensive method of dispute resolution that decreases servicing costs of this loan . . . ." Therefore, without more specific facts, the family could not argue the provision was unconscionable due to substantial costs.

Chapter III
Advocates of Arbitration

Arbitration advocates argue in the legislature that private dispute resolution allows for the quick, economical, unbiased resolution of conflict to the benefit of all involved. This is the premise used by arbitration advocates in seeking to prevent any possible roll back of arbitration through legislation.[53] However, as noted in Chapter II, these policy goals are often times not met.

In reality, some speculate that arbitration advocates argue for private dispute resolution because it is better for a company's bottom line.[54] For example, private judges are not likely to be familiar with the policies and nuances behind consumer protection statutes.[55] In turn, even when a plaintiff wins in an arbitration proceeding, damages are typically much lower than what would be awarded in a court of law.[56]

As discussed in Chapter II(B), arbitration places an inherent "thumb on the scale" for defendants. This stands in stark contrast to the neutrality found in juries.[57] While consumers would favor a jury's attempt to do "justice," arbitration advocates would prefer an arbitrator's sympathetic predisposition. In turn, arbitration advocates vehemently fight against any and all rollbacks in the legislative process presumably because they place value in a system of dispute resolution providing consistent favorable outcomes. In the eyes of certain industries, even if the plaintiff prevails in arbitration, the award will presumably be smaller.[58] For the most part, the primary legislative presence working for arbitration in Texas is the business group Texans for Lawsuit Reform (TLR).

Texans for Lawsuit Reform

This past session Texans for Lawsuit Reform actively opposed House Bill 1862. HB 1862 created a stir when it passed both chambers yet was vetoed by Governor Rick Perry. HB 1862, also referred to as the "prompt pay" bill, would have guaranteed doctors payment by health maintenance organizations (HMOs) in a certain amount of time. The bill would also have prohibited the use of binding arbitration in resolution of disputes between doctors and HMOs. The bill's prohibition on binding arbitration prompted TLR into a full court press seeking the veto of HB 1862. In an effort to obtain

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[53] It is more common to see legislation dealing with rolling back arbitration, as opposed to expanding arbitration. This is because federal and state statutes have already been determined to broadly allow arbitration. Hence, there is not a pressing need for arbitration advocates to pursue additional legislation.
[54] Jean Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash U.L.Q. 637, 683-84 (1996).
[55] *Id.*
[56] Schwartz, *Enforcing Small print to Protect Big Business: Employee and Consumer Rights In An Age of Compelled Arbitration*, 1997 Wis. L. Rev. 33, 60-61,
[57] Juries in Texas cannot have an affiliation with either party in a case. In fact, it is grounds for mistrial if a juror even accepts aspirin from one of the parties. *Occidental Life Ins. Co. v. Duncan*, (Tex. App. – San Antonio 1966, writ ref'd n.r.e.). On the other hand, arbitration is systematically riddled with conflicts calling into question the ability of arbitrators to impartially hear a case. See Chapter II (B).
[58] Schwartz, *supra*.

the veto, TLR members appeared to flood Governor Perry with campaign cash.[59] In the end, HB 1862 was vetoed to the chagrin of doctors across the sate.

Another bill worth noting is SB 1706 introduced by Senator Leticia Van de Putte. This bill would have restricted when binding arbitration could be employed. It also would have established certain requirements pertaining to the neutrality of arbitrators. However, unknown dynamics behind the scenes prevented the bill from obtaining a hearing.

Health Maintenance Organizations (HMOs)

Health Maintenance Organizations firmly endorse arbitration. HMOs apparently played a role in the veto of HB 1862. While it is hard to say what HMOs directly did behind the scenes to successfully obtain the veto, the link between HMOs and TLR are strong.

Alan Shivers is a prominent member of TLR and a former spokesperson for that organization. Just recently Shivers also headed up Texans for Quality Healthcare, an HMO front group.[60] In addition, Mr. Shivers sits on the board of The Institute of Rehabilitation and Research (TIRR) with other active TLR supporters. TIRR has numerous links to the managed care industry. At the very least, this leaves the impression that the agenda of HMOs and TLR came together in the pursuit of the veto of HB 1862.

Homebuilders

Permanent homebuilders advocate for binding arbitration with great enthusiasm. Builders of manufactured homes are just as vigorous in their advocacy, if not more so. In part, this may be because permanent homebuilders are not subject to the protections found in the Texas Deceptive Trade Practices Act, while manufactured home builders are.[61]

Much of the debate for manufactured home interests has largely been fought in the courts.[62] This industry consistently produces *amicus* briefs for the Texas Supreme Court to consider. For example, in two recent Texas Supreme Court cases argued in 2001 (*In re First Merit Bank* and *In re Homestar*), the Texas Manufactured Housing Association (TMHA) filed *amicus* briefs with the Court defending the use of binding arbitration.

Permanent homebuilders figure prominently in TLR. This may explain TLR's commitment to binding arbitration. TLR President Dick Weekley is the brother of David Weekley of David Weekley Homes. Richard Weekely is a major contributor to the efforts

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[59] Wayne Slater, *Suits-limit group is Perry Top Donor*, Dallas Morning News, August 19, 2001.

[60] "Texans for Quality Health Care, an association of business interests set up to fight the 1997 law [creating laibility for an HMO for denial of coverage] and headed by Allan "Bud" Shivers Jr., a Bush Pioneer (a title given to a person who raised at least $100,000 for Bush's presidential campaign), no longer exists. But the group was housed by the Texas Association of Business and Chambers of Commerce. http://www.salon.com/politics/feature/2001/07/17/patient/.

[61] The DTPA does not apply to permanent structures. Tex. Prop. Code Ann. §27.002 However, the DTPA does apply to manufactured homes. Recall FN 47. Hence, arbitration becomes an easy way to thwart basic consumer protection statutes.

[62] See *In re Homestar*; *In re First merit Bank.*

of TLR, contributing $126,000 to the TLR agenda in 2000 alone.[63] The Weekley brothers like to use arbitration in their contracts.[64]

Financial Institutions

One bill that did not gain the attention of TLR, but did gain the attention of the financial community, was SB 1581. SB 1581 introduced by Senator Royce West originally prohibited binding arbitration in the home-lending context. Anyone who has ever taken out a mortgage is well aware of the many dotted lines one must sign at closing. Often arbitration provisions are slipped in to the dismay of the consumer. SB 1581 sought to halt such practices.

SB 1581 was amended on the floor of the Texas Senate, removing the prohibition against binding arbitration in prime and sub-prime mortgages. Senator Carona lead the charge in stripping this provision. Actively testifying against the bill before it reached the floor were numerous lending institutions and affiliated trade groups. These included the Texas Mortgage Bankers Association, the American Bankers Insurance, and the Texas Financial Services Association.

[63] Texans for Public Justice, *Texans for Lawsuit Reform: How the Texas Tort Tycoons Spent Millions in the 2000 Election*, http://www.tpj.org/reports/tlr/page3.html#topdogs.
[64] For example, See *Weekley Homes v. Jennings*, 936 S.W.2d 16 (San Antonio – 1996).

CHAPTER IV
CASE STUDIES AND EXAMPLES OF ARBITRATION ABUSES

The following case studies document instances in which arbitration poses an unbalanced bargaining position for individuals seeking justice against corporate entities.

Doctors v. HMOs

As a whole, doctors are harmed incessantly by binding arbitration agreements in contracts with Health Maintenance Organizations (HMOs). Doctors often encounter HMOs which refuse to promptly pay medical bills submitted by doctors, despite HMOs' obligation to both doctor and insured. The amount of money in question for each doctor is too small to make it economically efficient to bring a lawsuit against an HMO in a court of law. However, if doctors banned together in a class action lawsuit, then perhaps they could gain relief from miserly HMOs. However, HMOs routinely employ arbitration clauses with doctors, and these clauses, among other things, typically preclude the use of class action lawsuits.

In a recent story by Texas Medicine writer Walt Borges, several medical professionals discussed the difficulties imposed by HMOs' use of binding arbitration and why doctors view courts as an essential avenue of recourse.[65] For example, Dr. David Rogers, an Allen, Texas Gynecologist, discussed how binding arbitration places doctors on an uneven playing field with powerful HMOs. Dr. Rogers stated, "Physician can't afford to go to arbitration over small, individual claims. In the courtroom, we can join together many similar issues for a common solution. Both arbitration and litigation may be lengthy and costly, but ultimately class action suits ought to be more efficient when it comes to hundreds of thousands having the same problems."[66]

Dr. Rogers also noted that in binding arbitration, "the insurer can draw things out," and that "arbitration doesn't set precedents and it doesn't change behavior." In other words, noted Dr. Rogers, "That means whatever solution comes out of binding arbitration doesn't help other doctors or patients."[67]

In another recent interview Dr. Rogers emphasized that in the area of medicine "contracts are take it or leave it documents." Dr. Rogers elaborated by stating, "If we have a dispute we are forced to go to an arbitration proceeding where it is a David and Goliath scenario." He added, "Any kind of situation where the playing field is not level can be bad for consumers."[68]

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[65] Walt Borges, *In a Bind: Binding Arbitration Not Always Preferable to lawsuits*, Texas Medicine, Sept. 1, 2001.
[66] *Id.*
[67] *Id.*
[68] Interview with Dr. David Rogers, March 25, 2002.

TMA General Counsel Donald Wilcox also recently described how arbitration thwarts effective discovery and therefore precludes doctors from proving HMO malfeasance. Mr. Wilcox stated, "Physicians should watch for arbitration contracts that prohibit discovery and provide unreasonable limits on the amount of damages that can be awarded against an insurance company."[69]

Laura Kabay, executive director of Preferred Independent Physicians Association (PIPA) stated in the same piece, "There are lots of reasons not to go into arbitration. It's not cheap – that's the biggest one. It can be faster [than litigation], but it can also be drawn out." Ms. Kabay further elaborated by describing PIPA's one experience with arbitration. She stated, "Just invoking arbitration created considerable expense. Choosing the arbitrator alone took a long time and considerable attorney involvement and expense."[70]

Homeowners v. Homebuilders

Dawn and Scott Richardson, along with daughters Alexa and Erica, thought they were having their dream home built by David Weekley Homes. Instead, they purchased a dangerous nightmare. Within weeks of moving into their newly built home shoddy construction would lead to water leaks and the development of black mold. Not only did the mold pose a serious health threat, but also many of the building materials used in the construction process were releasing high levels of carcinogens, including formaldehyde and benzene.

All members of the family suffered severe reactions to the mold and the air bound carcinogens. Perhaps most disturbing was that two-year old Erica lost all expressive speech. Despite the obvious, Weekley Homes was non-responsive, and made little effort to remedy the hazardous situation the homebuilder created. The Richardson's decided to sue, but are now faced with being forced into binding arbitration.

Dawn and Scott are both electrical engineers and highly educated. They had read the contract with Weekley Homes and had no idea they were signing away their right to a jury trial. As Ms. Richardson stated, "We read the contract and did not know what arbitration meant on a legal level. There must be a lot of people like us who innocently and unknowingly sign away their constitutional rights."[71]

Ms. Richardson feels that homebuilders rely on stealth arbitration provisions because they realize it is economically inefficient for homeowners to fight poor and hazardous workmanship in the course of the arbitration process. Ms. Richardson is very concerned

[69] Walt Borges, *In a Bind: Binding Arbitration Not Always Preferable to lawsuits*, Texas Medicine, Sept. 1, 2001.
[70] *Id.*
[71] Interview with Dawn Richardson, February 19, 2002.

that her family will not even have a fighting chance in the impending arbitration proceedings "to overcome the inequities inherent to the arbitration process."

Ms. Richardson also states, "The proceedings are stacked against the homeowner as a result of the repeat player phenomena and the close relationship between the homebuilder and the arbitrators. Even worse, there is no way for us to research how the arbitrator previously ruled. There is no precedent for us to examine, while Weekley is apparently well aware of the arbitrators' previous rulings and reasoning."

Ms. Richardson also states that arbitration is cost prohibitive in the pursuit of justice against homebuilders. Ample evidence supports Ms. Richardson's position. For example, a family from Houston, Texas bought a new home from the Ryland Homes. Upon moving in, the family found numerous defects including faulty roofing and electrical wiring. The contract with Ryland contained a hidden arbitration clause forcing arbitration. The family lost their claim, and the total cost just to pay for arbitration was $12,576.[72]

Another example is a family from Austin, Texas. They entered into a contract with Number One Custom Homes to build a house. Third party experts verified numerous construction defects. However, the family was forced into arbitration as well. While the family ultimately prevailed in the arbitration proceeding, they still expended an enormous amount of money. The total cost just to engage in the arbitration proceeding was $13,068.[73]

Ms. Richardson is very disturbed that she has been forced to waive her right to a trial before her peers. She states, "It offends me that I am being deprived of my right to a trial before my peers, after Weekley Homes hurt my family so badly. It is bad enough that we were all harmed by the terrible construction of the house. It was further insult to injury when I learned we were deceived out of our constitutional right to seek justice in the courts."

Credit Card Holders v. Banks

Almost all Texans are vulnerable to abusive practices on the part of credit card companies. Credit card companies are able to nickle and dime card holders into oblivion via deceptive fee arrangements and annual percentage rates. Sadly, when a single consumer has been bilked out of $100, it is very difficult for them to seek recourse in a court of law. It is simply not worth the effort. However, $100 is a lot of money to most people, and the ability of consumers to use class action lawsuits to obtain a refund ensures that large and anonymous financial institutions will not cheat cardholders a few dollars at a time. Consumers throughout the state are vulnerable to this sort of abuse unless consumers can come together as a class and protect themselves from deceptive practices on the part of credit card companies.

[72] See soon to be released Public Citizen report, "The Cost of Arbitration."
[73] *Id.*

The key weapon for consumers is the threat of a class action against bullish credit card companies. However, arbitration service providers are aggressively soliciting major corporations and credit card companies encouraging them to use their services as a means to escape responsibility to the public. By using arbitration, credit card companies can forbid the use of class actions.

In a recent interview, Edward Anderson, Managing Director of the National Arbitration Forum, discussed "do it yourself" civil justice reform through the use of arbitration. Mr. Anderson states, "[N]ow is the time for corporate counsel to reexamine the use of the arbitration tool to accomplish their own civil justice reforms."[74] In other words, according to Mr. Andersen, corporations can avoid responsibility to its customers by using arbitration. In the context of credit cards, Andersen argues financial institutions can have clients assent to arbitration by simply using the credit card in question.[75]

The disturbing fact of the matter is that hundreds of thousands of Texans are at risk when credit card companies unilaterally impose arbitration on customers, terminating the public's ability to seek recourse via class actions. If it were not for class actions, Texans would have never seen justice in the following cases of credit card company abuse:

* A $45 million settlement to consumers by Citigroup as a result of the company assessing finance charges and higher interest rates when payments were received after 10:00 a.m. on a given due date;
* A $105 million settlement to consumers by Providian Financial for, among other things, charging "no annual fee," yet requiring card holders to buy a $156 annual credit protection plan; and
* A $84.9 million settlement to consumers from First USA for promising a fixed annual rate, but increasing it nonetheless.

However, now that arbitration clauses are quickly becoming a part of all credit card agreements, consumers can expect to see these types of abuses to increase. Not only does arbitration deprive consumers of the chance to have their day in court, it can also create an environment vulnerable to manipulation and deception.

Nursing Home Residents v. Nursing Homes

Perhaps the most vulnerable members of our state are nursing home patients. For obvious reasons, nursing home residents and their families can be taken advantage of.

[74] *Do an LRA: I* No. 8, August 2001.
[75] *Id.*

There have been recent reports of facilities requiring patients to sign arbitration agreements as a condition of continued treatment or as part of the terms of being admitted to a facility.

Nursing home residents often have very few choices in terms of facilities to choose from. Furthermore, nursing home patients are often in crisis and not in a position to question what they are being asked to sign. However, some nursing home patients in Texas have been confronted with "Dispute Resolution Plans" that state:

> "This Plan spells out the only way to deal with any and all disputes or differences between the nursing home and its residents. Residents cannot sue in a court of law the nursing home or its officers, directors, employees, or agents..."[76]

Such coercive agreements threaten the health and safety of nursing home patients. The ability of nursing home patients to seek recourse in a court of law serves as a deterrent to neglect and abuse. Beth Ferris of Texas Advocates for Nursing Home Residents states, "Large corporations do not understand some of the fines and sanctions imposed by the state of Texas. They are not meaningful and do not deter bad conduct. However, some of the suits force nursing homes to take notice."[77]

Ms. Ferris's statement is well founded. Other states around the country are witnessing the growth of arbitration in the nursing home context, and how arbitration can be conducive to an abusive environment. For example, in a case involving the molestation of forty-five year old woman with a severe head injury in a New Mexico nursing home by a nursing home employee, the nursing home is invoking an arbitration agreement signed at the time the patient was admitted to the facility, effectively depriving the victimized woman of her day in court.[78]

There are approximately 1,140 nursing homes in Texas. It is difficult to assess how many actually use arbitration agreements. However, John Willis, State Ombudsman for the Texas Department on Aging recently stated, "While these agreements may be legal and voluntarily entered into, families should examine them very carefully before signing." Willis continued, "Often, their main purpose is to preclude legal action against nursing homes. And if they're required as a condition of admission or continued stay, they're inappropriate and unethical."[79]

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[76]Representative nursing home arbitration agreement obtained from Texas Department on Aging.
[77]Interview with Beth Ferris, March 19, 2002.
[78]Ziva Branstetter, *Nursing Home Sues Family*, Tulsa World, March 1, 2002.
[79]Interview with John Willis, March 26, 2002.

Chapter V

What Can Consumers Do To Protect Themselves?

Unfortunately, there is little consumers can do to avoid waiving their right to a jury trial. That is ultimately the dilemma we all face. We may need to purchase certain goods or services on the one hand, but on the other hand we are being asked to waive a constitutional right in order to do so. However, here are some basic things to keep in mind that may help:

- Consider avoiding businesses using binding arbitration.
- Read everything and understand what you are being asked to waive. For example, if you suffer harm and the arbitration clause prohibits class actions, there is the outside chance the clause is unenforceable.[80]
- If in doubt, do not sign anything if you are worried about waiving your right to a jury trial.
- Cross through a contract provision demanding binding arbitration, and see if the transaction can still be completed. If you cannot eliminate the arbitration provision, document the event. This could be evidence illustrating the contract was one of adhesion.
- For significant purchases, consider consulting a lawyer. While this may be an additional cost to the transaction, it could help preserve the right to a jury trial and a fair shake in the legal system.
- Seek passage of fundamental reforms in the state legislature. For example, SB 1706 was an attempt to minimize the bias inherent to arbitration in Texas. Comprehensive reforms in other states are currently being debated and could be explored in the Texas Legislature as well.[81]

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[80] *Ting v. AT&T*, F.Supp. cite not published (court held prohibitions against class actions was unenforceable as unconscionable).

[81] Kevin Livingston, Taking On Arbitration: California Assembly Members Introduce Package of Reforms Aimed at ADR," The Recorder, March 13, 2002. ("If passed, the bills introduced Monday would preclude arbitration companies from engaging in repeat player activity -- the process of having the same neutrals handle repeat cases for specific companies. Proposed legislation would also do away with immunity from malpractice suits for ADR providers, force the industry to reveal arbitration results, put an end to financial conflicts between ADR providers and the companies that use their services, and halt loser pay provisions that often leave consumers picking up the tab.)

Glossary

Adhesion Contract: Standardized contract offered to consumers of goods and services on essentially "take it or leave it" basis without affording consumer realistic opportunity to bargain and under such conditions that consumer cannot obtain desired product or services except by acquiescing in form contract. Distinctive feature of adhesion contract is that weaker party has no realistic choice as to terms.

Alternative Dispute Resolution (ADR): Dispute resolution by means other than civil judge and/or jury. Among other things this can include arbitration or mediation.

Amicus Curiae Brief: Means, literally, friend of the court. A person or organization with strong interest in or views on the subject matter of an action may petition the court for permission to file a brief, ostensibly on behalf of a party but actually to suggest a rationale consistent with it own views.

Arbitration: A form of dispute resolution conducted before a private and purportedly impartial third party

Arbitrator: A private and purportedly impartial judge employed during arbitration

Binding Arbitration: The decision to use arbitration in the context of a contract prior to the dispute actually arising. In the event a dispute does arise, parties to the contract must engage in arbitration unless one of very few exceptions applies.

Constitutional Right: A right guaranteed to citizens by the Constitution and so guaranteed as to prevent legislative interference therewith.

Discovery: Pre-trial devices used by one or both parties to obtain facts and information about the case from opposing parties to assist in the preparation of trial. Among other things, this may include depositions, production of documents and written questions.

Injunctive Relief: An enforceable order from a court of law requiring a party to refrain from, or perform, certain acts.

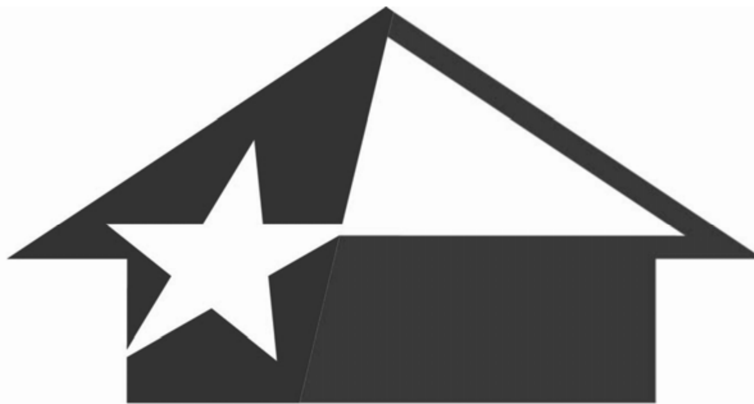
Jury: A certain number of men and women selected according to law, and sworn to impartially inquire of certain matters of fact, and declare the truth upon evidence.

Mediation: A device often used prior to civil trial where parties discuss their concerns with a neutral person (the mediator) in hopes of settling before going to court.

Rules of Evidence: Framework for introducing facts to a jury.

APPENDIX D: ARBITRATION TASK FORCE SURVEY ARBITRATION USED FOR DISPUTE RESOLUTION REGARDING ISSUES RELATED TO RESIDENTIAL CONSTRUCTION

THE HOMEOWNER / HOME BUYING CONSUMER PERSPECTIVE



Arbitration Task Force
January 2005

Arbitration Task Force Survey

Texas Residential Construction Commission

Arbitration Used For Dispute Resolution Regarding Issues Related to Residential Construction

THE HOMEOWNER / HOME BUYING CONSUMER PERSPECTIVE

NOTE: **The responses to this survey are anonymous.** The data on this survey is being collected to gather information on the arbitration process when used in resolving disputes arising from residential construction. The information will be used in developing the task force's report and recommendations to the 79th and 80th Texas Legislature.

ARBITRATION - The use of an impartial third party to render a decision in a dispute between two parties outside a court of law.

Today's Date: ______________________

1. How many new homes have you purchased: _____
2. How many homes have you had remodeled: _____
3. Did you enter into a written construction contract in each instance: _____ Yes _____ No
4. If you entered into a written agreement, did you have it reviewed by your own lawyer: _____ Yes _____ No
5. How many, if any, construction contracts have you entered that contained an arbitration clause: ______
6. If the contract contained an arbitration clause, was the arbitration clause explained to you by: _____ Counsel _____ Builder's representative ______ Not explained to you
7. Did you request the arbitration clause be removed: _____ Yes _____ No
   Did the builder comply with the request: _____ Yes _____ No

   Explain: ____

8. Did you request the arbitration clause be modified: _____ Yes _____ No
   Did the builder comply with the request: _____ Yes _____ No

   Explain: ____

9. What modification to the arbitration clause was requested:

   ____

10. If you have participated in more than one (1) arbitration proceeding to resolve a dispute arising from residential construction, please provide the # of proceedings have you participated in: __________

If you have participated in an arbitration proceeding please respond to question #11 as it relates to the use of arbitration for resolution of a residential construction dispute.

For a single arbitration proceeding that you have participated in, please answer questions #12-40.

11. The arbitration resulted from a dispute which arose:
    _____ Prior to project completion
    _____ After substantial completion of project

12. The month and year of the arbitration: ________________

13. The disputed issues included: (check all that apply)

    _____ Financial obligations of builder or owner/customer
    _____ Adherence to plans and specs during construction process
    _____ Post-construction completion of items noted during the walk-through
    _____ Post-construction warranty obligations
    _____ Construction did not adhere to building codes (in place at time of construction)
    _____ Personal Injury
    _____ Other ____

14. Arbitration agreement contained in: _____ Contract/Warranty clause _____ Post-dispute agreement

15. Was the arbitration binding: _____ Yes _____ No

16. The sale price of the new home: $_________________ or the total cost of the remodeling project: $__________________

17. Did the arbitration clause or agreement contain rules or refer to rules for the conduct of the arbitration:
    _____ Yes _____ No

    If yes, which rules did it refer to: Explain: ____

18. Was the arbitration conducted by an:

    _____ Individual arbitrator not affiliated with an arbitration service provider

    _____ Arbitrator or arbitration panel selected by an arbitration services provider

    Name of Service Provider: ____

    _____ Arbitrator or arbitration panel provided by an organization other than an arbitration services

provider (i.e. The Better Business Bureau)

19. The arbitrator or arbitration services provider was selected as a result of:

    _____ Builder's/Warrantor selection

    _____ Owner's selection

    _____ Negotiated selection pre-construction

    _____ Negotiated selection post-construction

20. What information did you have about the arbitrator (or panel members) prior to the arbitration:

    _____ Trained or certified as a professional arbitrator

    _____ Experienced in resolving construction disputes

    _____ Number of arbitrations conducted

    _____ Years as an arbitrator

    _____ Judicial experience

    _____ Other Explain: ____

21. Prior to the arbitration was there a mediation: _____ Yes _____ No

    The costs of mediation were paid by the: ______% Owner/Customer ______% Builder/Warrantor

    Who requested the mediation: ______ Owner/Customer ______ Builder/Warrantor

22. The length of time from submission of the arbitration to the award: ____ Weeks/Months/Years

23. Out-of-pocket cost for the arbitration:

    $_______ Arbitration fees

    $_______ Legal fees

    $_______ Inspection fees

    $_______ Witness fees

    $_______ Other Explain: ____

24. If the builder/warrantor assumed any fees related to the arbitration, what fees were assumed $ _______ or what percentage was assumed: ______%

25. Were you represented by legal counsel: _____ Yes _____ No
    If no, did you seek the assistance of an attorney(s): _____ Yes _____ No
    With how many attorneys did you seek assistance: _________
    Why did you not end up using an attorney: ____

26. Was the builder/warrantor represented by legal counsel: _____ Yes _____ No

27. The value of the claim was: $_____________

    ________% for costs relating to construction defect(s); ________% other damages

28. The prevailing party was the: ______ Owner/Customer ______Builder/Warrantor ______ Partial

29. The prevailing party prevailed on what percentage of the disputed issues: ______%

30. If each party prevailed on separate issues, what percentage of issues did each party prevail on:
    ______% owner/customer _______% builder/warrantor

31. Did the prevailing party receive an award for fees or costs related to the arbitration: _____ Yes

    ______% _____ No

    What percentage of fees or costs were covered: _________%

32. Was post-arbitration award litigation filed: _____ Yes _____ No _____ by the owner/customer

    _____by builder/warrantor

    Was the award: _________modified _________vacated or __________ affirmed by the court

33. Did the non-prevailing (i.e., losing) party fulfill its obligations under the award: _____ Yes

    _____ No _____ Partially

34. Was a judgment filed to compel compliance with the award: _____ Yes _____ No

    If so, did filing a judgment result in compliance: _____ Yes _____ No

35. Would you agree to or recommend arbitration as a dispute resolution process in the future:

_______Yes _____No

36. On a scale of 1 to 10 (1 being the worst; 10 being the best), please rate the fairness of your arbitration experience – as it relates to the process: __________

37. As specifically as possible, please explain your primary reasons for the rating given in Question #37:

____

____

38. On a scale of 1 to 10 (1 being the worst; 10 being the best), please rate your level of satisfaction as it relates to the arbitration award: __________

39. As specifically as possible, please explain your primary reasons for the rating given in Question #39:

____

____

ADDITIONAL COMMENTS

Note: Please feel free to use the space below to clarify or elaborate on your answers to the survey. This survey is not a venue to express dissatisfaction with a particular builder, its' product, the industry or the Texas Residential Construction Commission. For comments pertaining to a particular builder or construction issue please submit them to the commission via e-mail at info@trcc.state.tx.us or Texas Residential Construction Commission, P.O. Box 13144, Austin, TX 78711.

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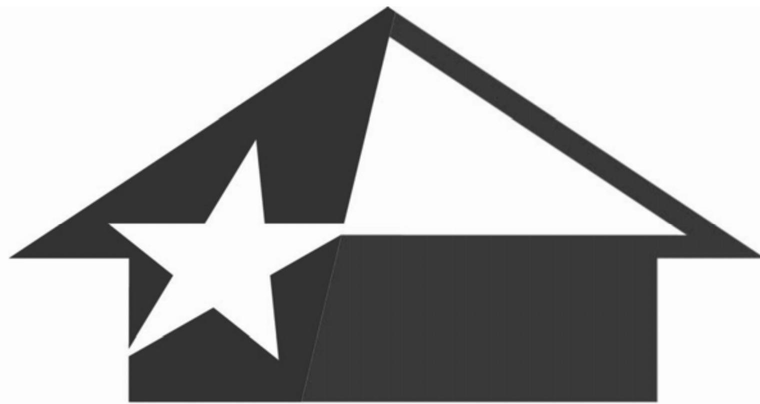
APPENDIX E: ARBITRATION TASK FORCE SURVEY

ARBITRATION USED FOR DISPUTE RESOLUTION REGARDING ISSUES RELATED TO RESIDENTIAL CONSTRUCTION

THE BUILDER / WARRANTOR PERSPECTIVE



Arbitration Task Force
January 2005

Arbitration Task Force Survey

Texas Residential Construction Commission

Arbitration Used For Dispute Resolution Regarding Issues Related to Residential Construction

THE BUILDER / WARRANTOR PERSPECTIVE

NOTE: **The responses to this survey are anonymous.** The data on this survey is being collected to gather information on the arbitration process when used in resolving disputes arising from residential construction. The information will be used in developing the task force's report and recommendations to the 79th and 80th Texas Legislature.

ARBITRATION - The use of an impartial third party to render a decision in a dispute between two parties outside a court of law.

1. Today's Date: ___________________
2. Approximate number of residential construction projects sold/warranted in the previous five (5) years: __________
3. What is the current average price range of your residential construction projects: $___________ to $ ____________
4. Have you used arbitration to resolve disputes with homeowners arising from residential construction projects: _____ Yes _____ No
5. If so, how long have you been using arbitration to resolve such disputes: _______ years
6. Provide the approximate number of arbitrations you used to resolve an owner/customer claim in the past five (5) years: ______
7. Is an arbitration clause a standard clause in all your contracts/policies: _____ Yes _____ No
8. Does the clause identify the arbitration as binding: _____ Yes _____ No _____ N/A
9. Your contract was written by:
   ___ Legal counsel
   ___ Professional Association
   ___ Yourself
   ___ Other Explain: ____
10. When did you begin using a contract with an arbitration clause: ____________________ (month/year): _____N/A
11. If requested by the customer will you remove the arbitration clause: _____ Yes _____ No
12. Has a customer ever asked to have the arbitration clause removed:_____ Yes _____ No

    If yes, estimate the percentage of your contracts that are signed without an arbitration clause: ____%
13. If requested by a customer, will you modify the arbitration clause: _____ Yes _____ No
14. Have you executed contracts with customer requested modifications to your arbitration clause:

    ____ Yes ___ No

What modifications, if any, have been requested?

____

What requested modifications, if any, have you agreed to:

____

15. Does your arbitration clause include personal injury claims: _____ Yes _____ No ___ N/A

16. Does your arbitration clause or agreement contain rules or refer to standardized rules for the conduct of the arbitration: _____ Yes _____ No
    If yes, to which rules do they refer:
    Explain:____

17. Does your arbitration clause identify a particular dollar value related to the claim that "triggers" the arbitration clause as the dispute resolution method: _____ Yes _____ No

18. Does your contract require mediation prior to arbitration or litigation: _____ Yes _____ No

    Does your company agree to pay costs of the mediation fees: ___All _____% or _____ the first $_____ then the cost is shared (_______% you pay)

The following questions regard your involvement with arbitrations in the past five years

19. What is the average length of time, from submission of the arbitration request to receipt of an award, for the arbitrations with which your firm has been involved: ________ weeks/months/years

20. Are the arbitrations conducted by an:
    ___ Individual arbitrator not affiliated with an arbitration service provider

    ___ Arbitrator or arbitration panel selected by an arbitration service provider

    Name of Service Provider: ____

    Arbitrator or arbitration panel provided by an organization other than an arbitration service provider (i.e. The Better Business Bureau)

21. The percentage of arbitration disputes arose: ___ Prior to project completion ___ After substantial completion of project

22. Please provide the category of the disputed issues by percentage:
    ______ % Financial obligations of builder or owner/customer
    ______ % Adherence to plans and specs during construction process
    ______ % Post-construction completion of items noted during the walk-through
    ______ % Post-construction warranty obligations
    ______ % Construction did not adhere to building codes (in place at time of construction)
    ______ % Personal Injury
    ______ % Other

23. Average cost for arbitration: $_______________

    ______ % Arbitrator fees:

    ______ % Legal fees

    ______ % Construction inspection fees:

______ % Witness fees

______ % Other Explain: ____

24. The average value of the portion of the dispute that arises from a claim for construction repair: $ _______
25. The average value of non-construction related issues of the dispute (if any): $______________________
26. Do you assume any of the customer/owner arbitration fees: ___No _____% $_____ of Total Fee ___Negotiable
27. During arbitration are you represented by legal counsel: ___ Yes ___ No ___Sometimes ___% of times "yes"
28. Is the opposing party represented by legal counsel: _____ Yes _____ No ___Sometimes ___% of times "yes"
29. If each party prevailed on separate issues, what percentage of issues did each party prevail on: ______% owner/customer _______% builder/warrantor
30. Did the prevailing party receive an award for fees or costs related to the arbitration: _____ Yes ______% _____ No
31. What percentage of awards include reimbursement of costs and/or fees to the prevailing party:

    ____ %
32. In what percentage of arbitration disputes is post-arbitration litigation filed: _________%
33. In post arbitration litigation what percentage of awards are:

    ____ % Modified

    ____ % Vacated

    ____ % Affirmed
34. In what percentage of arbitrated disputes in which the customer is the prevailing party, does the customer file the award for judgment: _______%
35. Have you failed to pay an award or judgment: _____ Yes _____ No
    Reason: ____

35. On a scale of 1 to 10 (1 being the worst; 10 being the best), please rate the fairness of your arbitration experience – as it relates to the process: __________
36. As specifically as possible, please explain your primary reasons for the rating given in Question #35:____

    ____
37. On a scale of 1 to 10 (1 being the worst; 10 being the best), please rate your level of satisfaction as it relates to the arbitration award: __________
38. As specifically as possible, please explain your primary reasons for the rating given in Question #37

ADDITIONAL COMMENTS

Please Note: Please feel free to use the space below to clarify or elaborate on your answers to the survey. This survey is not a venue to express dissatisfaction with a particular owner, builder, finding, the industry or the Texas Residential Construction Commission. For comments pertaining to a construction issue please submit them to the commission via e-mail at info@trcc.state.tx.us or Texas Residential Construction Commission, P.O. Box 13144, Austin, TX 78711.

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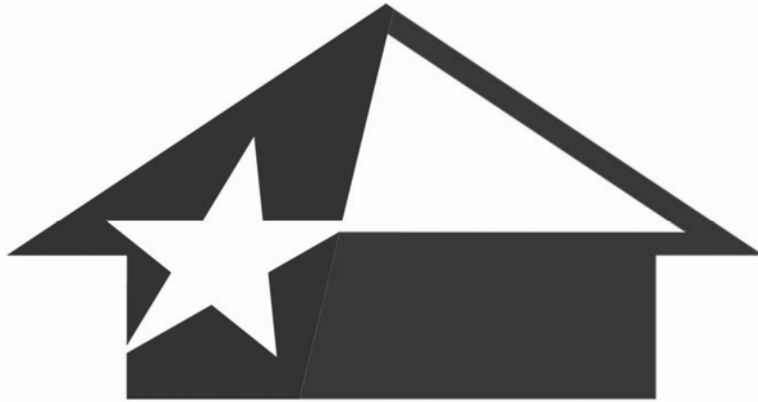
APPENDIX F: SCHEDULE OF ARBITRATION TASK FORCE MEETINGS

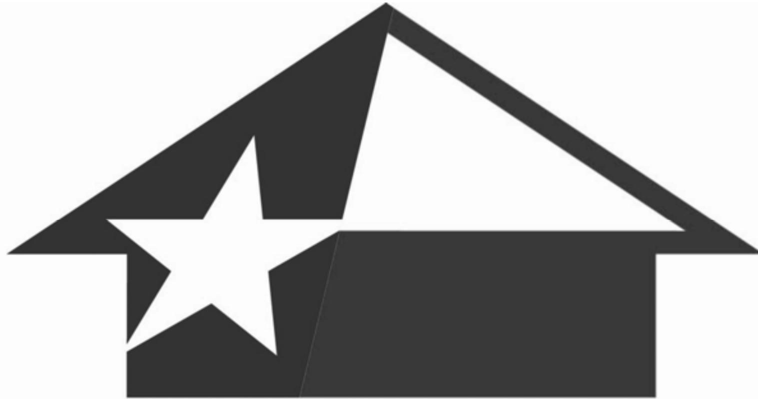


Arbitration Task Force
January 2005

SCHEDULE OF ARBITRATION TASK FORCE TOWN HALL MEETINGS

DATE	CITY
SEPTEMBER 29, 2004	HOUSTON
SEPTEMBER 30, 2004	AUSTIN
OCTOBER 5, 2004	MCALLEN
OCTOBER 6, 2004	FORT WORTH
OCTOBER 7, 2004	LAREDO
OCTOBER 12, 2004	EL PASO
OCTOBER 13, 2004	SAN ANTONIO
OCTOBER 14, 2004	LUBBOCK
OCTOBER 20, 2004	LUFKIN

APPENDIX G: SAMPLES OF ARBITRATION CLAUSES



Arbitration Task Force
January 2005

Example 1

23. **MEDIATION AND BINDING ARBITRATION**. It is the policy of the State of Texas to encourage the peaceable resolution of disputes through alternative dispute resolution procedures. The parties to this Contract specifically agree that this transaction involves interstate commerce and that any dispute (whether contract, warranty, tort, statutory or otherwise), including, but not limited to, (a) any and all controversies, disputes or claims arising under, or relating to, this Contract, and any amendments thereto, the Property, or any dealings between the Purchaser and Seller, (b) any controversy, dispute or claim arising by virtue of any representations, omissions, promises or warranties alleged to have been made by Seller or Seller's representative; and (c) any personal injury or property damage alleged to have been sustained by Purchaser on the Property or in the subdivision shall first be submitted to mediation and, if not settled during mediation, shall thereafter be submitted to binding arbitration as provided by the Federal Arbitration Act (9 U.S.C. §§ 1 et seq.) or, if applicable, by similar state statute, and not by or in a court of law. All decisions respecting the arbitrability of any dispute shall be decided by the arbitrator. In no event shall Purchaser be initially required to pay arbitration costs and fees in excess of those that would have been incurred in filing suit in a court of law and effecting service of process. The arbitrator may award to the prevailing party, if any, as determined by the arbitrator, all or any portion of its costs and fees. "Costs and fees" may include reasonable expenses of mediation and/or arbitration, including arbitrator's fees, administrative fees, travel expenses and out-of-pocket expenses such as copying and telephone, court costs, witness fees and reasonable attorney's fees. The mediation and, if necessary, the arbitration shall be conducted pursuant to any procedures set forth in the applicable warranty documents. If there is any conflict between this Contract and such procedures, the provisions of this Contract shall control. Furthermore, if the mediator and/or arbitrator designated in any applicable warranty documents cannot conduct the mediation or arbitration for any reason, or if no mediator and/or arbitrator is designated, the parties agree to work together in good faith to select a mediator and, if all disputes are not resolved by mediation, an arbitrator in the county where the subject property is located. If the parties are unable to agree on the appointment of a mediator and/or arbitrator, either party may petition a court of general jurisdiction in the subject county to appoint a mediator and/or arbitrator. It is stipulated and agreed that the filing of a petition requesting appointment of a mediator and/or arbitrator shall not constitute a waiver of the right to enforce binding arbitration.

In any arbitration proceeding between the parties:

(a) All applicable Federal and State law (including Chapter 27 of the Texas Property Code) shall apply;
(b) All applicable claims, causes of action, remedies and defenses that would be available in court shall apply;
(c) The proceeding shall be conducted by a single arbitrator selected by a process designed to ensure the neutrality of the arbitrator;
(d) The parties shall be entitled to conduct reasonable and necessary discovery;
(e) The arbitrator shall render a written award and, if requested by any party, a reasoned

award;

(f) The Purchaser shall not be required to pay any unreasonable costs or fees and the arbitrator shall have the right to apportion costs and fees in an equitable manner in the arbitration award; and

(g) Any award rendered in the proceeding shall be final and binding and judgment upon any such award may be entered in any court having jurisdiction.

Purchaser and Seller agree that notwithstanding anything to the contrary, the rights and obligations set forth in this mediation-arbitration agreement shall survive (1) the termination of this Contract by either party; or (2) the default of this Contract by either party. The waiver or invalidity of any portion of this mediation-arbitration agreement shall not affect the validity or enforceability of the remaining portions of this mediation-arbitration agreement and/or the Contract. Purchaser and Seller further agree (1) that any dispute involving Seller's directors, officers, employees and agents shall be resolved as set forth herein and not in a court of law; and (2) that Seller shall have the option to include its subcontractors and suppliers as parties in the mediation and arbitration.

If any party to this Contract files a proceeding in any court to resolve any such controversy, dispute or claim, such action shall not constitute a waiver of the right of such party or a bar to the right of any other party to seek arbitration of that or any other claim, dispute or controversy, and the court shall, upon motion of any party to the proceeding, direct that such controversy, dispute or claim be arbitrated in accordance herewith. Inasmuch as this Contract provides for mandatory arbitration of disputes, if any party commences litigation in violation of this Contract, such party shall reimburse the other parties to the litigation for their costs and expenses including attorneys' fees incurred in seeking abatement of such litigation and enforcement of arbitration.

24. In the event that the reasonable cost of repair necessary to repair a construction defect or defects in or related to the Improvements that are the responsibility of Contractor exceeds 30% of the then current fair market value of the Improvements, as determined without reference to the construction defect(s), Contractor may elect to repurchase the Property in accordance with Section 27.004 of the Texas Property Code. This right of election shall survive the completion of this Contract and the delivery of the deed to the Property from Seller to Purchaser and shall be binding on Owner's successors and assigns.

EXAMPLE 2

DISPUTE RESOLUTION: Mediation and Binding Arbitration. Any claim, dispute or cause of action involving seller or purchaser (including any claim or cause of action brought by either party against subcontractors, suppliers, manufacturers, affiliated companies, the developer of the property, or any other provider of goods or services in connection with the property or this agreement), shall be resolved by binding arbitration, in accordance with the Federal Arbitration Act (Title 9, U.S. Code) or the applicable state arbitration statute, if the Federal Arbitration Act does not apply. This includes claims brought by through or under Purchaser, their dependents or other occupants of the Property, whether sounding in contract, tort, or otherwise. The claims, disputes or causes of action within the scope of arbitration include, but are not limited to, those arising in connection with: (i) this Agreement, including the negotiation, formation, subject matter, breach, cancellation or termination hereof; (ii) the development, design, construction, preparation, maintenance or repair, of improvements to the Property; (iii) marketing or sale of the Property; (iv) any representations or warranties, express or implied, relating to the Agreement or the Property; (v) any transaction, event or relationship between Purchaser and Seller, including any subsequent agreement or alleged agreement between Purchaser and Seller; (vi) any violations of any statute including, but not limited to, consumer protection, disclosure, or similar statutes or regulations; (vii) any personal injury or property damage claim; and/or (viii) any other agreement, transaction, occurrence or event giving rise to a dispute over breach of legal duties, rights or obligations which involve Purchaser and Seller ("the Dispute"). At any time prior to the final arbitration hearing, any party may require that the Dispute be submitted to mediation. If the Dispute is not resolved by mediation, then the arbitration proceeding shall continue to conclusion. This arbitration provision shall survive closing, breach or termination of this Agreement and shall not be superseded by the doctrines of merger or waiver.

Administration of Mediation and Arbitration. If the Dispute arises in connection with an alleged construction defect, the arbitration shall be initiated and administered in accordance with the provisions of the Home Warranty. Unless the parties to the dispute agree otherwise, all other arbitration proceedings shall be administered by the American Arbitration Association (“AAA”), in accordance with the rules determined by the arbitrator or administrative agency to be most applicable to the nature of the Dispute. If administered by the AAA, the Consumer Due Process Protocol and Supplemental Procedures for Consumer-Related Disputes shall apply. If the AAA declines to administer a claim, it shall be administered by Judicial Arbitration and Mediation Services, unless otherwise agreed by the parties. If the Dispute is within the jurisdictional limits of small claims court, the claiming party may bring the Dispute in small claims court as an alternative to arbitration; if the claim is subsequently amended to an amount in excess of applicable small claims court jurisdiction, the Dispute must be resolved by binding arbitration, as set forth herein. If Purchaser elects to submit a Dispute to arbitration that would otherwise be within the jurisdiction of small claims court, Seller will pay that portion of the filing fees which exceeds the published court costs for filing a claim in small claims court.

Costs of Arbitration and Mediation. If the amount in controversy in the Dispute exceeds applicable small claims court jurisdiction, Purchaser will be responsible for payment of filing fees up to $375 to initiate arbitration (or less if provided by AAA Rules); Seller will then pay the portion of filing fees which exceeds $375 for claims up to the amount of the Purchase Price. All

other administrative, mediation and arbitration fees and expenses will be split equally between the parties, subject to being awarded by the arbitrator to the prevailing party.

Appeal. The arbitration award or decision is final and may be confirmed, entered and enforced as a judgment in a court having jurisdiction, subject to appeal only in the event of the arbitrator's misapplication of the law, no evidence to support the award, or such other grounds for appeal of arbitration awards that exist by statute, common law or the applicable rules of the administrative agency.

Forum. Any mediation or arbitration shall be administered by the office of the administrator that is closest to the Property, and the mediation and arbitration proceedings shall be conducted in the locale where the Property is located. Any arbitrator or mediator must have at least five (5) years of experience serving as an arbitrator or mediator and shall have technical expertise and knowledge appropriate to the subject matter of the Dispute.

EXAMPLE 3

BINDING ARBITRATION
a. [This paragraph 12.a. applies if this Contract closes:] To the extent permitted by law, any and all claims or disputes of any kind arising from or relating to this Contract shall be submitted to final and binding arbitration pursuant to and in accordance with the provisions of the arbitration agreement (the "Arbitration Agreement") contained in the HOME BUILDER'S LIMITED WARRANTY, administered by Professional Warranty Service Corporation, which arbitration agreement is incorporated by reference herein as though fully set forth.
b. [This paragraph 12.b applies if this Contract does not close or if the claim or dispute is not subject to the Arbitration Agreement:] To the extent permitted by law, any claim or dispute of any kind (a "Claim"), whether such claim sounds in contract, tort, or otherwise, arising from or in any way related to this Contract, the Property, any representations or warranties, expressed or implied, relating to this Contract or the Property, and/or the construction or workmanship of the Property shall be settled by binding arbitration in accordance with the Federal Arbitration Act (Title 9 of the United States Code). The arbitration shall be conducted by the American Arbitration Association ("AAA") and the Construction Industry Arbitration Rules of the AAA shall apply. Judgment upon the award rendered by the arbitrator be confirmed, entered, and enforced in any court having jurisdiction. The parties shall first mediate the Claim in accordance with the Construction Industry Mediation Rules of the AAA. Mediation of the Claim is an express condition precedent to the arbitration of the Claim. The mediation and arbitration shall be administered by the Dallas Regional Office of the AAA and shall occur in Dallas, Texas. No conduct on the part of either Seller or Purchaser (such as filing a suit in a court at law or filing an arbitration action prior to mediation) shall be deemed to be a waiver of a parties' right to compel mediation or arbitration.

Arbitration/Limits on Claims. With the exception of claims under the Homebuilders Limited Warranty, all other claims for breach of this Contract or arising from this Contract in any way are limited solely to the specific remedies provided for herein. The Purchaser further agrees that, at Seller's sole option, any controversy or claim or matter in question arising out of or relating to (a) this Contract or any alleged breach thereof, (b) the sales transaction reflected by this Contract, (c) the construction of the Improvements, (d) any representations and/or warranties, express or implied, relating to the Property and the Improvements, and/or (e) any controversy or dispute between the Purchaser and Seller with regard to the Property or its condition or construction, whether now existing or which may exist in the future, shall be determined by binding arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association. The arbitration shall be determined by a single arbitrator selected under American Arbitration Association rules, and the prevailing party shall be entitled to recover attorney fees from the losing party. Unless the parties otherwise agree, arbitration shall be held in the county in which this Contract is signed or where the Improvements are located. This arbitration clause does not apply to claims for personal injuries. Any action, regardless of form, arising out of this Contract must be brought by the Purchaser within two (2) years of the date the cause of action accrues.

EXAMPLE 4

DISPUTE RESOLUTION PROCEDURE [Read carefully]

To the extent not in conflict with the rules, guidelines and procedures under or adopted pursuant to the Texas Residential Construction Commission Act (TRCCA), or the Residential Construction Liability Act (RCLA), the following section shall control all disputes arising out of, connected with, related to or resulting from the transaction between Purchaser and Drees, including acts, conduct, representations, negligence, breach of contract, torts, statutory causes of actions, errors or omissions prior to the execution of the Contract, and up through the closing contemplated by the Contract. It is the intent of Drees and Purchaser that TRCAA, RCLA, and the provisions set out below control during and all disputes of any nature of kind, between the parties, but that TRCAA and RCLA procedures, rules and guidelines control when a conflict or ambiguity exists, or an omission is discovered.

It is the policy of the State of Texas to encourage the peaceable resolution of disputes through alternative dispute resolution procedures. The parties to this Contract specifically agree that this transaction involves interstate commerce and that any dispute (whether contract, warranty, tort, statutory or otherwise), including, but not limited to, (a) any and all controversies, disputes or claims arising under, or relating to, this Contract, and any amendments thereto, the Property, or any dealings between Purchaser and Builder (b) any controversy, dispute or claim arising by virtue of any representations, omissions, promises or warranties alleged to have been made by Builder or Builder’s representative; and (c) any personal injury or property damage alleged to have been sustained by Purchaser on the Property or in the subdivision shall first be submitted to mediation and, if not settled during mediation, shall thereafter be submitted to binding arbitration as provided by the Federal Arbitration Act (9 U.S.C. §§ I et seq.) or, if applicable, by similar state statute, and not by or in a court of law. All decisions respecting the arbitrability of any dispute shall be decided by the arbitrator. The mediation and, if necessary, the arbitration shall be conducted pursuant to any procedures set fort in the applicable warranty documents. If there is any conflict between this Contract and such procedures, the provisions of this Contract shall control. Furthermore, if the mediator and/or arbitrator designated in any applicable warranty documents cannot conduct the mediation or arbitration for any reason, then the mediation and arbitration shall be conducted by the American Arbitration Association (“AAA”) in accordance with its applicable rules. If, for any reasons, the AAA is unable or unwilling to conduct the mediation and/or binding arbitration proceedings specified above, then the parties agree to work together in good faith to select a mediator and, if all disputes are not resolved by mediation, an arbitrator in the county where the subject property is located. If the parties are unable to agree on the appointment of a mediator and/or arbitrator, either party may petition to a court of general jurisdiction in the subject county to appoint a mediator and/or arbitrator. It is stipulated and agreed that the filing of a petition requesting appointment of a mediator and/or arbitrator shall not constitute a waiver of the right to enforce binding arbitration.

In any arbitration proceeding between the parties:

(a) All applicable Federal and State law (including Chapter 27 of the Texas Property Code) shall apply;

(b) All applicable claims, causes of action, remedies and defenses that would be available in court

shall apply;

(c) The proceedings shall be conducted by a single arbitrator selected by a process designed to ensure the neutrality of the arbitrator;

(d) The parties shall be entitled to conduct reasonable and necessary discovery;

(e) The arbitrator shall render a written award and, if requested by any part, a reasoned award;

(f) The Purchaser shall not be required to pay any unreasonable costs, expenses or arbitrator's fees and the arbitrator shall have the right to appoint the cost of any such items in an equitable manner in the arbitration award; and

(g) Any award rendered in the proceeding shall be final and binding and judgment upon any such award may be entered in any court having jurisdiction.

Purchaser and Builder agree that notwithstanding anything to the contrary, the rights and obligations set forth in this mediation-arbitration agreement shall survive (1) the termination of this Contract by either party; or (2) the default of this Contract by either party. The waiver or invalidity of any portion of this mediation-arbitration agreement shall not affect the validity or enforceability of the remaining portions of this mediation-arbitration agreement and/or the Contract. Purchaser and Builder further agree (1) that any dispute involving Builder's directors, officers, employees and agents shall be resolved as set forth herein and not in a court of law; and (2) that Builder shall have the option to include its subcontractors and suppliers as parties in the mediation and arbitration.

If any party to this Contract files a proceeding in any court to resolve any such controversy, dispute or claim, such action shall not constitute a waiver of the right of such party or a bar to the right of any other party to seek arbitration of that or any other claim, dispute or controversy, and the court shall, upon motion of any party to the proceeding, direct that such controversy, dispute or claim be arbitrated in accordance herewith. Inasmuch as this Contract provides for mandatory arbitration of disputes, if any party commences litigation in violation of this Contract, such party shall reimburse the other parties to the litigation for their costs and expenses including attorney's fees incurred in seeking abatement of such litigation and enforcement of arbitration.

The requirement that the parties submit any disputes between them to mediation and, if that does not resolve the dispute, binding arbitration is absolute and enforceable despite there being no signature by either party on this page of the contract. The parties, by their signatures at the end of this contract, agree to arbitration as if their signatures appeared on the page where arbitration is made part of the agreement.

EXCLUSIVE DAMAGE REMEDY

After completion of the mediation process described above, if there are any outstanding claims, Buyer agrees that the exclusive remedy for any such claim for damages against Builder for breach of warranty or any other claim whatsoever, is under the effective version of the Residential Construction Liability Act ("RCLA"). Buyer and Builder also acknowledge and agree that a request for warranty performance shall not be construed as a notice of construction defect under RCLA, and that any notice under RCLA shall be separately sent to Builder in the manner required by RCLA.

ATTORNEY FEES

If Builder or Buyer is the prevailing party in any arbitration or legal proceedings brought under or with relation to this Contract, the prevailing party will be entitled to recover from the non-prevailing party all costs of such proceeding and reasonable attorney's fees, and reasonable expert fees, to the extent not prohibited by the governing law.

Purchasers each hereby represent to Drees that they have been given the opportunity to read each paragraph of this Agreement, that they have been given the opportunity to seek legal advice regarding the Agreement and that they are signing herein below, signifying their agreement to and acceptance of each provision and condition herein contained. Purchaser agrees that the references herein to home, house, residence or a like term refers to the property described in Paragraph (1), above. The reference to agreement, Agreement, contract, this document or a like term refers to the Construction and Purchase Agreement, unless otherwise indicated.

Purchaser's initial on each page, together with Purchaser's signature on the last page of this Agreement shall be a representation to Drees that Purchaser has read each page of this Agreement, has understood the terms of this Agreement, and Purchaser agrees to accept the terms and conditions of this Agreement.

EXAMPLE 5

Better Business Bureau Agreement to Arbitrate

AGREEMENT TO ARBITRATE

Consumer: John and Jane Doe **Case No.: A-04-101**

Business: ABC Widget Company

NATURE OF DISPUTE: Consumer alleges that:

____

Business alleges that :

____

DECISION SOUGHT: Consumer would like:

____

Business would like:

____

I agree to arbitrate the above dispute in accordance with this agreement to arbitrate. I acknowledge that I have received a copy of the “BBB Rules of Arbitration.” I also understand that the decision rendered will be binding upon both parties.