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May 5, 2009

House Judiciary Committee
Subcommittee on Commercial and Administrative Law
Hearing on: the Federal Arbitration Act: is the Credit Card Industry Using it to Quash Legal Claims?

Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee:
I appreciate the opportunity to testify about the arbitration of disputes arising out of agreements between credit card issuers and cardholders. I am the John M. Rounds Professor of Law at the University of Kansas School of Law, and the Chair of the Consumer Arbitration Task Force of the Searle Civil Justice Institute. I also am an Associate Reporter for the Restatement, Third, of the U.S. Law of International Commercial Arbitration, and have written extensively on the law and economics of arbitration.

Overview

The use of arbitration clauses in credit cardholder agreements is widespread,[1] and the practice of resolving credit card disputes through arbitration has been controversial.[2] Increasingly, both critics and supporters of the practice have come to recognize the importance of empirical evidence in making sound public policy decisions in the area.[3] Indeed, Professor Peter B. Rutledge has recently written that "there now appears to be a consensus that the future of arbitration should be decided by data, not anecdote."[4]

My testimony today addresses the empirical evidence on five key issues dealing with the use of arbitration to resolve credit card disputes: (1) the upfront costs to consumers of resolving disputes through arbitration; (2) the fairness of procedures in arbitration; (3) how consumers fare in arbitration; (4) whether arbitrators are biased in favor of repeat players (in this case, credit card issuers); and (5) the relationship between arbitration and class actions. Some of these concerns arise only when consumers are claimants, in particular the upfront costs of arbitration and the relationship between arbitrations and class actions. The other issues arise both in cases with consumer claimants and in cases with business claimants.

An important source for my testimony is a new empirical study entitled "Consumer Arbitration Before the American Arbitration Association," recently issued by the Consumer

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[1] Theodore Eisenberg, Geoffrey P. Miller, & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REF. 871, 882-83 (2008) (reporting that 76.9 percent of a sample of consumer financial and cell phone contracts included arbitration clauses); Linda J. Demaine & Deborah R. Hensler, "*Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55, 62 (2004) (finding that "[t]he prevalence of arbitration clauses is highest (69.2%) in the financial category (credit cards, banking, investment, and accounting/tax consulting)").

[2] E.g., Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers (Sept. 2007), *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf.

[3] Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. PUB. POL'Y 549, 589 (2008) (concluding that "[i]ncreased congressional attention" to consumer and employment arbitration "can be valuable, for it promotes discussion and study about this valuable dispute resolution tool" but also "can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study"); Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration 2 (2008), *available* at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf ("Rutledge concludes *Whither* with the warning that congressional scrutiny of arbitration 'can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study.' We agree.").

[4] Peter B. Rutledge, *Common Ground in the Arbitration Debate*, Y.B. ARB. & MED. ___, ___ (forthcoming 2009).

Arbitration Task Force of the Searle Civil Justice Institute ("SCJI"). The study is the most comprehensive empirical research to date on consumer arbitration procedures and outcomes. A copy of the Executive Summary is appended at the end of this statement, and a full copy of the study is available at www.searlearbitration.org.

Searle Civil Justice Institute Task Force on Consumer Arbitration

Founded in early 2008 as a division of the Searle Center on Law, Regulation, and Economic Growth, the SCJI aims to become the preeminent national source of large-scale, empirical studies on public policy issues related to our nation's civil justice system. An operating premise of the SCJI is that hard data is a powerful and necessary tool in public policy debates.

The American Arbitration Association ("AAA") is a leading provider of arbitration services, including arbitrations between consumers and businesses. SCJI commissioned a Task Force to advise and lead this study of AAA consumer arbitrations. Funding for the study came exclusively from the initial grant establishing the Searle Center from the late Daniel C. Searle, longtime philanthropist and Northwestern University trustee.

Data and Methodology

The Task Force reviewed a sample of AAA case files involving consumer arbitrations. The primary dataset consists of 301 AAA consumer arbitrations that were closed by an award between April and December of 2007. (The focus on cases closed by an award during this particular timeframe is based on the availability of the original case files.) Slightly under ten percent of the cases in the sample, both cases brought by consumers and cases brought by businesses, involved credit card disputes. Most of the cases in the sample brought by businesses, including the cases brought by credit card issuers, were debt collection cases.

The sample of cases was then coded for approximately 200 variables describing various aspects of the arbitration process. In addition, when possible a broader AAA dataset comprising all consumer cases closed between 2005 and 2007 was utilized. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA. Prior to release, the report was reviewed by independent academic experts on arbitration and empirical studies, including both critics and supporters of consumer arbitration. It also was subject to review by the SCJI Board of Overseers, which consists of general counsels, plaintiffs' lawyers, defense lawyers, academics, and state and federal judges.

Issues

Although the Searle study is ongoing and will ultimately examine many aspects of AAA consumer arbitrations, the initial research inquiries were directed at two general topics: (1) the costs, speed, and outcomes of AAA consumer arbitrations; and (2) AAA enforcement of the

Consumer Due Process Protocol. Each of the issue regarding credit card arbitrations fall within these two general topics.

1. Costs

Arbitration differs from litigation in that it is a private dispute resolution process. Unlike litigation, in which taxpayers pay the salaries of judges and the costs of court administration, in arbitration the parties themselves must pay those costs. Critics of consumer arbitration have contended that these upfront costs deter consumers from asserting claims in arbitration.[5] The Searle study examines the steps the AAA has taken to mitigate such risks.

Like other leading arbitration providers, the AAA has adopted consumer arbitration rules that provide for low-cost arbitration of small consumer claims.[6] Under those rules, the total fee to be paid by a consumer asserting a claim for $10,000 or less is $125, which the AAA applies solely to the arbitrator's fee.[7] The total fee to be paid by a consumer asserting a claim of between $10,000 and $75,000 is $375, again applied solely to the arbitrator's fee.[8] All administrative fees and the remaining arbitrator's fees are to be paid by the business.[9] In cases of financial hardship, the consumer can seek deferral or waiver of administrative fees, as well as the appointment of an arbitrator serving on a pro bono basis.[10] Moreover, the arbitrator is authorized to reallocate administrative and arbitrator's fees between consumers and businesses in the award.[11] Finally, if the arbitration agreement provides for the business to pay a greater share (and the consumer a lesser share) of the arbitration fees, which a number of clauses do, then the clause controls.

The Searle study found that the fees assessed to consumer claimants bringing small claims are on average below the levels specified in the AAA fee schedule, as a result of businesses agreeing in the arbitration agreement to pay a greater share of the costs and arbitrators reallocating consumer fees to businesses in the award. In cases with claims of less than $10,000, consumer claimants were assessed an average of $96 ($1 administrative fees plus $95 arbitrator fees). In cases with claims of between $10,000 and $75,000, consumer claimants were assessed an average of $219 ($15 administrative fees plus $204 arbitrator fees). Thus, the effective fees

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5 *E.g.*, Public Citizen, The Costs of Arbitration 1 (2002) (stating that the upfront costs of arbitration "have a deterrent effect, often preventing a claimant from even filing a case."). For a detailed analysis of this issue, see Christopher R. Drahozal, *Arbitration Costs and Contingent Fee Contracts*, 59 VAND. L. REV. 729 (2006).

6 *See* American Arbitration Association, Supplementary Procedures for the Resolution of Consumer-Related Disputes (effective Sept. 15, 2005).

7 *Id.* Rule C-8 ("Fees and Deposits to be Paid by the Consumer").

8 *Id.* For cases seeking more than $75,000, the fee schedule in the AAA Commercial Arbitration Rules applies..

9 *Id.* Rule C-8 ("Fees and Deposits to be Paid by the Business: *Arbitrator Fees*"); *id.* Rule C-8 ("Fees and Deposits to be Paid by the Business: *Administrative Fees*").

10 American Arbitration Association, Administrative Fee Waivers and Pro Bono Arbitrators ("Pro Bono Service by Arbitrators"), *available at* www.adr.org/si.asp?id=22040 ("A number of arbitrators on the AAA panel have volunteered to serve pro bono for one hearing day on cases where an individual might otherwise be financially unable to pursue his or her rights in the arbitral forum.").

11 American Arbitration Association, Commercial Arbitration Rules, Rule R-43(c) (amended and effective Sept. 1, 2007).

for consumer arbitration in these cases were less than indicated in the applicable arbitration rules, and may have been less than court filing fees.

Any full comparison of the costs of arbitration and litigation needs to take into account all the costs of the dispute resolution process, especially attorneys' fees. Of course, consumers who proceed pro se do not pay any attorneys' fees. For consumers who are represented by an attorney, however, we have no data on what those attorneys' fees were in the cases in our sample or how they compared to the attorneys' fees the consumer would have incurred in litigation. A number of commentators have suggested that attorneys' fees likely are lower in arbitration than in litigation.[12] Without solid empirical data, however, any comparison of arbitration costs to litigation costs necessarily is incomplete.

The study did find, however, that arbitrators awarded attorneys' fees to prevailing consumer claimants in a substantial proportion of cases in which the consumer sought such an award. Consumer claimants sought to recover attorneys' fees in over 50% of the cases in which they were awarded damages, and were awarded attorneys' fees in 63.1% of those cases. In those cases in which the award of attorneys' fees specified a dollar amount, the average attorneys' fee award was $14,574. Although the awards generally did not indicate the basis for the award of attorneys' fees, the substantial majority of the cases were not of the sort in which a fee-shifting statute would be applicable.

2. Procedural Fairness

In response to concerns about unfair procedures in arbitration, leading arbitrator providers have adopted "due process protocols" – privately developed standards of fair procedure in consumer (and employment) arbitration.[13] Due process protocols commonly require independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court. The AAA has pledged not to administer arbitrations arising out of arbitration clauses that violate the Consumer Due Process Protocol, which applies to credit card arbitrations. Previously, empirical evidence on the effectiveness of such private enforcement efforts had been lacking.[14]

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[12] *E.g.*, Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 564 (2001); Rutledge, *supra* note 3, at 576-79.

[13] National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (April 17, 1998), *available at* www.adr.org/sp.asp?id=22019; *see also* Task Force on Alternative Dispute Resolution in Employment, Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship (May 9, 1995), *available at* www.adr.org/sp.asp?id=28535; Commission on Health Care Dispute Resolution, Health Care Due Process Protocol (July 27, 1998), *available at* www.adr.org/sp.asp?id=28633; JAMS, JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness (revised Jan. 1, 2007), *available at* www.jamsadr.com/rules/consumer_min_std.asp; JAMS, JAMS Policy on Employment Arbitration, Minimum Standards of Procedural Fairness (revised Feb. 19, 2005), *available at* www.jamsadr.com/rules/employment_Arbitration_min_stds.asp; National Arbitration Forum, Arbitration Bill of Rights (2007), *available at* www.adrforum.com/users/naf/resources/ArbitrationBillOfRights3.pdf.

[14] W. Mark C. Weidemaier, *Arbitration and the Individuation Critique*, 49 ARIZ. L. REV. 69, 107 (2007); *see also id.* at 93 n.138.

The Searle study provided the first empirical evidence on the enforcement of due process protocols. It found that a substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Consumer Due Process Protocol when the case was filed. Moreover, the AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations. In 98.2% of cases in the sample subject to AAA protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and addressed by the AAA.

Moreover, the Searle study found evidence that businesses modify their arbitration clauses as a result of the AAA's protocol compliance review to make them consistent with the Consumer Due Process Protocol. In response to AAA review, more than 150 businesses either waived problematic provisions on an ongoing basis or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. This is in addition to the more than 1550 businesses identified by the AAA as having arbitration clauses that comply with the Protocol. By comparison, AAA has identified 647 businesses for which it will not administer arbitrations because of Protocol violations, most commonly the business's failure to pay its share of the arbitration fees.

3. Outcomes

A central controversy in discussions of credit card arbitration is how consumers fare. A number of empirical studies have examined the success rate of credit cardholders in arbitration. Most of those studies have focused on cardholders as respondents in arbitration, and have used data on arbitrations administered by the National Arbitration Forum. The studies find a win-rate for business claimants (almost exclusively credit card issuers or their assigns) ranging from 67.9% to over 99%.[15] Much of the variation in these results is due to differences in how the studies treat cases that are dismissed before an award. The win-rate for consumer claimants (who are rare in NAF arbitrations) ranges from 37.2% to 65.5%.[16]

By comparison, the Searle study found that consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255, while business claimants won some relief in 83.6% of their cases and recovered an average of $20,648. The average award to a successful

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[15] Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, METRO. CORP. COUNSEL, July 2006, at 32 (business claimants "prevail in 77.7% of the cases that reach a decision"); Jeff Nielsen et al., Navigant Consulting, National Arbitration Forum: California Consumer Arbitration Data 1 (July 11, 2008), *available at* http://www.instituteforlegalreform.com/index.php?option=com_ilr_docs&issue_code=ADR&doc_type=STU (businesses prevailed in 67.9% of NAF arbitrations either heard by an arbitrator or dismissed); Public Citizen, Arbitration Trap, *supra* note 2, at 15 ("In 19,294 cases in which an arbitrator was appointed, the business won in 18,091 (or 93.8%)"); Answers and Objections of First USA Bank, N.A. to Plaintiff's Second Set of Interrogatories, Ex. 1, Bownes v. First U.S.A. Bank, N.A. et al., Civ. Action No. 99-2479-PR (Ala. Circuit Ct. 2000), *available* at http://www.tlpj.org/briefs/McQuillan%20exhibits%2016-19%20(300dpi).pdf (last visited Dec. 10, 2008) (bank prevailed in 19,618 NAF arbitrations, while credit cardholder prevailed in 87).

[16] Ernst & Young, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases 8 (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf (win-rate for consumer claimants of 54.6%); Fellows, *supra* note 16, at 32 (win-rate for consumer claimants of 65.5%); Public Citizen, Arbitration Debate Trap, *supra* note 3, at 10 (win-rate for consumer claimants of 37.2%).

consumer claimant in the sample was 52.1% of the amount claimed and to a successful business claimant was 93.0% of the amount claimed. This difference in win-rate and percent recovery between business claimants and consumer claimants appears to be driven in important part by differences in the types of claims brought by consumers and business. Business claims are almost exclusively for payment of goods and services while consumer claims are seeking recovery for non-delivery, breach of warranty, and consumer protection violations.[17]

These data face an important limitation, however, one to which studies of outcomes in credit card arbitration are likewise subject: the absence of a baseline for comparison. A fifty percent win-rate for claimants may be extremely high if claimants bringing similar claims tend to win at a lower rate in court, or extremely low if claimants bringing similar claims tend to win at a higher rate in court. For example, the available evidence suggests that business claimants tend to prevail at a very high rate in debt collection actions in court.[18] If so, then the high win-rate of businesses in credit card arbitrations is not particularly problematic.

4. Repeat-Arbitrator Bias

A related concern is so-called "repeat-arbitrator bias." Unlike judges, who get paid regardless of how many cases they decide, arbitrators get paid only when they are selected to decide a case. These differing compensation structures have given rise to fears that arbitrators will be biased in favor of "repeat players," parties that are more likely to be in a position to appoint the arbitrator in a future case.[19] In credit card arbitrations, the credit card issuer is a repeat player; cardholders are unlikely to be repeat players, although their attorneys may be.

Prior academic studies have some found evidence of a "repeat-player effect" – that repeat players have higher win-rates in arbitration than non-repeat players. But the studies have generally attributed the repeat-player effect to better screening of cases by repeat players rather than bias by arbitrators.[20] The findings of the Searle study are similar.

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[17] Again, as noted above, the Searle study does not break out its results by type of business, so we do not have results on arbitration outcomes specific to credit card arbitrations.

[18] *E.g.*, Urban Justice Center, Debt Weight: The Consumer Credit Crisis in New York City and Its Impact on the Working Poor 17 (Oct. 2007) (in New York City Civil Court cases studied, 81.8 percent of consumer credit lawsuits filed were resolved by default judgment in favor of creditor); John A. Goerdt, Small Claims and Traffic Courts: Case Management Procedures, Case Characteristics and Outcomes in 12 Urban Jurisdictions 53 (1992) (National Center for State Courts) (finding business win-rate against individual claimants of 87 percent in small claims court).

[19] *E.g.*, Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1256 (2001); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 60-61; *see also* Public Citizen, Arbitration Debate Trap, *supra* note 3, at 24-26.

[20] *E.g.*, Lisa B. Bingham, *Unequal Bargaining Power: An Alternative Account for the Repeat Player Effect in Employment Arbitration*, IRRA 50TH ANN. PROC. 33, 39-40 (1998); Lisa B. Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Differenc*e, *in* ALTERNATE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NEW YORK UNIVERSITY 53RD ANNUAL CONFERENCE ON LABOR 303, 323 tbl. 2 (Samuel Estreicher & David Sherwyn eds. 2004); Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, DISP. RESOL. J., May/July 2003, at 15.

First, the study found no statistically significant repeat-player effect using a traditional definition of repeat-player business. Consumer claimants won some relief in 51.8% of cases against businesses that appear more than once in the AAA dataset (repeat businesses) and 55.3% of cases against businesses that appear only once (non-repeat businesses) – a difference that is not statistically significant.

Second, using an alternative definition of repeat player, some evidence of a repeat-player effect was identified. Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses (as defined based on the AAA's categorization of businesses in enforcing the Consumer Due Process Protocol) – a difference that is statistically significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that the repeat-player effect is attributable to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims), rather than arbitrator bias.

5. Class Relief

Another criticism of arbitration clauses in consumer contracts, including but not limited to credit card contracts, is that they prevent consumer claims from being resolved in class actions.[21] When parties agree to arbitration, they contract out of court proceedings, including class action proceedings. While class actions in arbitration ("class arbitrations") have become more common in recent years,[22] at least some businesses have responded by including class arbitration waivers – provisions that waive the availability of class proceedings in arbitration – in their standard form contracts. These developments have led to fears that consumers are being denied remedies, and even that class actions will soon become extinct.[23] The available empirical evidence suggests that such fears are overblown.

Overall, most of the arbitration clauses in the sample of AAA consumer arbitrations did *not* include class arbitration waivers. Only 36.5% of the cases arose out of arbitration clauses with a class arbitration waiver; 63.5% arose out of arbitration clauses without a class arbitration waiver. Moreover, the use of class arbitration waivers varied widely by industry. It plainly is not the case that all arbitration clauses preclude recovery on a class basis.

By comparison, and consistent with prior studies,[24] the Searle study found that all credit card arbitration agreements in the sample did include class arbitration waivers. That fact, however, does not necessarily mean that cardholders will be unable to proceed on a class basis. Rather, current law allows the courts to examine the enforceability of class arbitration waivers on a case-by-case basis. According to Alan Kaplinsky et al., an "increasing number of state courts

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21 *E.g.*, Public Citizen, Arbitration Trap, *supra* note 2, at 43.

22 The growth of class arbitration proceedings has occurred as a result of the Supreme Court's decision in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003).

23 *E.g.*, Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 375 (2005).

24 *See* Eisenberg, Miller, & Sherwin, *supra* note 1, at 884.

have shown hostility" toward consumer arbitration agreements with class arbitration waivers, and "[a] number of state appellate courts have invalidated class action waivers within the past couple of years."[25] Some federal courts have done so as well.[26] Because many credit card contracts provide that if a court holds the class arbitration waiver invalid the entire arbitration clause is invalid,[27] class claims filed in such jurisdictions may well end up in court, or at the very least in a class arbitration proceeding.[28] In short, class proceedings may continue to be available even for consumers who are parties to an arbitration clause with a class arbitration waiver.

Finally, assuming that credit card issuers view class arbitration waivers as critical components of their arbitration agreements, important empirical questions remain unanswered, such as:

- How frequent are class actions against credit card companies? What kinds of class actions have been brought (i.e., what is the nature of the alleged violations and the requested relief)? How much have cardholders recovered? What costs have credit card issuers incurred?

- How effective are possible alternatives to class actions – including individual arbitrations, class arbitrations, and formal and informal regulatory proceedings? What kinds of claims have been pursued in these proceedings? How much have cardholders recovered? What costs have credit card issuers incurred?

The next phase of the Searle study will consider the extent to which class actions are comparable to the individual arbitrations in the sample, for purposes of developing a baseline for evaluating the costs, speed, and outcomes of AAA consumer arbitrations. But much more research remains to be done in order to evaluate in a meaningful way the relationship between arbitration and class actions.[29]

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[25] Alan S. Kaplinsky, Mark J. Levin, and Martin C. Bryce, Jr., *Consumer Arbitration: The Tug of War Between the Federal and State Courts Intensifies*, 64 BUS. LAW. 627, 627-28 (2009).

[26] *See In re* American Express Merchants' Litigation, 554 F.3d 300, 319-20 (2d Cir. 2009).

[27] *See* Eisenberg, Miller, & Sherwin, *supra* note 1, at 885.

[28] For a more complete discussion, see Christopher R. Drahozal & Quentin R. Wittrock, *Franchising, Arbitration, and the Future of the Class Action*, 3 ENTREPRENEURIAL BUS. L.J. ___ (forthcoming 2008).

[29] Some empirical research has been done on these questions for other types of cases. For example, a recent study of employment class actions found that "potential individual recoveries for many types of employment disputes are valuable enough to place in question the arguments that these are 'negative value' cases that will be brought forward, if at all, only through the class action vehicle." Samuel Estreicher & Kristina Yost, *Measuring the Value of Class and Collective Action Employment Settlements: A Preliminary Assessment*, *in* EMPLOYMENT CLASS AND COLLECTIVE ACTIONS: PROCEEDINGS OF THE N.Y.U. 56TH ANNUAL CONFERENCE ON LABOR 107, 137 (David Sherwyn ed. 2009). That said, the mean and median potential individual recoveries in the class actions studied were consistently less than the mean and median recoveries in individual employment arbitrations reported in other studies. *Id.* at 136.

Limitations and Conclusions

While the empirical results presented in the Searle study are the most comprehensive available and thus may usefully inform the policy debate on consumer arbitration, the study nonetheless has limitations. First, its findings are limited to AAA consumer arbitration. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. That said, in setting national policy concerning arbitration, information on consumer arbitrations administered by the AAA, a leading provider of arbitration services, certainly is necessary for making an informed decision.

Second, as discussed above, the study's findings on the costs and outcomes of AAA consumer arbitrations are difficult to interpret without a baseline for comparison. The next phase of this research project thus will seek to compare the procedures and outcomes in AAA consumer arbitrations with procedures and outcomes in court. Only by undertaking such a comparison is it possible to draw meaningful conclusions about how consumers fare in arbitration.

At bottom, the Searle study reinforces the importance of empirical work in the policy debate over consumer and employment arbitration. Sound policymaking – whether dealing with credit card arbitration in particular or consumer and employment arbitration in general – should consider statistically valid empirical studies, not just anecdotal reports.

Northwestern Law
Searle Center on Law, Regulation, and Economic Growth

Searle Civil Justice Institute

CONSUMER ARBITRATION BEFORE THE AMERICAN ARBITRATION ASSOCIATION

Executive Summary
March 2009

Issues and Background

Empirical evidence has become a central focus of the policy debate over consumer and employment arbitration. Both supporters and opponents of the proposed Arbitration Fairness Act, which would make pre-dispute arbitration clauses unenforceable in consumer and employment (and franchise) agreements, have recognized that empirical evidence on the fairness and integrity of consumer and employment arbitration proceedings is essential to making an informed decision on the bill. Yet the empirical record, particularly on consumer arbitration, has critical gaps.

One set of issues on which further empirical research would be helpful is the costs, speed, and outcomes of consumer arbitrations. How much do consumers pay to bring claims in arbitration? How long do consumer arbitrations take to resolve? How do consumers fare in arbitration, particularly against businesses that are repeat users of arbitrators and arbitration providers? While a number of important studies on employment arbitration have been provided, the empirical record on these issues in consumer arbitrations is sparse.

A second set of issues of interest involves the enforcement of arbitration due process protocols -- privately created standards setting out minimum requirements of procedural fairness for consumer and employment arbitrations. Due process protocols commonly require independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court. Leading arbitration providers have pledged not to administer arbitrations arising out of arbitration clauses that violate the protocols. But empirical evidence on the effectiveness of these private enforcement efforts is lacking.

Searle Civil Justice Institute Task Force on Consumer Arbitration

To shed light on these issues, the Searle Civil Justice Institute (SCJI) undertook a large-scale study of consumer arbitrations administered by the American Arbitration Association (AAA). The AAA is a leading provider of arbitration services, including arbitrations between consumers and businesses. SCJI commissioned a Task Force to advise and lead this study of consumer arbitrations. Although the study will ultimately examine many aspects of AAA consumer arbitrations, the initial research inquiries were directed at two topics:

1. *Costs, Speed, and Outcomes of AAA Consumer Arbitrations.* This aspect of the Preliminary Report assesses key characteristics of the AAA consumer arbitration process. In particular, it examines the following research questions:

    - General characteristics of AAA consumer arbitration cases including claimant type (i.e., consumer or business), types of businesses involved, and amounts claimed.
    - Costs of consumer arbitration (arbitrator fees plus AAA administrative fees), including the impact of the arbitrator's power to reallocate such fees in the award.
    - Speed of the arbitration process from filing to award, in the aggregate and by claimant type (i.e., consumer or business).
    - Various measures of outcomes such as win-rates, damages awarded, and evidence of as well as possible explanations for any repeat-player effects.

In addition to these broad research questions, SCJI also examined the extent to which consumer arbitrations are resolved ex parte; the frequency with which arbitrators award attorneys' fees, punitive damages, and interest; and results for consumers proceeding pro se.

2. *AAA Enforcement of the Consumer Due Process Protocol.* This aspect of the Preliminary Report provides an empirical analysis of how effectively the AAA enforces compliance with the Consumer Due Process Protocol. It considers a number of key research questions including:

    - To what extent do the consumer arbitration clauses comply, in their own right, with the Due Process Protocol?
    - How effective is AAA review of arbitration clauses for compliance with the Due Process Protocol?
    - To what extent does the AAA refuse to administer consumer cases because of the failure of businesses to comply with the Due Process Protocol?
    - How do businesses respond to AAA enforcement of the Protocol?

In addition to these research questions, SCJI examined several other issues that arise in connection with the Due Process Protocols.

Data and Methodology

SCJI reviewed a sample of AAA case files involving consumer arbitrations. The primary dataset consists of 301 AAA consumer arbitrations that were closed by an award between April and December of 2007. (The focus on cases closed by an award during this particular timeframe is based on the availability of the original case files.) This sample of cases was then coded for approximately 200 variables describing various aspects of the arbitration process, including a review of the arbitration clause in the file. In addition, when possible a broader AAA dataset comprising all consumer cases closed between 2005 and 2007 was utilized. The AAA maintains this dataset in the ordinary course of its business, collecting data for internal purposes but not

recording all variables of interest to SCJI. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA.

Key Findings – Costs, Speed, and Outcomes of AAA Consumer Arbitrations

The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.

In cases with claims seeking less than $10,000, consumer claimants paid an average of $96 ($1 administrative fees + $95 arbitrator fees). This amount increases to $219 ($15 administrative fees + $204 arbitrator fees) for claims between $10,000 and $75,000. These amounts fall below levels specified in the AAA fee schedule for low-cost arbitrations, and are a result of arbitrators reallocating consumer costs to businesses.

AAA consumer arbitration seems to be an expeditious way to resolve disputes.

The average time from filing to final award for the consumer arbitrations studied was 6.9 months. Cases with business claimants were resolved on average in 6.6 months and cases with consumer claimants were resolved on average in 7.0 months.

Consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255; business claimants won some relief in 83.6% of their cases and recovered an average of $20,648.

The average award to a successful consumer claimant in the sample was 52.1% of the amount claimed and to a successful business claimant was 93.0% of the amount claimed. This result appears to be driven by differences in types of claims initiated by consumers and business. Business claims are almost exclusively for payment of goods and services while consumer claims are seeking recovery for non-delivery, breach of warranty, and consumer protection violations.

No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.

Consumer claimants won some relief in 51.8% of cases against repeat businesses under a traditional definition (i.e., businesses who appear more than once in the AAA dataset) and 55.3% against non-repeat businesses – a difference that is not statistically significant.

Utilizing an alternative definition of repeat player, some evidence of a repeat-player effect was identified; the data suggests this result may be due to better case screening by repeat players.

Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses under an alternative definition (based on the AAA's categorization of businesses in enforcing the Consumer Due Process Protocol) – a difference that is statistically

significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that such effect is attributable to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims).

Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.

Consumer claimants sought to recover attorneys' fees in over 50% of the cases in which they were awarded damages and were awarded attorneys' fees in 63.1% of those cases. In those cases in which the award of attorneys' fees specified a dollar amount, the average attorneys' fee award was $14,574.

Key Findings – AAA Enforcement of the Due Process Protocol

A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.

Most arbitration clauses in consumer contracts that come before the AAA are consistent with the Consumer Due Process Protocol as applied by the AAA. The same is true for cases in which protocol compliance was a matter for the arbitrator to enforce.

AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations.

In 98.2% of cases in the sample subject to AAA protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.

In 2007, the AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases (9.4% of its consumer case load), because the business failed to comply with the Consumer Due Process Protocol. The most common reason for refusing to administer a case (55 of 129 cases, or 42.6%) was the business's failure to pay its share of the costs of arbitration rather than any problematic provision in the arbitration clause.

As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.

In response to AAA review, more than 150 businesses have either waived problematic provisions on an ongoing basis or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. This is in addition to the more than 1550 businesses identified

by the AAA as having arbitration clauses that comply with the Protocol. By comparison, AAA has identified 647 businesses for which it will not administer arbitrations because of Protocol violations.

Policy Implications and Next Steps

The empirical findings in the SCJI Preliminary Report on AAA consumer arbitrations have important implications for those interested in discussing and formulating public policy regarding arbitration.

1. Not all consumer arbitrations, arbitration providers, or arbitration clauses are alike. Differing results from empirical studies of arbitration may reflect variations associated with case mix, type of claimant, or provider review processes. This suggests the need for a nuanced approach to public policy concerning arbitration.

2. Private regulation complements existing public regulation of the fairness of consumer arbitration clauses. Policy makers should not ignore the role that arbitration providers can play in promoting fairness on behalf of consumers.

3. Courts could usefully reinforce the AAA's enforcement of the Consumer Due Process Protocol by declining to enforce an arbitration clause when the AAA has refused to administer an arbitration arising out of the clause or by otherwise reinforcing the role of the Due Process Protocol.

4. Arbitration may be less expensive for consumers than sometimes believed. For many consumers, the AAA arbitration process costs less than the amount specified in the AAA rules because arbitrators often shift some portion of the costs to businesses. Moreover, arbitrators award attorneys' fees to a substantial proportion of prevailing consumers in AAA consumer arbitrations.

5. Empirical studies have tended to find that repeat players fare better in arbitration than non-repeat players. To the extent such a repeat-player effect exists in arbitration, the critical policy question is what causes it. Our findings are consistent with prior studies in suggesting that any repeat-player effect is likely caused by better case screening by repeat players rather than arbitrator (or other) bias in favor of repeat players. A further as yet unresolved question is whether a repeat-player effect exists in litigation, and, if so, how litigation compares to arbitration in this regard.

While the empirical results presented in the SCJI Preliminary Report on Consumer Arbitration may usefully inform the policy debate on consumer arbitration, the Report nonetheless has limitations. First, its findings are limited to AAA consumer arbitrations. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. Second, its findings on the costs, speed, and outcomes of AAA consumer arbitrations are difficult to interpret without a baseline for comparison, such as the procedures and practices in traditional court proceedings. A future phase of this research project by the Searle Civil Justice

Institute's Task Force on Consumer Arbitration will undertake that comparison. It will seek to compare the procedures in AAA consumer arbitration with procedures available for consumers in court as well as comparing empirically key process characteristics of courts and arbitration.