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Whither Arbitration?

by

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Abstract: Over the past several decades, scholars and policymakers have debated the future of arbitration in the United States. Those debates have taken on new significance in the present Congress, which is considering a variety of reform proposals. Among the most widely watched are ones that would prohibit the enforcement of predispute arbitration clauses in employment, consumer and franchise contracts. Reviewing the available empirical literature, the paper explains how many of the assumptions driving the arbitration reform debate are unproven at best and flatly wrong at worst. It then tries to sketch out the economic impact of any move by Congress to limit arbitration in certain fields. The effect, I submit, would be to harm the very consumers and employees whom Congress is trying to protect. While arbitration certainly can be refined on the edges and more empirical research needs to be done, advocates for reform simply have not made their case.

Arbitration in the United States is at a crossroads. Or is in the crosshairs? Presently the 110th Congress is considering some of the most sweeping reforms to the field in decades. Among the most closely watched proposals are ones that would invalidate wide swaths of predispute arbitration agreements in

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employment contracts, franchise contracts and consumer contracts.²

While this degree of legislative attention is perhaps new, the arguments are not. Since the United States Supreme Court largely interred the non-arbitrability doctrine in the late 1980s and early 1990s, there has been a steady and mounting drumbeat of protest, from various segments of the bar and the academy, over the growing use of arbitration, particularly in employment and consumer disputes.³ These arguments have taken a variety of forms: that arbitrators systematically favor big companies, that arbitration deprives individuals of their day in court before a jury, that arbitral procedures are unfair, and ultimately that arbitration leaves employees and consumers worse off.⁴

While the academic pontification has been plentiful, the empirical research has been sparse. Until recently, much of the

² See S. 1782, Arbitration Fairness Act, Cong. Rev. S. 9144 (July 12, 2007). In its current form, the scope of this legislative proposal is potentially quite sweeping and, more importantly, decidedly vague. Not only does it bar enforcement of predispute arbitration agreements in the above-described fields, it also covers disputes arising under states intended to “protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power.” The statute does not define how courts should define “unequal bargaining power” or identify the precise statutes qualifying under this provision.

³ See, e.g., Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employee Rights: The Yellow Dog Contracts of the 1990s*, 73 Denver L. Rev. 1017 (1996); Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion under the Federal Arbitration Act*, 77 N.C. L. Rev. 931 (1999); Jean Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 Stan. L. Rev. 1631 (2005).

⁴ See David S. Schwartz, *If You Love Arbitration, Set it Free: how ‘Mandatory’ Undermines ‘Arbitration,’* Paper No. 1052 (University of Wisconsin Law School Legal Studies Research Paper Series Aug. 2007); Russell Feingold, *Mandatory Arbitration*, 39 Harv. J. Legis. 281 (2003).

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debate rested largely on anecdotes, not data.⁵ Such horror stories and success stories allow commentators to score rhetorical points. But they provide an extremely flimsy foundation upon which to construct policy prescriptions. As legislators weigh the future of arbitration for wide swaths of the economy, it is imperative to take an honest assessment of this empirical picture.

This paper takes up that charge. In recent years, a handful of researchers have attempted to analyze the issues in the arbitration debate more systematically: generating hypotheses, constructing data sets, testing their hypotheses, reporting their conclusions and suggesting further avenues for research. Synthesizing that research, this paper asks the basic questions that should be the centerpiece of any legislative debate: What do we know about arbitration? What do legislators need to know to make sound decisions about arbitration's future?

After surveying the empirical landscape, this paper reaches some surprising conclusions. Here is perhaps the most important conclusion: most of the methodologically sound empirical research does not validate the criticisms of arbitration. To give just one example, one routine criticism of employment arbitration is that it produces inferior results for employees.

⁵ See Richard Bales, *Normative Consideration of Employment Arbitration At Gilmer's Quinceanera*, 81 Tulane L. Rev. 331, 342 (2006) ("The early debate over employment arbitration occurred in a vacuum, with both proponents and critics making policy arguments without empirical support.") (footnote omitted).

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In fact, with one notable exception discussed below, arbitration generally produces higher win rates and higher awards for employees than litigation. This is just one example of the disconnect between rhetoric and reality in the arbitration debate.

In the sections of this paper, I analyze several of the questions that lie at the fault lines of the current legislative debate over the future of arbitration in this country. Cutting across the various sections are two recurring themes. First, it is essential to move beyond anecdote and consider the empirical data on a particular issue. Second, it is equally critical not to analyze arbitration in isolation but, instead, to compare it to the alternatives (in particular litigation or post-dispute arbitration). What emerges is a picture far more complex than most commentators have been willing to admit, and one that bespeaks caution before Congress acts.

My claim is a measured one. There is much empirical work still to do. There also certainly are examples of arbitration regimes that, by any measure, are hard to defend. Yet the current landscape of arbitration law in the United States already has several potential tools ferreting out those regimes - whether through refusing enforcement of the arbitration agreement or vacating the arbitral award. The proper question, thus, is not whether arbitration is flawless. Surely it is not.

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Rather the proper question is whether eliminating predispute arbitration agreements for wide swaths of the economy yields a net benefit. That is the burden confronting advocates of arbitration reform and one that, based on my review of the available empirical evidence, they have not met.

This Paper unfolds in five parts. Part I provides essential background to the arbitration debate - a brief history of arbitration law in the United States and an overview of its use. Part II addresses the question whether employees, consumers and franchisees (collectively referred to hereinafter as "claimants") are better off in arbitration.⁶ Part III considers questions relating to the fairness of arbitration procedures such as whether arbitration is prohibitively expensive and whether arbitrators display a systematic bias for the "repeat player" (the employer, the big company or the franchisor). Part IV looks more broadly at the economic impact of arbitration, its distributive effects and the economic consequences of proposals to eliminate predispute arbitration. Part V considers two of the most frequently discussed alternatives to the current system: (a) postdispute arbitration (under which arbitration agreements are enforceable only after a dispute has arisen) and (b) voluntary arbitration (under which

⁶ I use the term "claimants" primarily for simplification in the analysis, and some of the policy debates tend to lump them together.

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arbitration can be offered at the predispute stage but cannot be mandated as a condition of the underlying substantive agreement).

I. Background

This Section of the article unfolds in two parts. The first part provides a brief historical overview of the legal landscape. The second part details the frequency of arbitration.

A. Historical Overview

Others have detailed the modern history of American arbitration law, so I will only reprise it here to the extent relevant to lay the groundwork for the discussion that follows.⁷ Until the early twentieth century, courts in the United States displayed a marked hostility to arbitration agreements.⁸ Generally speaking, during this era, they held such agreements unenforceable as illegal attempts to oust courts of their jurisdiction.⁹ To be sure, there were exceptions, but the general trend was a hostile one.¹⁰

⁷ See, e.g., I. Macneil, R. Speidel, & T. Stipanowich, 1 FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS, AND REMEDIES UNDER THE FEDERAL ARBITRATION ACT § 4-5 (1996).

⁸ *Id.* § 4.3.2.2; See also Gary Born, INTERNATIONAL COMMERCIAL ARBITRATION 35 (2d ed. 2001).

⁹ Born at 35; Macneil at §4.3.2.2.

¹⁰ See *Burchell v. Marsh*, 58 U.S. 344 (1854).

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The tide began to turn in the early 20th century. New York's enactment of its arbitration law marked a major milestone in reversing the trends toward hostility.¹¹ Following on its heels, federal legislators showed renewed interest in enacting a parallel federal law.¹² In 1925, this renewed interest culminated in the enactment of the Federal Arbitration Act ("FAA").¹³ Two features of the FAA were especially noteworthy. One section provided that arbitration agreements were enforceable "except upon such grounds as exist at law or in equity for the revocation of any contract."¹⁴ Another section set forth limited grounds upon which a reviewing court could vacate an arbitral award.¹⁵

For the next five decades, courts showed greater solicitude for arbitration agreements, but there still were limits. Most notably, they developed a nonarbitrability doctrine under which they refused to enforce arbitration agreements with respect to claims arising under various federal laws such as the securities laws.¹⁶ Beginning in the early 1970s, the Court began to trim back the nonarbitrability doctrine. It began in the

¹¹ N.Y. Arbitration Law, L. 1920, C.275, Consol. C. 72 (1920). The current New York Arbitration Law is found in N.Y. Civ. Prac. L. & R. §§ 7501-7514.

¹² Macneil, *supra* note 3 at §§ 5.4.1-5.4.2; Born, *supra* note 4 at 35; *See* Hearings on S. 4213 and S. 4214 Before the Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess. (1923), Joint Hearings on S. 1005 and H.R. 646 Before the Subcommittee of the Committees on the Judiciary, 68th Cong., 1st Sess. (1924).

¹³ Federal Arbitration Act, 43 Stat. 883 (1927), 61 Stat. 669 (1947) (as codified at 9 U.S.C. §§ 1-16).

¹⁴ 9 U.S.C. §2.

¹⁵ *Id.* §10.

¹⁶ *See, e.g.,* Wilko v. Swan, 346 U.S. 427 (1953) *overruled by* [Rodriguez de Quijas v. Shearson/Am. Express, Inc.](#), 490 U.S. 477 (1989).

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international sphere, holding in *Scherck v. Alberto-Culver* that claims arising under the securities laws could be subject to an arbitration agreement in an international dispute.¹⁷ In the 1980s, the Court built on this precedent and expanded it into the domestic sphere, holding a variety of claims under the securities laws and the antitrust laws arbitrable. In doing so, it trimmed back and in some cases overruled some of the prior precedent that formed the cornerstone of the nonarbitrability doctrine.¹⁸ Finally, in 1991, the Court held in *Gilmer v. Interstate Lane* that claims under the Age Discrimination in Employment Act were arbitrable.¹⁹

Just as the Court's retreat from the nonarbitrability doctrine promoted growth in arbitration, so too did its approach to other areas of arbitration law. For example, in a series of decisions, the Court developed the separability doctrine.²⁰ Under that doctrine, courts generally determined challenges to the enforceability of an arbitration agreement whereas arbitrators initially would determine challenges to the underlying contract. This doctrine had the effect of expanding arbitrators' power and contracting that of courts. Likewise, in

¹⁷ *Scherck v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

¹⁸ *See Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 228-33 (1987)

¹⁹ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991).

²⁰ *See, e.g., Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 448-49 (2006); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995); *Prima Paint Corp. v. Floor & Conklin Mfg. Co.*, 388 U.S. 395, 411 (1967).

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the area of FAA preemption, the Court held that the FAA applied to state court proceedings (at least in part) and preempted state laws that put arbitral clauses on an unequal footing with contracts.²¹

In sum, a declining nonarbitrability doctrine, a firm separability doctrine and a robust preemption rule combined to create the conditions for more widespread use of arbitration in various types of disputes and industries. The next section synthesizes extant data on how this legal landscape affected the frequency of arbitration as a dispute resolution tool.

B. Data on Frequency

As the legal landscape has changed, arbitration has grown in popularity according to most reports.²² Caseloads at some of the major arbitral institutions have risen.²³ Surveys similarly show that a growing number of employers and companies are using

²¹ See *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995); *Doctors Associates*; *Allied-Bruce Terminix Co. Inc. v. Dobson*, 513 U.S. 265 (1995).

²² Recent research by Eisenberg and Miller represents a notable exception to this trend. Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335 (2007). In their review of 8-K filings by public companies, they found that arbitration clauses appeared infrequently in these companies' contracts. *Id.* at 335. According to their review of over 2800 contracts, arbitration clauses only appeared 11% of the time. *Id.* While certain types of contracts (such as employment contracts and licensing agreements) were relatively more likely to utilize arbitration clauses, no type of contract contained an arbitration clause more than 50% of the time. *Id.* at Table 2. Their findings should be interpreted in light of the data set they employed which may skew the utilization rate.

²³ See Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the AAA*, 18 OHIO ST. J. ON DISP. RES. 777, 779-80 (2003); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RES. J. 44, 44 (Nov. 2003-Jan. 2004). From January to August of 2007, 2144 arbitration cases have been filed with FINRA (formerly NASD). FINRA Dispute Resolution Statistics, http://www.finra.org/ArbitrationMediation/FINRA_Dispute_Resolution/Statistics/index.htm;

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arbitration clauses.²⁴ Likewise, other surveys indicate that a growing number of contracts, both consumer contracts and employment agreements, are likely to contain arbitration clauses.²⁵

Such measures of arbitration's popularity can, however, be misleading. While caseloads may be rising and the use of arbitration clauses increasing, various measures suggest that, at any given point in time, only a fraction of businesses are actually engaging in arbitration. A recent survey of Fortune 1000 companies found that while many had used arbitration at some point in the past three years, mediation was much more common.²⁶ More dated studies by the General Accounting Office found a widespread use of alternative dispute resolution, mediation was far more frequent than arbitration.²⁷ More

²⁴ David Lipsky, AN UNCERTAIN DESTINATION, IN U.S. CORPORATIONS AND ADR IN EMPLOYMENT (Estreicher & Sherwyn, eds. 2004); Lisa 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 Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303, 325 (Estreicher & Sherwyn eds. 2004); Michael Burr, *The Truth About ADR: Do Arbitration and Mediation Really Work*, Corp. Legal Times at 44 (Feb. 2004); Linda Demaine & Deborah Hensler, *Volunteering to Arbitrate Through Pre-dispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55 (Winter/Spring 2004); GAO, *Alternative Dispute Resolution: Employers' Experiences With ADR in the Workplace* (1997); Bickner et al., *Developments in Employment Arbitration*, 52 DISP. RES. J. 10, 78 (1997).

²⁵ Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the AAA*, 18 OHIO ST. J. DISP. RES. 777, 779 (2003) (employment agreements); Arbitration Clauses Prevalent, Consumer Action News at 5, http://www.consumer-action.org/downloads/english/CA_News_CC_07.pdf (Spring 2007) (credit card agreements); Mark Furletti, *Discussion Paper, Mandatory Arbitration Clauses in the Credit Card Industry* (Payment Cards Center of FRB Philadelphia) (Winter 2003) (same).

²⁶ David Lipsky, AN UNCERTAIN DESTINATION, IN U.S. CORPORATIONS AND ADR IN EMPLOYMENT (Estreicher & Sherwyn, eds. 2004). See also National Arbitration Forum & General Practice Solo and Small Firm Division of the American Bar Association, *Survey: ADR Preference and Usage* 19 (2006) (survey showing that 93.6% of attorneys surveyed resolved 5 or fewer cases by arbitration in the preceding year)..

²⁷ GAO, *Alternative Dispute Resolution: Employers' Experiences With ADR in the Workplace* 2 (1997); GAO, *Employment Discrimination: Most Private Sector Employers Use ADR*, 7 (1995).

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microscopic studies are to the same effect. According to one case study of a company with one of the oldest nonunion grievance system in the country, only 2% of employee disputes actually reached arbitration; the majority were resolved at an earlier stage in the grievance process.²⁸

To suggest that arbitration is infrequent does not imply, however, that it is unimportant. As will become clear later in the paper, particularly in the section on economic impact, the availability of arbitration, particularly the enforceability of the arbitration commitment, is an integral part of this broader system of dispute resolution management and a critical component to companies' abilities to realize the cost savings from alternative dispute resolution.

Therefore, as to frequency, the available data support three main conclusions. First, over a medium-term horizon, arbitration caseloads have risen. Second, while an increasing percentage of businesses are employing arbitration clauses, particularly in their employment and consumer contracts, only a fraction of those clauses actually result in arbitration. Third, arbitration must be seen in context, as part of a larger strategy of alternative dispute resolution techniques that companies use to manage conflicts with their employees and

²⁸ David Lewin, *Dispute Resolution in NonUnion organizations: Key Empirical Findings, in Alternative Dispute Resolution in the Employment Arena* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 379, 386 (Estreicher & Sherwyn eds. 2004).

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customers. With this picture in mind, we can now turn to the main fault lines of the arbitration debate.

II. Are Claimants Better Off In Arbitration?

This Section addresses the following basic question - are employees, consumers and franchisees (hereinafter "claimants" better off in arbitration. I answer this question by considering four methods for measuring outcomes in arbitration. I also consider the methodological limits to each of those methods.²⁹

A. Raw Win Rates

One simple but crude way to answer the "better off question" is to look at absolute win rates: that is, how often are claimants actually winning in arbitration? Some early empirical studies in various fields (including employment arbitration, securities arbitration and consumer arbitration) employed this approach. Generally speaking, the data showed that claimants were as likely as or more likely than defendants to prevail in arbitration.³⁰ For example, a 2003 article by

²⁹ For prior studies synthesizing the data, see National Workrights Institute, *Employment Arbitration: What Does the Data Show?*, available at http://www.workrights.org/current/cd_arbitration.html#_ednref9; Kirk D. Jensen, *Summaries of Empirical Studies and Surveys Regarding How Individuals Fare in Arbitration*, 60 Consumer Fin. L.Q. Rep. 631 (2006)

³⁰ See Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 108-11 (2003); Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 15 (2004), <http://www.arb-forum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf>; California

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Lewis Maltby, a well known employment arbitration expert and civil rights lawyer, synthesized the results from several studies of AAA arbitration and concluded that employees prevailed approximately 62% of the time.³¹ A review of consumer arbitrations in California by the California Dispute Resolution Institute found that the consumer prevailed 71.2% of the time.³² Echoing these results, a study for the SEC by Michael Perino, a noted securities arbitration professor, concluded that 52.56% of arbitrations resulted in awards for customers.³³ The net lesson from these studies is that, across a variety of disputes, claimants are not systematically losing in arbitration.³⁴

Raw win rates are, however, a relatively poor method by which to answer the "better off" question. For one thing, standing alone, they offer relatively little insight into how the claimant would have fared in litigation. For another thing,

Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure*, Figure 4 (2004); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 Disp. Resol. J. 40, 44 (Oct.-Dec. 1995); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, 130-31 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author); GAO, *Securities Arbitration: How Investors Fare*, 7-8 (May 1992).

³¹ Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 110 (2003).

³² California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure* (August 2004). [\[confirm cite\]](#). See also Mark Fellows, *The Same Result As In Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, Metro. Corporate Counsel 32 (July 6, 2006) (discussing results of California report in light of other studies of win rates in arbitration).

³³ Michael Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* 32 (November 4, 2002).

³⁴ In fact, the only reported data showing a win-rate of less than 50% is William Howard's study of securities arbitration. Howard's review of 61 SRO-administered employment arbitration in the securities industry between February 1992 and October 1994 found that the employee prevailed 48% of the time (compared to a 52% win rate for the employer). See William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 122 & Table 8 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author)

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anyone interpreting these results must closely consider how the researchers define a "win." An arbitration might award a claimant \$100 (thereby qualifying as a "win" according to some reports), yet, if the claimant were seeking \$100,000, such a paltry sum could hardly be considered a good outcome if the claimant had a meritorious claim.

B. Comparative Win Rates

In an attempt to overcome these problems, more recent research has considered comparative win rates in arbitration and litigation. Here too, the data, with one exception, generally show that arbitration produces outcomes for claimants that are as good, if not better than, the outcomes in litigation. For example, a 1995 study of employment cases by William Howard found that, with respect to litigation, employees received some recovery 71% of the time.³⁵ By contrast, in arbitration, the employee prevailed 68% of the time, leading Howard to conclude that the choice of forum had relatively little effect on a claimant's win-rate.³⁶ More recent papers about employment arbitration by Maltby, Estreicher and Sherwyn, some presenting

³⁵ William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 127 & Table 3 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 *Disp. Resol. J.* 40, 42 (Oct.-Dec. 1995)..

³⁶ William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 130-31 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author)

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original research and others synthesizing existing research, all confirm this basic conclusion.³⁷

Comparative win rate methodology is also not flawless. It still suffers from the definitional problem that plagued studies looking at raw win rates - whether the definition of "win" overstates the results. Comparative win-rate methodology also injects a comparability problem - the types of cases that may be in arbitration can differ from those that are litigated. Indeed, rarely will it be the case that two cases are exactly alike, so attempt to draw any firm conclusion about how different systems of dispute resolution treat those cases must be approached cautiously. Finally, comparing arbitrated outcomes to litigated outcomes injects a third bias into the data. Most litigated cases are terminated prior to verdict (either through settlement, dismissal, etc.) so any data set that looks solely at verdicts (and several do) also can skew the data set - a fact that authors of several of these studies and other commentators have recognized.³⁸

C. Comparative Recoveries

³⁷ Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. DISP. RES. 559, 564-65 (2001); Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 111-12 (2003); Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1569 (2005).

³⁸ Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1566 (2005); Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29 (1998) [\[need pin\]](#); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served* 127-28 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author).

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A third measure considers comparative recoveries – how much are claimants recovering in arbitration compared to claimants in litigation? Here, the data cut in different directions. For example, a 2003 study of employment disputes in the securities industry by Delikat and Kleiner found that claimants actually recovered slightly more in arbitration than litigation.³⁹ By contrast, an earlier study of employment disputes by Howard found that mean and median verdicts in litigation exceeded awards in arbitration.⁴⁰ This led Howard to conclude that the choice between litigation and arbitration did affect the amount of recovery.

Each of these studies was criticized for flaws in its methodology, particularly Howard's study that collapsed civil rights cases with other employment cases.⁴¹ More recent research by Hill and Eisenberg sought to overcome these defects by separating out the two. Their study of employment arbitration in non-civil-rights cases found no material differences in

³⁹ Michael Delikat & Morris Kleiner, *Comparing Litigation And Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?*, *American Bar Association Litigation Section Conflict Management*, Vol. 6, Issue 3, 10 & Table 3 (2003).

⁴⁰ William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 132 & Table 12 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 *Disp. Resol. J.* 40, 45 (Oct.-Dec. 1995).

⁴¹ For criticism of Delikat & Kleiner's methodology, see Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 *OHIO STATE J. ON DISP. RES.* 777, 791-92 (2003). For criticism of Howard's study, see Richard Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quincenera*, 81 *Tulane L. Rev.* 331, 348 & n. 122 (2006); Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 *STAN. L. REV.* 1557, 1567-68 (2005); Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 *OHIO STATE J. ON DISP. RES.* 777, 788-89 (2003).

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outcomes between arbitration and litigation, at least for higher-compensated employees.⁴²

Those results might suggest arbitration is an inferior option for lower-compensated employees. That conclusion would be mistaken. As both the authors themselves and subsequent commentators have noted, the sample size was quite small, and the standard deviations in their regressions were sizable.⁴³ A more powerful cause of these outcomes may be the difficulties that lower income employees face in obtaining qualified legal counsel. While I explore this “access to justice” phenomenon in greater detail in the following section, I briefly summarize the problem here. Roughly speaking, lower compensated employees only will be able to afford legal counsel who are willing to take their case on a contingent-fee basis. Prospective counsel will be willing to do so if the likelihood of recovery and the amount of expected recovery are both sufficiently high to make the case economically rational for the attorney to undertake.⁴⁴ Indeed, a founder of the National Employment Lawyers’ Association, an organization dedicated to employee

⁴² Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RES. J. 44, 44 (Nov 2003-Jan 2004). The authors define “higher-compensated” employees to include those who earn a gross annual income of at least \$60,000. *Id.* at 46.

⁴³ Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1572 (2005); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RES. J. 44, 49 (Nov. 2003-Jan. 2004).

⁴⁴ David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1574 & n.88 (2005); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. DISP. RES. 559, 563 (2001); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 Disp. Resol. J. 40, 45 (Oct.-Dec. 1995).

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representation in employment disputes, recently testified that claimants' attorneys turned away at least 95% of employees who sought representation.⁴⁵ Consequently, only promising high-stakes cases ever even make it to court, and only a fraction of those reach a verdict.⁴⁶ Thus, mere consideration of comparative outcomes masks two critical facts - first, that many potential claimants never get the opportunity to litigate their case and second that plaintiffs' lawyers perform a screening function so that only higher-stakes, highly meritorious claims end up in court. Both phenomenon can artificially inflate the recovery rate differential for this cohort of plaintiffs.

D. Recovery Rates Relative To Amounts in Controversy

A final measure of whether arbitration makes claimants better off is to look at recovery rates relative to amounts claimed. Lewis Maltby undertook a study of this sort in the late 1990's in an effort to overcome some of the methodological limitations in studies utilizing comparative win rates and comparative verdict rates. His study of employment arbitrations and federal district court cases from the mid-1990's found that mean damages in arbitration were only 25% of the amount demanded whereas mean damages received in court were 70% of the amount

⁴⁵ Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 107 (2003).

⁴⁶ Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 56-58 (1998).

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demanded, further suggesting a comparative advantage to litigation.

While comparing recovery relative to amount claimed eliminates some of the data distortions associated with comparative win rates and comparative recovery rates, it injects new ones. For one thing, it still contains the selection bias present in some of the research on comparative recoveries. For another thing, Maltby's research compared arbitration disputes not dominated by discrimination claims with litigated disputes that were dominated by discrimination claims.⁴⁷ Here too, therefore, the data present a comparability problem. Finally, as Sherwyn has noted, Maltby's study assumes that lawyers will be accurate in their demand estimates.⁴⁸

In sum, by most measures - raw win rates, comparative win rates, some comparative recoveries and some comparative recoveries relative to amounts claimed - arbitration generally produces better results for claimants.⁴⁹ The primary contra-indicator is Eisenberg & Hill's research suggesting that employees earning less than \$60,000 may achieve less favorable results. Given the difficulties that this class of claimants

⁴⁷ Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RES. J. 44, 45 (Nov 2003-Jan 2004).

⁴⁸ Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1577 (2005)

⁴⁹ Richard Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceanera*, 81 Tulane L. Rev. 331, 347 (2006) (“[M]ost empirical studies suggest that employees do at least as well in arbitration as they do in litigation.”).

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would have in obtaining litigation, however, it is far from clear that arbitration necessarily makes them worse off. I return to this "access to justice" question in the next section.

II. Is Arbitration Fair?

This Section addresses the basic question - is arbitration fair? It proceeds in two parts. The first part considers a methodological question of just how to measure fairness. The second part considers some of the specific complaints about perceived unfairness of arbitration such as the costs and the lack of meaningful access to a forum.

A. Fairness and Methodology

There are at least two possible ways to measure arbitration. One would be survey data polling participants in arbitration about their experience. A second would be to derive an independent standard for what set of procedures should be considered "fair."

1. Surveys

As to the first measure, some survey research sheds light on the fairness question. In general, most surveys of arbitration participants have indicated that arbitration's participants were satisfied with the proceedings. For example, a 2005 study by Harris Interactive surveyed 609 adults who had

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participated in some type of arbitration.⁵⁰ Participants found that arbitration was faster (74%), simpler (63%) and cheaper (51%) than going to court. Perhaps more notably, 66% of survey participants stated that they would be likely to use arbitration again, including 1/3 of participants who had lost in the proceedings. Similarly, a 2005 study by Ernst & Young surveyed 226 consumer-initiated arbitration cases and asked participants whether they were satisfied with the process.⁵¹ While the response rate was low, 69% of respondents stated that they either were very satisfied or satisfied with the arbitral process.⁵²

While the Harris and the Ernst & Young study generated similar results, both studies might be criticized on the ground that the studies were underwritten by industry associations.⁵³ Irrespective of the legitimacy of that criticism, other reports have largely validated these studies' conclusions. For example, a 2003 study by the Roper Organization surveyed a random cross section of 1036 adults (who had not necessarily participated in arbitration). 67% felt that court litigation took too long. When arbitration was explained to them, 64% said they would

⁵⁰ Harris Interactive survey conducted for US Chamber's Institute of Legal Reform, *Arbitration: Simpler, Faster, Cheaper than Litigation* (April 2005), <http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf>.

⁵¹ Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* <http://www.arb-forum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf>.

⁵² *Id.* at 2.

⁵³ See Public Citizen, *How Credit Card Companies Ensnare Consumers* 20 (September 2007).

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prefer arbitration over litigation.⁵⁴ Surveying a slightly different (but more informed) group, a 2003 study by the American Bar Association asked approximately 700 lawyers in its litigation section about their perception of arbitration.⁵⁵ The results were consistently positive. 86.1% felt that arbitration was as effective, if not more effective, than litigation; 75% felt that the outcomes in arbitration were superior to or at least equal to those in litigation.

Studies of securities arbitration reach the same conclusion; a paper by Tidwell surveyed 415 individuals who had participated in NASD arbitrations. 93.49% felt that the arbitration was handled fairly and without bias.⁵⁶ In a more recent paper, Michael Perino reported similar results.⁵⁷ he also reported that 91% of surveyed investors who had participated in NASD arbitrations found that the arbitrators demonstrated either an excellent or a good level of fairness.

Thus, survey results across a variety of industries and a variety of individuals consistently report positive attitudes toward arbitration and the fairness of its procedures. Of course, apart from some of the specific methodological concerns

⁵⁴ Roper ASW, 2003 Study for Institute for Advanced Dispute Resolution (April 2003).

⁵⁵ ABA Section on Litigation Task Force on ADR Effectiveness (Aug. 2003).

⁵⁶ Tidwell et al., *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations*, Paper presented at Aug. 5, 1999 meeting of Academy of Legal Studies in Business p. 3 (Aug. 5, 1999), available at http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p009528.pdf.

⁵⁷ Michael Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* 34-36 (November 4, 2002).

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about particular studies, an additional one cuts across all of them: selection bias. Individuals who were pleased with the outcome of arbitration may be more willing to invest the time to participate in a survey about it. By contrast, those who were disappointed by the outcome may want nothing more to do with the system. This concern appears to be more hypothetical than documented (indeed the results of the Harris Interactive study suggest this to be the case), but in the absence of additional research (which itself may be hard to come by) should cause the data to be interpreted with caution.

Apart from the methodological difficulties with measuring fairness by surveys, why should we rely on individual assessments as a proper measure of fairness? Should fairness not be derived from a normative standard that entails basic concepts of due process like a neutral decision maker and an opportunity to be heard? We will return to those issues later in this Section when we explore the legitimacy of specific complaints about arbitral procedure like costs. For now, I introduce the concept only as a reason to check excessive reliance on survey data.

2. Normative Measures

If we shift from a survey-based to a normative method for testing arbitral fairness, it is important to observe that

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arbitral procedures, at least with respect to some of the fields that are subject of current congressional interest, have not been static. Rather, most arbitrations in the consumer and employment fields are now subject to Due Process protocols.⁵⁸

I have discussed the background to the Due Process protocols elsewhere, so I summarize that background here only to the extent relevant to the present article. The protocols trace their genesis to the Dunlop Commission, established in 1993 and to investigate the current state of worker-management relations in the United States" and headed by former Labor Secretary John Dunlop.⁵⁹ Part of its mandate required the Commission to consider "[w]hat (if anything) should be done to increase the extent to which work-place problems are directly resolved by the parties themselves, rather than through recourse to state and federal courts and government regulatory bodies."⁶⁰ President Clinton created the Commission shortly after the Supreme Court's decision in *Gilmer*, so it was perhaps inevitable that the Commission eventually would focus on the adequacy of procedural protections in arbitration.⁶¹ At the request of Chairman Dunlop,

⁵⁸ For commentary on the protocols, see Margaret M. Harding, *The Limits of the Due Process Protocols*, 19 OHIO ST. J. ON DISP. RESOL. 369 (2004).

⁵⁹ Commission on the Future of Worker-Management Relations, Fact-Finding Report xi (May 1994).

⁶⁰ *Id.*

⁶¹ See Harding, 19 Ohio St. J. Disp. Res. at 373-74.

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a coalition of labor, management and arbitration representatives turned to employment arbitration – the area at issue in *Gilmer*.⁶²

The primary vehicle for their reform efforts came in the form of a “due process” protocol – that is, a set of rules governing certain arbitrations falling under the protocols.⁶³ As Paul Verkuil has observed the choice of terminology is a “odd” one in light of the above-discussed conclusion that arbitration does not constitute state action and, as a strictly doctrinal matter, is not subject to constitutional requirements of due process.⁶⁴ Nonetheless, the protocol functions in a manner not unlike due process requirements, setting forth a series of procedural norms that must be observed in a decision making process.⁶⁵ The employment protocol sets forth a variety of rights including:

- the employee’s right to be represented by a person of her own choosing;
- the employer is encouraged to pay at least a share of the employee’s fees;
- employees should have access to all information reasonably relevant to their claims;

⁶² On the history behind the drafting of the employment protocol, including a rich history of the industry participants, see Bales, *The Employment Due Process Protocol at Ten: Twenty Unresolved Issues and a Focus on Conflicts of Interest*, 21 Ohio St. J. on Disp. Res. 165 (2005); Harding, 19 Ohio St. J. Disp. Res. at 371, 390-91.

⁶³ See Nat’l Academy of Arbitrators, *Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship* (May 9, 1995); Nat’l Consumer Disputes Advisory Cmte., *Due Process Protocol for Mediation and Arbitration of Consumer Disputes* (Apr, 17, 1998); Nat’l Consumer Disputes Advisory Cmte., *Due Process Protocol for Mediation and Arbitration of Health Care Disputes* (July 27, 1998).

⁶⁴ Verkuil, 57 Admin. L. Rev. at 985.

⁶⁵ The content of some of the protections finds its roots in procedural protections attendant to labor-management arbitrations under collective bargaining agreements. See Harding, 19 Ohio St. J, Disp. Res. at 395-96.

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- before selecting an arbitrator, parties should have sufficient information to contact parties who previously have appeared before her;
- arbitrators should have sufficient skill and knowledge;
- arbitrators should be drawn from a diverse background;
- arbitrators should be free of any relationships that would create an actual or apparent conflict of interest;
- the employee's entitlement to the same array of remedies in arbitration as she would be entitled to in a judicial proceeding

Subsequent protocols governing consumer disputes and health care disputes differ in some of the specifics but contain the same basic protections. Many of the major arbitration associations have committed to administering arbitrations in the consumer and employment areas only if the parties agreed to be bound by the protocols.⁶⁶

The protocols differ from governmentally required procedures in one important respect: whereas governmentally required procedures would bind all arbitrations, the protocols ultimately depend on the voluntary willingness of the industry to abide by them; some arbitral systems might not observe them, and this lack of total observance has been one of the complaints

⁶⁶ Am. Arbitration Ass'n, *Consumer Due Process Protocol* (1998), available at <http://www.adr.org/sp.asp?id=22019>; Am. Arbitration Ass'n, *Employment Due Process Protocol* (1995), available at <http://www.adr.org/sp.asp?id=28535>; JAMS, *JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness* (2007), available at http://www.jamsadr.com/rules/consumer_min_std.asp; JAMS, *JAMS Policy on Employment Arbitration: Minimum Standards of Procedural Fairness* (2005), available at http://www.jamsadr.com/rules/employment_Arbitration_min_stds.asp

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of arbitration's critics. Even in those cases, courts currently can decline to enforce arbitration agreements or arbitration awards on the basis of procedural irregularity.⁶⁷

Moreover, the protocols remain relevant even as to arbitrations that are not subject to them. As I have explained elsewhere, some courts, including several justices on the Supreme Court, have looked to the protocols as a benchmark by which to assess the procedural fairness of a particular arbitral scheme. In other words, while the protocols technically do not have the binding force of a legal rule, they nonetheless have exerted a persuasive influence on how some courts have interpreted existing doctrine governing the enforceability of arbitral agreements and awards.⁶⁸

This inquiry into the general question of fairness has yielded three main conclusions. First, to the extent surveys provide an appropriate measure of arbitral fairness, the results are uniformly positive for arbitration. Second, to the extent some normative standard provides the proper metric of fairness, the Due Process protocols have sought to satisfy it. Third, to the extent the protocols are not formally binding, existing

⁶⁷ *Walker v. Ryan's Family Steak Houses, Inc.*, 400 F.3d 370 (6th Cir. 2005) (refusing to enforce arbitration agreement where arbitral forum was nonneutral); *McMullen v. Meijer, Inc.*, 355 F.3d 485 (6th Cir. 2004) (refusing to enforce arbitration agreement which granted exclusive control over arbitrator selection to employer); *Murray v. United Food and Commercial Workers Intern. Union*, 289 F.3d 297 (4th Cir. 2002) (refusing to enforce arbitration agreement after finding agreement unconscionable); *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (refusing to enforce agreement with one-sided procedural rules).

⁶⁸ *See Rutledge, Is Arbitration State Action? Does It Matter?* (unpublished manuscript on file with author).

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arbitration law provides opportunities for courts to police procedurally unfair arbitrations, and the protocols have helped guide that judicial inquiry. With this general overview, we now can turn to some of the particular procedural points about arbitration that attracted attention.

B. Particular Problems

Apart from generalized concerns about arbitration's fairness, certain features of arbitration have fallen under special scrutiny. These include whether arbitration systematically favors the repeat player, whether the costs of arbitration are excessive and whether an arbitration requirement coupled with other features of a dispute resolution clause effectively deprive claimants of access to justice.⁶⁹ This section considers each of those concerns.

1. Repeat Player Phenomenon

One oft-stated concern about arbitration is that it systematically favors the repeat player.⁷⁰ According to the argument, many arbitrations such as in the fields currently under consideration by Congress involve participation by one party who regularly arbitrates (the employer, the company, the

⁶⁹ For a recent publication detailing some of these criticisms, see Public Citizen, *How Credit Card Companies Ensure Consumers* (Sept. 2007).

⁷⁰ See Arbitration Fairness Act §2(4).

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franchisor) and one who rarely does so (the employee, the consumer, the franchisee). Because the former party in each case is a repeat player, this will skew the results in favor of that party's advantage.

Why might the repeat player phenomenon exist? One reason might be that the repeat player may have superior knowledge about the arbitral process and, therefore, may be able to exploit that informational asymmetry to its advantage. The validity of the phenomenon, however, is not unique to arbitration. Rather, it would be equally valid in any other dispute resolution forum. The employer, the corporation or the franchisor would appear in the forum more frequently and, therefore, could have superior knowledge about the forum's operations. Thus, to the extent informational asymmetries drive the repeat player phenomenon, eliminating arbitration does not correct the asymmetries.

Another reason for the repeat player phenomenon might be the financial incentives of arbitrators. The argument would go that arbitrators, unlike judges, depend on repeat business to generate a stream of income and, therefore, have an incentive to render awards favoring the party more likely to appoint them in

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the future.⁷¹ Unlike the informational asymmetry explanation, this reason is indeed unique to arbitration.

Here too, however, there are several reasons to be skeptical about the claim. For one thing, it probably is incorrect to consider the repeat player phenomenon from the parties' perspective. Rather, the proper level of analysis is probably at the level of the parties' lawyers, who have the superior incentive to remain informed about the reputations of particular arbitrators. Insofar as certain lawyers develop reputational expertise representing claimants or defendants in particular arbitrations (i.e., employment arbitration, consumer arbitration, etc.), the repeat player advantage would be less pronounced.⁷² For another thing, arbitral institutions have some incentives to ensure that the repeat player phenomenon does not take root. If it were to do so, that might call into doubt the neutrality of the tribunal and, consequently, the enforceability of any award. Finally, as I have explained elsewhere, at least some arbitrators like arbitral institutions have an incentive to cultivate a reputation for neutrality, which may over the long run create more opportunities for business than if they develop

⁷¹ The Salary clause in Article III reflects this concern to remove any mercenary incentive for the judge's decision. Moreover, the Court has made clear that tying a judge's compensation to a particular act could violate the Due Process Clause as well. See *Tumey v. Ohio*, 273 U.S. 510 (1927).

⁷² See Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 565-66 (2001); Christopher Drahozal, *Privatizing Civil Justice: Commercial Arbitration and the Civil Justice System*, 9 KAN. J. L & PUB. POL'Y 578, 588-89 (2000).

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a reputation as an industry-friendly or claimant-friendly arbitrator.⁷³

Moving from the theoretical discussion to the empirical case, some research has explored the validity of the repeat player phenomenon. Lisa Bingham's research on employment arbitrations has provided the most systematic to date. In her review of AAA arbitration decisions between 1993 and 1994, Bingham observed that employees won less frequently and recovered a lower percentage of the amount requested when they were arbitrating against employers who were repeat players.⁷⁴ Subsequent studies by Bingham offer additional support for these results.⁷⁵

While these results suggested some validity to the repeat player hypothesis, other research arguably casts doubt on it.⁷⁶ An earlier study by Bingham reviewed all AAA-arbitration awards for several years and found that employees obtained systematically more favorable results when the arbitrator was compensated.⁷⁷ If financial motives explained the repeat player

⁷³ See Peter B. Rutledge, *Toward a Contractual Theory of Arbitral Immunity*, 39 Ga. L. Rev. 151 (2004).

⁷⁴ Lisa Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189, 208-09 (1997).

⁷⁵ Lisa 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 Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303 (Estreicher & Sherwyn eds. 2004).; Lisa Bingham, *On Repeat Players, Adhesive Contracts and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 234 (1998).

⁷⁶ Apart from the conflicting evidence discussed here, Bingham's sample size was quite small.

⁷⁷ Lisa Bingham, *Is there a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Actual Cases and Outcomes*, 6 INT'L J. ON CONFLICT MGMT. 369, 380 (1995).

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phenomenon, one would have expected employers to obtain superior results in paid cases where the arbitrator actually had a financial incentive to generate further business. A 2003 study by Hill of AAA employment arbitration found no demonstrable "repeat player" effect.⁷⁸

Regardless of how one reconciles these results, it is important to differentiate between demonstrating the repeat player phenomenon and identifying its cause. While it might be due to the arbitrator's financial incentives or informational asymmetries, it might also have less problematic explanations. For example, the repeat player's experience in the arbitration might have "learning effects;" that is, the repeat player learns what sorts of cases can be won and, therefore, is more likely to settle those, leaving for arbitration those where the repeat player is relatively confident it can win outright (or at least where the costs of taking the case through arbitration are lower than the minimum amount that the claimant is prepared to accept in settlement). Subsequent research by Bingham suggested that this was probably the correct explanation for the repeat player phenomenon.⁷⁹ Elizabeth Hill's 2003 study investigated this

⁷⁸ Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 814-16 (2003).

⁷⁹ Lisa 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 Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303, 323 & Table 2 (Estreicher &

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precise point and found support for what she termed an “appellate effect” – that is, employers resolved meritorious cases in-house, leaving frivolous cases for adversarial setting.⁸⁰

In sum, there is some support for the “repeat player” phenomenon in the empirical literature, but the picture there is mixed at best. Even if such an effect exists, however, the best available research suggests that there may be quite benign causes such as “learning effects” for the repeat player phenomenon.⁸¹

2. Costs

A frequently heard complaint about arbitration in the consumer and employment contexts concerns the costs of proceedings. The argument from costs takes both a weak and a

Sherwyn eds. 2004). *See also* Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1570-71 (2005).

⁸⁰ Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 816 (2003).

⁸¹ A very recent report by Public Citizen lambastes the arbitration industry for systematically favoring credit card companies in its disputes with consumers. Public Citizen, *How Credit Card Companies Ensure Consumers* (Sept. 2007). It cites data from litigation in Alabama and NAF’s Section 1281.96 filings in California to argue that arbitrators find for the company in a disproportionately high percentage of cases. The study is noteworthy for, unlike many other studies of arbitration, it involves a set of cases where the company, rather than the consumer, is typically the claimant. Nonetheless, it commits the same basic error identified in the prior research on employment arbitration – that the success rate may be due to the company’s learning effects rather than some systematic bias in arbitration. That is, banks only commence collection actions against their consumers when they have a strong case on the merits. If outcomes in the collection cases were due to arbitrator bias, one would expect similarly high success rates for companies where the consumer initiated the dispute against the credit card company. Yet the Public Citizen study reveals that this was not the case. The Alabama data set was quite small (n=4), but the consumer either prevailed or settled in 75% of the cases. The California data set was slightly larger (n=118), but there the consumer prevailed in somewhere between 25%-50% of the cases (the results in approximately 25% could not be determined. To be clear, this does not mean that the hypothesis in the Public Citizen study is invalid; rather, it simply shows that, until the “learning effects” can be controlled in the methodology, the data do not necessarily prove the hypothesis.

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strong form. According to the weak form, the costs of arbitration exceed those of litigation, making it an inferior dispute resolution forum for claimants. According to the strong form of the argument, arbitration entails exceptionally high up-front costs for the claimant; those costs, if prohibitive, effectively deny claimants access to the forum.

As with the other fault lines in the debate examined so far, these criticisms are not entirely invalid, but the rhetoric far exceeds the reality. A few studies have attempted to consider the cost issue more systematically.⁸² On the employment side, Bickner's 1997 study surveyed 36 employers who had arbitration plans and determined that fifty percent of employer plans required the employer to pay the costs of the proceeding.⁸³ A more recent study of 200 randomly selected awards in AAA-administered employment arbitrations found that 61% of low and middle income employees paid no forum fees (i.e., no arbitrator fees or administrative costs).⁸⁴ On the consumer side, a recent

⁸² See Michael H. LeRoy & Peter Feuille, *When is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Mandatory Employment Arbitration*, 50 U.C.L. A. L. Rev. 143 (2002). For a good recent discussion of the empirical literature on costs, gaps in the data and empirical pitfalls in any analysis of it, see Richard A. Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceanera*, 81 Tulane L. Rev. 331, 344-49 (2006).

⁸³ *Bickner et al.*, *Developments in Employment Arbitration*, 52 DISPUTE RES. J. 10, 78 (1997). A contemporaneous study of five employer arbitration programs by the General Accounting Office found that four of those schemes charged the employee only a nominal fee or capped the employees share of the costs. See GAO, *Alternate Dispute Resolution: Employers' Experiences* (1997).

⁸⁴ Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 802 (2003). A more recent study by LeRoy and Feuille suggests that cost-shifting rates may be lower for high-income employees. See Michael H. LeRoy & Peter Feuille, *When is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Mandatory Employment Arbitration*, 50 U.C.L. A. L. Rev. 143 (2002).

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study by Demaine and Hensler analyzed arbitration clauses from companies in a variety of consumer industries and found that slightly under half divided the arbitration fees equally between the company and the consumer (all but three of the clauses they the considered required arbitration to take place at a location near the consumer's residence or the location where the service had been provided).⁸⁵

While such employer-paid systems are far from uniform, other mechanisms can serve to regulate any financial burden of arbitration on the claimant. The Due Process Protocols, described above, contain language governing cost allocation. Specifically, both the employment protocol and the consumer protocol encourage a cost allocation mechanism that does not preclude a claimant from pursuing her claim. Moreover, apart from the protocols, the arbitration institutions' own rules sometimes mitigate any financial burden. For example, in 2002, the American Arbitration Association adopted a rule that limited an employee's forum fees under a predispute arbitration agreement to \$125.⁸⁶

Even if the arbitral institutions do not observe the due process protocols or otherwise employ procedures designed to limit an employee's or consumer's out of pocket costs, courts

⁸⁵ Demaine & Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 L. & CONTEMP. PROBS. 55 (Winter/Spring 2004).

⁸⁶ Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 Disp. Res. J. at 12 (May-July 2003).

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can fulfill this role under current arbitration law. In *Green Tree Financial Corp. v. Randolph*, the Supreme Court unanimously agreed that a court could refuse to enforce an arbitration agreement based on a party's inability to shoulder the costs of the proceeding.⁸⁷ While the justices were in accord on this point, they did differ over who bore the burden of proof on the affordability issue, and a bare majority of the Court held that the claimant (i.e., the party resisting arbitration) bore that burden. *Green Tree's* holding on that point has been the subject of some academic criticism.⁸⁸ While the majority's resolution of the burden issue is debatable,⁸⁹ the post-*Green Tree* case law demonstrates that claimants sometimes have been able to make the required showing of financial burden and that, in such cases, courts have been willing to invalidate arbitral clauses on the basis of such a showing.⁹⁰

Finally, it bears emphasis that arbitration, compared to litigation, affords greater opportunities to shift the forum fees. The rules of virtually all major arbitral institutions permit the arbitrator to shift fees at the arbitrator's

⁸⁷ *Green Tree Financial Corp. –Alabama v. Randolph*, 531 U.S. 79 (2000).

⁸⁸ Jennifer Peresie, Note, *Reducing the Presumption of Arbitrability*, 22 *Yale L. and Pol'y Rev.* 453, 460-61 (2004); R. Brian Tipton, *Allocating the Costs of Arbitrating Statutory Claims under the Federal Arbitration Act: An Unresolved Issue*, 26 *Am. J. of Trial Advoc.* 325 (2002).

⁸⁹ An alternative to the approach taken in *Green Tree* would have been one that required the employer or the party in the otherwise dominant bargaining position to bear the costs of arbitration. See *Cole v. Burns Int'l Security Services*, 105 F.3d 1465 (D.C. Cir. 1997). This might have alleviated any cost pressures but perhaps exacerbated the appearance, at least, of partiality.

⁹⁰ *Spinetti v. Service Corp. Intern.*, 240 F.Supp.2d 350 (W.D. Pa. 2001). See generally Michael H. LeRoy & Peter Feuille, *When is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Mandatory Employment Arbitration*, 50 *U.C.L. A. L. Rev.* 143 (2002).

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discretion⁹¹ By contrast, federal courts have relatively less flexibility to shift forum fees or attorneys fees. Generally, they can only shift attorneys fees in cases of certain claims (like civil rights claims) and can only shift costs in certain procedural situations (like offers of judgment).⁹²

Therefore, a review of the present state of the cost debate reveals several things. First, the empirical picture on costs is far more complicated than the rhetoric would suggest; companies, especially employers, utilize arbitration clauses that reduce, and in some cases eliminate, the financial burden on the employee or consumer. Second, to the extent that companies themselves do not regulate the matter, arbitral institutions have incentives to manage the issue and, in some cases, have in fact done so. Finally, to the extent that neither employers nor arbitral institutions have stepped up, courts have performed a type of oversight role.

3. Access to Justice

A third specific criticism about arbitral procedure is that it effectively denies claimants of access to justice.⁹³ This argument is particularly acute in the consumer arbitration

⁹¹ Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29 (1998).

⁹² See 42 USC §1988 (2000); Fed. R. Civ. P. 68

⁹³ See Arbitration Fairness Act §2(7). For a variation on the access to justice argument in the employment setting, see Michael Z. Green, *Opposing Excessive Use of Employer Bargaining Power in Mandatory Arbitration Agreements Through Collective Action*, 10 Tex. Wesleyan L. Rev. 77 (2003).

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context. According to the argument, arbitration clauses coupled with class action waivers effectively deny claimants any opportunity for meaningful relief. The arbitration clause takes them out of court, depriving them of the procedural advantages (such as discovery and a jury); the class action waiver eliminates the opportunity to aggregate small claims, thereby eliminating the incentive for any private party (much less any attorney) to prosecute the case.

As with the costs argument, the access to justice argument is not entirely invalid but has been badly exaggerated. Here, it is helpful to dispel three faulty premises of the access-to-justice critique.

First, the critique presumes that, if claimants could go to court, it would be relatively easy for them to obtain a lawyer. In fact, just the opposite is true. As discussed above, civil litigation presents significant access to justice barriers for claimants.⁹⁴ Some studies suggest that prospective plaintiffs' counsel are extremely picky in the types of cases they will undertake. Generally speaking, they only will take on representation in cases where the amount in controversy is sufficiently high and the likelihood of success sufficiently great. According to one oft-cited estimate, plaintiffs' counsel

⁹⁴ See *supra* note [x].

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will require a meritorious case with damages of at least \$60,000 to \$75,000.⁹⁵

A second faulty premise is the belief that litigation will in fact offer aggrieved claimants their day in court. This premise is demonstrably false. A vast corpus of literature has noted that a tiny fraction of filed cases actually ever reach a jury - generally, they are either settled or dismissed before trial.⁹⁶ For example, in a 2003 review of 3,000 discrimination cases filed in one federal court over a four-year period, Delikat and Kleiner concluded that only 3.8% (n=110) ultimately were resolved by juries.⁹⁷

A third faulty premise in the access-to-justice argument is that it assumes that justice will come swiftly in the civil litigation system. Here too, the empirical data demonstrate precisely the opposite. Virtually every study considering the issue has concluded that results in arbitration are far swifter than those in litigation. In fact, of all the empirical premises about arbitration that has been subject to empirical

⁹⁵ See William M. Howard, *Arbitrating Claims of Employment Discrimination*, Dis. Resol. J., Oct.-Dec. 1995, at 40; William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes* (1995) (unpublished dissertation on file with author).

⁹⁶ Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1566 (2005) (Vast majority of cases dismissed or resolved without court action undermines claim that arbitration will stagnate development of the law); Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 47(1998) (Cases never reach jury - of 3419 employment discrimination cases filed in 1994 that led to definitive judgment, 60% were disposed of by pretrial motion, with employers prevailing in 98% of those).

⁹⁷ Michael Delikat & Morris Kleiner, *Comparing Litigation And Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?*, American Bar Association Litigation Section Conflict Management, Vol. 6, Issue 3, 8 (2003). **[confirm court re sample set]**.

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study, this is the one where the data results are most consistent.⁹⁸ For example, Delikat and Kleiner concluded in their study of securities arbitrations that mean and median times between filing and judgment were approximately 50% longer in litigation compared to arbitration.⁹⁹ Thus, for those claimants who desire speedy resolution of their claims (whether for financial reasons, psychological ones or others), arbitration is far superior.

This analysis suggests that we should avoid sweeping claims about how arbitration denies claimants access to justice. Rather than compare arbitration with some idealized form of litigation, it is important to compare it instead to a system where the claimant may have difficulty obtaining legal representation, most likely never will have a jury consider his claim and ultimately must wait far longer before receiving any determinative resolution on his claim.

Having corrected the faulty premises in the access-to-justice argument that might otherwise have misframed the debate,

⁹⁸ California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the CCP* (August 2004); David Sherwyn et al., *In Defense of Mandatory Arbitration of Employment Disputes: Saving the Baby, Tossing out the Bath Water, and Constructing a New Sink in the Process*, 2 U. PA. J. LAB. & EMP. L. 73, 99 (1999); GAO, *Alternate Dispute Resolution: Employers' Experiences With ADR in the Workplace* 19 (1997); Garry Mathiason & Pavneet Singh Uppal, *Evaluating and Using Employer-Initiated Arbitration Policies and Agreements: Preparing the Workplace for the Twenty-First Century*, C902 A.L.I.-A.B.A. 875, 894 (1994) (citing Rand Corporation's Institute for Civil Justice study indicating that average processing time from complaint to decision in arbitration = 8.6 months plus 20% cost savings to parties); GAO: *How Investors Fare* (May 1992).

⁹⁹ Michael Delikat & Morris Kleiner, *Comparing Litigation And Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?*, American Bar Association Litigation Section Conflict Management, Vol. 6, Issue 3, 9 (2003).

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we can now consider the strongest basis for the access to justice argument: the class action waiver.¹⁰⁰ The argument runs as follows. Arbitration claims, particularly in consumer disputes, often involve claims in such small amounts that it would not be rationale for either the individual consumer or plaintiff's attorney to pursue. Shuttling those claims to arbitration may hamper the potential plaintiff's access to a convenient forum. A plaintiff might overcome that disincentive by pursuing a class action in arbitration. But if the arbitration clause is combined with a class action waiver, the combination of the two effectively eliminates any incentive to pursue the claim whatsoever.

While this critique is not entirely unfounded, the empirical literature does not fully support it. The empirical literature suggests that the practice of combining class action waivers and arbitration clauses may not be as widespread as the rhetoric suggests. For example, Demaine and Hensler's study of arbitration clauses in consumer agreements found that only 30.8% of the sample size (n = 52) contained class action exclusions; in other words, over 2/3 of the clauses lacked such a provision.¹⁰¹

¹⁰⁰ See Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 L. & Contemp. Probs. 75 (Winter/Spring 2004).

¹⁰¹ Demaine & Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 L. & CONTEMP. PROBS. 55 (Winter/Spring 2004).

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Moreover, to the extent such clauses are used and do in fact risk eliminating any incentive to pursue a claim, the current legal regime provides a variety of mechanisms by which to police these clauses. First, courts can rely on Section 2 of the FAA to refuse to enforce arbitration agreements on the grounds that the surrendered procedural rights effectively render the arbitration clause unconscionable.¹⁰² Second, even where an arbitration clause is enforceable, often it does not preclude the claimant from seeking relief in small claims court. Both the Due Process protocols and certain employer-developed arbitration clauses exempt small claims cases.¹⁰³ Third, administrative agencies such as the EEOC can pursue claims in court on behalf of an aggrieved group of claimants.¹⁰⁴ Only recently, the Supreme Court only recently made clear that arbitration clauses do not preclude such administrative agencies

¹⁰² [Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1176 \(9th Cir.2003\)](#) (holding that a class arbitration waiver in an employment contract was unconscionable); [Ting v. AT & T, 319 F.3d 1126, 1150 \(9th Cir.2003\)](#) (holding that a class arbitration waiver in a contract for AT & T telephone services was unconscionable). See David S. Schwartz, *If You Love Arbitration, Set it Free: how 'Mandatory' Undermines 'Arbitration,'* Paper No. 1052 at 20-27 (University of Wisconsin Law School Legal Studies Research Paper Series Aug. 2007)

¹⁰³ Demaine & Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 L. & CONTEMP. PROBS. 55 (Winter/Spring 2004) (30.8% of 52 consumer clauses exempt small claims). See also Am. Arbitration Ass'n, *Consumer Due Process Protocol* (1998), available at <http://www.adr.org/sp.asp?id=22019>; Am. Arbitration Ass'n, *Employment Due Process Protocol* (1995), available at <http://www.adr.org/sp.asp?id=28535>; JAMS, *JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness* (2007), available at http://www.jamsadr.com/rules/consumer_min_std.asp; JAMS, *JAMS Policy on Employment Arbitration: Minimum Standards of Procedural Fairness* (2005), available at http://www.jamsadr.com/rules/employment_Arbitration_min_stds.asp.

¹⁰⁴ Admittedly, one response here might be that the agencies lack sufficient resources adequately to pursue all of the potentially meritorious claims in litigation. That response however does not support the position for which it is being advanced. Instead, it merely suggests that the proper solution is to infuse those agencies with more resources. It does not justify wholesale elimination of arbitration and, therewith, the potential benefits derived from that system of dispute resolution.

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(who are not parties to the underlying arbitration agreement) from commencing civil litigation.¹⁰⁵

Finally, it bears emphasis that class actions do not necessarily represent a beneficial alternative for claimants. While a detailed discussion of class actions is beyond the scope of this paper, some literature does cast doubt on the viability of class actions to overcome the access to justice problem. Many scholars have questioned the efficacy of current class action mechanisms to afford meaningful recovery for class members.¹⁰⁶ Sometimes, the class action results in a settlement that offers class members simply a coupon or some other nonpecuniary benefit that may be of little or no value to the consumer.¹⁰⁷ Moreover, the value of the class action will depend on the "take rate" (that is, the rate at which class members actually complete the steps necessary to obtain a benefit).¹⁰⁸

This Part has considered broad question "is arbitration fair." It yields up several conclusions, suggesting that in

¹⁰⁵ See *E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279 (2002). Reliance on agency intervention may be criticized on the ground that agencies are overworked and underfunded. If that is the cause, however, the solution is to beef up the agency budgets and not to discard a system that yields meaningful benefits.

¹⁰⁶ See Geoffrey P. Miller & Lori S. Singer, *Non-Pecuniary Class Action Settlements*, 60 *Law & Contemp. Probs.* 97 (1997); Samuel M. Hill, *Small Claimant Class Actions: Deterrence and Due Process Examined*, 19 *Am. J. Trial Advoc.* 147 (1995); Reagan W. Silber & Frank E. Goodrich, *Common Funds and Common Problems: Fee Objections and Class Counsel's Response*, 17 *Rev. Litig.* 525 (1998). For a very recent article summarizing the scholarly literature critical of class actions, see Jonathan R. Macey & Geoffrey P. Miller, *Judicial Review of Class Action Settlements* (NYU Center for Law & Economics), Working Paper No. 07-34 at 2 n 7 (Sept. 2007).

¹⁰⁷ See Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 *U.C.L.A. L. Rev.* 991 (2002). The value of such coupon settlements is the subject of much debate. To the extent the purpose of a class-action settlement is compensatory, coupons may offer little. To the extent the purpose is deterrence, coupons may be superior to cash settlements. See A. Mitchell Polinsky & Daniel L. Rubinfeld, *A Damage-Revelation Rationale for Coupon Remedies*, Stanford Institute for Economic Policy Research, Discussion Paper No. 04-09 (2005).

¹⁰⁸ See 4 Newberg on Class Actions § 14:7 (4th ed. 2007).

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some respects the answer is a clear “yes” and that, in others, the situation is not as dire as arbitration’s opponents would like to believe. To the extent fairness is best measured by the opinions of participants in the process, the results are positive. To the extent fairness is best measured by some external normative standard, arbitration still fares well, but there are some gaps in the empirical picture. For example, empirical research has documented a repeat player effect but does not necessarily link that effect to any non-neutrality on the arbitrator’s part. Likewise, concerns about costs and access to justice are valid ones, but arbitral institutions and courts already have mechanisms to address those concerns. Marginal tweaks may be appropriate, but the case is simply not there for a major overhaul of the arbitral system. The next section explores the impact of such a course.

III. The Economic Impact of Arbitration

This section addresses the following basic question - if Congress were to prohibit mandatory predispute arbitration clauses in employment, consumer and franchise contracts, what would be the economic impact of that decision. First, it constructs a theoretical model. In brief, the model explains why arbitration lowers the costs of dispute resolution and that a portion of those savings are passed on to individuals.

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Second, it surveys the empirical literature in order to test the validity of that model. In contrast to the preceding two sections, the empirical picture is far hazier (due mostly to the fact that the aggregate data on corporate legal budgets is unavailable).

A. The Theoretical Model

Basic principles of law and economics provide the architecture for explaining why parties choose arbitration, how it reduces costs and how those savings are distributed.¹⁰⁹ Parties confronted with a dispute have a variety of options for resolving it - mediate, arbitrate, litigate, among others. A rational actor will prefer the dispute resolution option with the greatest differential between benefits and costs even if that option may not yield the highest gross benefit.¹¹⁰ For example, assume that litigation offers an expected benefit of \$100 and an expected cost of \$90, yielding a marginal benefit of \$10. Assume further that arbitration offers an expected benefit of \$75 and an expected cost of \$25, yielding a net benefit of \$50. Under these circumstances, according to the theoretical model, a party will opt for arbitration: it yields a higher net

¹⁰⁹ Hylton, *Agreements to Waiver or to Arbitrate Legal Claims: An Economic Analysis*, 8 *Supreme Court Economic Review* 209 (2000); Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 *J Legal Stud* 1 (1995)

¹¹⁰ Hylton & Drahozal, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, BU Working Paper (also published in 32 *J Legal Stud* 549 (2003); Hylton, *Agreements to Waiver or to Arbitrate Legal Claims: An Economic Analysis*, 8 *Supreme Court Economic Review* 209 (2000).

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benefit than litigation even though the gross benefit is lower.¹¹¹

If those are the interests of the individual rational actor, how do the interests of two adverse parties interact? Litigation provides the default position. That is, absent agreement, parties can always litigate (in whatever forum where jurisdiction lies). Parties will agree to an alternative to litigation in one of two circumstances. First, they will naturally agree to another form of dispute resolution when, for each party's preference ordering, that form provides the greatest marginal benefit over all other possible forms of dispute resolution. That is, if two parties both have the expected benefit/cost distribution described in the preceding framework, they naturally will agree to arbitration.

Second, parties will agree to an alternative form of dispute resolution where it is the preferred form for at least one party, and that party can make a side payment to the other party. For example, assume that for one party, the marginal benefit of litigation is \$20 and the marginal benefit for arbitration is \$10. Assume further for the second party that the marginal benefit of arbitration is \$30 and the marginal benefit of litigation is \$10. Under these conditions, the second party can make a side payment to the first party in an

¹¹¹ Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J Legal Stud 1 (1995).

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amount greater than \$10 but less than \$20 in return for his willingness to arbitrate. This will increase the net wealth to the first party so that arbitration plus the side payment exceeds the marginal benefit of litigation. The side payment will decrease slightly the net wealth of the second party but will still keep the marginal benefits of arbitration above the marginal benefit of litigation.

This theoretical model captures the essence of why arbitration emerges as a preferred form of dispute resolution - either because both parties deem it to be in their economic interest, or one party deems it to be in its economic interest and compensates the other party sufficiently to offset any suboptimal outcome without paying to the point that it renders arbitration inefficient.

The model may be criticized on the ground that it imports various assumptions.¹¹² First, it assumes that both parties are fully informed about the marginal benefits of various dispute resolution options. Second, it assumes that both parties will engage in economically rational decision making. Third, it assumes that the market for dispute resolution services is costless; in other words, that parties can costlessly move between dispute resolution options.

¹¹² See Sternlight & Jensen, *Using Arbitration to Eliminate Class Actions*, 67 L & Contemp Probs 75 (Winter/Spring 2004):

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Each of these assumptions is of course not entirely accurate, but the imperfections in the assumptions do not affect the underlying explanatory value of the model. The basic reason why is that, even if we accept that at least one party to the transaction is not a fully informed rational actor, arbitration still can be an economically superior option for that party.¹¹³ Steven Ware has illustrated this point elegantly in his scholarship on process costs (like formal pleading requirements, protracted discovery, litigating evidentiary questions, etc.).¹¹⁴ As Stephen Ware has explained, companies might prefer arbitration where its process costs are lower than comparable costs in litigation. The reduced costs of arbitration lower the firm's overall expenses. This reduction in the firm's process costs increases its overall profitability. Depending on the elasticity of the various demand curves, this increase in profits can be passed on to employees (in the form of higher wages), customers (in the form of lower prices) and shareholders (in the form of dividends or higher share prices).¹¹⁵

If this theory is correct, then the converse is also true.

To the extent firms are forced to litigate, rather than

¹¹³ Christopher Drahozal, *Privatizing Civil Justice: Commercial Arbitration and the Civil Justice System*, 9 KAN. J. L. & PUB. POL'Y 578, 587 (2000).

¹¹⁴ Stephen Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. DISP. RES. 735, 748-50 (2001); Stephen Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 89 (2001).

¹¹⁵ Keith Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209, 252 (2000); Stephen Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. DISP. RES. 735, 741 (2001); Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361, 361-66 (1990-91).

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arbitrate, this can increase process costs. Depending again on the elasticity of the demand curves, those increased process costs are then passed on to the employee (in the form of lower wages), the consumer (in the form of higher prices) or the investor (in the form of lower dividends or lower share prices).

B. Testing the Model

Having set forth the theoretical model for the economic benefits of arbitration, the question then becomes whether that theoretical model finds support in the empirical literature. This breaks down into two subsidiary questions. First, to what extent does arbitration actually save money? Second, to what extent are those savings actually passed on to the individuals with whom those companies interact? The section answers each of those questions in turn and then synthesizes the results.

1. Does arbitration save money?

It has been difficult to document systematically the cost savings that result from commercial arbitration. This lacuna appears to be due to researchers' lack of access to a broad spectrum of corporate legal budgets.¹¹⁶ In response to this gap in the empirical literature, some commentators have argued that

¹¹⁶ Stephen Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements* 2001 J. DISP. RESOL. 89, 89 (2001).

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arbitration in fact is not cheaper than litigation.¹¹⁷ That response, however, is mistaken. While the present state of the literature may inhibit a certain completely confident conclusion that arbitration is cheaper than litigation, several indicators suggest that this is the case.

Some studies on the economic impact of court-annexed arbitration support this conclusion. The Rand Corporation's Institute for Civil Justice has undertaken a series of studies of court-annexed arbitration. Most relevant for present purposes is a 1990 study by E. Allen Lind of a court-annexed arbitration program in the Middle District of North Carolina.¹¹⁸ Among other things, Lind considered whether a party's legal fees and costs were lower in the court-annexed arbitration program than litigation. To effect this comparison, the study carved out a "control group" of cases not eligible for arbitration and then identified a second set of cases that went to arbitration. Lind then surveyed counsel from the two groups and asked about the total costs that they had charged their clients. After making adjustments for various potential biases in the data, Lind ultimately concluded that the court-annexed program reduced

¹¹⁷ See, e.g., Jeffrey W. Stempel, *Arbitration, Unconscionability, and Equilibrium: The Return of Unconscionability Analysis as a Counterweight to Arbitration Formalism*, 19 OHIO ST. J. DISP. RESOL. 757, 851 (2004) ("there is nothing to suggest that vendors imposing arbitration clauses actually lower their prices in conjunction with using arbitration clauses in their contracts."); Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?* 67 L. & CONTEMP. PROBS. 75, 95 (2004) ("[N]o published studies show that the imposition of mandatory arbitration leads to lower prices."). Michael Green, *Debunking the Myth of Employer Advantage from Using Mandatory Arbitration for Discrimination Claims*, 31 RUTGERS L. J. 399, 421-23 (2000).

¹¹⁸ E. Allan Lind, *Arbitrating High-Stakes Cases* (Rand Institute for Civil Justice 1990).

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the legal costs by approximately 20%.¹¹⁹ While other research by Rand was less conclusive,¹²⁰ more recent studies confirm Lind's conclusion that arbitration can meaningfully lower process costs.¹²¹

Differences between court-annexed arbitration and commercial arbitration counsel caution in drawing too strong a lesson from the Rand research. First, court-annexed arbitration, as the name implies, flows from a judicial mandate whereas commercial arbitration flows from the parties' mutual consent. Second, under court-annexed arbitration, the party dissatisfied with the decision can demand a trial *de novo* whereas in commercial arbitration the FAA almost always constrains judicial review of the arbitrator's award. Third, in court-annexed arbitration, the court (or its administrator) generally determines the applicable procedural rules whereas in commercial arbitration the parties have greater latitude to define the applicable procedural law.

Even accepting the above-noted differences between court-annexed arbitration and commercial arbitration, none appears fatal to the explanatory value of the research.¹²² If anything,

¹¹⁹ *Id.* at 38. Unadjusted savings would have been closer to 33%.

¹²⁰ E. Allan Lind, *Arbitrating High-Stakes Cases* vi (Rand Institute for Civil Justice 1990).

¹²¹ See Hensler, *Court-Ordered Arbitration: An Alternative View*, 1990 U. CHI. LEGAL F. 399, 414 n. 70 (summarizing results of another Rand study that found similar cost savings from a court-annexed arbitration program in Hawaii).

¹²² One limitation on the explanatory value of Lind's particular data set concerns the differences between the stakes of the cases. Lind focused on high-stakes cases (generally those with claims up to \$150,000 though some

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the differences between the two regimes suggest that commercial arbitration could generate even larger reductions in process costs.¹²³ This is particularly true to the extent that the procedures in commercial arbitration are less regimented and that judicial oversight may be more limited. Thus, studies on court-annexed arbitration programs important empirical support for the theoretical proposition developed in Part IV.A that commercial arbitration can lower costs (and conversely that the elimination of arbitration could increase them).

Survey data also lend empirical support to the hypothesis that arbitration reduces process costs. The available survey data uniformly suggest that both lawyers and their clients find arbitration to be a cheaper alternative. For example, a 2003 survey of trial lawyers by the American Bar Association found that 56% believed arbitration to be more cost effective than litigation.¹²⁴ Echoing these results, a 2003 survey of corporate

claims in the sample set involved claims reaching as high as \$7.5 million). To the extent that case preparation for those cases may be more labor intensive (and thus more expensive) than case preparation for smaller-stakes cases (which may be the case in some consumer and employment arbitrations), the savings rate could be lower.

¹²³ It should be noted that the savings rate will depend on the retainer arrangements between parties and their counsel. To the extent counsel operates on a contingent fee basis, the savings may be negligible (unless the fee percentage in the retainer agreement differs for arbitration and litigation). To the extent counsel works on an hourly rate (as is typically the case for defense counsel), savings will be more substantial. *See* Hensler, 1990 U. CHI. LEGAL F. at 413-14 n. 66.

¹²⁴ ABA Section on Litigation, Task Force on ADR Effectiveness (Aug. 2003). *See also* National Arbitration Forum, *Mediating and Arbitrating Healthcare Disputes* 4-5 (Jan. 2005) (summarizing survey data on cost savings of arbitration).

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in-house counsel found that 59.3% believed that arbitration was less expensive than "traditional adjudication processes."¹²⁵

Anecdotal research buttresses the survey data.¹²⁶ For example, in 1997, the General Accounting Office undertook an extensive study of employers' experiences with alternative dispute resolution, including arbitration.¹²⁷ As part of its study, GAO examined the arbitration programs of five major companies such as Hughes Electronics, Rockwell, Polaroid and TRW. All five companies had adopted ADR programs, which included an arbitration component, after spending exorbitant fees defending against employment lawsuits. Brown & Root adopted its ADR program after spending \$400,000 in legal fees to defend against an employment discrimination suit which it won.¹²⁸ Similarly, Rockwell adopted an ADR program after it spent over \$1 million in legal fees defending against a wrongful discharge/disability discrimination suit which it too won.¹²⁹

¹²⁵ Michael Burr, *The Truth About ADR: Do Arbitration and Mediation Really Work*, CORP. LEGAL TIMES 45 (Feb. 2004). A slightly older survey of 36 companies by Bickner found that 75% of them had adopted employment arbitration over concerns about the costs of litigation. See Bickner *et al.*, *Developments in Employment Arbitration*, 52 DISPUTE RES. J. 10, 78 (1997).

¹²⁶ See, e.g., Mark Furletti, *Mandatory Arbitration Clauses in the Credit Card Industry* (Payment Cards Center of FRB Philadelphia) led by Alan S. Kaplinsky (identifying the increased popularity of arbitration among credit card issuers to control legal costs); Gamlem & Sommer, *Developing an Alternative Dispute Resolution Program*, SHRM White Paper (Oct. 1997, rev. Aug. 2002) (cites one company which reported success of in-house ADR program including reduction in discrimination charges and reduced legal fees); Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 54 (1998) (anecdotal research on cost savings from arbitration); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 Disp. Resol. J. 40, 45-46 (Oct.-Dec. 1995) (citing studies on cost savings from arbitration); GAO, *How Investors Fare* at 33 (May 1992) (noting 1988 testimony from SEC Chairman that arbitration was cheaper forum than litigation for resolution of securities disputes).

¹²⁷ GAO, *Alternate Dispute Resolution: Employers' Experiences With ADR in the Workplace* (1997).

¹²⁸ *Id.* at 39.

¹²⁹ *Id.* at 50.

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According to GAO, all five companies reported that their ADR programs enabled them to reduce their litigation costs. Brown & Root, for example, reported a 90% reduction in its legal fees during the first three years of its ADR program.¹³⁰ Even factoring in the additional costs of the ADR system, Brown & Root's overall costs of dealing with employment conflicts, including ADR costs, were now less than half of what the company used to spend on legal fees for employment-related lawsuits.¹³¹

A more recent case study by David Sherwyn at Stanford University reports results similar to those found in the GAO study.¹³² Sherwyn obtained access one company's data in order to determine the economic impact of its alternative dispute resolution program. Based on his review, he concluded that, since instituting its dispute resolution program, the company was able to reduce its outside counsel fees by 50%.¹³³

At bottom, researchers must acknowledge that we still lack systematic data on the cost savings generated by commercial arbitration. At the same time, arbitration's critics surely are wrong to infer from this state of the literature that arbitration does not reduce process costs. Virtually all of the available evidence - studies of analogous regimes, surveys, and

¹³⁰ *Id.* at 40.

¹³¹ *Id.* at 4, 19, 40.

¹³² Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557 (2005)

¹³³ *Id.* at 1589.

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case studies -- suggests precisely the opposite: that arbitration, as a necessary part of a broader fabric of alternative dispute resolution programs, can significantly reduce a company's process costs. To reach this conclusion still leaves unanswered a critical question - accepting that arbitration can generate cost savings for companies, to what extent are those cost savings passed on to employees and customers. The next subsection takes up that question.

2. Who benefits from the savings?

Recall that the theoretical model suggested that the savings generated from arbitration would be passed onto consumers, employees and investors depending on the elasticity of demand for products, labor and capital. As with the literature on cost savings, there appears to be no systematic study on the distributive effect of commercial arbitration.¹³⁴ Nonetheless, several anecdotes do suggest both that arbitration does yield economic benefits to these constituencies and that the absence of predispute arbitration would eliminate these economic gains.

¹³⁴ By contrast, some empirical literature does demonstrate that, in the collective bargaining context, laws requiring arbitration (or at least some "duty to bargain") increase employee compensation. See Ichniowski *et al*, *Collective Bargaining Laws*, 7 J. LABOR & ECON. 191 (1989) (concluding that pay of unionized police officers in states with compulsory arbitration laws is 15-21% above pay in nonunion departments in states without such laws); Ashenfelter & Hyslop, *Measuring the Effect of Arbitration on Wage Levels: The Case of Police Officers*, 54 INDUS. & LABOR REL. REV. 316, 321-24 (Jan. 2001) (concluding that arbitration appears to raise wage rates relative to states without arbitration law by 15% but difference is negligible relative to states with "duty to bargain" requirement).

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One early indication of the relationship between dispute resolution and individual wealth came in the Dunlop Commission Report.¹³⁵ President Clinton created the Dunlop Commission in order to investigate the future of worker-management relations in the United States. As part of its work, the Commission considered the impact of employment litigation and dispute resolution. It concluded:

For every dollar paid to employees through litigation, at least another dollar is paid to attorneys involving in handling both meritorious and non-meritorious claims. Moreover, aside from the direct costs of litigation, employers often dedicate significant sums to designing defensive personnel practices (with the help of lawyers) to minimize their litigation exposure. *These costs tend to affect compensation as the firm's employment law expenses grow, less resources are available to provide wage [sic] and benefits to workers.*¹³⁶

This "dollar for dollar" statistic derives from a report of factual findings issued by the Secretaries of Labor and Commerce.¹³⁷ Those findings trace to a 1988 study of wrongful termination litigation in California conducted by the Rand

¹³⁵ U.S. Commission on the Future of Worker-Management Relations, Final Report (1994) (hereinafter "Dunlop Commission Report").

¹³⁶ *Id.* at 50.

¹³⁷ Factual Findings at 109-110 ("A conservative estimate is that for every dollar transferred in litigation to a deserving claimant, another dollar must be expended on attorney fees and other costs of handling both meritorious and non-meritorious claims under the legal program.") (footnote omitted). [**confirm Labor + Commerce were source of factual findings**]

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Corporation's Institute for Civil Justice.¹³⁸ In that study, researchers reviewed a sample of jury trials over an eight-year period in California. The authors surveyed counsel in each case to gather information in litigation costs. Based on their analysis of counsel's answers and the final recovery by prevailing claimants, they determined that a claimant's legal fees were more than one-third of her final payment and that the sum of the claimants' legal fees and the defendant's legal fees represented over 75% of the final payment received by the claimant.¹³⁹ Thus, the Commission's findings provide some support of an inverse relationship between litigation costs and employee compensation.

More recent research by Bickner also confirms that the cost savings generated through arbitration results in benefits passed on to employees.¹⁴⁰ Bickner surveyed 36 employers whom he identified as having arbitration plans. In his results, he found that several employers provided employees consideration in return for their willingness to arbitrate their disputes such as the right to participate in a corporate profit sharing plan.

Finally, an article by Chris Drahozal suggests that the distributive benefits of cost savings might extend to the credit

¹³⁸ Dertouzos *et al.*, *The Legal Consequences of Wrongful Termination* (Rand Institute for Civil Justice 1988).

¹³⁹ *Id.* at 38. To clarify the terminology, the final payment is the amount actually received by the claimant (which may be lower than the verdict due to post-verdict negotiations between the parties). The net payment represents the difference between the final payment and the claimant's legal fees.

¹⁴⁰ Bickner *et al.*, *Developments in Employment Arbitration*, 52 DISPUTE RES. J. 10, 78 (1997).

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industry as well.¹⁴¹ Drahozal unearthed a case in which a finance company varied the interest rate on its credit facility with a consumer's willingness to agree to arbitration.¹⁴² If the borrower did not agree to arbitration, the APR was 18.96%; if the borrower agreed to arbitration, the interest rate dropped to 16.96%. In other words, arbitration generated some unspecified quantity of cost savings for the lender, a portion of which was passed on to the customer in the form of a 2-point drop in the interest rate. While one should not draw too strong a lesson from a single anecdote,¹⁴³ it supplies further evidence that the cost savings generated from arbitration yield measurable economic benefits for both parties (and conversely that the elimination of arbitration would result in a net economic loss to the consumer).

In sum, the state of the empirical research does not allow us to conclude categorically whether (and the extent to which) the savings from arbitration are passed on to claimants. Nonetheless, statistical evidence from related fields and anecdotal evidence from a variety of sources do support the basic economic theory laid out in Part IV.A. The following

¹⁴¹ Christopher Drahozal, *Unfair Arbitration Clauses*, 2001 U. Ill. L. Rev. 695; Christopher Drahozal, *Privatizing Civil Justice: Commercial Arbitration and the Civil Justice System*, 9 KAN. J. L & PUB. POL'Y 578, 584-85 (2000). See also Stephen Ware, *Case for Enforcing Adhesive Arbitration Agreements*, 5 J. AM. ARB. 251, 256 n. 8 (2006).

¹⁴² *Stiles v. Home Cable Concepts, Inc.*, 994 F. Supp. 1410 (M.D. Ala. 1998).

¹⁴³ Drahozal acknowledges this point. See Christopher Drahozal, *Unfair Arbitration Clauses*, 2001 U. Ill. L. Rev. 695, n. 437 (2001). Moreover, in the context of this paper, a second limitation is that the case concerned practice in a single industry (financed purchase of a satellite system).

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subsection synthesizes the results of this research with the results from the research on cost savings.

3. What does it mean?

The incomplete empirical record makes it difficult to provide secure assessments of the economic impact if Congress were to eliminate arbitration. Nonetheless, it is possible to stitch together some projections based on the available data.

Employment disputes provide the best area in which to evaluate the economic impact of arbitration. We can assess the economic impact of a prohibition on predispute arbitration through a comparative cost analysis. That method requires us to consider the current arbitration caseload and then to compare the relative costs of arbitrating those cases against the cost of resolving them some other way.

Before engaging in the analysis, let me make explicit two simplifying assumptions. First, I assume that there is no access-to-justice problem: that is, I assume that an arbitration claimant will be able to obtain litigation counsel. Second, I assume that the employee's attorney's fees do not differ between arbitration and litigation.¹⁴⁴ This is because many plaintiffs' counsel often work on a contingency fee basis. If anything,

¹⁴⁴ According to one study that looked at fee awards, employees' attorneys' fees in arbitration averaged \$14,173.

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this assumption should lower the expected process costs of litigation - to the extent litigation involves more intensive discovery¹⁴⁵ and, according to some reports, slightly higher recoveries,¹⁴⁶ the process costs would presumably be higher.

Comparative cost analysis requires one to look at both the caseload and the relative costs of resolving those cases. As far as caseload, I have been unable to locate a source that synthesizes or estimates the total number of employment arbitrations that take place in the United States annually. Contacts with the major associations directly yielded some results. The annual employment arbitration caseload at the American Arbitration Association in 2006 was 1,912. **[hold for JAMS data]**.

As far as costs, Elizabeth Hill's research provides the best insights into the process costs of resolving these disputes through arbitration. The process costs in arbitration consist of the arbitral fees (filing fee, hearing fee & arbitrator's fee) plus the attorneys' fees:

- Arbitral fees - \$5724¹⁴⁷

¹⁴⁵ According to one estimate, the employees's costs of discovery ran at least \$10,000-\$15,000. See Richard Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceanera*, 81 Tulane L. Rev. 331, 354 (2006).

¹⁴⁶ See text accompanying note [x], *supra*.

¹⁴⁷ Following Hill, I use the mean, rather than median figures, for these costs. I use the figure for all arbitrations rather than the separate ones for negotiated and promulgated arbitration agreements. This step is justified on the ground that the congressional proposals would prohibit both sorts of predispute agreements.

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- Employer's attorney's fee - \$10,000¹⁴⁸ (as noted above, I have assumed that the employees' attorneys fee will be the same in both litigation and arbitration)

If Congress were to prohibit predispute arbitration agreements in employment cases, these cases would be resolved in one of three ways - (1) they would be resolved by post-dispute arbitration, (2) they would be resolved in some other forum (litigation or otherwise), or (3) they would not be brought at all. Assuming that we ignore the access-to-justice problem, prior research offers some insights on what would happen to these cases:

- Post-dispute arbitration - 5%¹⁴⁹
- Resolution by EEOC - 20%¹⁵⁰
- Resolved at trial - 8%¹⁵¹
- Resolved in pretrial proceedings - 67%¹⁵²

Prior research also offers some insights into the likely cost of litigation. Sherwyn *et al.* supply one recent measure¹⁵³:

¹⁴⁸ Following Hill, I use the median rather than mean figures in order to reduce distortions caused by outlier awards.

¹⁴⁹ Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 William Mitchell L. Rev. 313 (2003).

¹⁵⁰ David Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1585-86 (2005). This is a conservative estimate, as Sherwyn *et al.* suggest a rate of resolution by the EEOC between fifteen and twenty percent.

¹⁵¹ Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice Be Served* (May 1995).

¹⁵² This figure represents the leftover of cases not otherwise resolved by one of the three other means. As noted above, given the access to justice problems, the actual number of cases reaching this stage should be expected to be lower than the model suggests.

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- Defending EEOC investigation \$4,000–\$10,000
- Resolving case at summary judgment - \$75,000
- Trial - \$125,000 to \$500,000.

Synthesizing the caseload figures, the disposition figures and the cost figures,¹⁵⁴ we can generate the following tentative conclusion: prohibiting predispute employment arbitration agreements will yield a net increase of approximately \$88 million in process costs in the form of higher attorneys' fees and related litigation expenses for employers. In more generic terms, the aggregate process costs of litigation are slightly less than four times that of arbitration.

My claim is a tentative one. The model offered here builds on an incomplete empirical record that necessitates several simplifying assumptions. Nonetheless, such tentative conclusions are essential right now so that the academic debate can inform the congressional debate over the future of arbitration.

To the extent my model does make simplifying assumptions, those assumptions suggest that prohibiting predispute arbitration could be even more costly or counterproductive.

¹⁵³ See Sherwyn *et al.*, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1563-64 (2005). Compared to some anecdotal reports discussed elsewhere in this article, these estimates seem slightly low. For a collection of earlier literature on the costs of defending an employment suit, see Richard Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceanera*, 81 Tulane L. Rev. 331, 355 (2006).

¹⁵⁴ In each case, I apply the more conservative estimate which would tend to understate the process costs of litigation.

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Higher counsel costs of litigation could drive up the process fees. Litigation might even lower some process costs, but that likely would be due to the fact fewer employees could obtain access to counsel and, consequently, to the courts. Ironically, then, savings would come on the backs of the very individuals whom Congress is trying to protect.

Consumers in other industries could experience similar effects. Consider the credit card industry, where we have less data on the process costs but better data on the economic stakes. While estimates vary, some recent reports indicate that Americans pay approximately \$60 billion per year in credit card interest and fees.¹⁵⁵ Several commentators have asserted that most major credit card companies currently utilize arbitration clauses in their customer agreements (a fact I have not yet been able independently to verify).¹⁵⁶ The *Stiles* case suggests, albeit in a related industry, that the economic effects of eliminating arbitration sometimes manifest themselves in the form of an interest rate increase. While I have been unable to locate aggregate data on the litigation costs of the credit card industry, a cost shift even 1/1000th of the shift in *Stiles* could

¹⁵⁵ GAO, *Credit Cards: Increase Complexity in Rates and Fees Heightens Need for More Effective Disclosure to Consumers* 72 (GAO Sept. 2006). According to another estimate, that figure may be closer to \$90 billion. See Derek Douglas, *Safety Sells: The Case for an Incentive-Based Credit Card Disclosure System* at 7 (November 2006), <http://www.americanprogress.org/issues/2006/11/pdf/creditcards.pdf>.

¹⁵⁶ Mark Furletti, *Mandatory Arbitration Clauses in the Credit Card Industry*, Winter 2003 Discussion Paper, (Payment Cards Center of FRB Philadelphia) led by Alan S. Kaplinsky; *Arbitration clauses prevalent*, Consumer Action News at 5 (Spring 2007).

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generate several million dollars in higher interest charges for American consumers.

At bottom, we can draw three basic conclusions from this analysis. First, a powerful theoretical model suggests that eliminating arbitration could drive up the costs of resolving these disputes and that individuals would bear a share of those greater costs. Second, a limited empirical record, consisting of both anecdotal evidence and some systematic evidence, suggests some validity to this theoretical model. Third, a great deal more empirical research needs to be done before researchers can confidently predict the true economic impact if Congress were to prohibit predispute arbitration agreements. In the final section of this paper, I consider two of the most frequently discussed alternatives.

V. Alternatives

Having considered the main critiques of the current arbitral system in the United States and the economic impact of changing it, this paper closes with consideration of the two main alternatives that have been floated in policy and academic circles.¹⁵⁷ One would replace the current system of enforceable predispute agreements with one that only enforces arbitration

¹⁵⁷ For other views floated in the academic literature that have not been as widely received in policy circles, see Richard Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceanera*, 81 Tulane L. Rev. 331 (2006) (proposing mandatory due process rules and punitive damages in case of lopsided arbitration agreements).

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agreements after a dispute has arisen. I will refer to this alternative as "postdispute arbitration". A second would permit predispute agreements but require companies to decouple them from the underlying substantive contract (that is, the company could not *condition* the contract on the employee's/consumer's willingness to arbitrate). I will refer to this alternative as "voluntary arbitration." This section analyzes both options and concludes that neither is viable. In fact, both would effectively eliminate arbitration as a tool of dispute resolution and, in some respects, could make claimants worse off.

A. Postdispute arbitration

Some commentators have argued that we should replace our system of predispute arbitration agreements, at least for employment and consumer disputes, with postdispute agreements. Defenders of postdispute agreements argue that companies obviously have an incentive for preferring arbitration over litigation. Those incentives are equally strong both before and after the dispute has arisen. Thus, postdispute arbitration makes the company no worse off. Moreover, it makes the employee or consumer better off because she can make a more fully informed choice, after the dispute has arisen, about whether arbitration is in her interest.

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As a theoretical matter, postdispute arbitration presents several problems. First, defenders of postdispute arbitration are mistaken when they claim that the company's incentives are equivalent in the predispute and postdispute contexts. In the postdispute context, companies are arguably in a superior position insofar as they have better information about the nature and terms of the dispute.¹⁵⁸ This enables the company to make a more strategic calculation about which form of dispute resolution better advances the companies (or more effectively hinders the claimant's) interests. Consider this in light of the access-to-justice discussion above. If employers know that an employee's claim is less than \$60,000, they may calculate that the employee could have difficulty obtaining a counsel willing to represent her. In those cases, after a dispute has arisen, the employer may be less likely to agree to arbitration precisely because it knows that, effectively, its holdout will prevent the employee from pursuing her claim.¹⁵⁹

Now contrast this state of affairs with those in the predispute context. In this setting, neither the employer nor the employee knows in advance the terms or nature of a

¹⁵⁸ Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 320 (2003); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 567-68 (2001);

¹⁵⁹ Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 58 (1998).

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dispute.¹⁶⁰ Yet, synthesizing the analysis from the preceding sections of the paper, we can see that each has an incentive to enter into arbitration - from the employee's perspective, arbitration provides an affordable forum with superior chances for obtaining a favorable result; from the employer's perspective, arbitration can lower the company's litigation costs. To be sure, both sides are engaging in some tradeoffs- the employee is trading greater forum accessibility off against higher mean recoveries; the employer is trading lower litigation costs off against a reduced likelihood of prevailing in the dispute. The comparative advantage of arbitration is that it enables both parties to enter into an arrangement that enables them to manage some of the *ex ante* uncertainties about disputes before they arise, a possibility that is lost once the dispute arises and the terms are better known.

Both Lewis Maltby and Samuel Estreicher have captured this essential tradeoff in predispute arbitration. In Maltby's terms, employers "are willing to create a risk of liability in many cases they could have otherwise ignored in order to decrease the risk of a ruinous punitive damages award."¹⁶¹ According to Estreicher, "in a world without employment arbitration as an available options, we would essentially have a

¹⁶⁰ They may be able to predict a likely dispute to a degree. They could base these predictions on their past experiences and the nature of the relationship between the parties.

¹⁶¹ Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 317 (2003).

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Cadillac system for the few and a rickshaw system for the many.”¹⁶² By contrast, in a world with predispute arbitration, most people substitute their Cadillacs and rickshaws with Saturns (representing the greater access to justice afforded by arbitration traded off against the marginal reduction in expected recoveries).¹⁶³

Moving from the theoretical discussion to an empirical one, the case against postdispute arbitration becomes clearer. At bottom, it just does not work. A variety of empirical measures suggest this to be the case. A recent survey of lawyers indicated that 86% of them would advise their clients not to agree to postdispute arbitration.¹⁶⁴ Utilization rates tell a similar story, a recent study of AAA employment arbitrations by Lewis Maltby found that only 6.9% were post dispute in 2001 and a mere 2.6% were postdispute in 2002.¹⁶⁵

Of course, one should view these statistics with some hesitation. Declining utilization rates of postdispute arbitration do not necessarily show that postdispute arbitration would not be used if it were the only option. An equally valid

¹⁶² Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 563 (2001) (internal quotations omitted).

¹⁶³ See also Richard A. Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceanera*, 81 Tulane L. Rev. 331, 357-58 (2006).

¹⁶⁴ David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 BERKLEY J. EMP. & LAB. L. 1 (2000) [\[check pin\]](#) A slightly more dated GAO study found that most employers likewise do not use postdispute arbitration. GAO, *Alternative Dispute Resolution: Employer's Experiences with ADR in the Workplace 2* (1997).

¹⁶⁵ Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 319 (2003).

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hypothesis might also be that, as employers increasingly use predispute clauses, the frequency of postdispute arbitration will decline. Other research, however, suggests that the infrequency of postdispute arbitration is more attributable to its structural defects.¹⁶⁶ In his study of postdispute arbitration, David Sherwyn investigated the Illinois Human Rights Commission, a public agency that offered postdispute arbitration of claims falling within its jurisdiction. Sherwyn found that virtually no one utilized the postdispute option. While the topic of Sherwyn's study is admittedly specialized, it does lend credence to the statistics suggesting that parties will not utilize postdispute arbitration.

B. Voluntary Arbitration

Voluntary arbitration represents the other major alternative offered in the literature. Lewis Maltby, an ardent defender of arbitration as a superior alternative to litigation, has proposed this approach.¹⁶⁷ Unlike defenders of postdispute arbitration, advocates of voluntary arbitration recognize that the viability of arbitration depends on its use in a predispute setting. Nonetheless, according to the voluntary arbitration

¹⁶⁶ These would include the greater opportunity for strategic behavior (described above) and perhaps too the fact that, once a dispute has arisen, the parties' are more "dug in" to their positions and may be less willing to enter into any accommodation with their opposing party.

¹⁶⁷ Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313 (2003).

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argument, it is inappropriate for companies to present arbitration clauses on a "take it or leave it" basis to their employees or customers.¹⁶⁸ Instead, they would simply prohibit companies from conditioning rights and opportunities on a customer's or employee's willingness to consent to predispute arbitration.

While voluntary arbitration presents an alluring option, it ultimately founders for three main reasons. First, voluntary arbitration presents a normative difficulty: what is so special about the dispute resolution right? As David Sherwyn has explained, a variety of terms in an employment or consumer relationship are nonnegotiable.¹⁶⁹ For example, employers may dictate the choice of health insurance providers or pension administrators. Lenders may condition their willingness to do business on a prospective customer's willingness to release credit reports. Like arbitration, these practices may be widespread across particular areas of industry, meaning that individuals who wish to enter the market (whether as employers or customers) have little choice but to accept those norms. A threshold normative problem with the voluntary arbitration argument, therefore, is that it has no logical stopping point. The position rests on an objection to a practice not unique to

¹⁶⁸ Arbitration Fairness Act §2.

¹⁶⁹ Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1563-64 (2005).

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arbitration rather to any practice where the terms of an arrangement are offered on a "take it or leave it" basis.

A second problem with the voluntary arbitration argument is that it overlooks the context in which predispute arbitration operates. As noted above, while the use of arbitration clauses is widespread and the frequency of arbitration is on the rise, arbitration still represents one frame in a larger fabric of corporate dispute resolution programs, particularly in the employment context. Most disputes are resolved before the case reaches arbitration. Of course, that does not mean that arbitration was irrelevant to the calculus. It may well have been the prospect of arbitration that induced the parties to settle, or the availability of arbitration that enabled the company to set up its dispute resolution practice. To allow individuals to opt out of arbitration would undermine the integrity of such multi-step arbitration systems.

A third and final problem with the voluntary arbitration argument is that it ignores the risk-regulating rationale for arbitration from a company's perspective. As noted above, from a company's perspective, one of the primary advantages of arbitration is that it enables the company to regulate risk. The company avoids the risk of crippling high-damage awards and trades that risk off against the likelihood that it will have to pay out damages in a higher number of cases (represented by the

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comparatively higher win rates in arbitration). That justification holds provided that opt-out opportunities are low. Yet if a large number of employees or consumers exercise their option to undertake the transaction but not to agree to arbitration, that enhances the company's potential exposure to high-damage awards and, consequently, eliminates the risk-management advantages to arbitration. If the opt-out rate is too high, it would be economically rational for the company to abandon arbitration altogether. That result would, of course, leave employees who wanted to arbitrate worse off and, to borrow Estreicher's terms again, likely would return us to a world of Cadillacs for the few and rickshaws for the many.

CONCLUSION

Increased congressional attention has brought our present system of arbitration under a microscope, particularly with respect to employment and consumer disputes. That scrutiny can be valuable, for it promotes discussion and study about this valuable dispute resolution tool. At the same time, that scrutiny can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study.

This paper has sought to ensure that any congressional consideration of arbitration take into account the current state of research on the arbitration regime. It has shown that, by

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most measures, arbitration does not leave claimants worse off and, in many cases, makes them better off. It also has shown that complaints about unfair arbitral procedures are exaggerated. To the extent dubious arbitral procedures do exist, industry self-regulation, judicial oversight and agency action already provide important checks. Jettisoning our system of enforceable predispute arbitration agreements would be a costly endeavor with potentially deleterious consequences for the very individuals whom Congress seeks to protect. Finally, the main alternatives - postdispute arbitration and voluntary arbitration - do not appear viable and effectively would eliminate the use of arbitration in these settings.

This article is not simply a plea to "leave well enough alone." There are places where reform could be appropriate. One would be to address the apparent disparity in results in employment arbitration between higher-income and middle/lower-income employees. Another would be to reconsider the cost allocation rules and whether the party resisting arbitration should bear the burden of proving its unaffordability. Finally, as to many questions, there are uncomfortable gaps in the empirical research. Further study in these areas may help shed light on whether, and to what extent, additional reforms are justified.