

**University of Kansas**

---

**From the Selected Works of Stephen Ware**

---

2001

# Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements

Stephen Ware, *University of Kansas*



Available at: [https://works.bepress.com/stephen\\_ware/3/](https://works.bepress.com/stephen_ware/3/)

# Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements

Stephen J. Ware\*

Arbitration clauses now appear in many of the form contracts through which consumers obtain goods, services and credit.<sup>1</sup> Why do so many businesses that deal with consumers choose arbitration? Relative to litigation, arbitration provides opportunities for a business to save on its dispute-resolution costs. If arbitration does, in fact, lower these costs then arbitration lowers the prices (and interest rates) consumers pay because competition forces businesses to pass their cost-savings on to consumers.<sup>2</sup>

This pro-consumer aspect of arbitration is generally overlooked,<sup>3</sup> and the enforceability of consumer arbitration agreements is often criticized.<sup>4</sup> Not all consumer arbitration agreements are enforced.<sup>5</sup> Courts regulate consumer arbitration by enforcing arbitration clauses that have certain features, while refusing to enforce

---

\* Professor of Law, Samford University, Cumberland School of Law. Thanks to Chris Drahozal and Ed Anderson.

1. See Stephen J. Ware, *Arbitration and Unconscionability after Doctor's Associates, Inc. v. Casarotto*, 31 WAKE FOREST L. REV. 1001, 1001 n.3 (1996). Other form contracts frequently containing arbitration clauses include employment contracts, franchise agreements, and investor-brokerage agreements. While this article is worded in terms of consumer contracts, the reasoning generally applies to other form contracts as well. See, e.g., Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. (forthcoming 2001).

2. See *infra* Part I.B.

3. But see Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 U. ILL. L. REV. (forthcoming) (acknowledging possibility that arbitration lowers prices); Jeremy Senderowicz, *Consumer Arbitration and Freedom of Contract: A Proposal to Facilitate Consumers' Informed Consent to Arbitration Clauses in Form Contracts*, 32 COLUM. J.L. & SOC. PROBS. 275, 298-99 (1999) ("The benefits of arbitration which accrue to consumers, [include] savings on legal fees by the company (some of which will inevitably be passed on to consumers in the form of lower costs) . . ."); Stephen J. Ware, *Consumer Arbitration as Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen)*, 29 MCGEORGE L. REV. 195, 211-13 & n.95 (1998).

4. See F. Paul Bland, Jr., *To Fight Arbitration Abuse, The Devil is in the Details*, TRIAL, July, 2000, at 31; Paul D. Carrington, *The Dark Side of Contract Law: Courts Are Increasingly Validating Standard Form Contracts That Eviscerate People's Rights: Trial Lawyers Must Fight the Trend*, TRIAL, May 2000, at 73; Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331; R. Larson Frisby, *Congress Considers Curbing Mandatory Arbitration*, DISP. RESOL. MAG., Summer 2000, at 32; Thomas J. Methvin, *Alabama The Arbitration State*, 62 ALA. LAW. 48 (2001); Jean Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 642-43 (1996); Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion under the Federal Arbitration Act*, 77 N.C. L. REV. 931 (1999); David G. Wirtes, Jr., *Suggestions for Defeating Arbitration*, 24 AM. J. TRIAL ADVOC. 111 (2000).

5. See cases cited *infra* notes 36 & 40. See also Drahozal quote *infra* note 56. See generally STEPHEN J. WARE, ALTERNATIVE DISPUTE RESOLUTION §§ 2.25 & 2.28 (2001).

arbitration clauses that lack those features.<sup>6</sup> This judicial regulation of arbitration agreements increases the dispute-resolution costs of the businesses with which consumers deal. And this cost-increase, in turn, raises the prices consumers pay. In short, judicial regulation of consumer arbitration agreements imposes costs on consumers. Whether such regulation yields any benefits that outweigh these costs is a complex and controversial question.<sup>7</sup>

## I. ARBITRATION CLAUSES LOWER PRICES

### A. Assumption: Arbitration Clauses Lower Business' Costs

Arbitration, like litigation, is a form of binding adjudication.<sup>8</sup> The process of arbitration, however, can be very different from the process of litigation. These differences can make arbitration attractive to businesses that deal with consumers. Relative to litigation, arbitration provides opportunities for such a business to save on its dispute-resolution costs.

First, arbitration does away with juries and, for that reason, is commonly thought to reduce the likelihood of high damages awards against businesses.<sup>9</sup> Second, arbitration's confidentiality "lessens the risk of adverse publicity" about a business and its disputes.<sup>10</sup> Third, arbitration can resolve disputes "according to a nationally uniform set of procedures,"<sup>11</sup> thus saving interstate businesses the costs of adapting to different procedural rules in different states. Fourth, arbitration's finality (near absence of appellate review) saves businesses the costs of appeals.<sup>12</sup> Fifth, arbitration can eliminate the possibility of class actions against businesses.<sup>13</sup> Sixth, arbitration can deter claims against businesses by requiring consumer-plaintiffs to pay arbitrator fees, as well as filing fees that exceed the filing fees in litigation.<sup>14</sup> Seventh, arbitration can reduce the amount of discovery available to consumer-plaintiffs, thus

---

6. Those features are identified and discussed *infra* Part II.

7. See *infra* Part III.

8. See WARE *supra* note 5, § 1.6(c).

9. See Nancy J. Warren & Michael D. Young, *Arbitration Sees Victories in U.S. Supreme Court*, NAT'L L.J., Jan. 15, 2001, at B14.

For those who represent large companies, arbitration is also seen as an opportunity to avoid the unpredictability of juries. Arbitrators are generally viewed as more likely to render awards that bear a reasonable relationship to actual damages incurred, although large awards for noneconomic injury, as well as punitive damage awards, are not unheard of in arbitration.

*Id.* See also ALAN S. KAPLINSKY & MARK J. LEVIN, *Alternative to Litigation Attracting Consumer Financial Services Companies*, in ARBITRATION OF CONSUMER FINANCIAL SERVICES DISPUTES 845-48 (1999) (arbitration "eliminates irrational jury verdicts").

10. KAPLINSKY & LEVIN, *supra* note 9, at 845.

11. *Id.*

12. *Id.* See WARE, *supra* note 5, § 2.43 (courts rarely vacate arbitration awards).

13. See *infra* Part II.A.

14. See *infra* Part II.B.

reducing the amount of time and money businesses must spend on the discovery process and also making it harder for consumers to prove their claims.<sup>15</sup>

The foregoing is a list of just some of the reasons why arbitration might enable a business to save on its dispute-resolution costs. And these reasons have apparently led a number of businesses to include arbitration clauses in their consumer contracts.<sup>16</sup> There is not, however, any publicly-available study indicating whether arbitration clauses have in fact saved businesses money. A business using consumer arbitration agreements could study the effects of those agreements on the business' bottom line,<sup>17</sup> and it seems likely that some such businesses have done so. Nevertheless, research revealed no publicly-available studies of that sort. So this article will proceed on an assumption. The assumption, customary in economics, is that businesses generally act in their own interests, i.e., are "profit-maximizing."<sup>18</sup> This article will assume that those businesses that use consumer arbitration agreements are doing so because those businesses find that they benefit from those agreements, i.e., that those agreements lower their dispute-resolution costs.<sup>19</sup>

### B. Competition Forces Businesses to Pass on Cost-Savings to Consumers

Assuming that consumer arbitration agreements lower the dispute-resolution costs of businesses that use them, competition will (over time) force these businesses to pass their cost-savings to consumers.<sup>20</sup> This pass-on follows from a basic principle of economics, the *rate-of-return equalization principle*. As a standard economics text explains:

If the market price of a good is greater than the opportunity cost of producing it, suppliers will gain from an expansion in production. Profit-seeking entrepreneurs will be attracted to the industry. Investment capital will flow into the industry, and output (supply) will expand until the additional supply lowers the market price sufficiently to eliminate the profits. In contrast, if the market price is less than the good's opportunity cost of production, suppliers will lose money if they continue to produce the good. The losses will drive producers from the market and capital will flow away from the industry. Eventually the decline in supply and

---

15. See *infra* Part II.C.

16. See KAPLINSKY & LEVIN, *supra* note 9, at 845-48.

17. On the methodological issues surrounding such a study, see Ware, *Effects of Gilmer*, *supra* note 1.

18. See JAMES D. GWARTNEY & RICHARD L. STROUP, *ECONOMICS: PRIVATE AND PUBLIC CHOICE* 532-39, 563-65 & 595-98 (7th ed. 1995) (profit-maximizing firms produce additional output so long as the marginal revenue of doing so exceeds the marginal cost).

19. It is possible that businesses using arbitration agreements are acting against their own interests by doing so. Similarly, it is possible that businesses that choose not to use arbitration agreements are acting against their own interests. Given the variety of businesses and their situations, it seems likely that consumer arbitration agreements are in the interests of some businesses, but not others.

20. The pass-on can be in the form of lower prices or some other change favoring consumers, such as a more generous warranty.

shrinkage in the *capital base* (durable productive assets) of the industry will push prices upward and eliminate the losses.

In a market economy, characterized by freedom of entry and exit, there will be a tendency for the after-tax rate of return on investment to move toward a uniform rate, the competitive or normal-profit return. Neither abnormally high nor abnormally low after-tax returns will persist for long periods of time. This tendency for returns on investment capital to move toward a uniform, normal rate is sometimes referred to as the *rate-of-return equalization principle*.<sup>21</sup>

The rate-of-return equalization principle implies that whatever increases an industry's profits ultimately attracts additional capital to that industry, causing an increase in that industry's output and therefore a reduction in its price. Suppose, for example, that firms in the widget industry add arbitration clauses to their consumer contracts and that this causes a reduction in these firms' dispute-resolution costs and a corresponding increase in their profits. These above-normal profits will attract additional capital to the widget industry, causing an increase in the supply of widgets and therefore a reduction in the price of widgets.

Importantly, this process occurs regardless of whether consumers understand, or even notice, the arbitration clauses.<sup>22</sup> This process works to lower prices because investors and entrepreneurs are alert to above-normal profits, not because consumers are alert to the arbitration clauses which cause those profits.<sup>23</sup> The increase in output attracted by above-normal profits is what lowers prices. In other words, the fact that widget-buying consumers get arbitration clauses is what causes them to also get lower prices. This is an example of the general insight that contract terms favorable to sellers go hand-in-hand with lower prices. Recognition of this has been standard in the law-and-economics literature for at least a quarter of a century.<sup>24</sup>

The law-and-economics literature features debate about the existence of, and proper response to, the problem of imperfect information causing unregulated form contract terms to be too harsh to the consumer with respect to terms about which consumers are often ignorant and (therefore) too favorable to the consumer with respect to those terms, such as price, about which consumers are typically knowledgeable.<sup>25</sup> Some articles opposing enforcement of consumer arbitration

---

21. GWARTNEY & STROUP, *supra* note 18, at 67-68 (emphasis in original).

22. Ware, *supra* note 3, at 212 n.95.

23. For this reason, one must be careful about assertions that "the competitive defense of form contracts depends on an assumption that consumers read, understand, and evaluate the cost of the binding arbitration clause being imposed by the seller." Sternlight, *supra* note 4, at 688. If the "competitive defense" refers to the contention that "benefits secured by [sellers] through imposition of an arbitration provision will be passed on to the consumers," *Id.* at 687, then the competitive defense, as explained in the text, does not depend on an assumption that consumers read or understand the arbitration clause.

24. See Victor P. Goldberg, *Institutional Change and the Quasi-Invisible Hand*, 17 J.L. & ECON. 461, 485-87 (1974) "[H]arsh terms will, . . . in equilibrium, yield lower prices." *Id.* at 487.

25. See R. Ted Cruz & Jeffrey J. Hinck, *Not My Brother's Keeper: The Inability of an Informed Minority to Correct for Imperfect Information*, 47 HASTINGS L.J. 635 (1996); Lee Goldman, *My Way and the Highway: The Law and Economics of Choice of Forum Clauses in Consumer Form Contracts*, 86 NW. U. L. REV. 700 (1992); Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and*

agreements cite this law-and-economics debate.<sup>26</sup> These articles can be read as asserting that imperfect information causes consumer arbitration agreements to be too harsh to the consumer with respect to the arbitration clause and too favorable to the consumer with respect to price.<sup>27</sup> These articles, however, lack an explicit acknowledgment that harsh terms yield lower prices.<sup>28</sup> So these articles may reflect a belief that price-reductions occur only when consumers “read, understand, and evaluate” the arbitration clause.<sup>29</sup> To reiterate, that belief clashes with the reasoning of this article’s previous few paragraphs.<sup>30</sup>

Those paragraphs began with the plausible assumption that enforceable consumer arbitration agreements lower the dispute-resolution costs of businesses that choose to use such agreements. These cost-savings lead, through competition among businesses for capital, to lower prices for consumers. The greater the cost-savings to business, the greater the price reduction for consumers. To put it another way, the more costly arbitration is to business, the more consumers pay for goods, services and credit. When arbitration law changes in a way that makes arbitration more costly to business, then arbitration law is raising prices paid by consumers. Attempts to make arbitration more favorable (or “fair”) to consumers have a downside for consumers if the effect of those attempts is to raise businesses’ arbitration costs.

The following section discusses recent judicial decisions likely to make arbitration more costly to business. To the extent these cases have that effect, they can be known as “price-raising cases” or simply “price-raisers.”

## II. PRICE-RAISING CASES

### A. *Requiring Class Actions*

---

*Economics Meets the Real World*, 24 GA. L. REV. 583 (1990); Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979); Alan Schwartz & Louis L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387, 1402-20 (1983); M.J. Trebilcock & D.N. Dewees, *Judicial Control of Standard Form Contracts*, in *THE ECONOMIC APPROACH TO LAW* 93-119 (Paul Burrows & Cento G. Veljanovski eds. 1981); M.J. Trebilcock, *The Doctrine of Inequality of Bargaining Power: Post-Benthamite Economics in the House of Lords*, 26 U. TORONTO L. J. 359, 375-76 (1976).

26. Carrington, *supra* note 4, at 74-76; Sternlight, *supra* note 4, at 688.

27. *See* Ware, *supra* note 3, at 212 n.95 (reading Sternlight’s article that way).

28. Carrington, *supra* note 4, at 74-76; Sternlight, *supra* note 4, at 688.

29. Sternlight, *supra* note 4, at 688. *See also* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. ON DISP. RESOL. 267, 332 (1995) (describing “consumer advocates’ ” view that it is “unlikely the cost savings realized by arbitration would be passed on to consumers”); Carrington, *supra* note 4, at 74-76 (the market does not work to “assure[] fair value” because of the “profound disparity of information between parties when a dispute resolution clause is inserted into a standard form contract . . .”); Jeffrey W. Stempel, *Bootstrapping and Slouching Toward Gomorrah: Arbitral Infatuation and the Decline of Consent*, 62 BROOK. L. REV. 1381, 1397 (1999) (“no evidence to suggest any reduction in price flows from enforced arbitration”).

30. *See supra* text accompanying notes 20-24.

First among the price-raisers are cases holding that arbitration agreements must allow for class actions. Businesses can incur substantial liability in consumer class actions, both in cases that provide significant relief to the class and in cases that provide insignificant relief to the class but significant fees to plaintiffs' lawyers.<sup>31</sup> Limiting consumer claims to individual actions would deter some of those claims that plaintiffs' lawyers find worth pursuing as part of a class action, but not as an individual action.<sup>32</sup> Accordingly, some businesses use arbitration clauses in the hope that courts will enforce these clauses to preclude class actions.<sup>33</sup> And many cases have done just that.<sup>34</sup> Other cases, by contrast, have certified classwide arbitration,<sup>35</sup> or allowed classwide litigation to proceed notwithstanding the arbitration clause.<sup>36</sup>

---

31. Drahozal, *supra* note 3 ("class actions tend to be run by, and for the benefit of, the plaintiffs' attorneys"). See generally Bruce Hay & David Rosenberg, "Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy, 75 NOTRE DAME L. REV. 1377 (2000); Geoffrey P. Miller, *Class Actions*, in NEW PALGRAVE DICTIONARY OF ECONOMICS & THE LAW (Peter Newman ed., 1998).

32. A few of these claims would not be deterred because the consumer would pursue the claim pro se, i.e., without a lawyer.

33. See generally Jean R. Sternlight, *As Mandatory Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1 (2000).

34. Cases enforcing arbitration agreements to preclude classwide relief include *Johnson v. West Suburban Bank*, 225 F.3d 366 (3d Cir. 2000); *Thompson v. Illinois Title Loans, Inc.*, 2000 WL 45493 (N.D. Ill. Jan. 11, 2000); *Brown v. Surety Finance Service, Inc.*, 2000 WL 528631 (N.D. Ill. Mar. 24, 2000); *Sagal v. First USA Bank, N.A.*, 69 F. Supp. 2d 627 (D. Del. 1999); *Zawikowski v. Beneficial National Bank*, 1999 WL 35304 (N.D. Ill. Jan. 11, 1999); *Howard v. Klynveld Peat Marwick Goerdeler*, 977 F. Supp. 654, 665 n.7 (S.D.N.Y. 1997); *Doctor's Associates, Inc. v. Hollingsworth*, 949 F. Supp. 77, 80-81 (D. Conn. 1996); *Lopez v. Plaza Finance Co.*, 1996 WL 210073 (N.D. Ill. Apr. 25, 1996); *McCarthy v. Providential Corp.*, 1994 WL 387852 (N.D. Cal. July 19, 1994); *Meyers v. Univest Home Loan, Inc.*, 1993 WL 307747 (N.D. Cal. Aug. 4, 1993); *Erickson v. Painewebber, Inc.*, 1990 WL 104152 (N.D. Ill. July 13, 1990); *Perry v. Beneficial National Bank*, 1998 WL 279174 (Ala. Cir. Ct. May 18, 1998); *Patterson v. ITT Consumer Financial Corp.*, 18 Cal. Rptr. 2d 563 (Cal. Ct. App. 1993).

This issue is complicated in the securities arbitration context by a National Association of Securities Dealers rule. See, e.g., *Champ v. Siegel Trading Co., Inc.*, 55 F.3d 269 (7th Cir. 1995); *Nielsen v. Piper, Jaffray & Hopwood, Inc.*, 66 F.3d 145 (7th Cir. 1995); *In re Nasdaq Market-Makers Antitrust Litigation*, 169 F.R.D. 493 (S.D.N.Y. 1996); *In re Regal Communications Corp. Secs. Litig.*, 1995 WL 550454 (E.D. Pa. Sept. 14, 1995).

35. *Blue Cross of California v. Superior Court*, 78 Cal. Rptr. 2d 779, 785 (Cal. Ct. App. 1999); *Lewis v. Prudential Bache Secs., Inc.*, 225 Cal. Rptr. 69 (Cal. Ct. App. 1986); *Izzi v. Mesquite Country Club*, 231 Cal. Rptr. 315 (Cal. Ct. App. 1986). See also Sternlight, *supra* note 33, at 110 ("Thus far, while experiences with class action arbitration are scant, participants in the few classwide arbitrations that have been held have not voiced sharp criticism of the inefficiency of such arbitrations."). See generally IAN R. MACNEIL, RICHARD E. SPEIDEL & THOMAS J. STIPANOWICH, *FEDERAL ARBITRATION LAW* § 18.9 (1994 & Supp. 1996).

36. See *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp. 2d 1087, 1105-06 (W.D. Mich. 2000) (finding an arbitration provision is unconscionable in part because it waives class remedies allowable under Truth in Lending Act ("TILA"), as well as certain declaratory and injunctive relief under federal and state consumer protection laws); *Ramirez v. Circuit City Stores*, 90 Cal. Rptr. 2d 916, 920-21 (Cal. Ct. App. 1999) (finding arbitration clause in contract of employment voided as unconscionable, in part, because it would deprive arbitrator of authority to hear classwide claim), *review granted and opinion superseded*, 995 P.2d 137 (Cal. 2000); *Powertel v. Bexley*, 743 So. 2d 570, 577 (Fla. Ct. App. 1999) (refusing to enforce arbitration clause as unconscionable in part because of its retroactive application to preexisting lawsuit and because one factor as to its substantive unconscionability was that it precluded the possibility of classwide relief).

The Supreme Court recently declined to address (because it was not properly raised in the lower courts) a consumer's argument that her arbitration agreement was unenforceable because it precludes pursuit of

These cases, by requiring that arbitration preserve the class action, raise the cost of arbitration to businesses and, therefore, raise prices to consumers.

---

her Truth In Lending Act claim as a class action. *Green Tree Fin. Corp.-Alabama v. Randolph*, 121 S. Ct. 513, 524 (2000).



### B. Capping Consumer Fees

While litigation is subsidized by the taxpayer, the parties must pay the full costs of arbitration. It has long been customary in arbitration for the claimant to pay the filing fee charged by the arbitration organization<sup>37</sup> and for the parties to pay equal shares of the arbitrator's fee. Recent employment arbitration cases, however, have refused to enforce agreements requiring the employee-claimant to pay fees according to this custom.<sup>38</sup> These cases effectively require the business to subsidize the arbitration claim against it. Some employment cases go so far as to require the business to pay all or nearly all of the costs of arbitration.<sup>39</sup> Several lower courts have moved toward this approach in the consumer arbitration context.<sup>40</sup>

The Supreme Court addressed this topic in a recent Truth in Lending Act case, *Green Tree Financial Corp. v. Randolph*.<sup>41</sup> The Court said that "the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her

---

37. See AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULE R4(a)(ii) & ADMINISTRATIVE FEES (1999).

38. See *Shankle v. B-G Maintenance Mgmt. of Colorado, Inc.*, 163 F.3d 1230 (10th Cir. 1999).

In this case, Mr. Shankle signed the Agreement as a condition of continued employment. The Agreement requires Mr. Shankle to arbitrate all disputes arising between he and his former employer. In order to invoke the procedure mandated by his employer, however, Mr. Shankle had to pay for one-half of the arbitrator's fees. Assuming Mr. Shankle's arbitration would have lasted an average length of time, he would have had to pay an arbitrator between \$1,875 and \$5,000 to resolve his claims. Mr. Shankle could not afford such a fee, and it is unlikely other similarly situated employees could either. The Agreement thus placed Mr. Shankle between the proverbial rock and a hard place—it prohibited use of the judicial forum, where a litigant is not required to pay for a judge's services, and the prohibitive cost substantially limited use of the arbitral forum. See *Cole v. Burns Int'l Sec. Serv.*, 105 F.3d 1465, 1484 (concluding employees would be unable to pursue statutory claims if required to pay for arbitrator fees in addition to the administrative costs and attorney fees, which accompany both arbitration and litigation). Essentially, B-G Maintenance required Mr. Shankle to agree to mandatory arbitration as a term of continued employment, yet failed to provide an accessible forum in which he could resolve his statutory rights. Such a result clearly undermines the remedial and deterrent functions of the federal anti-discrimination laws.

*Id.* at 1234-35. See also *Paladino v. Avnet Computer Technologies, Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998) ("Because Avnet makes no promises to pay for an arbitrator, employees may be liable for at least half the hefty cost of an arbitration and must, according to the American Arbitration Association rules the clause explicitly adopts, pay steep filing fees (in this case \$2000)."); *Cole*, 105 F.3d at 1485 (interpreting agreement to hold that employer would pay fees and then enforcing agreement); *Armendariz v. Foundation Health Psychcare Servs., Inc.*, 99 Cal. Rptr. 2d 745, 765 (Cal. 2000) ("[W]hen an employer imposes mandatory arbitration as a condition of employment, the arbitration agreement or arbitration process cannot generally require the employee to bear any type of expense that the employee would not be required to bear if he or she were free to bring the action in court."). But see *Arakawa v. Japan Network Group*, 56 F. Supp. 2d 349, 351 (S.D.N.Y. 1999) (rejecting *Paladino* and comparing authorities from various courts).

39. See cases cited *supra* note 38.

40. See *Dobbins v. Hawk's Enters.*, 198 F.3d 715, 717 (8th Cir. 1999); *Rollins, Inc. v. Foster*, 991 F. Supp. 1426, 1439 (M.D. Ala. 1998); *In re Knepp*, 229 B.R. 821, 838 (Bankr. N.D. Ala. 1999); *Patterson*, 18 Cal. Rptr. 2d at 567; *Brower v. Gateway 2000 Inc.*, 676 N.Y.S.2d 569, 574 (N.Y. App. Div. 1998).

41. *Green Tree Fin.*, 121 S. Ct. 513.

federal statutory rights in the arbitral forum,”<sup>42</sup> and this would presumably make the arbitration clause unenforceable. But the *Randolph* Court placed the burden of showing prohibitively high fees on the consumer:

[W]here, as here, a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs. *Randolph* did not meet that burden. How detailed the showing of prohibitive expense must be before the party seeking arbitration must come forward with contrary evidence is a matter we need not discuss; for in this case neither during discovery nor when the case was presented on the merits was there any timely showing at all on the point. The Court of Appeals therefore erred in deciding that the arbitration agreement's silence with respect to costs and fees rendered it unenforceable.<sup>43</sup>

Justice Ginsburg's dissent in *Randolph* pointed out that “[a]s a repeat player in the arbitration required by its form contract, Green Tree has superior information about the cost to consumers of pursuing arbitration.”<sup>44</sup> The dissent added: “In these circumstances, it is hardly clear that *Randolph* should bear the burden of demonstrating up front the arbitral forum's inaccessibility, or that she should be required to submit to arbitration without knowing how much it will cost her.”<sup>45</sup> The dissent “would remand for clarification of Green Tree's practice” (if any) of subsidizing the arbitration costs of its consumer-claimants.<sup>46</sup>

Case law requiring a business to subsidize a consumer's arbitration claim would raise prices in two respects. First, it would make arbitration more costly to businesses by making businesses pay more in fees for each case. Second, it would make arbitration more costly to businesses by increasing the number of cases brought at all. It would do this by lowering the financial barrier to asserting a claim.

### *C. Requiring Substantial Discovery*

“Limitations on discovery, particularly judicially initiated discovery, remain one of the hallmarks of American commercial arbitration.”<sup>47</sup> An important employment

---

42. *Id.* at 522.

43. *Id.* at 522-23. The *Randolph* Court seems to have overruled not only the Eleventh Circuit's decision in that case, but other cases placing on the defendant the burden of proof regarding fees. *See* *Baron v. Best Buy Co.*, 75 F. Supp. 2d 1368, 1370-71 (S.D. Fla. 1999) (refusing to grant a defendant's motion to compel arbitration before the National Arbitration Forum because defendants “failed to demonstrate in this record that the National Arbitration Forum is a neutral, inexpensive, and efficient forum to determine these claims as required by law”).

44. *Green Tree Fin.*, 121 S. Ct. at 524-25 (Ginsburg, J., dissenting).

45. *Id.* at 525.

46. *Id.*

47. MACNEIL, SPEIDEL & STIPANOWICH, *supra* note 35, § 34.1.

arbitration case, however, indicates that arbitration agreements should not be enforced unless they provide for "more than minimal discovery."<sup>48</sup> And there are a few cases refusing to enforce employees' arbitration agreements because of, among other things, the courts' concerns about insufficient discovery.<sup>49</sup>

It is not clear whether these precedents will be extended to consumer arbitration<sup>50</sup> or whether they require as much discovery as litigation has. If they require litigation-like discovery, they would raise the cost of arbitration to businesses and therefore raise prices to consumers. Litigation-like discovery would both increase the amount of time and money the business must spend on the discovery process and make it easier for consumers to prove their claims.<sup>51</sup>

#### D. Prohibiting Carve-Outs

Some arbitration agreements require arbitration of the consumer's claims but permit the business to bring its claims in court. For example, some consumer credit agreements require arbitration of all claims except for: (1) collection actions; and (2) actions to preserve, repossess or foreclose on collateral.<sup>52</sup> These two "carve-outs" encompass nearly all the claims lenders assert against consumer-borrowers.

---

48. *Cole*, 105 F.3d at 1482. See also *Armenariz*, 99 Cal. Rptr. 2d at 750 (agreement to arbitrate employment discrimination claims enforceable if "the arbitration [meets] certain minimum requirements, including neutrality of the arbitrator, the provision of adequate discovery, a written decision that will permit a limited form of judicial review, and limitations on the costs of arbitration").

49. See *Kinney v. United Health Care Servs., Inc.*, 83 Cal. Rptr. 2d 348, 354-55 (Cal. Ct. App. 1999) ("The unconscionable nature of the unilateral arbitral obligation is heightened by certain other terms of United's arbitration policy. Given that United is presumably in possession of the vast majority of evidence that would be relevant to employment-related claims against it, the limitations on discovery, although equally applicable to both parties, work to curtail the employee's ability to substantiate any claim against United."); *Gonzalez v. Hughes Aircraft Employees Fed. Credit Union*, 83 Cal. Rptr. 2d 763, 766-67 (Cal. Ct. App. 1999), review granted and opinion superseded, 978 P.2d 1 (Cal. 1999), appeal dismissed per stipulation, 990 P.2d 504 (Cal. 1999); *Hooters of America Inc. v. Phillips*, 39 F. Supp. 2d 582, 614-15 (D.S.C. 1998) (arbitration held unconscionable in part because procedural rules were biased against employee and in favor of company where company had total control over selection of arbitrators, employee had severely limited discovery, and witness disclosure and sequestration were one-sided), *aff'd on other grounds*, 173 F.3d 933 (4th Cir. 1999) (holding employer had breached arbitration agreement by issuing biased rules).

50. See Jean R. Sternlight, *Drafting a "Bulletproof" Consumer Arbitration Agreement: Is It Possible?*, in *ARBITRATION OF CONSUMER FINANCIAL SERVICES DISPUTES*, 763, 790 (1999) (courts "are likely to strike down clauses which . . . deny the consumer access to discovery which is necessary in order for the consumer to have a chance of prevailing").

51. Paul H. Haagen, *New Wineskins for New Wine: The Need to Encourage Fairness in Mandatory Arbitration*, 40 ARIZ. L. REV. 1039, 1053 ("More restrictive discovery may leave a plaintiff with a meritorious claim unable to prove it."); Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1, 89-90 (1997) ("Where, for example, one party has substantially greater access to relevant witnesses and physical and documentary evidence, denying the other party any discovery will essentially deny them the opportunity to prevail in an arbitration.")

52. See, e.g., *Lackey v. Green Tree Fin. Corp.*, 498 S.E.2d 898, 905 (S.C. Ct. App. 1998) ("Green Tree retained the option to use judicial or non-judicial relief to enforce a security agreement relating to the manufactured home, to enforce the monetary obligations secured by the manufactured home, or to foreclose on the manufactured home.")

A lender may find that these carve-outs save it money.<sup>53</sup> Collection actions against consumers often result in default judgments,<sup>54</sup> so the challenge for the lender-plaintiff is not winning judgments but collecting them from often insolvent or judgment-proof debtors. Also, collection actions against consumers nearly always involve small amounts of money. The combination of these two facts makes collections practice an assembly line in which large numbers of small claims are processed at a low cost per claim.<sup>55</sup> Even a slight increase in the cost per claim can make a significantly higher percentage of debts effectively uncollectible. Arbitration of collection actions may increase the cost per claim because the lender must win an arbitration award and then get that award confirmed in court,<sup>56</sup> rather than simply win a default judgment in court.<sup>57</sup>

The carve-out relating to collateral also seems well-suited to saving the lender money. A court order is a preliminary step to repossession of collateral by a sheriff

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

54. Yvonne W. Rosmarin, *Consumers-R-Us: A Reality in the U.C.C. Article 2 Revision Process*, 35 WM. & MARY L. REV. 1593, 1625-26 (1994) (the author is an attorney with the National Consumer Law Center).

The prevalence of default judgments in collection actions likely explains why, in the case of a major credit card issuer, "not only has the company sought arbitration far more often than consumers, it has also won in 99.6 percent of the cases that went all the way to an arbitrator." Caroline E. Mayer, *Win Some, Lose Rarely?: Arbitration Forum's Rulings Called One-Sided*, WASH. POST, Mar. 1, 2000, at E1. See Matthew C. McDonald & Kirkland E. Reid, *Arbitration Opponents Barking Up Wrong Branch*, 62 ALA. LAW. 56, 60 (2001) ("[V]irtually all of these cases were collection cases filed by the bank against customers more than six months behind on their credit cards bills. Unquestionably, the result in collections court would have been the same.").

55. See, e.g., Lawrence R. Peterson, *The Beauties of Mechanization*, UTAH BAR J., Nov. 1998, at 11, 12 (describing collections practice as "mechanized" and "automated"); Duke Nordlinger Stern, *Reducing Your Malpractice Risk*, A.B.A. J., June 1986, at 52 ("A collections practice, on the other hand, generally involves a large volume of smaller matters. Effective and specialized management systems, which the average law firm would not necessarily use, are needed to avoid improper practices and to honor numerous deadlines.").

56. 9 U.S.C. § 9 (1994). See Drahozal, *supra* note 3.

To enforce an arbitration award, a party will need to get it reduced to a court judgment, not a complicated requirement but an additional step nonetheless, before it can recover on the judgment. In simple disputes over money due it may be cheaper to skip that intermediate step by having a court enter judgment for the amount owed. Similar arguments may explain why foreclosure and eviction actions commonly are excluded from arbitration.

*Id.*

57. On the other hand, arbitration agreements may lower the cost of collections. The costs of complying with the Fair Debt Collections Practices Act, 15 U.S.C. §§ 1692 - 1692(o) (1994), and similar state statutes may be higher when debts are collected through litigation than through arbitration. For instance, these statutes may prohibit a nationwide creditor from threatening suit until it has taken the costly step of engaging a lawyer with the present ability (local license) to sue. Cf. *id.* § 1692(e)(5). In contrast, these statutes may permit a nationwide creditor to threaten, and even bring, a collection action in arbitration without a local lawyer, or even any lawyer at all. Cf. JONATHAN SHELDON & CAROLYN L. CARTER, NATIONAL CONSUMER LAW CENTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 5.1.4a (Supp. 2000) ("The creditor mails or even e-mails minimal paper work to initiate an arbitration collection action, and need not even involve an attorney."). See also Brad O. Nakamoto, *Arbitration of Consumer Financial Services Disputes*, in ARBITRATION OF CONSUMER FINANCIAL SERVICES DISPUTES 827 (1999).

58. U.C.C. § 9-503 (1999) ("judicial process").

or to a judicial foreclosure sale of collateral.<sup>59</sup> Arbitration of lenders' claims relating to collateral would be an additional step the lender would have to take before going to court to get the necessary order.<sup>60</sup>

Some courts have refused to enforce arbitration agreements with one or both of these carve-outs, in part because of the carve-outs.<sup>61</sup> These courts do not purport to prohibit these carve-outs under all facts among all parties. But with respect to facts like those before them, these courts effectively require lenders to arbitrate collection actions and actions relating to collateral. By doing so, these cases make arbitration more costly to lenders. Therefore, these cases raise the interest rates consumers pay.

### III. CONCLUSION: IS THE PRICE WORTH IT?

The previous section of this article discussed judicial decisions that raise prices (and interest rates) by requiring arbitration to: (1) allow for class actions, (2) subsidize the consumer's fees, (3) include substantial discovery, and (4) encompass both parties' claims. Whether these price increases are worth incurring, i.e., whether the judicial decisions are good policy, plainly depends on a number of factors including the amount of the price increase caused by each category of judicial decision. And different observers will certainly have different views about the value of, for example, class actions and litigation-like discovery. This article makes no attempt to assess the merits of those different views. Rather it argues that any such assessment should consider the influence consumer arbitration law has on the prices consumers pay.<sup>62</sup> Failure to address price inevitably biases any assessment of

---

59. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 66 (3d ed. 1996).

60. See Drahozal quote *supra* note 56.

61. *American General Fin., Inc. v. Branch*, 2000 WL 1868516 (D. Ala. Dec. 22, 2000) (collection actions and, not relied upon by court, actions relating to collateral); *Showmethemoney Check Cashers, Inc. v. Williams*, 27 S.W.3d 361, 367 (Ark. 2000) (collection actions); *Iwen v. U.S. West Direct*, 977 P.2d 989, 995-96 (Mont. 1999) (same); *Arnold v. United Cos. Lending Corp.*, 511 S.E.2d 854, 858-61 (W. Va. 1998) (collection actions and foreclosure). Cf. *Fritz v. Nationwide Mut. Ins. Co.*, 1990 WL 186448, \*6 (Del. Ch. Nov. 26, 1990) (uninsured motorist arbitration).

Cases enforcing arbitration clauses with carve-outs include: *Harris v. Green Tree Financial Corp.*, 183 F.3d 173 (3d Cir. 1999); *We Care Hair Development, Inc. v. Engen*, 180 F.3d 838 (7th Cir. 1999); *In re Pate*, 198 B.R. 841, 844 (Bankr. S.D. Ga. 1996); *Meyers*, 1993 WL 307747; *Green Tree Agency, Inc. v. White*, 719 So. 2d 1179 (Ala. 1998); *Sablosky v. Edward S. Gordon Co.*, 538 N.Y.S.2d 513, 516 (N.Y. 1989).

62. Cf. Drahozal, *supra* note 53 at 587-88.

I don't think I can really tell you whether consumer arbitration agreements should be enforced or not. What I do think important to keep in mind is that courts that decide not to enforce arbitration agreements, for whatever reason, perhaps justifiably, can impose costs on the parties. Courts can't just hold something unconscionable without consequences. Given that sophisticated parties find these arbitration agreements beneficial, it seems to me that there is evidence that they may be beneficial to unsophisticated parties as well. You should at least keep in mind that there may be costs to not enforcing them. The costs may be worth taking. It is not my place to tell you one way or the other, but there are costs there that need to be taken into account.

*Id.*

consumer arbitration law. It is easy to insist upon “due process” in consumer arbitration,<sup>63</sup> indeed “due process” is as widely-cherished as “mom and apple pie,” but the hard thinking begins when one asks who pays the price of process and how much they pay.

---

63. Which is not to say that it is easy to get consensus about what constitutes due process. Many major arbitration organizations have promulgated procedures designed to ensure due process in consumer arbitration. See, e.g., American Arbitration Association, *A Due Process Protocol for Mediation and Arbitration of Consumer Disputes*, available at [http://www.adr.org/education/education/consumer\\_protocol.html](http://www.adr.org/education/education/consumer_protocol.html) (1998); National Arbitration Forum, *Due Process Standard*, available at <http://www.arbforum.com/other/index.html> (last visited April 30, 2001); JAMS, *Minimum Standards of Procedural Fairness Policy on Financial Services Arbitrations*, available at [http://www.jamsadr.com/fin\\_minimum\\_stds.asp](http://www.jamsadr.com/fin_minimum_stds.asp) (June 2000). All three of these can be found in print in *ARBITRATION OF CONSUMER FINANCIAL SERVICES DISPUTES* (Practicing Law Institute 1999).