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Why Congress and the Courts Must Respect Citizens' Rights to Arbitration

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Abstract
The Federal Arbitration Act (FAA) established strong federal policy in favor of arbitration. Arbitration is a form of private dispute resolution that utilizes neutral, professional arbitrators in lieu of costly litigation. Both businesses and consumers benefit from the speed, efficiency, and professionalism of recognized arbitration associations. However, arbitration has come under attack in Congress, executive agencies, and the courts. This term, the Supreme Court of the United States will decide two cases concerning the FAA. The Court should continue to craft clear rules that enforce the plain meaning of contracts between the parties. Furthermore, all Americans should be concerned about efforts to limit citizens' arbitration rights, and Congress should resist special-interest, lawyer-friendly amendments that weaken or undermine the purposes of the FAA.

In 1925, Congress passed the Federal Arbitration Act (FAA),[1] establishing a strong federal policy in favor of arbitration. A form of alternative dispute resolution, arbitration reduces litigation costs, a savings that is passed on to consumers. Despite its advantages, however, arbitration has recently come under attack in Congress, executive agencies, and the courts. Thankfully, in three cases in the past two years, the Supreme Court of the United States has upheld the right of private parties to contract to arbitrate, pursuant to the FAA, and two more cases are pending before the Court.[2]

Regrettably, Congress can easily interfere. In fact, Congress has authorized the Consumer Financial Protection Bureau to limit arbitration,[3] and some Senators have attacked arbitration on the floor of the Senate. As the use of arbitration continues to expand—particularly with regard to consumer

Key Points

- Arbitration facilitates commerce by keeping litigation costs down and making dispute resolution simpler and faster. Businesses and consumers benefit from the speed, efficiency, and professionalism of recognized arbitration associations.
- The Supreme Court of the United States has recognized that the Federal Arbitration Act represents a "strong federal policy" favoring arbitration. The FAA ensures that free contracting of parties is respected even in the face of activist judges' policy preferences.
- Arbitration is being attacked in the courts, in Congress, and in executive agencies. All Americans should be concerned when special interests seek to limit the rights of parties to resolve their own disputes quickly and cheaply.
- As the Supreme Court hears cases that might limit arbitration rights, it should respect the will of Congress and the American people as enshrined in the FAA. Federal courts and Congress should respect the plain meaning of contracts between the parties.

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transactions—all Americans should be concerned about unwise congressional action that would limit arbitration.

It is clear that the Supreme Court and Congress are intensely interested in the issue of arbitration, particularly with respect to aggregate claim mechanisms such as class actions. A recent Pew study of the 100 largest banks in the United States found that 56 percent of the largest 50 banks have arbitration clauses in their checking account agreements and that, of the top 100 banks that use arbitration clauses, roughly 75 percent also include a class action waiver.[4] The increased use of arbitration agreements in all manner of consumer transactions makes it important to analyze some of their costs and benefits, and what the current state of the law is with respect to their enforceability.

What Is Arbitration?

Arbitration is a type of private dispute resolution that involves authorizing a third party, usually a professional arbitrator who is a member of a recognized arbitration association, to issue decisions that are legally binding and enforceable on the parties. For example, a contract between a homeowner and a home builder might state that if any disputes arise between the two parties, the homeowner would not sue the home builder in court, and vice versa. Rather, the homeowner and the home builder agree in an arbitration clause to have a neutral, professional arbitrator (from, for example, the American Arbitration Association) hear the dispute and issue a ruling. These professional arbitrators have a reason to be fair: If they are perceived as unfair, they lose business to other arbitrators.

At the outset, one point must be made clear: Arbitration, like class action, is simply a procedure that has no substantive effect on the underlying claims it adjudicates. These procedures do not determine which claims can be asserted and do not preclude the right to recover under any particular legal theory. The benefits and costs of arbitration, like those of class action, are procedural benefits and costs. Therefore, the availability of arbitration is not about "fundamental fairness," but about efficient social ordering and the manner in which claims are adjudicated. Further, there is much evidence to suggest that arbitration greases the wheels of a prosperous economy.

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Arbitration is particularly attractive for businesses. Plaintiffs' lawyers in civil lawsuits often "forum shop," picking and choosing when and where to sue in order to find the most sympathetic jury or judge. Businesses thus have a hard time gauging their litigation exposure as a cost of doing business, and their confusion is compounded when disputes occur across state or international borders. Further, settling disputes in court is costly and slow; one lawsuit might take years and cost millions of dollars in attorneys' fees and thousands of dollars in direct costs even when the business is successful in the litigation.

As a result, businesses are happy to stipulate in contracts that disputes will be heard before a private arbitrator, subject to the published rules of a recognized arbitration association. Such a system is much cheaper than leaving dispute resolution to the courts.

1. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662 (2010); AT&T Mobility LLC v. Concepcion, 563 US. ___ (2011); CompuCredit Corp. v. Greenwood, 132 S.Ct. 665 (2012). *See also* 9 U.S.C. §§ 1–16.
2. In re American Express Merchants' Litigation, 667 F.3d 204 (2nd Cir. 2012), *cert. granted*, 81 U.S.L.W. 3264 (U.S. Nov. 9, 2012) (No. 12-133); Oxford Health Plans, LLC. v. Sutter, 675 F.3d 215 (3rd Cir. 2012), *cert. granted*, 81 U.S.L.W. 3324 (U.S. Dec. 7, 2012) (No. 12-135).
3. 12 U.S.C. § 5518. Any discussion of the authority of the CFPB should note that the agency has no constitutionally appointed agency head. *See* Charlie Savage & Steven Greenhouse, *Court Rejects Obama Move to Fill Posts*, N.Y. Times, Jan. 25, 2013, *available at* http://www.nytimes.com/2013/01/26/business/court-rejects-recess-appointments-to-labor-board.html?_r=0.
4. The Pew Charitable Trusts, Banking on Arbitration: Big Banks, Consumers, and Checking Account Dispute Resolution (2012), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_arbitration_report.pdf.

However, arbitration should be attractive to consumers as well, for similar reasons. In a study of cases filed with the National Arbitration Forum between January 1, 2003, and March 31, 2007, the overwhelming majority of consumers (99.3 percent) paid no fee, and the median fee paid by the remaining 0.7 percent of consumers was $75.[5] Compare this service's low costs—which still allow claimants to be heard—with the several hundred dollars it takes to file in almost any court in the United States, and the advantages of arbitration grow ever clearer.[6]

Arbitration serves the efficiency of the overall litigation system by maximizing the total volume of claims that can be heard.

Furthermore, the cost of proving one's case before an arbitrator can be relatively low. In an antitrust dispute, for example, parties to arbitration can appoint an arbitrator who is an antitrust expert, thereby saving hundreds of thousands of dollars in expert fees when compared with traditional litigation. The cost of attorneys' fees is also often significantly lower, and arbitration is usually much faster than litigation.

One goal of arbitration is therefore to expand the universe of claims that can be heard. Many consumers who could not afford litigation in court can afford to vindicate their rights in an arbitral forum. To be sure, arbitration comes with its trade-offs: Some claims might be adjudicated more efficiently with a class action lawsuit in court. However, arbitration serves the efficiency of the overall litigation system by maximizing the total volume of claims that can be heard.[7]

Consumers benefit from arbitration in other ways as well. Since litigation exposure is a cost of doing business, the ability of businesses to reduce litigation costs can lead to trickle-down cost savings to the consumer.[8] For example, some lawsuits have been known to tie up the working capital of firms, stifling innovation for years, and even where companies are large enough to afford a lawsuit, litigation costs are baked into consumer costs. It is the elimination of these transaction costs that makes arbitration attractive to consumers, but these costs feed predictable interest groups, such as trial lawyers and expert witnesses, and raise predictable opposition to arbitration. Finally, it should be noted that there is no reason to believe that arbitrators are biased against consumers.[9]

Arbitration Policy in the United States

Enacted on February 12, 1925, the Federal Arbitration Act facilitates arbitration in a variety of ways. Indeed, "it is difficult to overstate the strong federal policy in favor of arbitration" embodied in the FAA.[10] Prior to enactment of the FAA, there was

5. *See* Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration*, 15 Dispute Resolution Magazine (A.B.A., Washington, D.C.), Fall 2008.
6. For example, to litigate a consumer credit transaction case effectively before the New York City Civil Court, Small Claims Part, the fees add up: a $140 Consumer Credit Transaction filing fee, $45 summons fee, $40 notice of trial fee, $70 demand for jury trial fee, $25 transcript of judgment for filing fee, $15 transcript of judgment for issuance, and so forth. If the case is more complex, the fees continue to rack up. *See* New York City Civil Court, Small Claims Part, Court Frees in the New York City Civil Court, http://www.nycourts.gov/courts/nyc/smallclaims/fees.shtml.
7. While it makes for a good story, the claim that arbitration disfavors certain claims or is stacked against plaintiffs is unfounded. To give one high-profile example: A female contractor claimed that she was raped in Iraq and unable to bring a claim due to an arbitration clause with her former employer. This story made national news and even encouraged Senator Al Franken (D–MN) to introduce a bill prohibiting such clauses to contractors funded by the United States. Later, however, the claims were proved false in a court of law, and the female contractor was ordered to pay $145,000 in court costs. *See* Jessica Priest, *KBR Rape Suit Loss Devastates Accuser; Company Relieved*, Houston Chronicle, July 8, 2011.
8. *See* Ted Frank, Manhattan Institute, Legal Policy Report: Class Actions, Arbitration, and Consumer Rights: Why *Concepcion* Is a Pro-Consumer Decision (2013) (citing Stephen Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. Disp. Resol. 89 (2001)).
9. Peter B. Rutledge, Arbitration—A Good Deal for Consumers: A Response to Public Citizen (April 2008), *available at* www.instituteforlegalreform.com/get_ilr_doc.php?id=1091.
10. Arciniaga v. GMC, 460 F.3d 231, 234 (2nd Cir. 2006).

widespread judicial hostility to arbitration agreements, and the Act was designed to place agreements to arbitrate "upon the same footing as other contracts."[11] The FAA ensures, for example, that arbitration provisions in contracts are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[12]

It was not until the 1984 Supreme Court decision in *Southland Corp. v. Keating* that the FAA was conclusively held to apply to state law contracts.[13] This decision came down one year after the Senate ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, widely heralded as the single most important private international law achievement of the United Nations.[14] The treaty obliges signatories to enforce arbitration agreements and awards, and it has benefitted U.S. trade tremendously.

However, in the past few years, the precise contours of the FAA's preemptive effect have been hotly contested before the Supreme Court. The argument in *Oxford Health Plans, LLC v. Sutter* on March 25, 2013, was the fifth time in three years that the Court has addressed the interplay between arbitration clauses in contracts and aggregate claim procedures such as class action or class arbitration.

Arbitration and the Supreme Court: Previous Decisions

Undoubtedly, the ability of private parties to limit arbitration of aggregate claims contractually is a white-hot issue right now, and it is worth noting what the current state of the law is and where it might be going.

- The Supreme Court first addressed the issue of aggregate claims interplay with the FAA in 2010 in *Stolt-Nielson SA v. AnimalFeeds Int'l Corp.* The massive rise in class action lawsuits in the late 1990s led the American Arbitration Association to develop rules to authorize arbitrators to determine whether an arbitration clause permitted class arbitration. In *Stolt-Nielson*, two parties to a maritime dispute had stipulated before an arbitrator that their contract was silent as to the availability of class arbitration; nevertheless, the arbitrator determined that the contract allowed for class arbitration.

  The Second Circuit had ruled that applying class arbitration was not in "manifest disregard" of the law, because there was no rule of maritime custom and usage against class arbitration and no New York state law to the contrary. The Supreme Court reversed this decision, holding that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so."[15] In short, the FAA ensures that the policy preferences of federal judges and arbitrators regarding the availability of class arbitration will take a backseat to what private parties expressly agree to include as a part of their contract.

- The following year, the Supreme Court again addressed aggregate claims and arbitration in *AT&T Mobility LLC v. Concepcion*.[16] In *Concepcion*, the Court overturned a Ninth Circuit decision holding unconscionable a contractual provision precluding class arbitration under the rule announced in *Discover Bank v. Superior Court*,[17] a decision of the California Supreme Court. The Supreme Court of the United States held in *Concepcion* that the FAA preempts state laws that interfere with the free ability of contracting parties to set their own arbitration procedures—even if such procedures have the effect that certain claims "might otherwise slip through the legal system." Thus, while parties may contract

11. *Concepcion*, 131 S. Ct. at 1757 (citing Scherk v. Alberto-Culver Co., 417 U.S. 506, 411 (1974)).
12. 9 U.S.C. § 2.
13. 465 U.S. 1 (1984).
14. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 330 U.N.T.S. 38.
15. 559 U.S. at 624 (emphasis in original).
16. 563 US. ___ (2011). This decision prompted the Second Circuit to voluntarily revisit its post–*Stolt-Nielson* decision. *See* Italian Colors Restaurant v. American Express Co., 2011 U.S. App. LEXIS 19851.
17. 36 Cal. 4th 148 (Cal. 2005).

to allow class arbitration, state law may not compel class arbitration.

- The Supreme Court also addressed class action waivers in arbitration agreements last year. In *CompuCredit Corp. v. Greenwood*, the plaintiffs filed a class action claiming that the defendants violated the Credit Repair Organizations Act (CROA).[18] While acknowledging the existence of a class action waiver in the arbitration agreement, the plaintiffs claimed that the CROA "right to sue" provisions overrode the FAA's mandate that such arbitration class action waiver clauses be enforced. In overturning the Ninth Circuit and interpreting the CROA more narrowly, the Supreme Court held that had Congress intended to preclude arbitration in this circumstance, it would have clearly done so.

American Express Co. v. Italian Colors Restaurant

When the Supreme Court heard oral argument in *American Express Co. v. Italian Colors Restaurant* last month, it was the second time the case has been before the Court. The case arises out of an antitrust dispute that the plaintiffs filed in the U.S. District Court for the Southern District of New York.

American Express credit and charge card arrangements with businesses contain an "Honor All Cards" (HAC) provision. American Express charges higher fees to businesses to process their cards than it charges competitors, and businesses are willing to pay these higher fees because of the higher volume of business the average American Express customer brings. However, American Express began issuing credit cards with similarly high fees for businesses, but serving a down-market clientele. Businesses accepting the lucrative American Express charge card business were bound by the HAC provision to accept the unattractive American Express down-market credit card business. This, the plaintiffs alleged, was an improper "tying" arrangement in violation of section one of the Sherman Act.[19] Essentially, the plaintiffs alleged that American Express was using market leverage to force the businesses to purchase the lower-value product that they did not want.

Before the district court, American Express filed a motion to compel arbitration pursuant to the FAA, which was granted. On appeal, the U.S. Court of Appeals for the Second Circuit reversed the district court and refused to enforce the class action waiver,[20] holding that the plaintiffs had established that they would be unable to prove their case absent costly expert witness testimony and that this would "effectively" deprive the plaintiffs of their substantive rights. In other words, because proving an antitrust claim usually requires costly expert witnesses to testify as to market size and the power of the business accused of antitrust violations, the plaintiffs claimed that prohibiting class arbitration would make it too expensive for any one plaintiff to win at arbitration, effectively eliminating their right to bring antitrust claims. The Supreme Court summarily vacated and remanded this decision following its decision in *Stolt-Nielson*.[21]

On remand, the Second Circuit again refused to enforce the class action waiver, holding that precluding class arbitration would "effectively depriv[e] plaintiffs of the statutory protections of the antitrust laws,"[22] and the Supreme Court granted certiorari for a second time. The issue before the Supreme Court is broad: "whether the Federal Arbitration Act permits courts, invoking the 'federal substantive law of arbitrability,' to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim."

In one sense, this issue was not resolved by *Concepcion*, which dealt primarily with the issue of federal preemption and the existence of state laws that conflict with the FAA. Yet the *Concepcion* decision implicitly rejected the radical notion advanced

18. 15 U.S.C. § 1679 et seq. The 8–1 decision authored by Justice Scalia is essentially an application of the presumption against implied repeal of a statute. Thus far, there has been only one explicit congressional exception to the FAA: the Motor Vehicle Franchise Contract Arbitration Fairness Act of 2002, 15 U.S.C. § 1226.
19. *See, e.g.*, Eastman Kodak Co. v. Image Tech. Services, Inc., 504 U.S. 451 (1992).
20. In re American Express Merchants' Litigation, 554 F.3d 300 (2nd Cir. 2009).
21. American Express Co. v. Italian Colors Restaurant, 130 S.Ct. 2401 (2010) (summarily vacated and remanded in light of *Stolt-Nielson*).
22. In re American Express Merchants' Litigation, 634 F.3d 187, 197 (2nd Cir. 2011).

in *American Express*: The fact that class actions are necessary to prosecute "small-dollar claims that might otherwise slip through the legal cracks" is somehow relevant to the formal availability of a cause of action.[23]

This issue was precisely the one pressed at oral argument before the Supreme Court,[24] where a large portion of the questioning of American Express dealt with whether the prohibitive cost of a cause of action meant that the cause of action was substantively barred if an aggregate action were not permitted; if so, a procedural waiver of class arbitration could be considered a *de facto* substantive waiver of the underlying antitrust claims and would violate the Supreme Court's decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*[25]

Justice Antonin Scalia was particularly hostile to the idea that the legal determination that a cause of action was substantively available should rest at all upon litigation costs, particularly those voluntarily assumed by the plaintiffs. Justice Stephen Breyer expressed the same skepticism, stating at one point that expert witness costs are not relevant obstacles to substantive vindication of a federal right, noting: "It's just [that] you brought a very expensive claim."

Oxford Health Plans, LLC v. Sutter

Finally, in March, the Supreme Court heard oral argument in *Oxford Health Plans, LLC v. Sutter*, a case arising out of an insurer's alleged failure to make prompt and accurate payments to participating physicians. These physicians initiated arbitration pursuant to their agreement with the insurer and submitted to the arbitrator the question of whether the contract allowed for class arbitration. In construing the broad arbitration clause, the arbitrator decided that "civil action" under the agreement encompassed class actions and that since "all such disputes" were committed to arbitration, the parties had thus expressly agreed to class arbitration. The arbitrator further noted that it would be "bizarre for the parties to have intended to make class action impossible in any forum."[26]

The health insurer filed an action before the United States District Court for the District of New Jersey seeking to vacate the arbitrator's construction of the arbitration agreement, citing *Stolt-Nielson* for the proposition that inferring the availability of class arbitration from broad contractual provisions exceeds the authority of arbitrators.[27] The district court instead upheld the judgment, and on appeal, the Third Circuit affirmed, holding that while *Stolt-Nielson* prohibits an arbitrator from inferring consent to class arbitration from a failure to preclude class arbitration, construing text of a contract to authorize class arbitration is permissible under the FAA.

What to Expect

Over the past several years, the Supreme Court has issued a string of decisions reflecting two fundamental legal principles.

First, the Federal Arbitration Act evinces "strong federal policy" in favor of commercial arbitration, and federal courts have limited authority to interfere with arbitration procedures agreed upon by the parties. Arbitration has clear commercial benefits and keeps cases out of an already burdened federal court system.

Second, these recent cases imply that relatively modern aggregate claims devices such as class action and class arbitration are simply procedures for bringing underlying claims. Consequently, there should be no federal "thumb on the scale" to ensure their availability because the free contracting of parties is the touchstone for their availability; private ordering, not government interference, will determine whether such procedures benefit the market. To the extent that the parties to a contract define their own arbitration procedures, there is no reason for federal courts to invalidate those procedures.

Since arbitration has been recognized consistently by the Court as an important procedural

23. *Concepcion*, 131 S. Ct. at 1753.
24. Transcript of Oral Argument, In re American Express Merchants' Litigation, 667 F.3d 204 (2nd Cir. 2012), *cert. granted*, 81 U.S.L.W. 3264 (U.S. Nov. 9, 2012) (No. 12-133), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/12-133.pdf.
25. 473 U.S. 614 (1985). This decision held that statutory rights could be submitted to arbitration so long as the "prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum."
26. Sutter v. Oxford Health Plans, LLC., 675 F.3d 215, 218 (3rd Cit. 2012).
27. 9 U.S.C. § 10(a)(4).

device, there seems little reason to believe the Second Circuit's *Italian Colors* decision will be upheld. Finding that effective vindication of rights would require a net recovery for litigants after their litigation costs, especially if the plaintiffs present novel or expensive theories, would rock the federal judiciary in unforeseeable ways.[28]

As the costs of litigation continue to rise, arbitration offers an alternative to expensive court battles, thereby benefiting consumer and plaintiffs alike. Consequently, the Supreme Court would do well to continue crafting clear rules that enforce the plain meaning of contracts between two parties.

The outcome of *Oxford Health Plans*, on the other hand, could be a closer call. To the extent that the arbitrator in that case sought to comply with the plain meaning of an arbitration clause, as opposed to blindly following his policy preferences, a decision in favor of allowing class action or class arbitration, even absent explicit use of the term, might appeal to both sides of the Court.

Ultimately, the decisions in both *Italian Colors* and *Oxford Health Plans* may turn on how the federal courts conceive of arbitration. Given congressional statutes and delegations of authority by one branch to another, the arbitration scheme set up by the FAA raises familiar questions of judicial deference, questions that arise in other contexts, such as review of agency decisions or lower court decisions. One can clearly see that the issue in *Oxford Health Plans* and *Concepcion*—the extent to which an arbitrator can interpret his or her own authorizing contract—is analogous to another important case before the Court this term: *City of Arlington v. FCC*, addressing the scope of a federal agency's authority to interpret its own jurisdiction.[29]

As the costs of litigation continue to rise, arbitration offers an alternative to expensive court battles, thereby benefiting consumer and plaintiffs alike. Consequently, the Supreme Court would do well to continue crafting clear rules that enforce the plain meaning of contracts between two parties. Whatever the decision of the Supreme Court, it is clear that longstanding federal policy respects arbitration and the free rights of private parties to contract. While any decision will likely turn on interpreting the FAA itself and is thus subject to congressional override, legislators should think long and hard before they decide to craft legislative solutions in search of a problem. America's arbitration system has served this country well and will continue to do so.

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28. For example, such a decision could expand *Mitsubishi* to the point that it essentially destroyed the entire arbitration system: If a plaintiff wanted to get out of an arbitration clause, he or she would simply have to plead an incredibly complex and unaffordable cause of action, and the arbitration clause would be invalidated as foreclosing "effective vindication" of statutory rights. Such a decision might not even be cabined to arbitration, damaging other areas of law.
29. 668 F.3d 229 (5th Cir. 2012), *cert. granted*, 81 U.S.L.W. 3193 (U.S. Oct. 5, 2012) (No. 11-1545).