The Evils of Binding Arbitration In Consumer Contracts

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I. Introduction

Alabama first experienced the use of binding arbitration in our consumer contracts in late 1995. The first companies to include binding arbitration clauses were what we call the poverty industry – title pawnshops, check cashing outlets, and "catalog stores." Across the state, many cases were filed against these type companies because of their deceptive sales tactics, fraud, and the usurious interest charged. As expected, these companies attempted to compel any and all cases to arbitration. Once the Republican majority led Alabama Supreme Court agreed that arbitration was the proper forum to resolve disputes against these companies, the door was flung open and the new "kudzu" took root and began spreading across our state creeping into every consumer contract imaginable. Now, binding arbitration is spreading into other states' consumer contracts at a rampant pace.

II. The Loss Of Trial By Jury

The civil jury system in our country is under constant siege. A carefully planned and orchestrated attack by The American Tort Reform Association has been carried out with great skill and precision. Over the past 10 years, the term tort reform became a political buzzword that most Americans really didn't understand but bought into due to the constant bombardment with propaganda. By constantly hammering home their themes of "frivolous lawsuits," "greedy trial lawyers," "runaway juries," and "jackpot

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justice," the masterminds of the attack chipped away at the very institution of the civil jury in America. The political advantage of keeping tort reform alive was more important to groups operating under The American Tort Reform Association umbrella, such as the Business Council of Alabama, than was actual passage of any type meaningful tort reform. These groups had a fund-raising issue that was the best ever devised by mortal men, and they weren't about to give it up. Because we were somewhat successful keeping tort reform out of our state, the tort reformists convinced the companies operating in Alabama to rewrite their consumer contracts to include binding arbitration clauses. In essence, these companies are using binding arbitration as "self-help" tort reform. However, in 1999 our Legislature, backed by the Alabama Trial Lawyers Association, the Governor's office, and Senate Democrats, passed a tort reform package. We have tort reform in Alabama, but we also have binding arbitration. And, it is the use of binding arbitration that has intensified the attack on the jury system that is unparalleled in modern times. Mandatory, binding arbitration has found its way into every conceivable consumer transaction and is accomplishing something that Legislative tort reform was not intended to do, and that is to shut the courtroom door to victims of corporate abuse.

III. Is Arbitration Being Misused?

In 1925, Congress passed the Federal Arbitration Act (FAA). This Act was never intended to settle disputes between a consumer and a large business. Prior to the last quarter of the 20th century, courts in this country had been overtly hostile to arbitration. At common law, arbitration was utilized strictly on a voluntary basis. Courts traditionally refused to order specific performance of arbitration agreements. While the FAA

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superseded state laws that clearly prohibited arbitration agreements, arbitration was seldom utilized except when businesses fought each other. All the FAA did originally was to make arbitration agreements stand on the same footing as any other contract. In other words, the FAA made such agreements enforceable to the same extent that any other contract could be enforced. This was the intent of the FAA and that cannot be disputed.

Clearly, Congress never intended to give corporate America an unfair advantage over consumers. Had that been the case, it would be much more difficult to fight this monster. Even a casual reading of the legislative history of the FAA, however, reveals that Congress never intended for the Act to be applied in consumer transactions. The Act came about when the American Bar Association and business groups of that day attempted to permit a freer use of arbitration in commercial disputes involving businesses. The lawyers who drafted the FAA on behalf of the ABA explained to Congress that the proposed legislation would not extend to employment contracts nor to constitutional or statutory rights. There was not even a hint in the debate that arbitration would involve consumers.

After its passage, the FAA had no effect on consumer contracts for over 60 years. In 1985, the U. S. Supreme Court declared that the FAA established "emphatic federal policy in favor of arbitral dispute resolution." In *Mitsubishi Motors Corporation v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), the court took the presumption in favor of enforcing arbitration beyond the commercial context. For the first time, we saw consumer contracts being affected by arbitration, but again, on a limited basis. Since

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that decision, the U. S. Supreme Court has allowed the enforcement of arbitration clauses in contracts to enter into other arenas.

In the widely acclaimed decision of *Allied-Bruce Terminix Companies v. Dobson*, 513 U.S. 265 (1995), the U. S. Supreme Court took to even greater heights the application of arbitration. This decision expanded the effect of the Commerce Clause into every imaginable fact situation dealing with consumers and citizens generally. Corporate America seized the opportunity, and has now set out to destroy the jury system once and for all. We now see arbitration slowly being applied in every conceivable setting, including adhesive contracts involving consumers, which cannot be justified either legally or morally. The tragedy is that the vast majority of American citizens still do not have the slightest idea what mandatory, binding arbitration is all about. Apparently even lawyers didn't see the dangers lurking on the horizon in the form of arbitration, back in the late 80's and early 90's, and did nothing to alert the public. As a result, the proponents of arbitration have established a tremendous foothold in Alabama. However, the tide of public opinion appears to be shifting and that is most encouraging.

Alabama was apparently selected as a testing ground to determine how far arbitration can be pushed and if in reality the jury system can survive. Some proponents in Alabama claimed that Article IV, §84 of the Constitution of Alabama required arbitration to be enforced in our state.[1] However, it is abundantly clear that §84 does not mandate arbitration. The Legislature did pass an Act that dealt directly with arbitration, *Alabama Code* 8-1-41 (3)(1975), and said no to arbitration in Alabama.

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Unfortunately for our citizens, the Alabama Supreme Court has taken to arbitration much like a duck takes to water. We have seen arbitration spreading in Alabama much more rapidly and causing more problems than anybody could have ever imagined possible. The tort reformers now believe that the jury system actually can be destroyed. Groups such as the Business Council of Alabama, Citizens for a Sound Economy, AVALA, and other shadow groups set up by the ATRA have attempted to sell the myth that mandatory, binding arbitration is more efficient and less expensive than the civil justice system. These groups, under the direction of Neal Cohen and Karl Rove, have also done a tremendous job of selling ordinary citizens on the idea that the civil jury system is an evil creature and is totally out of control. Lawyers are largely responsible for sitting back, doing nothing, and letting this occur. Those of us who have been fighting arbitration over the past 5 years know that the arbitration process is designed to protect corporate defendants and hurts ordinary citizens. Consumers are now becoming aware of the problem because arbitration is affecting them adversely. Nothing good can result when you take a concept, originally designed to involve only large corporate entities in a dispute, and apply it where one of the two parties is clearly dominant over the other. Arbitration is grossly unfair for consumers and even to the owners of small businesses who have disputes with corporate giants. More and more business owners are realizing that arbitration is unfair and favors large corporations.

Consider the positions taken by the National Automobile Dealers Association before Congress. First, this group told Congress that arbitration favored carmakers over car dealers because of the vast power of the carmakers and should not be allowed

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[1] Section 84 provide "It shall be the duty of the legislature to pass such laws as may be necessary and proper to decide differences by arbitrators to be appointed by the parties <u>who may choose</u> that mode of

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in their contracts. That makes good, common sense and should carry over to disputes involving consumers and small business owners. However, back in our state the Alabama Automobile Dealers Association forces arbitration on the purchasers of motor vehicles. The hypocrisy of the positions of the car dealers is most clear. However, their bill has passed the House and awaits approval in the Senate. Because of the lobbying strength of NADA, we expect their bill to pass out of the Senate. If George W. Bush becomes President, expect the bill to become law.

IV. What Is Wrong With Binding Arbitration?

Binding arbitration is simply not suited for a fact situation that involves a consumer on one side and a corporate defendant on the other. In binding arbitration, there are no rules of evidence and no established rules of procedure that would tend to make the playing field level. Such basic things as pre-trial discovery are put on the shelf. Under some binding arbitration agreements, there is not even a guarantee of a hearing before the arbitrator. Seldom, if ever, will you deal with an arbitrator who is truly independent and impartial. On top of this, arbitration is extremely expensive.

Basically, binding arbitration is unfair to consumers because in the event of a dispute: (1) the consumer must pay an up front filing fee that could be thousands of dollars; (2) the consumer must pay an hourly fee to the arbitrator; (3) the business has more say than the consumer in who the arbitrator is; (4) the business usually gets to choose where the arbitration takes place and it could be in a far away state where the business has its headquarters; (5) the arbitrator makes the final decision, and is not required to follow the law; (6) there is no right to appeal the ruling of the arbitrator.

V. How Do We Combat This Evil?

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adjustment." [Emphasis added.]

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What can be done to save the civil jury system? When a system is not used, it will die a slow, silent death. That is exactly what the proponents of arbitration have in mind. One line of thinking is that the problem-solving should take place in Congress. Obviously, we can ask them to simply amend the FAA. During the last session of Congress, a Senate floor amendment was placed on the Bankruptcy Bill that would have outlawed arbitration in consumer transactions. Interestingly, this amendment passed in the U. S. Senate on a voice vote. However, at that stage, further action on the bill halted and it was then deferred to the next session. Hopefully, Congress would see fit to limit the FAA to business disputes as was the original intent. The FAA can be amended to simply state that the Act does not apply to consumer transactions or to employment contracts. However, the chances of passing an amendment to the FAA in Congress and getting it signed by the President are virtually nonexistent. Certainly, if the Republicans maintain control of Congress, and a Republican President is elected, there will be no relief in Congress. As I write, this appears to be the case.

Simply put, we must do a better job of fighting arbitration in our states. In our last legislative session, we were unsuccessful in passing any meaningful legislation that would soften the blow of binding arbitration. We will attempt to do so again in February. However, the courts are the place where citizens must look for real relief. In the insurance context, we are hopeful that the Alabama Supreme Court will follow the law, including Alabama's stated public policy, and say no to arbitration in insurance policies. Yet, this has not occurred. Unfortunately, our Supreme Court has allowed partisan politics to become involved and most of the decisions are anti-consumer. While courts around the country, both State and Federal, are moving away from arbitration,

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Alabama's Supreme Court is holding fast to its position. We do not expect this to change. Starting in January 2001, we will have a Supreme Court with 8 business-backed Republicans and only 1 Democrat serving to hear our consumer advocacy appeals.

Eventually, the question of whether or not the Constitutional guarantee to a trial by jury still exists in America will be presented to the U. S. Supreme Court. It is most important that the proper case be selected for this challenge. The facts must clearly and precisely present the question for review. The Constitutional guarantee of a jury trial is a right about which most American citizens feel most strongly. No citizen should be forced into an arbitration agreement simply because one side has tremendous power over the other. Neither should a citizen be forced into involuntarily giving up a right guaranteed under the Constitution. When discussing arbitration and the Courts, the question that is raised more often than any other in non-lawyer groups is "what about the Constitutional guarantee to a trial by jury?" A review of this Constitutional guarantee is in order so that this issue can be better understood.

The FAA was originally designed by Congress to allow sophisticated parties engaged in commercial and business activities to agree among themselves to submit their disputes that might arise out of their activities in interstate or maritime commerce to binding arbitration. The United States Supreme Court recognized, however, that under the FAA, an arbitration provision is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *See, e.g., First Options of Chicago, Inc. v. Kaplan*, 514 US 938 (1995). This gives any court an

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opportunity to be "tough" on arbitration claims. For some reason the Alabama Supreme Court has ignored this language in the Act.

The U. S. Supreme Court, existing solely under the authority of the United States Constitution, should never apply an Act of Congress so as to undermine the right of trial by jury in a state that guarantees that right in its Constitution. The United States Constitution guarantees the right of trial by jury in the Seventh Amendment. This amendment was adopted as a limitation on the Federal Government in the Bill of Rights. The Tenth Amendment provides "that powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." Any conflict between the Commerce Clause and the Bill of Rights must be resolved in favor of the Bill of Rights. The adoption of the Bill of Rights as a limitation on federal power was crucial to the ratification of the Constitution.

It is difficult to see how the United States Supreme Court can construe an Act of Congress such as the FAA and apply it beyond its original intent in such a way as to prevent citizens of the United States and the several states from exercising their Constitutional right to litigate in a court of law before a jury. In order to do so, the Court must ignore the Seventh and Tenth Amendments to the U. S. Constitution as well as the state constitutional guarantees of the right to trial by jury.

Alabama's Constitution guarantees a jury trial to Alabama citizens. The U. S. Supreme Court has never interpreted the FAA in such a way to deprive individuals of the right of trial by jury when the constitutional question was before the Court. Simply put, the Constitutional questions have neither been addressed nor answered by the

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Court. Unless an individual has "voluntarily" waived the right to a jury trial, the Constitutional guarantee must prevail.

Consider the very strong requirements for a waiver of the Constitutional right to a jury trial in criminal law. Judges go to great lengths to make sure that criminal defendants fully and completely understand that a Constitutional right to a jury trial is being waived before a guilty plea is accepted. Why then should a consumer in a civil dispute be treated differently?

The U. S. Supreme Court has never addressed the application of the Seventh Amendment to the U. S. Constitution to the FAA and that is most significant. Many persons believe, as do I, that the Tenth Amendment strengthens the Constitutional argument insofar as binding arbitration is concerned. If any state guarantees its citizens the right of trial by jury in civil cases in its Constitution, as is the case in Alabama, the power of Congress to regulate commerce should never be taken to strip away the Constitutional protections of the rights of access to the Court, to due process of law, and to the basic right of trial by jury. Some renowned Constitutional scholars remind me that the right to trial by jury was extremely important to the drafters of our Nation's Constitution. History records that the King of Great Britain had deprived the colonists in many cases of the benefits of the right to trial by jury. This was unacceptable then and I believe the feeling is equally strong today. If our Constitution means anything at all, the courts must eventually come to the rescue of American consumers and small business owners.

Other than the Constitutional issue, there are other areas where binding arbitration simply should not be enforced. The courts should always deny an attempt by

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a dominant party to compel arbitration in any case involving a contract of adhesion. Many consumer and employment contracts are contracts of adhesion. What is required to constitute a contract of adhesion? If the party in an inferior bargaining position did not have a meaningful choice of agreeing to arbitration, and if the superior party has reserved to itself the choice of arbitration or litigation, this is always sufficient to constitute a contract of adhesion. A contract of adhesion may also be one that is offered on "a take it or leave it basis" to a consumer who has no meaningful choice in the acquisition of goods or services. I suspect this would apply to most consumers who, by necessity, have to buy on credit. A similar situation would be an employment contract where the employer puts it like this – "either you sign the arbitration agreement or you don't get (or keep) this job." Most appellate courts – at least outside of Alabama – recognize that arbitration can't be enforced where the contract is one of adhesion. I frankly do not understand how any court could require arbitration in a factual setting that gives rise to a contract of adhesion. The economic power and relative sophistication of the parties to a contract should be considered by the courts in any case where arbitration is being requested.

VI. Conclusion

Finally, consumers and small business owners are in a battle that must be won. If binding arbitration replaces the civil jury system in spite of the guarantees of the Federal and State Constitutions, our country will suffer. Can the fight be won? It is up to the citizens of each state to decide once and for all whether the jury system is worth preserving. I believe that it is and I also believe the vast majority of Americans believe very strongly as I do. However, we as lawyers must do our part. We cannot afford to

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comfortably sit on the sidelines and hope others will fight the battle for us. Lawyers, who represent victims of corporate abuse of all kinds – many of whom can't speak for themselves, must get actively involved with groups who have already recognized what will happen to America when the jury system is destroyed. Binding arbitration does not belong in consumer contracts. The way binding arbitration is being misused takes away our right to a trial by jury, our right to serve on a jury, and our right to go to court to settle any dispute. Please be fully aware that today when you purchase or lease a vehicle, purchase life or health insurance, purchase a manufactured home, purchase a brick home, start a new job, open a checking or savings account, borrow money from a large bank or "secondary" lending company, get a credit card, get a cellular phone, or use a check cashing store, catalog store, or title pawnshop, **you may be required** to sign a binding arbitration agreement. As you can see, no one is immune from the disadvantages of binding arbitration. Because of these facts, in closing, I encourage you to get actively involved in fighting the evils of binding arbitration in consumer contracts.

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